

The Regents of the University of California

**COMMITTEE ON AUDIT**

September 11, 2007

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

Members present: Regents Allen, Bugay, De La Peña, Lozano, Ruiz, Schilling, and Varner; Advisory member Croughan; Expert Financial Advisor Vining

In attendance: Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, University Auditor Reed, and Recording Secretary Smith

The meeting convened at 3:05 p.m. with Committee Chair Ruiz presiding.

1. **APPROVAL OF THE MINUTES OF THE MEETING OF MAY 17, 2007**

Upon motion duly made and seconded, the minutes of the meeting of May 17, 2007 were approved.

2. **UPDATE ON ETHICS BRIEFING AND CONFLICT OF INTEREST PROGRAMS**

University Auditor Reed presented a brief update on the efforts to roll out all the UC ethics programs, with statistics regarding what has been accomplished so far. He anticipated presenting a more detailed report by location at the November 2007 meeting, but noted considerable progress since May. Mr. Reed outlined the three currently active programs. The online Ethics Briefing, which has now been rolled out to every UC employee, is intended to raise awareness of UC's Statement of Ethical Values and Standards of Ethical Conduct. More than 104,000 UC employees have participated in the program, of a total of 152,000 people registered for the course. Mr. Reed informed the Committee that the chancellors have received a report on their completion statistics and have been urged to undertake campaigns to strengthen compliance, which ranges from 59 percent to 78 percent across the system. He recalled that the program began in November 2006 with the Office of the President and that some campuses did not begin implementing the program until April 2007, so that even a 60-percent completion rate is an indication of progress.

The two other programs began in late spring. The Conflict of Interest program for Designated Officials concerns the approximately 1,500 designated officials who are required to file annually with the Fair Political Practices Commission. About two-thirds of these designated officials have completed the program. Because of

the small number of people involved, follow-up is being pursued on a one-to-one basis at the locations. The Conflict of Interest program for Researchers was launched in May and June and rolled out to 15,000 people. Approximately 6,500 have taken it so far. Since many researchers may not be available during the summer, there will be a major push for completion in the fall. Between now and the November meeting, there will be substantial efforts at each location for the three programs.

University Counsel Thomas observed that the medical centers, with the exception of the UC Davis Medical Center, are implementing their online programs in a different way. Specific statistics for these locations will be reported separately. Mr. Reed informed the Committee that location statistics will be distributed in November.

Faculty Representative Croughan noted that the email notifications sent to faculty about these programs were well-designed and informative, especially in dealing with all three programs in one coherent fashion. She recalled that some faculty have completed these programs in person rather than online. She requested confirmation that the completion statistics also include in-person completion. Departments are recording this information, but Ms. Croughan was not certain if this information was being transmitted to the University Auditor's Office. Mr. Reed responded that the statistics include in-person programs that have been offered through the training coordinators. If there are other programs, equivalent to these but the result of location-specific initiatives, it is possible that they are not being recorded. He recalled the Committee on Audit's consensus and President Dynes' statements that all UC employees should receive the ethics training at the same time, to encourage dialogue about these issues.

Committee Chair Ruiz asked about the sexual harassment training. Mr. Reed informed the Committee that a second two-year time frame for sexual harassment training for UC officials who work in a supervisory capacity will be rolled out in the next week. This program is being carried out with a new learning management system. In response to Committee Chair Ruiz's question, he confirmed that this training is required by law and that the University expects 100 percent compliance. Mr. Reed expected that existing UC tools would be adequate to ensure compliance. In the new training cycle, individuals who did not complete the previous program will be approached first.

Committee Chair Ruiz inquired about the Regents' completion of the Ethics Briefing. Mr. Reed responded that there may be one or two Regents who have not yet completed the training. Secretary and Chief of Staff Griffiths stated that she will verify the Regents' completion of this training.

3. **REPORT ON NEW UNIVERSITY POLICY ON EDUCATIONAL LOAN PRACTICES**

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Vice President for Student Affairs Sakaki provided a review of issues that led to the development of the currently proposed Policy on Educational Loan Practices and described key features of the proposal. She began with observations on the importance of loans to UC students. Thirty percent of UC undergraduates are low-income, Pell Grant-eligible students, a higher percentage than in any comparable public or private university in the U.S. Loans are the single largest source of support for professional degree students. The development of a new policy can thus have a positive impact on many UC students and their families.

