

**MINUTES OF MEETING
COUNTY EMPLOYEES RETIREMENT SYSTEM
AND KENTUCKY RETIREMENT SYSTEMS
BOARD OF TRUSTEES JOINT AUDIT COMMITTEE
NOVEMBER 4, 2021, 10:00 A.M., E.T.
VIA LIVE VIDEO TELECONFERENCE**

At the November 4, 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, Larry Totten, and Lynn Hampton. Staff members present were David Eager, Erin Surratt, Michael Board, Vicki Hale, Jillian Hall, Connie Davis, Madeline Perry, Matthew Daugherty, Kristen Coffey, Dominique McKinley, Chris Johnson, Ann Case, Ashley Gabbard, Elizabeth Smith, Sherry Rankin, Shaun Case, Phillip Cook, and Glenna Frasher. Others present included Ed Owens, CERS CEO, John Chilton, KRS CEO, Ryan Graham and Alan Norvell with Blue & Company, and Eric Branco with Johnson Bowman Branco, LP.

Ms. Pendergrass called the meeting to order and read that Opening Video Teleconference Statement.

Ms. Rankin called roll.

Being no Public Comment, Ms. Pendergrass introduced the agenda item *Approval of August 26, 2021 Joint Audit Committee Meeting Minutes*. A motion was made by Mr. Totten and seconded by Ms. Hampton to approve the minutes as presented. The motion carried unanimously.

Ms. Pendergrass introduced the agenda item *External Audit*. Ms. Pendergrass introduced Ryan Graham and Alan Norvell with Blue and Company, who is the external auditor in charge of the audit of the Kentucky Public Pensions Authority. After a brief introduction of themselves, being their first audit conducted for the Pensions Authority, Mr. Norvell expressed his thankfulness to the committee, as well as the KPPA Staff, for the additional work that has been done during this entire process. Mr. Graham reemphasized the thankfulness to the KPPA staff in this process

and stated that the audit is still currently in progress but is coming to a close. Blue and Company are completing the financial statements and getting a draft ready for committee review. Ms. Pendergrass asked if they have any of the auditors' Communications with those Charged with Governance that need to be addressed today. Mr. Graham responded that they do not at this time as those will come with the final draft audit report. Ms. Pendergrass then stated she wanted to remind the Committee members that another Joint Audit Committee meeting has been scheduled for November 30, 2021 to review the final audit report and its findings. This date was chosen because Board meetings are scheduled for CERS on Wednesday, December 1, 2021, and KRS on Thursday, December 2, 2021, to officially accept all of those reports.

Ms. Davis then spoke about the changes in the future presentation of the Financial Reports given at the Board and Committee meetings. She indicated that during the process of conducting the external audit, it was upon the recommendation of Blue and Company, that the Financial Reports should list the plans as County Employees Retirement System, Kentucky Employees Retirement System, State Police Retirement System, and Insurance. She then reviewed a new report that further breaks down the County Employees Retirement System and Kentucky Employees Retirement System to show the Hazardous and Non-Hazardous funds. Ms. Davis stated that due to the State Police Retirement System being all hazardous, there is no need for a further breakdown of that plan. Ms. Davis also reviewed the new format for the Fiduciary Net Position for Insurance that is broken down to Hazardous and Non-Hazardous for County Employees Retirement System and Kentucky Employees Retirement System and State Police Retirement System. She stated that these changes are also reflected in the Changes in Fiduciary Net Position and these changes were necessary for reporting for GASB. Ms. Pendergrass indicated that she feels this will give a concise view of the Systems' as they are administered and managed, as well as improves the financial reporting.

