

**University of
California
Audit and
Communications
Plan**

*For the year ending June
30, 2008*



February 22, 2008

To The Regents' Committee on Audit
University of California

Dear Committee Members:

We appreciate the opportunity to discuss the University of California's business issues and your expectations of PricewaterhouseCoopers as your independent auditors.

We are pleased to present you our audit plan, which includes our communication strategy, a summary of our mutual understanding between you and others within your organization and PricewaterhouseCoopers, an analysis of key risks, our audit approach, reporting and audit timetable and other matters. Discussion of our plan with you ensures our PricewaterhouseCoopers engagement team members understand your concerns and that we agree on mutual needs and expectations to provide the highest level of service quality. Our approach is responsive to the many changes affecting the University of California.

We fully support the recent change to move the Committee's meetings to an off-cycle schedule thereby allowing for more time to cover relevant topics and issues. We hope to take the opportunity afforded by these meetings to introduce the Committee to our higher education and healthcare industry leaders who can share their views of current issues facing the University and its peer institutions with you.

If you have any questions regarding this plan please contact Joan Murphy, engagement partner, at 415-498-7690.

Yours truly,

PricewaterhouseCoopers LLP

Table of Contents

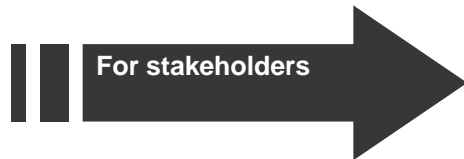
	Page
Our Objectives	1
Communications Plan	2
Developments Affecting your Business	3 - 6
Terms of Engagement	7
Audit Approach	8
Audit Plan: Risk Analysis	9 – 18
Materiality	19
Perspectives on Fraud Risk and Responsibilities	20
Related Parties	21
Reporting Timetable	22
Thought Leadership	23
Engagement Team	24
Appendices:	
PwC Principles and Practices	
Independence	
Corporate Governance: Roles and Practices	
Glossary of Acronyms	

The matters raised in this and other reports that will flow from the audit are only those which have come to our attention arising from, or relevant to, our audit that we believe need to be brought to your attention. They are not a comprehensive record of all the matters arising, and in particular we cannot be held responsible for reporting all risks in your business or all internal control weaknesses. This report has been prepared solely for your use and should not be quoted in whole or in part without our prior written consent. No responsibility to any third party is accepted as the report has not been prepared for, and is not intended for, any other purpose.

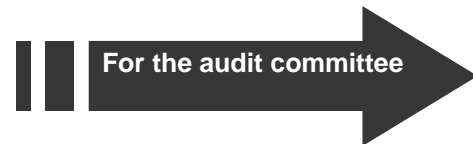
Our Objectives

Audit objectives

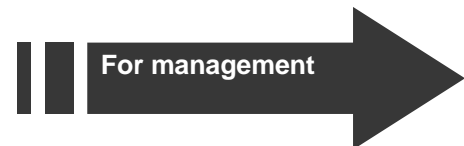
Our audit is directed towards delivering our services at three levels:



- independent opinions and reports that add credibility to financial information released by the University of California
-