Ms. Sakaki recalled recent media attention to troubling practices by lenders and institutions related to student loans and President Dynes' commitment to the Regents that UC would conduct a survey of its current practices to ensure integrity and transparency and develop a systemwide policy. She noted that University Auditor Reed presented the results of this survey in July, results which showed no problems at UC comparable to those receiving national attention. However, the survey revealed that the University's Conflict of Interest policies were not well understood by campus financial aid staff. Decisions about lender relationships were often not well documented or fully disclosed to students.

Ms. Sakaki outlined the policy development process, the advisory committee membership, and consultation with campus officials. She anticipated that the policy proposal will be finalized and submitted for the President's approval within a few days. Ms. Sakaki discussed two key principles in the policy. First, the University has the obligation to help students and families identify the best loans for students. Second, UC practices in this area must meet the highest standards of integrity, transparency, and student service. The policy calls on campuses to develop preferred lender lists, to help with identifying, evaluating, and comparing loans. Ms. Sakaki opined that these lists will become more important as students, especially graduate students, borrow more. In addition, the University's role as a trusted advisor is more important than ever, given aggressive marketing tactics by lenders and direct-to-consumer campaigns that target students and their families. Ms. Sakaki discussed the policy's framework for developing and communicating lender lists. The Office of the President will collect information from lenders annually that will be used to rate and select loans objectively. The selection criteria will reflect the best interests of borrowers. As an example, the University will compare the student loan equivalent of an annual percentage rate, which reflects the true cost of a loan, and seek ways to compare the quality of lenders' customer service. UCOP will work with the campuses to develop a common rating system for display and comparison of loans. Students will also be informed that they may borrow from lenders who are not on the list.

The policy assists campuses in their choice between the two major federal loan programs, the Direct Loan Program and the Federal Family Education Loan (FFEL) program. Ms. Sakaki noted that recent developments at the federal level will likely narrow the differences between the two programs. The policy encourages campuses to accommodate individual students with unique circumstances if one program rather than the other more closely meets their needs.

Referring to the results of the recent survey, Ms. Sakaki informed the Committee that the policy requires training in Conflict of Interest guidelines for all staff who are involved with education loans. Under the policy, financial aid directors will be Designated Officials, subject to disclosure requirements and gift prohibitions.

The policy also places new restrictions on lenders' relationships with UC. The University may receive no benefit from a lender in exchange for including the lender on a preferred lender list. A lender may not circumvent the rating and selection process by providing funds or services to a campus. The University may negotiate with lenders to receive superior terms for UC students. Lenders are prohibited from identifying themselves as UC employees. Benefits and services may be accepted from lenders only if three conditions are met: 1) The benefit or service must be beneficial to students and borrowers; 2) there must be no actual or perceived conflict of interest, and 3) the acceptance of the benefit or service must be documented by the campus financial aid office and approved by the chancellor or a designee. As an example, many lenders provide web-based services for entrance and exit counseling. A campus may accept such services only after determining that they offer a real benefit to borrowers. Students must be informed that the services were selected on that basis, not because the University necessarily endorses that lender's loans.

Ms. Sakaki recalled that alumni associations often rely on corporate sponsorships to supplement their fundraising activities. If those partnerships involve the marketing of education loans, the policy requires the alumni association to consult with the campus financial aid office about the terms of the lender's products and the agreement must be approved by the chancellor. Any benefit received from the lender by the association must be fully disclosed to the borrowers. She believed that these safeguards achieve the right balance between allowing the alumni associations to pursue fundraising while protecting borrower interests.

The Office of the President is responsible for communicating the policy to the campuses and for periodically reviewing and revising the policy. UCOP and the campuses have joint responsibility for developing frameworks for the establishment and communication of preferred lender lists and for reviewing UC practices to ensure compliance.

