The Regents of the University of California

COMMITTEE ON AUDIT
November 7, 2007

The Committee on Audit met on the above date at James E. West Center, Los Angeles campus.

Members present: Regents Allen, Bugay, Kozberg, Ruiz, Varner; Advisory member Croughan; Expert Financial Advisor Vining

In attendance: Associate Secretary Shaw, University Counsel Birnbaum, University Auditor Reed, Chief Compliance and Audit Officer Vacca, Vice President Broome, Recording Secretary Johns

The meeting convened at 10:45 a.m. with Committee Chair Ruiz presiding.

1. **PUBLIC COMMENT PERIOD**

There were no speakers wishing to address the Regents.

2. **ANNUAL REPORT OF THE EXTERNAL AUDITORS FOR THE YEAR ENDED JUNE 30, 2007**

Regent Allen asked if the PricewaterhouseCoopers audit reports for UC were publicly available or private. Assistant Vice President Plotts stated that they are public and available online.

PricewaterhouseCoopers Lead Partner Joan Murphy began her presentation with some general remarks. PricewaterhouseCoopers has different teams at different UC locations. She introduced her colleagues, Medical Center Partner Peggy Arrivas and Engagement Manager Karen Li. PricewaterhouseCoopers produces an audit opinion on consolidated financial statements for the University, the hospitals, and for campus foundations, and stand-alone opinions on the financials at each of the medical centers. The Required Communications to The Regents' Committee on Audit are those required by the audit profession for the committee overseeing the external audit. PricewaterhouseCoopers has also produced a Report to The Regents, a summary of recommendations for internal control.

Ms. Murphy began with an overview of the Required Communications. She noted that PricewaterhouseCoopers conducted its audit in accordance with generally accepted auditing standards and government auditing standards. She specified that the audit gives reasonable but not absolute assurance regarding detection of material fraud. The financial statements are those of management; the opinions are those of the auditor. PricewaterhouseCoopers audits nine of the ten campus foundations; the UCD Foundation is audited by another firm.

She noted that the University has adopted Governmental Accounting Standards Board (GASB) Statements number 48 (sales and pledges of receivables and future revenues) and number 50 (pension disclosures) during the past year, but that the implementation of these statements has had no effect on UC's net assets or changes in net assets.

Ms. Murphy next discussed unusual transactions. For the past year, the one significant such transaction was a $17.4 million adjustment (receivable and corresponding liability), a Department of Energy contribution for pension costs of former Los Alamos National Laboratory employees whose pension liability has been retained in the UC Retirement Program. As of October 1, 2007, Lawrence Livermore National Laboratory is also under the purview of a joint venture (Lawrence Livermore National Security, LLC). For the upcoming fiscal year, the University will account for its investment in LLNS using the equity method of accounting, as it currently does for Los Alamos National Security, LLC.

Ms. Murphy pointed out that some figures in the University's financial statements are easily verifiable by third parties (e. g., cash and readily traded securities), while others involve estimation (estimation of revenue and reserves for the medical centers, charges to federal contracts, market values for non-publicly traded investments, self-insurance reserves, allowances for uncollectible pledges).

Regent Bugay referred to an estimate in the report regarding the carrying value of mortgage loans ($396 million) and asked if this amount is associated with UC's internal loan program. Ms. Murphy responded that it is associated with the loan program to faculty and not with mortgage securities.

Ms. Murphy explained that there are certain areas in which the University has a choice of alternative accounting policies. As a public institution, the University reports under government accounting standards (GASB requirements). Until 1989, UC was subject to private standards of the Financial Accounting Standards Board (FASB). She commented that this shift to GASB was a choice by the University and opined that this method is preferable. As an example, under GASB standards, the University can choose whether to use restricted or unrestricted funds first for research; FASB standards require use of restricted funds first. Under GASB, the University is allowed to present federal refundable loans as liabilities or part of net assets. UC presents these loans as liabilities. Another area in which there is diversity in practice regards the recording of perpetual trusts held by third parties. UC records the estimated value of such trusts.

