www.pwc.com

University of California
Audit and Communications Plan

For the year ending June 30, 2013

Members of The Regents
Committee on Compliance and Audit
University of California

February 20, 2013

Dear Members of the Committee on Compliance and Audit:

We are pleased to have the opportunity to meet with you on March 14, 2013 to present our 2013 Audit and Communications Plan for the University of California (the University), as well as our annual value report and relationship commitment, which is included in Appendix A of this document. Discussion of our past performance and 2013 plan with you ensures our engagement team members understand your concerns and we agree on mutual needs and expectations to provide the highest level of service quality. Our plan has been developed to provide the University with efficient, high quality audits, which address the key risks and issues impacting the organization. Our plan also takes into account our responsibility to provide the Regents and management PwC's best thinking and insight on technical accounting and industry matters that may be of interest to you.

We look forward to meeting with you to present our audit plan, address your questions and discuss any other matters of interest to you.

Please feel free to contact Joan Murphy at (415) 498-7690 with any questions you may have.

Very truly yours,

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP, Three Embarcadero Center, San Francisco, CA 94111
T: (415) 498 5000, F: (415) 498 7100, www.pwc.com

Contents

Executive Summary

The University of California system and its stakeholders expect us to deliver a high quality audit and during our tenure, that has been our number one goal as your auditor. As we have described in prior communications, PwC has been driving comprehensive audit quality and change initiatives over the past several years to ensure we can continue to deliver on that commitment.

You also expect an audit that makes the best use of your time. So as we entered our planning activities for the 2013 audit, we looked at how we can audit more efficiently while delivering quality and keeping you apprised of the audit and financial reporting impacts caused by changes to your organization, operating environment, regulatory developments and new accounting standards.

Keeping Your Audit Fresh: What's New for 2013

We have brought a continuous improvement mindset to our audit every year. This means we build upon things that have worked well in the previous year and enhance our approach from lessons learned. In that spirit, we wanted to bring a fresh look to our audit planning for 2013. In January, we brought together members of your core PwC engagement team, along with some of PwC's top industry leaders and technical specialists to bring a fresh set of eyes on our audit methodology and planning. From this effort, as well as your feedback, we hope to drive additional improvements into our audit process for 2013, which are highlighted below and discussed in more detail in the remainder of this document.

- Earlier audit planning and guidance to minimize re-work and eliminate late surprises.
- Leveraging our understanding of your processes and controls to reduce your time supporting the audit.
- Continuing to leverage work across teams to avoid duplication in procedures performed.
- Enhancing our project management tools and techniques to manage our audits most effectively.
- Better phasing of our audit work throughout the year to balance the workload and reduce year-end crunch.
- Accelerating our A-133 audit procedures to better leverage the compliance work into our financial statement audit and to ensure a succinct conclusion to the A-133 audit.
- Incorporating information technology (IT) and data management tools to improve our engagement management capabilities.
- Significantly upgrading our audit documentation capabilities to standardize audit procedures and documentation templates.

Looking Forward: The Impact of Business, Regulatory and Financial Reporting Changes

We will continue to bring a forward looking perspective to the audit and adapt it to the changing facts and circumstances in your business and regulatory environment. Below we highlight some of the changes that will impact your audit from 2013 and beyond.

- Regulatory developments such as the Patient Protection and Affordable Care Act, the continued compliance under American Reinvestment and Recovery Act (ARRA) and the interest by the Securities and Exchange Commission (SEC) in monitoring the Municipal Securities Market continue to impact you. We update our risk assessment and audit approach to reflect their immediate and long term implications.

- Significant IT implementations such as UCPath, FUNDRIVER, PeopleSoft and EPIC continue to impact our audit scope. During and after implementation, we will continue to hold discussions and perform procedures, as applicable, to ensure the effectiveness of IT controls and consider the level of reliance we can derive for audit support.

- Significant transactions such as the Children's Hospital of Oakland combination have accounting and reporting implications. We will advise you of the accounting and reporting impacts of such transactions so you can make more informed decisions and eliminate surprises.

- There are numerous new Governmental Accounting Standards Board (GASB) pronouncements that will require implementation in 2013 and beyond, which we detail later in this document. We will continue to work with you to implement and assess the impacts of these new GASB pronouncements on your financial reporting as part of our audit plan.

Our Audit Objectives

As the University's auditor, we are responsible for reporting on numerous financial statements. In performing our audits for 2013, our primary objectives are as follows:

- Perform an audit of the University of California financial statements, University's Retirement Plan (UCRP), Voluntary Retirement Incentive Program (PERS Plus 5 Plan), Retirement Savings Program (UCRSP), Retiree Health Benefit Trust fiduciary fund and each of the five University Medical Centers, in accordance with *Generally Accepted Auditing Standards* (GAAS) and, as applicable, *Government Auditing Standards* (GAS). In connection with our audits, we will obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.

- Perform an audit of the University's compliance with federal award requirements (OMB Circular A-133) in accordance with GAS. In 2012, we accelerated the timing of the A-133 audit in order to issue the final report in early February 2013, even though the regulatory due date is March 31 2013. We will conduct the 2013 A-133 audit on a similarly accelerated timeline.

- Communicate in writing to management and the Committee all material weaknesses and significant deficiencies identified during the audit. In addition, communicate in writing to management all deficiencies in internal control, of consequence, over financial reporting identified during the audits.

- Complete other communications required under professional standards to the Committee on a timely basis.

In meeting these objectives, we will do the following:

- Consult with management on a timely basis regarding accounting and financial reporting issues and ensure all matters of significance are reviewed and discussed at the Office of the President and relevant location level.

- Coordinate efforts with management to ensure that all significant financial statement components are subject to sufficient audit coverage.

- Evaluate changes in the University, risk profile and internal controls to determine the nature, timing and extent of our testing of controls and substantive tests.

- Provide relevant expertise to facilitate the resolution of important issues.

- Report the results of our work to management and the Committee, including constructive observations relating to the University's financial processes and controls.

We note that the campus foundations have separate audits of their financial statements and the auditor's reporting on those foundations is directed to the individual foundation audit committees. Accordingly, this Audit and Communications Plan is not focused on the specifics of the campus foundations.

Business, Regulatory and Other Changes Impacting our Audit

Our 2013 audit plan has been updated to reflect our prior years' experience, changes in the University and current regulatory developments. In forming our 2013 audit plan, we factored in our experience from our 2012 audit of the University, including further enhancing our risk-based approach to the audit and our scoping of significant locations and accounts. We have also taken a "fresh look" at our audit approach and considered areas of the audit that we can perform more efficiently, while still achieving the same effectiveness. We actively keep current with the University through the actions detailed below.

Monitoring Regulatory Developments

- Continuing to monitor developments in federal and state hospital reimbursement mechanisms and their potential effect on the University's Medical Centers. In particular the expected effects of the Patient Protection and Affordable Care Act of 2010, which will impact the University as a provider of healthcare services and as an employer.

- Monitoring developments in government contracting regulations and their potential effect on federal contracts held by the University such as the continued oversight of the ARRA expenditures.

- Being alert to the potential control and other impacts from the state budget reductions over the past five years, some of which would be restored under the proposed state spending plan.

- Identifying other regulatory developments which could either affect our audit procedures under a risk-based approach or have longer term implications, such as the potential effects of the SEC’s July 2012 Report on the Municipal Securities Market.

- Working with management to assess the impact of future technical pronouncements on the University's various financial statements.

Considering Significant IT Implementations

We also consider and evaluate current and planned IT system changes and their impact to our audit scope. The University has numerous initiatives in process, some of which will affect our current year audit scope. The most significant initiatives are:

- **EPIC Implementation at UCLA Medical Center** – In March 2013, UCLA Medical Center plans to implement EPIC, a new patient information data management system. EPIC software allows for patients to access their records using the same charts as their doctors. EPIC is a “one patient, one record” approach that eliminates duplicate patient files. We will continue to engage management in discussions regarding the new software implementation. As part of our audit, we will perform procedures in connection with this system implementation to ensure the proper IT controls are designed and operating effectively and the transfer of data is appropriate.

- **General Ledger Implementation at UCSF Medical Center** – In April 2013, UCSF Medical Center plans to implement a new general ledger system, PeopleSoft. The Medical Center's system will be a separate instance from that of the Campus but maintained by UCSF campus IT department. UCSF plans in the following year to move towards one instance of a PeopleSoft general ledger with the same chart of accounts across all of UCSF. We will perform audit procedures in connection with this new general ledger system to ensure the proper IT controls are designed and operating effectively, as well as the appropriate transfer of data. In addition, we will continue to be in discussions with management and be available as resources to share any value-added insights and considerations as UCSF moves towards one instance of PeopleSoft.