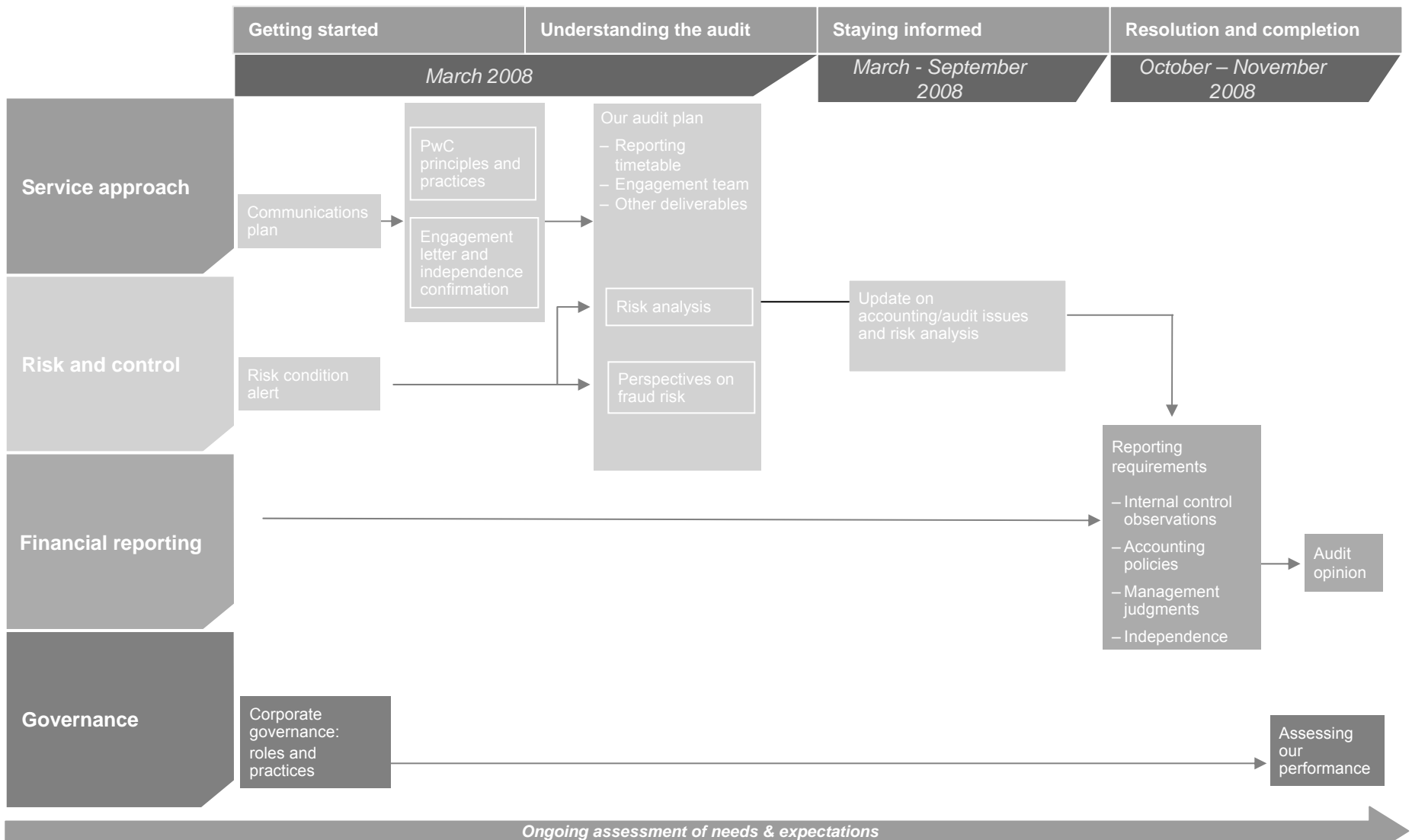


- assistance to The Regents' Committee on Audit in discharging its corporate governance and compliance responsibilities
-



- observations and advice on financial reporting and business issues from senior professionals who have an in-depth understanding of your industry, including sharing experience on industry best practice issues

Communications Plan



Developments Affecting Your Industry

Based upon discussion with management and our understanding of the University of California (the “University”) and the higher education and healthcare industries, we note the following recent developments. As applicable, these matters are considered in developing our audit approach, as discussed in this report:

Regulatory

OIG and A-133 Compliance

The federal government continues to be concerned about issues such as research effort reporting and subawards. Areas of focus include cost transfers, summer salary limits, tracking effort on training grants, policy for timeliness of effort certification and distinction between vendors and sub-recipients. We are also anticipating changes to the 2008 Compliance Supplement (expected to be issued in March 2008) in the areas of program updates and sub-recipient distinctions. In addition, the new AICPA Statement on Auditing Standards No. 112 continues to impact any potential findings discovered during the testing phase of our A-133 audit. We will consider all these developments in our audit, however, we do not expect these changes to have a significant impact on the University.

Developments Affecting Your Industry (continued)

Operational

- As a public institution, there continues to be scrutiny and review of the University's practices and overall financial condition/activities.
- The State of California's announced budget constraints that will impact the University's future operating budget and potentially its current structure of internal controls.
- Expansion and capital needs continue at the medical centers and campuses.
- Operation and management of the Lawrence Livermore National Laboratory was transitioned to the LLNS joint venture effective October 1, 2007.
- Due to the newly formed joint venture at the Lawrence Livermore National Laboratory, changes related to the transfer of employees and related benefits on the UC employee benefit plans have occurred.
- Challenges are faced by the academic medical centers due to federal and state reductions in payments for services and challenges in applying reimbursement regulations. Reimbursements and reserves are always an area of audit emphasis. We plan to continue our review of the reserves for Medicare and Medi-cal, as well as other compliance and intermediary issues.