Ms. Murphy called attention to a change now required by GASB for accounting for post-employment benefits, hitherto recorded on a cash or pay-as-you-go basis. Effective July 1, 2007, GASB requires conversion to accrual basis accounting for these benefits.

Regent Bugay expressed concern about the report's expectation of a "significant additional accrual basis expense" for this change in practice and requested an estimate for what that expense might be. Assistant Vice President Plotts stated that this would be an annual expense of about $1.35 billion to $1.45 billion. Regent Bugay asked if this would appear beginning with the fiscal year 2007-08 budget. Ms. Murphy explained that this change in accounting principles would first appear in fiscal year 2008; the University will continue to pay as it goes (from a cash perspective), but for the first time, the University will have to place a liability on the records and record an expense for a calculated estimate of what is owed at the balance sheet date. Expert Financial Advisor Vining observed that this change represents a very large liability which significantly reduces the University's net equity. Ms. Murphy stated that this amount is ultimately between $11 billion and $13 billion; GASB rules allow UC to spread this total expense (as of fiscal year 2008) over a thirty-year amortization period.

Regent Bugay commented that, although this is a non-cash item, it affects UC's balance sheet, and expressed concern about the real financial constraints it would place on the University from a budgetary perspective. Vice President Broome stated that UC will have to find a method for addressing this funding liability. She indicated the large gap between $200 million per year, associated with the pay-as-you-go method, and more than $1 billion, associated with the accrual basis method. She anticipated that this liability will be a part of future budget requests for State funding and stated that it can be approached through plan changes or funding methodology. A final decision on a funding plan has not yet been made. Regent Bugay asked about a possible impact on the University's borrowing capacity. Vice President Broome responded that there would not be an impact; she noted that rating agencies are well aware of this development, which affects all public corporations. Ms. Murphy stated that the footnote disclosure will include the amount of true future funding for the plan and stressed that lending organizations understand that this is a non-cash item. Mr. Vining opined that the single largest variable other than size of the program affecting current liability in this item is medical cost inflation. In the private sector, this area has been reviewed by corporations to try to limit future liability by sharing it with their employees (paying up to a certain percentage of medical cost inflation, and leaving the rest to be paid by employees). While this method might not make much difference initially, in later years it might make a great difference. Mr. Vining questioned the political acceptability of this approach in a public environment like the University.

Ms. Murphy briefly discussed UC's spending rate policy for endowment investment returns and the valuation of non-publicly traded investments. She then reviewed dollar amounts for significant estimates in UC financial statements for June 30, 2007 (self-insurance reserves, reserves for bad debts and for medical center third party payor liabilities, and carrying values of various non-readily marketable investments). Regent Bugay requested a historical comparison for the

$560 million amount in self-insurance reserves. Vice President Broome responded that this amount is fully funded, without deficits. The expense to these reserves was $524 million last year. Ms. Murphy explained that the auditor attempts to understand the basis for the actuaries' recommendations about these reserve amounts – the assumptions involved, as well as previous payout and loss patterns. She noted that PricewaterhouseCoopers has its own actuaries who review some of the University's assumptions. Committee Chair Ruiz asked if the PricewaterhouseCoopers actuaries were conservative compared to the University's actuaries. Ms. Murphy responded in the affirmative. Vice President Broome noted a raised confidence level in the professional liability program. Ms. Murphy stressed that differences of opinion are not uncommon among actuaries, but that PricewaterhouseCoopers seeks to have a dialogue among actuaries if the range in estimates is wider than expected. Regent Bugay asked if any significant or dramatic changes have been made for reserve items that are based on accounting estimates. Ms. Murphy confirmed that no changes have been made with significant impact to financial statements; the assumptions have remained fairly consistent from year to year.