- **New Endowment Processing System at UCOP** – FUNDRIVER is web-based software for automating the administration of pooled endowment funds, unitizing endowments and providing reporting on the endowment funds. FUNDRIVER is expected to be implemented by the closing process for the year ending June 30, 2013. We will engage management to understand the changes to endowment processing as a result of this implementation. Additionally we will perform procedures to ensure design and operating effectiveness of IT controls where appropriate, including review of the FUNDRIVER service auditor report and the effectiveness relevant user control considerations.

- **UCPath** – The first stage of UCPath is expected to be deployed in fiscal 2014. The Path initiative will deploy in stages a single payroll system and a single human resources system across all ten campuses and five medical centers that meets the core needs of each location while capturing the efficiencies, improved data and cost-savings associated with unified systems. We will engage management at the Office of the President and appropriate locations to understand the impact of the system implementation and to provide a perspective on key IT related controls through the course of our fiscal 2013 planning and execution of the audit.

Advising on Significant Transactions

- **Children's Hospital of Oakland** - UCSF Medical Center is currently performing due diligence on establishing a formal affiliation with the Children's Hospital of Oakland. While this transaction is not expected to close during fiscal 2013, we will continue to provide input to management on the potential accounting impact and reporting treatment as the transaction progresses.

- **University Insurance Captive** – In 2012 the University established an insurance company to provide for certain self-insured risks. That company will require an audit beginning with the year ending June 30, 2013. We will continue to hold discussions with management to obtain details related to the company to allow us to design an effective audit of the insurance captive. An experienced insurance partner and manager will lead that engagement team.

Assessing New Auditing Standards and Accounting Pronouncements

With the release of Statement on Auditing Standards (SASs) Nos. 122-125, the Auditing Standards Board (ASB) substantially completed its project to redraft all of the auditing sections in Codification of Statements on Auditing Standards (contained in AICPA Professional Standards). As part of this project, the ASB also converged the standards with the International Standards on Auditing. Although the "Clarity Project" (as this project was titled) was not intended to create additional requirements, some revisions have resulted in substantive changes and primarily clarifying changes that may require auditors to make adjustments in their practices.

While the impact of the Clarity Project was fairly broad, we believe the greatest impact to the University's audit relates to the guidance on Group Audits. As discussed on pages 18 and 19 of this document, the University's financial statements represent information of multiple entities (components) including the Office of the President, the campuses, medical centers, foundations, etc. Because there are multiple components involved, the University's audit is required to be designed to ensure the professional standards on Group Audits are followed. While the Clarity Standards are effective for periods ending on or after December 15, 2012, PwC implemented this guidance during our 2011 audits. These standards require additional hours for us to complete the University's financial statement audit – at a cost that we absorbed and have not embedded in our audit fees.

In addition, the 2011 revision of GAS is effective for the University's audit of fiscal 2013. The major changes provided by this revision include the addition of a conceptual framework for independence. This was added to provide a means for auditors to assess their independence for activities that are not expressly prohibited in the standards.

The GASB continues to be active in standard setting and has a full agenda of projects including recognition and measurement, fair value, financial guarantees and postemployment benefits accounting which are on the horizon. One standard, GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* is effective for fiscal 2013 and requires reporting of service concession arrangements from certain public-private partnerships in the University's financial statements. Under this standard, a governmental entity may be required to reflect, for example, the fair value of a building constructed by a third party, related liabilities and a deferred inflow for a public-private partnership. Our current audit plan contemplates expanded procedures relative to any such arrangement identified.

For future years, the GASB has issued five new standards covering pension plan reporting, technical corrections, displays of outflows and inflows and government combinations and disposals. Of these standards, the largest expected impact is related to pension plan reporting which establishes a revised model for measuring and reporting an employer's pension liabilities. While the University's obligation to UCRP is expected to increase under the new model, management is still evaluating the impact of this new standard. As part of our audit plan for 2013, we will advise the University, as appropriate, on our views on implementation questions that may arise on this standard and other GASB developments.

A more detailed discussion on pending GASB standards is contained in Appendix D.

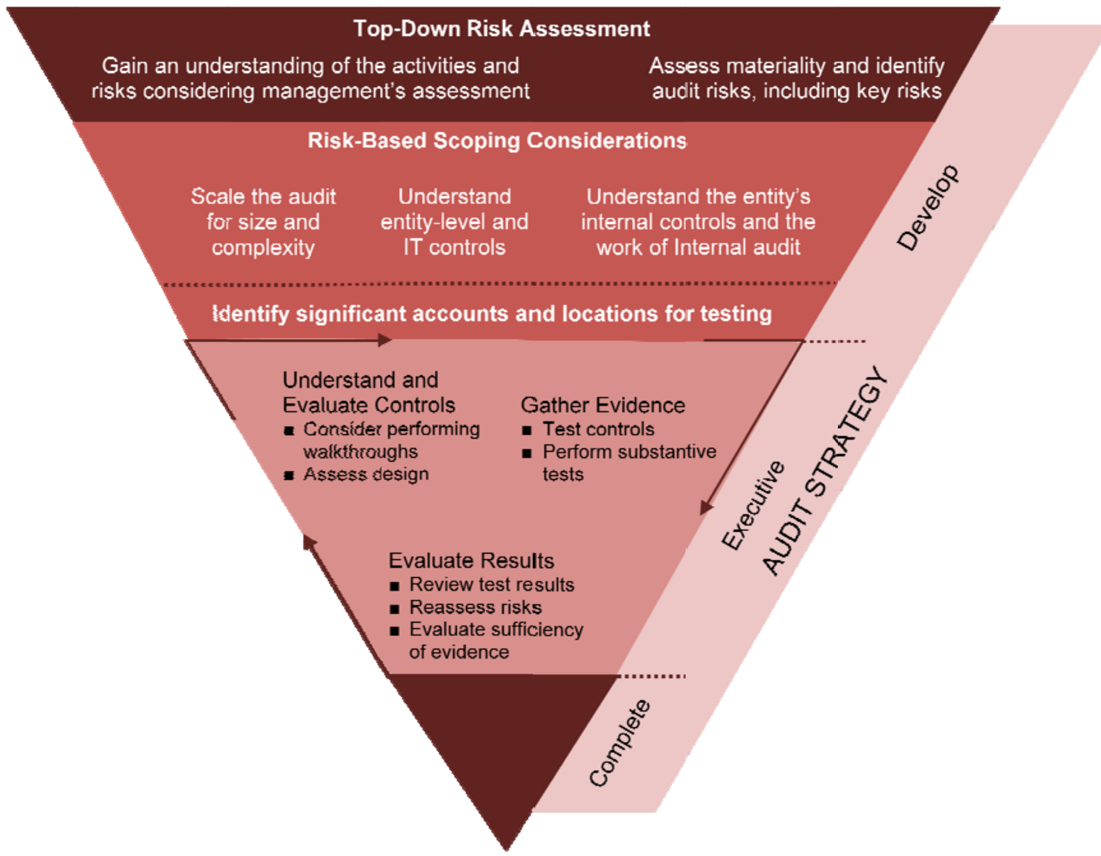
In addition to the required adoption of GASB Statement No. 60 described above, we understand the University is considering making a voluntary change in its accounting for outside, perpetual third-party trusts. Practice among governmental entities has varied, with some institutions reflecting such trusts, as the University has historically, and others not including them in the statement of net position. While there is no definitive guidance on the accounting for such trusts by the GASB, we believe either treatment is acceptable, and will work with the University to review this change if implemented.

Our Audit Approach and Risk Assessment

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.



Opinion on the Financial Statements

Significant Risks

The designation of significant risks which is required by the professional auditing standards ensures that we place appropriate emphasis and testing on those areas most likely to cause a material financial reporting misstatement. Accordingly, as part of our audit planning, we identify certain audit areas as subject to significant risk of material financial reporting misstatement in the financial statements based on our knowledge of the University and the industries in which it operates. Such audit areas are subject to inherent or specific risks and complexities, critical accounting policies and/or significant judgments and estimates, as further described in the University's consolidated financial statements, and are key considerations as we develop our current year audit approach. We identified the following significant risks:

- Management override of controls - This is an area of presumed significant risk on all audit engagements. We perform testing on the appropriateness of journal entries and other adjustments, significant accounting estimates, and significant and/or unusual transactions to address this risk.

