The Regents of the University of California

COMMITTEE ON COMPLIANCE AND AUDIT
January 25, 2010

The Committee on Compliance and Audit met on the above date by teleconference at the following locations: 1111 Franklin Street, Room 12322, Oakland; Aliso Beach B, Student Center, Irvine campus; 4127 Hinderaker Hall, Riverside campus; 1130 K Street, Sacramento; 260 Student Services Center, San Diego campus.

Members Present: Regents De La Peña, Ruiz, Stovitz, Varner, and Zettel; Advisory member Hime; Expert Financial Advisor Schneider and Expert Compliance Advisor Guyton

In attendance: Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Compliance and Audit Officer Vacca, Executive Vice President Taylor, Senior Vice President Stobo, Vice President Broome, and Recording Secretary Johns

The meeting convened at 2:00 p.m. with Committee Chair Ruiz presiding.

1. **PUBLIC COMMENT**

There were no speakers wishing to address the Committee.

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

Upon motion duly made and seconded, the minutes of the meetings of October 28 and November 18, 2009 were approved, with Regents De La Peña, Ruiz, Stovitz, Varner, and Zettel (5) voting "aye." [1]

3. **THE UNIVERSITY OF CALIFORNIA'S TECHNOLOGY AGENDA – 2010**

[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.]

Associate Vice President and Chief Information Officer Ernst provided an update on information technology at UC, patterns of information technology adoption, and the strategic foundation in place for information technology projects. The effect of the economic downturn and budget reductions is obvious. However, investment in information technology can help save money in other areas.

The University is fortunate in having a robust information technology network linking campuses to each other and to the other higher education segments in California, which is

[1] Roll call vote required by the Bagley-Keene Open Meeting Act §11123(b)(1)(D) for all meetings held by teleconference.

the Corporation for Education Network Initiatives in California (CENIC). The network infrastructure on the campuses, however, is in need of upgrades. This is important because the quality of information security is dependent on the quality of the information network.

Mr. Ernst noted that there appears to be a growing attitude of cooperation among the campuses, especially regarding information technology. This may be due to the fact that information technology is a level playing field, but also due to possible economies of scale; certain measures can be applied once systemwide, rather than reinvented for each location. He noted that, in the past, UC has undertaken projects in information technology that were possible but not advisable. Products were built at UC that might have been better purchased. This is an area where economies of scale may produce savings. Mr. Ernst observed that the University has a long history of unique research and educational programs. At times, this culture of "being special" has influenced how individual University locations conduct their administrative functions. The business world has long known the importance of best practices. Mr. Ernst stated that the University needs to move from being an outstanding developer of information technology to being an outstanding user, and to avoid the "tyranny of the technologist." He explained this as a phenomenon of well-meaning individuals on the campuses who wish to solve problems, and do so with their own programming, when a purchased product may function equally effectively. The University should distinguish itself in those areas of information technology where only it is capable of building the technology; in areas where technology can be purchased, UC should move toward purchasing.

The University's strategic plan for information technology is embodied in two reports: the Information Technology Guidance Committee report, which appeared about 18 months previously, and the more recent Building Administrative Efficiency report. The University has the necessary philosophical or cultural basis as well as specific projects to move forward. A strategic plan is in place; the challenge is in the question of where to begin.

Mr. Ernst then outlined initiatives which are now in progress. Until about five years ago, each campus needed one large library and one large data center. It is no longer necessary for a campus to have a large data center, due to the robust nature of the information technology network in place. The geographical location of the data center is no longer important, as long as it is accessible in ways that are invisible to the end user. The University has begun a program to examine the use of regional data centers as a long-term solution, rather than building out more data center space. There are opportunities for the consolidation of such centers at the San Diego Supercomputer Center and in space at the Lawrence Berkeley National Laboratory. These actual locations would be invisible to an end user on any of the campuses. This is important during difficult fiscal times, when major capital improvement projects for the development of data centers are not advisable. Service can be provided at a distance at two regional centers. The San Diego space is now available, and campuses are beginning to move racks of computers there. From a technology standpoint, this is an obvious step to take, but it can be a more difficult cultural or political issue.

The two locations are also being used as reciprocal disaster recovery sites. Much of the information technology operating at the Oakland data center for the Office of the President (UCOP) is mirrored at UC San Diego. If the UCOP center shuts down, the San Diego center can run UCOP's systems, and vice versa. The University is moving toward this approach rather than offsite disaster recovery.

Mainframe computing is becoming obsolete. Many campuses are still running applications which must operate in an expensive mainframe environment. There is no reason for campuses to invest in mainframe space when centralization in regional data centers is possible. The Oakland data center is taking on a great deal of the mainframe load for UC Berkeley and other northern campuses. A similar procedure will take place for the southern campuses.

