The Regents of the University of California

COMMITTEE ON COMPLIANCE AND AUDIT
November 3, 2008

The Committee on Compliance and Audit met on the above date by teleconference at the following locations: 1111 Franklin Street, Room 12322, Oakland; James E. West Alumni Center, Los Angeles Campus; 3750 University Avenue, Suite 610, Riverside; 931 Southwood Boulevard, Incline Village, Nevada.

Members present: Regents Cole, De La Peña, Reiss, Ruiz, Scorza, and Varner; Advisory member Croughan; Expert Financial Advisors Schneider and Vining, and Expert Compliance Advisor Guyton

In attendance: Regent-designate Stovitz, Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Compliance and Audit Officer Vacca, Vice President Broome, University Auditor Reed, and Recording Secretary Johns

The meeting convened at 11:25 a.m. with Committee Chair Ruiz presiding.

1. **PUBLIC COMMENT**

The following persons addressed the Committee.

A. Ms. Maricruz Manzanarez, a UCB employee and a representative of service workers at the University, noted UC's recent settlement with patient care workers. She urged the University to offer fair wages and a just contract to its service workers. She described extremely difficult conditions experienced by service workers and their families and emphasized that a University job should provide financial advancement for employees. She also stressed that UC has the financial resources to provide a fair contract.

B. Ms. Yolanda Gonzales, a UCR employee, spoke on behalf of more than 500 service workers on the Riverside campus. She emphasized the daily financial struggles service workers have to face and stated that their wages are 30 percent below market. She stated that service workers on campus are looked on as second-class citizens. She urged the University to recognize them and give them a fair, livable contract, one that would make it possible for a UCR worker to purchase a home in Riverside.

C. Mr. Leo Tolliver, a UCR employee, urged the Regents to accelerate the contract negotiation process for UC's service workers and to offer them a decent wage. He reported that some UC workers are not able to meet their children's needs. He emphasized the importance of the work performed by the service workers and urged the University to bring them out of poverty.

2. APPROVAL OF MINUTES OF PREVIOUS MEETING

Upon motion duly made and seconded, the minutes of the meetings of September 11, November 7, and December 17, 2007, and August 27, 2008 were approved.

3. FAIR AND ACCURATE CREDIT TRANSACTIONS ACT UPDATE

Chief Compliance and Audit Officer Vacca informed the Committee that she will submit a plan for Committee approval in January 2009 regarding identity theft prevention. This plan is in response to the "Red Flag Rules" which are part of the Fair and Accurate Credit Transactions Act of 2003. While there is an implementation deadline of November 1, 2008 for these rules, enforcement agencies are allowing more time for implementation across industries.

4. ANNUAL REPORT OF THE EXTERNAL AUDITORS FOR THE YEAR ENDED JUNE 30, 2008

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

PricewaterhouseCoopers (PwC) representative and UC's lead engagement partner Joan Murphy recalled that PwC issues several reports resulting from its audit. She began with an overview of the Required Communications to The Regents' Committee on Compliance and Audit. She recalled that PwC has been engaged to conduct an audit in accordance with generally accepted auditing standards as well as government auditing standards. This is because, in addition to a financial audit, PwC also performs an audit in accordance with U.S. Office of Management and Budget (OMB) Circular A-133, which is required by the high level of federal awards received by the University. Ms. Murphy specified that the audit gives reasonable but not absolute assurance regarding detection of material fraud. While PwC examines internal controls in designing its audit, it does not separately opine on the internal control environment. The deadline for the A-133 audit report is March 31, 2009, and this audit is still in process. The current presentation concerns the audit of financial statements.

Ms. Murphy recalled that this year, the University adopted Governmental Accounting Standards Board (GASB) Statement 45, which requires UC to record post-employment benefits that are not pension benefits using accrual basis accounting, rather than on a cash basis. The private sector, under the Financial Accounting Standards Board (FASB) standards, has been recording these benefits on an accrual basis for many years. GASB 45 has now applied this requirement to public institutions. The implementation of GASB 45, representing the cost of retiree health benefits on an accrual basis, decreased the University's changes in net assets by $1.36 billion. Another pronouncement, GASB 52, had a minimal effect on the University.