- Fraud risk in revenue - As discussed in this document, in the section titled, *Perspectives on Fraud Risk and Responsibilities*, we are required to consider the fraud risk in revenue, which includes grants and contracts, educational activities and patient service revenue.

- Valuation of alternative investments - The University has complex investments that are recorded at fair value. The underlying assumptions used to value certain of these investments may be judgmental and subject to risk that amounts received in settlement differ significantly from fair value measurements.

For further information on the implications on our audit associated with these risks, refer to Appendix C.

Areas of Audit Emphasis

In addition to the significant risks identified above, we have identified the areas below that are not considered significant risks but are areas of focus during the audit due to materiality of the balance or complexity/judgment involved in the accounting. Such audit areas are subject to material accounting policies and/or judgments and are considerations as we develop our current year audit approach. They include the following:

- Accounting and reporting for actuarially determined estimates (retirement plans and retiree health benefit obligations).

- Accounting for receivables and allowances established for uncollectible pledges, other receivables and medical center receivables.

- Determination of which entities are to be included as component units under GASB reporting guidelines due to their significance and the nature of the University's relationship with the entities.

- Notes, bonds payable and commercial paper liabilities.

- Presentation and disclosure of the financial statements.

- Treatment of related party transactions with the University, as applicable to the separately-issued financial statements of the foundations, medical centers, benefit plans and benefit trusts.

A-133 Reporting and Compliance Risk

Although not considered a significant risk from a financial reporting standpoint, we also focus our audit procedures on regulatory compliance, including healthcare reimbursements, federal grants, and continued focus on compliance processes and controls over the University's federally sponsored research and financial aid programs in connection with our OMB Circular A-133 audit due to the reputational risk and potential legal ramifications associated with non-compliance.

Additional procedures are required for performing an audit of compliance with requirements applicable to each major federal program in accordance with GAS. At the time of preparing this report, we have identified two major programs (research and development and student financial aid) that will be subject to our OMB Circular A-133 audit for the year ending June 30, 2013. We expect that one or two additional programs requiring audit as part of the 2013 A-133 work will be identified as part of the preparation of the 2013 Schedule of Expenditures and Federal Awards.

Refer to Appendix B for a summary of how we develop our audit strategy and execute our audit.

Our Deliverables

As part of our service to the University, we provide advice on emerging accounting and reporting issues and provide certain other services. Refer to the table below for a listing of services we expect to provide. For 2012 these services required over 28,000 hours. Prior to commencing any other services, we are required to obtain preapproval from the Committee or the Committee's designee pursuant to the University's preapproval policy for its independent auditor.

Audit Opinions	■ Report on the financial statements of the University of California ■ Report on the financial statements of the five Medical Centers ■ Report on the University of California Retirement System ■ Reports in accordance with OMB Circular A-133, including: - Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* - Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance ■ Report on the University of California Cash Contributions to the Retirement System ■ Report on the financial statements of the newly formed University Captive Insurance Company
Internal Control Observations	■ Report to the Committee on control and process deficiencies and observations, including material weaknesses and significant deficiencies (Regents Letter) ■ Reports to the campus Chancellors on control and process deficiencies and observations (Chancellor Letters)
Agreed-Upon Procedures	■ Agreed-upon procedures related to the sale of Mortgage Origination Program and Supplemental Home Loan Program loans ■ Agreed-upon procedures on Intercollegiate Athletic Departments (NCAA requirements) for six campuses
Other Services	■ Reviews in connection with bond offerings ■ Accounting consultations and other assistance associated with emerging accounting and reporting issues and complex transactions ■ Financial reporting observations
Committee Reporting	■ Audit and communications plan ■ Results of audits and required communications

Client Service Team Composition

Joan Murphy*
Engagement Partner

John Mattie*
National Industry Leader
Higher Education

Tim Weld*
National Industry Leader
Health Care

Rick Stover*
Denise Marbach*
Quality Review Partners

Jim Henry*
Senior Relationship Partner

Retirement Plans	Taxes	Financial Statements	Investments	Government compliance	Information Systems	Medical Centers
Joan Murphy* Partner **Lindsay Alexovich*** Senior Manager	**Gwen Spencer*** Partner **Erin Couture*** Director	**Joan Murphy*** Partner **Jaime Jones*** Senior Manager **K.C. Deatsch*** Manager	**Ann Kennedy*** Partner **Ted Sloyer*** Senior Manager **Dan Puts*** Manager	**Ian Fleming*** Partner **Ralph DeAcetis*** Director **Laura Coletti* / Kevin Mitchell** Senior Managers	**Suzanne Cragin*** Partner **Chris Chung*** Director **Helen Kernasovsk*** Manager	**Mike MacBryde*** Partner **Billy Kim*** Senior Manager

Medical Center teams
Davis, Irvine, Los Angeles, San Diego, San Francisco

Partners:
Mike MacBryde*
Jill Tregillis-Bacon*

Managers:
Billy Kim*
Rick Wang*
Yair Katz*

Campus teams
Berkeley, Davis, Irvine, Los Angeles, Merced, Riverside, San Diego, San Francisco, Santa Barbara, Santa Cruz

Partners:
Joan Murphy*
Mike MacBryde*
Lee Overstreet*
Jill Tregillis-Bacon*

Managers:
Billy Kim*
Kathleen Hopely*
Kevin Mitchell
Robert Lemmon*

Foundation teams
Davis, Irvine, Los Angeles, Merced, Riverside, San Diego, San Francisco, Santa Barbara, Santa Cruz

Partners:
Joan Murphy*
Mike MacBryde*
Lee Overstreet*
Zahid Rahman*
Jill Tregillis-Bacon*

Managers:
Sara Mijares*
Kim Berger*
Kathleen Hopely*
Perry McNeal*

*Recurring team member

Key Engagement Team Members

In selecting our team, we have continued to focus on those team members with significant, relevant industry experience in areas that are important to the University – the Medical Centers, the foundations and the benefit plans. All partners and managers have relevant higher education and/or healthcare experience from past university audits and, in almost all cases, other relevant experience. We continue to balance continuity with some new team members providing a fresh perspective.

Joan Murphy, Engagement Leader and Signing Partner

Joan leads and directs our overall engagement team and will sign our audit opinion. She is your primary point of contact and speaks for the firm for all technical decisions and matters related to the audit. She will continue to meet regularly with the Committee and be in frequent contact with Office of the President management.

Mike MacBryde, Medical Center Audit Partner

Mike will continue to lead the Medical Center audit teams and be the focal point through which all Medical Center matters are addressed and resolved. Mike and the Medical Center teams will continue to work closely with Joan on specific Medical Center-related issues as they arise.

Ann Kennedy, Investments Audit Partner

Ann will continue to lead the PwC audit team that serves the Office of the Treasurer. This team is responsible for performing all audit procedures over the investment portfolios managed by the Office of the Treasurer. Ann and her team will continue to work closely with Joan on investment issues that may affect the University, UCRS and the Foundations audits.

Suzanne Cragin, IT Controls Partner

Suzanne will continue to lead the IT Controls team. This team is responsible for addressing risks associated with your IT systems and controls, as well as identifying areas within your IT environment that can assist with enhancing the quality and efficiency of our audit.

Rick Stover, University Quality Review Partner and Denise Marbach, Medical Center Quality Review Partner

Rick and Denise will serve as the Quality Review Partners of the University and the Medical Centers, respectively. In this role, they will provide an independent view of the engagement team's judgments related to auditing and technical accounting matters. They will independently assess the audit plan and its execution, including the quality of the financial statements and the appropriateness of our reports.

Relationship Support

Jim Henry, Senior Relationship Partner and PwC's U.S. Leadership Team Member

A member of the firm's U.S. Leadership Team and Strategy Committee and current Market Managing Partner for PwC's Northern California practice, Jim will continue to serve as the Senior Relationship Partner on the University engagement. Jim provides the University with access to an independent leadership resource.

John Mattie, PwC's U.S. Higher Education Leader and Tim Weld, PwC's U.S. Healthcare Leader

John and Tim will continue to be resources to you and your engagement team on complex industry issues as well as to be available to the Committee and management to discuss national trends and hot topics.

Use of Specialists

The University operates in a highly complex environment, requiring additional expertise beyond traditional audit resources. During the course of the audits, we will utilize our functional experts to evaluate key areas of your business risks— such as the valuation of self-insured risks and insurance accruals, the valuation of pension and post employment benefit obligations, valuation of certain investments, and third party settlements. Drawing upon their best practice knowledge, our team will provide points of view related to your business, industry and regulatory compliance.

