

# Supreme Court of Kentucky

2019-11

## ORDER

IN RE: Rules of Administrative Procedure AP Part XIX, Internal and External Audits of the Administrative Office of the Courts

Pursuant to Sections 110(5)(b) and 116 of the Constitution of Kentucky, SCR 1.010, and KRS 27A.010, this Order hereby establishes Rules of Administrative Procedure, AP Part XIX, Internal and External Audits of the Administrative Office of the Courts. This Order replaces in its entirety Supreme Court Order 2019-04.

### **PART XIX. INTERNAL AND EXTERNAL AUDITS OF THE ADMINISTRATIVE OFFICE OF THE COURTS.**

#### **SECTION I – Definitions**

As used throughout AP Part XIX, the following definitions apply:

1. “AOC” means the Administrative Office of the Courts.
2. “Division of Audit Services” means the Division within the AOC Office of Audits responsible for audits of Circuit Court Clerks, Master Commissioners, Domestic Relations Commissioners, and operating costs for Court Facilities.
3. “Division of Internal Audit” or “IA” means the Division within the AOC Office of Audits responsible for evaluating AOC’s internal controls, including its governance, operations, information technology security, and accounting processes.
4. “External audit” means an audit of the AOC’s financial information performed by an independent auditor or auditing firm under contract with the AOC.
5. “External auditor” means an auditor or auditing firm under contract with the AOC to audit the AOC’s financial information.

6. “Internal audit” means an independent, objective assurance and consulting activity designed to add value and improve the AOC’s operations.
7. “Special investigation” means any matter that the Division of Internal Audit reviews that is not included in the annual audit plan, including matters brought to the attention of the Office of Audits through the fraud, waste, and abuse tip line.
8. “Specialized services” means consulting services engaged or obtained by the Division of Internal Audit to assist it with one or more of its duties as described in Section III of these rules.

## **SECTION II – Audit Oversight Committee**

### **A. Purpose/Mission**

1. The Audit Oversight Committee (Committee) will assist the Chief Justice of the Commonwealth in fulfilling his oversight responsibility as executive head of the Kentucky Court of Justice.
2. The Committee shall advise the Chief Justice on:
  - a. The integrity and presentation of the financial and operational reporting process of the Administrative Office of the Courts (AOC);
  - b. The qualifications, independence, and performance of independent external auditors and the internal audit function of the AOC;
  - c. The system of internal controls within the AOC, including information technology security and controls, and including procedures for detecting fraud, waste, and abuse;
  - d. The adequacy of the AOC’s strategic and operational risk management processes;
  - e. The AOC’s compliance with applicable laws, Administrative Procedures of the Kentucky Court of Justice (KCOJ), and Rules of Court, and with all AOC policies and procedures;
  - f. The adequacy of the AOC’s investigation processes;
  - g. The AOC’s ethics, values, and culture; and

h. Other matters as directed by the Chief Justice.

**B. Membership**

1. The Chief Justice is the Chair of the Audit Oversight Committee.
2. The Committee is comprised of the following additional members:
  - a. A justice of the Kentucky Supreme Court, appointed by the Chief Justice;
  - b. The AOC Director;
  - c. The Secretary of the Finance and Administration Cabinet or designee;
  - d. The AOC Deputy Director;
  - e. The AOC Chief Information Officer; and
  - f. The AOC Director of Finance and Administration.
3. The AOC General Counsel or designee shall serve as an advisory member.

**C. Responsibilities**

1. Key responsibilities of the Committee include but are not limited to:
  - a. Approving decisions regarding the appointment and removal of the AOC Director of Audits.
  - b. Overseeing the audit function of the AOC, reviewing its budget, resource plan, activities, and organizational structure with the AOC Director of Audits.
  - c. Assessing the independence of the internal audit function of the AOC.
  - d. Reviewing and approving the annual audit plan established by the AOC Office of Audits, including internal audits of the AOC as well as audits of Circuit Court Clerks, Master Commissioners, Domestic Relations Commissioners, and operating costs for Court Facilities. In connection with this review, the Committee is authorized to offer recommendations regarding programs or activities to be audited.

- e. Reviewing the results of audits performed by the AOC Office of Audits.
- f. Assessing the adequacy of corrective actions planned and taken as a result of audit findings and recommendations and recommending actions as necessary to address unresolved audit findings.
- g. Reviewing assessments of the AOC Office of Audits.
- h. Reviewing and approving the proposed audit scope of any external auditors, including coordination of audit effort with the internal audit function.
- i. Reviewing the performance of any external auditors and exercising final approval on the appointment or discharge of external auditors.
- j. Reviewing and overseeing special investigations as needed.

