

The Regents of the University of California

COMMITTEE ON COMPLIANCE AND AUDIT

February 28, 2012

The Committee on Compliance and Audit met on the above date by teleconference at the following locations: 1111 Franklin Street, Room 12322, Oakland; 3104 Mosher Alumni House, Santa Barbara campus; 550 East Shaw Ave., Fresno; 6840 Carothers Parkway, Ste. 600, Franklin, Tennessee.

Members Present: Regents Makarechian, Pelliccioni, Ruiz, and Zettel; Advisory member Anderson; Expert Compliance Advisor Guyton; Staff Advisor Herbert

In attendance: Faculty Representative Powell, Secretary and Chief of Staff Kelman, Associate Secretary Shaw, Chief Compliance and Audit Officer Vacca, Chief Financial Officer Taylor, and Recording Secretary Johns

The meeting convened at 1:25 p.m. with Committee Chair Zettel presiding.

1. **PUBLIC COMMENT**

There were no speakers wishing to address the Committee.

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

Committee Chair Zettel explained that due to lack of a quorum, approval of the minutes would be deferred to the March meeting.

3. **APPROVAL OF THE SCOPE OF THE EXTERNAL AUDIT FOR THE YEAR ENDING JUNE 30, 2012**

The President recommended that the scope of the external audit of the University for the year ending June 30, 2012, which includes the following reports, be approved:

- A. University of California
- B. University of California Retirement Plan, including the PERS-VERIP Plan, University Retirement Savings Program, including the Defined Contribution, 403(b) and 457(b) Plans
- C. Annual financial reports for the University of California Medical Center Pooled Group
- D. National Collegiate Athletic Association (NCAA) audit procedures
- E. Federal grants and contracts (A-133) audit

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

Regent Makarechian expressed concern about the proposal to combine the audits of the medical centers into one report. He noted that the savings this would achieve, \$190,000, were modest in relation to the large size of these institutions, which have a combined revenue of approximately \$8 billion. He reported the opinion of Regent De La Peña that it would be preferable to maintain separate audit reports for the medical centers, with distinct data for billing, receipts, and purchases. Regent Makarechian suggested that this matter be discussed with the Committee on Health Services.

Associate Vice President Peggy Arrivas explained that under the proposal, the main financial statements would show the five medical centers combined. However, the report would include supplemental schedules of medical center data, statements of net assets, changes in net assets, and cash flows shown separately for each medical center. The management discussion and analysis at the front of the report would include separate statistical data for each medical center. A significant amount of data would still be reported separately. Medical center administrators and staff have indicated that they approve of the proposed change. It would produce savings not only in audit fees, but also administrative savings at the medical centers and the Office of the President.

Regent Makarechian expressed concern that a combined audit of large institutions would result in less transparency and make close analysis of financial information more difficult. Public companies with as little as \$5 million in revenue are required to carry out this type of audit. The audit reports for the medical centers should be as transparent as possible and readily understandable.

PricewaterhouseCoopers (PwC) representative Joan Murphy stated that the proposal involved a change in reporting, but no major change in auditing.

PwC representative Michael MacBryde observed that concerns frequently arise in organizations when they move to a consolidated audit approach. There are typically concerns about risk assessment, because materiality increases when there is greater consolidation. Mr. MacBryde stated that the UC medical centers, with the possible exception of UC Irvine, are similar in size based upon revenues, and the audit procedures and the detailed work on revenues, receivables, and expenditures would continue as before. The proposed change concerned only the consolidation of information into one report, and this accounted for the rather modest savings. PwC would continue to deploy its personnel at UC, and risk areas would continue to receive appropriate attention.

Regent Makarechian reiterated his concern.

Chief Financial Officer Taylor stated that he would like to show Regent Makarechian an example of the new reporting format and expressed the view that the combined approach would provide the detailed information needed and meet the Regents' expectations. If it did not, the University would return to its current method of reporting. He stressed that

the University would not pursue the relatively modest savings of \$190,000 if this resulted in less transparency; that would defeat the purpose of the audit.