Developments Affecting Your Industry (continued)

Accounting and Auditing

The following GASB and AICPA pronouncements will have an effect on the University:

- GASB 43 will have a major impact on the financial reporting of the University's postemployment benefit plans and fiduciary fund financial statements and is effective this fiscal year. This statement establishes uniform financial reporting standards for postemployment benefit plans and makes the reporting for these plans more consistent with the approach followed for pension plans.
- GASB 45 will have a major impact on the financial reporting by the University of postemployment benefits offered to employees and retirees. *GASB 45 Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions* covers financial reporting for these benefits by the University. This statement is effective for the year ending June 30, 2008. The requirement to adopt an accrual basis of accounting will result in a significant current expense and the recording of a significant liability upon full adoption to the extent the annual required contribution is not funded. As a result of the adoption of GASB 45, the University has established a trust for any assets set aside to fund the University's postemployment benefit obligations related to campuses and medical centers.
- GASB 49, issued in November 2006, will be effective for the University's fiscal year ending June 30, 2009. GASB No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, requires the University to assess existing pollution remediation liabilities when one of five obligating events takes place. These liabilities should be capitalized based on reasonably estimable amounts, utilizing discounted cash flows and probability weighted assumptions. The University is currently evaluating the effect that GASB No. 49 will have on its financial statements.
- GASB 51, issued in June 2007, will be effective for the University's fiscal year ending June 30, 2010. GASB 51, *Accounting and Financial Reporting for Intangible Assets*, requires capitalization of identifiable intangible assets in the statement of net assets and provides guidance for amortization of intangible assets unless they are considered to have an indefinite useful life. The University is currently evaluating the effect that GASB No. 51 will have on its financial statements

Developments Affecting Your Industry (continued)

Accounting and Auditing (continued)

- In November 2007, the GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. This standard requires the University to record any land or real estate held in the endowment at current fair value instead of at cost. Adoption of this standard is not expected to have a significant impact on the University's financial statements.
- As the investments market continues to experience adverse trends related to the subprime mortgage and credit risk issues, we will consider exposure to the University with regards to the valuation and liquidity of certain of its investments. Securities with previously available public prices may no longer have observable market prices. In this situation, the valuation process becomes subject to judgment and model-based valuation techniques may be required.
- Initially effective during the 2007 fiscal year, AICPA Auditing Standard No. 112, *Communication of Internal Control Related Matters Identified in an Audit*, continues to be a focus for the University. The standard will continue to require evaluation of control deficiencies in order to determine whether the deficiency rises to the level of a significant deficiency or material weakness. Previously identified control deficiencies that have not been addressed will be evaluated to determine if they should be elevated to a significant deficiency or material weakness. Management should continue to be cognizant of the requirements under this standard and evaluate current controls in place.

