The Regents of the University of California

COMMITTEE ON AUDIT
April 28, 2008

The Committee on Audit met on the above date by teleconference at the following locations: 1111 Franklin Street, Room 10325, Oakland; 5123 Cheadle Hall, Santa Barbara Campus; 700 S. Flower St., Suite 3000, Los Angeles; 3750 University Avenue, Suite 610, Riverside.

Members present: Regents Bugay, Lozano, Ruiz, Schilling, and Varner; Advisory member Croughan

In attendance: 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 11:00 a.m. with Committee Chair Ruiz presiding.

1. **PUBLIC COMMENT PERIOD**

There were no speakers wishing to address the Committee.

2. **UNIVERSITY OF CALIFORNIA, SAN DIEGO AUDIT AND ADVISORY SERVICES PRESENTATION**

[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.]

UCSD Audit and Advisory Services Director Stephanie Burke began her presentation with background information about the San Diego campus. She noted high rankings received by the campus from the National Science Foundation, U.S. News and World Report, and the Washington Monthly. The campus' revenue is $2.4 billion, with contracts and grants totaling $714 million. The current population of approximately 21,000 undergraduates is 92 percent of the expected steady state of 23,000. The average incoming freshman grade point average is 3.93. The graduate student population, about 5,500, is 60 percent of the expected steady state of 9,200. The current graduate population includes 1,400 medical students and 200 pharmacy students.

UCSD Audit and Advisory Services staff has 17 FTEs: the director, three managers, one administrator, one systems support staff member, and 11 professional auditors. There are 11 certified public accountants, 5 certified internal auditors, 8 certified information systems auditors, 3 certified fraud examiners, and 1 certified professional coder for medical billing, all with an

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average of 17 years of experience. The office performs financial, compliance, operational, and information systems audits and advisory services for the campus and the Office of the President.

Next Ms. Burke discussed how the campus' audit program has assisted UCSD in maintaining information systems security. This area is a continuing challenge for the University, which is subject to a number of regulations regarding electronic information storage, such as the Health Insurance Portability and Accountability Act (HIPAA), the Family Educational Rights and Privacy Act (FERPA), California SB 1386, and payment card industry standards. The risks and costs of inadequate security are increasing while there is a lag in information technology to counteract security threats.

The UCSD audit program has been active in the campus' Administrative Computing and Telecommunications Policy Committee, which has published revised minimum campus-wide standards for information security. This reflects the campus' philosophy of providing control advice before problems surface. Ms. Burke noted a pilot program now under way to provide training for system administrators. Over the last two years, campus audit has carried out several reviews of information technology security in various vice chancellor areas. This has resulted in a clarification of security roles and implementation of improved security practices. The reviews have sometimes included remote electronic vulnerability assessments. In the current year, reviews have been expanded to test for application-level control vulnerabilities. An audit of HIPAA information security drew attention to the need for improvements to the computer security environment, for central security administrative efforts, and for additional security measures. In response there has been a clearer delineation of responsibility and accountability. Network security at UCSD has improved, including performance of scanning and analysis, intrusion detection, and periodic security assessments. Compromised hosts are being blocked.

Ms. Burke turned to current challenges and opportunities. Campus budget reductions will strain systems of internal control, and the demand for audit services is likely to increase as key positions remain unfilled and internal controls are bypassed in order to reduce costs. The number of external regulatory audits at UCSD is increasing. The campus audit office serves as the liaison for State, federal, and local entities which perform reviews. There have been 20 active external audits during this fiscal year, carried out by the California Department of Health Services, the National Science Foundation, and the County of San Diego, among others. There is also greater scrutiny from external funding sources. Ms. Burke observed that the environment of budget reductions, turnover, and increased scrutiny is also an opportunity for the audit program to provide advice, assist with best practices, and assist in systems development design as needed.

Ms. Burke identified the greatest operational challenge for the internal audit program as the effective allocation of resources to areas of greatest risk, given

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budget constraints. She briefly outlined the campus' audit planning process, which includes campus interviews and the work of the campus audit committee. In presentations to this committee, campus representatives from a number of divisions and schools address formal and informal processes for risk assessment, identify the most significant areas of risk, and share their plans to mitigate those risks. The campus audit program has performed analytical review of prior audit coverage and received analytical review information from the Office of the President. Ms. Burke described the formal risk model used by the campus, which takes into account factors such as business exposure, quality of internal controls over time, and political sensitivity, and enumerated new topics and areas brought under the purview of the audit program.