Committee Chair Zettel asked if the income for each medical center would be reported under the proposal, and if all expenses would be listed. Mr. MacBryde responded in the affirmative.

Mr. Taylor recalled that both the Regents and the Office of the President have fiduciary responsibility in this case. He reiterated his wish to make the case for the proposed change. Since it was clear that the existing process works, the University could fall back on that.

Regent Ruiz expressed agreement with Regent Makarechian, concern about any possible loss of quality in the audit process, and hope that any change would lead to improvement.

Chief Compliance and Audit Officer Vacca responded that relevant information regarding the proposed change would be provided to the Regents.

Committee Chair Zettel stated that it would be prudent to bring the matter back to the Committee for further discussion, with more information. Regent Makarechian added that Regent De La Peña should also be consulted. Mr. Taylor suggested that the item be discussed again at the March meeting.

Committee Chair Zettel explained that due to lack of a quorum, approval of this item would be deferred to the March meeting.

4. **APPROVAL OF EXTERNAL AUDIT PLAN FOR THE YEAR ENDING JUNE 30, 2012**

The President recommended that the external audit plan of the University for the year ending June 30, 2012, as shown on pages 7-8 of Attachment 3, and the fees shown in Attachments 1 and 2, be approved.

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

PricewaterhouseCoopers (PwC) representative Joan Murphy drew attention to the fact that, although PwC granted UC a sizeable fee reduction in the past year, this did not reduce the scope of PwC's work. Referring to the preceding discussion of consolidated audit reporting for the medical centers, she noted that auditing rules do not allow the auditor to reduce the scope of work, even if reporting is consolidated. One factor not anticipated the previous year that influenced the 2011 audit and that would influence the 2012 audit was an increased amount of testing of controls and detailed transactions concerning revenues. This focus was the consequence of a message by the Public Company Accounting Oversight Board (PCAOB) for the need for a greater focus on

revenue accounts. PwC did and would continue to do additional work for UC on certain revenue line items such as grants, contracts, and educational activities.

Ms. Murphy indicated that PwC would seek a renewed focus on the A-133 audit in the current year, with the goal of making the work on this audit proceed as smoothly as the financial statement audit. There would be further discussions with the Office of the President on how to achieve this. PwC would carry out the A-133 audit at four to five UC locations this year, testing in the areas of research and development and student financial aid. PwC would accelerate the time frame of this work. The campuses would like the A-133 work to be carried out in spring or early summer, rather than close to the time of the financial statement audit, which takes place in August and September. The federal government is eventually expected to move the nine-month reporting deadline for the A-133 report to a six-month deadline; UC would be required to file its report by December 31. Currently the deadline is March 31 of the subsequent year. There are opportunities for improvement of UC's A-133 audit.

Ms. Murphy concluded by remarking that PwC's engagement team has remained consistent. If reporting for the medical centers is consolidated, PwC representative Michael MacBryde, who currently had responsibility for two medical centers, would be responsible for all five. PwC at this time had individual teams at every medical center and at most campuses.

Mr. MacBryde observed that whatever the University's decision on consolidated or individual medical center reporting, areas that present the greatest risk are those concerning patient revenues. PwC has changed its strategy in response to PCAOB, with more focus on detailed transactions, expenses, and new revenue.

Regent Ruiz stated his perception that the audit process at UC was effective in spite of State funding reductions and loss of UC personnel, and asked if this perception was accurate. Ms. Murphy responded in the affirmative. There were no material weaknesses or significant deficiencies in internal controls in the previous year. Essentially, campus and medical center staff are required to produce more with fewer people. PwC has not observed deterioration, but greater stress on UC staff who collaborate with the PwC audit. She praised the staff's dedication.

Chief Financial Officer Taylor thanked PwC representative and senior relationship partner Jim Henry for his attention to UC's account.

Committee Chair Zettel explained that due to lack of a quorum, action on this item would be deferred to the March meeting.

