

**MINUTES OF MEETING
COUNTY EMPLOYEES RETIREMENT SYSTEM
AND KENTUCKY RETIREMENT SYSTEMS
BOARD OF TRUSTEES JOINT AUDIT COMMITTEE
SPECIAL CALLED MEETING
AUGUST 26, 2021, 10:00 A.M., E.T.
VIA LIVE VIDEO TELECONFERENCE**

At the August 26, 2021 meeting of the Joint Audit Committee of the Board of Trustees of the County Employees Retirement System and the Kentucky Retirement Systems, the following Committee members were present: Betty Pendergrass, William O'Mara, Kelly Downard, and Lynn Hampton. Staff members present were David Eager, Rebecca Adkins, Erin Surratt, Michael Board, Steven Herbert, Vicki Hale, Carrie Bass, Connie Davis, Madeline Perry, Matthew Daugherty, Steve Willer, Jerry Yang, Kristen Coffey, Dominique McKinley, Chris Johnson, Shaun Case, Phillip Cook, and Glenna Frasher. Others present included Larry Totten, Ed Owes, and John Chilton.

Mr. Eager called the meeting to order.

Ms. Bass read the Statement on Special Meetings.

Ms. Rankin called roll.

Being no Public Comment, Mr. Eager introduced the agenda item *Election of Chair*. Mr. Eager opened the floor for nominations for the position of Chair of this committee. Mr. Downard made a motion and Mr. O'Mara seconded to elect Ms. Betty Pendergrass as Chair. The motion carried unanimously.

Ms. Pendergrass introduced the agenda item *Election of Vice-Chair*. Ms. Pendergrass opened the floor for nominations for the position of Vice-Chair of this committee. Mr. O'Mara made a motion and Mr. Downard seconded to elect Ms. Lynn Hampton as Vice-Chair. The motion carried unanimously.

Ms. Pendergrass introduced the agenda item *Approval of February 4, 2021 Audit Committee Minutes*. Ms. Pendergrass noted that these are the minutes from the Kentucky Retirement Systems Audit Committee when they met in February 4, 2021. Ms. Pendergrass indicated that she was on that committee, and Mr. Chilton who is present today, was the chair of that committee; she has reviewed these minutes for their completeness and has no edits. Ms. Pendergrass asked Mr. Chilton if he saw any edits that were needed, and he indicated he saw none. Mr. Downard asked if they didn't attend the meeting, can we vote on approving the minutes. Ms. Pendergrass stated that she asked for clarification on that subject, and according to *Robert's Rules of Order*, approval of minutes even though you did not attend that particular meeting is allowed. Ms. Pendergrass noted that her personal rule is to not make motions on those minutes, and she feels most would follow that rule. However, in this instance, we are in a situation that *Robert's* calls "an item of necessity". Ms. Pendergrass stated that out of necessity, we need to approve these minutes, and with her being the only member of the committee that was present at this particular meeting, and Mr. Chilton, as the Chair of the prior committee, weighing in on this matter, she is asking this Board to approve those previous meeting minutes. Mr. Downard made a motion and Mr. O'Mara seconded to approve the minutes from the February 4, 2021 Kentucky Retirement Systems Audit Committee. The motion carried unanimously.

Ms. Pendergrass introduced the agenda item *Joint Audit Committee Approval Requests*. Ms. Pendergrass indicated that there are two charters being presented for review, the Charter for the Joint Audit Committee and the Charter for the Division of Internal Audit Administration. The Charter for the Joint Audit Committee was reviewed first. Ms. Pendergrass asked the question, "is it possible for the Joint Audit Committee itself to hire an external firm to conduct and audit or investigation of its own, separate from that routine audit that is completed every year". Ms. Coffey deferred to the legal department for their input, and then it was discussed that this matter would be researched further. Ms. Pendergrass indicated it wasn't necessary for this particular document, but that she was curious if it could be done after reviewing the section regarding who hires which firms.