These specialists also will ensure that we have the right resources to achieve our audit objectives. Accordingly, our PwC engagement team will include the following specialists who will work with our audit teams and management at your business units to assist us in executing our audit:

Area of expertise	Description of service
Financial Services Valuation	Assistance with the evaluation of the fair value of investments and related disclosures
Self Insurance	Review of actuarially determined balances and actuarial models involving self insurance reserves
Compensation and Benefit Plans	Review actuarial assumptions related to compensation programs and benefit plans
Healthcare Reimbursements	Review third party account transactions subject to complex rules and interpretation
Information Technology	Review and testing of IT and application controls
Healthcare Compliance	Provide guidance to Medical Center audit teams and the University regarding healthcare compliance requirements
Regulatory Compliance	Review the University's A-133 report and provide perspective on federal agencies' monitoring and expectations of award recipients

Multi-location Audit Coordination

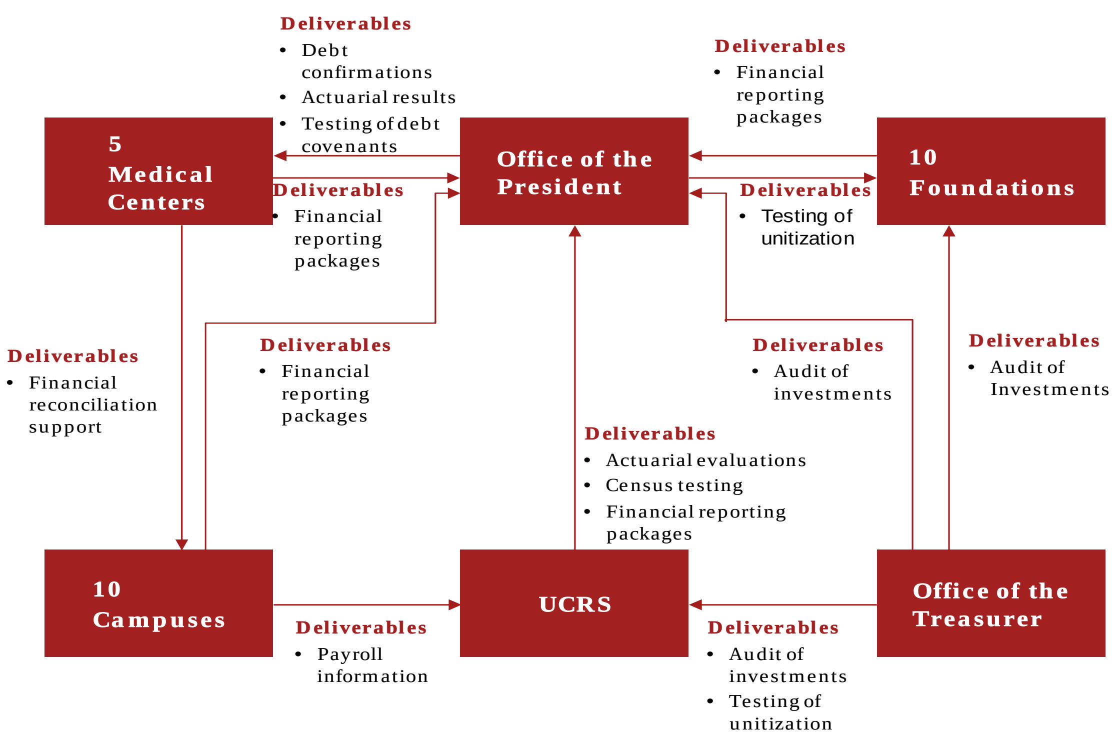
PwC has adopted a consistent approach for our audit procedures at all University and University related entities. We have developed standardized reporting templates and common audit programs and approaches to achieve consistency and effectiveness. As a result, our reporting structure allows for local teams who understand the unique aspect of each entity but who work within the framework of a common reporting structure.

We have taken the following steps to ensure the overall quality of audit engagement:

- Prepared and communicated a centrally determined audit scope and plan.
- Established a framework for continuous communications throughout our engagement teams.
- Adhered to engagement timelines to achieve your reporting objectives.
- Achieved continuity across the majority of engagement team.

The multi-location engagement team is aligned to the University's geographical organization and mirrors the management control structure of your organization. This structure, coupled with centralized engagement management, leverages the expertise of our local professionals who can respond directly to questions at each location. The following depicts the organization and flow of information among the different component audit teams.

The flow of information from the component auditors to the group auditors



For every deliverable, a set of instructions is issued communicating a particular scope of work, materiality and timing.

Office of the President and Office of the Treasurer – Audit procedures are performed as necessary at these locations in order to opine on the financial statements of the University. We also take into consideration in our audit scope for these locations the requirements of the medical centers audits, the UCRS audit and the audits of the campus foundations. In particular, the investment work we perform at the Office of the Treasurer has a wide-sweeping impact on various other University components.

Medical Centers and UCRS - As described throughout this document, we perform audits of the stand alone financial statements for the five medical centers and the University Retirement System which consists of multiple benefit plans. We rely on those stand alone audits for purposes of the audit of the University's consolidated financial statements and fiduciary fund financials.

Campuses – We perform specific audit procedures at the campus locations as needed to achieve sufficient coverage to express an opinion on the University's financial statements. Based on our analysis for the fiscal 2013 audit, we will perform audit procedures at the following campus locations: Berkeley, Los Angeles, San Francisco, San Diego, Davis and Irvine.

Foundations – The audits of the ten campus foundations are performed by separate foundation audit teams. However, as the combined financial statements of the campus foundations are presented discretely in the University's financial statements, we coordinate with and rely upon the work performed by the campus foundation teams.

Regardless of the extent of audit procedures performed at a location, each location has an assigned partner and manager. Accordingly, our engagement teams have established local points of contact to facilitate the completion of scheduling and planning to support local audit requirements as well as discussion of issues of local interest.

For further discussion of our audit strategy refer to Appendix B.

Audit Timeline

We have developed the following reporting timeline that facilitates the University meeting all of its legal and regulatory requirements. As you can see below, this timeline spans the entire year and represents our commitment to the University throughout the year.

Key Procedures Performed	Timing of Procedures
Planning and Audit Management	
■ Meet with management to understand the University's activities and assess risk; and obtain update of operating plans and activities	■ Ongoing throughout the year
■ Assess key audit risks and materiality	■ January - February 2013
■ Complete understanding of controls and preliminary scoping of accounts, processes and locations	■ February – March 2013
■ Meet with the Committee to discuss service plan	■ March 2013
■ Coordinate with PwC engagement teams and issue instructions for the audits of the University and Medical Center financial statements and benefit plans and A-133 testing procedures	■ April 2013
Execution and Audit Management	
■ Provide consultations on major issues and developments	■ Ongoing throughout the year
■ Perform testing of key monitoring, internal accounting and management controls	■ April – June 2013
■ Evaluate nature, timing and extent of substantive procedures based on controls testing	■ April – June 2013
■ Perform substantive audit procedures at interim for both financial statements and A-133 audits	■ April – June 2013
■ Perform substantive audit procedures at year end for both financial statements and A-133 audits	■ August – October 2013
Completion and Audit Management	
■ Issue audit opinions and related financial statements	■ October 2013
■ Meet with the Committee to communicate results of year-end audit and internal control recommendations	■ November 2013
■ Agreed-upon procedures related to the sale of Mortgage Origination Program and Supplemental Home Loan Program loans	■ October 2013
■ Agreed-upon procedures related to the 415(m) plan	■ November 2013
■ Agreed-upon procedures on Intercollegiate Athletic Departments	■ November 2013
■ Issue report on A-133 compliance	■ February 2014

Mutual Understanding of Responsibilities

PwC Responsibilities

Our responsibility is to express opinions, based upon our audits, on the University's consolidated financial statements, the University of California Retirement System financial statements; and the five Medical Center financial statements. We conduct our audits in accordance with GAAS and GAS. Those standards require that the auditor obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Accordingly, a material misstatement may remain undetected. Also, an audit is not designed to detect error or fraud that is immaterial to the financial statements. An audit includes obtaining an understanding of internal control sufficient to plan the audit and to determine the nature, timing and extent of audit procedures to be performed. An audit is not designed to provide assurance on internal control or to identify all significant deficiencies. However, as your auditor, we are responsible for ensuring that Committee is aware of any significant deficiencies or material weaknesses that come to our attention.