Regent Varner asked about follow-up procedures for external regulatory audit recommendations which the University may not agree with, and how the campus ensures that these auditors are satisfied. Ms. Burke responded that this is the rationale for having a single audit office to serve as a liaison. The UCSD audit program coordinates an official response on behalf of the campus, and local follow-up action is pursued. The Office of the President is engaged in the resolution of campus-wide issues, which are coordinated with other campuses. University Auditor Reed observed that the status of external regulatory audits is reported to the campus audit committee.

Faculty Representative Croughan asked about the UCSD audit program's actions regarding access to medical records, HIPAA protections, and privacy and confidentiality issues. Mr. Reed noted that there are three systemwide task forces currently active which are examining issues of systems access. In response to a question asked by Committee Chair Ruiz, Ms. Burke stated that UCSD is doing everything possible to ensure information security and HIPAA compliance.

Regent Bugay commented on new problems that have arisen with new methods of information storage and retention. He expressed concern about the consequences of an information security breach involving personal information and the University's liability. General Counsel Robinson opined that such a breach could result in criminal liability, grand jury investigations, and potential criminal prosecutions at the individual and corporate level. This would involve a lack of safeguards and a finding of criminal intent or gross negligence.

Regent Varner stressed that this issue involves not only liability but public confidence as well, and that the University must present accurate information about its safeguards and follow-up procedures.

Ms. Burke noted that the campus investigates every information security breach. In previous cases the campus has called in the FBI and involved law enforcement at an early stage. Chief Compliance and Audit Officer Vacca emphasized the need for individual accountability in access to and use of information. She

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referred to a recent breach of personal information concerning a celebrity at UCLA and noted that the campus took appropriate action immediately.

Mr. Robinson distinguished the problem of appropriate controls from the problem of ensuring that individuals who operate within those controls do not misuse their access to information. Mr. Reed emphasized the importance of training on this issue.

Regent Schilling observed that the University cannot prevent individuals from making inappropriate use of information they have access to. Ms. Vacca concurred that this is a matter of individual accountability and trust, although controls are in place to minimize this kind of activity. Mr. Reed observed that absolute control in this area would paralyze the University's operations. Mr. Robinson stated that the University needs to be rigorous in enforcing rules in this area and send the correct message.

Regent Bugay asked what recourse the University has if an employee abuses his or her access to information and disseminates it. He expressed concern about the public perception that incidents of this nature represent a deficiency of the UC system, not of an individual employee. He stressed that there should be a signed agreement for employees with concomitant fear of prosecution and repercussions. Mr. Reed noted that the recent matter at UCLA has generated discussion about consequences for employees. Ms. Vacca observed that UC staff members have been terminated for breaches of privacy and confidential information, while enforcement for faculty is a different process and may not be as speedy.

Regent Bugay emphasized the significant public trust placed in the University to guard personal information and the importance of how the public perceives UC's response to incidents. He stressed that employees must act correctly and be aware of the enormous consequences for violating that public trust.

Ms. Vacca suggested that an update on HIPAA issues could be presented at the July meeting. Committee Chair Ruiz confirmed that the Committee wishes to have this presentation. He observed that information security enforcement should be addressed by the compliance function and stressed that both the University and the public wish to see that UC has the relevant processes under control. Ms. Croughan noted areas of risk in patient care and research subjects.

Ms. Burke continued with some remarks on audit productivity at UCSD. Over 85 percent of the campus' annual audit plan has been completed in each of the last three years. She anticipated that the completion rate this year might go down to 75 percent due to time spent on investigations. Composite customer service rankings during this time have averaged over 4.5 on a scale of 1 to 5. Over 120 audits and advisory services projects were active during fiscal year 2007.

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UCSD has a strong audit follow-up system. About 140 management corrective actions are open at any one time; about half of these are in the health sciences. During the past year there has been a marked reduction in the number of medium and high risk open items considered "past due" as a result of management attention. Currently 26 open items are considered high risk, but none of these is overdue at this date.

