The Regents of the University of California

COMMITTEE ON COMPLIANCE AND AUDIT
March 4, 2009

The Committee on Compliance and Audit met on the above date by teleconference at the following locations: 1111 Franklin Street, Room 12322, Oakland; James E. West Alumni Center, Los Angeles Campus; 3750 University Avenue, Suite 610, Riverside; Dolder Grand Hotel, Kurhausstrasse 65, Zurich, Switzerland.

Members present:	Regents De La Peña, Ruiz, Scorza, and Varner; Advisory member Croughan; Expert Compliance Advisor Guyton and Expert Financial Advisor Schneider
In attendance:	Regent-designate Stovitz, Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Compliance and Audit Officer Vacca, Vice President Broome, and Recording Secretary Johns

The meeting convened at 12:15 p.m. with Committee Chair Ruiz presiding.

1.   **PUBLIC COMMENT**

Committee Chair Ruiz explained that the public comment period permitted members of the public an opportunity to address University-related matters. The following person addressed the Committee.

A.   Mr. Ken Avelino, a representative of the Greater Sacramento chapter of the Organization of Chinese Americans (OCA), a national civil rights organization dedicated to the well-being of Asian Pacific Americans, expressed OCA's concerns regarding the freshman eligibility reform. He stated that, under the new policy, the University would deny admission to 24 percent of qualified Asian Pacific American applicants. Mr. Avelino argued that the new policy is unconstitutional and would not in fact foster diversity at UC. He requested that the Regents amend, revoke, or terminate the freshman eligibility reform.

Faculty Representative Croughan indicated that she would be happy to discuss this matter further or provide a formal written response.

2.   **APPROVAL OF EXTERNAL AUDIT PLAN FOR THE YEAR ENDING JUNE 30, 2009**

The President recommended that the scope of the external audit of the University for the year ending June 30, 2009, including the expanded external audit coverage of the Lawrence Berkeley National Laboratory, be approved.

[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.]

PricewaterhouseCoopers (PwC) representative Joan Murphy introduced two other members of the PwC engagement team, Peggy Arrivas and Karen Li. She presented highlights of PwC's Audit and Communication Plan for the year ending June 30, 2009.

Ms. Murphy first discussed the audit objectives. PwC is engaged to audit the consolidated financial statements of the University and the medical centers in accordance with generally accepted auditing standards and government auditing standards, due to the amount of federal awards the University receives. PwC provides a financial statement audit and an A-133 audit of federal awards.

The audit provides reasonable assurance that PwC would detect material fraud, but not absolute assurance. PwC's work complements the overall environment and tone set by UC management. At the close of the audit, PwC will provide audited financial statements and a debriefing on the audit work.

Vice President Broome observed that, if a significant concern arose during the course of the audit, UC management would ensure that the auditors contact Committee Chair Ruiz. Ms. Murphy responded that she has contacted Committee Chair Ruiz directly in the past and would not hesitate to do so again if necessary.

Next Ms. Arrivas discussed the services PwC provides to the University above and beyond issuing audit opinions. These include the implementation of new accounting pronouncements and communication about industry trends and developments. She pointed to information in the PwC report about areas for which such service was provided in 2008.

Ms. Murphy described the overall design of the audit, which allows PwC to evaluate and assess internal controls as they support financial reporting. PwC's assessment of the internal control environment and its reliability determines the amount of detail testing to be done.

Turning to areas of emphasis in the audit, Ms. Murphy recalled that financial statements include some numbers that are easily verifiable through reference to outside data, while the determination of other numbers involves judgment and estimates. These latter numbers can vary based on audit assumptions. PwC pays close attention to these areas if significant dollar amounts or significant risk are involved. PwC employs a specialist to examine self-insurance reserves and post-employment benefits.

Ms. Murphy remarked that PwC is aware of the current economic environment and how this may affect financial reporting. She called attention to a new accounting standard, Governmental Accounting Standards Board (GASB) Statement 49, a requirement for institutions to survey and determine if they have any remediation obligations regarding pollution. As an example, the University must remove or remodel any buildings that

contain asbestos. This requires an estimate, and the campuses have been gathering this information. PwC will review this estimate of liability.

