

The Regents of the University of California

**COMMITTEE ON COMPLIANCE AND AUDIT**

July 15, 2010

A meeting of the Committee on Compliance and Audit was held on the above date at UCSF–Mission Bay Community Center, San Francisco.

Members present: Regents Cheng, Hime, Island, Makarechian, Ruiz, and Zettel; Ex officio member Gould; Advisory member Simmons

In attendance: Regents Blum, DeFreece, De La Peña, Johnson, Kieffer, Lansing, Lozano, Maldonado, Marcus, O’Connell, Reiss, Schilling, Varner, Wachter, and Yudof, Regents-designate Hallett, Mireles, and Pelliccioni, Faculty Representative Powell, Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, Chief Compliance and Audit Officer Vacca, Provost Pitts, Executive Vice Presidents Brostrom and Taylor, Senior Vice President Stobo, Vice Presidents Beckwith, Duckett, Lenz, and Sakaki, Chancellors Block, Blumenthal, Drake, Fox, Kang, Katehi, White, and Yang, and Recording Secretary Johns

The meeting convened at 10:00 a.m. with Committee Chair Ruiz presiding.

**1. APPROVAL OF MINUTES OF PREVIOUS MEETING**

Upon motion duly made and seconded, the minutes of the meeting of March 10, 2010 were approved.

**2. ANNUAL REPORT ON INTERNAL AUDIT PLAN FOR 2010-11**

The Senior Vice President and Chief Compliance and Audit Officer recommended approval of the Annual Report on Internal Audit Plan for 2010-2011.

[Background material was mailed to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Chief Compliance and Audit Officer Vacca highlighted key points of the University’s Internal Audit Plan for 2010-11. The current environment of financial challenges and resource constraints can lead to inadequate audit controls. UC internal auditors have been striving during the past year to address the most significant areas of risk on the campuses to ensure that controls are maintained. Ms. Vacca outlined the Plan’s risk assessment process for 2010-11. The internal audit program works with management to ensure that campus priorities are identified.

Key risk areas have been identified for the campuses and for UC operations in general. The University also recognizes and monitors day-to-day processes which might not be considered high priorities.

The Plan provides for an increase in advisory service hours to assist management in addressing internal control issues in a restructured and constrained budget environment. This includes work with management before controls are put in place; auditors can provide helpful advice in this area. The Plan affords flexibility, with over 13,000 hours provided for audit topics to be determined based on local or systemwide priorities. As an example, one priority is outside compensated professional activities, for which a systemwide audit has been carried out. The Plan contains nearly 8,000 hours for audit follow-up on corrective actions. This represents an increase in hours, motivated by the wish to ensure that issues identified by auditors are resolved in spite of current resource constraints. The Plan budgets almost 2,000 hours for the University's compliance program. Ms. Vacca called attention to a shift in outlook for the internal audit program, which is seeking to reduce its involvement in investigations that can appropriately be handled by management. The University aims to identify the appropriate resources for investigations, not automatically assigning investigations to the internal audit program.

Ms. Vacca briefly presented the allocation of direct hours for the various services provided by the internal audit program – planned audits, audit support, investigations, advisory services, audit follow-up, and supplemental audits – as well as the distribution of planned audit projects, which was determined based on extensive consultation.

Regent Zettel asked if the internal audit program provides a timeline for corrective action after it has identified a weakness. Ms. Vacca responded that internal audit and management work together to determine the most appropriate corrective action to address a problem. Management decides on a timeline and internal audit monitors completion of the corrective action. Sometimes corrective actions cannot be completed in a timely manner because of delayed system implementation or due to other variables beyond the control of management.

Regent Zettel asked if the University tracks corrective actions which are past due. Ms. Vacca responded in the affirmative. In June, the University implemented a database which tracks the timing and resolution of corrective actions and allows identification of high risk audit findings which have not been addressed. A persistent delay will be brought to the attention of the relevant individuals in the management structure, including chancellors, the Committee, and the President.

Upon motion duly made and seconded, the Committee approved the Senior Vice President and Chief Compliance and Audit Officer's recommendation.

