

Minutes of the Audit and Compliance Committee Meeting  
University of Kentucky  
Tuesday, April 30, 2019

The Audit and Compliance Committee (ACC) of the University of Kentucky (UK) met on Tuesday, April 30, 2019, in the Bolivar Art Gallery, School of Art and Visual Studies Building.

A. Meeting Opened

Chair Claude “Skip” Berry III called the meeting to order at 9:00 a.m.

B. Roll Call

The following members of the ACC answered the call of the roll: Jennifer Barber, Claude “Skip” Berry III, James Booth, Angela Edwards, David Hawpe, Kim McCann, Elizabeth McCoy, and Robert Vance.

C. Approval of Minutes

Chair Claude “Skip” Berry III reported that the minutes of the February 22, 2019 ACC meeting had been distributed. Trustee McCoy moved for approval of the minutes and Trustee McCann seconded the motion. The minutes from the February 22, 2019 ACC meeting were approved as presented.

D. Executed Fiscal Year 2019 Audit Engagement Letter

Susan Krauss, University of Kentucky Treasurer, discussed the execution of the engagement letter with BKD, LLP (BKD) for the audit of the financial statements for the year ended June 30, 2019.

Ms. Krauss stated that the audit will include a financial statement audit for the University and its Affiliated Corporations and three organizational units of the University, including the University of Kentucky Hospital Systems, Kentucky Tobacco Research and Development Center, and WUKY-FM radio station.

Ms. Krauss explained that a separate audit will not be performed for the Center on Aging Foundation. The Foundation was dissolved on July 1, 2018 with the approval of the Board of Trustees at the February 2018 Board Meeting. The assets of the Foundation were transferred to the University on July 1, 2018, for the benefit of the Sanders-Brown Center on Aging and the activities and transactions of the Center will be subject to audit as part of the engagement for the University.

Ms. Krauss then discussed that the Alumni Association, a 501(c)(3), would be included in the University's consolidated financial statements for the first time. She explained that the full adoption of the integrated funding model of University of Kentucky Philanthropy and the Alumni Association provides the appropriate evidence under Governmental Accounting Standards Board (GASB) standards that the organization is fully integrated with the University. The assets of the Association, \$22,000,000, will be included on the University's consolidated financial statements, but

BKD also would be performing a separate audit of the Alumni Association's books.

Ms. Krauss explained that this audit will be conducted in accordance with Generally Accepted Auditing Standards (GAAS) and standards applicable to financial audits for governmental entities as prescribed by the Office of Management and Budget's (OMB) Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards uniform guidance. The University's primary responsibility is to prepare the financial statements in accordance with Generally Accepted Accounting Principles (GAAP).

Ms. Krauss introduced Mary McKinley and explained that Ms. McKinley will serve as the partner for the engagement and this will be her second year in this capacity after a two-year break, which is best practice, as discussed in detail at the February meeting.

Ms. Krauss closed with an overview of BKD's engagement fees. These engagement fees are to be approximately \$416,000, representing a 3% increase over the Fiscal Year 2018 engagement fees of \$404,000.

E. Executed National Collegiate Athletic Association Agreed-Upon Procedures Engagement Letter

Ms. Krauss began by discussing the first of three Agreed Upon Procedure (AUP) letters. She stated that the first letter relates to procedures required by the National Collegiate Athletic Association (NCAA) to verify the accuracy and completeness of financial data of the University's Department of Intercollegiate Athletics.

F. Executed Eastern State Hospital and Central Kentucky Recovery Center Agreed-Upon Procedures Engagement Letter

Ms. Krauss shared the second AUP, which sets forth the procedures related to contract compliance between the University and the Kentucky Department of Behavioral Health, Developmental and Intellectual Disabilities as it relates to the management of Eastern State Hospital, and the Central Kentucky Recovery Center.

G. Executed Kentucky Medical Service Foundation Agreed-Upon Procedures Engagement Letter

Ms. Krauss completed her discussion of the AUP letters by outlining the procedures related to UK's contract with the Kentucky Medical Services Foundation. She stated that there were no notable changes in the agreed-upon procedures for the engagements to be performed this year.

H. BKD Pre-Audit Report to the Audit and Compliance Committee

Ms. McKinley presented the pre-audit report for the University's June 30, 2019 audited financial statements. She outlined the auditor's responsibility and areas which will specifically focus on the organizations that are listed in the engagement letter. Ms. Krauss had reviewed these organizations and focus areas earlier. Ms. McKinley then discussed that all the entities mentioned earlier will be included in the scope of the audit. BKD has begun planning meetings with various

individuals to discuss the audit process for 2019.