Terms of Engagement

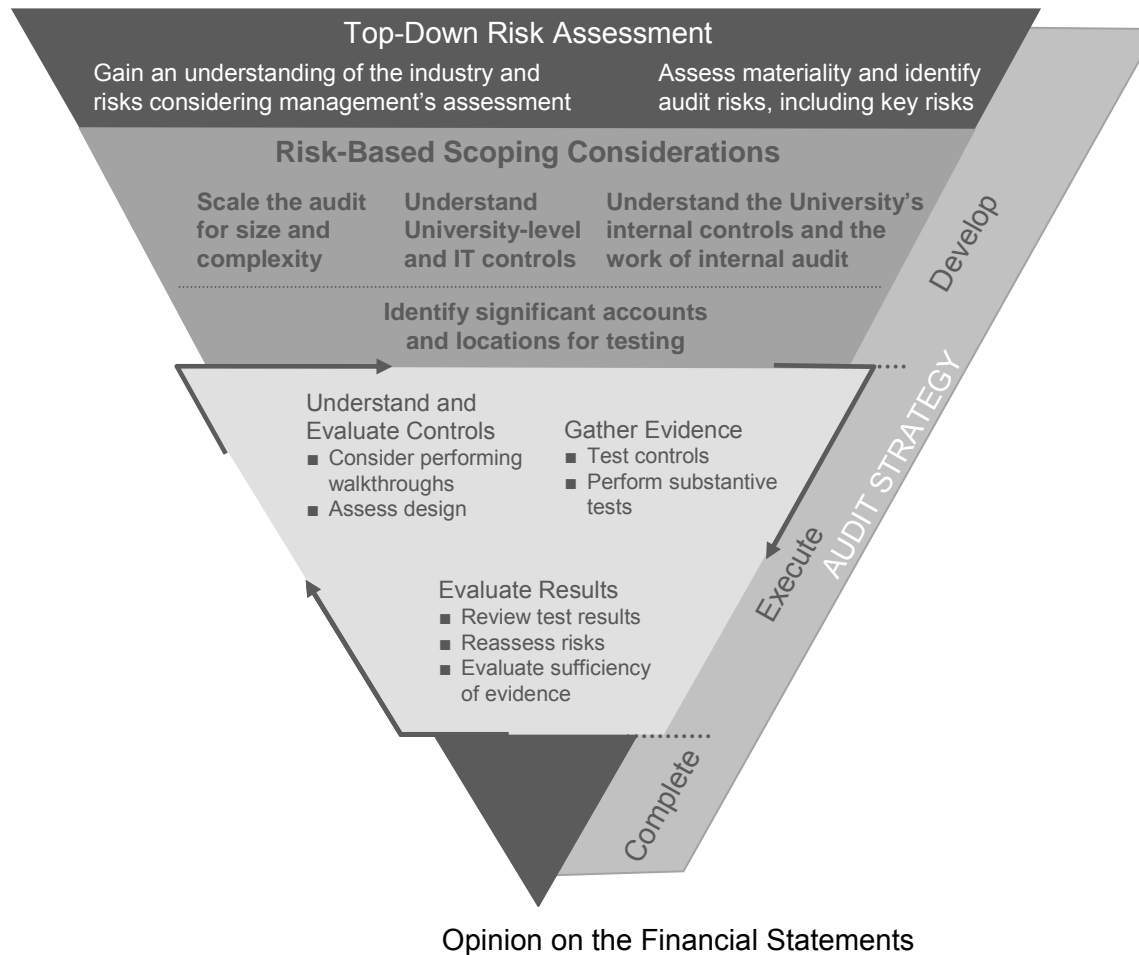
- Our engagement letter sets out the terms of our appointment as auditors of the University.
- The engagement letter covers the following matters:
 - Scope of annual audit, including OMB Circular A-133, for the year ending June 30, 2008
 - Our responsibilities and limitations
 - Management’s responsibilities
 - Other documents
- A copy of the engagement letter will be provided to the Chair of the Regents’ Committee on Audit and its Financial Expert Advisor.

PwC Top-Down, Risk-Based Audit Approach

Our Audit Strategy is based on:

- The use of a top-down, risk-based approach to planning and conducting the audit; and
- The application of well-reasoned professional judgment.

These principles allow us to develop and execute our audit strategy in an effective and efficient manner.



Audit Plan: Risk Analysis

Our audit approach is risk based. Assessment and identification of risk is performed throughout the audit process in coordination with senior financial management. We focus on risks that have a potential impact on financial reporting and the financial accounting systems and controls that mitigate those risks.