PricewaterhouseCoopers did not detect any fraud as a result of its audit, which included queries made to the Audit Committee Chair and UC management at the locations and UCOP, and an examination of internal audit reporting. Committee Chair Ruiz asked about the dollar amounts PricewaterhouseCoopers uses as a defining criterion for fraud. Ms. Murphy repeated her earlier statement that the audit provides reasonable assurance to detect material fraud, but is not designed to detect fraud. She explained that the audit examines internal controls only to the extent needed to determine how much reliance will be placed on them. In response to Committee Chair Ruiz, she confirmed that UC is effectively managing issues in this area. Expert Financial Advisor Vining noted that an important methodology is testing, and that PricewaterhouseCoopers is testing at a high level. Ms. Murphy identified misappropriation of assets or an intentional misstatement in the financial statements as the kinds of fraud that the PricewaterhouseCoopers audit is focused on. Chief Compliance and Audit Officer Vacca stated that this was the reason for a robust Compliance and Internal Audit function, which helps management to identify weaknesses in controls at the operational level. Ms. Murphy concurred, noting that external auditors come in at the end of the year and are not present year-round.

PricewaterhouseCoopers did not encounter any significant difficulties in performing the audit. Ms. Murphy reported that there were a number of adjustments resulting from the audit, and that these adjustments resulted in a $17.7 million increase in net assets. She discussed two unrecorded adjustments (one related to reclassification of an investment-related asset, the other related to cash flow of State-related accounts receivable balances) which she described as immaterial. She explained that PricewaterhouseCoopers reads the management discussion and analysis (MDNA) in the UC Annual Report to ensure that it is consistent with financial statements, but that this information is not audited. She briefly covered other issues related to PricewaterhouseCoopers' engagement by UC, including consultation with other accountants, disagreements with management, and issues related to their retention by UC.

Ms. Murphy repeated her earlier point that the audit includes testing of UC internal controls, and while it does not issue an opinion on these controls, it will report to the Committee any significant deficiencies or material weaknesses. PricewaterhouseCoopers did not note any such items. Ms. Murphy briefly discussed the issue of related party transactions. She reviewed potential risks, exposures or material uncertainties regarding federal and State reimbursements for medical center operations, federal awards, and the Department of Energy laboratories.

Regent Allen asked about audits carried out for the DOE laboratories. Ms. Murphy responded that PricewaterhouseCoopers has been engaged to perform audits for the new laboratory joint ventures, but stressed that these audits are conducted separately and concern stand-alone financial statements. Vice President Broome pointed out that UC and the LANS Board have engaged PricewaterhouseCoopers to perform reviews for their respective laboratories. Ms. Murphy clarified that the 2006-07 financials for the Lawrence Berkeley and Lawrence Livermore laboratories are "rolled into" the UC statements, since these laboratories were operated solely by UC. The accounting treatment of the Lawrence Livermore laboratory will change now that it has become part of a joint venture. Committee Chair Ruiz asked about UC's continuing involvement in future audits of the labs, and suggested that it might seem self-serving of the University to use PricewaterhouseCoopers for its own audit and for auditing the laboratories. Ms. Murphy responded that, going forward, only Lawrence Berkeley laboratory will be part of this audit, as the only remaining laboratory operated solely by UC. She noted that PricewaterhouseCoopers does not have full access to the laboratories as it does to the campuses, due to the high-security nature of some laboratory activities. PricewaterhouseCoopers examines and reports on laboratory control procedures. From now on this will be performed only for Lawrence Berkeley laboratory. She again emphasized that the audits of financial statements for the joint ventures are separate from the audit for UC. PricewaterhouseCoopers was selected in a typical bidding process by all the parties in the joint ventures, not only by UC. Ms. Murphy added that it is not uncommon for PricewaterhouseCoopers, as a large firm, to audit entities for which UC has some degree of ownership. Mr. Vining opined that using PricewaterhouseCoopers as the auditor for UC as well as for the joint ventures is a protection for UC rather than a conflict of interest. He found comfort in the fact that UC's partner(s) in the joint ventures have chosen PricewaterhouseCoopers as auditor.