5. **ORGANIZING TECHNOLOGY FOR SHARED SYSTEMS**

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

Associate Vice President and Chief Information Officer David Ernst began his presentation by calling attention to three major factors motivating change in how UC conducts and organizes information technology. The first was a resolution adopted by the Regents in July 2010 calling for systemwide shared administrative systems. The second was the goal of achieving a target administrative environment for UC, with a common set of administrative best practices, supported by shared systems and software that would run in effective and efficient information technology environments, such as regional data centers or cloud computing, rather than separate data centers throughout UC. The third and immediate factor was the current implementation of a new human resources and payroll system.

There had been two major reviews over the last 12 months regarding how UC is organized to implement shared systems. One review was conducted by the Information Technology Leadership Council, which includes all campus and medical center chief information officers. A second in-depth review considered changes necessary in the Department of Information Technology Services (ITS) at the Office of the President and the campuses in order to implement services and infrastructure. These two reviews have resulted in a new charge for ITS. ITS will offer shared administrative information technology solutions, which will require a different set of skills than was required in the past. ITS will provide a technical infrastructure for campus shared services and provide enhanced services for the Office of the President. ITS will also serve as a strategic information technology adviser to the Office of the President and campus executives.

Mr. Ernst reported that ITS would adopt best practices and standards for information technology organizations which have been shown to be effective in many other environments. ITS would implement a set of project management capabilities based on established principles. ITS client services concerned not only customer service, but also managing a set of relationships among campuses and stakeholders, based on transparency, strategic plans, measurable outcomes, and ongoing assessment. ITS financial planning would consider implementation and life cycle costs for information technology projects. These changes to ITS have been recommended by the campus and medical center chief information officers.

Mr. Ernst indicated that a new administrator, the Chief Information Security and Privacy Officer, would begin work the following week. This was a new position for UC. The individual hired for the position has about six years of experience in a similar position with the California State University. Other ITS administrative positions, focused on client services, strategic planning, and architecture represented the new evolving ITS structure. ITS was treating its current transformation as a project in itself, with long-term goals of service management, clarification of roles and expectations, support of best practices, and the development of a strategic plan for information technology at UC.

Current ITS activities included implementation of the new human resources and payroll system, client relationship development, development of architecture and standards teams for shared services and ITS services, helpdesk reorganization and customer service

training for helpdesk staff, and leadership and change management training for all ITS managers.

Mr. Ernst noted that he chairs the Shared Technology Services Oversight Committee, which makes recommendations on how information technology services are put in place at UC. He concluded that a significant amount of the work discussed in the presentation would be in place by June 30.

Regent Ruiz asked how much of the ITS work would be accomplished by June 30. Mr. Ernst responded that 40 to 50 percent would be implemented by June 30. Projects were not yet fully staffed, and the remainder of the current calendar year would be required for full staffing. By June 30 there would be sufficient staffing to make progress in each subject area; there would be full staffing for the new human resources and payroll system by that date.

In response to a question by Regent Makarechian, Chief Financial Officer Taylor added that the payroll system implementation would occur in three stages. The last stage would be implemented in September 2014.

Regent Makarechian asked if all the other activities mentioned in the presentation would be implemented at the same time. Mr. Ernst responded that these projects would be implemented by the end of the current calendar year.

Regent Makarechian asked about duplicate systems being run simultaneously. Mr. Ernst responded that this was not the case for the helpdesk. The University had one helpdesk system that would transition to a new way of working. In the case of the payroll system, the University would keep its 30-year-old system operating until the last campus moved to the new system.

In response to a question by Regent Makarechian, Chief Compliance and Audit Officer Vacca responded that there were requirements for the retention of data and documents from the old payroll system. Mr. Ernst added that data history would be retained, but that the University would not run two operational payroll systems after the transition to the new system was complete.

Regent Makarechian referred to measures taken by various organizations to protect data from cyber attacks. He asked how the University would protect its data. Mr. Ernst responded that the security of the University's human resources and payroll system would increase significantly. The University would not be operating the system; Oracle would run the system in a hardened data center in Austin, Texas, where it runs most of its own and clients' highly secure operations.

