The Regents of the University of California

COMMITTEE ON COMPLIANCE AND AUDIT
August 27, 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.

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

In attendance: President Yudof, Regent-designate Bernal, 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 11:35 a.m. with Committee Chair Ruiz presiding.

1. **PUBLIC COMMENT**

The following person addressed the Committee.

A. Mr. Charles Schwartz, UCB professor emeritus, stressed that the University should be guided by ethical principles and respond promptly to allegations of wrongdoing of any kind by any University official. He expressed concern about the University's whistleblower process. He reported that he submitted a formal whistleblower complaint on July 1 and a follow-up message on July 21, and stated that he is still awaiting a response by the University.

2. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

Upon motion duly made and seconded, the minutes of the meetings of July 1 and July 16, 2008 were approved.

3. **STATUS OF FISCAL 2008 FINANCIAL STATEMENT AUDIT**

PricewaterhouseCoopers (PwC) representative and UC's lead engagement partner Joan Murphy introduced her colleague, manager Chris Chung, and provided a brief update on the fiscal year 2008 audit. She recalled that interim work was done in April, including internal controls testing and Office of Management and Budget (OMB) A-133 compliance testing. PwC teams are now carrying out the year-end phase of audit fieldwork at UC locations: the ten campuses, the five medical centers, the Office of the President (UCOP), the retirement system, and the ten campus foundations. This work will include follow-up on any issues identified during the earlier control phase. For an organization of this size, with many decentralized controls, Ms. Murphy stressed that

very few control deficiencies have been found to date. She described these control weaknesses as small or subtle, such as reconciliation on individual accounts which was not performed in a timely manner or lack of evidence of review of such reconciliation by a second reviewer.

Mr. Chung then described some of the results of the information technology controls testing. Internal audit staff is involved in the information technology audits at each location. PwC has visited several locations this year for the information technology audit, including UCOP, the UC Davis Medical Center, UC Berkeley, the UCSF Medical Center, UCLA, the UCLA Medical Center, UCSD, the UCSD Medical Center, and the UC Irvine Medical Center. The control findings were not very different from those of the previous year, and there was not a significant number, but there were findings at all locations. PwC's assessment is currently pending, to determine the significance of the findings.

President Yudof asked what PwC's general concerns were, and if the findings had to do with the security of computers and databases. Mr. Chung responded that PwC is currently in its preliminary assessment and anticipated that there would be no significant deficiencies this year. One concern that emerged during the audit was risk assessment and monitoring sensitive data access. He noted that there is a risk from an operational as well as a financial perspective, but PwC has focused on the financial perspective. Another concern is the monitoring of sensitive information technology users, ensuring that access to the information technology applications and environment is granted to appropriate individuals. All UC locations have shown improvement in this area. Given the complexity of UC, PwC anticipated that a multi-year remediation effort would be necessary. Mr. Chung noted that, increasingly, PwC's findings concern formal documentation and evidence rather than lack of controls.

President Yudof observed that information technology is highly distributed in universities and that sensitive data is sometimes found on and stolen from personal computers. He asked if PwC, besides examining central systems, is also reaching down to the level of individual departments, alumni groups, or law schools. He noted that some sensitive data are not financial in nature. Mr. Chung responded that PwC examines centralized systems for its financial audit, but also cooperates with the University on several reviews of systems which are not financial. Ms. Murphy added that PwC examines any reporting system that drives key financial data.

President Yudof pointed out that databases at universities are frequently breached, including information which may not have a bearing on financial statements, such as Social Security numbers and patient records. As an item for a future meeting, he suggested an inventory or audit of UC's information technology systems in problematic areas that do not affect financial statements or liability. Ms. Murphy pointed out that PwC is carrying out data protection assessments at UCSF and other campuses to identify the processes for handling private data, relevant controls, and points of vulnerability.

Regent Varner asked if the findings are coupled with recommendations. Ms. Murphy answered in the affirmative.

President Yudof observed that there are software packages for universities to help address data security issues. He suggested that the Office of the President might be able to obtain such software at a lower rate for the campuses.

Expert Financial Advisor Vining recalled the scope of the financial review that PwC has been engaged to perform. While PwC takes note of non-financial issues of concern, some specific systemwide security issues touched on in the present discussion are outside the scope of the annual financial review.

Faculty Representative Croughan described a thorough six-hour site visit and audit performed of her office and research database at UCSF. From the point of view of faculty, audits are being performed at the individual level.

Chief Compliance and Audit Officer Vacca reported that Associate Vice President and Chief Information Officer David Ernst has expressed interest in addressing the Committee on information technology security.