Ms. Burke mentioned two local technology-driven audit initiatives, continuous audit and the business and research assessment surveys. The business and research assessment survey program involves the conduct of anonymous electronic surveys, the Control Environment Survey and the Research Compliance Survey. The continuous audit program has been conducted in partnership with the campus controller's office. This program allows an auditor to provide written assurance on subject matter for which management is responsible, using a series of audit reports issued simultaneously with or directly after transactions have been processed. During the past year, commercial data mining software called Audit Command Language has been used to evaluate the purchase-to-payment cycle.

Ms. Burke concluded by remarking that UCSD has a strong audit function which is well respected in the campus community. Audit staff resources will have to be stretched to address the most significant issues facing the campus. Information security and integrated audits will remain high priorities, and efforts to leverage the use of technology will continue.

[At this point Regent Lozano left the meeting.]

3. **RISK SERVICES OVERVIEW**

[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 introduced Chief Risk Officer Crickette and stated that the mission of the Office of Risk Services, located in the Department of Financial Management, is to enable faculty, staff, and students to identify and manage risks, to reduce loss, and to create greater financial stability.

Ms. Crickette outlined the administrative functions of the Office of Risk Services (OPRS). OPRS administers risk management programs including self-insurance programs, it purchases insurance for the University, and it administers claims management through a third party. OPRS provides oversight for the University's environmental health and safety programs at the campuses, medical centers, and the Lawrence Berkeley laboratory. OPRS also has various programs and initiatives to assist campuses and medical centers with strategic risk management.

While the University purchases insurance, this insurance covers only 6 percent of the cost of risk. Ms. Crickette explained that the cost of risk includes retained

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losses, the extra premium, and claims administration. She stressed that this insurance is important to the University and that it sometimes has a low deductible. The University retains most of its losses. OPRS analyzes these losses and develops methods for UC locations to implement controls and loss prevention programs in order to manage and reduce the frequency of losses and ultimately, cost.

Ms. Crickette pointed out that OPRS possesses a wealth of information. Its centralized claims system records incidents, claims, and lawsuits. OPRS monitors professional liability, especially medical malpractice, general liability, property losses, threats and security, environmental health and safety, business continuity planning, employment practices, workers' compensation, construction, human subject injury, and emergency management.

Ms. Crickette then focused on risk management in employment practices. She stated that currently the Regents are advised regarding only those lawsuits with a settlement above $250,000. This represents only about 8 percent of losses in general liability claims, about 9 percent in professional liability claims, and about 2 percent of all claims recorded. General Counsel Robinson stated that the bimonthly Regents' reports include settlements down to $50,000. Ms. Crickette estimated that this lower threshold would represent about 10 percent of the University's losses.

Regent Bugay asked if these percentages represent loss as the aggregate dollar amount of liability or numbers of incidents. Ms. Crickette clarified that they represent numbers of incidents.

Regent Bugay asked if this means that the University experiences many incidents at small dollar amounts. Ms. Crickette stated that some areas of loss involve small dollar amounts, while others do not. Some areas of loss involving large dollar amounts are not reported to the Regents because they are payments for damages. Multimillion-dollar property losses are not reported. Vice President Broome stressed that property losses are a distinct area and that the University has a separate self-insured property program.

Ms. Crickette noted that OPRS provides an annual report to the Regents with a high-level view of the program, highlighting frequency and total cost of claims. The program is focused on insurable risk but is expanding to examine risk more broadly.

Legal exposures and litigation in employment practices are a substantial cost to many California employers. Ms. Crickette described the current employment practices liability climate as a bad one for employers, as there are few deterrents to lawsuits by plaintiffs. There are thousands of employment practices claims filed annually with the Department of Fair Employment and Housing. Another sign of volatility in this area is the fact that many commercial insurance carriers

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no longer offer employment practices policies for employers in California. Currently the University spends between $11 million and $12 million annually to pay for employment practices losses. The University's actuary has projected that UC's ultimate employment practices loss and legal exposure for fiscal year 2007-08 will exceed $12.4 million. Not only are there financial risks in this area, but operational risks and harm to the University's reputation.