Regent Makarechian asked about penalties if the Oracle system is breached. Mr. Taylor responded that the contract includes penalties requiring Oracle to pay the University if there is a breach and an intruder extracts UC data. Oracle devotes considerable attention to information security and had confidence that it could provide enhanced protection.

Regent Makarechian asked if the University was hiring new employees or transitioning existing staff to the new system. Mr. Ernst responded that both were occurring. The new technology and aspects of the new system required new staff; at the same time the University was trying to provide training opportunities for current staff.

Regent Makarechian requested presentation of timelines and some numerical data that would show that the University was achieving cost savings. Mr. Taylor responded that the University has an implementation timeline, but that it was still early in the process for updated estimates of cost savings. He expressed confidence that cost savings would be significant.

Regent Ruiz asked what the initial estimate of cost savings from the new payroll system had been. Mr. Taylor responded that the estimate was for approximately \$230 million in annual savings in net present value.

Regent Makarechian asked that the Regents receive updates at future meetings to show that the University was accomplishing its established goals for the new payroll system. Mr. Taylor recalled that the principal goals for the new system were that it function reliably, as the current system was rapidly deteriorating, and that the new system be used as an opportunity to drive administrative efficiencies. With regard to Regent Makarechian's question about staffing, he observed that all the projects mentioned in the presentation require increases in staffing during the development and design phases. For the most part, the University is hiring contract rather than permanent employees to meet these staffing needs.

Faculty Representative Anderson recalled that there was a breakdown in email service on the Berkeley campus for a few weeks in November 2011. The service was either not functioning at all or functioning less than optimally. He asked what the University had learned from this incident and how it would prevent such problems in the future. Mr. Ernst responded that he would receive a report on the incident from Berkeley campus Chief Information Officer Shelton Waggener in early March. Mr. Ernst could provide information from this report.

Mr. Anderson reported that many faculty have communicated that they have difficulties obtaining adequate bandwidth for communication with colleagues within and outside UC, for example for videoconferencing. He asked how the University would address this need. Mr. Ernst responded that the University has more than adequate bandwidth through the Corporation for Education Network Initiatives in California (CENIC). This regional operating network connects the UC campuses to one another and to other educational institutions in the state. Mr. Ernst stated that the problems observed by faculty are not due to faulty intercampus connectivity, but to problems on a particular campus. He acknowledged that this still causes difficulties for the end user. The University's efforts to address this problem should focus on campus bandwidth rather than interconnectivity in CENIC. This issue was one remaining element of networking infrastructure to be addressed by the Shared Technology Services Oversight Committee, as part of its assessment of campus strengths and weaknesses.

6. **UNIVERSITY OF CALIFORNIA HEALTH SCIENCES PRIVACY COMPLIANCE**

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

UCLA Health System Chief Compliance Officer and Systemwide Health Sciences Privacy Liaison Marti Arvin began her presentation with results of a survey of UC health sciences privacy officers, who rated the quality of health sciences privacy compliance at the University in seven compliance program areas. The survey showed that they found that oversight is “good,” but that auditing and monitoring are “fair.”

In the area of standards, policies, and procedures, Ms. Arvin reported that each campus has a process in place to review policies and procedures. UC is evaluating the need for a social media policy. One systemwide policy currently being revised concerns the Health Insurance Portability and Accountability Act (HIPAA) and research; it is the last of the systemwide HIPAA policies to be revised. Campuses are adding new policies and clarifying existing policies regarding the sharing of information with law enforcement, and are revising policies to comply with new provisions of the Health Information Technology for Economic and Clinical Health (HITECH) Act.

In the area of oversight, she noted that each health sciences campus has one or more committees that oversee privacy compliance. Three campuses have committees dedicated to privacy or privacy and information security, while the other two campuses integrate privacy and information security oversight into broader compliance committees.

