

The Regents of the University of California

**COMMITTEE ON COMPLIANCE AND AUDIT**

March 15, 2011

The Committee on Compliance and Audit met on the above date at UCSF–Mission Bay Community Center, San Francisco.

Members Present: Regents Hime, Island, Makarechian, Ruiz, and Zettel; Advisory members Pelliccioni and Simmons

In attendance: Faculty Representative Anderson, Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Compliance and Audit Officer Vacca, Executive Vice President Taylor, and Recording Secretary Johns

The meeting convened at 12:45 p.m. with Committee Chair Ruiz presiding.

1. **PUBLIC COMMENT**

There were no speakers wishing to address the Committee.

2. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

Upon motion duly made and seconded, the minutes of the meeting of January 20, 2011 were approved.

3. **PRESENTATION ON INDUSTRY TRENDS IN HIGHER EDUCATION**

[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.]

Mr. John Mattie, lead higher education industry partner for PricewaterhouseCoopers (PwC), discussed industry trends in higher education, outlining a number of topics. He observed that there was a unique convergence of significant financial, political, and compliance and accountability issues at this time for institutional boards.

One topic currently receiving attention is student well-being. Colleges and universities are concerned about at-risk students. At this time, one-third of U.S. undergraduates have received some form of counseling before beginning college. Institutions have generally been able to identify students who need support, but ensuring that they receive the proper level of support has been more challenging.

Affordability and student access are other areas of concern. A strategic question for the University is what kind of students it wants to attract five, ten, or 15 years in the future, and what kind of academic programs and resources should be in place to serve this future

student body. There are national debates about whether the undergraduate campus-based educational system will become obsolete.

Public and private educational institutions are struggling with the issue of enhancing services while reducing administrative costs, and are considering measures such as shared service models and more efficient information technology delivery. Mr. Mattie observed that implementation in this area has lagged behind innovative and strategic thinking. Many of the concepts only now being explored by higher education institutions have been current in the commercial world for many years.

Mr. Mattie then discussed research funding and administration, noting that federal support for research was projected to increase by 6.5 percent in the next few years, in contrast to recent years, when the growth in research funding was below three percent; however, the level of federal funding was still uncertain and dependent on budget negotiations in Washington. Many states have reduced their appropriations for higher education, and there have not been indications that the federal government might provide support to replace funding at the state level. While there is a proposed increase in federal funding for research, this is accompanied by increased audit activity. Mr. Mattie noted that a certain amount of federal stimulus funding was earmarked for auditing.

Many universities are becoming aware of the extent to which post-retirement obligations will strain their cash budgets in the future. Faculty members are displeased by the fact that a greater percentage of their research awards will be used to support indirect costs in the area of fringe benefit rate increases.

Information security and privacy present a significant reputational risk for universities, and monitoring sensitive data in an environment of open access is a challenge. Mr. Mattie reported that institutions view this as an area which can impair the ability to pursue strategic plans. He stated his view that there is no current national best practice in information security and privacy, and that there has not been much progress in developing one. Computing is ubiquitous and the information technology environment changes quickly. This matter would remain a concern for higher education institutions for some time to come.

Mr. Mattie stated that the University has accomplished a great deal in the areas of governance, risk, and compliance. Institutions are paying significant attention to enterprise risk, not only compliance risk but also strategic risk, which he defined as the risk of missing opportunities by not moving quickly enough. He expressed his view that UC is well positioned in this regard.

Higher education institutions are examining strategies for global engagement in education and research, including infrastructure and compliance issues. Many institutions are considering the establishment of a separate administrative structure for global operations, following the model of corporations with international operations.

Institutions are seeking to increase revenue through fundraising, technology transfer, and alliances and affiliations. Mr. Mattie noted that the current level of activity surrounding alliances and affiliations was higher than it had been over the past 20 years. He emphasized that institutions must understand the due diligence involved in partnering with other organizations.

Mr. Mattie presented a number of issues of concern regarding academic medical centers, such as clinical billing and conflict of interest. Medical centers would come under increasing government audit scrutiny.

Finally, sustainability is an important issue for universities. Mr. Mattie noted that there is still uncertainty regarding how to measure the benefits of sustainability or return on investment.