Vice President Broome noted that it can take years to implement a new GASB pronouncement, due to the size of the University. The University actively consults with PwC in developing its implementation plans.

Ms. Murphy concurred that implementation is a long process. She opined that the University is ahead of new standards and that the Office of the President provides direction for the locations regarding compliance. She then pointed out a list of audit opinions to be provided by PwC as part of its Audit and Communication Plan, an audit timeline, and a chart of the engagement team.

Committee Chair Ruiz thanked Ms. Murphy and her colleagues for the report materials provided, which would serve as a useful outline for the Committee's work. He urged the Committee members to read and familiarize themselves with these materials. He thanked PwC for its partnership with the University.

Associate Secretary Shaw explained that, due to the lack of a quorum, action on this item would be deferred to the March 18 meeting.

3.   **INFORMATION TECHNOLOGY SECURITY ASSESSMENT RESULTS**

[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.]

Associate Vice President and Chief Information Officer Ernst reported on the campuses' second annual self-assessment of information technology security. He recalled that the first assessment was carried out at the campuses, the medical centers, the Division of Agriculture and Natural Resources, the Office of the President, and Lawrence Berkeley National Laboratory. The results of the first assessment, completed in 2007, were not presented to the Board. This was due to Mr. Ernst's recent arrival and the desire to present two years' data to the Regents.

Mr. Ernst discussed a chart showing compliance levels in 17 categories of electronic information security for 2007 and 2008. For example, the first category, "Designation of Information Security Officer," showed progress from some compliance in 2007 to full compliance in 2008. The category of "Risk Assessment" also showed progress from 2007 to 2008. In all 17 categories, over the two-year period, the University either maintained the existing compliance level or made progress.

There were still several areas that require attention. Mr. Ernst stated that his objectives for this year would be to address the most urgent compliance categories so that a self-assessment at the end of the year would produce different results, and, at a minimum, to eliminate areas of non-compliance.

Mr. Ernst identified the area of security education and awareness training as one in which the University can achieve the greatest results for the smallest investment. Most security breaches over the last five years have resulted from human error, not from an effort to break into University information systems. He believed that the University could significantly reduce the number of these incidents if it implemented a systemwide comprehensive training program for information security. Such programs already exist, and the University could acquire one to meet its basic needs. Mr. Ernst stated that he would discuss the development of a baseline training program, probably web-based, with campus chief information officers later that week. Campuses could add elements to such a program to accommodate specific campus needs. He emphasized that every UC staff and faculty member should receive baseline training regarding security practices.

Another area of concern was risk mitigation measures and preparedness for disaster recovery. The campuses need greater coordination and the University could help by providing guidelines and establishing a floor or baseline. In this, as in other areas, one systemwide program would benefit all locations and require less effort.

Finally, Mr. Ernst discussed the collection, management, and analysis of log data, which was to be another area of focus in the coming year. The University logs a great deal of data regarding access to its information systems. Retrospective examination of this data is very helpful in identifying patterns, insufficient vigilance, and system weaknesses.

Mr. Ernst cited the limited resources available as a reason for focusing on the three areas just discussed, areas where the University is most out of compliance or where significant progress can be made. He requested support and adequate resources for these three areas of emphasis. He expressed willingness to present a progress report every six months and advocated another self-assessment to determine whether there has been improvement in categories that were out of compliance. After that point, there could be a discussion on next steps, which might include continuing self-assessment or external sampling reviews.

Regent De La Peña noted that it would be helpful to know the cost of the various proposed programs. He also requested a global plan including medium- and long-term goals, and showing how the present three areas of focus would affect other areas of information security compliance. Mr. Ernst anticipated that he would be able to present such a plan, including one-year, three-year, and five-year goals, resources needed, and priority areas. He stated that he would contact Regent De La Peña to discuss this further.

Committee Chair Ruiz asked if a strategic plan for information technology was being actively developed. Mr. Ernst responded that the development of an information technology security plan would begin that week, in discussions with campus chief information officers. The University currently did not have a strategic plan for information technology. Mr. Ernst opined that the University should have such a plan at the systemwide level. Such a plan would clarify what areas or projects should receive systemwide investment in order to benefit individual campuses and to improve the system as a whole, and would integrate projects in a sensible way.