Our responsibility with respect to other information in documents containing audited financial statements is to read such information and consider whether the information or the manner of its presentation is materially inconsistent with information appearing in the basic financial statements.

Our responsibility with respect to Committee communications is to convey those matters that have come to our attention as a result of the performance of our audit.

Our audit does not relieve management of its responsibilities with regard to the financial statements.

We also are responsible for issuing several agreed upon procedures reports, for purposes of the Mortgage Origination Program and Supplemental Home Loan Program as well as agreed upon procedures at six of the ten campuses covering the National Collegiate Athletic Association Bylaws. These agreed upon procedures engagements and resulting reports are performed in accordance with the attestation standards established by the American Institute of Certified Public Accountants. These procedures do not constitute an examination, but rather are procedures designed in conjunction with the specified parties receiving the reports.

Management’s Responsibilities

As part of the audit process, management is responsible for the following:

- Preparing the University’s, Medical Centers’, and benefit plans’ financial statements in accordance with generally accepted accounting policies.
- Establishing and maintaining effective internal control over financial reporting.
- Identifying and ensuring that the University complies with the laws and regulations applicable to its activities.
- Making all financial records and related information available to PwC.
- Providing PwC with a letter that confirms certain representations made during the audits.
- Adjusting the financial statements to correct material misstatements and affirming to PwC in the representation letter that the effects of any uncorrected misstatements aggregated by PwC during the current engagement pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Committee’s Responsibilities

As part of the audit process, the Committee is responsible for the following:

- Oversee the reliability of financial reporting including the effectiveness of internal control over financial reporting.
- Review and discuss the annual financial statements for the University, the Medical Centers and the benefit plans 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 those risks.
- Understand the audit scope and approve audit and non-audit services.

Communications and Planned Interactions

Our Communications Plan with Management

We communicate with management both in writing and verbally continuously throughout the year. Examples of our ongoing communications include:

- Issues identification and resolution
- Meetings with management at Office of the President, Office of the Treasurer, local campuses and Medical Centers
- Planning and scoping discussions
- Internal Audit planning and coordination
- Discussions of interim audit findings
- Review of draft financial statements
- Year-end clearance meetings

Our Communications Plan with the Committee

Our communications with the Committee are designed to comply with standards established by the American Institute of Certified Public Accountants.

Our formal communications will occur via periodic meetings with the Committee at various stages during the year. As part of these meetings we will communicate with the Committee our service approach and audit plan, and our views on risks and controls, including those over financial reporting and governance. In addition, we will present the results of our audits upon completion.

In addition to our scheduled meetings, we are also available, at any time, to respond to Committee members' questions.

Our Interaction with Internal Audit

Although our objectives and responsibilities are necessarily different from those of Internal Audit, the efforts of both our organizations are very much complementary and provide a combined program of balanced audit coverage for the University. In our view, there is an excellent working relationship between our two organizations characterized by regular communication and formal and informal meetings.

We consider Internal Audit to be an effective and important element in the University's overall internal control environment. We complete certain procedures when relying on their work, as follows:

- Reviewing on a timely basis Internal Audit reports and management responses.
- Understanding the Internal Audit plan, including the nature, timing and extent of work.
- Considering the impact of Internal Audit findings on our audits.

Materiality and Independence

Materiality

We consider both quantitative and qualitative factors in our assessment of materiality. We also assess the metrics used by the users of the 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 different materiality levels for our audit of the various financial statements including the consolidated statements, the medical center statements, and the University's benefit plans statements.

Independence

As auditors of the University, we are subject to a variety of standards to ensure our independence, including American Institute of Certified Public Accountants, Governmental Accountability Office and internal PwC standards. Our quality control processes include confirmation of independence by professional staff and training and are established to ensure our continuing independence.

We hereby confirm our independence of the University for the fiscal year ending June 30, 2013. We will reconfirm our independence at the completion of our June 30, 2013 audits for the University.

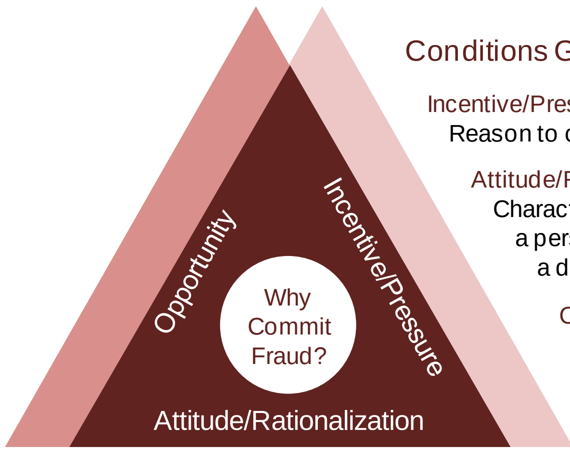
Perspectives on Fraud Risk

We have a responsibility to plan and perform our audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. In order to fulfill that responsibility, as part of our audits, 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

Fraudulent Financial Reporting

Misappropriation of Assets



Conditions Generally Present

Incentive/Pressure
Reason to commit fraud

Attitude/Rationalization
Character or set of ethical values that allow a person to knowingly and intentionally commit a dishonest act

Opportunity
Circumstances exist such as the absence of controls, ineffective controls or ability for management to override controls that allow fraud to occur

Attributes Contributing to Increased Fraud Risk

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

The oversight responsibilities of senior management and the Committee and the auditor's responsibilities are outlined below.

Management Responsibilities	■ Design and implement programs and controls to prevent, deter and detect fraud (antifraud programs) ■ Ensure that the University's culture and environment promote honesty and ethical behavior ■ Perform a risk assessment that specifically includes the risk of fraud addressing incentives and pressures, opportunities, and attitudes and rationalization ■ Assess management override of controls and communicate with the Committee

Committee Considerations	■ Evaluate management's identification of fraud risks, implementation of antifraud measures, and creation of appropriate "tone at the top" ■ Ensure that senior management implements appropriate fraud deterrence and prevention measures to better protect investors, employees and other stakeholders ■ Investigate any alleged or suspected wrongdoing brought to its attention ■ Challenge management in the areas of non-routine, related party and inter-company transactions
PwC's Role	■ Plan and perform the audit to provide reasonable assurance that the financial statements are free of material misstatement, whether caused by fraud or error ■ Evaluate whether the University's programs and controls that address identified risks of material misstatement due to fraud have been suitably designed and placed in operation ■ Evaluate management's process for assessing effectiveness of antifraud programs and controls ■ Evaluate fraud of any magnitude on the part of senior management and the impact on the control environment
PwC's Procedures	In order to fulfill our responsibilities related to fraud, we plan to perform the following procedures: ■ Inquiries of management, the Chair of the Committee, Internal Audit and others related to knowledge of fraud or suspected fraud, the fraud risk assessment process and how fraud risks are addressed by the University ■ Disaggregated analytical procedures, primarily over revenue ■ Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures to be performed annually ■ Identify and select journal entries and other adjustments for testing ■ Evaluate estimates ad assumptions used by management that could have a material impact on the financial statements ■ Review Internal Audit reports and remain alert for matters that are indicators of fraud

Appendix A

2012 Value Report and 2013 Service Commitments

Like the University, PwC is committed to a high performance culture including striving for excellence in everything we do, continuous improvement and exceeding expectations. As part of our commitment to excellence and consistent with our reports in prior years, we have summarized responses to the commitments we made to the Committee and management relating to our 2012 audit plan and our commitments for the 2013 audit plan in this Appendix. We look forward to discussing our assessment with you as both a means of measuring our performance for the past year and the start of setting expectations for 2013.