In the area of education and training, all the health sciences campuses have a requirement that all new employees attend training that incorporates privacy and information security compliance. All existing employees take annual compliance training. UCLA has a mandated training requirement based on a settlement decree. Four campuses review the training annually, and one campus reviews the training as needed. All the health sciences campuses perform ad hoc privacy training following departmental requests, changes to regulations, or as part of remediation after compliance issues have arisen.

Asked about the level of understanding regarding privacy issues among various campus groups, the UC privacy officers stated that staff and volunteers had the best understanding, faculty had a good understanding, while the level of understanding among residents and students presented some concerns.

All five health sciences campuses have a privacy auditing and monitoring program. Routine monitoring done by privacy compliance staff includes activities such as privacy rounds in clinics. Some campuses have automated alerts for system accesses that can detect unusual activity, and some carry out electronic review of outbound emails to screen for restricted information.

In response to a question by Chief Compliance and Audit Officer Vacca, Ms. Arvin explained that the procedures for automated alerts may vary by campus. UCLA's system has a particular focus on access to information for persons of interest and celebrities. Automated alerts might also be generated if an employee was examining the record of a person with the same last name or address, presumably a family member, or the record of a person with an address in close proximity to the employee's address, presumably a neighbor. Electronic review of outbound emails screens for information such as Social Security numbers, medical record numbers, or diagnostic information. The screening technology is designed to identify these kinds of terms and to either encrypt the information or to send an alert to the individual sending the email, prompting the sender to review the contents of the email and to secure those contents if appropriate.

Ms. Vacca stressed that electronic review of outbound email messages is not review of content. Ms. Arvin concurred. She noted that the campus systems also recognize that there can be instances of "false positives," information that is not in fact restricted but looks like restricted information.

In response to a question by Faculty Representative Anderson, Ms. Arvin and Ms. Vacca confirmed that under no circumstances would the contents of an email be inspected in this electronic review system.

Committee Chair Zettel presented a hypothetical situation in which many alerts would be generated by one employee. She asked if this would raise suspicion and how the system would respond. Ms. Arvin responded that if a campus observes such a series of outgoing emails with restricted information, it may provide additional training for the individual. Under current provisions, the campuses do not examine the content of emails.

Committee Chair Zettel expressed concern that UC privacy officers had rated the auditing and monitoring function in this area as "fair." The institution should have a goal of improving this and other ratings to "good" or "very good." Ms. Arvin responded that campuses are challenged by the limited resources available for auditing and monitoring. Some campuses have open positions or are not staffed adequately for what they consider an appropriate level of auditing and monitoring.

Committee Chair Zettel stated her view that the results of ad hoc privacy training would be uneven. She requested an outline of systemwide best practices for health sciences privacy compliance, and stated that the University should develop a policy on social media. Ms. Vacca responded that the University is developing such a policy.

Regent Pelliccioni emphasized the need for solutions in meeting campus auditing and monitoring needs. Ms. Arvin concurred that the University must think creatively, work as efficiently as possible with existing resources, and identify resources that are needed. UCLA has increased its resources in the previous few years. Its staff for privacy and information security has grown from three to seven. Other campuses have implemented technology-based solutions. Ms. Arvin acknowledged that there are areas for improvement. Campuses are discussing best practices and learning from one another.

Regent Makarechian stated that the current report and other reports like it should be forwarded to the Committee on Health Services, or that members of that Committee should be invited to the meeting of the Committee on Compliance and Audit when this issue is on the agenda.

Regent Ruiz asked that goals for improvement be better defined, and asked about the dollar-value or other actual return on investment for becoming more efficient and effective in health sciences privacy compliance. Ms. Arvin responded that it is difficult to “prove the negative” in compliance. She noted that UCLA’s resolution agreement was related to patient information security breaches in 2005-08. This cost the campus \$865,500, and indirect costs have not even been calculated. If the campus had been able to demonstrate then the procedures and policies it has in place now, this would have resulted in a different outcome with the U.S. Department of Health and Human Services’ Office for Civil Rights. A campus might not be able to demonstrate how much it has saved by implementing compliance measures until it is evaluated by an external agency. Ms. Vacca added that the administration would work with UC’s privacy officers to develop strategic targets and goals.