Regent Makarechian asked about the Committee's role in relation to the topics just outlined, and about the University's performance relative to other institutions. Chief Financial Officer Taylor responded that UC performance in the areas discussed in the presentation varied; performance in some areas was excellent, while it needed improvement in others. Mr. Mattie added that PwC has discussed the role of the Committee at previous meetings. The issues in the presentation were strategic issues which present both risk and opportunity. The Committee should ensure that these topics are being appropriately reviewed by other Regental Committees and that UC management is addressing risk appropriately. Mr. Taylor recalled that the Committee receives an annual report on risk services, which outlines UC performance in a variety of these categories and endeavors to provide the Committee with a full survey of the risks faced by the University.

Regent Makarechian asked if the University intended to engage PwC consultants to address any of the issues raised in the presentation. Mr. Taylor responded that the administration is trying to reduce spending on consultants. It would consider engaging a consultant if an appropriate situation or opportunity arose, in which case the matter would come before the Committee.

Regent Makarechian asked if the University would engage a consultant to address the issue of UC's recovery rate for indirect costs, which is lower than that of some other institutions and represents a potential for increased revenue. Mr. Taylor responded that the University has not engaged a lead consultant to address this issue. Members of the administration, including Associate Vice President and Systemwide Controller Arrivas, are working to present an effective case for a rate increase to federal officials.

Regent-designate Pelliccioni asked if the risk environment surrounding health care issues for the University has changed due to federal stimulus funding, increased government audits, and new interest on the part of the Office of Inspector General and others. Mr. Mattie responded in the affirmative. He anticipated that there would be a high level of audit scrutiny by federal agencies in the coming 18 to 36 months, particularly in the areas of clinical research and reimbursement. Mr. Taylor observed that the University

also faces political risk. He reported that some represented employee groups have asked elected officials to seek audits of the University which are burdensome and use up a great deal of staff time. There have been three such audits in the past several months.

Committee Chair Ruiz expressed concern about the multiple challenges facing the University and how this situation would affect students. The University's practice of shared governance would help in identifying and acting on important issues.

#### 4. **REPORT ON PRIVACY AND SECURITY**

Associate Vice President and Chief Information Officer Ernst recalled that the University has carried out an information security self-assessment for the past three years, comparing security practices to policy. An internal audit of compliance with the University's electronic information security policy, UC Business and Finance Bulletin IS-3, was scheduled to begin soon, in the fourth quarter of fiscal year 2010-11.

Over the past six months, the University evaluated information security training programs available at other universities and in industry and developed a Request for Proposals. The University was now about to engage a firm to implement an information security training program for UC. Mr. Ernst anticipated that this web-based program would be deployed by June or July of the current year. Initially, the training would be offered on a voluntary basis to encourage widespread participation. This would allow time to make adjustments or enhancements. At a later point, the training would become mandatory systemwide.

The UC Privacy and Information Security Initiative, currently under way, is actively examining relevant policy and best practices. This effort attempts to achieve a balance between UC tradition and the best existing data protection techniques. A systemwide group has been charged by President Yudof to develop recommendations by 2012 on policy changes and guidelines on information security to ensure full compliance with the law and best practices. The group is chaired by UC Santa Barbara Executive Vice Chancellor Gene Lucas.

As part of its compliance with the Americans with Disabilities Act (ADA), the University is examining electronic accessibility. Information technology is a pervasive tool in the U.S. to which individuals with disabilities must have equal access. A systemwide group with representatives from the campuses, formed about six months previously, has been reviewing practices at other institutions, particularly the California State University, and developing programs to ensure that information technology at UC is accessible to all students, faculty, and staff.

Mr. Ernst reported that he would like to reinvigorate the UC Records Management Committee, which has been moribund for a number of years. This committee includes campus records managers who are responsible for records retention schedules. The University receives and maintains voluminous amounts of data in paper and electronic form; in many cases records are retained longer than necessary or appropriate. This group would consider revision of the University's records management policies.