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Investments (45% of total University assets; 99% of total Retirement System Assets)</p> <ul style="list-style-type: none"> •Are not properly valued. Use of the model-based valuation techniques may be required. •Do not exist. •Are not reconciled to manager/custodian records. •Contracts, e.g., derivatives, are entered into by University managers without approval and are not known to the Committee on Investments. 	<p>All traded investments are priced using independent pricing services. All non-traded investments priced based upon audit reports, appraisals, pricing models or other available information. Although not expected, Management will need to evaluate those securities impacted by the current credit market conditions and determine a method for valuation if securities are not actively trading.</p> <p>Investments are reconciled at least monthly.</p> <p>The University uses strict guidelines to evaluate its managers and evaluates their performance.</p>	<p>We independently reprice a significant portion of all traded investments. These are held by the custodian and are confirmed directly with the custodian; non-traded investments are confirmed on a sample basis. We will review the valuation methodology and results applied to marketable securities not trading actively, if any. We also review and validate management's valuations of alternative investments and due diligence investing procedures.</p> <p>We review all significant reconciliations and year end portfolios for evidence of non-recorded transactions and contracts. We confirm pending trades and other liabilities.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Investments (continued)</p> <p>•Net asset values used to determine the amount of investment pool ownership by the various pool participants are calculated accurately</p>	<p>Management maintains investment guidelines to limit the exposure in particular sectors to ensure the quality of the investments purchased and regularly reviews performance of its managers.</p> <p>Management has established controls to ensure that purchase and sale transactions are authorized.</p> <p>Management has established procedures to ensure that investment pool balances and net asset values are accurate.</p>	<p>We obtain an understanding of the investment guidelines and review, on a limited sample basis, compliance therewith.</p> <p>We review controls over investments activities, valuations and obtain SAS 70 reports over the custodian.</p> <p>We will review controls over the determination of periodic net asset values used in investment pool calculations and will test a sample of transactions into and out of the pools for accuracy.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Capital assets (44% of total University assets)</p> <ul style="list-style-type: none"> • Are not properly initially recorded at cost. • Do not exist. • Are not appropriately depreciated. 	<p>There are specific authorizations required for capital projects. Accounts are subject to monthly reconciliations. Capitalization thresholds, depreciable life guidelines are in place. Periodic inventories are performed of moveable equipment.</p>	<p>We obtain an understanding of the policies and procedures over capital assets. We vouch a sample of capital asset additions and review year end reconciliations. We recompute depreciation on a test basis and perform analytical procedures over depreciation expense. We review results of physical inventories and reconciliation of the subsystem to the general ledger.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Accounts receivable</p> <ul style="list-style-type: none"> •Are not properly categorized. •Do not exist. •Are not properly valued or collectible. 	<p>Accounts receivable are subject to review at year end for collectibility. Overdue accounts are investigated.</p>	<p>We review a sample of accounts receivable for collectibility issues. We review the reconciliation to detail and perform analytical reviews.</p>
<p>Accounts payable and accrued expenses</p> <ul style="list-style-type: none"> •Are not complete or accurate. 	<p>Accounts are reconciled on a monthly or quarterly basis. A year end cutoff is performed to ensure that significant payables are captured.</p>	<p>We perform analytical procedures on balances and review year end reconciliations for all accounts over a given threshold, as well as a sample below the threshold. We perform a search for unrecorded liabilities.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Other assets and liabilities</p> <ul style="list-style-type: none"> •Are not appropriately stated. •Are not reconciled or properly deferred. 	<p>Reconciliations are subject to monthly monitoring and review. Large fluctuations are investigated.</p>	<p>We perform analytical procedures on balances and review reconciliations for all accounts over a set threshold, as well as a sample of those below the threshold.</p>
<p>Revenues and Expenses</p> <ul style="list-style-type: none"> •Are not appropriately categorized. •Are not complete. 	<p>Accounts are reviewed monthly for unusual trends. Budget to actual is monitored.</p>	<p>We vouch selected revenues and expenses in connection with other audit areas. We perform analytics of changes in accounts and consider the work completed by internal audit.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Notes and bonds payable</p> <ul style="list-style-type: none"> •Are not complete or accurate. •Result in non-compliance with terms and conditions. 	<p>Management reviews all agreements for compliance with internal debt policy and covenants. Procedures are in place to ensure payments are made as required.</p>	<p>We independently confirm all significant debt. We review compliance on a sample basis with debt covenants. We review reconciliations to the general ledger, as well as footnote disclosures.</p>
<p>Net assets</p> <ul style="list-style-type: none"> •Are not in the appropriate category. •Are not supported by appropriate detail. 	<p>Management produces a year end detail of net assets by category and ensures that this detail reconciles to the financial statements.</p>	<p>We perform analytical procedures on balances and review year end reconciliations. We review a sample of balances to ensure proper categorization.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Sponsored research</p> <ul style="list-style-type: none"> • Non-compliance exists which would be material to the financial statements or to federal or state programs. 	<p>Management has extensive policies, procedures and training in place to ensure compliance with sponsored research guidelines. This area also receives internal audit attention and review.</p>	<p>We perform analytical review of revenues and expenses. In connection with the A-133 audit, we examine charges to federal and state awards for compliance with federal and state regulations. We consider results of internal audits, regulatory audits and federal regulatory changes.</p>
<p>Medical Centers</p> <ul style="list-style-type: none"> • Extensive judgment is required in developing liabilities for contingencies and third party payors. • Complex regulations with changing interpretations make compliance difficult. 	<p>Management focuses on reviewing subjective liabilities and complying with regulatory issues.</p>	<p>We have separate PwC audit teams who specialize in healthcare. Audit procedures focus on reasonableness of estimates, historical results and consistency in application. Regulatory exposures are considered at each hospital.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Financial Reporting</p> <ul style="list-style-type: none"> •Disclosures omitted or not appropriate. •Errors made in basic statements in terms of classification or amounts. 	<p>Draft financial statements are subject to numerous internal reviews prior to completion.</p>	<p>We agree the financial statements to the underlying accounting records. We complete a disclosure checklist to ensure all significant disclosures are made and test disclosures back to underlying support. We obtain a legal letter to understand the nature of any potential claims against the University.</p>
<p>Fraud</p> <ul style="list-style-type: none"> •Misappropriations. •Fraudulent billings to contracts. •Reporting of performance. 	<p>Policies, procedures and controls to ensure segregation of duties, compliance with federal and state regulations, and oversight of managers.</p>	<p>We consider incentives and pressures, have and will continue to expand our interviews, and consider the possibility of fraud in every audit. We also review internal audit reports and are alert for matters that are indicators of fraud.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Information Technology</p> <ul style="list-style-type: none"> •Systems could fail on implementation resulting in inaccurate data. •Security could be breached. •Management resources could be distracted based upon time devoted to implementing new systems. 	<p>Management is focused on dealing with issues related to systems.</p>	<p>We will review general computer controls and security as it relates to the general computer environment.</p>
<p>Lawrence Berkley National Lab (LBNL)</p> <ul style="list-style-type: none"> •Revenues and expenses are consolidated by UC and subject to the risk that amounts are not properly stated. •Contract noncompliance which could be material to the University or could indicate poor financial stewardship of federal resources. 	<p>Management has augmented and enhanced oversight of LBNL, including reviews of internal control systems, redefined reporting, and strengthened internal audit presence.</p>	<p>We focus on evaluating key financial controls and testing material year end balances.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Lawrence Livermore National Lab (LLNL)</p> <ul style="list-style-type: none"> • Revenues and expenses are consolidated by UC and subject to the risk that amounts are not properly stated. • Contract noncompliance which could be material to the University or could indicate poor financial stewardship of federal resources. 	<p>Through September 30, 2007, Management has augmented and enhanced oversight of LLNL, including reviews of internal control systems, redefined reporting, and strengthened internal audit presence.</p>	<p>Effective October 1, 2007, a contract was entered into transferring the responsibilities for the lab to another entity. We will focus on the first quarter activity and evaluating the transition costs related to the contract.</p>