Committee Chair Ruiz expressed the need for action in this area, which he described as one of great exposure and weakness. Ms. Vacca answered that there has been action, including responses to PwC findings. This has not yet been reported to the Committee in a high-level review.

President Yudof stressed the need for systemic recommendations and action, and suggested that Mr. Ernst report to the Committee on systemic measures. In response to a question by Committee Chair Ruiz, Ms. Vacca anticipated that this issue could be addressed at the next or following meetings.

Ms. Murphy reminded the Committee that one of the issues addressed in the 2008 financial statements is the implementation of a new Governmental Accounting Standards Board (GASB) accounting standard regarding post-employment benefits such as health care and life insurance, which are not part of pension benefits. Historically, private companies have accounted for these benefits on an accrual basis, while governmental entities have accounted for them on a pay-as-you-go basis. This year, governmental entities must convert to an accrual basis. The liability of UC is approximately $1 billion. Ms. Murphy stressed the effort needed to arrive at this calculation. In response to a statement by Committee Chair Ruiz, Ms. Murphy stated that accrual-basis accounting provides a more accurate financial picture.

Mr. Vining observed that the purpose of accrual-basis reporting is not only to show liability accurately, but to include related expenses in each period that is reported. In the past, UC has underreported these expenses.

Vice President Broome noted that, during the last few years, the University was aware of what the magnitude of its liability would be under the new GASB pronouncement, but this year this liability will be accounted for in the University's financial statements.

Ms. Murphy observed that the University thinks far in advance and began to tackle this challenge three years ago. She concurred with Ms. Broome that funding is now the significant issue.

Mr. Vining stated that UC financial staff have gained a good understanding of the actuarial variables involved and will be able to recommend policy in the future which will affect financial statements while not significantly affecting the individuals who are receiving benefits. He noted that there are ways policy can be set to change actuarial calculations.

Ms. Broome recalled that last year was the first year of Statement on Auditing Standards (SAS) 112 implementation, and that the information technology area is more likely than others to experience internal control challenges. She felt that the whole UC system should be commended for its effort and for the fact that there were no significant weaknesses.

4. **COMPLIANCE PROGRAM UPDATE**

Chief Compliance and Audit Officer Vacca briefly discussed the status of compliance program development. The campuses are now forming their compliance risk committees.

Addressing the concern that had been raised earlier during the public comment period, Ms. Vacca reported that the University is making efforts to maintain timely response to whistleblower allegations. She observed that whistleblower complaints may sometimes be delayed in a queue if they are submitted by email.

Ms. Vacca stated that she would provide an annual report at the November meeting about program progress over the last year, especially process and structure. She noted that there have been significant outcomes. The report would also address outcomes of whistleblower and compliance concerns, and industry trends.

In response to a question asked by Faculty Representative Croughan, Ms. Vacca affirmed that the University has addressed Mr. Schwartz's concerns.

Committee Chair Ruiz asked how often the Committee should receive reports on whistleblower complaints and the University response. Ms. Vacca responded that such reports would be provided on a quarterly basis. She stated that whistleblower complaints are evaluated in terms of priority. The Committee will be informed about high-priority items. Their high-priority status is due to visibility, materiality, or risk. The Committee will also receive quarterly updates on trends, tracking, and emerging issues, with a categorization of whistleblower complaints and performance metrics concerning timeliness and resolution.

Ms. Vacca reminded the Committee that, as the University increases its compliance program efforts, more issues will be brought forward. She stressed that this is a positive sign of greater awareness within the institution.

5. **QUALITY ASSESSMENT REVIEW FOLLOW-UP**

[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 recalled the presentation, at the July 1 meeting, of an external Quality Assessment Review (QAR) of UC's internal audit activity by Protiviti Inc. and discussed the University's actions in response to the QAR recommendations.

Mr. Reed discussed the first recommendation, which concerns information technology, an acknowledged significant risk. He stressed the challenge of maintaining an information technology audit program, especially at smaller campuses like UC Santa Barbara. Skills in this area are fungible and valuable in the marketplace, making it difficult to retain highly skilled employees.

A task force of audit directors is now working to redefine the scope of the information technology audit program and the expectations for the campuses. The expectations will set a systemwide standard which campuses must meet through their own resources, resources borrowed or leveraged through the system or brought in from outside. Mr. Reed noted that outside resources would include high-end skills difficult or not reasonable to maintain in a full-time staff. He stressed the need to break down barriers between campuses for better resource sharing.

Mr. Reed then turned to a recommendation concerning use of outside resources and expertise. Outside specialists have been called in to assist with construction as well as information technology audits. The internal QAR process will be augmented with independent chief audit executives from peer institutions.