Mr. Ernst then discussed information security breaches. There were fewer security incidents in 2010 than in 2009, which might be due to an improvement in elimination and encryption of sensitive information. The University has also communicated effectively with employees about the need for greater care regarding sensitive information. Nevertheless, Mr. Ernst emphasized that the University must make a special effort in encryption and control techniques, given the large number of UC mobile devices in use. The University is examining ways to reduce data storage on laptop computers and mobile devices and to increase storage on servers. This would prevent the theft of data from mobile devices. A pilot effort in this area would take place at the Office of the President in the coming months.

Systemwide Privacy Officer Russell Opland reported on breach response preparedness efforts. Following incidents in 2009 and with some external guidance, a large multidisciplinary group worked for almost a year on development of a systemwide privacy and information security incident response plan. Prior to this effort, each campus had developed its own plan. The incident response plan was put into effect in the last part of 2010; campuses subscribe and contribute to the plan.

The University has executed three systemwide master services agreements with companies that provide breach response services. The services provided would depend on the nature of incidents and on campus needs. The University has secured preferential pricing for mailing of notification letters, call centers, credit monitoring services, and assistance in cases of actual identity theft.

Regarding some of the risks mentioned earlier by Mr. Ernst, Mr. Opland called attention to encryption activities at the campuses and medical centers, and the development of secure web applications to address potential server breaches.

Mr. Opland recalled that in 2009, as part of the federal American Recovery and Reinvestment Act (ARRA), the Health Information Technology for Economic and Clinical Health (HITECH) Act revised and updated Health Insurance Portability and Accountability Act (HIPAA) privacy and security regulations, including breach response, and introduced higher penalties. The University has instituted revised UC systemwide HIPAA policies and campuses have conducted training for affected employees.

Mr. Opland called attention to two recent enforcement actions by the U.S. Department of Health and Human Services (HHS), through its Office for Civil Rights. In the first case, an employee of Massachusetts General Hospital took home patient information for 192 patients and left it on the subway. Massachusetts General was fined \$1 million in the first action taken under the new HITECH civil monetary penalties. In addition to the fine, the resolution agreement required that Massachusetts General develop new policies, train staff, and report to HHS every six months over the next three years. Although this incident was limited to paper records, Massachusetts General was required to develop policies regarding encryption.

The second enforcement action involved Cignet Health, which was fined \$4.3 million under HIPAA for failure to provide patients with timely access to and copies of medical records. The fine included \$1 million for actual offenses and \$3.3 million for failure to cooperate with the HHS investigation.

The “Red Flags Rule” is a Federal Trade Commission regulation of 2009 which requires implementation of “red flag” procedures to detect possible identity theft. The Red Flag Program Clarification Act of 2010 revised regulation criteria. Campuses are being informed of these changes but are being advised to continue with procedures they had implemented in 2009. Finally, Mr. Opland reported that, outside the HIPAA context, UC has revised data security language in all its contracts.

Regent Makarechian asked about the University’s security breach insurance relative to other institutions. PricewaterhouseCoopers representative John Mattie responded that UC belongs to a minority of institutions with this kind of insurance. Chief Financial Officer Taylor reported that the University has begun to evaluate pricing for the coming year to determine whether or not to continue the current insurance policy. Other insurers have entered the market, an encouraging development which might lead to better pricing. Mr. Taylor emphasized that this insurance policy encourages best practices at the campuses and medical centers. Access to insurance is provided by adhering to security standards.

Regent Makarechian asked how the University can be assured that, after a breach occurs, there is not further unauthorized access to information. Mr. Ernst responded that forensic analysis can determine if data elements have been accessed, but that the results of such analysis are often inconclusive. In some cases the University is obligated to inform individuals that their data might have been compromised, even when the University is not entirely certain of this.

Regent Makarechian asked if there were periodic audits regarding data security. Chief Compliance and Audit Officer Vacca responded that the campuses’ internal audit programs carry out privacy and security audits. There are ongoing audits at the medical centers in response to HIPAA and HITECH Act regulations.