Committee Chair Ruiz emphasized the importance of having such a strategic plan in place and asked Mr. Ernst to present an outline to the Committee on the strategic planning process. Mr. Ernst responded that he would do so and that his objective was to have a first draft of a plan in place by the end of the current calendar year.

Regent De La Peña concurred with Committee Chair Ruiz on the importance of this strategic plan. He cited the decentralization of the University's information systems and indicated that there was now an opportunity for improvements, such as pooled software purchases. He opined that Mr. Ernst, in his role as chief information officer, would be instrumental in realizing such improvements.

In response to a question asked by Committee Chair Ruiz, Mr. Ernst confirmed that he would present an outline for a strategic information technology plan for UC at the May meeting.

Faculty Representative Croughan expressed the willingness of the Academic Senate to assist with this effort.

Chief Compliance and Audit Officer Vacca noted that the University's internal audit program plan had earlier included an independent information technology security assessment. This was deferred to allow the self-assessment first. She recommended that, when the self-assessments are completed, this independent security assessment should be restored to the internal audit program plan for 2010-11.

Vice President Broome stressed the importance of the internal audit function, and that it be reliable.

Committee Chair Ruiz thanked Mr. Ernst for his report and welcomed the progress made in this area.

4.   **INTERNAL AUDIT QUARTERLY REPORT**

[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 presented highlights from the internal audit quarterly report. The campuses had about ten percent fewer available hours than they should have according to the internal audit plan. This was close to the level last year and reflected hiring freezes at most locations, which are not able to add staff, except for critical positions. The audit director position at UC Irvine was filled in January with the hiring of the individual who had been the campus Director of Controls and Accountability, a seasoned professional who had also served as audit director at the University of Southern California. Recruitment is under way to replace the outgoing audit director at UC Santa Cruz. The University's audit program has capable leadership but insufficient staff resources.

The audit program is behind in its plan for the year because of the shortage of resources and because of time spent on work carried over from the previous year. Audit directors have been encouraged, in examining the plan for the remainder of the year, to take a risk-based approach in determining priorities. Mr. Reed pointed out that hours spent on investigations numbered around 10,000, which was close to plan and did not indicate a deterioration, as some had expected. He recalled that there was flexibility in the current year plan to allow audit staff to be available for advisory services to managers with budget constraints who are involved in restructuring efforts. While the advisory services hours were below plan, their number was higher than in the previous year.

Mr. Reed briefly discussed systemwide audits. A systemwide audit of effort reporting was nearly complete. This is a critical research compliance area concerning the reporting of time charged to federal contracts and grants by investigators and research assistants. The University has recently implemented a new system for effort reporting. Mr. Reed indicated that, while this system is a useful tool which allows for better tracking mechanisms, it cannot spur compliance or change the culture of reporting on its own. The effort reporting audit has shown that there are still issues of concern, differing by location, and has demonstrated the need for more training of principal investigators regarding the principles of effort reporting, the importance of timeliness, and ensuring that the individuals who sign off on an effort report have first-hand knowledge of how time was spent. There are still concerns about time moved from one contract to another contract. The results of the audit will be conveyed to those responsible for the effort reporting system, including Vice President Beckwith.

The internal audit program has almost completed its review of the annual report on executive compensation, and its review of the President's and chancellors' travel, entertainment, and housing expenses. Mr. Reed observed that there are complexities in the conventions used in the annual report. It was the Regents' wish to be provided with annual compensation rates rather than actual cash compensation for the year. For that reason, the report numbers are not taken directly from existing records or from W-2 reporting for tax purposes. This process could be streamlined.

The internal audit program is beginning an audit of indirect cost waivers. In some circumstances, the University waives the charging of indirect costs to contracts and grants. While this is a narrow area of compliance, it is an area where the University may be neglecting funding to which it is entitled.

Faculty Representative Croughan noted that the chancellors' and President's associates have received training regarding budgets and expenditures and that the training has been effective. She informed the Committee that the Academic Senate was currently reviewing the effort reporting system.

Chief Compliance and Audit Officer Vacca noted that the effort reporting process would be a focus for the compliance program during the next quarter.