As part of its transactions with the Lawrence Livermore and Los Alamos laboratories, the Department of Energy (DOE) acknowledged its financial responsibility for these Other Post-Employment Benefit (OPEB) obligations for retirees of those two laboratories. The $1.36 billion expense recorded by the University does not include costs for these individuals; it includes costs for Lawrence Berkeley National Laboratory (LBNL) employees and retirees.

In conjunction with the adoption of GASB 45, the University created the UC Retiree Health Benefit Trust (UCRHBT) to serve as a mechanism for funding of these benefits.

Ms. Murphy recalled that on October 1, 2007, the Lawrence Livermore laboratory moved into the joint venture arrangement, out of UC's direct oversight. The UC Retirement Plan transferred $1.6 billion in assets to the plan which now covers those employees and retirees. This was similar to the transaction that took place at the Los Alamos National Laboratory.

Ms. Murphy noted that in previous years the University did not record a receivable for estimated recovery in the Enron securities litigation. In 2008, litigation has proceeded far enough to allow UC to record a $35 million receivable for estimated recovery.

Ms. Murphy then discussed those accounting policies of the University which are most critical, sensitive, or subject to judgment. One is the establishment of revenue, contractual and other reserves for the medical centers. Other sensitive accounting policies concern federal reimbursement rates for grants received and the University's post-employment benefit obligation. She recalled that UC's financial statements include some amounts that are easily verified, while others are subject to estimation. Actuaries advise University management on some of these accounts, and their assumptions change over time.

In response to a question asked by Committee Chair Ruiz, Ms. Murphy expressed confidence in the accuracy of the University's estimates of these amounts. She noted that the University is served by actuaries who know the institution well, and by different actuaries for different obligations.

Ms. Murphy noted that, in some areas, the University has choices on how to apply accounting policies, and that its procedures differ from those of private industry.

Ms. Murphy then enumerated some estimates in the University's financial statements, including self-insurance reserves, reserves for bad debts, and reserves for medical center third-party payor settlement liabilities. The University has a significant portfolio of non-readily marketable securities. Since there is no daily trading for these securities, their pricing is subject to estimation. The Office of the Treasurer monitors the performance of these investments.

The University's financial statements include disclosure concerning the volatility of the investment market after June 30, 2008. Ms. Murphy stressed that, if there were any specific events causing a significant decline in the University's portfolio, these would

have to be disclosed. While there has been a general market decline, there have been no such specific events. She noted that the University had interest rate swap agreements with Lehman Brothers and Merrill Lynch. It is now investigating options for terminating those contracts.

Vice President Broome informed the Committee that the University has terminated its agreement with Lehman Brothers, working with a swap advisor. The University's new counterparty is Deutsche Bank.

In response to a question asked by Regent Varner, Ms. Murphy expressed confidence in the estimates in the University's financial statements.

In response to a question asked by Expert Financial Advisor Schneider, Ms. Murphy affirmed that the estimation processes used by the University are the same as those used by public companies.

Ms. Murphy then noted adjustments which were recorded as a result of PwC's audit. The overall net impact of these adjustments was a decrease in net assets of just under $29 million. Most of the decrease was related to changes in the valuation of non-readily traded securities.

Ms. Murphy reviewed potential risks regarding federal reimbursements for medical center operations, federal awards, DOE oversight of Lawrence Berkeley National Laboratory, State appropriations, which can be modified without warning, and litigation.

Ms. Murphy pointed out that PwC did not identify any significant deficiencies or material weaknesses. She affirmed PwC's independence of the University and briefly discussed the purpose and intention of UC's management representation letter to PwC.

In response to a question asked by Committee Chair Ruiz, General Counsel Robinson confirmed that it was legal for Interim Provost Grey to have signed the management representation letter to PwC for President Yudof.

Ms. Murphy then commented on PwC's Observations from Agreed Upon Procedures at the Lawrence Berkeley National Laboratory (LBNL). These procedures go beyond audit and focus on the internal control environment. Accounts payable was the only area in which PwC had a recommendation. DOE laboratories have a September 30 year-end, while it is important for UC purposes to conduct a stringent review of accounts payable at the UC financial close on June 30. PwC found an unrecorded liability of $2.9 million not detected through LBNL's normal process. Ms. Murphy briefly described the LBNL management response.