Ms. Pendergrass introduced the agenda item *Financial Reporting*. Ms. Pendergrass began by indicating the CERS quarterly financial statements are presented to the Finance Committee of the County Employees Retirement Systems and the KRS quarterly financial statements are presented to the Kentucky Retirement Systems Board of Trustees. The quarterly financial statements as a whole have been presented to the Joint Audit Committee since this is the

committee with assigned audit functions. Ms. Pendergrass felt that the committee would like to see the combining statements as a whole since these eventually become part of the annual report. Ms. Pendergrass asked the Joint Audit Committee members to consider whether or not the committee wishes to continue to look at these in the future or if those reports should be presented only to the CERS and KRS Boards. Ms. Hampton wanted to respond to Ms. Pendergrass' question. She stated first that everyone has the capability of watching the Finance Committee/Board meetings, so they could see these reports in that way. The one thing that is gained from having these presented to the Audit Committee is the ability to ask questions that were not addressed by the Finance Committee/Board. With that in mind, if questions are asked and action is taken, that could affect the Finance Committee/Board. Ms. Pendergrass answered that since two members are from the County Employees Retirement System and two are from Kentucky Retirement Systems, those representatives can go back to their respective Finance Committees/Board or the Chairs and relay that information about the questions the Joint Audit Committee raised. Ms. Pendergrass stated that she feels we could build a collaborative effort, which is why she thought we should have this with four more sets of eyes looking at these reports and taking a different approach. Ms. Pendergrass indicated that another reason she likes the way things are presented here, is that it provides a nice summary of all of the Systems and the KPPA total, and that does not appear in the individual statements that are given to the CERS and KRS Boards. Ms. Pendergrass stated that as representatives we can build that collaboration between the Joint Audit Committee and the individual Finance Committees/Board. Mr. Totten stated that by the time all the meetings are concluded, he will have reviewed these same reports three different times. However, since this is the first time it has been brought in this format, maybe we should continue with the reports for now and review its need and purpose in a future meeting.

Ms. Davis then reviewed the following financial statements as of September 30, 2021: Combining Statement of Fiduciary Net Position for Pension Funds, Combining Statement of Changes in Fiduciary Net Position for Pension Funds, Combining Statement of Fiduciary Net Position for Insurance Fund, and Combining Statement of Fiduciary Net Position for Insurance Fund. Mr. Eager asked if it would be helpful to see the percentage changes in the totals and subtotals. Ms. Pendergrass answered not necessarily because she looks at the percentage change

to identify specific issues. The reasons for the changes in the totals will be a combination of all of those individual items. Therefore, there is not a clear explanation for why the totals change the way they did. She feels the analysis is better suited for the individual line items.

Ms. Davis proceeded to review the Quarterly Budget to Actual Analysis and indicated we are right on target with the quarter. She highlighted the Plan – Specific Expenses and indicated that we are tracking these expenses and are currently awaiting direction from the Ad Hoc work group on how we are going to allocate these expenses. Once this is decided, we will go back and adjust these expenses. Mr. Totten raised a question regarding the line item, Workers Compensation, with an expenditure of over \$75,000. He asked was this attributable to the workers compensation case that has been mentioned in previous meetings. Ms. Davis indicated that the workers compensation case was a one-time payment, but this figure is actually our yearly premium for workers compensation insurance. This amount has increased due to the one claim that was settled.

Ms. Davis then reviewed the Contribution Reports for both Pension and Insurance Funds for the County Employees Retirement System, Kentucky Employees Retirement System and State Police Retirement System. She indicated that the Hazardous contribution is down a little from last year because service purchases are down. Ms. Davis stated that we are still using the 12% increase in the contribution, and since that is still in effect, we cannot raise the rate higher than 12% each year, but that should end in a couple of years. For the Kentucky Employees Retirement System, Ms. Davis indicated that the reduction in member contributions in Hazardous is due to a decrease in salaries for that group. Ms. Hampton indicated that in the Kentucky Employees Retirement System Hazardous, there is a significant difference in the outflow compared to inflow, and asked if that is a response to the Committee/Board wanting to get more in balance, or what has contributed to this. Ms. Davis answered that it is still over 100% funded so it will be this way until it under 100% funded. Mr. Totten asked the question of whether or not we received any of the employer buyout payments in the Kentucky Employee Retirement System, non-hazardous plan, because that is a significant increase. Ms. Surratt stated that Mr. Totten is referring to the cessation of Kentucky Housing Corporation. Ms. Davis answered yes. Ms. Elizabeth Smith added to the response provided to Ms. Hampton's question.