Another recommendation addressed the use of technology. The internal audit program is increasing its efforts to automate internal business processes, management of outstanding corrective actions and recommendations, and communication and reporting. The goal is to become more prospective regarding corrective actions, rather than merely reporting on past due items.

In response to a QAR recommendation for establishing criteria for reporting audit results to the Committee, Mr. Reed noted that the internal audit program always seeks guidance from the Committee. He recalled that the annual audit plan, approved in May, identifies systemwide audits which present the highest risk to the University and which will be reported on in detail. Mr. Reed pointed out that the internal audit program employs criteria like those of PricewaterhouseCoopers to determine when an issue should be brought to the Committee's attention. These criteria are also similar to the Statement on Auditing Standards (SAS) 112, but applied at a more granular level. Mr. Reed noted that, in an average campus audit focused on a specific department or function, it is rare that a matter would rise to a level which would require that it be reported to the Committee. Thus it may be difficult for the Committee to gain a sense of the work done by audit staff.

Mr. Reed added that any guidance from the Committee on what it would find informative would be useful for the internal audit program.

Committee Chair Ruiz asked about the dates for implementation of specific actions. Mr. Reed observed that the QAR recommendations can be broken down into a number of different tasks. While individual tasks might be assigned implementation dates, the implementation for the overall recommendations will be further in the future. The internal audit program is aggressively pursuing the QAR recommendations for information technology. A redefinition of the structure of the information technology audit program is expected by October 1. He noted that the current recruitment for a new manager or lead information technology auditor for the Irvine campus has provided a campus perspective on this program. Mr. Reed stated that he would include progress in implementing these recommendations in the written quarterly reports.

6. **HEALTH INSURANCE PORTABILITY AND ACCOUNTABILITY ACT (HIPAA) PRIVACY IMPLEMENTATION PLAN**

[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.]

Director of Research Compliance and Interim HIPAA Privacy Officer Schlesinger recalled that the University's plan for implementation of the Health Insurance Portability and Accountability Act (HIPAA) was discussed at the July meeting and now presented the early work and findings of the systemwide strike teams. Mr. Schlesinger noted that the plan originally called for the creation of four strike teams. Two of the teams, Surveillance Strategies and Information Technology Capabilities, have been combined into one, since the capabilities will be designed to implement recommendations which emerge from surveillance strategies.

Mr. Schlesinger discussed the work of the first team, the Education and Training team. The team examined current education and training practices at each campus and shared materials used among the campuses. He emphasized the varied nature and complexity of UC institutions, including campuses with and without medical centers or large research enterprises. HIPAA privacy breaches which receive media attention usually occur in hospitals, but there are many other areas in the University where protected health information needs to be monitored and safeguarded.

All campuses currently engage in HIPAA privacy training activities. The most common current practices are training at new employee orientations, annual HIPAA training, periodic email reminders, and reminders during staff meetings. While one of the recommendations of the strike teams will be for increased frequency of training, Mr. Schlesinger observed that there is a limit to what can be accomplished by training. He noted that some of the UC employees involved in HIPAA privacy breaches had been recently trained and warned before incidents took place. Other measures must be applied.

The Surveillance Strategies-Information Technology Capabilities team has developed a list of risk factors currently used as criteria, such as celebrity medical records, and methods used to audit access to higher-risk records. The most common surveillance strategies currently in use are surveillance based on a facility's past experience of unauthorized access, reviews of employee access to family member records, and reviews based on patient or employee complaints. Mr. Schlesinger stated that these surveillance strategies are being developed in a way to ensure that the University is acting responsibly and appropriately with respect to peer institutions with large research and medical enterprises.

Faculty Representative Croughan observed that most employees know there will be a record of a request for family or celebrity medical records. For this reason, employees sometimes submit a request using a colleague's name and identification number. Instances of this have been traced by examining all the employees working in a nursing shift and seeking links between all the shift colleagues and an individual's family records. Employees may also ask friends to retrieve records for them. Mr. Schlesinger noted that there are many subsidiary methods to track unauthorized access. In some cases, employees have sought information on neighbors, and the University has screened employees and patients by their zip codes. Measures like these will be included in the upcoming recommendation report.

The Enforcement and Discipline team carried out an inventory of campus policies on discipline for patient privacy violations and of practices and procedures for fair and equitable discipline outcomes. Mr. Schlesinger recalled that in popular press accounts of some high-profile HIPAA privacy breaches, a concern was expressed that the discipline imposed on an employee would vary widely depending on the employee's status, on whether he or she was a physician or a member of the clerical staff. Mr. Schlesinger stressed that this has to be corrected.