Ms. Crickette then discussed recent California cases in which plaintiffs have received multimillion-dollar settlements from both private sector and public entities. While public entities may not be subject to punitive damages, compensatory damages awarded to plaintiffs may be very high. Ms. Crickette pointed out two settlements against California State University Fresno involving sexual harassment and gender discrimination. In one of these cases, the original settlement of $19.1 million was reduced to $6 million. By comparison, UC's average settlement cost is between $150,000 and $200,000; legal costs comprise half of this total. Ms. Crickette stressed the high cost of claims of this nature. The national average for settlement, excluding legal costs, is $89,000. While UC is not paying more than the national average, this loss could be reduced with more active mandatory training, as has been shown in other institutions and entities. The average settlement cost for a large public entity pool in California with such mandatory training is only $50,000.

Insurance carriers are reluctant to underwrite the University's risk. Last year, two of the world's largest off-shore carriers refused to quote coverage for UC. There is concern about potential class action litigation. In UC's case, no carrier would quote below a $5 million risk retention level for each loss. Insurance carriers informed UC that they would have more confidence in the University's ability to manage multimillion-dollar class action claims if it could demonstrate consistent hiring, firing, and training practices. Currently there is only limited systemwide training for frontline managers and supervisors; this is the area in which claims usually develop. OPRS is working with the Office of the General Counsel on a plan to address this.

Next Ms. Crickette presented a chart of UC expenditures on employment practices incidents over the last four fiscal years, showing that costs have been escalating, with a significant rise in the last year. These costs include indemnity paid to claimants to resolve lawsuits and legal expenses. In some years expenses have been higher than settlement costs; she attributed this to the age of claims, and to the fact that not all past claims have been resolved. Actuarial reports show that these costs will continue to increase unless the University changes its training and supervision of supervisors and managers.

The University is required to report non-litigated employment practices incidents to its excess insurance carriers. During the last two fiscal years, some UC locations have reported no non-litigated incidents, but Ms. Crickette stated that this is not accurate, and that there have been filings with regulatory agencies.

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There has been some improvement in reporting. In fiscal year 2005-06, 79 non-litigated incidents were reported; in 2006-07, the number rose to 185. Nevertheless she believed that non-litigated incidents are still underreported. The University needs all this information in order to develop strategies to prevent loss. Ms. Crickette stressed that frequency is a critical factor in loss strategy, along with severity or magnitude of cost. While the magnitude of individual incidents or settlements may be due to many factors, frequency can serve as an indicator of specific departments or managers with training needs. OPRS anticipates carrying out in-depth training at locations with marked frequency.

Ms. Crickette then discussed a chart listing the top 10 areas of frequency and severity at UC from 2000 to 2007. She focused on the area of disability discrimination, which is first in frequency and second in severity or cost. Most incidents involving disability discrimination arise from the University's management of workers' compensation claims. She stated that the University's return-to-work program needs to be examined. Even in the best cases, UC locations return workers to work for a maximum of 90 days only. Ms. Crickette suggested that the University could reduce employment claims related to disability discrimination and the cost of workers' compensation. She noted the difficulties experienced at locations by managers who feel they do not have the budget resources to accommodate employees in modified duties. In the coming year, OPRS will focus on disability discrimination and improvement of the University's return-to-work program.

Regent Bugay requested clarification of the relationship of disability discrimination to workers' compensation issues. Ms. Crickette described a scenario in which a manager did not accommodate an injured employee by purchasing equipment or modifying the employee's job. The employee could then file a workers' compensation claim, an employment action through the Department of Fair Employment and Housing or the Equal Employment Opportunity Commission, or a lawsuit under the Americans with Disabilities Act.

Ms. Crickette outlined remediation plans for employment practices issues. The Risk Management Leadership Council, with membership drawn from the medical centers and campuses, has committed to performing retrospective reviews on all claims over $50,000, litigated and non-litigated. Retrospective reviews are meetings with the department where a loss occurred. All parties, including new managers who may not have been involved in the original incident, are brought in for a structured discussion to learn from mistakes and to develop specific remediation plans, which are then monitored. Ms. Crickette observed that the style of management sometimes causes losses to occur.

