

The Regents of the University of California

COMMITTEE ON AUDIT

September 21, 2006

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

Members present: Regents Coombs, Island, Parsky, Preuss, Ruiz, and Schilling;
Advisory member Oakley; Financial Expert Advisor Vining

In attendance: Regents Blum, De La Peña, Dynes, Gould, Hopkinson, Johnson, Kozberg, Lansing, Ledesma, Marcus, Pattiz, Schreiner, and Varner, Regents-designate Allen, Brewer, and Bugay, Acting Secretary Shaw, University Counsel Thomas, Chief Investment Officer Berggren, Provost Hume, Executive Vice President Darling, Vice Presidents Broome, Foley, and Gomes, Chancellors Birgeneau, Bishop, Córdova, Drake, Fox, Vanderhoef, and Yang, Acting Chancellors Abrams and Blumenthal, Provost Alley representing UC Merced, University Auditor Reed, and Recording Secretary Bryan

The meeting convened at 10:50 a.m. with Committee Chair Ruiz presiding.

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

Upon motion duly made and seconded, the minutes of the meeting of July 20, 2006 were approved.

2. **INTERNAL AUDIT PLANNING AND RISK ASSESSMENT PROCESSES**

University Auditor Reed recalled that the University's internal audit program was decentralized in 1978. The audit program reports functionally to The Regents through the Committee on Audit; campus programs report functionally to The Regents through the University Auditor and administratively to local managers. At the end of the last quarter, the University had 117 auditors at 12 locations; this includes an audit director at each location and specialists working in information technology and investigations.

Mr. Reed stated that the risk assessment process is a means of bringing discipline and a rationality to the audit process. Limited resources must be spread Universitywide. The University has 600 academic departments that are the basic business unit of the University through which most of the spending occurs. There are 14 health sciences schools on 6 campuses and 5 medical schools, associated with 8 hospitals and hundreds of clinics. The University has \$4 billion of contracts and grants expenditures annually, constituting in excess of 25,000 contracts and grants. There are over 500 organized research units, each of which is considered a business unit in auditing terms. They have discrete spending, hiring, firing, and contract authority, as do the academic departments.

There are upwards of 4,000 individual audits that could be done, making risk assessment particularly necessary. Last year's audit plan was based on 325 audits. In addition, the auditors do advisory services, some of which will substitute for an audit. For reporting purposes, the 4,000 audit possibilities are divided into 14 categories. The planning objective is to address, through a risk assessment process, the highest risks, some of which are constant within the University. Some risks are contemporary, such as the Y2K changeover that required a substantial preparedness effort. In about 1998, it appeared that risk assessment tended to drive the auditors away from the core business activities. A core element was developed to assure that these areas receive the necessary attention. The unique risks in individual business environments and coverage over time must be balanced across the University's lines of business, and the auditors must maintain a presence and visibility around the system.

Mr. Reed reported that the audit plan is driven by both risk-based assessment and cyclical auditing for the core program, which has 15 areas, each of which is audited every 3 years. Most are financially-oriented audits, but some have a compliance orientation; these include research, cost liability clauses, financial aid, gift processing, and the health care compliance program. Risk assessment starts in the winter; the audit plan is prepared in the spring and presented in May for Regental approval; and the plan is executed throughout the year, during which quarterly reports are issued. In November, the Regents receive an annual report. This constitutes an 18-month cycle. The process involves guidance by the Office of the University Auditor in terms of how the campuses budget and allocate their time and how they do the risk assessment process. Each location uses a model to assess risk and submits plans to the University Auditor. The plans are then consolidated and presented to the Regents. The input process for risk assessment involves discussions, interviews, surveys, financial analysis, trend changes, and growth of dollars by department. The industry, the economy, and regulatory agencies play a role and about 30 interviews are conducted at each University location. The 4,000 items in the audit universe are scored against five risk factors that are based on studies over the years. Quality and stability of the control environment are examined, as are materiality and liquidity of resources. Public and political sensitivity is the qualitative materiality counterpoint to the quantitative materiality and liquidity of fiscal resources.

Mr. Reed reported that each campus risk assessment is analyzed by the Office of the University Auditor for common themes around the system to ensure that locations have scored things consistent with risk. Based on the highest risks, audit plans are created that address risk, core, and balance. The chancellors approve the audit plans for their locations, and the University Auditor approves those plans for recommendation to the Committee on Audit.

In response to a request from Regent Lansing, Mr. Reed commented that he would welcome the opportunity to receive more input from the Regents as a whole and also Committee chairs in important areas of operations such as health sciences and the national laboratories.

Executive Vice President Darling believed it would be beneficial to expand the interaction the Auditor has with the Chair of the Audit Committee to include the Chairs of the Committee on Finance, Health Services, and others so that as the audit plan is formulated, all perceived risks or concerns may be put into the risk assessment and factored into the audit plan for the year.

Regent Blum noted that the system will always be accident prone by virtue of its size and complexity. He urged University Auditor Reed to report to The Regents any problem areas as they are identified.