Materiality

We consider both quantitative and qualitative factors in our assessment of materiality. We also assess the metrics used by the users of the consolidated financial statements in determining the appropriate base for calculating materiality.

We identify and assess the risk of material misstatement at:

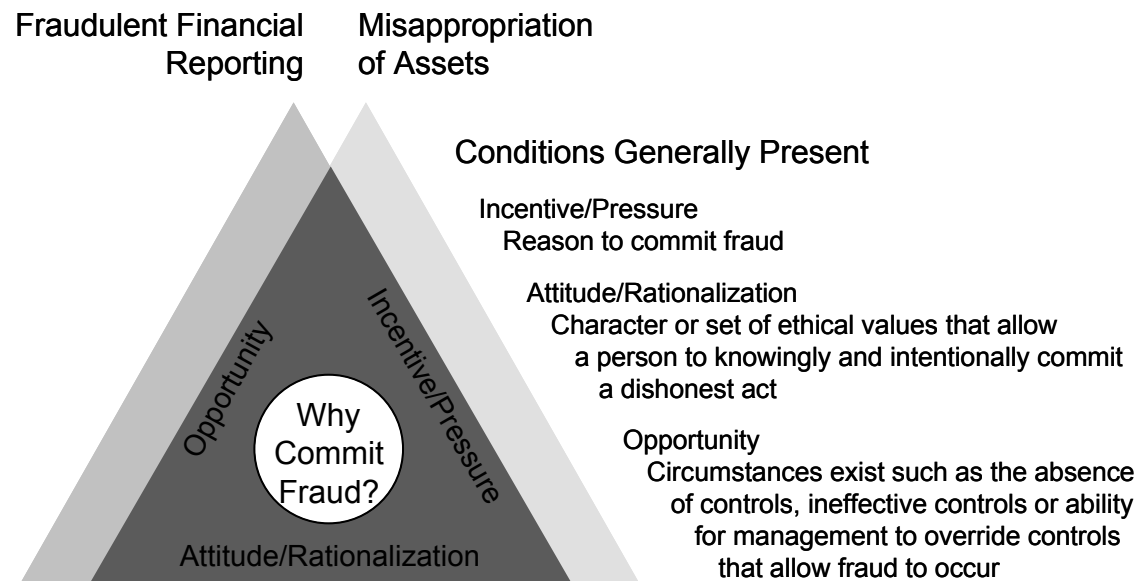
- The overall financial statement level, and
- In relation to classes of transactions, account balances and disclosures.