Mr. Ernst then discussed the Shared Research Computing Services pilot project. The project will involve 24 or more principal investigators from all the campuses over the next two years. They will move their research computing to the regional data center in San Diego, rather than housing it on a local server. In the past, faculty included computers in their grant requests. The computers were installed locally, and data was not backed up very well. In some cases, the purchased computers ran out of capacity because the researchers had underestimated their requirements, and the grant funds had already been spent. In this project, the principal investigators will be computing at a distance. The data will be backed up. There will be program support 24 hours a day and seven days a week, and additional capacity will be available if needed. This is not a complicated technological feat, but it represents a significant cultural shift for faculty, who have wanted to be in control of their computing environment, although this may not have made economic sense. This project should serve to demonstrate the advisability of shared research computing, practiced by other institutions around the U.S., rather than reliance on local servers.

Chief Compliance and Audit Officer Vacca observed that several compliance and audit risks are decreased with this approach. Mr. Ernst noted that consolidated data centers provide a more controlled environment for information security. Data are backed up regularly. There is better security and better service to faculty.

Regent De La Peña asked about action on the UC payroll system, such as a decision on outsourcing or developing an internal system. He expressed interest in a system to be used UC-wide, so that any equipment purchased for the future will be consistent with the University's future direction.

Mr. Ernst explained that the University is now examining the business processes and practices in the UC payroll system in order to establish a standard, common set of best practices. This is a first step in responding to Regent De La Peña's question on which kind of information technology support should be in place for this new standardized payroll process. Outsourcing is an option to consider, but is not a real possibility until the University arrives at a single payroll process.

Chief Financial Officer Taylor noted that Vice President Broome is actively engaged in this project. Ms. Broome stated that UC is examining its business practices to establish a common set of best practices.

Regent De La Peña asked how far the University is from a conclusion to this process. Mr. Taylor responded that UC is now in "Stage Two" of the process. Ms. Broome explained that "Stage One" was to identify and hire an outside consultant and a project director. The goal was to have both in place by January 1, which was achieved. The University was able to arrange a cost-effective agreement with the consultant and has been fortunate in finding a highly qualified project director. Ms. Broome emphasized that this process will take time. She pointed out that the University does not simply have a payroll system with 11 manifestations; on an individual campus, there may be 120 departments, each with different business practices for processing information and entering it into the payroll system. The University is examining this through a "deep dive" approach on three campuses: one campus with a medical center, one large campus, and one small campus. In order to save time, the information gained about practices at these campuses will be applied to other campuses, with an examination of similarities and differences. Ms. Broome stated that the University would be in a position, a year from now, to determine whether to outsource or develop its own system.

Committee Chair Ruiz asked where the project will be in a year. Mr. Taylor responded that the decision regarding outsourcing would be made and a Request for Proposal (RFP) would be issued.

Regent De La Peña asked about the time needed for implementation. Ms. Broome responded that this would depend on the solution. Mr. Ernst estimated that implementation would take at least two years. Mr. Taylor added that the project director has been hired on a three-year contract. Ms. Broome stated that this individual is an expert project director from Sun Microsystems who will provide appropriate leadership. Mr. Taylor emphasized that the University is committed to remaining open without bias on the choice of an internal product or outsourcing.

Regent De La Peña asked if there is information on UC expenditures for running the payroll process, and if an outside provider could furnish estimates on what the process should cost. Ms. Broome responded that the University does not have an accurate estimate. The problem has been studied for a number of years, and every outside consultant produces a different estimate of the staffing involved. An essential point is that the University needs better business processes, both for controls and compliance as well as efficiency.

Regent De La Peña asked if a company such as Automatic Data Processing, Inc. (ADP) could provide a project scenario and cost estimate. Ms. Broome responded that this step would occur after the University has identified the business practices it wishes to implement, or its needs definition. The needs definition will determine the search for a payroll system. A company such as ADP would likely recommend outsourcing immediately. The University does not yet know whether outsourcing is the appropriate

solution; the needs definition must come first. Mr. Taylor added that this must be accomplished by the end of 2010. He acknowledged that there have been studies of the problem for almost ten years.

Regent De La Peña expressed concern about the University becoming bogged down in this process and finding itself in the same place next year. Mr. Taylor indicated that President Yudof has identified this as a high priority which must be completed. He expressed his determination that there be progress on this matter.

Committee Chair Ruiz noted that three years is a long period. He requested a project description, including a timeline and projected return on investment for the project. He noted that a statement of projected savings might help to address resistance that the project might encounter. Ms. Broome observed that, in implementing an administrative or financial system, there may not be immediate demonstrable savings. These systems are expensive. Savings are achieved in the future, through better controls and compliance, need for fewer personnel, and more efficient use of personnel. There may not be a significant return on investment for this project, but there will be a reduction of future costs. Ms. Broome noted that, during the University's compensation crisis, the payroll system was unable to provide information responsive to various records requests.