In response to an observation by Committee Chair Ruiz, Ms. Murphy cited the last sentence in the management response: "Following this recommendation, and in subsequent months beyond June 2008, the Lab began to properly accrue for these uncertified items as part of its month-end close procedures."

In response to a remark by Regent Reiss, Ms. Murphy confirmed that these items will be listed as accounts payable even if they have not been certified. Regent Reiss asked if the financial statements would include a notation of these amounts. Ms. Murphy responded that LBNL would have to assess whether these amounts were owed at the June 30 year-end. She explained that the assets and liabilities of the national laboratories are kept track of by DOE. LBNL activities are tracked by UC through the statement of net assets.

PwC senior manager Karen Li discussed the report to the Regents' Committee on Compliance and Audit for the year ended June 30, 2008. The report presents findings based on testing of key controls at the Office of the President, the campuses, and the medical centers; there are four themes in this year's report. None represent material weaknesses or significant deficiencies.

The first recommendation is for improvement of reviews and the timeliness of controls. While reconciliations were reviewed, evidence of review was not always clear, and reviews could be conducted in a timelier manner. PwC recommends that each location formally implement policies which highlight appropriate evidence retention procedures. Ms. Murphy added that, in certain locations, the lack of timeliness was due to employee turnover.

Committee Chair Ruiz observed that this issue arose last year. Ms. Murphy emphasized the size of the University and the many locations and departments where reconciliations and reviews are carried out. The lack of evidence of timeliness was not widespread, but present at enough locations to cause PwC to comment on it.

In response to a question asked by Committee Chair Ruiz, Ms. Murphy stated that the situation is improving and that some locations are more challenged than others.

Ms. Li then noted that the audit identified two adjustments involving non-routine transactions. PwC's second recommendation is that UC management reinforce the importance of communicating non-routine transactions to the controller's office in a timely fashion.

In response to a question asked by Committee Chair Ruiz, Ms. Li responded that the two instances involved amounts of approximately $11 million and $9 million. One instance was reported in UC's financial statements and published at year-end. The other instance was identified later and not recorded in the financial statements. Ms. Murphy added that the second instance did not meet the reporting threshold.

Committee Chair Ruiz referred to the negative $29 million adjustment presented and explained on page 15 of the Required Communications to The Regents' Committee on Compliance and Audit, and requested a clarification of its relationship to the two adjustments just discussed. Ms. Murphy explained that the $11 million adjustment formed part of the total $29 million negative adjustment, but that the bulk of the negative adjustments were due to a change in the valuation of investments.

In response to a question asked by Committee Chair Ruiz, Ms. Li explained that a "significant deficiency" would be over $37 million for the past year. The threshold for what is deemed a significant deficiency changes annually based on operating expenses and other factors. Ms. Murphy added that a $37 million or higher adjustment would not automatically give rise to a control deficiency.

Faculty Representative Croughan suggested that increased use of centralized databases would lead to fewer control deficiencies. Ms. Murphy anticipated that control deficiencies surrounding non-routine transactions will still occur. The two instances in question concerned the leasing of radio waves, a unique transaction. What is essential is that anyone involved in such a transaction be aware that there is a financial reporting implication.

In response to a question asked by Committee Chair Ruiz, Ms. Murphy opined that these two instances did not warrant a further report to the Committee, and that the actions at each location were appropriate.

Ms. Li then discussed the third recommendation, that each location should perform periodic review of information technology professional and application user access rights and ensure that those individuals' access rights are commensurate with their job responsibilities. She noted that this situation is improving.

In response to a question asked by Mr. Schneider, Ms. Li confirmed that PwC did not identify any instances where an employee or terminated employee had unauthorized access rights.

Committee Chair Ruiz suggested that the management response to this recommendation could have been more satisfactory. He suggested that the response could include a proposal for action with specific timelines.

Vice President Broome noted that Dan Sampson, Assistant Vice President, Financial Controls and Accountability, follows up on the implementation of all recommendations by outside accountants. He seeks specific information from locations about their plan for implementation and compliance and checks their progress. Ms. Broome suggested that the Committee might wish a more specific response on the University's internal follow-up procedure.

Committee Chair Ruiz stated that whenever possible, he would like a concrete response by management on action and timelines.

