

The Regents of the University of California

**COMMITTEE ON AUDIT**

May 25, 2005

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

Members present: Regents Blum, Lee, Novack, Parsky, and Ruiz

In attendance: Regents Dynes and Ornellas, Regents-designate Juline, Rominger, and Rosenthal, Faculty Representative Brunk, Associate Secretary Shaw, University Counsel Thomas, Senior Vice President Mullinix, Vice President Broome, University Auditor Reed, and Recording Secretary Nietfeld

The meeting convened at 3:55 p.m. with Committee Chair Novack presiding.

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

Upon motion duly made and seconded, the minutes of the meeting of March 16, 2005 were approved.

**2. ADOPTION OF STATEMENT OF ETHICAL VALUES AND STANDARDS OF ETHICAL CONDUCT**

The President recommended that the attached Statement of Ethical Values and Standards of Ethical Conduct be approved.

University Counsel Thomas informed the Committee that a minor amendment was proposed to the Standards of Ethical Conduct to add "Officers of the University" to the paragraph on applicability.

The Statement of Ethical Values and Standards of Ethical Conduct was sent to the Board of Regents for information in January 2005 prior to final review by the Academic Council, unions, and several other employee groups within the University. These various groups have had an opportunity to review and comment on the draft, and this feedback provided the basis for the version now addressed to The Regents for adoption. There have been some changes to the documents since the January iteration although for the most part they are minor.

During its review in January, the Committee on Audit recommended that the Statement of Ethical Values and the Standards of Ethical Conduct be applied to the Board of Regents as well as all other members of the University community and that recommendation is reflected here.

As reported in January, there is a robust commitment to ethical conduct embodied in existing University of California policies, codes, procedures, and other directives. This Statement

of Ethical Values and Standards of Ethical Conduct does not supersede existing codes or policies such as the Faculty Code of Conduct. Rather, the document organizes the substance of these many sources of ethical instruction, in order to raise awareness of this important commitment and to generate a higher level of interest in compliance.

Next steps include development of an online training program in both ethics and conflict of interest. A team is currently assessing available programs and essential topics for inclusion with rollout scheduled for early fall.

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

### 3. **APPROVAL OF ANNUAL REPORT, INTERNAL AUDIT PLAN 2005-2006**

The President recommended that the **Annual Report, Internal Audit Plan 2005-2006** 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.]

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

(At this point Regents Blum and Parsky and Senior Vice President Mullinix left the meeting.)

Regent Lee observed that the audit plan proposed that 31 percent of internal audit's resources be devoted to the national laboratories, although there is no assurance that the University will be awarded the contract to manage the Los Alamos National Laboratory. University Auditor Reed explained that the plan was intended to conform to current circumstances. As reported earlier to the Committee on Oversight of the Department of Energy Laboratories, the contract will be awarded later in the year, and there will be an eight-month transition period. He indicated that there may be a need to change the audit plan to address matters such as close-out costs and anticipated that the University's auditors at Los Alamos would remain there through June 30, 2006. In response to a further comment from Regent Lee with respect to a contingency plan, University Auditor Reed agreed to request that the auditors be asked to review the contract with respect to the potential need to change the audit effort. He noted that the auditors at Los Alamos are paid as part of the management contract.

Regent Ruiz requested that there be presented to the Committee an audit report from each of the campuses describing any ongoing issues that the Regents should be aware of. University Auditor Reed recalled that he provides a quarterly report to the Committee which includes a list of all audit reports for the quarter. He added that the intent of the Audit Tracker system is to identify whether management has taken all the corrective actions to

improve internal controls that flow from the findings and recommendations in the audit reports. If any of the reports finds a material deficiency in internal controls, these events are reported to The Regents. He noted that any Regent would be welcome to review any of these audit reports. Mr. Reed commented that the challenge he faced was how best to communicate the work of internal audit in a summary fashion that communicates ongoing issues.

With respect to Regent Ruiz' comments regarding a report from each of the campuses, University Auditor Reed acknowledged that one of his objectives was to improve communications with the Regents, and he offered to look into the suggestion.

Mr. Reed presented highlights from the audit plan, noting that the prime objective is to deploy resources to meet multiple objectives, including the following:

- Provide an audit program that addresses high and contemporary risks while ensuring appropriate attention to core business functions and broad audit coverage of the University over time.
- Assure adequate audit attention is directed to unique activities at all campus, health science, national laboratory, and Office of the President locations.
- Have available sufficient resources to perform investigations as necessary without excessive intrusion on the audit program and be available for consultations, special projects, and other management assistance as appropriate.

High-risk coverage will focus on major areas of concern including HIPAA security, the physical security of computers, and human subjects research compliance. The Core Audit Program was established in recognition of the fact that while a risk assessment process is necessary for the prioritization of efforts when resources are limited, by itself this process may not guarantee adequate audit coverage of fundamental business operations over time. The goal is to audit every location on a three-year cycle.

Regent-designate Juline suggested that Mr. Reed may wish to present an analysis of either an area of core coverage or a specific location as to any consistent concerns that may arise. He believed that Audit Tracker would be of assistance in this regard. The Committee should be informed of any systemic problems that are identified.

#### 4. **FINAL UPDATE ON PROTIVITI REPORT RECOMMENDATIONS**

It was recalled that at the March meeting a request was made for a final report on the status of implementation of all the recommendations contained in the March 2003 report from Protiviti on the University's internal audit program. The final status report is summarized in two documents that were distributed to the Regents in advance of the meeting.

The first document updates the Committee on the Protiviti recommendations that related to the University's consideration of appropriate elements of the Sarbanes-Oxley Act. It conveys the completion of those recommendations with the May 2005 actions to appoint a Financial Expert Advisor to the Committee on Audit and to consider for approval a Statement of Ethical Values and Standards of Ethical Conduct.