Committee Chair Ruiz asked that the project description include some kind of return on investment component. Ms. Broome responded that the University would try to do so, but emphasized the importance of avoiding a false or misleading statement.

Regent Zettel echoed Regent De La Peña's concerns about a cost estimate to determine whether it would be prudent to outsource this project. She expressed the hope that the University's system will be an open system compatible with many kinds of software. Mr. Ernst responded in the affirmative. The University is seeking to develop an explicit set of specifications and business processes for UC payroll. This is the prerequisite for the adoption of any system, whether developed by UC or outsourced. Without this key information, any software company could offer the University a system which would function no better than the current system. Mr. Taylor added that the University is studying payroll system failures at other major institutions. He noted that the State of California spent about $80 million on a payroll system which was not an improvement over its previous system.

Regent Zettel asked if it would be prudent to consider an out-of-state location for data backup, in case of a massive earthquake in California. Mr. Ernst responded that this would be a matter for future consideration. Currently the University wishes to ensure that it has at least one data center located on each side of the San Andreas Fault. Out-of-state locations would be more costly. The first step is to consider facilities already owned and operated by the University; following this, it would be possible to carry out a cost-benefit analysis of a backup site outside California.

Regent Zettel asked about privacy protection in the Shared Research Computing Services project. Mr. Ernst responded that computing security for researchers will be much better in a shared facility than on a local server, which may be in a vulnerable location.

Regent Stovitz asked about the University's ability to consolidate employees. He noted that one campus has separate information technology departments for its campus and its medical center. He asked if there could be a viable consolidation in this case, without losing support for mission-critical needs. Mr. Ernst responded that the University has been examining this issue. There are monthly meetings of the chief information officers of the five medical centers and the ten campuses to discuss common technology challenges. The meetings are focused on areas where most agreement is possible; this tends to be facilities rather than employees. There is an effort to take on mainframe computing from the UC Irvine Medical Center. Data can be shared in a facility, whether it is medical or accounting data. The closer one moves to actual applications, however, the more important specific skill sets become. At this time the University is building bridges in technology, which is the easiest area for such efforts.

Mr. Ernst then discussed information technology initiatives being planned. The University is examining applications to determine which would best be shared on the campuses and at the medical centers. As an example, he noted the possibility that the accounts receivable processes could be standardized among campuses. The University can achieve significant savings in seeking common approaches based on best business practices. For this reason, it is important that the payroll standardization project succeed. If the University can successfully standardize its payroll process, it can standardize general ledger, procurement, and other applications.

The University is also considering middleware, technology which enables communication among systems which might otherwise remain disparate. UC is considering universalizing identification and authentication procedures, which would allow sending of e-mails to lists across the University. While this seems mundane, it is not possible at the moment because of the different systems within the University. Mr. Ernst explained the concept of "cloud computing," computing done at another site, such as a regional data center. It does not matter where computing is done, as long as it is secure and accomplished within a reasonable response time. The University is building proprietary "clouds" within its system; this is a precursor to moving some computing, which does not need to be proprietary, outside the University for possible cost savings and better service. To the extent that the University adopts best business practices, supported by common applications, it will be able to implement standardized controls and compliance capabilities, which is not now the case.

Mr. Ernst concluded that the University's 2010 information technology agenda is one which challenges the way UC does business. Information technology is enabling the University to take advantage of common best practices which were not implemented in the past due to lack of willingness or incentive. Budget and other pressures are now serving as an inducement to implement such practices. Measures such as payroll

standardization and shared regional data centers will help the University save money and avoid costs in the future.

Committee Chair Ruiz emphasized the strategic importance of payroll standardization. He expressed the hope that it could be accomplished in less than three years. He requested regular updates and an estimate of cost and savings. Mr. Taylor stated that he would provide a timeline; he would provide a cost and savings estimate later in the year. Ms. Broome added that the payroll project is led by a sponsor group with campus representatives, who are enthusiastic and have an interest in defining business objectives. The project description will explain roles and responsibilities and how the University will meet its objectives. Technology will be the last element of the project; the business planning must first be in place. Mr. Taylor stated that quarterly updates would be provided to the Committee.

Regent De La Peña asked how the Regents might expedite this project and ensure that it receives adequate support. Mr. Taylor responded that at some point, securing adequate resources will become a matter of concern. At present the project has a source of funding within the Office of the President. The campuses are very much involved. He expressed optimism about the project.