Expert Compliance Advisor Guyton noted that this issue also concerns compliance and emphasized the importance of documenting remediation and of an audit trail to monitor access rights.

In response to a question asked by Regent Scorza, Ms. Murphy explained that PwC's audit is focused on financial reporting and does not examine how this corresponds to the University's compliance efforts. She pointed out that, in its report next year, PwC will note if there has been improvement in the areas of the recommendations. She noted that PwC visits six locations every year; other locations are visited on a rotating basis.

Committee Chair Ruiz observed that Associate Vice President and Chief Information Officer David Ernst would play an important role in how the University approaches this issue.

Ms. Li then turned to the fourth recommendation, which concerns database administrators with direct access to and ability to change data such as vendor or payroll information. PwC recommends that each location perform a risk-based analysis to determine which data types are most susceptible or risky, and whether these data types should be monitored. This is a recurring issue; it was the subject of a recommendation last year. However, there has been improvement in this area over previous years.

Committee Chair Ruiz found that the management response to the recommendation was not strong enough; the response should guarantee implementation of a solution. Ms. Murphy observed that the response is rather generic. She recalled that last year, when this issue was raised and understood at one of the larger locations, the location embarked immediately on corrective measures.

Mr. Schneider stressed the seriousness of this issue and the necessity for follow-up action to assure the Committee and the Regents that these problems have been fixed. He recalled that the PwC audit is not designed to detect fraud and that this is an area where fraud can occur.

Committee Chair Ruiz suggested that this issue could be the topic of a report at a future meeting.

Mr. Vining observed that, in private industry, vendor databases are the area where controls are most often breached and information misused. Fraud is most often discovered in vendor transactions. He urged the University to focus on this area first.

Ms. Murphy observed that PwC tests both systems and manual controls, and that manual controls sometimes compensate for weaknesses. Nevertheless, there is no reason for the University not to make the recommended improvements.

In response to remarks by Ms. Vacca on the methodology used by PwC, Ms. Murphy clarified that a more detailed report exists for action-specific follow-up; the report now being discussed is a high-level summary.

Ms. Broome noted that, according to the Statement on Auditing Standards (SAS) 112, it is part of PwC's obligation to report on control weaknesses. She emphasized the size,

diversification, and decentralized nature of the University and described the internal follow-up procedure for control weaknesses.

5. **INFORMATION TECHNOLOGY SECURITY INVENTORY**

Associate Vice President and Chief Information Officer David Ernst informed the Committee of his areas of focus during his first three months in this position. His visits to campuses have shown that information security is an area of keen importance. It is a major challenge for the University to solve this problem systemwide.

Mr. Ernst recalled that the campuses performed a self-assessment last year. During the last month, he authorized a second self-assessment. Results of this assessment will be presented to the Committee in March 2009, including information on needed improvement and possible systemwide purchase of security protection software. He emphasized the importance of implementing best practices across the system.

One focus of the current assessment is information security training. Mr. Ernst observed that most security problems derive from human behavior. Training in good information security practices is important for all UC employees, faculty, staff, and students. Each campus should have, but does not currently have, a full-time information security officer. Each campus should also have an information security plan based on systemwide specifications.

Mr. Ernst noted that incident responses and notification to management should be more rapid. Rules for data access should only be formulated once, and applied systemwide.

It is essential that the University carry out a full assessment of risk and vulnerability. Written security plans for each campus will provide a benchmark of progress for management and for the Regents.

Mr. Ernst observed that the University could do a better job of examining its logged data and could improve its backup and recovery strategies. Ongoing security assessment could combine self-assessment and external review. There should be an annual report on the University's response to its information technology security challenge.

Mr. Ernst concluded that his next steps will be to complete his campus visits and develop recommendations for an action plan.

Expert Financial Advisor Vining asked about the funding and resources available to the University to address the issue of information security and ensure that the University is in compliance with good practices. Mr. Ernst responded that the important first step is to develop a budget with a reasonable set of top priority items. He advised that not all issues could be addressed at once.

Committee Chair Ruiz asked Mr. Ernst for a copy of his presentation.