Regent Zettel emphasized that the threat of unauthorized access to the University’s electronic information network is ongoing, and the importance of correct handling of patient information. She noted that a recent data security breach at Health Net involved the misplacement of a mobile hard drive; data for as many as two million people could have been compromised. She asked if the University uses portable hard drives with medical information, if such hard drives are encrypted, and if such an incident could occur at UC. Mr. Opland responded that the Health Net incident has affected 53,494 current and former UC members. In some cases, compromised data included Social Security numbers and financial information. However, he stated his view that the likelihood of these data being accessed and used was remote. He confirmed that there are many hard drives with patient information throughout the University’s academic medical centers; not every hard drive is encrypted. Regulations require that the University

conduct risk assessment, and, based on the vulnerability or exposure of a particular system, determine whether particular files require encryption or not. There is a multi-leveled system of defenses in place to protect patient information. If data are not encrypted, there are other layers of defense protecting them.

Regent Zettel asked if the adoption of electronic medical records at UC health centers would help in responding to records requests by patients. She noted the risk of litigation when medical institutions do not produce records in a timely manner. Mr. Opland responded that during the current transitional period, a significant amount of patient records would still be on paper. Prospectively, the transition to electronic records would be an improvement, although there can be challenges in making information available to patients in an electronic format.

Regent Makarechian referred to the risk that a University hard drive might be stolen and physically removed. He asked why every hard drive would not be encrypted. Mr. Opland responded that whether or not a hard drive is encrypted depends on the location of the hard drive and the type of data stored on it. As an example, the San Diego Supercomputer Center is physically very secure, with controlled access. Mr. Ernst observed that some hard drives are under such significant levels of protection that encryption would not be worthwhile or add value. The more portable a device is or the more susceptible it is to access, the greater the need for encryption. Mr. Opland added that in the area of health care, most of the University's large information systems are purchased from outside vendors. The University may not apply encryption to vendors' proprietary products. The use of a magnetic resonance imaging (MRI) machine with a personal computer to view images is regulated by the U.S. Food and Drug Administration. The University may not encrypt these data; this requires the vendor's intervention.

Faculty Representative Anderson asked if Health Net or UC has notified UC employees whose information might have been compromised. Mr. Opland responded that Health Net has begun mailing notification letters to the affected individuals. UC benefits personnel systemwide have been informed. Questions are being directed to a breach response vendor retained by Health Net.

Committee Chair Ruiz remarked on the magnitude of the Health Net breach and the related financial risk. He emphasized that the University must act more quickly to prevent such risks and that the Committee must ensure that there are no obstacles or delays hindering this effort.

The Committee recessed at 1:50 p.m.

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The Committee reconvened at 2:15 p.m. with Committee Chair Ruiz presiding.

Members Present: Regents Hime, Island, Makarechian, Ruiz, and Zettel; Advisory members Pelliccioni and Simmons

In attendance: Faculty Representative Anderson, Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Compliance and Audit Officer Vacca, Executive Vice President Taylor, and Recording Secretary Johns

**5. APPOINTMENT OF THE REGENTS' EXTERNAL AUDITOR**

The President recommended that the Regents' contract with the current external auditor, PricewaterhouseCoopers, be continued for an additional two-year period, commencing with the fiscal year 2012 annual 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 explained that the current item proposed to extend the contract with the Regents' external auditor, PricewaterhouseCoopers (PwC), for another two years. In return, the University would receive a 15 percent fee reduction. At the end of the extension period there would be a Request for Proposals for the UC contract.

Regent Zettel requested clarification regarding the fee structure for the campus foundations. Associate Vice President and Systemwide Controller Arrivas responded that the fees for the campus foundations are negotiated directly with the foundations, over and above the \$3.8 million PwC audit cost. PwC has offered a fee reduction for some foundations. Collectively, the audit cost for the campus foundations is approximately \$800,000.

Regent Zettel asked why reduced fees were offered for some but not all campus foundations. Ms. Arrivas responded that PwC has proposed reductions for foundations which participate in the investment pools managed by the Office of the President, due to the economy of scale; these investments are audited as a pool as opposed to individual securities within their own portfolios. Mr. Taylor observed that previously, the University required that the campus foundations engage PwC, but did not negotiate on their behalf. The University is now negotiating on behalf of the campus foundations in order to achieve cost savings.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board.