Ms. Arvin continued her presentation, noting that auditing conducted by the five health sciences campuses varies but can include review of accesses to the records of persons of interest, co-workers, or family members. Campuses assess compliance with policies and procedures, and review access to records for research purposes, a particularly complex area.

In the area of response and prevention, Ms. Arvin reported that three of the five health sciences campuses have a functionality known as “break the glass,” an alert that occurs if the records of certain individuals or certain classes of patients are accessed. The user is prompted to provide a reason for examining the record. This is intended to serve as a deterrent for individuals who might access records out of curiosity. Most information privacy compromises that occurred in an 18-month period between July 1, 2010 and December 31, 2011 were the result of simple human error. At four of the health sciences campuses human error accounted for approximately 80 percent of compromises, while at the remaining campus it accounted for approximately 40 percent. Three of the five health sciences campuses identified technology errors as the cause of approximately ten percent of the privacy compromises. For all five health sciences campuses fewer than ten percent of the compromises were the result of intentional actions. There were a total of 398 privacy compromises that resulted in notification to an external agency. The number per campus varied from as few as 25 to as many as 146, an average of 80 per campus. Of the total breaches, 288 required notifications to the California Department of Public Health; 36 required notification to the Office for Civil Rights.

Mr. Anderson asked if the differences among campuses in the number of information privacy compromises are consistent from year to year, or if they vary. Ms. Arvin responded that the University had not monitored this situation long enough and did not yet have enough data to provide an answer.

Ms. Arvin reported that all the health sciences campuses had been audited by an external entity; four of the five campuses had been audited one to five times, while one campus had over 60 audits. Ms. Vacca explained that a single incident had given rise to the large number of audits on that campus.

Three of the campuses required the use of an external vendor to assist with responses to information security breaches. The cost of this assistance has varied. For one campus, the cost of mailing out notifications was \$4,000. The cost to UCLA was recently \$45,000 when an external hard drive was stolen from the home of a UCLA physician.

In the 18-month period between July 1, 2010 and December 31, 2011, two health sciences campuses had fines imposed by the California Department of Public Health in the amounts of \$6,325 and \$15,600; UCLA paid a resolution amount of \$865,500. There were a total of 111 campus disciplinary actions related to information privacy compromises, an average of 22 per health sciences campus. Ms. Arvin expressed confidence that UC has appropriate penalties in place.

UC privacy officers reported that their greatest concern was restricted information on personally owned devices, for which the degree of security or data protection is unknown. Lost or stolen devices account for a large number of information security breaches. Privacy officers also expressed a high degree of concern about restricted information on University-owned mobile devices and access to restricted information by outside contractors or vendors.

Ms. Arvin concluded her presentation by pointing out some concerns for privacy compliance posed by external agencies. The Office for Civil Rights has increased enforcement. Under the HITECH Act, civil monetary penalties have increased from \$100 per violation to as much as \$50,000 per violation. For the first time, the Office for Civil Rights would be proactively carrying out audits in 2012 in a pilot program. Ms. Arvin noted that a UC medical center might be selected for one of these audits, and she cautioned that response to such an audit would demand a great deal of UC time and resources. She recalled that California law allows for nominal damages of \$1,000 per individual if it can be proven that the entity in question negligently disclosed patient information. Finally, there are proposed regulatory changes resulting from the HITECH Act which may impose additional obligations on UC.

7. INTERNAL AUDIT ACTIVITIES REPORT

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

Systemwide Audit Director Matthew Hicks noted a positive trend with regard to Management Corrective Actions (MCAs) and observed that the Regents' continued attention to high risk MCAs was helpful. Issues of concern included cash controls and information technology security compliance. He anticipated that compliance in

information technology security would probably improve with shared systems implementation and centralized controls.

Committee Chair Zettel emphasized the importance of training in addressing vulnerability.