Ms. Sakaki called attention to changes in the field of education loans. Lenders have voluntarily ended some questionable practices, new federal regulations are anticipated, and student loan providers will likely increase their direct-to-student marketing efforts. Ms. Sakaki concluded that the University's time and energy will be well spent by helping students sort through many confusing options to identify the best loan for them.

Regent Allen asked if the proposed policy reflects the consensus of the advisory committee. Ms. Sakaki responded that campuses have in the past been able to choose the loan program that was best for their campus. There has been no systemwide approach. She believed that the policy does reflect the views of the advisory committee, although it did not enjoy unanimous support. Some campuses wished to maintain the status quo. Regent Allen asked about feedback from chancellors on the policy. Director of Student Financial Support Jeffery responded that there was support and agreement from the chancellors for most of the policy. There was concern about one aspect of the policy, the campuses' autonomy in selection of which of the two federal loan programs to participate in. Ms. Jeffery emphasized that the policy reflects the desire that campuses try to accommodate students who might be better served by one or the other program. She noted that the differences between these loan programs have varied over time. Lenders in the FFEL private loan program have been able to offer additional support beyond that established by the federal government. This is expected to change with the enactment of the Budget Reconciliation Act. There will no longer be significant differences between the two programs.

Regent Allen suggested that the policy's provisions concerning the federal loan programs, requiring campuses to offer both programs, might be premature, since federal legislation in this area is expected to change. Ms. Jeffery specified that the policy calls for campuses to review, at least every five years, their decision about which loan program to participate in. They are encouraged to accommodate students from both programs. She noted that the model for this is the current practice at UCI. Irvine is a direct loan campus, but students with particular needs are allowed to take out loans from private lenders. Ms. Sakaki reported that UCOP will support campuses with training and start-up costs to implement the Irvine model.

University Auditor Reed asked about the current status of the policy and next steps. Ms. Jeffery responded that she has received editorial and technical comments which are now being incorporated into the policy. She anticipates having a finalized policy completed within a week for the President's approval. Committee Chair Ruiz asked about when the policy would be implemented. Ms. Sakaki stated that the next step will be the President's approval. Responding to Regent Allen's earlier question, she stated that, if federal legislation regarding loan programs changes significantly, the policy will be revised accordingly.

Regent Allen stated his understanding of how the wording of the policy had changed, from a declaration that campuses were not precluded from offering both federal and private programs, to a declaration that the campuses are encouraged to offer both. He noted that many campuses have switched over to the Federal Family Education Loan program and reported a concern that students are being flooded with misleading advertisements from private lenders. Regent Allen wished the other Regents to be aware that there is discontent about this issue among students.

Committee Chair Ruiz described the proposed policy as a good start, noting particularly that it protects students and their families from unscrupulous lenders. He asked what the policy reporting process would be on a regular basis. Ms. Sakaki expressed her willingness to report periodically and to provide updates to the Regents on the policy's implementation.

4. **UNIVERSITY OF CALIFORNIA, BERKELEY AND UNIVERSITY OF CALIFORNIA, LOS ANGELES AUDIT DIRECTOR PRESENTATIONS OF LOCAL PROGRAMS**

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

University Auditor Reed recalled that, while the Committee agenda for the year was being set, the Committee Chair had requested presentations on the types of risks and issues observed by auditors. Mr. Reed noted that presentations to the Committee by campus audit directors are a new development. He introduced UCB Audit Director Stephanie Siri and UCLA Audit Director Edwin Pierce.

Director Siri began with some general remarks about the Berkeley campus student, faculty, and staff population, and annual revenues. She informed the Committee that the UCB Audit and Advisory Services Office has nine authorized auditors. Referring to the audit report for fiscal year 2006, Ms. Siri stated that her office did not identify any deficiencies that would represent material control weaknesses and that this is true for fiscal year 2007 as well. She confirmed that management and others did not limit the scope of the work her office performed and that the auditors' independence and objectivity were not impaired in any instance. Management has been responsive to the recommendations provided in audit reports and has developed corresponding action plans.