Ms. Pendergrass then referenced page 2 of the document there is a discussion about independence, wherein it states “Each Joint Audit Committee member will be independent”. In the footnote for that, there is the Merriam-Webster definition. In the AICPA Code of Ethics outlines a different definition of independent, so Ms. Pendergrass feels like there may need to be another word used in this instance in order to protect the CPAs that are on this committee to not interfere with the AICPA Code of Ethics. Ms. Pendergrass asked for suggestions on another word other than “independence” that could be used in this context. Ms. Hampton asked for clarification of Ms. Pendergrass’ view on where she sees the conflict since the committee members are not conducting audits or doing any financial work for KPPA. Ms. Pendergrass responded that her concern would be that if someone else looked at this sentence and then goes to the AICPA Code of Ethics and sees their definition of independent, then the CPAs on the committee don’t meet that definition and there might be criticism of the Joint Audit Committee members because we are not meeting the AICPA code of ethics definition. Ms. Pendergrass indicated that it is just the use of the word and how it is defined differently in the KPPA Joint Audit context and in professional standards. Ms. Hampton suggested that maybe the legal counsel should approach the state board to inquire if the usage of the word is inappropriate in this context. Ms. Pendergrass indicated that it’s not a legal matter but rather a professional ethics question and she offered to contact AICPA to have them review the paragraph that includes this language for their comments. Mr. Chilton suggested working the concept in there that instead of being independent, indicate that the members have no conflicts of interest. Ms. Pendergrass indicated that was one thought she had considered, and it might be a better way of phrasing it. Ms. Pendergrass suggested a possible change of wording to state that each audit committee member will not have conflicts of interest with respect to projects under the purview of the joint audit committee, or something to that effect. Mr. Downard indicated that it is easier and accomplishes the intent. Ms. Pendergrass asked Ms. Coffey to make those changes and updates.

Ms. Coffey indicated that she had received a comment regarding section Internal Controls and Compliance, in that should we specify KPPA, CERS and KRS, or do we think that is clear in this Charter. Ms. Pendergrass indicated that it never hurts to make things more clear, and has

no problem with the heading indicating all 3 names. Mr. Chilton agreed. Ms. Coffey indicated that she would make that change.

Ms. Pendergrass then spoke about the Internal Audit Section we talk about the review and make recommendations regarding the appointment, dismissal and replacement of the Internal Auditor. Ms. Pendergrass questioned who has the authority to appoint or dismiss the Internal Auditor, does that lie with the Governor since in number 2 the rest of the staff is at the discretion of the Governor, and she assumes that they are under Section 18A. Ms. Coffey indicated that she had received comments on this section as well. Ms. Coffey received a suggestion that perhaps the language in number 1 should read, "review and make recommendations to the KPPA Executive Director regarding appointment, dismissal and replacement", due to the fact that the KPPA Executive Director is the one who has been given that authority. Ms. Coffey indicated that the same would also be true for number 2, and should read, "review and make recommendations to the KPPA Executive Directors regarding salary of the internal auditor". Ms. Pendergrass stated that her concern with the internal auditor being hired and fired by the Executive Director was whether that would create a subtle pressure if internal audit, especially the director, is choosing audit engagements and making reports on audit findings, but the director's appointment, dismissal and replacement is controlled by the Executive Director, then there might be some issues there. Ms. Pendergrass is wondering if the Joint Audit Committee should have the responsibility, especially for the Internal Audit Director, for appointment, dismissal and replacement. Mr. Downard stated that he did not agree with that, he feels that the committee can make a recommendation, but he is not sure that the Board Committee can take on the executive duties of hiring and firing of personnel. Mr. Downard indicated that we make the recommendation as required, and if the Executive Director disagreed, and hired someone else, then I think we would take it back to our Boards and indicate that we have a problem. Mr. Chilton stated that in most organizational charts, the Internal Auditor would report to the Board with a solid line on the chart and with a dotted line to the Executive Director. Mr. Eager stated that the Bylaws indicate that the Executive Director is responsible for staffing and compensation. Mr. Downard asked if language could be added to indicate that the Joint Audit Committee would approve the actions of the Executive Director in the appointment, dismissal and replacement of the Internal Audit Director, in case any issues arose. Ms. Bass stated that