8. **ETHICS AND COMPLIANCE ACTIVITIES REPORT**

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

Chief Compliance and Audit Officer Vacca drew attention to reporting trends and differences between fiscal year 2011 and fiscal year 2012. There had been no difference in the amount of reporting of workplace misconduct or of discrimination and harassment. Ms. Vacca stated that this result was not surprising for an organization the size of UC. In the area of fraud, theft, and embezzlement, the University's auditing had improved, and this accounted for an increase in reported cases. Deputy Compliance Officer Lynda Hilliard briefly noted a few key projects – a workgroup focused on the management of youth activities and a billing and coding process inventory at the medical centers.

Regent Makarechian asked about training on conflict of interest issues. Ms. Vacca responded that UC's Locally Designated Officials are required by the State to take training. UC has mandated training for researchers, and under Public Health Service requirements, 18,000 more UC affiliates may be required to take conflict of interest training. She acknowledged that there is not yet consistency throughout the UC system in information gathering and disclosure. Relevant policies are in place, but the monitoring of conflict of interest could be improved, and the University would make further efforts in this area.

Chief Financial Officer Taylor stressed that one of the University's goals is to identify and address risks before they become problems. He called attention to the fact that the campuses were struggling with difficult budget decisions. Campus budget reductions have had a clearly negative impact on the quality of instruction and teaching on all campuses. Many indicators, such as class size, suggest that the student experience at UC is no longer as good or as rigorous as it was in the past. In this environment, it is difficult for the Office of the President to request that campuses spend additional resources on risk mitigation. Mr. Taylor emphasized that it is not fair to students when the University is put in a position of choosing between monitoring conflict of interest or offering a course section.

Committee Chair Zettel suggested that outsourcing some information technology functions might be more cost-effective than developing in-house services. Mr. Taylor responded that the University seeks to secure outside vendors or services when these can do a better job and cost less. Most of the University's revenue comes from taxpayers, students and their families, and patients in UC hospitals. Mr. Taylor expressed his wish that the funds from these sources be devoted to support of faculty, teaching assistants,

research assistants, or student services. He stressed that the University must remain mindful of its core mission.

Principal Counsel Kathleen Quenneville observed that the University tries to monitor conflict of interest, but has limited information. The Office of the General Counsel would work with the internal audit program to examine target areas. She stressed that the University relies on individuals to identify their own potential conflicts of interest, and training helps them to do this.

In response to a question by Committee Chair Zettel, Ms. Vacca confirmed that the internal audit program reviews conflict of interest disclosure. There is a limit to available information; for example, the audit program would not examine an individual's tax statements, but there have been campus audits on conflict of interest processes.

Faculty Representative Anderson concurred with Mr. Taylor's statements and emphasized the University's need for more revenue. He questioned various percentages of new revenue that had been presented as necessary for the University to return to a reasonable financial situation.

In response to a question by Faculty Representative Powell, Ms. Vacca explained that in taking an integrated approach to managing its youth activities, the University looks to 4-H programs as a standard for best practices.

9. **CHIEF FINANCIAL OFFICER DIVISION AIM REPORT: ACTIONABLE INFORMATION FOR MANAGERS**

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

Chief Financial Officer Taylor recalled that his division's AIM report is issued quarterly to provide benchmarks in administrative efficiency measures for the campuses and to encourage improvement. An annual report of these campus data is given to the President, and this information contributes to his annual review of each chancellor. In the annual report for the President some data are broken down in greater detail, such as safety index data on workers' compensation and general liability.

Regent Makarechian referred to information in the report on hand postings at UCLA, and asked why these postings had increased. Associate Vice President Peggy Arrivas responded that this was due to the retirement of a campus employee with 30 years' experience. The transition to new employees was challenging for UCLA. Mr. Taylor noted that this circumstance was an opportunity for the campus to make improvements; if it had not occurred, campus leadership might not have recognized that there could be a problem.

Regent Makarechian asked if the University was not sufficiently system-oriented, such that an individual's retirement could cause paralysis. Ms. Arrivas responded that some of

the University's systems are old and rather complicated and require a fair amount of training for new employees. In this case, the campus was aware that it was challenged by the transition to new staff, and it brought the situation to Ms. Arrivas' attention.