The KERS Hazardous Employer Contribution Rate is split and the KERS Hazardous rate is currently at 0% going to the insurance fund because of the funding status. This is why you are not seeing the inflows to offset the outflows. Ms. Hampton stated that basically the employers are contributing what the actuaries have said to contribute. Both Ms. Davis and Ms. Smith answered yes.

Ms. Davis then reviewed the Outstanding Invoices by Type and Employer. Ms. Hampton asked in regard to the Outstanding Invoices listed for the State Police Retirement Systems, do the external auditors look at that as being collectible and do we get any push back from the external auditors on this. Ms. Davis answered that we do look at it as collectible but we do not get any push back from the external auditors. The State Police know this amount is owed and they have received some general fund money specifically for these invoices, but they simply do not have enough funds in their budget right now to make a significant payment toward these invoices. Ms. Pendergrass stated that this is an appropriation issue. The State Police can pay only what the General Assembly puts in their budget and that's all they can pay. Ms. Pendergrass explained that we have been working over the last three to four years to get some additional allocations to their budgetary appropriation so that they can pay down some of this balance. She stated that we have not taken a position of deciding that some balances are uncollectible because these are employer contributions for pension benefits. So, they have to get paid at some point. She stated that the State Police is still a viable organization and they are not going away any time soon, so we are dependent upon the General Assembly to get additional dollars in their budget appropriations to take care of this balance. Mr. Chilton stated that regarding the State Police, the amounts that they owe actually have a fairly long time in which to pay, maybe a year so, that accounts for some of the large balances because the due date on them is so long. Ms. Surratt stated that she believes the majority of the State Police invoices are for sick leave and those are due in 30 days. Ms. Davis agreed. Ms. Surratt explained that the employer pension spiking is the invoice that has a year due date. Mr. Chilton then indicated that if it is majority sick leave, the employer doesn't know what that amount is until the employee retires. Ms. Surratt answered yes and that bill is sent to them generally three months after the employee has retired and the account has settled. But yes, it is after retirement. Mr. Eager indicated that these have been outstanding for quite some time, some are multiple years old. Ms. Surratt agreed

with that statement. Ms. Pendergrass indicated that it all comes back to the budgetary appropriations.

Ms. Davis then reviewed the Penalty Waiver Report. There being no questions, she then reviewed the Draft Management Response to the Fiscal Year 2020 GFOA letter. Ms. Davis indicated that we had five comments, the first being with the letter of transmittal. We concurred with all of their comments and we are taking steps to ensure we include these items in this year's ACFR. Ms. Davis indicated that the last two comments were regarding using "fair value" instead of "market value", and to use "covered payroll" as the measure of payroll since the contributions to the plan are based on a measure of pay. Ms. Pendergrass pointed out that the achievement of this particular award is a very nice feather in the caps of all of the staff that work on the Annual Financial Reports and do such a great job of getting those reports assembled and put together in a professional manner. Ms. Pendergrass indicated that the comments in this letter are fairly minor. The last one regarding the term "covered payroll" actually came from a GASB omnibus standard that was issued a year or so ago and those types of changes are hard to notice. Again, this is very minor and she commends the staff. She indicated that we always get comments, but this level of comment where we have some editorial changes speaks to the fact of what a great job our staff has done in putting our Annual Reports together. Ms. Pendergrass expressed her gratitude to Ms. Adkins, Ms. Davis, Ms. Smith and all of the staff that worked together on the Annual Report. Ms. Hampton stated that as a person who has graded these reports in the past, she seconds everything that Ms. Pendergrass has stated. Mr. Chilton asked if these comments relate to the last Annual Report. Ms. Pendergrass and Ms. Davis both answered yes. Mr. Chilton questioned the date on the letter being December 2021 which hasn't occurred yet. Ms. Davis indicated that this letter will be submitted with our new 2021 Annual Report and she dated the letter December 15, 2021, the date of the KPPA Board Meeting, when the Annual Report will be approved and ready to be issued. Ms. Pendergrass stated that it can take up to a year to get the reports reviewed and to receive the comments, so that is why it coincides with the issuance of the next year's Annual Financial Report. Mr. Totten asked about the update on the Annual Report and SAFR timetable. Ms. Davis indicated that the Communications Department is working on the SAFR and it should be completed so that it can be sent to the Legislators in January. She indicated that as stated before, the Annual Report will