Ms. McKinley discussed BKD's responsibilities and the identified risk areas, which include the risk of management override of controls and improper revenue recognition. BKD documents various control processes as they relate to the financial statements and conduct discussions with various members of management to assess the risk of fraud and override of controls. Additionally, the risk areas include the University's self-insurance practice and workers' compensation insurance, valuation of alternative investments, the allowance for doubtful accounts and pledge receivables, and compliance with Uniform Guidance. BKD will look at the evaluation of these, as they may be subjective in nature, and also will review the allowance for doubtful accounts for Medicare and Medicaid.

Ms. McKinley turned the presentation over to Ms. Joanie Duckworth, BKD Director. Ms. Duckworth shared that the audit report issuance will be consistent with the Commonwealth of Kentucky's reporting deadline of October 4, 2019. The reports will be presented to the Audit and Compliance Committee at its December 2019 meeting.

Ms. Duckworth discussed the new accounting pronouncements for the upcoming years. For Fiscal Year 2019, GASB Statements Number 88 (Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements) and 83 (Certain Asset Retirement Obligations) are effective. She stated that these new pronouncements are not expected to have a material impact on the Fiscal Year 2019 financial statements but will be reviewed by BKD along with management. For Fiscal Year 2020, GASB Number 84 (Fiduciary Activities) is required for all material fiduciary funds. The last two pronouncements she discussed, which are effective for Fiscal Year 2021, were GASB Number 87 (Leases) and 89 (Accounting for Interest Cost Incurred before the End of a Construction Period). Ms. Duckworth stated that management is currently reviewing the impact of these new pronouncements. Chair Berry complimented Susan Krauss, her team, and BKD for being proactive in preparing for the new lease accounting standards.

Ms. Duckworth discussed BKD's procedures to address consideration of error or fraud, which include engagement team brainstorming and inquiries of management and others at UK to determine what risk and other items should be brought to BKD's attention; reviewing accounting estimates for bias; and evaluating the business rationale for significant unusual transactions. BKD also incorporates an element of unpredictability into the audit each year.

#### I. University of Kentucky Internal Audit Fiscal Year 2019 Activity Update

Mr. Joe Reed, Chief Audit Executive, provided the University of Kentucky Internal Audit (UKIA) Fiscal Year 2019 Activity Update for July 1, 2018 - March 31, 2019. He reviewed the percentage of hours UKIA spent on 'planned' (38 percent), 'unplanned' (42 percent), and 'other' activities (20 percent). He pointed out that UKIA resources were largely spent supporting 'unplanned' activities such as inquiries, investigations, assessments, and consultations. UKIA's 'unplanned' activities included an assessment review of Institutional Research and Data Management as well as an inquiry review of the Student Center Construction Change Orders. Combined, these two projects alone comprised 21 percent of UKIA's 'unplanned' activity hours. Mr. Reed explained that the Audit and Compliance Committee would not receive communication regarding 'unplanned' activities where concerns were not substantiated.

Mr. Reed then discussed the four categories of ‘planned’ activities: comprehensive (including Information Technology), repetitive auditing programs, data mining, and follow-up reviews. Mr. Reed explained that closed activity relates to those projects where the audit has been completed and final reports issued. Data-mining activities include such projects as the Vendor Master File and involve mining and reviewing data for exceptions and verifying for appropriateness.

Mr. Reed concluded the Fiscal Year 2019 Activity Update by reviewing UKIA’s ‘other’ activities, which comprised 20 percent of UKIA’s year-to-date activity hours and include partnerships, training, and meeting participation. Mr. Reed discussed the benefits derived by both parties through the partnerships. He went on to showcase UKIA’s yearly training held for higher education auditors throughout the state of Kentucky, fostering relationships with other colleges as well. These trainings, coupled with continued education of UKIA’s staff, help UKIA to stay abreast of current industry standards, allowing UKIA to function at an exceptional level. He finished by explaining that 64 percent of total activity hours in the ‘other’ category are comprised of meetings. These meetings enable UKIA to share and discuss key information, ensuring that UKIA communicates the same information, whether the client is speaking to the Chief Audit Executive or a UKIA team member.

Trustee Vance inquired about the risk of management override of controls, stating, for instance, “if the Dean of the College of XYZ gives students more grant money than they have allocated or spends more money than was budgeted, say \$6,000,000, would UKIA monitor that?” He also asked if this was something UKIA would identify.

