

The Regents of the University of California

COMMITTEE ON AUDIT

March 15, 2000

The Committee on Audit met on the above date at UCSF-Laurel Heights, San Francisco.

Members present: Regents Bagley, Davies, Moores, Nakashima, Sayles, Taylor, and Vining

In attendance: Regents Atkinson, Bustamante, Hopkinson, O. Johnson, S. Johnson, Khachigian, Kozberg, Lansing, Leach, Lee, Montoya, Pannor, and Preuss, Regents-designate Kohn and Miura, Faculty Representatives Coleman and Cowan, Secretary Trivette, General Counsel Holst, Provost King, Senior Vice President Kennedy, Vice Presidents Broome, Darling, Gurtner, and Pister, University Auditor Reed, Director Nation, Chancellors Cicerone, Dynes, Orbach, and Vanderhoef, and Recording Secretary Nietfeld

The meeting convened at 2:35 p.m. with Committee Chair Vining presiding.

APPROVAL OF EXTERNAL AUDIT PLAN FOR THE YEAR ENDING JUNE 30, 2000

The President recommended that the annual external audit plan for the year ending June 30, 2000 be approved.

[The plan was mailed to all Regents in advance of the meeting, and a copy is on file in the Office of the Secretary.]

Representatives of The Regents' external auditors, PricewaterhouseCoopers (PWC), presented the external audit plan for the year ending June 30, 2000. Mr. Carmine Guerro, Senior Advisory Partner, reported that since its appointment in November 1999 as The Regents' external auditors, members of the firm had visited the campuses, medical centers, Office of the Treasurer, and Department of Energy Laboratories and reviewed the work papers of the previous auditors in developing the audit plan.

Mr. Bob Forrester, Client Service Partner, noted that the scope of the audit and the services that the firm will provide are set forth in the plan. The reintegration of the UCSF medical center with the campus represents a major change in the audit that was presented to the Committee in November, and as a result a new partner will transfer to the San Francisco office to direct that account. In summarizing the audit plan, Mr. Forrester pointed out that it is recognized that University management has the primary responsibility for adopting sound accounting policies, maintaining an adequate and effective system of accounts, safeguarding assets and devising a system of internal control that will, among other things, help ensure the preparation of proper financial statements, compliance with applicable laws and regulations, and execution of the operating directives of management. His initial impression is that management has a good understanding of those responsibilities. The responsibility of PWC, as The Regents' independent accountants, is to conduct

an audit of the general purpose financial statements in accordance with generally accepted auditing standards and Government Auditing Standards and to report the results of the audit to the Committee.

Ms. Joan Murphy, administrative audit partner, explained that the audit has been designed based upon PWC's assessment of risk and would be coordinated with the internal audit, controllership, and compliance functions. In particular, the external auditors will assess the role of the controller position on each of the campuses. In conducting the audit, PWC will determine whether revenues were accounted for properly, whether appropriate controls were in place, whether the University was in compliance with its bond covenants, and whether management has taken action on prior recommendations. The results of the external audit will be presented to the Committee at its November 15, 2000 meeting. Ms. Murphy outlined the basic focus of the audit, which will address the following areas:

Campuses

PWC's strategy will be based upon an assessment of controls surrounding significant systems and procedures designed to verify major balance sheet accounts. The auditors will visit selected departments and operations. The purpose of these visits is to assess the local control environment, further understand departmental activities, and test compliance with federal regulations and University policies and procedures.

Computer System Controls

The primary purpose of the review of the University's computer systems is to gain comfort about the controls and accuracy of those systems which are relied upon to accumulate and provide accounting and financial reporting information.

Medical Centers

In auditing the University's medical centers, the firm recognizes that the University is affected by the changing nature of the delivery, financing, and regulation of health care, both in California and the nation. These changes can have a profound effect on the revenues recorded and the related reserves required to be estimated on the University's academic medical centers' receivables. This component of the revenue and receivables accounting cycle will be one of the key areas of focus during the audit. In addition, within the context of the audit, key personnel will be interviewed regarding the compliance programs that are in place at each of the medical centers. Experts on the audit teams will assist in the review of these areas, including specialists from the Healthcare Regulatory Advisory Group and the healthcare audit staff.

Plant Accounting and Capital Expenditures

With the projected growth in enrollment and research, the University has a number of significant construction projects in progress. The effective control and correct accounting for these activities is a critical issue for the University. The firm will audit significant capital expenditures during the interim and year-end audit procedures.

Mr. Forrester continued with the report, touching on the following areas:

Technology Transfer

The University has entered into a number of business relationships with commercial and other enterprises as part of its technology transfer and sharing programs. These relationships can be complex and require specific accounting. The Regents and the public have a legitimate concern about the development of intellectual property at the University of California. The auditors will obtain an understanding of the level of activity and how the University is accounting for these transactions and, on a test basis, will review these transactions as part of the audit of the financial statements.