Delivering value during the 2012 audit

What we committed to	Value delivered to the University of California
• **Manage expectations to prevent surprises**	• Technical accounting and financial reporting matters relevant to the University's 2012 financial statements were addressed in conjunction with management in advance of year-end audit work • Issues raised through local campus and medical center teams discussed timely with local management as well as Office of the President • Assisted the University with multiple debt offerings always meeting the University's deadlines
• **Improve audit effectiveness and efficiency**	• Medical centers experienced more consistent audits as a result of our revised approach to testing patient accounts receivable, net patient service revenue and expenses • Coordinated NCAA reporting amongst the multiple teams to promote consistency in report requirements • Issued our A-133 report one month earlier than in 2011 and six weeks in advance of the regulatory deadline • Less time was spent by University management and staff responding to PwC requests and inquiries given our consistent audit approach
• **Provide a high quality engagement team**	• Each of our audits was led by experienced industry relevant partners and managers. These individuals facilitated discussions on issues relevant to each University team as well as Office of the President management • The majority of the PwC team recurred including 15 managers and 6 partners bringing expertise to campus, medical center, Office of the Treasurer and Office of the President management teams • All new staff went through special training, accelerating their effectiveness on the University audit

What we committed to	Value delivered to the University of California
• **Regularly share insights**	• We met regularly with Peter Taylor, and separately with Peggy Arrivas to stay at the forefront of issues impacting the University • We issued a Report of Cash Contributions to the University Retirement System in order to assist management in responding to a regulator's request • Our pension and postretirement benefit specialists and actuarial specialists for workers compensation provided perspectives to management regarding industry discount rates, actuarial modeling and assumptions, and disclosure requirements • Our internal control recommendations included our observations related to IT and business processes and our recommendations for remediation and improvement to the related control processes • We invited all medical center executives to our annual client conference known as "Health180" where issues are shared amongst the top healthcare industry professionals • We invited medical center chief financial officers to our annual hosted CFO Roundtable Event for Healthcare Industry Executives • We shared relevant industry insights with management such as our annual Academic Medical Center benchmark report • Our industry lead partners, Tim Weld and John Mattie, visited with members of University management in early 2012 to discuss relevant issues and share perspectives • Joan Murphy held monthly calls with the University's Chief Compliance and Audit Officer, Sheryl Vacca, to discuss University regulatory and compliance activities
• **Direct access to an independent PwC leadership resource was important to you**	• Jim Henry, a member of PwC's U.S. Leadership Team and Strategy Committee and current Market Managing Partner for PwC's Northern California practice, served as your Senior Relationship Partner • Jim held discussions with Peter Taylor and other members of University management several times throughout the year to independently assess PwC's performance; Jim also attended Committee meetings where PwC presented our 2012 audit plan and the results of our audits for that year • The feedback provided to Jim from different members of management (from both Office of the President and campus) related to PwC's service to the University is being incorporated into our service for the 2013 audit

Our service commitments for the 2013 audit

In preparing for this year's audit, we have listened to your input on what is most important to you as it relates to your needs and expectations for the audit. Below are the commitments we are making to you related to delivering a quality audit in accordance with professional standards. Throughout the year, we plan to revisit these commitments and evaluate our progress with you and welcome your feedback on how we can best work together.

What we heard about your needs and expectations	Our commitment to the University of California
Engagement team	• Begin planning for required engagement partner rotation, including identification of successor partner • Assign industry focused resources and maintain team continuity of senior team members at key locations • Provide direct access to Jim Henry, Senior Relationship Partner, PwC industry leaders John Mattie and Tim Weld and other specialists, as needed throughout the year
Audit performance	• Conduct effectiveness and efficiency review of the audit to improve 2013 plan • Conduct a 2012 audit debrief with the University to co-ensure a successful audit for 2013 • Execute a high quality audit with no surprises through effective project management, timely partner and manager involvement throughout the audit process and regular contact with management and the Committee • Work proactively with management on transactions and technical issues • Deliver an audit that reflects the complexities of the University's business and risks • Optimize the work of Internal Audit by understanding its activities and sharing our external audit scope with them • Minimize year-end work with significant interim audit procedures
Coordination, communication and project management	• Communicate proactively and continuously with management and the Committee • Hold regular status update meetings with Peggy Arrivas and Mike Riley throughout the year/ weekly meetings with all team leads during year-end • Meet with the Internal Audit teams to discuss significant findings and upcoming plans • Meet with IT management throughout your organization to further our understanding of the University's activities, communicate the status of our audits and to assist us with the identification of issues and risks • Work closely and meet regularly with our component audit engagement teams to monitor accounting issues arising and ensure timely issuance of deliverables • Actively coordinate with all locations to eliminate duplication of efforts by providing the results of certain audit procedures that are performed at Office of the President to these teams, as applicable • Seek feedback regarding our performance from the Committee on Compliance and Audit, senior management and other key accounting/finance personnel at least annually

What we heard about your needs and expectations	Our commitment to the University of California
Business insights	**Overview** • Hold quarterly business strategy and update meetings with Peter Taylor • Hold monthly regulatory and compliance update calls with Sheryl Vacca • Through IT Audit Partner Suzanne Cragin and other specialists, provide views on the University's IT implementations including the effectiveness of controls within core applications • Share industry leading practices to assist the University with the development of a global set of IT controls that can be leveraged across campuses and medical centers • Help implement new GASB pronouncements that will be effective in 2013 • Share audit observations and thought leadership around process improvement ideas and regulatory matters • Invite management to attend technical training sessions as well as relevant industry-specific seminars • Share insights with the Committee gathered from our Center for Board Governance • Provide access to PwC specialists who bring valuable input to topics important to the University such as in the areas of IT, investments, pensions, workers compensation and medical center receivables **Healthcare Reform Assessment** • Provide an assessment of the continued impact of the recent Healthcare reform legislation on the University's medical centers that identifies the major forces of change within healthcare reform that will affect the medical centers • Meet with your senior management team to discuss these changes and help identify potential strategic resources the medical centers should consider in capitalizing on the opportunities healthcare reform creates **Emerging Technical Issues Briefings** • Leverage Martha Garner, who serves as our National Technical Accounting Director for Higher Education and Healthcare and has been exclusively servicing higher education and healthcare entities in her national role for more than 25 years, to provide technical advice and advice on emerging GASB pronouncements and ensure the timely resolution of technical issues for the University **Annual Regulatory Update** • Ralph DeAcetis (our Higher Education and A-133 Regulatory Managing Director) will provide a briefing on the latest developments from the Office of Management and Budget, the Department of Education, and other key federal initiatives that may impact the University's federal award programs • Mike MacBryde (your lead Healthcare Partner) will cover healthcare regulatory compliance and reimbursement updates

Appendix B

Audit Strategy

Developing Audit Strategy

Top-Down Risk Assessment

Our audit approach is based on the application of well-reasoned professional judgment. We identify audit risks first by considering the business and its environment, and then by considering the key risks related to the significant accounts and relevant assertions, locations or business units and significant processes. Key risks are audit risks that require special audit consideration.

Where applicable, we also obtain an understanding of management's risk assessment. The result is the development of an audit strategy tailored to the risk conditions of the University and focused on identifying and testing only those key controls that are relevant to preventing or detecting material misstatements of the financial statements, whether caused by error or fraud.

Risk-Based Scoping Considerations

Fundamental to our top-down, risk-based audit approach is an understanding of:

- The size and complexity of the business and its components;
- The existence and effectiveness of entity-level and IT general controls (“ELCs and ITGCs”) in our determination of the nature, timing and extent of testing; and
- The existence and effectiveness of internal controls.

We scale our audit approach by considering the size and complexity of the business and management's monitoring of controls and business processes. By appropriately scaling the audit, we consider the control environment in which the University operates, which has a pervasive impact on our assessment of the controls necessary to address material risks of misstatement.

Early in the audit process, we assess ELCs and the University’s use of IT. ELCs are controls that may be operational throughout the entire organization, both at a corporate and business unit/management unit level. Our evaluation of the effectiveness of ELCs and the level of precision at which they operate can result in increasing or decreasing the testing that we otherwise would have performed on controls at the process, transaction or application levels. Accordingly, we emphasize the upfront identification and testing of ELCs, which can have a significant impact on the nature, timing and extent of our controls testing.

Generally, IT is a critical element in developing the audit plan. The assessment of IT considers the level and complexity of controls automation, system complexity, platforms used, approach to security and the security architecture, known problems, and the nature and volume of transactions. This understanding assists in determining the approach to auditing the effectiveness of automated controls and ITGCs.

Determining Significant Accounts and Locations

Once we have completed our initial risk assessment and gained an understanding of ELCs and ITGCs, we will determine the most effective and efficient way to obtain audit evidence using well-reasoned professional judgment. This determination begins at the financial statement level by identifying significant accounts and disclosures, considering the relevant assertions related to those accounts and disclosures, and identifying the significant processes and key controls.

Determining Significant Accounts

The determination of whether an account or disclosure is significant to the audit of the financial statements is based on whether there is a reasonable possibility that the account could contain a misstatement that, individually or when aggregated with others, could have a material effect on the financial statements. In addition to quantitative metrics, risk factors such as the following contribute to our determination of the significance of an account or disclosure:

■ Size and composition of the account	■ Accounting and reporting complexities associated with the account or disclosure
■ Susceptibility of misstatement due to errors or fraud	■ Exposure to losses in the account
■ Volume of activity, complexity and homogeneity of the individual transactions processed through the account or reflected in the disclosure	■ Possibility of significant contingent liabilities arising from the activities reflected in the account or disclosure
■ Nature of the account or disclosure	■ Existence of related party transactions in the account
■ Changes from the prior period in account or disclosure characteristics	■ Knowledge obtained in prior audits

For those accounts and disclosures deemed significant, we identify relevant financial statement assertions and the significant processes and then identify the key controls which serve to prevent or detect a material misstatement.