We use an overall financial statement materiality of 1% of operating expenses.

Perspectives on Fraud Risks and Responsibilities

We have a responsibility to plan and perform our audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether caused by error or fraud. In order to fulfill that responsibility, as part of our audit, we are required to gain an understanding of the risk of material misstatement due to fraud at the University and perform certain procedures to respond to the fraud risks identified.

Types of Fraud



Attributes Contributing to Increased Fraud Risk

- Size, complexity and ownership attributes of the University
- Type, significance, likelihood and pervasiveness of the risk

Related Parties

- Current standards and practices require emphasis on auditing related party transactions and communicating with the Committee on Audit in this regard.
- The University's controls over related party transactions include maintaining written policies governing related party transactions and transaction authorization procedures.
- Material related party transactions that came to our attention during the prior financial statement audit include appropriations, contracts and grants received from the state of California, of which the University is a component unit for financial reporting purposes; lease obligations to the state financed by the state revenue bonds; contributions received from and assets held by the University on behalf of the University's foundations and investments of the University of California Retirement System which are managed by employees of the University. All such transactions are disclosed.
- The separate medical center financial statements include disclosure of related party transactions with the University.
- The University acts as the administrative agent for the Retiree Health Benefit Trust activities.
- Other related party transactions exist including receipts of contributions by members of the Regents, transactions with affiliated entities such as alumni associations, etc. None of these were deemed material for disclosure purposes by management.

Reporting Timetable

Reporting/deliverables:

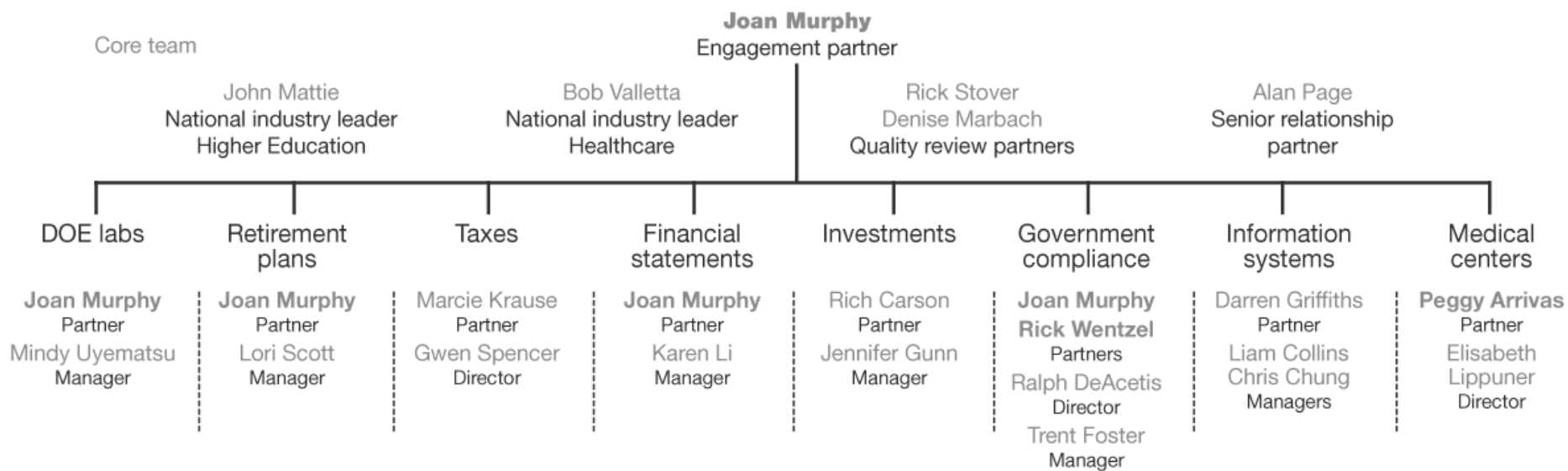
Your PricewaterhouseCoopers team works on the engagement throughout the year to provide the University with timely, responsive service. Below are the dates you can expect our reports.