Ms. Siri discussed a number of significant audit issues that arose during fiscal year 2007. There is a need for ongoing scans of the thousands of computers used in departments on the Berkeley campus. She reported on a new program of departmental information technology surveys, introduced by the Audit Office in cooperation with the campus Chief Information Officer. Six departments were surveyed in fiscal year 2007; 15 will be surveyed in fiscal year 2008. The surveys assess information technology-related risks in individual departments using

interviews, network scans for computer vulnerabilities, and scans of individual computers for restricted data. The initial sample identified a number of risks. The scans detected restricted data such as Social Security numbers with inadequate controls, lacking encryption or firewalls. Departments were advised to remove such data where possible or to implement appropriate system and process protections.

Most departments had not engaged in a continuity planning process integrating critical information technology systems and general business needs. Departments were advised to undertake continuity planning and to complete a template available online. Ms. Siri reported that the surveys have been well received. The UCB Office of the Chief Information Officer has expressed interest in developing a comprehensive department-level information technology assessment process to be owned and administered by that office. Ms. Siri noted revisions made to the survey for 2008.

Next Ms. Siri turned to research compliance. In fiscal year 2007, UCB received more than \$509 million in research support. UCB Audit and Advisory Services audits both pre-award processing of proposals for research contracts and grants and post-award administration of contract and grant-funded research. In the pre-award area, it was noted that more outreach and personal contact by the UCB Sponsored Projects Office would make it more likely that departments will submit research proposals early enough for full pre-submission review. In post-award administration, there were delays in distributing effort reports to departments for certification. In some instances campus departments could not locate signed effort reports. Ms. Siri pointed out that certified effort reports are required by federal regulations and University policy. She described an online effort reporting system recently developed by the Office of the President, to be piloted on the Berkeley campus in fall 2007 and rolled out to the entire campus in February 2008. This new system will produce reports in a timely fashion, maintain them electronically, and allow monitoring to ensure certification. Effort reports are particularly important because the bulk of research funding is expended on salaries. Two federal audit agencies, the Office of Naval Research and the National Science Foundation, are currently auditing UCB's effort reporting system. The campus Controller's Office has recently hired a Compliance Manager to work with campus departments that receive research funding. She will develop a program to respond to compliance risks and deliver training to address critical needs that are identified.

As part of the fiscal year 2007 audit plan, all campuses and the Office of the President audited compliance with Academic Personnel Manual Section 025, Conflict of Commitment and Outside Activities of Faculty Members. Ms. Siri discussed specific provisions of Section 025, such as the requirement that faculty members submit annual reports on their compensated outside professional activities and additional teaching activities. The audit carried out at the Berkeley campus showed that annual reports were on file, but not all were submitted by the

due date. In a few cases, required approval was not sought before an outside activity was undertaken. In response, the Vice Provost for Academic Affairs and Faculty Welfare will reiterate that faculty merit increases will not be processed until these annual reports are on file, will communicate policy requirements concerning prior approval, and will clarify what activities need to be reported by faculty.

Director Pierce then began his presentation with general remarks about the UCLA campus, its faculty and student populations, and its annual budget. He noted that UCLA Audit and Advisory Services has 27 professional auditors and described the scope of their activities. Mr. Pierce expressed the conviction that UCLA Audit and Advisory Services meets or exceeds performance goals and emphasized the commitment of this office to enhance its services.

Mr. Pierce commented on the control environment at UCLA, noting that during his tenure as Director he has never encountered any limitation on the scope of reviews carried out by his office, nor has the independence of this work or audit plan development been impaired for any reason. He stressed that campus management has been supportive of and has actively participated in the audit program. Mr. Pierce believed that UCLA internal control structures provide a reasonable but not absolute balance between the cost of control and the assumption of risk. He referred to the UCLA audit report for fiscal year 2006, affirming that his office did not identify any deficiencies that would represent material control weaknesses and that this is true for fiscal year 2007 as well.

Mr. Pierce discussed a review that has been completed of the UCLA Donated Body Program, to ensure that this program is operating in accordance with the UC Standards and Guidelines for the Anatomical Materials Programs. A considerable amount of time has been spent on this issue over the last three years. The UCLA Donated Body Program staff has assessed and implemented most of the recommendations in the audit review. Full compliance with the UC Standards has been slowed due to ongoing litigation, the fact that the centralized Anatomical Materials Registry is still under development by the Office of the President, and that the implementation of a records retention policy is still being reviewed by the systemwide Anatomical Materials Review Committee.