KRS 61.505 requires the Executive Director of KPPA to make all of the hiring, firing, salary decisions for all KPPA staff, and this includes the Internal Audit Director. Ms. Bass expressed concerns that a committee or board would not have the authority to override or add to that statutory language. Ms. Hale agreed and further stated that the statutes for the CERS and KRS indicated they were authorized to hire a CEO and general counsel, but did not indicate that jointly or separately that they are authorized to hire any other staff. Mr. O'Mara stated that the intentions of the committee is to maintain independence for the Director of Internal Audit and working within the confines of our state statutes, what would be the best way to do that. Mr. O'Mara agreed with Mr. Chilton regarding his comments on the organizational chart and how the dotted line to the Executive Director was so that the day to day business is conducted. So, if the state law states that we cannot usurp this, but can't the Executive Director accept that they will come to the Committee for approval before hiring and firing. Mr. O'Mara asked if there is an art to the wording where we are within the confines and still meet the independence that we are trying to establish. Ms. Bass responded that there may be some phrasing that can be done there, but it would have to be done in a way not to imply that the committee has the final approval or final say in the hiring, firing, or salary of the position. Ms. Bass indicated that there is a remedy in place if there is an issue with the KPPA Executive Director and the Director of Internal Audit. The remedy includes the members of the Joint Audit Committee going back to their respective boards to report the issue, and those boards will request that their members who are serving on the KPPA Board to take action to terminate the contract of the KPPA Executive Director or to reprimand the KPPA Executive Director in some other fashion. Ms. Hampton asked if it would be permissible to put a time frame in that the Executive Director would inform the committee, but not take action for a length of time, i.e. 5 days or longer, that would allow a board or committee meeting to be held quickly. Ms. Pendergrass asked if it is possible to reword number 1 paragraph so that the Executive Director makes a choice from a list provided by the Joint Audit Committee. This would take care of the appointment and replacement, and then we would just need to request that the Executive Director bring a request for dismissal to the committee prior to taking action. Mr. Eager asked what if the committee rejects the request for dismissal. Ms. Pendergrass responded that then we would have to go through the complications of reporting to our respective boards and then bring it before the KPPA board to attempt to resolve the differences. Mr. O'Mara asked if the word, "consult" is acceptable to all parties,

within the legal definition, that the “Executive Director will consult”. Ms. Bass answered yes, absolutely. Mr. O’Mara then stated this would ensure that the Executive Director has shared, either with the Chair or the committee as a whole, the issue of hiring and firing. Mr. Eager pointed out that if the committee is going to provide a list of candidates, then they will have to go through 45A and be involved in the hiring process. Ms. Pendergrass asked if the Internal Audit Director position under 18A or is it a contract position. Ms. Bass answered that this position falls under 18A and that prevents those individuals outside of 18A, like the committee members, from being allowed to sit on the hiring panel of an 18A employee. Ms. Pendergrass then asked if the Personnel Cabinet would be able to provide the committee with a list of applicants that are being interviewed. Ms. Bass indicated that she would like to follow-up with the Personnel Cabinet regarding if she is correct on individuals outside of 18A not being on the hiring panel of an 18A employee, and if so, then will ask if the committee can be contacted and included in a second interview process. Ms. Pendergrass indicated that otherwise, she unsure how they would be able to review and recommend if they were not provided information or be able to interview. Ms. Pendergrass suggested that we leave it as it is now and do the research regarding protecting the Director of Internal Audit from undue pressure and influence, and we can modify this Charter at a later date, when we get better language. Mr. Downard stated that he feels that we not only have to protect the Director of Internal Audit, but also, the Executive Director, but he doesn’t feel that the committee needs to get involved in the executive duties.

Ms. Pendergrass then indicated that under the heading External Audit, a provision needs to be added about the Joint Audit Committee having the authority to receive communications required by AICPA Auditing Standards Board from external auditors to governing boards. Ms. Pendergrass indicated that back in March, a question was asked that could the joint audit committee serve in that governing board role and the answer we received from the auditors that we consulted at that time was, yes, the joint audit committee as a designated representative of the two governing boards and the relationship that the joint committee has with KPPA, was sufficient for the external auditors to come to this Committee to deliver those communications. Ms. Pendergrass suggested that Ms. Coffey discuss this with our new external auditors and maybe get some wording from them or just make a simple statement. Mr. Chilton stated that his impression is that the external auditor’s communications are directed to the Board not the

audit committee. Ms. Pendergrass responded that we have three boards, which means that the auditors would have to go to all three boards to make those communications. And when discussions were held with the auditors, they felt like the Joint Audit Committee was a suitable representative for the three boards. Mr. O'Mara asked why wouldn't the communications go to the KPPA Board, which has members of both boards on them. Ms. Pendergrass responded that these communications have more to do with planning the audit, describing the scope of the audit, the management representation letters, etc. Mr. O'Mara then stated these are not the findings then. Ms. Pendergrass indicated no, but they could bring those to us, but finished report definitely goes to KPPA. Ms. Pendergrass stated that the communications she is speaking of are interim pieces and this function was previously held by the KRS Audit Committee. Ms. Hampton asked if this would be reviewed by the new auditors for their opinion. Ms. Pendergrass indicated that Ms. Coffey would reach out to the new auditors, Blue and Company, because we need to make sure that they have a path for their communications based on the auditing standards.