Regent De La Peña requested a timeline of proposed events and suggested that Regents be updated at every Committee meeting to ensure that the project is on track. Committee Chair Ruiz stated that the Committee will receive quarterly updates at a minimum. He observed that the Regents can support this project by calling attention to its needs.

Senior Vice President Stobo noted that the UC medical centers are examining possible implementation of electronic medical records.

Regent Zettel asked if the medical centers are going to use the same system and vendors. Dr. Stobo replied that they will use the same system. UCSF is now engaging with Epic Systems Corporation, and UCLA will engage with Epic next month.

Regent Zettel asked about a competitive bidding process and cost control. Dr. Stobo responded that the University hopes to receive a special proposal, since all its medical centers are using the same vendor. Committee Chair Ruiz suggested that the Regents might assist in this area.

Regent De La Peña asked if the University is considering use of a single, common system for electronic billing at all the medical centers. Dr. Stobo responded that there have been discussions about outsourcing this task to a single entity.

4. **CONFLICT OF INTEREST AND COMMITMENT DISCLOSURE FORM**

[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.]

Senior Vice President Stobo presented a draft Conflict of Interest and Commitment Disclosure Form for medical school faculty. He noted that the concept of conflict of interest is straightforward, but conflict of commitment less so. Conflict of commitment concerns time spent on outside activities relative to time spent on University activities. U.S. Senator Grassley has called attention to cases of conflict of interest. He has requested information from at least one UC medical center. In addition, the University knew of an active case of conflict of interest at one of its medical centers. This suggested that there might be other undetected cases in the system. Responding to pressure from Senator Grassley, pharmaceutical and device manufacturing companies have publicly posted the names of individuals who have been paid for consultation services. The University examined the list posted by one of the device manufacturers and discovered the name of a physician with an address located close to one of UC's medical centers. The individual received approximately $1.25 million from the manufacturer and did not report this to UC.

UC policies on conflict of interest and conflict of commitment are found in at least three different locations and thus not easy for faculty to reference. The draft document presented with this item represents an attempt to bring together in a single document the basic conflict of interest and conflict of commitment principles related to clinical activities in the medical centers. Dr. Stobo clarified that these principles do not concern research conflict of interest. The document was reviewed within the Office of the President and then by the deans of the UC schools of medicine. Responses were mixed, and there will be further discussion. President Yudof is concerned about compliance regarding conflict of interest, which presents a significant liability. Dr. Stobo noted that this matter would be brought up the following week at the Council of Chancellors meeting.

Many academic medical centers have effective conflict of interest documents. Harvard University has taken a strict stance on conflict of interest and faculty activity. UC needs a commitment that this issue will be taken seriously. Dr. Stobo stated his view that it was important for the Regents to take a stand on this issue and communicate the message that compliance in this area is not voluntary for the campuses. There is tremendous political and financial liability. The University wishes to facilitate faculty compliance.

Chief Compliance and Audit Officer Vacca observed that an important first step was to receive a report from the chancellors on existing processes.

Regent Varner asked if compliance in this area would be monitored campus by campus, or systemwide. Dr. Stobo responded that review could best be done at the local level, by a local conflict of interest committee. A process is needed, especially to address "gray areas," areas of uncertainty which might have been overlooked in the past.

Regent Varner praised this effort and emphasized the need for consistency. Dr. Stobo stated that the chancellors must take ownership of this issue.

Regent Stovitz asked if this compliance requirement would apply to adjunct professors of medicine. Dr. Stobo responded that he believed it applied to full-time professors.

Regent Stovitz noted the need for an above-board process with transparency and high standards of disclosure. He offered a suggestion regarding the format of the document and presented as an example the California Fair Political Practices Commission Form 700, which takes a cover sheet approach. This would allow a faculty member to check only those areas that apply to him or her and to attach only the relevant responses. This kind of form would be easier for faculty members and researchers to fill out and easier for the University to review. Regent Varner found this to be a good suggestion.

Committee Chair Ruiz referred to the draft document and its definition of compensation as "payment through cash, assets, or capital, received or having the potential to be received…" He asked if this definition takes into account any benefits, insurance, travel, or other forms of compensation. Dr. Stobo responded that the definition is meant to capture such elements of compensation. Ms. Vacca added that such elements would normally be disclosed.

Committee Chair Ruiz asked about the consequences for failure to disclose this information. Dr. Stobo responded that an employee could be subject to dismissal if he or she did not report this information. Regent Varner pointed out language in the draft document which makes it clear that failure to complete the form can lead to loss of compensation.

Committee Chair Ruiz requested a timeline for completion. He noted that there might be resistance to this measure, but that the Regents would support it. Dr. Stobo responded that the University had hoped to implement the disclosure form in the spring, but that this would not be possible.