The University is examining policy models, such as civil penalty policy used by federal agencies, which take into account the severity of a violation and whether it is intentional or unintentional. Discipline should be commensurate with the violation and consistency is being sought through consultation with Human Resource departments. Campus HIPAA privacy officers are involved in investigation of violations, and sanctions are most often imposed under medical staff bylaws.

A report on systemwide recommendations will be presented at the January 2009 meeting, along with an implementation schedule.

7. INTERNAL AUDIT QUARTERLY REPORT

[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 noted that this is the internal audit quarterly report for the quarter ended June 30, but not for the year, because the Lawrence Berkeley National

Laboratory follows the federal fiscal year cycle. The annual audit report will be presented in November.

More than 200 reports were issued during the quarter and more than 400 reports during the year. Mr. Reed emphasized the granular nature of the work done by the internal audit program and the fact that the 200 reports contain no concerns that would rise to a level which would require reporting to the Committee. The 200 reports include hundreds or even thousands of recommendations for management at the departmental level, and this is their special value. This is the process that helps the University to build up its internal control system step by step.

Mr. Reed explained that, if any reports revealed significant deficiencies, especially systemwide deficiencies, these would we brought to the Committee's attention. Each audit recommendation is graded as being of high, medium or low importance or urgency for follow-up by management. All corrective actions are tracked to completion and the internal audit program reports on past due corrective actions of high importance. Mr. Reed assured the Committee that instances in which management does not respond with appropriate corrective action will be reported. The fact that past due issues are reported to the Committee has served as an effective motivation for campuses to deal with aging issues.

Mr. Reed then turned to staffing issues. The program has been operating this year with 88 percent of its positions filled. The percentage of filled positions is usually in the low 90s, and this year the program had three positions fewer than it had planned for. Turnover for the year was 18 percent. More employees left for positions outside the University than is usually the case. Mr. Reed then noted the mix of service hours, the relative amounts of time spent on audit, investigations, and advisory services. The internal audit program spent more time on investigations than expected, leaving less time for advisory services, which the program considers a more proactive form of work.

Faculty Representative Croughan asked if the internal audit program has experienced cuts in staffing during the restructuring process at the Office of the President (UCOP). Mr. Reed reported that this has not occurred during the last year. Campuses are now responding to this and next year's budget, and most have not made definitive decisions. Two locations are considering cuts, and this is a matter of concern.

Mr. Reed noted the success of the recent Quality Assessment Review (QAR) and then discussed the internal audit program's involvement in restructuring initiatives. It advised on the control aspects in the creation of the Business Resource Center at UCOP, and in fact two audit employees moved to the Business Resource Center. At a time of changes at UCOP, an important role for the audit program is to preserve internal controls. Mr. Reed pointed out that the 2008-09 audit plan allows more flexibility for the audit program to provide service to other restructuring initiatives.

Mr. Reed noted a recent web seminar on effort reporting at the campuses. The status of the new effort reporting system will be included in next year's audit plan. The University

has absorbed the lessons of recent National Science Foundation (NSF) audits at UC Berkeley and UC San Diego.

Finally, Mr. Reed discussed the launching of a project, with the Institute of Internal Auditors Research Foundation, to determine criteria for resource requirements for audit programs in higher education. The project is led by university researchers from Michigan, Texas, and Georgia and will address staffing issues. Mr. Reed noted that current benchmarks for audit staffing levels in institutions are inadequate. The risk profiles of different institutions vary widely, depending on a number of factors. He anticipated that this project will provide a more complex and thorough assessment for development of a staffing model than that provided by traditional benchmarks.

Mr. Reed concluded by observing that the internal audit program is busy on three fronts, completing the audit plan, making itself available for restructuring initiatives and changes, and pursuing initiatives to address its own needs.

In response to a question asked by Regent Varner, Mr. Reed confirmed that the "2007" date on some of his slides was incorrect, and that all the information presented was current.

8. **APPOINTMENT OF EXPERT ADVISOR TO THE COMMITTEE ON COMPLIANCE AND AUDIT**

Committee Chair Ruiz informed those present that the Committee, in Closed Session, had appointed Mr. Jerry Schneider as Expert Financial Advisor. He expressed appreciation for the work by Expert Financial Advisor Vining in this process and stated that Mr. Vining will work with Mr. Schneider on orientation.

Mr. Vining noted that he has discussed with Vice President Broome a strategy for review of the University's financial statements without draining staff resources, while providing an educational process for Mr. Schneider. He expressed confidence that Mr. Schneider would carry out the duties of the position effectively. Committee Chair Ruiz again thanked Mr. Vining and emphasized the importance of this function.

The meeting adjourned at 12:35 p.m.

Attest:

Secretary and Chief of Staff