Ms. Pendergrass then referred to Section 7 of the Charter, we have a reference to financial statements in accordance with GAAP. We should add a phrase, GAAP for governmental entities in accordance with standards issued by the Governmental Accounting Standards Board. Mr. Downard agreed. Ms. Pendergrass asked that other than the items to be researched further, is the committee comfortable with voting to approve this Charter with the edits noted today, or would the committee prefer to see a clean copy at a later date. Mr. Downard made a motion and Mr. O'Mara seconded to adopt the Charter with edits, and get a clean copy to review at our next quarterly meeting. The motion carried unanimously. After the meeting, while determining if the Charter was consistent with State statutes, the KPPA Legal team suggested additional changes other than those discussed during the Joint Audit Committee meeting. The Joint Audit Committee Charter will be returned to the Joint Audit Committee for consideration of these changes. After approval by the Joint Audit Committee, both KRS and CERS need to review and approve.

Ms. Pendergrass then moved to the Charter for the Division of Internal Audit Administration. Ms. Coffey stated she has an edit, on the second page, under the heading "Independence", under

number 1, at the end of that statement it says “if required”. She received a comment that it may be better stated as “as deemed necessary”. Ms. Pendergrass suggested moving that quote “as deemed necessary” to follow the word “access” in that sentence, so that it is clear that it only applies to the access and not the independence. Ms. Pendergrass indicated that on page 3 of the Charter, under Activities, number 10, it states “Adherence to appropriate auditing standards”, she would suggest adding “including, but not limited to” then list the standards that you are following. Ms. Pendergrass then commented on Section 10, Risk Assessment and Audit Plan with more suggested research.

Ms. Pendergrass stated that the Committee of Sponsoring Organizations, known as COSO, has an internal control framework that outlines 5 basic components, one of which is risk assessment. It has 17 principles that an organization must have in place so that external auditors can do any kind of assessment of your internal controls. And since we are subject to yellow book audits, there is a separate internal control report that auditors provide to us that does a limited assessment, not an opinion on our internal controls, but they do evaluate whether we have any material weaknesses or substantial deficiencies. Ms. Pendergrass indicated that at some point she would like to add a section to the internal audit to outline how internal audit can assist KPPA in making sure that those 17 principles are in place and operating effectively.

Ms. Pendergrass had a question for Ms. Coffey regarding the last page with the approval date listed as September 15th, and was that correct given all of the Boards will need to sign after they approve. Ms. Coffey indicated that she used the date of the last scheduled meeting of the boards, which is the County Employees Retirement System meeting which is scheduled for September 15th. Mr. O’Mara made a motion and Mr. Downard seconded to adopt the Internal Audit Charter with the edits noted today. The motion carried unanimously.

Ms. Pendergrass introduced the agenda item *Office of Legal Services Reports*. Ms. Bass began by providing a Summary of Potential Disclosures/Breaches from the 4th Quarter of Calendar Year 2020. Even though the 4th Quarter would be from October through December 2020, notification was received from an outside vendor in February 2021, regarding potential event that occurred during this time frame. Ms. Bass then reviewed the same summaries for both the

1st and 2nd Quarters of 2021. Ms. Bass then reviewed the summary memorandum of anonymous tips and updates regarding those ongoing investigations. Ms. Hampton asked if this was a normal report and if these are usual numbers for these types of cases. Ms. Bass indicated that many of the cases included in this particular report have been ongoing for the last 18 months to 2 years, and due to COVID restrictions, it had been difficult for the investigations to proceed as they had prior to the pandemic. These documents were presented for informational purposes.