3. **OVERVIEW OF SELECTED UC COMPLIANCE PROGRAMS**

University Auditor Reed recalled that compliance issues had been under discussion often during the past year. He discussed some of the existing University compliance programs. They are evolving and in different stages of maturity. Two of the most significant risks are research compliance and health sciences compliance.

Director of Health Sciences Compliance Jaffe commented that U. S. sentencing guidelines related to compliance programs are used as a benchmark to assure that compliance is a part of the organization and that specific high-level personnel have overall responsibility. Health system compliance programs have the following elements: a code of conduct; compliance officers, auditors and trainers; screening for excluded persons who do not do business with the government; an anonymous hotline; a helpline; training; audits; discipline; investigations, and when appropriate, reports to federal authorities. The compliance officer for health sciences has a reporting relationship with the medical school dean. A corporate compliance committee which includes high-level personnel oversees the day to day operation of the program. Certain capabilities are required to be put into the program such as auditing and training and legal and regulatory expertise. Because training is very expensive, resources must be expended to ensure the training is valuable to the attendees.

Mr. Jaffe reported that the code of conduct covers elements such as quality of care, confidentiality, conflicts of interest, and coding and billing. It attempts to promote due diligence to prevent and detect improper conduct and promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law and regulations. The health sciences compliance program conducts annual risk assessments. Its challenges include building relationships that enhance cooperation, managing risk on a short-term basis, applying enforcement consistently and fairly, and understanding the rules and communicating them clearly. An effective program will produce an environment in which people feel comfortable disclosing problems and individuals are not held accountable for system failings, yet it will not tolerate a conscious disregard of rules or gross misconduct. Compliance programs offer no guarantees, however. The University is extraordinarily complex, and problems will emerge occasionally. The goals are to develop a self-correcting organization that learns from problems and makes sure they do not happen again, to demonstrate to the public that the University is a good steward of State resources, and to ensure that stakeholders are treated with respect.

Director of Research Compliance Schlesinger reported that the Research Compliance program began in fall 2005 with the appointment of a director and the establishment of the Research Compliance Advisory Committee, which includes members of the Academic Senate and the offices of the General Counsel, Audit, Financial Management, Clinical Services, and Sponsored Programs. The committee addresses several areas, including human subjects, animal research, health and safety programs, research integrity and misconduct, and the Native American Graves Protection and Repatriation Act. Other research compliance activities remain located in other units of the Office of the President. These include contracts and grants and time and effort reporting.

Mr. Schlesinger noted that the goals in setting up a systemwide research compliance policy are to develop a compendium of best practices and to communicate to all the campuses legislative and regulatory developments. The first phase involves training the researchers to do the right thing in the first instance so that when monitoring and reporting commence they have had an opportunity to gather the information they need. For that purpose, web-based fact sheets and training materials have been developed, and training modules for both in-person and on-line training for other relevant courses will be made available soon. Reporting at the systemwide level involves consulting with campus compliance officers on the status of programs and informing the Office of the President as to their status. Many of the research compliance programs are well established and are embedded in existing administrative structures at the campuses. There is a research compliance or integrity officer on each campus and research compliance committees. At the Office of the President, the development of systemwide best practices, training development, and campus assistance concerning compliance issues are under way. Mr. Schlesinger believed that the program will reap benefits for the University for years to come.

University Auditor Reed commented that the presence of robust compliance programs leverages the ability of the University's audit programs.

Chairman Parsky noted that the position of Vice President–Chief Compliance and Audit Officer is being recruited and will report directly to The Regents.

Financial Expert Advisor Vining stated that the University is beginning a process which many corporate boards have undergone. The Sarbanes-Oxley rules will require the Regents to be aware and responsible for institutional control. The University may face in the future the same costs that corporate American has in order to document compliance and other financial reporting programs which will be required in order to conform with the rule changes that are likely to appear.

Regent Moores noted that the University is not bound technically by Sarbanes-Oxley. University Counsel Thomas responded that there are some sections of the act that apply universally because they are criminal provisions regarding things such as the destruction of documents and cooperation with federal investigators. With regard to the Committee on Audit, The Regents decided previously to comply with some of the best practices that have arisen out of Sarbanes-Oxley.

Regent Moores asked what duty chancellors or vice chancellors have to report violations to the Board. University Auditor Reed responded that Sarbanes-Oxley recommends the creation of a hotline, which the University has done. The University's whistleblower policy encourages employees to report to their supervisor any wrongdoing of which they are aware. If there is an accusation of a violation, it may be conveyed to the compliance and audit function and be subject to a defined process for elevating that concern and reporting it to the correct parties. The most significant issues are reported to the Regents as they occur, and the Regents are advised of all significant open investigation matters quarterly.

Regent Moores expressed concern that for publicly traded corporations Sarbanes-Oxley designates specific responsibilities to many individuals within the organization. Chairman Parsky suggested that at the next meeting there be a presentation on exactly how the compliance office will function concerning potential violations. The goal of the compliance program is to develop a culture in which individuals are willing to identify issues and bring them forward based upon their own expertise.

The meeting adjourned at 11:40 a.m.

Attest:

Acting Secretary