6. **UNIVERSITY OF CALIFORNIA ETHICS AND COMPLIANCE SERVICES ANNUAL REPORT FOR 2007-08**

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Chief Compliance and Audit Officer Vacca presented the UC Ethics and Compliance Services Annual Report for 2007-08. She recalled that the Board of Regents officially adopted the systemwide Ethics and Compliance Program in July 2008. Compliance risk committees have met and identified a campus ethics and compliance officer at every campus but one. Ms. Vacca observed that the formation of high-level campus risk committees is a new concept for the University and will require more effort and skill.

The program has identified priority risk areas and is working both with management and with the internal audit program. The performance metrics of the program are tied to the accountability framework established by President Yudof.

Regent Reiss referred to a chart showing percentages of substantiated cases of misconduct in fiscal year 2007-08. She requested information from previous years, so that the Committee could see if there are trends in the substantiated cases of fraud, sexual harassment, and other inappropriate activity.

Regent Reiss asked about the definition of "workplace misconduct," which accounted for the largest percentage of substantiated cases. Referring to a chart showing remedies implemented in fiscal year 2007-08, she noted that legal action was not one of the remedies listed. She asked how many cases of fraud, theft, or embezzlement the University directs to the district attorney for criminal charges.

Ms. Vacca responded that the University's database does not currently allow for year-to-year comparisons or for more detail on what activities are considered "workplace misconduct." The University is now in the process of implementing a new database which would provide the kind of detailed answers requested by Regent Reiss.

Regent Reiss requested a definition of what constitutes "workplace misconduct" at a future meeting of the Committee.

General Counsel Robinson stated that he did not have specific data but confirmed that the University refers employee misconduct cases to the district attorney for prosecution and has assisted in prosecuting some cases. Ms. Vacca concurred that many cases have been referred to external enforcement agencies and that there has been appropriate cooperation with those agencies.

Regent Reiss stressed that employee training should communicate forcefully that any fraud, theft, or embezzlement will be prosecuted to the full extent of the law. Ms. Vacca responded that this is included in employee training.

Expert Financial Advisor Schneider asked if remedies shown on the chart address all complaints or only substantiated cases. Ms. Vacca responded that information is received through the University's vendor hotline; not every aspect of an issue is captured. Remedies are applied in cases of activity that has been validated as improper action.

Committee Chair Ruiz noted that he recently met with President Yudof, and that the President expressed the desire for more rapid cultural change at the University. He stated that he would be meeting with President Yudof, Ms. Vacca, and Expert Advisors Guyton, Schneider, and Vining later that day to discuss the design of UC's ethics and compliance program.

Ms. Vacca noted that President Yudof is establishing audit and compliance committees for the Office of the President. These two committees are being established with high-level senior leadership.

Committee Chair Ruiz asked that Committee members read this report, noting that it will be used as a reference.

Referring to the earlier question of prosecution, University Auditor Reed clarified that the University does not decide which cases are prosecuted. Every matter involving criminal activity is referred to the district attorney or appropriate law enforcement entity; that entity then makes a determination about prosecution.

Expert Compliance Advisor Guyton suggested that the University track matters referred to law enforcement entities.

Regent-designate Stovitz asked if the ethics and compliance program has a formal way of transitioning from its investigation to its training function. As an example, he asked if inappropriate actions in promotion or hiring, when discovered, could be included in employee training and education. Ms. Vacca answered in the affirmative. She referred to the high-level committee at each campus. Any substantial issue will be brought to this committee, and the committee will be tracked to ensure that part of its mitigation effort is related to training. If appropriate, the issue could be included in systemwide training.

Mr. Guyton asked if the University is able to track events by campus, in order to observe trends over one or two years. Ms. Vacca responded that the University can track events that have been reported, but stressed that, historically, only events defined as "improper governmental activities" have been reported to the Office of the President. The system is currently being strengthened so that all compliance issues come forward, not only improper governmental activities, and to improve tracking.

Mr. Vining observed that the fact that a campus has not reported events could be negative rather than positive. Mr. Guyton concurred.

Mr. Vining further observed that there could be cases which the University could not resolve through discipline or termination, concerning tenure or other issues, where criminal charges might be brought against a professor.

7. **PRESENTATION OF AUDIT AND ADVISORY SERVICES, SANTA CRUZ CAMPUS**

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

UCSC Director of Internal Audit and Advisory Services Geraldine Gail began her presentation with general facts and figures about the Santa Cruz campus, which has grown significantly since its opening in fall 1965. It has strong programs in the arts, social sciences, engineering, and humanities. Its linguistics department is ranked first in North America. The campus manages over 6,088 acres of land in the main campus and other facilities.