Ms. Murphy continued her review of potential risks, exposures or material uncertainties regarding UC's investment portfolio, fluctuations in State support, and outstanding litigation. Committee Chair Ruiz asked about the need for UC to act quickly on funding for the retirement program, and the need for employee contributions. Ms. Murphy stated that the UC pension plan is well funded. Mr. Vining noted that funding for the retirement program and employee contributions will be a major issue for the University. Ms. Vacca reported that there is an ongoing discussion with management on this issue, and on potential forward directions, and stated her understanding that the issue is addressed outside the Audit Committee. Faculty Representative Croughan emphasized the faculty's concern about employee contributions. She noted that, because the University's investments performed better than anticipated and the program is still fully funded, the State is currently unwilling to contribute. The University will be required to let the funding level drop lower than its original "comfort zone" before considering employee or State contributions. Committee Chair Ruiz emphasized that this is a high risk area which requires some kind of action. Regent Bugay concurred with the importance of this issue for the entire University and the Regents. He opined that the University has bought some time with the good market performance over the last 12 to 18 months, but that the issue will have to be confronted, and that the Committee on Audit should provide advance warning.

Ms. Murphy expressed confidence in UC management's commitment to making its disclosures as transparent as possible. Expert Financial Advisor Vining concurred and noted that his suggestions to internal staff on UC financial statements over the last three years have been considered, discussed, and sometimes adopted, resulting in different wording or additional disclosure. Ms. Murphy asserted PricewaterhouseCoopers's independence from the University and briefly discussed the purpose and intention of UC's management representation letter to PricewaterhouseCoopers. Mr. Vining pointed out that this letter is signed by all important UC parties and creates a liability for them.

Ms. Murphy turned to PricewaterhouseCoopers' Report to The Regents and summarized its three internal control recommendations. The first concerns evidence of review and timeliness of key controls. PricewaterhouseCoopers found that reconciliations were carried out in a timely manner. Reconciliations of account balances are performed by one person and should be reviewed by another person. There was not always evidence that this review was occurring. Ms. Murphy stressed the importance of documenting this review activity. The second recommendation concerns information technology (IT) professional and application user access: periodic reviews to ensure that users' access rights to University data and systems are appropriate for those individuals. Ms. Murphy provided as an example employees who move from one department to another within UC and whose access rights change. She suggested review on a quarterly basis. The third recommendation concerns risk assessment and monitoring of sensitive data access; IT management at each location should determine which data are most sensitive and carry out occasional reviews of changes to those data to determine if changes have been made by unauthorized users. Ms. Murphy observed that UC relies heavily on manual controls rather than system controls, and that this provides assurance that significant errors will be caught. In addition to this, she recommended that UC should strengthen its IT controls.

Committee Chair Ruiz inquired about management's response to the third recommendation, and asked if there is a plan for implementation to ensure better controls. He also asked how the University can ascertain if controls are improving or not on a year-to-year basis. Ms. Murphy responded that management at every location was receptive to the recommendation and to concrete suggestions for implementation, and that action steps have already been taken at some locations. Vice President Broome pointed out that recommendations from previous years (listed in the Appendix of the report) have all been implemented or are in progress. The Office of the President tracks these recommendations to ensure their implementation at the locations.

Committee Chair Ruiz asked about the one recommendation from the previous year that is still listed as "in progress" and an acceptable time frame for implementation. Ms. Broome explained that the complexity and scope of recommendations vary. PricewaterhouseCoopers Medical Center Partner Arrivas stated that this process (elimination or reconciliation of differences between the UCLA Medical Center General Ledger and the Campus General Ledger) is fairly complex and tedious due to the large amounts of capital assets involved, and cannot be fixed quickly.

Regent Allen asked if the staffing cuts or hiring freeze at the Office of the President have affected the University's ability to carry out the PricewaterhouseCoopers recommendations. Ms. Murphy believed that it has not, but noted that most of the relevant activity takes place at the local level. She discussed the rationale for how audit visits to locations are scheduled, explaining that the recommendations are presented to every location, but that locations are not given advance notice that an audit will take place.

