

MINUTES OF THE AUDIT AND COMPLIANCE COMMITTEE

University of Kentucky Board of Trustees

May 3, 2016

9:00 a.m. – 10:00 a.m.

Board Room, 18th Floor, Patterson Office Tower

Committee Members Present

Mark Bryant (Chair), Skip Berry, Angela Edwards, Bill Britton, Keith Gannon and David Hawpe

Approval of Minutes

The minutes of the February 18, 2016 Audit and Compliance Committee (ACC) meeting were approved as presented.

Reports and Discussion Items

UK Internal Audit Update

Mr. Joe Reed gave the following report.

Mr. Reed began with discussing the Physics and Astronomy Investigation. Mr. Reed stated that UKIA could not have performed this investigation without the partnerships of BKD, HR, Office of the Treasurer and, the most critical partner, the UK Police Department (UKPD). Mr. Reed thanked the partners of this investigation and thanked the internal audit department personnel who spearheaded the investigation. These individuals were Ralph Kimbrough and Lee Walker.

Chair Bryant asked about the prosecution protocol for a case like this. UKPD Chief Monroe stated the evidence against Ellis was presented to the US Attorney's Office and they are pursuing a federal indictment. UK Executive Vice President for Finance and Administration, Dr. Monday, asked if Mr. Reed could explain the two observations involved in this investigation. Mr. Reed stated that the first one involved the misappropriations of assets. Mr. Ellis would purchase tangible goods with UK funds or remove goods from UK inventory without proper authority. Additional evidence shows similar items were sold on Ellis's eBay account. The royalty payments received by Ellis was the second observation and this related to the execution of improper agreements. Ellis signed agreements obligating the university to contracts that benefited him even though he was not authorized signer.

Dr. Monday made the following statement: "At the University of Kentucky, we constantly assess how effectively and efficiently we are serving our campus and its students, faculty, staff, visitors, fans, patients, and alumni. Our commitment is to be accountable as well as innovative in providing the best possible support and service. Last week, our team presented a report to the Audit and Compliance Committee of the University Board of Trustees, detailing our plans to reinforce an important component of this promise. The report detailed ways to bolster the institution's internal audit capacity, as part of an initiative to strengthen the "culture of compliance" throughout our campus. To be sure, nearly all University employees do the right things all the time. But on those rare occasions when we do uncover inappropriate activity, we take action to address the situation. We constantly assess our processes, ensuring we're doing everything possible to help prevent these types of issues. In doing so, we also encourage individuals to come forward if and when they do see concerns. In the last few years, we have authorized four additional internal auditors for our team. In the coming year, we will continue to invest in this critical area. Our increased capacity in audit – and an ongoing commitment to open discussions and transparency at the board level – will enhance our efforts in the short-term. In the long term, our audit team members will help ensure that we sustain a vital culture of compliance."

Trustee Britton commented that unplanned activity is really key to what an internal audit function does. As a result of this unplanned activity, UKIA is not able to complete the planned work; however, it is in the unplanned work where things come out of the weeds. That is where UKIA will need to spend a lot of their time. Dr. Monday stated that Mr. Reed was going to speak about the dynamic work plan and build on Mr. Britton's comments and how we are evolving the internal audit function to allow for us to respond to more unplanned activities in a more dynamic environment.

Chair Bryant stated that Mr. Reed's audits, with the support of Former Chair Britton, made things easy for him to continue with this great work. Former Chair Britton strengthened our internal audit capacity. He also praised Mr. Reed and the audit team on how things are being done on campus the right way.

FY 2016 Activity Update

Mr. Reed reviewed the FY 2016 Activity Update as of February 29, 2016. The planned activity represents the fiscal year 2016 work plan approved in June 2015. Total productivity is made up of 52% planned activity, and 48% unplanned activity. The hours associated with unplanned activities are high due to the time required for planning and research. Mr. Reed stated that UKIA should complete 5 to 10 unannounced audits that include cash, procard and FERPA audits. UKIA completed 4 of the 22 audits as of February 29, 2016. Thus, 18% of the planned activity has been completed. This percentage should be 50% to 60% by year-end.