The UCSC student population is rapidly growing. The campus anticipates an enrollment of 15,725 students in 2008-09, with 14,255 undergraduates and 1,470 graduate students. This year's freshman class of 3,850 was selected from 27,800 applicants, with an average GPA of 3.7. The UCSC budget is the second smallest in the UC system, and the State budget cuts have had a severe effect on the campus.

There is a great deal of construction under way on campus, commensurate with plans to enroll over 17,000 students by 2011. Last year the campus had $174 million in new construction projects in process or recently completed.

Ms. Gail referred to the University Affiliated Research Center (UARC) at NASA Ames and noted that the campus' contract and grant support has tripled in the last ten years. This year it is estimated at $131 million. The UARC is a ten-year, $300 million national research program managed by UCSC and NASA. Its topics of research include space exploration, air traffic management, and nanotechnology. She also mentioned the UCSC Silicon Valley Center, which offers classes in the South Bay. The campus recently received $16 million for stem cell research.

Ms. Gail then discussed two of the campus' principal control challenges. The first is the reduction of resources due to State budget cuts, which makes it difficult to sustain control activities in a period of rapid growth. The second challenge results from changes in computing technology. New risks or threats arise quickly, and it is difficult to implement information security with limited resources.

The UCSC internal audit program works with the University Auditor and auditors on other campuses to work more efficiently, to develop its skills, and to employ effective auditing tools. Ms. Gail cited the systemwide implementation of TeamMate auditing software as an example.

The UCSC internal audit program has a staff of 6.75 FTE, with 4.75 auditors and one full-time analyst. The program is challenged in achieving its goals with its small staff. The effect of staff turnover is much greater than in a larger audit program such as that of UCLA. The Santa Cruz campus has over 200 auditable campus processes, systems, and units. In an environment of budget cuts and cuts to control units, Ms. Gail has additional responsibilities to ensure that control structures are not compromised. Like audit programs on other UC campuses, the UCSC program is required to perform 19 core audit subjects within a 3-4 year cycle, to review the top 10 campus risks, and to respond to special requests from the Office of the President, the University Auditor, the Regents, and campus management.

The UCSC campus audit committee meets quarterly and includes representation by top administrators. The committee discusses risks and controls and works closely with the campus controller. In order to maximize resources, Ms. Gail indicated that she focuses on review of process controls; currently she is reviewing the purchase-to-pay cycle. Controls in the information technology system are always examined. The vendor database has been examined and there is security over key vendor files. Ms. Gail emphasized the importance of information technology audits at UCSC.

Ms. Gail informed the Committee that she will be retiring in July 2009 and reflected on the advances in auditing in the thirty years of her experience. She praised University Auditor Reed's efforts to bring together the campus auditors as a collective function to share expertise.

Ms. Gail concluded with some observations and recommendations for the University. Special attention should be paid to ensure that UC control structures are strengthened and maintained. In difficult economic times, the internal audit program, accounting offices, and other control-related units, such as environmental health and safety, become more important to ensure that University funds are well spent. Budget cuts are often made to administrative units. Ms. Gail opined that risk analysis must always be carried out before cuts are made to control activities. She emphasized the importance of support for information technology systems security and of maintenance funds for timely systems updates.

Ms. Gail stressed the need for updated campus and systemwide policies and procedures. As an example, she cited a need for updated document retention policies which would address the disposition of internet and email communications. Current policies are out of date and the campuses are looking to the Office of the President for guidance.

Ms. Gail requested that the University find the means to support training of UC staff, faculty, and students to ensure compliance with laws, regulations, and best practices.

Committee Chair Ruiz thanked Ms. Gail for her observations and for her service to the University.

8. **ANNUAL REPORT ON INTERNAL AUDIT ACTIVITIES 2007-08**

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

University Auditor Reed briefly presented the annual report on internal audit activities for 2007-08. He noted the challenge in synthesizing the work of more than 100 UC employees carried out during the year into a report. The report serves to communicate the outcomes of internal audit activity to the Committee. The internal audit program found nothing that it would consider a material deficiency at any location, and Mr. Reed noted that management was cooperative and worked with the internal audit program on solutions to control deficiencies. The program had unhindered access to people, records, and facilities. It is not aware of anything that should have been reported to the Regents that was not reported. Mr. Reed referred to the accountability framework established by President Yudof and noted that the report contains performance standards and benchmarks for the program.