Consolidation and Reporting

The consolidation and elimination of inter-campus and inter-entity balances and transactions is a complex process. PWC will work with the campuses, the medical centers, and the Office of the President to understand and test the effectiveness of the consolidation process and procedures to ensure appropriate and accurate accounting.

UCSF Medical Center

PWC will review the initial recording of assets and the working papers of the former auditors of UCSF Stanford Health Care and will evaluate the recoverability of the net assets recorded both on the initial date of recording but also as of June 30, 2000. The Office of the President will be provided with financial due diligence including the completion of certain agreed-upon-procedures over the financial areas of UCSF Stanford Health Care. The firm is providing advisory services to the campus related to the reintegration of the accounts and to certain processes of the medical center.

Laboratories

In the past, external financial and compliance auditing at the national laboratories has been conducted largely by the Department of Energy and its contractors, with limited participation by the University's independent auditors. At the request of the Office of the President and the laboratories, PWC will perform procedures that represent a modest extension of tasks done in the past in order to gain a deeper understanding of the internal audit program at the three laboratories and to assess overall internal and external audit activities within the

context of the audit of the University's financial statements. The auditors also intend to test certain contract costs for allowability and allocability.

Mr. Forrester reported on recently issued professional pronouncements that will affect the audit of the University's financial statements beginning with the years ending June 30, 2001 and June 30, 2002. During 1999, the Government Accounting Standards Board (GASB) issued Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions,[®] which is effective for the University in fiscal 2000-2001; Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments,[®] and Statement No. 35, Basic Financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities,[®] both of which are effective for the University in fiscal 2001-02. These standards will have a profound effect on the University's financial statements. Standard No. 33 will affect the way in which the University's revenue is classified and accounted for in the financial statements. The University has already begun assessing and developing an implementation approach to adopting these standards. The auditors are actively involved in assisting the University in its assessment. Standard No. 35 will have a significant effect on the form and content of the University's financial statements. PWC is working with the Office of the President to develop a smooth and cost-effective transition to the new accounting standards.

The American Institute of CPAs and the U.S. General Accounting Office have promulgated new standards that will affect the audit. The AICPA will require that the auditors report any unadjusted differences that arise from the audit. The auditors are also required to comment to The Regents on the quality of the accounting principles used, as well as the fact that they are acceptable under generally acceptable accounting principles. The auditors will perform detailed compliance tests of major federally sponsored research award programs and underlying internal controls. They will specifically test direct expenditures (payroll, purchasing, and service centers) for compliance with laws and regulations and with the provisions of contracts and grants awarded to the University. As required by OMB Circular A-133 and the OMB Compliance Supplement,[®] they will perform selected testing of predetermined indirect cost rates established in previous years. The audit scope and testing plans are being coordinated with internal audit to ensure that all requirements, including those related to information technology and OMB Circular A-133, will be achieved effectively and efficiently.

Mr. Forrester briefly described work performed by PWC outside of the external audit for The Regents. The firm has assisted the Merced campus in gathering budget data for presentation to the State. It has won engagements to assist the San Francisco campus with its information systems strategy and to help the Office of the President assess its human resources and payroll systems.

Mr. Guerro reported that PWC has made the decision to restructure its business. The firm of PricewaterhouseCoopers will include the assurance practice, tax and legal services, and other business advisory services such as its regulatory and compliance groups and will continue to conduct the audit and most of the other services being provided to the University. The firm's management

consulting, process outsourcing, financial advisory, and human resource consulting practices will be developed into one or more separate businesses.

Regent Leach recalled that when PricewaterhouseCoopers presented its audit proposal to The Regents, the number of estimated hours was substantially lower than the two most recent auditors spent. He asked whether PWC's estimation remained the same now that the firm is more acquainted with the scope of the engagement. Mr. Guerro responded that the number of hours should be within 10 to 15 percent of the original estimate.

Regent Leach observed that the Department of Energy does not share its audits of the national laboratory with the University and asked whether the additional work being planned by PWC will provide the Regents with a level of comfort with respect to the operations of the laboratories. Mr. Forrester believed that the additional procedures put into place by Assistant Vice President Van Ness should provide access to information from the DOE and the Office of Laboratory Affairs. At the request of Regent Leach, Mr. Forrester stated that, if further information is required, the auditors will so inform the Regents.

Mr. Forrester confirmed for Regent Taylor that the requirements of Standards 33 and 35 would add more hours to the audit than anticipated. He intends to submit a proposal to Vice President Broome to cover implementation of the government accounting standards.

In response to comments from Regents Taylor and Vining, Mr. Forrester indicated that he would continue to press the University's request for the results of audits of the DOE laboratories which are pertinent to the University.

In response to a question from Regent-designate Miura regarding the NCAA Agreed Upon Procedures Report, Mr. Forrester explained that the NCAA requires that each Division I campus perform an independent audit of certain procedures of its athletics department. The management letter will be transmitted to the chancellor, with copies provided to the Regents.

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

The meeting adjourned at 2:55 p.m.

Attest:

Secretary