Faculty Representative Croughan referred to incidents of unauthorized access to sensitive data or the accidental release of such data, and asked if the PricewaterhouseCoopers recommendation addresses this concern. Ms. Murphy responded that information security breaches have not affected financial statement information, but that this issue was considered in discussions of the overall IT security environment. Security breaches have been addressed by the individual locations. Ms. Vacca stated that, from the compliance perspective, security breaches and information privacy are part of this topic, and anticipated that there will be more reports and information from locations as UC's compliance program is built.

Ms. Croughan noted that faculty have long requested and continue to support standardization across campuses of centralized payroll and personnel actions. She explained faculty concerns about security breaches, since faculty data is released, and observed that standardized payroll practices facilitate research on faculty

(e. g., equity studies on promotion and acceleration). Ms. Vacca observed that some of these topics will fall under Compliance, while others might be monitored by Compliance or Internal Audit. Actions are now in place to allow some systemwide standardization. The Compliance Office will be examining information access and security issues. Committee Chair Ruiz recalled that the Regents have formed a new strategic planning committee to help identify necessary long-term initiatives, and hoped that this new committee will address the critical issue of information security, which will create more problems if it is not resolved.

Mr. Vining expressed the University's pride in the high degree of autonomy of the campuses, but opined that this autonomy does not need to flow through the systems themselves. He identified the campuses' autonomy in their administration and decision-making. He suggested that centralized, consolidated accounting functions would save the University money and provide greater control and better information.

Ms. Murphy briefly commented on the two other reports, which summarize reviews performed by PricewaterhouseCoopers for the Lawrence Berkeley and Lawrence Livermore laboratories. Adjustments that came about as a result of PricewaterhouseCoopers audit procedures typically related to reconciliations not done in a timely fashion, or cases in which reconciliations were done, but areas that required reconciliation were not investigated. Ms. Murphy opined that the DOE laboratories, because they are driven by a September 30 year-end, are probably less stringent about the financial close on June 30, which is important for UC purposes, as about the September close. She reported that some adjustments at Lawrence Livermore laboratory were due to the transition and preparation for new management; there was significant employee turnover, and less experienced personnel performed reconciliations and investigations. Nevertheless, there were no serious adjustments in dollar amounts there or at Lawrence Berkeley. Ms. Murphy suggested that UC management needs to remind the laboratories of its need for accurate information at the June 30 date.

Mr. Vining recalled his concerns from the previous year about the Statement on Auditing Standards (SAS) 112, which requires communication between external auditors and Regents regarding three levels of concern. Ms. Murphy explained that SAS 112 requires that the auditor decide if any identified control deficiencies can rise to the level of "significant deficiency" or "material weakness." She pointed out that SAS 112 requires that the auditor evaluate whether a deficiency could have given rise to a significant dollar error, even if it did not actually do so, and evaluate compensating controls that might minimize the impact of the error. PricewaterhouseCoopers identified control deficiencies at UC, but none of these rose to the level of significant deficiencies or material weaknesses; the specific dollar thresholds it uses to identify these are $39 million for a potential "significant deficiency" and $195 million for a potential "material weakness." PricewaterhouseCoopers also identified themes in control deficiencies, and these become the basis for the recommendations in the Report to The Regents. Ms. Murphy stressed that there was extensive dialogue with UC about IT controls and the use of manual controls to mitigate risk.

Ms. Vacca suggested that the Report might be formatted differently in the future for greater conformance with SAS 112. Ms. Murphy responded that the Report cover letter explains the SAS 112 terms, each Report recommendation is labeled accordingly, and that the Report complies with SAS 112. Committee Chair Ruiz referred to the changes in GASB, and UC's anticipation of a greater number of identified control deficiencies. Mr. Vining acknowledged that UC staff at campuses, laboratories, and medical centers were aware of existing control deficiencies and have worked hard to address problems. Ms. Murphy recognized that UC management has been proactive in informing local teams about the new standard and about measures to address issues. She stressed PricewaterhouseCoopers' effort for robust dialogue with each location, particularly about implementation of mitigating controls. Committee Chair Ruiz recognized the hard work carried out for these reports, and stated his expectation that this level of performance will be maintained in the future. Ms. Murphy noted that local UC controllers were reminded that a recurring deficiency can become a significant deficiency if not addressed.