**6. APPROVAL OF EXTERNAL AUDIT PLAN FOR THE YEAR ENDING JUNE 30, 2011**

The President recommended that the scope of the external audit plan of the University for the year ending June 30, 2011, as shown in Attachment 1, and the fees shown in Attachments 2 and 3, be approved.



[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.]

PricewaterhouseCoopers (PwC) representative Joan Murphy presented PwC's audit plan for the year ending June 30, 2011. She began her presentation by outlining the audit service deliverables. PwC delivers a number of reports in connection with its audit of the University, including opinions on UC's consolidated financial statements, stand-alone audit opinions for the financial statements of the five medical centers, and opinions on the employee benefit and retirement plans. PwC performs agreed-upon procedures regarding certain deferred compensation programs. PwC provides internal control recommendations to the chancellors; if these recommendations are significant or indicate a trend, this will be included in the communication to the Regents. PwC performs procedures related to the Mortgage Origination Program and to National Collegiate Athletic Association (NCAA) programs. The latter procedures are concerned with the University's compliance with NCAA financial reporting requirements. Ms. Murphy observed that there has been an increase in the number of debt offerings made by the University in recent years. PwC is required to review these offerings and the audit includes an opinion on them.

Regarding PwC's interaction with the UC internal audit program, Ms. Murphy explained that PwC does not make direct use of UC internal audit. PwC reviews campus internal audit reports for the year, campus risk assessment, and the campus audit plans to ensure that PwC's work complements campus efforts.

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. PwC employs actuaries to develop estimates for UC pension benefit accruals and post-retirement health benefit obligations, a significant part of the financial statements. Another area of focus is the valuation and disclosure of investments. A team of PwC investment management specialists produce the audit for the Office of the Treasurer. A further area of focus is accounting for lease-type arrangements, which can be very complex.

PwC representative Michael MacBryde described the complexity of the revenue cycle at the UC medical centers and how this affects the auditing process. Key issues for these audit opinions are the revenue cycle and valuations.

Ms. Murphy then outlined some other audit considerations. In fiscal year 2010, as in earlier years, there was concern that the University might experience some deterioration in internal controls, given increasing resource constraints. PwC did not observe any deterioration in 2008; there was a small degree of deterioration in 2009. There was more deterioration in 2010 in evidencing and documentation of controls as they are performed. PwC reports control deficiencies to the campuses; any significant deficiencies are reported to the Regents. Ms. Murphy also noted that the University receives American Recovery and Reinvestment Act (ARRA) funding in a number of forms. These funding

programs are included in PwC's A-133 audit to ensure that the University complies with federal requirements, as is the case with any other federal award.

As part of the Health Information Technology for Economic and Clinical Health (HITECH) Act, the University will be eligible for incentive payments for implementation of electronic health records, if it demonstrates meaningful use of such records. Mr. MacBryde reported that the accounting for these payments is still being developed; PwC would monitor this situation. UCLA and UC San Francisco are embarking on significant information technology implementation with regard to electronic health records. This would require accounting for payments to external vendors and internal costs.

Ms. Murphy anticipated that there would not be significant changes to the University's financial statements this year as a result of new pronouncements by the Governmental Accounting Standards Board (GASB). She expressed satisfaction that UC has generally prepared itself a few years in advance of the implementation of new GASB standards. Chief Financial Officer Taylor reported that Associate Vice President and Systemwide Controller Arrivas has been appointed to the National Association of College and University Business Officers accounting task force, which meets regularly with GASB. Thus UC has the opportunity to engage with and present its views to GASB about potential future changes to accounting standards.

Ms. Murphy presented a list of key accounts in the University's financial statements which present significant risk, either due to dollar amount or to estimates in judgment involved, and which therefore receive greater attention from PwC.

Mr. MacBryde referred to concerns expressed earlier in the meeting about protected health information. PwC wishes to avoid including this information in its databases. When PwC tests revenue cycles at the medical centers, it does not gather any protected health information. Ms. Murphy added that PwC follows the same practice in its benefit plan audits, during which it has access to payroll records and Social Security information. PwC does not collect this information.