Another remediation plan is the loss prevention plan, in cooperation with the Office of the General Counsel. It will identify troubled departments through the claims system and provide targeted training. Additional information will be added to the learning management system. When minor claims arise in a

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department, remedial training of managers and supervisors will be required, either in person or through the learning management system. General Counsel Robinson added that this plan will require more investment, and that it will be brought to the Regents in July, as part of a comprehensive savings plan. Ms. Crickette stated that the plan has been vetted with outside experts.

OPRS can provide compliance information on environmental health and safety and business continuity planning. Currently only a few UC locations have business continuity plans. The Berkeley campus has a robust plan; this software package can be used by line managers at other locations to prepare their own disaster business continuity plans. There is also an enterprise risk management initiative to examine risks outside the University's insurable programs.

As an example of OPRS' effectiveness, Ms. Crickette cited the "Be Smart About Safety" program, undertaken over the last two years, and a 28 percent reduction in the frequency of employee injuries between 2004 and 2007. In 2004 there were 8,444 workers' compensation claims; in 2007 there were only 6,044.

Committee Chair Ruiz asked about the total cost of risk and the cost savings achieved between 2003-04 and 2006-07. Ms. Crickette responded that there have been savings of about $130 million during this period. She observed an overall current decrease in the cost of risk.

Committee Chair Ruiz asked about the cost of implementing the "Be Smart About Safety" program. Ms. Crickette responded that the program cost $10 million in the first year and $15 million in the second. This year, because of budget constraints, spending on the program will again be about $15 million. The program takes 10 percent of the internal premium collected from all locations and invests it in loss prevention, in order to reduce costs in the future. Rates for workers' compensation have gone down. Each campus decides which specific "Be Smart About Safety" programs to implement.

Ms. Crickette concluded her presentation by stressing that OPRS' wealth of information can be of value to the Committee in understanding risks faced by the University. She requested the guidance of the Committee to develop strategies to manage risks, to gain an overview of how OPRS' efforts fit into the Committee's overall risk management strategy, and welcomed the opportunity to report regularly to the Committee.

Regent Schilling asked if there is an incentive or reward for departments or campuses for implementing training which results in fewer incidents. Ms. Crickette explained that there is no monetary reward. There is an effort to educate the locations about how implementing this program can reduce their workers' compensation costs, and to promote and generate enthusiasm among employees about the "Be Smart About Safety" program. There may be small rewards for safety points, such as mugs or backpacks, within departments.

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Regent Schilling asked if campuses or departments are charged by their experiential rate. Ms. Crickette responded that the rates are calculated by an outside actuary. The actuary examines the exposure base relative to the frequency of losses and to the amounts of the losses. The actuary also examines loss prevention programs, and the locations receive credit for them.

Regent Schilling asked if the same approach is used for gender discrimination and other issues. Ms. Crickette responded that locations are rated on all these issues by the actuary in the same manner. The "Be Smart About Safety" program was initiated to address workers' compensation issues; it is now being expanded to cover other areas.

Vice President Broome observed that some campuses charge costs for incidents down to the level of the department or unit. She believed that this is a good practice for raising department or unit awareness. If the department or unit does not pay directly for an incident, it is less likely to implement preventive measures. She noted the effectiveness of the "Be Smart About Safety" program in helping to move the workers' compensation program from a $130 million deficit to a current surplus. Ms. Broome opined that the program should be expanded above all in employment practices, because UC supervisors are not trained adequately to handle employment situations.

General Counsel Robinson noted that there have been discussions with actuaries on how to enforce training. One approach is to surcharge departments which do not implement training. There is also a question of enforcing training for faculty, such as sexual harassment prevention training, which is mandated by State law. Mr. Robinson described this as a significant issue and stated that the General Counsel's Office is working with the leadership of the Academic Senate on this.

Regent Bugay emphasized that there are differences between workers' compensation and other discrimination issues, although the University may address them in a similar fashion as liabilities. He asked if the University has a code of conduct that must be signed. Ms. Crickette observed that departments with many workers' compensation incidents frequently also experience employment practices incidents, due to bad managers. It is strategically important to examine all losses coming from departments, as well as examining specific areas of risk.