**D. Meetings**

1. The Committee shall meet at least quarterly, or more frequently as circumstances may dictate, with the AOC Director of Audits. External auditors with pending business may meet with the Committee at those quarterly meetings as needed. Meetings may be called by the Chief Justice, the AOC Director, or the AOC Director of Audits. A majority of Committee members shall constitute a quorum for any meeting.
2. All recommendations from the Committee shall be reached by consensus of those members present at the meeting. If consensus cannot be reached, then any recommendations shall be reached by a vote of a simple majority of the Committee members present and the various perspectives of the members noted in the minutes.
3. The AOC Director of Audits will prepare an agenda in advance of each meeting. Minutes shall be prepared and maintained for each Committee meeting.
4. Records
  - a. Pursuant to KRS 26A.200, all records received, generated, kept, or maintained by or on behalf of the Committee shall be the property of the KCOJ and are subject to the control of the Supreme Court of Kentucky.

- b. All records created for or generated by the Committee shall not be considered Administrative Records of the AOC as defined by AP Part XVII.

### **SECTION III – Office of Audits**

#### **A. Division of Internal Audit**

1. There is established a Division of Internal Audit within the AOC Office of Audits. The Division of Internal Audit (IA) will provide independent assurance that the AOC’s risk management, governance, and internal control processes are operating effectively.
2. IA will evaluate the AOC’s internal controls, including its governance, operations, information technology security, and accounting processes. It will:
  - a. ensure compliance with applicable laws, Administrative Procedures of the Kentucky Court of Justice (KCOJ), and Rules of Court, and with all AOC policies and procedures;
  - b. provide support in accurate and timely financial reporting and data collection; and
  - c. help maintain operational efficiency by identifying problems and correcting lapses before they are discovered in an external audit.
3. The AOC Director of Audits and employees of IA shall be unbiased and objective in the performance of their job duties. The AOC Director of Audits and employees of IA must be independent from the operations they evaluate.
4. IA must be staffed with qualified, skilled, and experienced people who work in accordance with the Institute of Internal Auditors (IIA) Code of Ethics and Standards.

#### **B. Purpose and Mission**

1. The purpose of IA is to provide independent, objective assurance and consulting services designed to improve the AOC’s operations, promote transparency, and maintain the public trust and confidence in the AOC.
2. The mission of IA is to maintain the public trust and confidence in the AOC by providing risk-based and objective assurance, advice, and insight.

3. IA will bring a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes.

### **C. Professional Standards**

1. The AOC Director of Audits shall comply with standards adopting either Generally Accepted Government Audit Standards (Government Accountability Office) or the International Standards for the Professional Practice of Internal Auditing (Institute of Internal Auditors), or both.
2. IA will govern itself by adherence to the applicable professional standards.
3. The AOC Director of Audits will report to the Committee regarding IA's conformance to the IIA Code of Ethics and Standards.
4. IA will be proficient in the following standards to ensure the AOC is adhering to best practices:
  - a. GAO GAGAS (Yellow Book Standards);
  - b. IIASB IIPF (Red Book Standards); and
  - c. IIA Code of Ethics and Standards.

### **D. Authority**

1. The AOC Director of Audits will report functionally to the Chief Justice and administratively for day-to-day operations to the AOC Director's Office.
2. The AOC Director of Audits will have unrestricted access to and may communicate and interact directly with the AOC Director's Office, the Committee, and when necessary, the Chief Justice.
3. The AOC Director of Audits will have unrestricted access to and may communicate and interact directly with all AOC employees. This ability to communicate includes the ability to speak in private meetings without management present.

4. IA shall:
  - a. Have full, free, and unrestricted access to all functions, records, property, and personnel pertinent to carrying out any audit, subject to accountability for confidentiality and safeguarding of records and information.
  - b. Allocate resources, set frequencies, select subjects, determine scopes of work, apply techniques required to accomplish audit objectives, and issue reports.
  - c. Obtain assistance from any AOC personnel, as necessary or appropriate, as well as other specialized services from within or outside the AOC, in order to complete an engagement.

#### **E. Independence and Objectivity**

1. The AOC Director of Audits will ensure that IA remains free from all conditions that threaten the ability of IA to carry out its responsibilities in an unbiased manner, including matters of audit selection, scope, procedures, frequency, timing, and report content.
2. If the AOC Director of Audits determines that independence or objectivity may be impaired in fact or appearance, the details of impairment will be disclosed to the Committee.
3. IA employees will maintain an unbiased mental attitude that allows them to perform engagements objectively.
4. IA will have no direct operational responsibility or authority over any of the activities audited. Accordingly, IA employees will not implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that may impair their judgment, including:
  - a. Assessing specific operations for which they had responsibility within the previous year.
  - b. Performing any operational duties for the AOC.

- c. Initiating or approving transactions external to IA.
  - d. Directing the activities of any AOC employee not employed by IA, except to the extent that such employees have been appropriately assigned to auditing teams or to otherwise assist IA.
5. Where the AOC Director of Audits has or is expected to have roles and/or responsibilities that fall outside of IA, safeguards will be established to limit impairments to independence or objectivity.
6. IA employees will:
- a. Disclose any impairment of independence or objectivity, in fact or appearance, to the AOC Director of Audits.
  - b. Exhibit professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined.
  - c. Make balanced assessments of all available and relevant facts and circumstances.
  - d. Take necessary precautions to avoid being unduly influenced by their own interests or by others in forming judgments.
7. The AOC Director of Audits will disclose to the Committee any interference and related implications in determining the scope of internal audit, performing work, and/or communicating results.