Mr. Reed responded that this is not something UKIA monitors and asked Susan Krauss to address. Ms. Krauss stated that the Provost Budget Office monitors budget to actual results throughout the year very closely and asked Lisa Wilson to provide further comments. Lisa Wilson, Associate Provost for Finance and Operations, stated that the Provost Budget Office is the responsible area to monitor each of the colleges’ balances and, when issues are discovered, they work with the colleges to set plans to correct for them.

#### J. University of Kentucky Internal Audit - Audit Universe

Mr. Reed introduced UKIA’s risk-based audit function – Audit Universe - replacing the predetermined audit plan process. This will allow UKIA to be proactive, selecting and performing the right audit at the right time. He began by describing the evolution of UKIA’s ‘Audit Universe.’ This data repository will allow UKIA to continually base its audit work on risk rather than a yearly or quarterly work plan. He explained that this database began taking form in 2015, when the database system was Microsoft Excel with a storage space limitation of two gigabytes using independent datapoints. In 2017, the database grew, with Microsoft Access as a platform, with the same storage limitations as Microsoft Excel. Then, in 2019, UKIA began using the database system, Microsoft Structured Query Language (SQL), which has unlimited storage space using relational data points allowing improved manipulation of the data. SQL allows UKIA to be proactive, but more importantly, as a relational database, it gives the audit team the ability to relate key information.

Mr. Reed continued his introduction of UKIA’s data repository by explaining the method for data input and extraction. This method has been carefully constructed, allowing for key fields to be structured and linked throughout the process. This results in deliverables that allow us to identify

high risk areas for audit planning, or provide informational reporting regarding a unit, process, or application.

Data population has been structured such that information received by UKIA falls within the following categories: 1) 'process owner information,' 2) 'reported concerns' or 3) 'regulatory updates.' 'Process owner information' is information that pertains to a University process, such as ProCard activity. For example, the process owner could be the University Budget Office or University Financial Services because UKIA works in partnership with these units and information comes to UKIA monthly. 'Reported concerns' include event activity, such as industry or University events. The 'regulatory updates' category pertains to new or updated regulations at the federal, state, or University level. The information is first designated a primary key and secondary key(s). The primary key is the process the information relates to, while the secondary key categorizes the information into four elements: unit, application, concern or regulation.

At this point, Mr. Reed gave an example of information which was given to UKIA by a Process Owner. This categorization enables the data to be included in deliverables pulled by Process Owner or Process, so if we receive a request regarding Auxiliary Services, all information received that is associated with Auxiliary Services would be included in the deliverable. The method used for Process Owner would be the same for 'reported concerns' and 'regulatory' categorizations. Mr. Reed then walked the Committee through similar methods for data assigned to each of the other elements noted previously. Examples shared included data regarding a 'new vendor onboarding process.' This data would be assigned to Purchasing, then assigned an Enterprise Division, in this case Finance and Administration, then a process, in this case Vendor Setup. In this way, information requested regarding a single process, unit, or application would be included in the risk assessment deliverable.

Mr. Reed continued his discussion with an explanation of how the information is stored within the Audit Universe. Currently, the Audit Universe contains more than 300 processes, 900 units, 200 applications, 400 concerns, and over 1,000 regulations.

Mr. Reed then discussed the throughput of information in the Audit Universe from receipt to incorporation of the deliverable. Mr. Reed mentioned that the Audit Universe will provide additional help to the department as UKIA no longer has to worry about losing institutional knowledge or whether the persons who were in the unit last week are still available. Additionally, Mr. Reed explained that the information is purged based on such things as age, updates, or relevance. In this way, UKIA ensures that the audit team is looking at only pertinent information.

Mr. Reed concluded the introduction of UKIA's Audit Universe by discussing the various types of information the database will be able to provide. For today's discussion, Mr. Reed focused on deliverables only. Every time UKIA begins a project, the staff compiles an information packet for the auditors called the 'audit package' This up-to-date information provides the auditors with key audit information on the front end of the audit which will considerably reduce the number of hours auditors spend within the planning process. Whether the auditor is assigned a unit, process, or application, UKIA will be able to provide current information identified by source and date for each project. UKIA also will be able to provide informational packages when a client or other unit approaches UKIA for information regarding a unit, application, or University process.

Mr. Reed then introduced the Audit Universe implementation team, Mr. Jared Hicks and Ms. Stacey Wilson, to the Committee.

K. Adjournment

With no further business to come before the Committee, Chair Berry asked for a motion to adjourn. The motion was made by Trustee Barber and seconded by Trustee Vance. The motion carried. The meeting was adjourned at 9:40 a.m.