Regent Bugay noted the legislative constraints imposed on the University in dealing with workers' compensation issues. For other discrimination issues, such as gender or racial discrimination, employers implement training programs and signed codes of conduct, which are the employee's acknowledgment of participation in training. The employee takes personal responsibility. Regent Bugay again asked if UC has such a program. Ms. Vacca responded that each campus has its own code of conduct. These are now being inventoried, and the

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Compliance and Audit Office will work toward standard language for all these documents or a standard systemwide document. It will be a signed acknowledgement.

Regent Bugay stressed that, if the University is facing litigation, it has a better case if there is clear documented violation of standards on the part of an employee. He acknowledged that the University may still have liability.

General Counsel Robinson observed that this kind of program, once established, must be enforced. Vice President Broome opined that the real goal of such a program is to raise employees' awareness of their behavior and of what is appropriate in the workplace.

Committee Chair Ruiz expressed the Committee's desire to assist OPRS in its risk management efforts and requested a plan. Ms. Crickette responded that OPRS has a plan prepared by its actuary and that OPRS is working on it with the Office of General Counsel. Committee Chair Ruiz requested more specific information about the plan, its cost, targets, goals, timelines, and return on investment. He stressed the importance of the issue for future savings and cautioned that problems, if neglected, would lead to increasing future costs to the University. General Counsel Robinson responded that he would be prepared to present some aspects of this plan in July.

Faculty Representative Croughan noted the concerns of faculty members who are animal researchers; some have been physically assaulted. She pointed out that this is a longstanding problem and described the case of a Berkeley faculty member who was victimized 20 years ago. Some of these faculty are incurring significant personal security costs for protection and home repair. She requested that this issue be discussed at the July meeting, with information on what plans are being developed to address it. Ms. Vacca responded that there would be a presentation in July.

4. **COMPLIANCE PROGRAM AND ACTIVITIES UPDATE**

[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 began her presentation by discussing a proposed model for the UC ethics and compliance program infrastructure. This model is currently being vetted by the campuses to allow implementation with greater efficiency and effectiveness. She stressed that the University currently lacks a model or standard of communication for compliance risk, from the Board of Regents and the Office of the President down to campus locations. The purpose of the model is to enable communication and avoid duplication of effort.

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Ms. Vacca observed that there might be changes at the level of the campus compliance risk committees. She stated that there is a lack of awareness about compliance risks at UC and about how different risk areas are connected. At the same time, the connections between different risk areas can allow one plan to address several areas. She stated that an ethics and compliance program model would be presented in July for adoption by the full Board.

Next Ms. Vacca introduced Deputy Compliance Officer Lynda Hilliard. Ms. Hilliard reported that campus compliance activities are now being inventoried through on-site interviews that focus on various risk areas, including research, contracts and grants, conflicts of interest, and compensation. She defined the current activity as information gathering rather than analysis. The initial campus visits have now been completed and return visits are scheduled to begin this week. The first return visit will be to the Merced campus to share observations. The return visits should be completed by the end of June. An informational database is being compiled at the Office of the President. One goal of this database is to serve as a resource to the campuses, especially the smaller campuses.

Ms. Hilliard described the ongoing communications with the campuses. The focus of interest has been on campus-wide compliance activities. At the Office of the President, there has been communication with division heads about the need for collaboration. She described the compliance program a facilitative rather than a management function, identifying programs to be leveraged, providing support functions such as education, and overseeing the sexual harassment prevention training. The compliance program is working with the Office of General Counsel on ethics training and is making an effort to consolidate the mandatory trainings.

Ms. Vacca stressed the importance of training. The compliance program is seeking to develop effective training through the University's learning management system, but recognizes that there are a variety of ways to train employees.

Ms. Hilliard noted a recent successful training webinar on new rules regarding PubMed Central, a digital archive of the National Institutes of Health, which require researchers who receive federal grants to provide access to their reports on the web. This is a controversial issue. The purpose of the webinar was to provide a forum for campuses to report their activities. Interest was much greater than expected, with more sites wishing to participate than could be accommodated. This kind of service will continue to be provided monthly. The compliance program has also taken on Health Insurance Portability and Accountability Act (HIPAA) privacy and security issues.

Ms. Vacca noted that there has been a twofold increase in reporting over the last six months through the compliance function. She described this as a positive development and a sign of growing awareness and program effectiveness.