The second document summarizes and reports on the status of all other recommendations from the Protiviti report. Those recommendations dealt with aspects of the Committee on Audit's function as well as internal audit program matters mainly dealing with structure and reporting.

In summary, these reports demonstrate acceptance and implementation of the recommendations of Protiviti.

University Auditor Reed recalled that the University had declined to accept the recommendation that each member of the Committee be required to sign an annual statement of compliance with professional standards from the external auditors. An audit report which is issued at the end of each engagement is signed by each member of the audit team and states that the underlying audit work meets professional standards. The University adheres to the standards of the Institute of Internal Auditors and attests to that in every report.

#### 5. **SUMMARY OF THIRD QUARTER INTERNAL AUDIT ACTIVITIES, 2004-05**

University Auditor Reed recalled that ethics audits had been included in the 2004-05 internal audit plan. The Office of the General Counsel has retained outside counsel to consult with internal audit on this work. He anticipated presenting a report on these audits at the November meeting. Mr. Reed reported that the whistle blower hotline had been transferred to a new service provider, and a new case management tool has been established for all internal audit open investigations. In response to a question from Regent-designate Rosenthal, Mr. Reed explained that there is a link from the UCOP homepage to the whistle blower website, but there is no mechanism for lodging an online complaint. The website directs people to the confidential, third-party provider of a hotline service. The decision was made to remain with a personalized service rather than to go on line. The process also allows people to make a follow-up call based upon an assigned case number.

Regent Ruiz asked whether the Committee was informed on an ongoing basis with respect to whistle blower complains. University Auditor Reed pointed out that the hotline had historically provided about 25 to 30 percent of the matters that are investigated. A report on the operation of the hotline is presented annually. Significant matters are reported directly to the Chair of the Committee and the Chairman of the Board. He believed that internal audit had a reasonably successful history of reporting matters to the Committee before they become a major surprise. Regent Ruiz stated that he would be interested in knowing about similar reports coming from different sources, as well as whether the calls are concentrated on any one campus.

Regent Lee asked that University Auditor Reed present a quarterly report on whistle blower calls which would include the number received and the issues that are resolved. Mr. Reed noted that not all of these calls result in an investigation, as many are referred to human resources.

In response to a question from Regent-designate Rosenthal, Mr. Reed explained that State law requires the University to notify every employee at least annually about the whistle blower policy. Regent-designate Rosenthal suggested that a web-based whistle blower program would be attractive to younger employees.

Returning to his quarterly report, University Auditor Reed informed the Committee that last year Audit Tracker had been loaded with data from the audit reports issued for fiscal year 2003-04. He recalled that 2,058 recommendations for Management Corrective Actions (MCAs) were made in 2003-04. As of April 1, 2005, 60 percent were closed, 29 percent were open, and 11 percent were pending. The pending cases constitute those where management has reported that corrective action has been taken but the auditors have not yet validated this assertion. His goal would be to reduce the pending files to next to nothing. Mr. Reed displayed a slide which illustrated the rating distribution of the 589 open MCAs as high, medium, and low. Of the 264 open cases with a rating of "high," there are 80 that are 181 to 365 days past due. It was his intention to reduce these cases to zero by the November meeting. The campuses understand that they must respond.

Regent Lee believed that the data would be more meaningful if some details of these open cases were provided. University Auditor Reed commented that while he would agree, these details would be difficult to understand given the volume of the cases. He confirmed that the annual report will give a better overview.

In response to a comment from Regent Ruiz, Mr. Reed recalled that there is a process at each campus for reporting significant matters. Judgments are made at the Office of the President as to which incidents should be disclosed to the Regents. With respect to the recent thefts of laptop computers, Mr. Reed explained that typically these matters are handled within the information technology community. He has requested that an auditor be included on the response team for computer security breaches on every campus.

(At this point President Dynes entered the meeting.)

Committee Chair Novack pointed out that the Regents would agree with the observation that the number of past-due MCAs should be zero. He noted the importance of providing internal audit with adequate staffing levels in order to do the follow-up work. Management needs staff who will be able to implement the recommendations. University Auditor Reed commented internal audit expects the campuses to meet their commitments and not to make commitments that cannot be fulfilled with the available resources. The audit plan for 2005-06 budgets 9,000 hours for follow-up work.

Regent Novack summarized the discussion by noting that the Committee members are interested in receiving more information. Regent Ruiz added that the external auditors should be included in the process. Mr. Reed noted the presence of Mr. Mike Schini of PricewaterhouseCoopers, The Regents' external auditor.

Regent Novack turned to other matters of interest to the Committee, noting that the appointment of Mr. Kent Vining as a Financial Expert Advisor was being recommended to The Regents by the Nominating Committee. The Special Committee on Regents' Procedures is considering a further recommendation of the Nominating Committee pertaining to the independence of the members of the Committee on Audit such that spouses cannot be employed by the University. A recommendation has been made to the Committee on Finance pertaining to the indemnification of outside advisors. Two items are scheduled for the July meeting: an update on the Willd Body Program and a review of the external auditors' findings in the audit of the three national laboratories for 2003-04.

Mr. Schini confirmed for the Committee that the 2004-05 audits of the national laboratories would occur in the normal framework over the course of the summer and continue into the fall.

Committee Chair Novack commented that, in addition to completing its ongoing goals, the Committee had been successful in creating an environment in which risks could be discussed and hopefully actions would be put into place to minimize risks before they turn into events. The University has completed its response to the recommendations in the Proviti report, and high ethical standards have been set for the entire University community. A new process for more frequent financial reporting should prove useful to both management and the Regents, especially with respect to fine-tuning resources to meet the University's goals.

The meeting adjourned at 4:50 p.m.

Attest

Associate Secretary