The internal audit program issued 652 audit, advisory services, and investigation reports during the past year. It made 2,253 recommendations which led to management corrective actions (MCAs). The recommended MCAs include a request for information on who will carry out the MCA, what will be done, and when. The MCAs are tracked in a database. There are currently 19 high risk MCAs which are past due. Mr. Reed pointed out that these 19 items are past due not because of management inaction; the situation is often due to a delay in implementation of information systems, or there are other valid business reasons. The internal audit program wishes to ensure that, when these outstanding MCAs are reported to the Committee, there is a revised plan in place for near-term completion of these items.

Mr. Reed then discussed internal control themes based on recurring observations on the need for improvement in controls in information security, information privacy, supervision, monitoring, and account reconciliations. He emphasized the importance of account reconciliations at the department level as a cornerstone of the University's controls. The University's new effort reporting system is a continuing control concern. Reporting on conflict of interest and conflict of commitment is challenging because of numerous UC policies and state laws. Mr. Reed noted that it is difficult to maintain a desirable separation of duties at the department or unit level, especially when controls are challenged by budget cuts. The traditional response to an inadequate separation of duties is more supervision. That supervision may not be reliable when it is provided by non-business managers.

The report also provides information on the adequacy of staffing. Mr. Reed noted some challenges in this area. The University is sponsoring a research project, with the Institute of Internal Auditors Research Foundation, to determine better criteria for audit staff requirements in relation to risk in higher education.

9. **RISK MANAGEMENT UPDATE**

Chief Risk Officer Grace Crickette reported that the University is dedicating significant resources to threat and security issues. Assessments are currently taking place on six campuses which may lead to the installation of security systems. The Office of Risk Services is working with campus leadership, police departments, risk managers, and outside security firms. Ms. Crickette stressed that these outside firms are superior in their field. She described some features of the commercial alarm systems being installed and the limitations of some devices.

Security assessments of high-risk buildings have been completed or are in process on five campuses and should be complete at all relevant locations by June 2009. Ms. Crickette pointed out that this process is costly but essential for the protection of UC employees. The high cost is related to equipment installation and maintenance.

Ms. Crickette then discussed employment practices, one of the University's more significant areas of risk. In an effort to make improvements in this area, the Office of Risk Services has been working with the Office of General Counsel. Since the last Committee meeting, an Employment Practices Improvement Committee has been formed. There have been meetings with campus vice chancellors for administration and chief human resource officers to solicit their opinions on how to make improvements in this area. The Office of Risk Services is working with the University's third-party administrator to identify cases for early resolution. The University has revised its defense guidelines for outside counsel. Another effort now planned is management improvement training with key leaders at each campus.

Faculty Representative Croughan reported on compliance efforts with the faculty on training programs. These programs, now under review by the systemwide Academic Senate, are not supported by all faculty. She noted that many faculty still find the online effort reporting system difficult to use and that she is working with Director Jon Good on this. One point of particular difficulty is reporting for a staff member funded by more than one source.

In response to a question asked by Expert Compliance Advisor Guyton, Ms. Croughan noted that conflict of interest reporting is a less serious concern of faculty. She described conflict of interest reporting as a routine part of publishing a paper in an academic journal or making a scientific presentation. Faculty are used to this, but many are not accustomed to spending two hours on online sexual harassment prevention training.

In response to a remark by Mr. Guyton, Ms. Croughan stressed that faculty appreciate the need for effort reporting; they are concerned about the difficulty of the system for accomplishing it.

University Auditor Reed referred to audit work done in recent years on conflict of commitment reporting which showed deficiency in this area. He noted that there are still

outstanding questions and a need for policy clarification on what kinds of outside activities are permitted.

Ms. Croughan noted that this gray area in policy is a major concern for deans who maintain a faculty appointment, but operate under different guidelines.

The meeting adjourned at 1:25 p.m.

Attest:

Secretary and Chief of Staff