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In response to a question asked by Regent Bugay, Ms. Vacca reported that the content for the University's web-based learning management system is developed both in-house and by outside parties. She noted that former UC employees are helping to develop content for the new sexual harassment prevention training.

Committee Chair Ruiz asked about the role of the new Expert Advisor for compliance. Ms. Vacca informed the Committee that the new Expert Advisor, Odell Guyton, is Director of Compliance at the Microsoft Corporation; previously he was Corporate Compliance Officer at the University of Pennsylvania. He has extensive legal experience relevant to this position. Ms. Vacca stated that the Expert Advisor would review items to be brought to the Committee and provide an outside industry perspective to the Regents.

5. **ANNUAL REPORT: INTERNAL AUDIT PLAN 2008-09**

The President recommended that the Annual Report: Internal Audit Plan 2008-09 be approved.

[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 pointed out that pages 14 to 27 of the materials sent to the Committee provide a listing of all Audit and Advisory Services projects planned for the campuses for the next year. While the plan document for this year resembles those of previous years, there are different underwriting priorities and principles. This is the first plan which reflects the combined perspective of audit and compliance. The plan also reflects the environment of restructuring at the Office of the President and current budget constraints; it has been developed with flexibility in mind. It allows the Audit program to work with line managers to preserve controls at a time of uncertainty and change.

Mr. Reed discussed the risk assessment process for 2008-09. Input is solicited from systemwide and campus senior management about how they identify and manage risk. He noted that risk identification processes may not be in place in every location. This gathering of information leads to a more global comprehension of risk and risk management. Areas of risk are ranked or prioritized. Mr. Reed noted that implementation of the audit plan involves allocation of limited resources to a vast array of possible actions.

Mr. Reed distinguished three essential elements of the audit plan: risk areas to be addressed by Audit and Advisory Services at all locations during the coming year, risk areas to be addressed from a systemwide audit and compliance perspective, and risk areas to be addressed by location-specific audit plans. He discussed the first element, enumerating planned audits for all locations in the areas of compensation, information technology security, support groups and affiliated organizations, and denial management. Specific topics are still to be determined

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for the areas of research compliance and general compliance. There will be an evaluation of information technology security self-assessments which were conducted at each location. Mr. Reed noted that the issue of support groups has not been examined for some time. These include hundreds of organizations which range from relatively small and informal groups to major foundations. The denial management audit will evaluate claims denial management processes at the health sciences campuses for efficiency, and to maximize revenue.

Committee Chair Ruiz asked if denial management involved cases in which federal and State regulatory agencies refuse to pay for services provided by the University, and the creation of a process to justify claims. Mr. Reed confirmed this and noted that the process often involves a financial intermediary.

Mr. Reed then turned to the second element of the plan, risk areas to be addressed from a systemwide audit and compliance perspective. These areas will not necessarily be the subject of a traditional audit. They include Health Insurance Portability and Accountability Act (HIPAA) privacy and security program enhancements and the development of a system to monitor material donated to the University through the Willed Body Program. Mr. Reed identified another such activity, the development of continuous monitoring capabilities for business transaction processes, as a critical need for the system. In its decentralized environment and with its current information technology systems, the University does not have the desired analytical capability. As an example, Mr. Reed cited computer programs used by vendors such as American Express to track purchases and alert clients about purchases that do not correspond to the client's profile and may be fraudulent. The University needs to develop such tools for the procurement-payment cycle, payroll cycle, and revenue cycle.

Faculty Representative Croughan asked about one of the listed activities, principal investigator fiscal accountability training. Mr. Reed explained that this will be modeled on fiscal accountability training for principal investigators being developed at the Davis campus after a major investigation regarding the Food Stamp Nutrition Education Program. He noted the important role of principal investigators in the University's control structure and remarked that the University does not currently train principal investigators about UC procurement modes, split invoices, or duplicate payment risks.

General Counsel Robinson asked if there is a centralized source of information for principal investigators. Professor Croughan replied that there is not. Mr. Reed stressed that the University's auditors and controllers are willing to help, but that there must be recognition that help is needed and that resources are available.