Determining Locations

The scoping of locations is based on the risk of material misstatement. In determining the locations or business units at which to perform tests of controls, we assess the risk of material misstatement of the financial statements associated with the location or business unit and correlate the amount of audit attention devoted to the location or business unit with the degree of risk.

Executing Audit Strategy

We execute our audit strategy using the following process:

- Understanding, evaluating and assessing the design of controls through inquiry, observation, inspection and re-performance, including walkthroughs;
- Gathering evidence by execution of controls testing through our own work and substantive testing; and
- Evaluating the results of our testing, including reassessing risk and the sufficiency of evidence.

Assessing the Design of Controls

We evaluate and assess the design of controls with information obtained from various sources including our interaction with management, knowledge obtained from past audits, performing walkthroughs where deemed appropriate and different combinations of inquiry, observation, and inspection. Our controls testing provide us with evidence of the design and operating effectiveness of controls, including those related to the prevention or detection of fraud. Our controls testing approach is dependent on the work of Internal Audit and their competence and objectivity.

Gathering Evidence

We obtain sufficient competent evidence through a combination of our own audit procedures and reliance placed on the work of internal audit. We ensure an efficient audit by focusing only on those key controls that prevent or detect material misstatements of the financial statements, whether caused by error or fraud. For those identified key controls, we test operating effectiveness. Our method of testing will depend, amongst other things, on the risk of misstatements that the controls are intended to prevent or detect, the inherent risk associated with the related account and assertion, the control's complexity and other factors affecting the risk associated with the control. As the risk of material misstatement increases, the amount of audit evidence needed increases.

We assess the effectiveness of internal control and the nature of risk associated with an account in determining the nature, timing and extent of substantive procedures. The nature and degree of risk is the key determinant in how much additional audit evidence should be obtained from analytical procedures (such as trend or ratio analysis), tests of details (such as vouching third-party source documentation) or a combination of these procedures.

Evaluating Results

Our risk assessment is a pervasive process in which we continuously evaluate the nature, timing and extent of testing and determine whether we have obtained sufficient competent evidence. We evaluate evidence from the work of others, and our independent tests of controls and substantive audit evidence. The results of certain tests may lead to changes in our risk assessment, which may either increase or reduce the procedures performed.

Completion

Prior to the issuance of our audit opinion on the various financial statements, we will perform audit completion activities, including the evaluation of internal control deficiencies; the review of the financial statements, including the adequacy and reasonableness of presentation and footnote disclosures; and the performance of other audit procedures as required by professional standards.

Appendix C

Approach for Areas of Significant Risk

As described in the *Our Audit Approach and Risk Assessment* section of this document, our integrated audit approach is a top-down, risk-based approach, and we continually reassess audit risks throughout the audit process.

Higher risk areas, in our judgment, require special audit consideration because of the nature of the risk (higher inherent risk), the likely magnitude of potential misstatements (including the possibility that the risk may give rise to multiple misstatements) and the likelihood of the risk occurring.

We have obtained an understanding of your financial, accounting, business and information system strategies in order to assess audit risks at the University. The following list summarizes audit risks and our approach for the 2013 financial statement audits and the procedures we will perform to reduce the related audit exposure. It is not intended to be a complete listing of all risks or all procedures that we perform in connection with our audits.

Audit Area	Risk Factors	Audit Implications/ Approach
Valuation of alternative investments	■ Investments may not be valued appropriately. ■ Given the size of the University's portfolio, that it includes non-readily marketable securities, and the inherent risks and complexity of this area, our audit continues to place significant emphasis on the University's investment portfolio. ■ Valuation of securities, including non-marketable securities, such as private equity funds, real estate limited partnerships and hedge funds, are inherently more complex to value.	■ Obtain an understanding of the processes and procedures in place to ensure the existence and valuation of investments. ■ Test the operating effectiveness of key controls within the investments cycle, including due diligence and monitoring controls. ■ Assess the financial reporting risk inherent in each fund based on the level of transparency into each investment. ■ Consider the experience and expertise of individuals responsible for the accuracy of the fair value of investments. ■ Understand and evaluate service organizations used. ■ Confirm fair values of securities, on a sample basis. ■ Obtain audited/reviewed financial statements for selected non-readily marketable securities. ■ Review all important reconciliations and year end portfolios for evidence of non-recorded transactions and contracts; confirm material pending trades and other liabilities.

Audit Area	Risk Factors	Audit Implications/ Approach
Fraud risk in revenue	■ We have a responsibility to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.	■ Gain an understanding of the material risks of fraud at the University and perform audit procedures to address those risks, including management interviews, testing of journal entries, disaggregated revenue analytics and incorporating unpredictability into our audit work. ■ See "Perspectives on Fraud Risk and Responsibilities" section of this document.
Grants and contract revenue; and educational activities	■ The University receives significant funding from various agencies. The University must continue to comply with compliance regulations of federal agencies.	■ Obtain sponsored research contracts to gain comfort on the existence of the revenues received. ■ Test compliance with allowable cost principles for federally funded sponsored research programs in accordance with OMB Circular A-133, "Audits of Institutions of Higher Education and Other Non-Profit Organizations" (OMB Circular A-133) and other specific grant requirements. ■ Perform analytical review of revenues. ■ Assess and test key compliance controls; test compliance with material compliance requirements applicable to major programs.

Audit Area	Risk Factors	Audit Implications/ Approach
Medical Center patient service revenue	■ Revenue transactions are not processed in the proper period. ■ The environment surrounding billing, collecting and determining reserves continues to be complex. ■ Accounts may not exist.	■ Perform patient revenue testing, verifying the existence of patient charges. ■ Supplement our tests with analytical procedures on all key areas. ■ Assess the reasonableness of management's estimates for contractual allowances and bad debts by evaluating the current year's methodology, assessing the adequacy of the prior year's estimates and substantive analytics. ■ Utilize our Healthcare Reimbursement Specialists to assist us in our testing of contractual allowances.
Management override of controls	■ Financial statements could be materially misstated. ■ Misappropriation of assets.	■ Evaluate the design and operating effectiveness of internal controls as well as perform substantive tests of details for significant risk areas.

Appendix D

Relevant Pronouncements and External Guidance

GASB Pronouncements

The following GASB pronouncement will have an effect on the University beginning in fiscal 2013:

- **GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Agreements*** (fiscal 2013) – Agreements between governments and private entities or other governments, sometimes referred to as public-private or public-public partnerships, have become more prevalent as governments have sought alternative ways to provide services to their constituencies on a more efficient and cost-effective basis. These arrangements often result in governments transferring existing or newly constructed facilities and the obligation to provide certain services to an external entity.

  Statement No. 60 requires the University to report the activities for certain public-private partnerships as service concession arrangements in the financial statements. Service concession arrangements (SCAs) are a type of public-private or public-public partnership in which: (a) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset in exchange for significant consideration, such as an upfront payment, installment payments, a new facility, or improvements to an existing facility; (b) the operator collects and is compensated by fees from third parties; (c) the transferor determines or has the ability to modify or approve what services the operator is required to provide, to whom the operator is required to provide the services, and the prices or rates that can be charged for the services; and (d) the transferor is entitled to significant residual interest in the service utility of the facility at the end of the arrangement. Upon execution of a SCA, the transferor should continue to report the facility as a capital asset or report the new facility or improvement as a capital asset at fair value when it is placed into operation. A liability should be reported for any contractual obligations and the difference between the asset and liability should be recorded as a deferred inflow of resources.

  Statement No. 60 is effective for the University for the year ending June 30, 2013.

The following GASB pronouncements will have an effect on the University beginning in fiscal 2014 or beyond:

- **GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*** (fiscal 2014) – Statement No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

Concepts Statement No. 4, *Elements of Financial Statements*, introduced and defined the elements included in financial statements, including deferred outflows of resources and deferred inflows of resources. In addition, Concepts Statement 4 provides that reporting a deferred outflow of resources or a deferred inflow of resources should be limited to those instances identified by the Board in authoritative pronouncements that are established after applicable due process. Prior to the issuance of this Statement, only two such pronouncements have been issued. Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, requires the reporting of a deferred outflow of resources or a deferred inflow of resources for the changes in fair value of hedging derivative instruments, and Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, requires a deferred inflow of resources to be reported by a transferor government in a qualifying service concession arrangement. This Statement amends the financial statement element classification of certain items previously reported as assets and liabilities to be consistent with the definitions in Concepts Statement 4.