UCLA Audit and Advisory Services also audited compliance with Academic Personnel Manual Section 025, Conflict of Commitment and Outside Activities of Faculty Members, as part of a systemwide review. Mr. Pierce reported that currently there is no formal follow-up process at UCLA to ensure that faculty members comply with Section 025 pre-approval and annual reporting requirements. There is no clear formal delegation of authority specifying who is authorized and responsible for approving Category I compensated outside activities of faculty. Section 025 reporting requirements are communicated to faculty only once annually. Mr. Pierce stated that he was encouraged by corrective actions to be taken by the Vice Chancellor of Academic Personnel in



implementing the audit recommendations and by the Vice Chancellor's conviction that deans and academic department chairs must take a more active role in Academic Personnel Manual Section 025 oversight.

The current UCLA audit plan includes high-level reviews to assess compliance and controls. Mr. Pierce enumerated the challenges faced by department administrators: appropriate segregation of duties and responsibilities, adherence to established procurement methods, use of strategic sourcing agreements, and monitoring of employee access to systems. Continuous and additional training is needed for staff and management in some areas due to changing regulatory requirements, updates to procedures, and other new developments. Mr. Pierce concluded by stating that UCLA campus audit resources are geared to respond quickly to assist management in resolving difficult issues, and to respond to UC systemwide developments and needs.

Faculty Representative Croughan reported that the online effort reporting system requires a great deal of training. She noted that she attended two four-hour training sessions but still found the online forms to be challenging and requested assistance from her Management Service Officer. She also pointed out that there is not always a system in place to remind faculty to complete these forms. Ms. Siri referred to the UCB pilot online effort reporting system, undertaken with two departments. Feedback from these departments will be used for the full implementation. The Berkeley campus Controller has established a focus group that is responding to concerns that have been raised. The presence of a Compliance Officer in the Controller's Office will ensure that all reports will be certified, on file, and electronically verifiable.

Mr. Reed observed that the use of a new compliance tool, whether it is challenging or easy to use, will not necessarily change the organizational culture or ensure timely reporting. He noted that effort reporting initiatives are also under way at UCSD and UCSF, that effort reporting is a significant concern for federal agencies and other sponsors, and that time charges are the most significant cost involved in research contracts and grants.

In response to Mr. Vining, Ms. Croughan described the difficulties of filling out the online effort reporting forms, such as accounting for discrepancies, especially for a faculty member with several research assistants who are funded by different grants. She stated that the directions for completing the form are not sufficiently clear and suggested that a printed tutorial or "help" buttons would be helpful.

Referring to the UCLA audit report, Regent Bugay requested clarification regarding corrective or remedial actions in response to the review of Senior Management Group travel and entertainment expenses. Mr. Reed noted that this review followed on the executive compensation review of last year. It was carried out at each campus and Mr. Reed reported the results to the Committee in July 2006. Vice President Broome then required that each campus formulate a

corrective action plan; these campus plans were then approved by UCOP. Regent Bugay expressed the wish that information on the follow-up and corrective actions be included in this report.

Regent Bugay referred to another case at UCLA involving conflict of interest in the University Extension Instructional Technology Unit. He described the incident as egregious, noted that the unit director was terminated for misconduct, and asked what other corrective actions had been taken. Mr. Pierce clarified that UC was not the victim of this activity, which involved the Los Angeles Unified School District. UCLA has turned over all its relevant information to the office of the LAUSD Auditor General, who is now pursuing this matter.

Committee Chair Ruiz remarked that both the UCLA and UCB planned audit programs were negatively affected by time spent on compensation issues. Mr. Reed responded that the overall audit plan for the year was affected at all locations. Committee Chair Ruiz expressed serious concern that important internal audit work was not carried out due to compensation issues. Mr. Reed cited figures from the campus reports showing that UCLA completed 93 percent of its audit plan, while UCB completed 56 percent. He reminded the Committee that UCLA has a staff of 27, while UCB has a staff of nine. The impact of compensation issues on the audit plan was greater at the campuses with a smaller staff.