3. **ANNUAL REPORT ON INTERNAL AUDIT ACTIVITIES, 2006-2007**

University Auditor Reed presented a brief review of the Annual Report on Internal Audit Activities, 2006-2007. He began by noting that the UC Internal Audit Program prepared about 600 reports during fiscal year 2007, which resulted in nearly 1,800 recommendations. The scope of these activities make it difficult to summarize the impact of UC Internal Audit for one year on UC's control systems. As highlights, Mr. Reed cited the completion of a number of systemwide audits and a reduction in the number of open Management Corrective Actions (MCAs). The current number of open MCAs is 610. Mr. Reed then focused on the reduction of what he termed open High Risk MCAs. He explained that each MCA is categorized as high, medium, or low risk. This is not intended to correlate with SAS 112; the determination is made in a local context, the designation represents the urgency of the corrective action, and many recommendations cannot be converted to a financial statement impact because they concern financial processes and compliance matters. He called attention to the reduction of the number of open High Risk MCAs that are past due from 36 in fiscal year 2006 to 12 in fiscal year 2007. These 12 items frequently concern systems issues that take longer to implement.

Regent Allen requested an example of a high risk item. Mr. Reed cited IT control issues that had been raised in the previous discussion. He observed that certain issues might be significant or considered key controls at the department level, but not for the University's financial statements. Mr. Reed continued by noting the attainment of benchmarks for productivity, plan completion, and coverage.

Regent Allen requested clarification of the meaning of “productivity” in audit activities. Mr. Reed defined productivity as a measure of the time spent in direct audit activities as opposed to activities such as administration and conference attendance.

Mr. Reed asserted that UC management takes responsibility for controls. There is no interference with the Internal Audit Program’s work or with its obligation to report to The Regents. UC managers participate in risk identification and freely consult with Internal Audit on relevant matters. Mr. Reed placed special emphasis on the statement that matters of importance are reported to The Regents. He was aware of nothing from any audit finding in the University this year that should have been reported to the Regents but was not reported.

Over the last year, the Internal Audit Program found no evidence of material deficiency that would have had an impact on UC’s financial statements, and on no occasion has management accepted an unreasonable level of risk. There are opportunities for the University to strengthen controls in implementing more effective monitoring and oversight activities (for example, at the level of department chairs and principal investigators in their administration of grant funds). Mr. Reed underscored the need for systemwide monitoring to establish expectations to be met at the locations. He referred to a current evaluation of IT security controls at each location by Chief Information Officer Hafner.

Mr. Reed presented information on the three areas of Internal Audit Program service activity, including the relative amounts of time spent this year on audits (66 percent), investigations (16 percent), and advisory services (18 percent). He described advisory services as the most proactive of the services the Program provides, while investigations arise out of a failure of controls. A goal for the Program is a decrease in the percentage of investigations, and an increase in advisory services. Next he provided an analysis of the hours of service activity and MCAs provided for different functional areas of the University. Most Program activity and recommendations fall within the area of financial management. He clarified that this activity involves financial processes, not an audit of balances in financial statements. Mr. Reed continued with an analysis of the same MCA findings using the Committee of Sponsored Organizations (COSO) framework and categories. The bulk of recommendations fall within the area of control activities.

Mr. Reed briefly outlined systemwide audits. He noted that the particular importance of the audit regarding conflict of commitment and outside activities of faculty members was not the identification of deficiencies in reporting practices, but the recognition that without reporting practices, the University cannot manage conflicts of interest or commitment as well as it should. He commented on the audits of student loan programs, chancellor special allocations, the Willed Body Program, and the Health Science Compliance Program.