Committee Chair Ruiz asked about the monitoring and reporting process. Dr. Stobo responded that President Yudof should require the chancellors to report on their local processes for review and monitoring. It is common practice in this field for review to be carried out by a conflict of interest committee, with membership from within and outside the institution. Such a committee can provide oversight and judgment in cases where there is a question about whether an action is appropriate or not. However, it cannot prevent a rogue faculty member from engaging in inappropriate actions. General Counsel Robinson emphasized the importance for an institution of having a program in place.

Committee Chair Ruiz praised the proposed disclosure form and remarked that this was a good time to introduce this measure. The University must perform better than it has in the past regarding ethics and accountability.

Ms. Vacca stated that it would be helpful for the Regents to take a formal position on conflicts as this project proceeds.

Regent-designate Hime asked if Faculty Representatives Simmons and Powell had been briefed on this matter. Dr. Stobo responded that they would be within a few days. Committee Chair Ruiz noted that Faculty Representative Simmons had received the meeting materials, including this item.

5. **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.]

Chief Compliance and Audit Officer Vacca presented the Internal Audit Quarterly Report for the quarter ended December 31, 2009. She noted that the report took a new approach, with a high-level overview.

Systemwide Audit Manager Hicks presented a chart showing a breakdown of the 698 Management Corrective Actions (MCAs) by functional area for the first two quarters of the fiscal year. The breakdown is similar to that found in previous years, with the greatest percentages of MCAs falling in the areas of financial management, information technology, research and compliance, and campus departments and instruction. Some recurring themes that have been observed are control over cash, information technology security, conflict of interest, and policies and procedures. Mr. Hicks noted that these themes were not significant enough to raise red flags. Overdue MCAs on the campuses are driven by the current budget situation, furloughs, and restricted resources. Faced with competing priorities, the campuses are finding it hard to meet deadlines.

Ms. Vacca added that the internal audit program is working with campus controllers to address this. Segregation of duties is one issue of note. There are “one-man shops” in the University, units where the same individual creates an invoice, processes the invoice, and collects the cash. Another common concern is cash handling in cafeterias and bookstores.

Regent Zettel asked if there are surveillance cameras in all UC cashier locations, such as cafeterias and bookstores. Ms. Vacca responded that this depends on the campus and site; the presence of cameras is more likely in high-risk areas. Regent Zettel stated that this might be a best practice the University should strive for.

Regent Zettel asked when updates would be provided about MCAs for issues from the previous 2008-09 year. Ms. Vacca responded that updates could be provided at any time, such as in quarterly reports, if desired. Regent Zettel requested this.

Ms. Vacca observed that in MCAs, management does not always have a realistic idea of planned action, and sometimes a planned action is not what ultimately resolves the risk. The internal audit program is evolving toward a focus on risk mitigation rather than holding management tightly to completion of MCAs, if some manner of mitigating the

relevant risk has been found. Ms. Vacca anticipated that future reports will show that risks have been resolved. There will be less emphasis on the number of MCAs or whether they are past due. The focus will be on the group causing the concern and on resolution.

Regent-designate Hime expressed concern that all UC cashiers be treated equally; surveillance measures should be the same overall. Ms. Vacca responded that she would share this concern about standardization with campus controllers.

Committee Chair Ruiz recalled the presentation by PricewaterhouseCoopers (PwC) at the November meeting, which included a concern about greater risk due to furloughs, but findings that were better than expected. PwC representative Joan Murphy recalled that the risk assessment for 2009 assumed changes in control procedures and processes, given furloughs, retirements, and movement within the organization. With this in mind, PwC was attentive to any possible weaknesses not seen in the past. PwC found no deterioration in 2009 in the controls on which it relies for its audit of financial statements. Chief Financial Officer Taylor noted that Assistant Vice President Sampson has been actively visiting campuses in the current quarter, more than would normally be the case, for greater engagement and oversight in the new environment. Vice President Broome recalled that there have been many layoffs. Fortunately, due to the work performed surrounding Statement on Auditing Standards (SAS) 112, more employees are aware of control risks. Cash audits are often carried out at the request of campus controllers. Committee Chair Ruiz emphasized that the Committee wishes to be informed of any deterioration that is observed.

Ms. Vacca then discussed distribution of hours in the internal audit program. One goal of the program has been to spend more core time on advisory services and less on investigations. This has been accomplished through a restructuring of the department. Investigations are now conducted by a stand-alone unit. Auditors are being used for their audit expertise, rather than as investigators, which is a better use of their time. Ms. Vacca noted a small decline in the percentage of hours devoted to advisory services compared to fiscal year 2009. She anticipated that, next quarter, the update on the audit plan for this year will show that advisory services have declined much more, mostly due to furloughs and layoffs. The audit plan has required adjustments; campuses have had to decide which measures are most important, and audits are usually the highest priority.

