

Minutes of the Audit and Compliance Committee
Meeting University of Kentucky
Monday, May 4, 2020

The Audit and Compliance Committee (ACC) of the University of Kentucky (UK) met on Monday, May 4, 2020, via Zoom Webinar.

I. Call to Order

Chair Claude “Skip” Berry III called the meeting to order at 3:03 p.m.

II. Roll Call

The following members of the ACC were in attendance: Claude “Skip” Berry III, Kimberly Scott McCann, Elizabeth McCoy, Derrick Ramsey, and Sandra Shuffett.

III. Approval of Minutes

Chair Berry reported that the minutes of the February 21, 2020 ACC meeting had been distributed. Trustee McCoy moved for approval of the minutes and Trustee McCann seconded the motion. The minutes from the February 21, 2020 ACC meeting were approved as presented.

IV. Reports and Discussion Items

A. University of Kentucky Internal Audit Operation Adjustments and Dynamic Risk Assessment

Chief Audit Executive Joe Reed presented the University of Kentucky Internal Audit’s (UKIA) operational adjustments and dynamic risk assessment which reflect the recent University-wide COVID-19 changes. Mr. Reed explained that UKIA temporarily paused two of UKIA’s nine services: training classes (such as Fraud 1: The Business of Fraud and Fraud 2: Advanced Fraud) and unannounced/surprise audits. These services will resume once University operations return to normal.

Mr. Reed then discussed UKIA’s focus moving forward during this pandemic environment. He stated that, “UKIA is steadfastly focused on University processes and is closely monitoring changes to ensure the risk exposure is mitigated by compensating controls.” Mr. Reed continued by highlighting UKIA’s focus on research and grant activity, along with consultations to provide units with reasonable assurance that appropriate controls are in place for a remote work environment. Additionally, Mr. Reed announced that UKIA will increase Information Technology reviews to ensure that telework does not elevate the University’s information security exposure. Mr. Reed also specified that inquiries and investigations will remain a priority and that data mining activity will continue.

Mr. Reed described some of the measures that UKIA is taking to remain adherent to social-distancing guidelines. These were broken up into three categories: planning,

fieldwork, and reporting. Mr. Reed stated that interviews are now conducted via Zoom webinar meetings, rather than in-person. Also, audit consultants who must conduct on-site fieldwork, such as walk-through inspections or file collection, wear a mask and gloves and make every effort to maintain proper social-distancing guidelines.

Mr. Reed then explained that project status updates and audit results are now held via Zoom webinar meetings, rather than in-person. Final reports remain unchanged and continue to be distributed to the client, University administration, stakeholders, and the ACC.

Mr. Reed continued by discussing UKIA's risk assessment process and detailed the four risk assessment categories: information, assigning information, storing information, and deliverables. This information is used to create a table of weighted business risk factor scores that are divided into two sections, enterprise division and business risk factors. The enterprise divisions consist of academics, administration, affiliates, campus operations, finance and administration, and UK HealthCare. The business risk factors consist of public exposure, external factors, materiality, audit duration, control environment I, control environment II, and management requests. Each risk factor is based on each enterprise division (i.e., public exposure and academics, external factors and administration, materiality and affiliates, etc.). Mr. Reed then provided examples for academics and UK HealthCare. For academics, UKIA scored the control environment II risk factor a 20% due to information systems being managed independently. Public exposure was 17.5% due to numerous programs for minors. External factors were also 17.5% due to adherence to the Southern Association of Colleges and Schools Commission standards. Control environment I was 15% because of event identification and strategic alignment. Materiality was 10% due to major revenue sources including grants, tuition, and fees. Audit duration was listed at 10% as well due to the duration since the last audit (internal or external). Finally, management requests were rated at 10% because of requests received with associated explanations.

Mr. Reed then discussed UK HealthCare scores, where public exposure was 20% because of external clients and stakeholders. External factors was rated 17.5% because it is highly regulated. Materiality was 15% due to revenue sources (e.g., third-party payments). Control environment I was listed at 15% because of event identification and operational strategy. Control environment II was also 15% because of information security, data integrity, and disaster recovery. Audit duration was 10% due to the duration since the last audit (internal or external). Finally, management request was 7.5% due to the requests received with explanations.

Mr. Reed then gave an example of what an information packet looked like. He gave an example featuring the Gatton College of Business and Economics, which first featured a table of contents, along with the unfiltered information, which currently remains internal.

Mr. Reed then discussed UKIA's approved FY2019-20 work prioritization program, which was broken into three categories: processes, units, and applications. He stated that, while still important, the processes listed in gray – the Family Educational Rights Privacy Act, the Health Insurance Portability and Accountability Act, Agency Accounts, ProCard,

and Cash Handling – will not be given top priority due to the current COVID-19 environment. Additionally, the units that will be temporarily sidelined are shared services and service centers. Instead, UKIA will focus on the following processes during this time: contract management, conflicts of interest, regulatory compliance, student fees, the vendor master file, de-provisioning, and capital construction. Mr. Reed went on to say that the UK Alumni Associations, 501(c)(3) entities, unit reviews required by the Kentucky Revised Statutes, and academic units will remain a focus. Additionally, all applications, including in-house applications, server configuration, and unit applications will continue to be a priority.