Mr. Eager asked that Ms. Bass provide a quick overview of the retired reemployed restrictions. Ms. Bass stated that there are limitations or prohibitions on reemploying with a participating employer of the County Employees Retirement System or the systems administered by Kentucky Retirement Systems, after retirement. One of those requirements is that there cannot have been a prearranged agreement, or an agreement between the employer and employee to engage in employment once the employee retires. Another requirement is that the employee must sever their employment relationship with all participating employers before their retirement date. The third requirement is that a retired member cannot go back to work for a participating employer until they have observed the statutory break in service, and that can be from 1 month to 3 months in length.

Ms. Pendergrass introduced the agenda item *External Audit Updates*. Ms. Davis began by indicating that the external audit is going on and the auditors were in the office recently doing some testing. A calendar outlining the progress and estimated time lines for the annual report was reviewed by Ms. Davis. Ms. Adkins stated that our External Auditors, Blue and Company, with a question on whether we needed two annual reports or just one. After researching the subject, all parties agree that we can proceed with one annual report. Ms. Davis then reviewed the Financial Statements for Fiscal Year End June 30, 2021 including the Combined Statement of Fiduciary Net Position for the Pension Funds, Combined Statement of Changes in Fiduciary Net Position for Pension Funds and the Combined Statement of Fiduciary Net Position for Insurance Funds. Ms. Davis noted that this is not an audited statement. Ms. Adkins stated that the CERS Financial Statements will be presented to the CERS Finance Committee and will present the KRS and SPRS Financial Statements to the full KRS Board at their next respective meetings. These documents were presented for informational purposes.

Ms. Pendergrass introduced the agenda item *Division of Internal Audit Updates*. Ms. Coffey began by introducing herself and the Internal Audit staff, Jerry Yang and Madeline Perry, and Matthew Daugherty. Ms. Coffey then presented the Internal Audit Budget as of June 30, 2021. Mr. O'Mara asked if it was normal for the year to end with the budget at about a 90% usage. Ms. Coffey indicated that this was due to an employee that left, leaving a vacant position open for a few months. Ms. Coffey then reviewed the Fiscal Year 2022 Auditor Independence Statements. The Status of Current Internal Audit Projects that have been in progress or completed since the last update were then reviewed. Ms. Coffey reviewed the two audit reports that were completed since the last meeting and were comprised of the Reconciliation of Great Plains to eMARS and Coding of Expenditures and the Custodial Fee Payment Process. Ms. Coffey discussed the Audit Plan, which is still in place as a new plan has yet to be presented to the committee for a vote, pending the review of the list of current and possible additional audits that the Internal Audit department would like to conduct. These documents were presented for informational purposes.

Ms. Pendergrass introduced the agenda item *Professional Articles*. Ms. Pendergrass thanked Ms. Coffey for always including the articles that are very insightful in these meetings. The two articles presented were entitled, "Institute of Internal Auditors – Be a Problem Solver" and "AICPA – COVID – 19 Audit Committee Checklist". These documents were presented for informational purposes.

Ms. Pendergrass introduced the agenda item *Closed Session*. Ms. Pendergrass then indicated that a closed session would be needed to discuss an infrastructure item related to public safety. Mr. Downard made a motion and Mr. O'Mara seconded to go into closed session.

Ms. Bass read the following Closed Session Statement:

A motion having been made in open session to move into a closed session for a specific purpose, and such a motion having carried by majority vote in open, public session, the Joint Audit Committee shall now enter closed session to discuss an infrastructure record to keep it from disclosure due to public safety pursuant to KRS 61.810(1)(m) and KRS 61.878(1)(m), because

of the necessity of preventing and protecting against a terrorist act.

There were no actions taken in the closed session.

There being no further business a motion was made by Mr. O'Mara and seconded by Mr. Downard to adjourn the meeting. Copies of all documents presented are incorporated as part of the minutes of the Audit Committee meeting as of August 26, 2021.

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CERTIFICATION

I do certify that I was present at this meeting and I have recorded above the action of the Committee on the various items considered by it at this meeting. Further, I certify that all requirements of KRS 61.805-61.850 were met in connection with this meeting.


Recording Secretary

I, as Chair of the Audit Committee of the Board of Trustees of the Kentucky Retirement Systems, do certify that the Minutes of the meeting held on August 26, 2021 were approved by the Joint Audit Committee on November 4, 2021.


Committee Chair

I have reviewed the Minutes of the Audit Committee Meeting on August 26, 2021 for form, content, and legality.


Executive Director
Office of Legal Services