Ms. Murphy explained the concept of materiality, which helps determine the focus and extent of the financial statement audit as well as the threshold for evaluation of errors. PwC uses different measures of materiality for its various audits. At the overall financial statement level, the materiality threshold is one percent of total operating expenses. This is PwC's highest materiality threshold. For asset-based benefit plans, the threshold is one percent of net assets; Ms. Murphy deemed this to be a fairly low threshold. For the medical centers, the materiality threshold is one percent of total operating revenues. For the health and welfare benefit plans, which are driven by revenue and expense, the threshold is from one to three percent of revenue.

Ms. Murphy briefly discussed the PwC engagement team, emphasizing its consistency and continuity.

In response to a question by Regent Zettel, Mr. MacBryde explained that he is currently responsible for the audits at the UC Davis and UCLA medical centers. Another PwC partner, Ray Vicks, is responsible for the audits at the UCSF, UC Irvine, and UC San Diego medical centers. Ms. Murphy stated her view that, for greater efficiency and effectiveness, it is preferable for an engagement team to return to the same site. The campuses and medical centers differ from one another, and it is desirable for audit teams to develop a rapport with and knowledge of these institutions.

Regent Zettel suggested that it would be prudent to shift some personnel every few years. Ms. Murphy responded that PwC does this. PwC has 15 teams, not including the teams which audit the campus foundations. About 120 PwC staff work on the UC audit statewide. They are moved to different sites to gain better knowledge of University operations. At the same time, Ms. Murphy emphasized that PwC does not wish to compromise its knowledge of the institution. Mr. MacBryde noted that PwC's approach to the medical center audits includes knowledge sharing. The teams from the different locations discuss their work with one another, sharing knowledge and best practices.

Ms. Arrivas explained that Attachment 2 presented the detail of the audit fees paid in 2009 and 2010 and the proposed fees in 2011. Attachment 3 presented additional fees over and above audit fees, such as campus foundation audits and other audit-related and non-audit services performed by PwC. This information is required to be presented to the Regents annually.

In response to questions by Regent Makarechian, Ms. Arrivas clarified that the University follows GASB standards. The University is currently studying GASB Statement 59; it believes that GASB 59 will not require changes to the University's financial statements. It is also beginning to assess the possible impact of GASB Statements 60 and 61.

Regent Makarechian asked about the University's approach if a revision of financial statements were required under GASB. Ms. Arrivas recalled that the previous year, the University produced a restatement in response to GASB 53, which concerned accounting for derivatives. Certain revisions were made to the 2009 financial statements. These changes were acceptable because the University is implementing a new standard required by GASB.

Regent Makarechian asked if there had been a negative impact on the University's credit rating or penalties related to this restatement. Ms. Arrivas responded in the negative. Ms. Murphy added that, when a new pronouncement goes into effect, GASB anticipates that entities will restate their opening balances. This restatement was mandated.

Regent Makarechian asked about the auditing of bonuses at UC medical centers, payments made by the University for settlements in malpractice cases, and payment denials by insurance companies. He asked how these amounts are accounted for in UC financial statements. Ms. Arrivas responded that the Office of the President could provide these data. She explained that UC's malpractice insurance is pooled in a self-insurance program. The pool of funds is maintained at the Office of the President; claims are paid

from this pool, and the pool is audited by the UC internal audit program. The University engages actuaries to assess the amount of unpaid claims. The medical centers are charged for their pro-rated share.

Regent Makarechian referred to the accounting of charity care versus non-payment by insurance companies and asked if these are treated as one amount at this time. Ms. Arrivas responded in the affirmative, but noted that, in her experience, there are few malpractice claims related to charity care.

Regent Makarechian requested information on the categories of charity care and non-payment of insurance claims as percentages of total revenue. Ms. Arrivas responded that the Office of the President could provide these data.

Committee Chair Ruiz asked if the audit plan included any changes in staffing from the previous year. Ms. Murphy responded that there would be some changes at the manager and staff levels.

Committee Chair Ruiz asked if there would be a reduction in PwC staff and hours compared to the previous year. Ms. Murphy responded that, due to the negotiated fee reduction, PwC would seek to make its audit approach more efficient. She anticipated a marginal reduction of audit hours, perhaps one percent at some locations, noting that this was allowable under PwC's key audit approach.