B. Executed FY2018-19 Audit Engagement Letter and Agreed-Upon Procedures Letters for the NCAA, ESH/CKRC, and KMSF

Chair Berry introduced Penny Cox, Acting Treasurer with University Financial Services. Ms. Cox presented the executed engagement letter with Baird, Kurtz, and Dobson, LLC (BKD) for the audit of the financial statements for the year ending June 30, 2020. Ms. Cox stated that the audit will include a financial statement audit for the University, its affiliated corporations, and three organizational units of the University. The University and affiliated corporations include the UK Research Foundation, the UK Mining Engineering Foundation, the UK Gluck Equine Research Foundation, the UK Humanities Foundation, and Central Kentucky Management Services, Inc. She then stated that the organizational units include UK HealthCare Hospital Systems, Kentucky Tobacco Research and Development Center, and WUKY-FM radio station. She continued by saying that the UK Alumni Association statement of financial position and related statements of activities and cash flows for the year ending June 30, 2020, will also be audited.

This audit will be conducted in accordance with Generally Accepted Auditing Standards and standards applicable to financial audits for governmental entities as prescribed by the Office of Management and Budget's Compliance Supplement, 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. An overview of BKD's engagement fees for FY2019-20 are approximately \$430,000, representing a three percent increase over the FY2018-19 engagement fees of \$416,000.

Ms. Cox then went on to discuss the Executed National Collegiate Athletic Association Agreed-Upon Procedures Engagement Letter. The first of three Agreed Upon Procedure (AUP) letters relate to procedures required by the National Collegiate Athletic Association to verify the accuracy and completeness of financial data of the University's Department of Intercollegiate Athletics. The second AUP 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. The third AUP letter outlines the procedures related to UK's contract with the Kentucky Medical Services Foundation. There were no notable changes in the agreed-upon procedures for the engagements to be performed this year.

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

Ms. Cox introduced Mary McKinley, a partner with BKD CPAs and Advisors, to provide the Pre-Audit report for this year's financial statement audits and agreed-upon procedures, alongside Joanie Duckworth, Director with BKD.

Ms. McKinley discussed the impacts of COVID-19 on the audit process, which she stated will be minimal. Ms. McKinley believes that any uncertainties would be condensed into a few areas, including due dates for the submission of various audit reports, the financial statements, the data collection form, and Continuous Professional Development reporting. She also stated that there are some additional uncertainties regarding the testing procedures specific to certain federal awards related to COVID-19 funding, and whether or not certain funding will be included in the federal awards testing or the federal government will exclude certain portions of those from the scope. Ms. McKinley said stated that they are prepared to move forward as if there were no delays in due dates, effective dates of reporting, or any testing procedures.

Ms. McKinley then discussed the pre-audit report and stated that the audit process is not 100 percent free of errors but can provide reasonable assurance that they are in accordance with Generally Accepted Accounting Principles. The audit report outlined the scope of the testing for the transactions within each of the audits. It outlines the principles used in significant estimates that are made by management inherit in the financial statements. She then discussed the various entities that are covered in financial statement audits, including the University of Kentucky, UK HealthCare Hospital System, WUKY – FM Radio, and Kentucky Tobacco Research and Development Center.

Ms. McKinley explained that, as a part of their typical planning procedures, BKD assesses various areas of audit risk by gathering information about what might have changed in the processes and the internal control structure during the current year. She stated that they also look at potential new transactions that may affect the financial statements in the current year and hold discussions with management and various leadership levels throughout the organization. Ms. McKinley then specified the preliminary risk areas they have assessed, which include risk of management override of controls, improper revenue recognition, self-insurance for medical malpractice, long-term disability, workers' compensation, health insurance, litigation reserve, valuation of alternative investments, allowance for doubtful accounts and pledges receivable, compliance with uniform guidance, and contractual allowances and amounts due to/from third-parties.

Ms. McKinley then introduced Joanie Duckworth to discuss the timeline and ongoing communication. This consisted of the Commonwealth of Kentucky reporting deadline which is October 2, 2020. Ms. Duckworth explained that the BKD presentation to the Audit and Compliance Committee will likely be in December of 2020.

Ms. Duckworth encouraged regular communication between both BKD and the ACC regarding fraud involving senior management, illegal acts, any significant deficiencies or material weaknesses, and instances of noncompliance with awards that may be identified.

Ms. Duckworth then discussed new accounting pronouncements. There is currently an exposure draft from the Governmental Accounting Standards Board (GASB). This exposure draft is a result of COVID-19. These new accounting pronouncements include GASB Number 84, Fiduciary Activities; GASB Number 87, Leases; GASB Number 89, Accounting for Interest Cost Incurred before the End of a Construction Period; GASB Number 90, Majority Equity Interests – an amendment of GASB Statements Number 14 and Number 61; and GASB Number 91, Conduit Debt Obligations. GASB Number 84 through statement Number 93 will all be postponed by one year. GASB Number 87, Leases, will be effective as it currently stands for 2021, although it is delayed until 2022. Ms. Duckworth explained that this is just an exposure draft, and nothing is finalized.

Lastly, Ms. Duckworth discussed the consideration of errors or fraud. She listed several items from the engagement team's brainstorming inquiries with management, which included reviewing significant and unusual transactions, evaluating business rationale for significant unusual transactions, and incorporating an element of unpredictability into the audit each year. Several of these have already begun as planning procedures progress.

V. Adjournment

With no further business to come before the Committee, Chair Berry asked for a motion to adjourn. The motion was made by Trustee McCoy and seconded by Trustee McCann. The motion carried and the meeting was adjourned at 3:42 p.m.