Next Mr. Reed turned to the completion status of MCAs, calling attention to 78 open High Risk items, with 66 not yet due, and 12 past due. He reported that management has plans in place to complete the items in a reasonable amount of time. He then discussed Internal Audit's investigation activities. Seventy-seven percent of the sources for these investigations came from within the University. He interpreted this as a good sign, an indication that faculty, students, and staff at UC feel comfortable about coming forward. He also cited data showing that most reports were made directly rather than to the whistleblower hotline, and that most individuals identified themselves, which he also found to indicate an open environment where most people do not fear retaliation. Mr. Reed reviewed data on the relative frequency of the different types of allegations. He observed that allegations of improper use of UC resources were most frequent, but in fact this category represents the least significant financial impact. Data on investigation outcomes showed that anonymous allegations were substantiated almost as often (38 percent of cases) as allegations by identified individuals (40 percent). Mr. Reed presented this as evidence that anonymous allegations should not be dismissed or ignored.

Mr. Reed noted briefly that the topic of staffing levels for the Audit and Compliance functions would be discussed in the coming year. He concluded with an outline of priorities from the Audit Program's Strategic Plan. He described features of the Comprehensive Audit Reporting and Tracking System (CARTS) now being developed, and improvements to the tracking mechanism, including timely email notifications and reports to senior managers.

Referring to the issue of staffing, Ms. Vacca informed the Committee that three campuses (UCB, UCSB, and UCSC) have not had any changes in staffing since 1996 and are today working with the same resources they had ten years ago. Mr. Reed mentioned that Office of the President staffing in this area is lower now than it was 12 years ago. Regent Bugay referred to the systemwide audit of construction soft costs and the different methods used for measuring and assigning direct and indirect charges. He observed that these differences create confusion and asked if Mr. Reed had a recommendation to provide greater clarity in this area. Mr. Reed responded that during this audit process, and when it was reported to the Committee on Grounds and Buildings, it became clear that there are differences in methodology because cost accounting provides different methods of allocating costs, which can lead to inconsistencies. He stressed that what is important is not how costs are allocated, but what costs are put into the pool or capitalized. The Audit and Budget Offices are now working on new guidance in the University's accounting manual for locations on what costs may or may not be capitalized.

4. **COMPLIANCE PROGRAM**

Chief Compliance and Audit Officer Vacca discussed the development of UC's compliance and ethics program. She noted that ethics will be integrated into the compliance program. Ms. Vacca reported that she is currently developing an inventory of University activities that deal with audit and compliance but which may not be identified as such. She plans to assess what the University needs to link these activities and to develop a common risk communication, as an end goal. Ms. Vacca said she hopes to report back to the Regents on this effort in a few months.

In the area of risk mitigation activities, such as information security, she stressed the need for more guidance and accountability. This would be enabled by a systemwide reporting and tracking mechanism. Ms. Vacca expressed appreciation for the autonomy of UC campuses but emphasized that a common format and some shared methodology would allow this systemwide tracking to take place. She described this as a task of many years.

Ms. Vacca briefly described the current effort to integrate the compliance and audit services, so that they function in an integrated fashion as one unit, focused on prevention, detection, and deterrence of fraudulent activity and identification of gaps or weaknesses in controls.

Committee Chair Ruiz inquired about funding and staffing needs for the compliance program. Ms. Vacca responded the compliance program, as a new initiative, will need additional qualified staff to ensure success. This need will be reflected in the budget proposal. She also stated that the University will need additional auditors.

Expert Financial Advisor Vining emphasized the importance of audit and compliance efforts in financial terms. While there may not be an offset to the expense of this program in the first few years, in later years these efforts will have a significant impact on UC costs, as ethics training and controls are effective. Mr. Vining cited the example of private corporations that neglect the control function and experience accounting adjustments and a loss in stock value. Given the complexity of UC's operations (with government funding for programs, medical centers, etc.) this effort is absolutely necessary. The University risks embarrassment in the future if appropriate controls are not in place. Ms. Vacca commented that the University's compliance and ethics efforts, focused on accountability around risks, as well as proactive prevention and detection of risks, might also bring about positive cultural changes in the organization, especially more collaboration and cooperation.