Mr. Reed expressed appreciation for the Committee's questions and interest in the audit reports and solicited comments or questions about the annual reports or other communications. Ms. Croughan asked about future campus audit presentations at Committee meetings. Mr. Reed responded that these presentations are part of the plan for upcoming Committee meeting agendas. Mr. Vining welcomed this kind of in-depth reporting and the greater involvement of the Committee on Audit, compared to previous years.

5. **PROCEDURE FOR APPOINTING AN OUTSIDE EXPERT TO THE COMMITTEE ON AUDIT**

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Committee Chair Ruiz introduced the item and highlighted the importance of Expert Financial Advisor Vining's contribution to the work of the Committee.

University Counsel Thomas discussed the need for a period of overlap or transition from Mr. Vining to his successor. She noted that the procedure submitted to the Committee had been streamlined and shortened since the last time it was applied and that the process should be shorter this time. In response to Committee Chair Ruiz's recommendation, the specific name of the University's current external auditor was removed.

Regent Bugay requested clarification of the timeline for the appointment. Ms. Thomas responded that the solicitation process is ready to begin; email notifications will be sent out by Assistant Vice President for Alumni Affairs Stofan. When applications are received, Secretary and Chief of Staff Griffiths will be asked to convene a screening committee. Committee Chair Ruiz will be involved in review of the candidates. Ms. Thomas expressed the hope to have a new expert financial advisor in place, if not by November, by the January 2008 meeting.

Mr. Vining explained that Assistant Vice President Stofan is involved because it is felt that it would be necessary or at least beneficial to find someone in the alumni community with the appropriate skills who would be willing to make this commitment to the University. It might be more difficult to find such a person in the general public. He anticipated that the function of this position within the Committee will grow during the next three years and suggested that the Regents might want to utilize the person in this position for broader review of agenda items on various committees in the future.

6. **2007-08 AGENDA INPUT FROM COMMITTEE ON AUDIT**

University Auditor Reed expressed appreciation for the effort to formulate an agenda for the year. He noted that the November meeting will include external auditor PricewaterhouseCoopers' annual report, the annual report for Internal Audit, and a campus audit presentation. In March 2008, the external auditor will present its annual plan for the next year. In May, Mr. Reed will present the audit plan for 2008-09. He also noted that the position of Senior Vice President for Compliance and Audit will soon be filled and that the Committee will take an active interest in the compliance program in its formative stages in the coming year. There are tentative plans for a January presentation of the Health Sciences compliance program annual report. Another item scheduled for January is a discussion of the University's new relationship to the audit programs of the Los Alamos and Lawrence Livermore laboratories.

Regent Varner asked if there will be periodic or quarterly reports from the external auditors about any material issues. Mr. Reed responded that Vice President Broome manages UC's relationship with the external auditors. Between the annual report in November and the annual plan in March, the external auditors come before the Committee at the Committee's pleasure. Mr. Vining observed that the work of the external auditors is highly concentrated at two periods during the year. He reported that he has asked the external auditors to notify him and the Regents immediately at any time if there is any indication of material weaknesses or concern about an issue that might become a material weakness.

Mr. Reed pointed out that, at the November meeting, the external auditors will be reporting under new Statement on Auditing Standards (SAS) 112 standards and

reporting thresholds. Mr. Vining advised that these new standards, with two lesser categories, applied for the first time, will produce a lengthy list of issues.

Committee Chair Ruiz asked how the external auditors should communicate about material weaknesses. Mr. Vining responded that many of the issues involved would not necessarily be reported to the Committee and the Regents since the relationship to the external auditors is managed by the Financial Management Department, but that a special request has been made to the external auditors to report to the Committee.

Mr. Reed reminded the Committee that Internal Audit issues a quarterly activity report with detailed information, including a list of every audit and investigation report that has been issued and statistics showing progress toward the annual plan.

Regent Lozano requested that all meeting materials, including campus audit findings and recommendations, be sent to the Regents in advance to allow better preparation for the discussion. Mr. Reed noted that the agenda for this meeting was formulated later than usual; materials for future campus audit presentations will be sent in advance.

The meeting adjourned at 4:30 p.m.

Attest:

Secretary and Chief of Staff