### 3. **ETHICS AND COMPLIANCE PLAN FOR 2010-11**

The Senior Vice President and Chief Compliance and Audit Officer recommended approval of the Ethics and Compliance Plan for 2010-11.

[Background material was mailed to Regents in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Chief Compliance and Audit Officer Vacca noted that the report distributed to the Regents provides a high-level overview. It identifies seven key risk areas related to ethics and compliance: campus safety, an area which includes issues related to acts of intolerance; government funds reporting requirements accuracy; data privacy and security; research-related compliance risks; the culture of ethics and compliance; investigation practices; and health care reform. Ms. Vacca noted that the University is initiating a data privacy and security steering committee which will involve campus leadership. She acknowledged President Yudof's support for cultural change at UC regarding ethics and compliance.

Regent Zettel requested that information be presented at a future meeting on compliance in research and on the effectiveness of new software applications which track completion times for corrective actions.

Regent Makarechian referred to the University's efforts to consolidate various functions for cost-saving purposes. He expressed concern that when information is consolidated, information security breaches could be more damaging. Ms. Vacca responded that control mechanisms are more effective in standardized systems than in fragmented systems. While there is a risk in using shared, common databases, the risk is greater for fragmented systems. With single systems, resources can be dedicated to ensure that control mechanisms are in place. Chief Financial Officer Taylor added that the University will consider storing information offsite as it standardizes its systems. This is not a core competency of UC, and it may be preferable to turn to outside professionals.

In response to a question by Regent Makarechian, Mr. Taylor expressed his view that it would be preferable for the University in the long term to warehouse data centrally. Currently there are many individual computer servers throughout the UC system which cannot be secured.

Regent Zettel asked if the University has a policy regarding employees who have access to patient information at the medical centers and regarding best practices in this area. Ms. Vacca responded that the University is now reviewing its existing policies and developing new policies regarding the Health Insurance Portability and Accountability Act, which will be followed by training and implementation.

Committee Chair Ruiz emphasized the importance of compliance and of culture change at UC.

Upon motion duly made and seconded, the Committee approved the Senior Vice President and Chief Compliance and Audit Officer's recommendation.

#### 4. **SUMMARY OF RESULTS OF THE UNIVERSITY'S 2009 A-133 AUDIT**

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

Chief Financial Officer Taylor introduced the item, which concerns an audit performed in accordance with U.S. Office of Management and Budget (OMB) Circular A-133 for the fiscal year ending June 30, 2009.

PricewaterhouseCoopers representative Joan Murphy explained that the main purpose of the A-133 audit is the testing of the University's compliance with federal award requirements. The report, almost 300 pages in length, contains three auditor reports. The first is the opinion on UC financial statements, similar to the opinion issued regarding the statements in the University's annual financial report. The language used is somewhat different because this opinion references government auditing standards as well as generally accepted auditing standards. The second auditor report is the review of compliance and internal controls over financial reporting. The third auditor report concerns compliance and internal controls over compliance in regard to the administration of federal awards.

In carrying out this audit, PricewaterhouseCoopers visited four campuses, selected a representative sample of federal awards, and tested all the compliance requirements for those awards which are prescribed by the OMB Circular A-133.

In fiscal year 2009, the University's total federal award expenditures were \$3.7 billion. The research and development expenditures, at \$2.9 billion, account for the bulk of this amount. Student financial aid expenditures were \$259 million. A new development in fiscal year 2009 was State Stabilization Fund expenditures related to the American Recovery and Reinvestment Act, at \$269 million. These were the three key areas in which the University received federal awards.

Ms. Murphy briefly summarized the audit results. PricewaterhouseCoopers has issued an unqualified opinion on the University's compliance with requirements applicable to its major federal award programs. The audit discovered no material weaknesses in internal controls and no material noncompliance with federal award requirements. There were four findings, none of which involved any questioned costs. Ms. Murphy explained that compliance exceptions may or may not involve questioned costs. The federal government requires that the auditor report any exceptions that might result in a questioned cost above \$10,000, a low threshold. None of the audit findings involved significant deficiencies or material weaknesses.