Then Mr. Reed turned to highlights of the consolidated audit plans. The plan contains 8,600 hours to continue follow-up on corrective actions and 14,000 hours for topics to be determined based on emerging priorities. There is a 50 percent increase in advisory services hours, with a decrease in investigation hours, which

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is an effort to be more proactive and efficient. There are 265 planned audits, with about 300 hours to be spent on each audit, and 132 planned advisory services projects, with an average budget of 103 hours for each. Finally, Mr. Reed discussed a chart showing the distribution of planned audit projects across the University organizationally. This distribution of effort shows an emphasis on research and compliance, information technology, campus departments, health care operations, and financial management. Those five areas command almost 75 percent of Audit and Advisory Services' effort.

Regent Bugay asked how the University Auditor's role has changed with the University's changed relationship to the national laboratories. Mr. Reed responded that the Los Alamos and Lawrence Livermore laboratories, now LLCs, are not part of the UC audit plan, and their auditors do not report to him, but to Bechtel. He and Vice President Broome serve on the audit committees of the LLCs and thus maintain some contact. The Lawrence Berkeley laboratory is included in the audit plan just as the campuses are. Mr. Reed stated that the time he spends on the LLCs is nominal.

General Counsel Robinson observed that the University's representatives on the LLCs have responsibilities including receiving previous audit reports and assurance that controls are in place. Vice President Broome pointed out that the University's business partner also engaged PricewaterhouseCoopers (PwC), so that there has been continuity of PwC knowledge and staff. PwC carries out special procedures at the LLCs which are almost like a full scope audit. Ms. Broome stressed that the UC representatives monitor the LLCs closely, because the University's name is still associated with them.

Regent Bugay stated that the University's new relationship with the laboratories is not widely understood, and that publicity about an event would be associated with UC in media accounts. Mr. Reed reported that the audit committees of the LLCs are functioning well. There are frequent substantive meetings.

In response to a question asked by Committee Chair Ruiz, Chief Compliance and Audit Officer Vacca stated that problems or issues would be reported to the LLC board. Mr. Reed clarified that the auditors of those laboratories do not contact him; instead, their concerns move through the LLC channels.

Due to lack of a quorum, no action was taken on this item.

6. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

Due to lack of a quorum, no action was taken on this item.

Pending Approval

7. **APPOINTMENT OF REGENTS' EXTERNAL AUDITOR**

The President recommended that the Regents' contract with the current external auditor, PricewaterhouseCoopers (PwC), be continued for an additional three-year period commencing with the fiscal year 2008-2009.

[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.]

Vice President Broome recalled that the University sent out a Request for Information to four national auditors and carried out an internal customer satisfaction survey on services provided by PricewaterhouseCoopers (PwC). Based on the results of the request and survey, the Committee instructed the Financial Management Department to negotiate a continuation of the existing contract with PwC for the next three years, beginning with fiscal year 2009. Ms. Broome stated that PwC has recognized the difficult budget situation and has requested fee increases of 3, 4, and 5 percent over those 3 years. In previous years PwC has received a 6 percent increase. Ms. Broome noted that PwC's services are in demand and that the proposed fee increases are low. She stressed that PwC has achieved efficiencies for the University. Audit fees are now approximately $4 million. This is a core fee including out-of-pocket expenses. Beyond this core fee, there may be scope increases because of new Governmental Accounting Standards Board (GASB) pronouncements. Ms. Broome estimated that the core fee will increase to $4.2 million, $4.37 million, and $4.6 million over the three-year period.

Regent Bugay asked how closely actual fee increases have corresponded to proposed rates in the past, recognizing that there is room for adjustment. Ms. Broome stated that PwC has adhered to a 6 percent increase in the past. PwC lead partner Joan Murphy anticipated that there would not be unforeseen increases. If PwC is aware of a new accounting pronouncement scheduled to go into effect, it will provide an estimate in advance of the cost for implementation. Ms. Murphy stated that the range of scope changes in the UC audit is not as fluid as in most other PwC audits. Ms. Broome stressed that the University has always received an estimate for new work by PwC in accordance with the agreement.

Committee Chair Ruiz thanked Ms. Murphy for her work and observed that the University has a much better relationship with PwC than other public entities have with their auditors.

Due to lack of a quorum, no action was taken on this item.

Pending Approval

The meeting adjourned at 1:05 p.m.

Attest:

Secretary and Chief of Staff

Pending Approval