Committee Chair Ruiz praised Mr. Reed and his staff for the amount of work accomplished in spite of the reduced number of available hours.

5.   **PRESENTATION OF AUDIT AND ADVISORY SERVICES, SAN FRANCISCO CAMPUS**

[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.]

Ms. Abby Zubov, Director of Audit and Advisory Services at UC San Francisco, described the campus internal audit program and discussed the services it provides. She began her presentation with background information about UCSF, the only campus with no undergraduate students. It has four graduate health science schools in medicine, dentistry, nursing, and pharmacy, and two major medical centers. UCSF has multiple sites in San Francisco and the Bay Area. Its operating budget is $2.6 billion. The campus has somewhat less than 4,400 graduate students and 22,000 employees. It has $865 million in sponsored funding, of which $444 million is National Institutes of Health (NIH) funding. UCSF ranks second nationally in NIH funding, and first among public institutions. The graduate schools enjoy high national rankings.

The UCSF audit staff consists of 13 FTE, including the director, two associate directors, eight professional staff members, and two analysts. Due to budget cuts, the program expects to lose one FTE next year, one the following year, and one more the year after that. These are expected to be permanent cuts. Ms. Zubov emphasized that these cuts will affect the program's ability to complete its audit plan. Compared to industry standards, the program is understaffed. She expressed the hope that the program would be able to maintain its FTE level. The campus audit program has an annual budget of $1.8 million. Of this, $1.3 million is State 19900 funding, while $500,000 comes from medical center recharges. The program provides full scope audit services.

The UCSF audit program provided educational town hall sessions for the campus community about Statement on Auditing Standards (SAS) 112 requirements. As a follow-up, the program reviewed implementation of 13 key controls in the four graduate schools. Information from this review was provided to the departments as an advisory service. Last year the program carried out a more qualitative analysis of certain key controls, such as general ledger reconciliations.

Faculty Representative Croughan asked about the results of this analysis. Ms. Zubov responded that all the schools had implemented controls. Some departments experienced more difficulty than others, mainly because of available resources. There was awareness everywhere about what controls should be in place. Results from various departments in the School of Medicine were better than anticipated.

Ms. Zubov then discussed the program's contributions to UC systemwide auditing. UCSF is fortunate in having a great deal of information technology expertise. A number of UCSF audit staff members are certified in information security technology. The campus

is working with Chief Compliance and Audit Officer Vacca and University Auditor Reed to help the systemwide audit program with the implementation of CARTS, a tracking and monitoring system for management corrective actions. UCSF has also worked on development of a model to strengthen the systemwide information technology audit program.

Ms. Zubov outlined challenges and opportunities for the UCSF audit program. The campus has experienced a significant turnover in executive leadership. The Chancellor will step down in June. The School of Medicine does not currently have a dean. There is no vice chancellor for research. Two senior vice chancellors, for development and administration, will be leaving the campus in July and August. There is an interim chief medical officer, and the campus recently lost a chief operating officer.

Another major challenge for the program is to maintain internal control systems despite budget reductions. The campus is beginning recruitment for a vice chancellor for information resources.

Ms. Zubov identified international research and research collaborations as an area of new risk for UCSF. The campus conducts these contracts and grants as if they were in the U.S., but there are different risks inherent in operating in other countries. There is a need to protect principal investigators and the University.

The program experiences difficulty in recruiting and retaining qualified audit staff, due to the Bay Area housing market and the UC salary structure.

Ms. Zubov then noted some current opportunities. The expansion of leading edge translational medicine at UCSF would lead to new collaborations and funding. Budget reductions, turnover, and regulatory scrutiny have increased the value of audit services to areas in transition. The groundwork has been laid for the UCSF audit program to assist in emphasizing accountability for information security and protection of information resources.

The UCSF audit program monitors itself, examining quarterly results in customer service, financial performance, internal processes, and learning and growth. It strives to meet percentage goals for completion of the audit plan and to lower the average cost per audit project. The program monitors metrics from its customers, and audit staff members are regularly evaluated.