Committee Chair Ruiz asked about numerous audits requested by the State or federal government, referred to earlier in the meeting by Mr. Taylor, which are time-consuming and costly for the University. Ms. Murphy responded that this activity may be politically driven. Any federal agency has the right to examine federal awards. When UC receives queries from a federal agency regarding an area covered by the A-133 audit, PwC advises that the University remind the agency that the A-133 audit may be responsive to the request. Ms. Arrivas added that, when the University receives such requests, it provides existing audit information to minimize the scope of any new audit that will be required. The University has been able to negotiate the scope of these audits. Chief Compliance and Audit Officer Vacca noted that there were currently seven ongoing detailed audits at the University, affecting numerous departments. One such audit has lasted a year. The University is obligated to respond to these audit requests, which have been costly to UC and the public.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board.

## 7. **REPORT ON INTERNAL AUDIT ACTIVITIES**

[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 Compliance and Audit Officer Vacca reported on internal audit activities. Areas of focus for the past quarter were fraud management, cashiering, conflict of interest and commitment, procurement, and information technology security. Internal audit activities are determined by dynamically changing risks during the fiscal year. She briefly touched on conflict of commitment and conflict of interest issues, which are expected to assume greater importance in higher education institutions.

Systemwide Audit Manager Matthew Hicks outlined the University's process for management corrective actions (MCAs), including the escalation of past due MCAs. Progress continues throughout the year in closing MCAs. Internal audit observations resulting from the MCA process have concerned information technology governance and security, cash controls, and laboratory safety in particular. Ms. Vacca noted that, due to current limited resources and personnel, resolution of MCAs takes longer. She expressed concern about the maintenance of core controls.

Regent-designate Pelliccioni asked about campuses' flexibility in developing audit plans. Ms. Vacca responded that campus audit plans must be approved by campus audit committees and by her office at the Office of the President.

Regent-designate Pelliccioni asked if certain areas might not be routinely audited because campuses believed they did not present sufficient risk. Ms. Vacca responded that she believed that some areas are not audited because they do not reach a level of high risk. The audit plan is risk-based, but also examines low-risk areas to ensure that risk is being managed appropriately.

In response to a question by Regent-designate Pelliccioni, Ms. Vacca confirmed that, if an area had not been examined for three years, it would be included in the audit plan.

## 8. **REPORT ON ETHICS AND COMPLIANCE ACTIVITIES**

Deputy Compliance Officer Lynda Hilliard reported that the compliance program has hired an export control officer. The second compliance and audit educational symposium had just been completed. The two sessions, for the northern and southern campuses, were well attended and covered topics in audit, compliance, and investigations. The compliance program was currently working on its risk assessment and Ms. Hilliard anticipated that a draft compliance plan would be presented at the May meeting. The compliance program was also actively examining two topics: the revisions to the "Red Flags Rule" mentioned in the earlier report on privacy and security, and the University's protocol for responding to Public Records Act requests.

Committee Chair Ruiz stated that he attended the compliance and audit educational symposium and was pleased with the resources provided for compliance and audit staff, and with presentations made by UC executive leaders.

The meeting adjourned at 3:00 p.m.

Attest:

Secretary and Chief of Staff

## Our Service Deliverables

In addition to our audits, we provide advice on emerging accounting and reporting issues and provide certain other services including those listed below. The fees for these services are found in *Attachment I of Action Item for Approval of External Audit Plan for the Year Ending June 30, 2011*. Prior to commencing any services, we are required to obtain preapproval from the Committee, pursuant to the University's preapproval policy for its independent auditor.