Mr. Hicks outlined systemwide projects taking place in internal audit. One project is an update of the internal audit manual, which provides guidance on internal audit processes. The last comprehensive update of this document took place five or six years previously. The current update is motivated by new internal processes, such as a new internal audit management system, new methodologies, changes due to restructuring, such as titles and reporting relationships, and new professional standards, released last year by the Institute of Internal Auditors. Implementation of the new internal audit management system, called “Teammate,” began in spring 2009; full implementation is expected in April 2010. One module of this system, the electronic workpapers module, has been in use for several years. The system has a full suite of modules, and the system will be used to manage the entire audit process systemwide, including annual risk assessment, audit plans,

scheduling resources, tracking time, and reporting results. Ms. Vacca emphasized that this implementation is a positive achievement for the UC system.

Mr. Hicks concurred that this is a significant undertaking, a comprehensive system that will be integrated across all the campuses. The University can expect to gain significant efficiencies from the system, and it has already proven efficient in gathering and consolidating data for annual reports. It will facilitate tracking of MCAs, provide centralized access to audit data, increased standardization in templates and reporting across UC, and improved knowledge sharing.

Mr. Hicks discussed another new project, this one to enhance the online internal audit report repository database. Currently this database is essentially an Excel spreadsheet on the internal audit website. It is being restructured as a more sustainable SQL (Structured Query Language) database with enhanced functionality. Office of the President information technology staff are assisting in building this database, which will help ensure its compliance with the University's initiative for transparency. The database, with internal audit reports, advisory reports, and investigations, will be accessible from an internal website. There will be a link to the database from the University's transparency website, which is being built. The public will be able to access audit reports dating back to January 1, 2008. Ms. Vacca added that UC financial reports and other public information will also reside on this transparency website.

Ms. Vacca briefly noted professional development activities in internal audit, ensuring that auditors are skilled and certified. The University is making efforts to provide education and development in information technology for campus auditors. There are different kinds of certification in this area; it is costly but important. She recalled that this topic was raised the previous year by the University's external auditor, and in the outside quality assessment of the internal audit program.

Ms. Vacca called attention to retention and recruitment figures for the internal audit program and to priorities for the third quarter, including finalization of some fiscal year 2010 systemwide audits.

6. **ETHICS AND COMPLIANCE PROGRAM – COMPLIANCE QUARTERLY 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 presented a quarterly update on the compliance program. The Office of Ethics, Compliance and Audit Services (ECAS) is carrying out monitoring related to the requirements of the American Recovery and Reinvestment Act (ARRA), especially regarding timely reporting. There have been recent changes to the Higher Education Opportunity Act (HEOA); ECAS is working with the campuses on the necessary implementation. Royalty audits are another area of activity. The University has not had a formal monitoring or auditing system in place for its

royalties. This year, ECAS developed a pilot project with ten royalty audits. The project is not yet finished, but ECAS has found that the University was underpaid in some instances. Unfortunately, due to contract language, it is too late to recover some of these monies. In the future, new controls will be in place to prevent cases like these and agreements will be rewritten to provide greater clarity about licensing. Obviously, it is a concern for the Committee that UC not enter into relationships in which it cannot recover benefits from its agreement with a licensee, and that underpayments are recognized in a timely manner and paid. There must be proper controls surrounding these agreements. ECAS will conduct ongoing audits of royalties. Ms. Vacca noted that the University has a relatively small number of large royalty agreements; several of these agreements were examined in the royalty audits this year. In addition, the University has many agreements which represent small dollar amounts. These could represent a risk if no controls are in place.

Regent Zettel asked about royalties that may be out of date due to an expired contract. She asked if the University's relationships are with good faith partners who could be asked for reimbursement. Ms. Vacca explained that it is not a matter of expired contracts, but of a historical pattern that the University has followed until the present time. It would now be very difficult for the University to request back payments from its licensee partners, who contest the audit findings or dispute the interpretation of the agreement, sometimes in specific areas such as rate or category of product. Contract language needs to be refined and updated; the University is pursuing this. The University has engaged in discussions in an effort to recover funds. One case concerns an amount around $700,000; it is related to the disputed interpretation of a licensing agreement.

In response to a question asked by Regent Zettel, Ms. Vacca confirmed that the Office of the General Counsel (OGC) is involved in developing updated contract language.

Deputy Compliance Officer Hilliard outlined key focus areas of the compliance program. The first area is the performance metrics included in the annual plan. These metrics include general campus compliance, the compliance function on the campuses, investigations, mandatory training, and health sciences concerns such as billing, coding, and clinical trials. ECAS is identifying high-risk areas and will report on four or five indicators. It is working collaboratively with the campuses in order to obtain the necessary data without straining campus resources during a time of furloughs.

