

Minutes of the Audit and Compliance Committee Meeting
University of Kentucky
Friday, February 22, 2019

The Audit and Compliance Committee (ACC) of the University of Kentucky (UK) met on Friday, February 22, 2019, in Room 234B of the Lee T. Todd Pharmacy Building.

A. Meeting Opened

Chair Claude “Skip” Berry III called the meeting to order at 9:16 am.

B. Roll Call

The following members of the ACC answered the call of the roll: Jennifer Barber, Claude “Skip” Berry III, Kim McCann, Elizabeth McCoy, David Hawpe, and Robert Vance. James Booth and Angela Edwards were not in attendance.

C. Approval of Minutes

Chair Claude “Skip” Berry III reported that the minutes of the December 11, 2018, ACC meeting had been distributed. Trustee McCoy moved for approval of the minutes and Trustee Hawpe seconded the motion. The minutes from the December 11, 2018 ACC meeting were approved as presented.

D. University of Kentucky Internal Audit Fiscal Year 2019 Third Quarter Activity Update

Joe Reed, University of Kentucky Chief Audit Executive, shared the Fiscal Year 2019 Third Quarter Activity Update which reflected the audit activity from January 1, 2019 through March 31, 2019. Mr. Reed clarified that the audit activity status dated March 31, 2019 was representative of February 1, 2019 projections. Mr. Reed discussed the four quadrants into which the University of Kentucky Internal Audit (UKIA) work plan categorizes audit assignments: Compliance Programs, Business Operations, Information Technology, and UKIA Continuous Activities. He shared the current status, as of January 31, 2019, and the audit completion projections for the quarter.

During the review of the Business Operations quadrant of audit activities, Mr. Reed pointed out that three of the four current audits were expected to be completed by March 31, 2019. During this time, UKIA also undertook two new activities, one of which, the Ryan White Grant Review, will be quite a large undertaking. Mr. Reed then reviewed the last two quadrants of activity: Information Technology and Continuous Audits. He discussed the Information Technology Compliance program which supports Business Operations audits and Continuous Activities which encompass Follow-Up Reviews and Inquiries. Mr. Reed shared the large amount of time and resources that are required for each Inquiry in order to determine whether to close it out or upgrade to an Investigation once substantiated. He mentioned that approximately 45 to 50 percent of UKIA’s resources had been redirected during this quarter to support Follow-Up and Inquiry audits, and the effect on other audit areas was pronounced. Mr. Reed shared the Internal Audit plan to

improve operational efficiencies by revising individual metrics together with UKIA weekly team meetings.

Mr. Reed then shared the Training and Partnerships that had occurred during the quarter. He focused on the Fraud Classes offered through Human Resource Development and the Kentucky Auditors meeting to be held in March 2019 which includes University auditors from across the state. He finished the presentation by discussing the seven projects or areas in which Internal Audit currently partners: College of Medicine Expansion Project, Business Operations Training Transformation Project, Quality Improvement, University Human Resources, University Budget Office, University Financial Services, and Purchasing, as well as participation on various other committees.

Trustee Hawpe then referenced the slide which documented a Pharmacy Drug Diversion audit which had been closed due to an inquiry involving Pharmacy. He asked Mr. Reed if anything could be shared regarding the nature of the Inquiry. Mr. Reed stated that an Inquiry is not shared with the Board unless the issue has been substantiated, at which time an Investigation would be opened.

E. UKIA Metrics Trends Fiscal Year 2018-Present

Mr. Reed then introduced UKIA's Fiscal Year 2019 Metric Trends. He began by discussing the two Metric Categories: Efficiency and Effectiveness. He elaborated on the two metrics found within the Efficiency Category, Audit Duration, which represents planned activities only, and Productivity. Mr. Reed shared that Audit Duration, which was measured on December 31, 2018, was extremely high and would not meet the Fiscal Year's established goal. He then provided the strategies which have been implemented within UKIA operations to ensure this metric was met in the next Fiscal Year. UKIA has been structured as a flat organization which put added pressures on the efficiency of the department. Beginning in December 2018, UKIA implemented a Core Management Team which provides the needed support and direction for the department. Additionally, UKIA has reinitiated individual auditor meetings as well as weekly team meetings. Mr. Reed shared that the Productivity metric is on target to meet its goal of 75%.

Mr. Reed closed the metrics presentation with an overview of the second metrics category, Effectiveness, which has five components: Audit Coverage, Contacts, Partnerships, Remediation, and Survey Results. He shared that the Audit Coverage metric was measured once a year. He explained that UKIA has separated the University into six Enterprise Divisions: Administration, Affiliates, Campus Operations, Finance and Administration, HealthCare, and Academics. When a concern is identified in one of these enterprise divisions, UKIA communicates this concern to other areas within that enterprise division. This allows each unit to be proactive in mitigating any concerns, thereby increasing UKIA's Audit Coverage. He closed this section by reviewing Contact, Partnerships, Remediation, and Survey Results of the Effectiveness Metric Category. He shared that each metric is on track to meet its goal.