The nature of the audit findings in fiscal year 2009 was consistent with past results. There were untimely cost transfers and late returns of Title IV financial aid funds. The latter situation arises when students who receive financial aid withdraw from the University or revert to half-time enrollment. Monies are then owed back to the federal government and must be returned within a certain number of days. Another audit finding concerned late

reporting of student status changes. The University uses an outside service to provide this information to the U.S. Department of Education. Finally, there was a finding of unconfirmed registration with Selective Service related to a particular scholarship program.

Ms. Murphy provided more detail regarding the audit finding of untimely cost transfers. She noted that the National Institutes of Health (NIH) explicitly require that an error be corrected within 90 days after it is discovered. An example of such an error would be if a particular expense was charged to a grant inappropriately. NIH is the only federal agency that has prescribed this kind of action. The University's own policy stipulates that an error must be corrected within 120 days after the end of the month in which the relevant charge was incurred. UC policy is more stringent than NIH policy in this regard, and PricewaterhouseCoopers applies the stricter UC standard in its audit. Out of 120 items tested, there were ten exceptions, or about an eight percent error rate. This is an improvement over the 14 percent error rate the previous year, and UC has experienced improvement over the past several years. The exceptions have occurred at various UC locations. Ms. Murphy observed that untimely cost transfers are a common problem for universities and institutions that receive federal research awards. Associate Vice President and Systemwide Controller Peggy Arrivas informed the Committee that in response to this finding, the campuses continue to remind principal investigators who receive federal awards and relevant department heads to conduct reviews in a timely manner. The error rate has decreased, and the University will continue to monitor this situation and continue to reduce the error rate. Ms. Murphy added that UC has taken stringent steps in 2009 and stated that this accounts for the reduction in cost transfer error rates.

Ms. Murphy next discussed audit findings regarding student financial aid. Out of 60 returns of Title IV financial aid funds tested, two were found to be late, by 54 days and 98 days respectively. Compliance with student financial aid rules is onerous due to the volume of students, the variety of programs and aid students can receive, and the necessary monitoring surrounding receipt of aid. She noted again that there were cases of late reporting of student status changes. She commented on one unusual case. When a male student applies for financial aid, he must register with Selective Service. The University has procedures to ensure that the registration has taken place. In one instance this was overlooked, but the situation has been corrected. Manager Jorge Ohy added that in addition to technology and process improvement actions, the University is focusing effort on communications between campus departments and registrars' offices. A student may report to his or her department about a change in status but not notify the campus registrar. Improvement in communication should improve audit findings regarding late return of financial aid funds and late status reporting.

Regent Makarechian asked about the differences between UC and NIH policy referred to earlier. Ms. Murphy responded that UC policy allows 120 days after the end of the month when a charge is incurred for the cost to be transferred appropriately. NIH allows 90 days after the discovery of an error in charging an expense. UC policy provides a shorter time period for correction.

Regent Makarechian referred to information contained in the report and asked about an additional \$41 million liability due to the implementation of Governmental Accounting Standards Board (GASB) Statement 49. He asked who was responsible for meeting this cost. Ms. Murphy responded that GASB 49 requires that all entities reporting to GASB assess whether they have any outstanding pollution remediation liabilities. The main UC locations affected by GASB 49 were the Davis and Berkeley campuses. All UC locations determine whether they have a physical plant or other site requiring clean-up, such as asbestos removal. GASB 49 implementation is not related to the federal government's Superfund program to clean up hazardous waste sites.

Regent Makarechian asked why third-party liability regarding UC student housing must be reported in the University's financial statements. Ms. Arrivas responded that these liabilities are recorded in UC's financial statements because the University meets certain criteria related to its control over those outside organizations or third parties and to its debt responsibility.

In response to a question from Regent Makarechian, Ms. Arrivas responded that these liabilities are the stand-alone liabilities of student housing organizations. If student housing organizations are unable to pay, however, the University has certain responsibilities related to these liabilities; therefore they are included in UC's financial statements.

Committee Chair Ruiz underscored that the University is a large organization which is improving its controls, guidelines, and policies. If the University were a business, it would likely be the largest corporation in California.

The meeting adjourned at 10:35 a.m.

Attest:

Secretary and Chief of Staff