Other focus areas are effort reporting and export control. Effort reporting metrics are now being developed and should be completed this quarter. In export control, the campuses have looked to the Office of the President for leadership in the interpretation of export control rules. ECAS has developed a "help desk" professional services agreement with an external expert consultant for the campuses. Working with ECAS, OGC has engaged an outside law firm to work on compliance issues related to export control. Ms. Vacca underscored the importance of export controls to UC's research endeavors and to research-related revenue. This is an area that requires specialized skills and expertise. OGC has been responsive to needs in this area, and the University now has an outside consultant for operational issues. OGC may hire personnel with expertise in research-

related issues. These efforts have resulted from discussions with the campuses, and are a positive development for the campuses.

Ms. Hilliard noted that the next area, conflict of interest in the health sciences, had been addressed earlier in the meeting by Senior Vice President Stobo. When an operational process has been identified for this area, the compliance program will engage in monitoring. At this time, the compliance program is working with OGC to cover conflict of interest issues.

Privacy and security functions related to the Health Insurance Portability and Accountability Act (HIPAA) form another key focus area. The University is identifying and implementing all elements of the Health Information Technology for Economic and Clinical Health (HITECH) Act and ensuring compliance with the law regarding notification of breaches. Ms. Hilliard noted that she has been serving as Interim Compliance Officer at UC San Francisco, and that the campus has been diligent in its work on data encryption, primarily to protect patient information but also to prevent financial loss when a breach occurs.

Ms. Vacca informed the Committee of staffing transition in ECAS, in particular the loss of a capable compliance director who is moving to a position at Lawrence Berkeley National Laboratory. Due to campus needs, Ms. Vacca, Ms. Hilliard, Mr. Hicks, and other ECAS employees are currently actively interacting with the campuses or taking on interim functions there.

In compliance education and training, Ms. Hilliard reported that ECAS is tracking program completion. Systemwide completion of the sexual harassment prevention training is now at 89 percent. Ms. Vacca stated that the next update would include further information on completion of training programs.

Ms. Vacca then turned to investigatory activity and presented a chart displaying the second quarter 2010 hotline reports by allegation category. Ms. Hilliard observed that the largest single category was workplace misconduct. There has been an increase in the number of anonymous reports of workplace misconduct in the quarters after the furlough program was instituted. Ms. Vacca clarified that these reports are allegation which have not yet been substantiated. Substantiated allegations will be reported to the Committee. She estimated that about 25 percent of allegations are substantiated. That 25 percent or other percentage, which varies over time, can include significant matters and should be taken seriously.

Regent Stovitz noted that the second-largest allegation category concerned “other allegations.” He requested a further breakdown of this category. Ms. Vacca responded that this information would be provided. She then presented a chart comparing hotline reporting in the second quarters of 2008, 2009, and 2010 by allegation category. She shared her perception that certain peaks in the chart were related to the effect of furloughs and layoffs in the University. Peaks also tend to occur after training occurs. General ethics and compliance training programs are now being introduced. Ms. Vacca

anticipated higher reporting rates next quarter. This phenomenon, referred to as the Hawthorne effect, is normal and commonly experienced in hotline reporting.

7. **AUDIT OF HASTINGS COLLEGE OF THE LAW FOR FISCAL YEAR ENDED JUNE 30, 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.]

Chief Financial Officer Taylor presented the item, a review of the annual audit of Hastings College of the Law for the fiscal year ended June 30, 2009. It affirms that the University did not detect any violations that could be defined as control deficiencies, significant deficiencies, or material weaknesses. One recommendation arose from the audit and it was easily addressed. Mr. Taylor clarified that UC's oversight role in this matter is required by law. Given the types of issues found in this most recent audit, the University has determined that it is not necessary to communicate with the appropriate committees of the State Legislature.

8. **PRESENTATION ON INDUSTRY TRENDS IN HIGHER EDUCATION**

[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 John Mattie noted that he would discuss areas of focus for senior management and trustees at institutions like UC over the last year as well as current trends and trends projected for the next 18 to 36 months.

Mr. Mattie first noted the impact of the economy on higher education institutions, which have always experienced challenges in managing their balance sheets. The top 30 public and private institutions PwC works with are all now seriously studying cash flow forecasting, balance sheet modeling, and determination of liquidity. UC has greater liquidity than many of its peers. Compared to a year ago, institutions' focus has moved from only the operating budget to include balance sheet forecasting and liquidity.

Every major university in the U.S. is examining its donor-restricted endowment balances and seeking to loosen restrictions for greater flexibility. Institutions are experiencing success in approaching donors and families to use endowment funds for broader purposes than originally intended at a time of economic stress. Mr. Mattie predicted that this would be a growing trend.