be sent once it has been approved in December, but it must reach the GFOA office by December 31, 2021. Mr. Eager stated that last year a total of 5,500 copies were made and distributed. Each employer is sent two copies. Two copies are sent to each legislator's office. We also make it available to LRC as well. Ms. Pendergrass stated that for most of the fiscal year, except for the last quarter, things were consolidated and we decided early on to only have one SAFR this year. Between now and this time next year, we will have discussions on having separate SAFRs for the County Employees Retirement System and the Kentucky Retirement Systems. She indicated that those conversations will start after the first of the year. Ms. Pendergrass added that we may want to make sure that copies of the SAFR go to the libraries across the state to put in their catalogs.

Ms. Pendergrass introduced the agenda item *IT Security Updates*. Ms. McKinley reviewed the request for approval to contract with an external vendor to perform an infrastructure security assessment. She indicated that these assessments are done yearly to ensure that we are maintaining best practices and our security posture remains intact. The request is for approval of an expenditure of up to \$70,000 on an infrastructure assessment. Mr. Totten asked if a provider already been chosen for this service. Ms. McKinley indicated that the State of Kentucky has a master agreement with Crowe, LLC and we will be utilizing those services. Mr. Totten made a motion and Ms. Hampton seconded to approve this expenditure. The motion passed unanimously.

Ms. Pendergrass introduced the agenda item *Joint Audit Committee Administrative Updates*. Ms. Coffey began with the review of the Charter for the Joint Audit Committee. She indicated that we looked at this back in August 2021, but there were some changes that were requested and we made those changes but they were a little more significant than we originally thought. Therefore, we wanted to bring it back for another review and to vote on those changes. Ms. Pendergrass stated that the key change that we did not get a chance to discuss is found in Section Six, under Internal Audit where it speaks of the appointment, dismissal and replacement of the Internal Audit Director. Ms. Pendergrass indicated that the wording in this section was changed due to the research conducted by Mr. Board and the legal staff. Ms. Hampton expressed her appreciation for Mr. Board's input and appears it does not take away the executive powers. Ms.

Pendergrass indicated that is important. Ms. Hampton made a motion and Mr. Totten seconded to approve the Charter for the Joint Audit Committee. The motion passed unanimously.

Ms. Coffey then discussed the Memorandum concerning the establishment of the Joint Audit Committee Meeting Dates for the 2022 calendar year. She indicated that the Bylaws of both County Employees Retirement System and Kentucky Retirement Systems outline when the meetings take place. We are requesting approval of those dates, as well as the starting times for those meetings, which we have left at 10:00 a.m. ET (9:00 a.m. CT). She also indicated they are seeking approval for the Special Called Joint Audit Committee meeting to be scheduled for November 30, 2021 with a start time of 9:30 a.m. ET (8:30 a.m. CT). This special called meeting will include the fiscal year 2021 external audit and any internal audits that have been released since the last Joint Audit Committee meeting. Ms. Pendergrass pointed out that she feels it would be good to start the November 30th meeting a little earlier. The Annual audit deserves a certain amount of focus, and she does not want run short on time for that review. Mr. Totten made the comment that three of the dates listed are on Eastern Daylight Time and he makes a suggestion to just strike the word “Standard” and simply indicate Eastern Time (ET). Mr. Totten made a motion and Ms. Hampton to approve the dates and starting times of the Joint Audit Committee Meetings for the calendar year 2022 and the Special Called Meeting scheduled for November 30, 2021 to begin at 9:30 ET, with the change of using Eastern Time (ET) to denote the times of the meetings. The motion passed unanimously.