<b>Audit Opinions</b>	<ul style="list-style-type: none"> <li>■ Report on the consolidated financial statements of the University of California</li> <li>■ Report on the financial statements of the five Medical Centers</li> <li>■ Report on the University Defined Benefit Retirement Plans financial statements</li> <li>■ Report on the University Retirement Savings Program financial statements</li> <li>■ Report on the University Health and Welfare Program financial statements</li> </ul>
<b>Internal Control Observations</b>	<ul style="list-style-type: none"> <li>■ Report to the Committee on control and process deficiencies and observations, including material weaknesses and significant deficiencies (Regents Letter)</li> <li>■ Reports to the campus Chancellors on control and process deficiencies and observations (Chancellor Letters)</li> </ul>
<b>Additional Reports</b>	<ul style="list-style-type: none"> <li>■ Report on Federal Awards Programs of the University in accordance with OMB Circular A-133</li> <li>■ Report on the special purpose statement of income and expenses of the Revenue Bonds</li> <li>■ Lawrence Berkeley National Laboratory expanded procedures</li> </ul>
<b>Agreed-Upon Procedures</b>	<ul style="list-style-type: none"> <li>■ Agreed-upon Procedures related to the sale of Mortgage Origination Program and Supplemental Home Loan Program loans</li> <li>■ Agreed-upon Procedures related to the 415(m) plans</li> <li>■ Agreed-upon Procedures on Intercollegiate Athletic Departments (NCAA requirements)</li> </ul>

Other Services	<ul style="list-style-type: none"><li>■ Reviews in connection with bond offerings</li><li>■ Accounting consultations and other assistance associated with emerging accounting and reporting issues and complex transactions</li></ul>
Committee Reporting	<ul style="list-style-type: none"><li>■ Audit and communications plan</li><li>■ Results of audits and required communications</li></ul>



**Attachment 2**

**PricewaterhouseCoopers  
Audit Fees**

	<u>Actual 2009</u>	<u>Actual 2010</u>	<u>2011</u>
Core Audit, including expenses			
UC	\$3,913,745	\$4,042,000	\$3,619,000
National Laboratories	<u>68,000</u>	<u>69,400</u>	<u>62,000</u> <sup>(2)</sup>
Sub-total Core Audit Cost	3,981,745	4,111,400	3,681,000
Expanded Scope at the National Laboratory (Berkeley)	<u>130,000</u>	<u>132,600</u>	<u>119,000</u> <sup>(3)</sup>
Total Audit Cost	<u><u>\$4,111,745</u></u>	<u><u>\$4,244,000</u></u>	<u><u>\$3,800,000</u></u> <sup>(1)</sup>

<sup>(1)</sup> For FY11 PwC has agreed to reduce fees by net of 10% over the FY10 fees. After applying the 5% fee increase originally approved by the Regents for FY11, fees were reduced by 15%, resulting in a net reduction of approximately 10% as compared to FY10.

<sup>(2)</sup> Represents minimum scope of work necessary at LBNL to opine on the University of California financial statements.

<sup>(3)</sup> Represents the incremental cost of expanded procedures audit scope at LBNL. Includes out-of-pocket expenses.

### Attachment 3

**PricewaterhouseCoopers  
Audit and Consulting Fees <sup>(1)</sup>  
2009 and 2010**

Year	Core Audit	Other Audits	Audit Related	Consulting	Ratio of Consulting to Core Audit	Ratio of Consulting to Core Audit, other Audit and Audit Related Services
2009	3,981,745 <sup>(1)</sup>	925,038 <sup>(2)</sup>	745,381 <sup>(3)</sup>		-	
2010	4,111,400 <sup>(1)</sup>	920,509 <sup>(2)</sup>	836,595 <sup>(4)</sup>	160,738 <sup>(5)</sup>	4%	3%

<sup>(1)</sup> Fees are generally allocated to the fiscal year under audit for audit services and to the year performed for consulting projects, if any. Ongoing scope changes originating in each year are included in the core audit costs for the following years.

<sup>(2)</sup> Primarily fees related to auditing the campus foundations and ASUCLA.

<sup>(3)</sup> Relates primarily to tax compliance, data privacy and security assessment, transition assessments and the ANR ERM workshop.

<sup>(4)</sup> Relates primarily to tax compliance, LBNL expanded procedures, UCSF compliance attestation engagement, West Village leasing consultation, UCSF MC IT cost review and UCI MC Eclipsys implementation assessment.

<sup>(5)</sup> Relates to Payroll Assessment/Activity Analysis Survey.