## **F. Scope of the Division of Internal Audit**

1. The scope of IA encompasses, but is not limited to, objective audits for providing independent assessments to the Committee, the Supreme Court, the AOC Director's Office, and outside parties on the adequacy and effectiveness of governance, risk management, and control processes within the AOC.

2. IA audit plans may include audits that evaluate whether:
  - a. Risks relating to the achievement of the AOC's strategic objectives are appropriately identified and managed.
  - b. The actions of the AOC's officers, directors, management, employees, and contractors are in compliance with applicable laws, Administrative Procedures of the KCOJ, and Rules of Court, and with all AOC policies and procedures.
  - c. The results of operations or programs are consistent with established goals and objectives.
  - d. Operations or programs are being carried out effectively and efficiently.
  - e. Established processes and systems enable compliance with applicable laws, Administrative Procedures of the KCOJ, and Rules of Court, and with all AOC policies and procedures.
  - f. Information and the methods used to identify, measure, analyze, classify, and report such information are reliable and have integrity.
  - g. Resources and assets are acquired economically, used efficiently, and protected adequately.
3. The AOC Director of Audits will meet quarterly with the Committee and report periodically as needed regarding:
  - a. IA's plan and performance relative to its plan.
  - b. IA's conformance with the IIA's Code of Ethics and Standards, and action plans to address any significant conformance issues.
  - c. Significant risk exposures and control issues, including fraud risks, governance issues, and other matters requiring the attention of, or requested by, the Committee.
  - d. Results of audits or other activities.

- e. Resource requirements.
  - f. Any response to risk by management that may be unacceptable to the AOC or the Supreme Court.
4. The AOC Director of Audits may rely upon the work of other internal and external assurance and consulting service providers as needed.
  5. IA may perform advisory and related service activities, the nature and scope of which will be agreed to with stakeholders, provided IA does not assume management responsibility.

#### **G. Duties/Responsibilities**

1. The AOC Director of Audits has the responsibility to:
  - a. Oversee and supervise the Office of Audits, including the Division of Audit Services and the Division of Internal Audit.
  - b. Establish and ensure adherence to policies and procedures designed to guide IA.
  - c. Submit to the Committee, at least annually, a risk-based internal audit plan for the Office of Audits for review and approval.
  - d. Communicate to the Committee the impact of resource limitations on the annual audit plan.
  - e. Review and adjust the internal audit plan, as necessary, in response to changes in the AOC's business, risks, operations, programs, systems, and controls.
  - f. Communicate to the Committee any significant interim changes to the annual audit plan.
  - g. Ensure each annual audit plan is executed, including the establishment of objectives and scope, the assignment of appropriate and adequately supervised resources, the documentation of work programs and testing results, and the

communication of audit results with applicable conclusions and recommendations to appropriate parties.

- h. Follow up on audit findings and corrective actions, and report periodically to the Committee any corrective actions not effectively implemented.
- i. Confirm the principles of integrity, objectivity, confidentiality, and competency are applied and upheld.
- j. Certify IA collectively possesses or obtains the knowledge, skills, and other competencies needed to meet the requirements of these rules.
- k. Validate trends and emerging issues that could impact the AOC and communicate to the Committee as appropriate.
- l. Ensure adherence to the AOC's relevant policies and procedures, unless such policies and procedures conflict with these rules. Any such conflicts will be resolved by or otherwise communicated to the Committee.
- m. Document conformance of IA with the standards set forth in subsection 2.03 of these rules.
- n. Coordinate and assist in external audits as required by Section IV.

## **H. Meetings**

- 1. The AOC Director of Audits will staff and attend Committee meetings, meeting with the Committee at least quarterly.
- 2. During the quarterly meetings, the AOC Director of Audits will present the annual audit plan and any adjustments thereto to the Committee and will deliver results of any special investigation or audit to the Committee.

## **I. Quality Assurance and Improvement Program**

- 1. IA will maintain a quality assurance and improvement program that covers all aspects of IA. The program will include an evaluation of IA's

conformance with the standards set forth in subsection 2.03 of these rules and an evaluation of whether IA is adhering to the IIA's Code of Ethics. The program will also assess the efficiency and effectiveness of IA and identify opportunities for improvement.

2. The AOC Director of Audits will communicate to the Committee the IA's quality assurance and improvement program, including results of ongoing and periodic internal assessments and external assessments. External assessments will be conducted in accordance with the applicable standards by a qualified, independent assessor or assessment team from outside the AOC.

#### **SECTION IV – External Audits**

The AOC shall:

1. Issue Requests for Proposals to conduct an annual external audit of its financial information, beginning with Fiscal Year 2021; and
2. Make public any report resulting from an external audit.

This Order shall be effective upon entry and until further Order.

Entered this 23rd day of October 2019.

  
CHIEF JUSTICE

All sitting; all concur.