Trustee Hawpe asked Mr. Reed if the individual auditor meetings were replacing the weekly auditor team meetings. Mr. Reed stated that would not be the case, both meetings would occur.

F. BKD Report on January 2019 Bond Offering

Susan Krauss, University of Kentucky Treasurer, discussed BKD's procedures regarding the 2019 refunding bond sale of the 2009 A series bonds, which became callable this year.

Ms. Krauss discussed BKD's report dated January 19, 2019 regarding this bond offering conducted to capitalize on the market's lower interest rates. She described the procedures that BKD performed on the bond offering document which entailed a review of the June 30, 2018 audited financial statements to ensure that no events had taken place subsequent to June 30, 2018 and that no alterations to the financial statements included in the offering document had occurred. BKD also reviewed other information included in the offering document for consistency with the audited financial statements and identified no inconsistencies or misstatements of facts.

G. ACC 1 – Execute Fiscal Year 2018 - 2019 Audit Engagement Letter

Ms. Krauss discussed the ACC 1 recommendation that the Audit and Compliance Committee authorize Ms. Krauss to execute the engagement letter with BKD, for the audit of University of Kentucky financial statements for the fiscal year ending June 30, 2019. Ms. Krauss reviewed the scope of BKD's services which will include an audit of the basic financial statements for the University and affiliated corporations for the year. Included in the audit will be an audit of three organizational units of the University: University of Kentucky Hospital Systems, Kentucky Tobacco Research and Development Center, and WUKY FM radio station. Additionally, BKD will report on internal controls and compliance in accordance with state and federal governmental regulations and agreed upon procedures reports which UK engages BKD to perform annually. BKD will also report on estimated bond arbitrage liability. The anticipated audit engagement fees are \$416,000, representing a three percent increase over the prior year. Ms. Krauss stated that the executed engagement letter will be brought to the next Committee meeting for review and that BKD will attend to provide an update on the audit scope of services and an update on new accounting standards.

Trustee Vance stated that an advantage of having a long-term relationship with an auditor is that they do not have the learning curve that one would have if you changed auditors, while the disadvantage is that sometimes a fresh set of eyes may find things that would have been missed otherwise. One of the ways to mitigate this issue would be to have a different Principal in charge of the audit every three years and asked if Ms. Krauss' area had thought of this.

Ms. Krauss stated that the University follows the National Association of College and University Business Officers (NACUBO) guidance in this area. Ms. Krauss explained that as Sarbanes-Oxley (SOX) requires a rotation of the audit partner every five years with a five-year time out, NACUBO recommends a rotation of the audit partner every seven years, with a two-year time out. She explained that this will be the second contract with BKD as they had been engaged previously for an eight-year contractual period. With the new contract, the audit partner, Mary McKinley, rotated off the audit for two years and Jim Creeden served as the audit partner during Ms. McKinley's rotation. Ms. Krauss explained that, as Ms. McKinley has more experience in the higher education arena, she returned as the lead audit partner for the 2018 audit. Ms. Krauss discussed the University of Kentucky Request for Proposal (RFP) process which resulted in the hiring of BKD for a second contract, which would be a nine-year contract with a five-year fixed term and four one-year renewals.

Chair Berry then introduced ACC 1 - Execute the Fiscal Year 2018 and 2019 Audit Engagement letter for a motion to approve. The motion was made by Trustee McCoy and seconded by Trustee Hawpe. The motion carried.

H. Execute Revised Audit and Compliance Committee Charter

Mr. Reed brought forward the proposed Audit and Compliance Committee Charter revisions first presented at the December 11, 2018 Committee meeting. Mr. Reed explained that the charter had been updated for improved clarity and to allow for the Committee's structural changes. He explained that changes specific to the structure were the number of Board members allowed to serve on the Committee and the number of members who must be present to constitute a quorum. Mr. Reed presented the updated Charter for approval.

Chair Berry introduced ACC 2 - Execute Revised Audit and Compliance Committee Charter for a motion to approve. The motion was made by Trustee Barber and seconded by Trustee McCann. The motion carried.

I. Execute Revised University of Kentucky Internal Audit Charter

Mr. Reed reviewed the proposed UKIA Charter revisions which had been brought forward for review at the December 11, 2018 ACC meeting. Mr. Reed reviewed the updates for professional standard changes within the revised Charter. Mr. Reed presented the updated Charter for approval.

Chair Berry then introduced ACC Action Item 3 - Execute Revised UKIA Charter for motion to approve. The motion was made by Trustee Barber and seconded by Trustee Vance. The motion carried.

J. 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 McCann. The motion carried, and the meeting was adjourned at 9:44 a.m.