This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term *deferred* in financial statement presentations.

Statement No. 65 is effective for the University for the year ending June 30, 2014.

- **GASB Statement No. 66, *Technical Corrections - 2012 - an amendment of GASB Statements No. 10 and No. 62*** (fiscal 2014) - The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

  This Statement amends Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, by removing the provision that limits fund-based reporting of an entity's risk financing activities to the general fund and the internal service fund type. As a result, governments should base their decisions about fund type classification on the nature of the activity to be reported, as required in Statement 54 and Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*.

  This Statement also amends Statement No. 62 by modifying the specific guidance on accounting for: (1) operating lease payments that vary from a straight-line basis; (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans; and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. These changes clarify how to apply Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, and result in guidance that is consistent with the requirements in Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, respectively.

  Statement No. 66 is effective for the University for the year ending June 30, 2014.

- **GASB Statement No. 67, *Financial Reporting for Pension Plans*** (fiscal 2014) – Statement No. 67 replaces the requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans,* and No. 50, *Pension Disclosures,* as they relate to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 25 and 50 remain applicable to pension plans that are not administered through trusts covered by the scope of this Statement and to defined contribution plans that provide postemployment benefits other than pensions.

  This Statement revises existing standards for financial reporting for pension plans by changing the approach to measuring the net pension liability. The net pension liability is measured as the total pension liability, less the amount of the pension plan's fiduciary net position. The total pension liability is determined based upon discounting projected benefit payments based on the benefit terms and legal agreements existing at the pension plan's fiscal year end. Projected benefit payments are required to be discounted using a single rate that reflects the expected rate of return on investments, to the extent that plan assets are available to pay benefits, and a tax-exempt, high-quality municipal bond rate when plan assets are not available.

  Statement No. 67 is effective for the University for the year ending June 30, 2014.

- **GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*** (fiscal 2015) – Statement No. 68 replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers,* as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statement Nos. 27 and 50 remain applicable for pensions that are not covered by the scope of this Statement. This Statement and Statement No. 67 establish a definition of a pension plan that reflects the primary activities associated with the pension arrangement—determining pensions, accumulating and managing assets dedicated for pensions, and paying benefits to plan members as they come due.

  This Statement revises existing standards for measuring and reporting pension liabilities for pension plans provided by the University to its employees. This Statement requires recognition of a liability equal to the net pension liability, which is measured as the total pension liability, less the amount of the pension plan's fiduciary net position. The total pension liability is determined based upon discounting projected benefit payments based on the benefit terms and legal agreements existing at the pension plan's fiscal year end. Projected benefit payments are required to be discounted using a single rate that reflects the expected rate of return on investments, to the extent that plan assets are available to pay benefits, and a tax-exempt, high-quality municipal bond rate when plan assets are not available. This Statement requires that most changes in the net pension liability be included in pension expense in the period of the change.

  Statement No. 68 is effective for the University for the year ending June 30, 2015.

- **GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*** (fiscal 2014) – Statement No. 69 is intended to improve accounting and reporting for combinations and disposals of government operations. The Statement provides guidance for determining whether a specific government combination is a government merger, a government acquisition, or a transfer of operations; using carrying values (generally, the amounts recognized in the pre-combination financial statements of the combining governments or operations) to measure the assets, deferred outflows of resources, liabilities, and deferred inflows of resources combined in a government merger or transfer of operations; measuring acquired assets, deferred outflows of resources, liabilities, and deferred inflows of resources based upon their acquisition values in a government acquisition; and reporting the disposal of government operations that have been transferred or sold.

  The distinction between a government merger and a government acquisition is based upon whether an exchange of significant consideration is present within the combination transaction. Government mergers include combinations of legally separate entities without the exchange of significant consideration. This Statement requires the use of carrying values to measure the assets and liabilities in a government merger. Conversely, government acquisitions are transactions in which a government acquires another entity, or its operations, in exchange for significant consideration. This Statement requires measurements of assets acquired and liabilities assumed generally to be based upon their acquisition values. This Statement also provides guidance for transfers of operations that do not constitute entire legally separate entities and in which no significant consideration is exchanged. This Statement defines the term *operations* for purposes of determining the applicability of this Statement and requires the use of carrying values to measure the assets and liabilities in a transfer of operations.

  Statement No. 69 is effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis.

SEC Report on the Municipal Securities Market

In July 2012, the SEC issued a comprehensive report with recommendations to help improve the structure of the $3.7 trillion municipal securities market and enhance the disclosures provided to investors. The report is the culmination of an extensive review of the municipal securities market that was initiated by former SEC Chairman Mary L. Schapiro in mid-2010 and led by SEC Commissioner Elisse B. Walter. The recommendations address concerns raised by market participants and others in public field hearings and meetings with Commissioner Walter and SEC staff as well as the public comment process during the agency's review of the municipal securities market.

"The municipal securities market is the bedrock for funding of local government projects throughout our country. It is essential that the market work well and that investors have confidence in it," said former Chairman Schapiro. "While we have put in place measures to help investors make more knowledgeable decisions about municipal securities, we could do more for investors with statutory authority to improve disclosure and muni market practices."

Commissioner Walter said, "On behalf of my colleagues and the professional and dedicated staff at the SEC, I am pleased that the report brings into clear focus the current state of the municipal securities market and recommends potential action to address issues raised by investors, issuers, and other market participants. I look forward to moving forward with the efforts articulated in our report to further strengthen and enhance this vital market."

State and local governments issue municipal securities to finance a wide variety of projects that are critical to building and maintaining the nation's infrastructure.

At the start of 2012, there were more than one million different municipal bonds outstanding totaling $3.7 trillion, with 75 percent held by individual "retail" investors.

Despite its size and importance, the municipal securities market has not been subject to the same level of regulation as other sectors of the U.S. capital markets due to broad exemptions under federal securities laws for municipal securities.

Without a statutory regime for municipal securities regulation, the SEC's investor protection efforts in the municipal securities market have been limited. The SEC's report discusses potential legislative changes that could help improve disclosures to investors. For instance, the report recommends that Congress consider authorizing the SEC to set baseline disclosure standards and require municipal issuers to have audited financial statements.

Other potential legislative changes recommended in the report to help improve disclosures and practices in the municipal securities market include:

- Eliminating the availability of Securities Act and Exchange Act exemptions for conduit borrowers who are not municipal entities.
- Authorizing the Commission to establish the form and content of financial statements for municipal issuers who issue municipal securities and to recognize a designated private-sector body as the standard setter for generally accepted for federal securities law purposes.
- Providing a safe harbor from private liability for forward-looking statements of repeat municipal issuers that satisfy certain conditions.
- Permitting the Internal Revenue Service to share information with the SEC that it obtains from returns, audits, and examinations related to municipal securities offerings, particularly in instances of suspected securities fraud.
- Providing a mechanism, through trustees or other entities, to enforce compliance with continuing disclosure agreements and other obligations of municipal issuers to protect municipal securities bondholders.

In addition to potential legislation, the SEC's report identifies potential rulemaking by the Commission or the Municipal Securities Rulemaking Board and enhancement of best practices by the municipal securities industry.

The SEC's report discusses several disclosure issues including the timing and content of financial information, disclosures relating to pension and other post-employment benefit plans, derivatives use by issuers and obligated persons, and conflicts of interest including pay-to-play practices. The report also reviews the current structure of the municipal securities market and discusses potential initiatives to improve pre-trade and post-trade price transparency and support existing dealer pricing obligations.

The report was prepared after substantial input from investors, investor advocates, market professionals, and representatives of municipal issuers – including those who participated in the SEC's field hearings in San Francisco, Washington D.C., and Birmingham, Ala.

The SEC already has taken steps to improve municipal securities disclosure within its limited regulatory authority. In May 2010, the Commission adopted amendments to Exchange Act Rule 15c2-12 that were aimed at improving the quality and timeliness of municipal securities disclosure. The changes were intended to help provide investors with enhanced information by further regulating those who underwrite or sell municipal securities. The measures strengthened existing requirements for the scope of securities covered, the nature of the events that issuers must disclose, and the time period in which disclosure must be made.