Rating agencies and other external parties are moving away from traditional balance sheet measures, such as net assets and liquidity measures, to determine credit quality in this industry.

Mr. Mattie anticipated that the regulatory environment in the current period will resemble the early 1990s. The federal government is devoting significant time to examining

educational institutions which are recipients of federal award money. There is greater emphasis now by management and trustees not only on financial reporting controls, but on compliance controls as well. This impetus is partly due to federal stimulus funding. There are pilot programs in which federal auditors are considering whether State and local government recipients of federal funding should be subject to a quarterly compliance audit, much like public companies, rather than an annual compliance audit only. This trend has not yet reached universities. The federal stimulus funding includes rigorous quarterly reporting requirements surrounding job creation. There is a growing focus on the part of federal audit groups on cost transfers, conflict of interest, and effort reporting. Mr. Mattie stated that this focus would likely continue for the next 18 to 36 months. The U.S. Government Accountability Office (GAO) is embarking on an initiative to review the quality and effectiveness of compliance audits. This was last undertaken in 1989 and resulted in the U.S. Office of Management and Budget (OMB) Circular A-133 audit.

Mr. Mattie noted that he was encouraged by the current level of discussion about operational initiatives in the industry, which recalled the early 1990s. This includes discussions by major universities about shared service initiatives, such as consolidation of information technology and administrative functions. He noted that institutions comparable to UC in size are going about this task in the same way as discussed by the Committee earlier in the meeting. Mapping out a process is the first major step, especially for a multicampus institution. He recalled the eagerness to see the payroll standardization project completed in less than three years, but cautioned against hasty action which would seek a system solution before a process solution is in place. Institutions which try to implement such systems too quickly pay a significant price in inefficiencies. He estimated that a three-year period should be expected for the payroll standardization. As the economy improves, institutions are challenged to continue to push forward with difficult cultural changes which are necessary to effect operational enhancement.

Higher education institutions have been hesitant to embrace enterprise risk management and institutional compliance. More institutions are now discussing these issues, and UC is taking a leading role in enterprise-wide risk management. Mr. Mattie stated that the University should feel encouraged in these efforts.

Turning to the industry outlook for the future, Mr. Mattie focused on international operations. This area presents both opportunity and risk for institutions. More than ever before, maintaining compliance and managing political and compliance liabilities associated with doing business internationally are becoming an important topic for institutions the size of UC. Corporations commonly have vice presidents for international operations. Some of UC's peer institutions are now considering who should be responsible for the academic, research, and administrative aspects of international activities. The corporate model may be one that higher education institutions can adopt, if they succeed in integrating administrative and academic functions.

Mr. Mattie noted that the risks faced by higher education institutions are more similar now than they were in the past. He emphasized the importance of how institutions

prioritize and address risks. He presented a list of the most common risks discussed by institutions the size of UC.

Finally, Mr. Mattie presented a listing of issues of concern for audit committees of large universities with medical centers and research operations. These issues include the role of the audit committee in ensuring that an institution has the appropriate compliance controls; the amount of time spent by the audit committee on compliance controls and financial reporting controls; holding management accountable for conflict of interest policies; and self-assessment, compared to other high-performing audit committees. He concluded by remarking that UC is taking many good actions, and that the allocation of time is always a challenge.

Committee Chair Ruiz asked how UC compares to public and private institutions in this area. Mr. Mattie responded that in many ways, public institutions are ahead of private institutions due to the State rules and regulations imposed on them by law. Public institutions are also ahead on the topic of enterprise-wide risk. On the issue of audit committees holding management accountable for follow-up action, private institutions may have an easier time of ensuring accountability for follow-up on key control actions. It is more difficult for multicampus public institutions, especially with off-cycle meetings, to gather all audit committee members for a face-to-face meeting. On average, large private institutions have meetings like this six times annually, lasting three to three-and-a-half hours. Because of time constraints, public institutions do not have this kind of meeting schedule. Mr. Mattie emphasized the importance of face-to-face meetings.

In response to a question by Regent Zettel, Mr. Mattie responded that he could provide evaluation forms that committee members could use to provide comments and perspective for the following year. These are questions concerning minimum expectations and desirables. Many audit committees wish to have more time with management or outside parties to learn about industry issues and analysis of results. Another concern is the learning process for new committee members.

Regent Zettel suggested that training be provided for new Committee members on compliance and audit issues. Chief Compliance and Audit Officer Vacca responded that she has been working with Secretary and Chief of Staff Griffiths on this training and on an appropriate delivery method.

The meeting adjourned at 4:00 p.m.

Attest:

Secretary and Chief of Staff