Planning and coordination	January – April 2008
Committee on Audit Meeting	March 4, 2008
Interim audit procedures	May – June 2008
Year-end audit (analytical and substantive procedures)	August – September 2008
Completion of fieldwork	September 2008
Committee on Audit Meeting	November 2008
Issuance of Annual Report for University, Retirement Plan and Report to Management	November 2008
Issuance of Report Under OMB Circular A-133	January 2009

Thought Leadership

- Thought leadership is one of our key areas of focus - it is a way in which we distinguish ourselves and share our industry knowledge with our clients and others. Our partners are actively involved within the profession in addressing the complex challenges facing the higher education and healthcare industries.
- We would like to take advantage of the recently revised Committee meeting structure and bring to you the partners who lead our higher education and healthcare practices - John Mattie and Bob Valletta. We propose that each of these individuals attend one of the Committee's meetings during the year, to share his insights and observations on the overall industry, the University and its peer institutions. We believe this will give the Committee a broader perspective on the issues and challenges facing the University as well as other large, prominent higher education and healthcare organizations.

Engagement Team



Appendix - PwC Principles and Practices

- In today's challenging business and corporate reporting environment, we believe it is important that you remain confident about:
 - (i) the quality of our audit work
 - (ii) our steadfast commitment to independence and quality
- We recognize the importance of a strong and effective relationship between the Committee on Audit and the independent auditors.
- The PwC Principles & Practices Regarding Our Relationships With Client Audit Committees highlights our values and principles. A copy of this publication was provided to you in prior years and additional copies are available upon request.

Appendix - Independence Confirmation

We confirm our independence of the University as of February 2008.

Any work that is completed that is not related to the financial statement audit, such as completion of the NCAA agreed-upon procedures and attest work related to compensation is considered for potential conflicts of independence or whether the work would violate the independence standards of the GAO or AICPA. All of the work that we have done for the University beyond the core audit is related to the audit or other attest type work.

Our quality control processes are established to ensure our continuing independence.

We will again reconfirm our independence at the completion of our June 30, 2008 audit.

Appendix - Corporate Governance: Roles and Practices

The Regents' Committee on Audit

- Oversee the reliability of financial reporting including effectiveness of internal control over financial reporting.
- Review and discuss the annual financial statements and determine whether they are complete and consistent with operational and other information known to Committee members.
- Understand significant risks and exposures and management's response to minimize the risks.
- Understand the audit scope and approve core audit services
- Approve consulting services, if any.

Appendix - Corporate Governance: Roles and Practices (continued)

Management

- Properly record transactions in the accounting records, establish and maintain internal control sufficient to permit the preparation of financial statements and information in conformity with GAAP.
- Prepare the financial statements.
- Make available to us, on a timely basis, all of the University's original accounting records and related information and University personnel to whom we may direct inquiries.
- Adjust the financial statements to correct material misstatements; and affirm to us, that the effects of any uncorrected misstatements are immaterial, both quantitatively and qualitatively to the financial statements taken as a whole.
- Provide written representations to us regarding the financial statements and the effectiveness of internal control over financial reporting.
- Ensure the University complies with the laws and regulations applicable to its activities, especially those related to federal and state contracts and awards.

Appendix - Corporate Governance: Roles and Practices (continued)

PricewaterhouseCoopers

- Confirm expectations with The Regents' Committee on Audit and management. Monitor and report actual performance against those expectations.
- Conduct our audit in accordance with auditing standards generally accepted in the United States and Government Auditing Standards.
- Meet with The Regents' Committee on Audit to communicate matters required by professional standards and other matters of interest.
- Support The Regents' Committee on Audit's fiduciary responsibility to ensure the effectiveness of internal controls. Provide observations regarding key business processes and recommendations for improving internal controls.
- Discuss issues and concerns with management as they arise. Report significant matters as soon as they are confirmed.
- Provide management with proactive accounting and regulatory technical advice and provide timely access to PwC accounting and reporting experts to address unusual and non-routine items.
- Provide an accessible, experienced team with appropriate industry and technical expertise and align the team with the University management structure to ensure the effective resolution of issues.

Glossary of Acronyms

A-133	Office of Management and Budget (OMB) Circular A-133
AICPA	American Institute of Certified Public Accountants
AU	AICPA Auditing Standards reference
DOE	Department of Energy
GAAP	Generally Accepted Accounting Principles
GAO	Governmental Accountability Office
GAS	Government Auditing Standards
GASB	Governmental Accounting Standards Board
NCAA	National Collegiate Athletics Association
SAS	AICPA Statement on Auditing Standard



© 2008 PricewaterhouseCoopers LLP. "PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP a Delaware limited liability partnership or, as the context requires, the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.