UK Internal Audit Dynamic Work Plan Presentation

Mr. Joe Reed gave the following presentation:

Mr. Reed began by discussing the original approach to developing a work plan. Previously, the work plan was static and audits were determined by reviewing data collected annually. Audit selection was determined based on whether a unit's prospective risk was high, medium, or low. Work plan creation was based upon these risks.

Mr. Reed stated that UKIA is now moving toward a continuously updated work plan. UKIA is moving away from utilizing historical data that was analyzed annually, to a method that uses current data and is continuously analyzed. Our objective is to prioritize audits by continuously evaluating risk and engaging process owners to improve our resource allocation.

Office of Treasurer Update

Susan Krauss gave the following report.

BKD Bond Offering Report

Ms. Krauss discussed the results of the procedures performed by BKD on the bond offering document for the January 2016 bond sale. Dr. Monday previously reported the details of the bond sale to the Finance Committee in March 2016, reporting that the University had sold \$160 million to generate funds for the student center project. Ms. Krauss reported the offering document included a 2016A Title series for the tax exempt bonds and a 2016B Title series bonds that were taxable. BKD reviewed the offering document, which included the 2015 audited statements to ensure consistency of the information. BKD also performed a subsequent events review for information that would have impacted those 2015 financial statements. BKD's report, along with an updated management representation letter can be found in the packet. Ms. Krauss noted the representation letter was signed by her, Dr. Monday, President Capilouto and Ronda Beck, UK's Controller. Ms. Krauss reported that BKD found no material inconsistencies or misstatement of facts between the bond offering document and the 2015 audited statements.

BKD Engagement Letter

On Feb 18, 2016, the ACC approved ACC1, authorizing the Treasurer to enter contract negotiations with BKD for audit, accounting, tax, and consulting services to be performed over the next several years. Ms. Krauss reported the new contract has been executed and the packet contains the executed engagement letter for the 2016

audit and details the audit objectives, entities to be audited, and responsibilities of BKD and management. . Certain agreed-upon procedures (AUP) are also included in the engagement letter and separate engagement letters for those AUPs are being finalized and will be shared with the Committee in June. Fees for the 2016 engagement will total \$382,000.

BKD Update

BKD Pre-Audit Communication Report

Jim Creeden gave the following report.

Mr. Creeden thanked the Audit and Compliance Committee and expressed his appreciation of their confidence in BKD. Mr. Creeden introduced himself as the new lead engagement partner. In accordance with NACUBO best practice, which recommends rotation of the lead audit partner every seven years, the University asked BKD to perform this rotation.

Mr. Creeden discussed the pre-audit report to the Audit and Compliance Committee. The audit work plan is based upon management meetings, significant transactions, significant changes, and previous history. The audit will be performed in accordance with generally accepted auditing standards, government auditing standards and new OMB Uniform Guidance requirements, which require that if an entity spends more than \$750 thousand federal dollars they must undergo an audit governed by the Uniform Guidance. This year BKD plans to test the research and development cluster; therefore, all of the grants will fall under this umbrella. The scope and timing of the audit will be based on the areas of higher risks. The due date of the audited financial statements and related audit work is October 3, 2016, which is the Commonwealth of Kentucky's reporting deadline.

Mr. Creeden then discussed the updates to GASB. GASB 72 on fair value measurements, effective for the fiscal year 2016 financial statements, allows for a more transparent look at an entity's investment portfolio. Mr. Creeden also discussed the new exposure draft for leases, which covers the financial reporting for operating and capital leases. GASB is now suggesting a change in reporting all leases as capital leases, which will increase liabilities.

Chair Bryant expressed how he is constantly kept informed by Mr. Reed as well as by BKD as to what is going on. Chair Bryant thanked them for this.

Other Business

No other business to discuss.

Adjournment

Chair Bryant noted that with no further business to discuss and meeting was adjourned.

Next Meeting

Friday, June 24, 2016

- UKIA Budget Activity Report

Respectfully submitted,

Ralph Kimbrough