Ms. Hall presented the Summary of Potential Disclosures/Breaches Report for the Third Quarter of Calendar Year 2021. Ms. Hall proceeded to present the Anonymous Tips Report since the last meeting. There being no questions, the meeting proceeded.

Ms. Coffey reviewed the Fiscal Year 2022 Internal Audit Budget as of September 30, 2021. She indicated that there may be some adjustments to this as she heard that the Finance Cabinet has announced a 25th pay period for this fiscal year. Ms. Coffey indicated that if this does occur, she will make the changes necessary to this budget. Ms. Pendergrass added that for the past decade or so, the State of Kentucky has balanced its budget by moving the June 30th pay period to July 1st. This administration has decided that they are going to put payroll back to when the

payroll occurs, resulting in one extra pay period in the Fiscal Year 2022. Mr. Eager indicated that the Budget Director has indicated that it is on the table for consideration, but that a decision has yet to be made. Ms. Coffey stated that something else that may affect this budget is the fact that we lost one of our auditors, and we will be posting that open position soon. The salary of the new hire will be less than the salary of the employee we lost, so there will be some differences noted in the budget. Ms. Hampton asked about why the taxes and employer paid expenses are more than the salaries. Ms. Coffey answered that it is most likely the retirement line item, which is at around 83% to 84% of the salary amounts due to the contribution rates. Ms. Hampton stated that hopefully when the unfunded liability is paid down, those amounts will decrease. Ms. Coffey agreed.

Ms. Coffey then reviewed a report regarding the Status of Current Projects within the Division of Internal Audit Administration. There being no questions, Ms. Coffey reviewed the Final Audit Report regarding the Security Access Review. This audit resulted in 7 of 271 employees had access greater than what was required for their current roles. This was found to be attributable to employees moving from one division of the agency to another. By the end of audit, access for only one of the seven employees had not yet been corrected. Mr. Chilton asked what action has been taken to remedy some of these deficiencies. Ms. Coffey responded that management has reached out to those who had not completed those reviews and those reviews are being taken care of. She indicated that for the timeline that is in place, they are taking additional steps, like sending out a reminder that the review is still needed, and adding a step of reaching out to the Executive Management if warranted.

Ms. Pendergrass introduced the agenda item *Professional Articles*. Ms. Coffey reviewed the following professional articles: *Recognizing the Value of Independent Assurance* and *Confronting the Cybersecurity Monster*. Both articles are from the publication *Tone at the Top* published by the Institute of Internal Auditors. Ms. Pendergrass stated that at the same time that Trustee Education is being conducted, it may be a good idea to circulate these articles to the rest of the Trustees that may not have had a chance to see it in this material. She indicated it is an excellent article and doesn't think we can overemphasize enough the importance of remembering cybersecurity monster.

There being no further business a motion was made by Mr. Totten and seconded by Ms. Hampton to adjourn the meeting. Copies of all documents presented are incorporated as part of the minutes of the Audit Committee meeting as of November 4, 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 Joint Audit Committee of the Board of Trustees of the County Employees Retirement System and the Kentucky Retirement Systems, do certify that the Minutes of the meeting held on November 4, 2021 were approved by the Joint Audit Committee on November 30, 2021.


Committee Chair

I have reviewed the Minutes of the Audit Committee Meeting on November 4, 2021 for form, content, and legality.


Executive Director
Office of Legal Services