Faculty Representative Croughan noted the relatively low compliance rate for University training programs and inquired about the reasons for non-compliance and about possible disincentives for non-compliance. Mr. Reed stated that this topic would be taken up in the next item. Ms. Vacca suggested that the incentives around mandated training should be reexamined, and that accountability for enforcing the training begins with the Committee on Audit and the Regents, from the top, so that the organization as a whole realizes that this is an important area.

The Mercer and Monitor Group studies of roles and responsibilities might be helpful on this issue.

Committee Chair Ruiz affirmed the importance of the current compliance program and its likely positive impact on UC in the future. Mr. Vining stated that a goal for the University is to make certain problems that have occurred in recent years (he cited the Willed Body Program) impossible in the future. This is likely only if the culture of the University is changed. Mr. Reed added that appropriate processes have not always been in place, which is another form of vulnerability.

5. **ETHICS PROGRAM TRAINING REPORT**

University Auditor Reed presented information and reviewed overall completion rates for the systemwide online Ethics Briefing (71 percent completed, 29 percent not completed). He pointed out the 100 percent completion rate for all Regents. He explained that UCSF and UCLA Medical Centers show a zero percent completion rate due to a different rollout approach. Training will be provided on a consolidated basis, on an annual training day.

University Counsel Thomas reported that UCSF has begun its rollout of nursing staff. Ninety-three percent of its nursing staff have now completed the training. The Merced campus began its rollout late, and there may be a problem with the statistics that were reported. She believed the UCM completion rate to be at 42 percent; this figure will be verified.

Faculty Representative Croughan asked about the compliance level for the UCI Medical Center. Mr. Reed responded that the medical centers have used a different form of rollout, other than the web, and have not reported back yet. He noted the need for a more rigorous process for reporting back.

In response to a question posed by Committee Chair Ruiz, Mr. Reed confirmed that all Regents have completed the Ethics Briefing. He then turned to measures being taken to close the completion gap. He discussed how the high completion rate at the Office of the President was achieved, through specific emails and telephone calls to individuals. Lists of individuals by department who had not completed the training were given to department heads. Since the end of the summer the UCOP completion rate has risen to 95 percent. Mr. Reed explained that as one approaches 100 percent completion, there is a need for information about individuals on special assignment, sabbatical and medical leave. The campuses have been charged with the responsibility to close this gap, employing this tactic of approaching individuals locally through the chain of command. Mr. Reed noted that there have been many discussions with Human Resources and the Office of the General Counsel about possibilities for enforcement. He affirmed that the University has a right to expect 100 percent compliance and has disciplinary measures at its disposal to enforce this.

Ms. Croughan reported an Academic Senate proposal to relieve the University from paying legal costs for cases brought against faculty who have not completed the training. Committee Chair Ruiz opined that this would not be enforceable, citing UC's responsibility for its employees. University Counsel Birnbaum concurred, pointing to statutory obligations of the University to defend its employees acting in the course and scope of their employment. Mr. Birnbaum noted the difficulty of developing an effective enforcement model in this case. He suggested that the University should return to its established disciplinary procedures. Committee Chair Ruiz expressed his expectation that the goal of 100 percent compliance will be reached.

Mr. Reed confirmed that this is the goal. Campuses are now charged with reaching a percentage in the high 90s. He briefly reviewed completion rates for Conflict of Interest training by UC Designated Officials. UCOP completion is at 100 percent, and the campuses have been charged with reaching this same goal. He mentioned the more recent Conflict of Interest training rollout for UC researchers which began in late spring. This compliance effort is now under way. Mr. Reed concluded by stating that over 100,000 UC employees have completed the Ethics Briefing. He described this as a unique accomplishment in higher education. Ms. Thomas pointed out that the Conflict of Interest training for researchers has not yet rolled out at LBNL because the course has to be revised. Work on the revision is now being carried out, and Ms. Thomas opined that when the course is revised this rollout will go well.

The meeting adjourned at 12:50 p.m.

Attest:

Secretary and Chief of Staff