Ms. Zubov concluded by observing that the campus faces many challenges in today's environment of program expansion and budget cuts. Strong leadership is needed in times with significant turnover of key positions. UCSF has a mature audit function. The audit function is outcome-driven, with a robust monitoring system in place for audit productivity and campus completion of management corrective actions. Audit staff resources will continue to be stretched to address the most significant risks facing UCSF as the campus continues to expand globally and nationally. Audit efforts to leverage the use of technology expertise will continue both locally and systemwide.

Committee Chair Ruiz expressed concern that, with the administrative changes and expansion of hospital services at UCSF, there would be greater liability. He asked if there was any contingency planning to address this risk.

Chief Compliance and Audit Officer Vacca noted that there would be assessments of high-level offices at UCSF, and that President Yudof is aware of issues of concern surrounding the vacancies at UCSF, including the lack of a permanent compliance officer.

In response to a question asked by Committee Chair Ruiz, Ms. Zubov reported that the campus has an interim plan to address the high-level vacancies. The prior chief operating officer role is now filled by the chief financial officer. The chief financial officer's responsibilities are shared by associate directors. She identified the most significant risk as long-term decisions made by individuals in interim positions; there was less risk in the day-to-day operations.

General Counsel Robinson expressed concern about staffing for the UCSF audit program. He asked if there are benchmarks for number of staff and hours available for an enterprise of this size. He asked about when it would be appropriate for an oversight board like the Committee to express concern, intervene, or ask additional questions.

Ms. Vacca responded that there are professional benchmarks. The University monitors this situation at the campuses and systemwide. She recalled that UCSF might lose one FTE each year over three years and noted that audit services compete with other campus priorities such as police services.

Committee Chair Ruiz observed that the medical centers provide profit to the University. Ms. Zubov specified that the State 19900 funds are at risk; medical center revenues have remained at the same level.

PricewaterhouseCoopers representative Joan Murphy advised that the Committee should keep abreast of high-risk audits and have an understanding of which work was not being done. The University could leave some lower-risk work not completed.

Ms. Zubov responded that the UCSF audit plan is risk-based, and that all items in the plan are high-risk items. If the campus does not complete the plan, some high-risk areas are not addressed. The campus' ability to complete its plan depends on turnover and management response.

Mr. Robinson asked how the Committee could find out about projects or areas omitted from the audit plan. Ms. Vacca responded that this information was not being provided.

Ms. Croughan observed that the reality of understaffing at UCSF also affects the daily life of faculty. After a faculty member is notified of an upcoming audit, it may take six months before the audit occurs. This can cause inconvenience and time loss because

records have to be assembled more than once. She also expressed a significant concern regarding the campus Controller's Office. In one case, $1 million of an NIH contract was lost because ledgers and invoices were not properly prepared by the Controller's Office.

Vice President Broome noted that UCSF has a new campus Controller who reports to her. She expressed the wish for stronger staffing in the UCSF Controller function. Although the campus has received resources, recruitment for the Controller and positions reporting to the Controller has been difficult.

Ms. Zubov stated that the difficulty in attracting talented candidates was primarily due to the insufficient salary being offered.

Committee Chair Ruiz stated that he would discuss this situation with President Yudof. He also expressed confidence in the ability of the new Senior Vice President – Health Sciences and Services.

Ms. Vacca observed that some of the campus' concerns were broader leadership issues, encompassing more than the health arena.

Referring to the material provided by Ms. Zubov, Regent-designate Stovitz noted that one audit staff member had a health care compliance certification. He cited the enormous campus commitment to patient care and asked if enough staff members had the necessary experience in these disciplines and specialties.

Ms. Zubov responded that the certified individual is an associate director. Younger staff members are being trained in this area. She noted that health care compliance is a highly specialized field for which recruitment is difficult. Employees sometimes receive training at the University and then move on to higher-paying positions outside UC.

6.   **ETHICS AND COMPLIANCE PROGRAM UPDATE**

[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.]

Chief Compliance and Audit Officer Vacca informed the Committee that she would provide a detailed report on ethics and compliance activities during the last eight months at the May meeting. She presented material on efforts at the medical centers regarding compliance with mandatory anesthesia services procedures and documentation. She briefly reported on the first systemwide risk council meeting, which she described as productive, with substantial discussion and communication among the campuses.

The meeting adjourned at 1:35 p.m.

Attest:

Secretary and Chief of Staff