Regent Makarechian asked about a decrease in numbers for direct deposit payroll at UC Riverside. Ms. Arrivas responded that a variety of factors, such as staff turnover, might account for this.

Regent Ruiz asked Mr. Taylor what he anticipated for the following year's report. Mr. Taylor responded that he hoped that averages would move in the right direction. He recalled that AIM report data have only been gathered for about a year. As more data become available over time, the University will be able to better identify trends, areas of improvement, and areas where resources can be deployed to drive improvement. Ms. Arrivas noted one area of improvement, an increase in the percentage of employees receiving electronic W-2 forms. This was the result of installing a "pop-up message" reminder that appears when employees view their earnings statements online and that prompts them to sign up for an electronic W-2 form. Ms. Arrivas observed that the University is pursuing creative tools and training like this to encourage the right behavior. Mr. Taylor recalled that the pop-up message was very effective; within a few days a large number of employees signed up to receive electronic W-2 forms.

10. **UNIVERSITY OF CALIFORNIA INTERNATIONAL ACTIVITIES UPDATE**

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

This item was deferred.

The meeting adjourned at 3:00 p.m.

Attest:

Secretary and Chief of Staff

**PricewaterhouseCoopers
Audit Fees**

	<u>Actual 2010</u>	<u>Actual 2011</u>	<u>2012</u>
Core Audit, including expenses			
UC	\$3,992,000	\$3,619,000	\$3,745,700 ⁽³⁾
National Laboratories	<u>69,400</u>	<u>62,000</u>	<u>64,200</u> ⁽⁴⁾
Sub-total Core Audit Cost	4,061,400	3,681,000 ⁽²⁾	3,809,900
2012 Required Scope Changes:			
Recurring - see detail below	50,000	-	(228,000) ⁽¹⁾
Expanded Scope at the National Laboratory (Berkeley)	<u>132,600</u>	<u>-</u>	<u>-</u>
Total Audit Cost	<u>\$4,244,000</u>	<u>\$3,681,000</u>	<u>\$3,581,900</u>

⁽¹⁾ Ongoing scope changes originating in each year are included in the Core Audit costs for the following year. They are:

<u>Scope changes</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
New GASB pronouncements	\$50,000		
Changes in Medical Center and benefit plan reports			(193,000) ⁽⁵⁾
Elimination of bond audit report			(35,000) ⁽⁵⁾
	<u>\$50,000</u>	<u>\$ -</u>	<u>\$ (228,000)</u>

⁽²⁾ For FY11 PwC has agreed to reduce fees by net of 10% over the FY10 fees. After applying the 5% fee increase originally approved by the Regents for FY11, fees were reduced by 15%, resulting in a net reduction of approximately 10% as compared to FY10.

⁽³⁾ For FY12, UC agreed to increase the fees by 3.5% over the FY11 fees.

⁽⁴⁾ Represents minimum scope of work necessary at LBNL to opine on the University of California financial statements, which has been increased by 3.5%.

⁽⁵⁾ Reduction in fee due to report changes made by University of California for the five medical center reports, as well as benefit plan reports. Additionally, the bond audit report is no longer required.

PricewaterhouseCoopers
Audit and Consulting Fees ⁽¹⁾
2010 and 2011

Year	Core Audit	Other Audits	Audit Related	Consulting	Ratio of Consulting to Core Audit	Ratio of Consulting to Core Audit, other Audit and Audit Related Services
2010	4,111,400 ⁽¹⁾	920,509 ⁽²⁾	896,659 ⁽³⁾	160,738 ⁽⁵⁾	4%	3%
2011	3,681,000 ⁽¹⁾	851,431 ⁽²⁾	309,969 ⁽⁴⁾	47,537 ⁽⁵⁾	1%	1%

⁽¹⁾ Fees are generally allocated to the fiscal year under audit for audit services and to the year performed for consulting projects, if any. Ongoing scope changes originating in each year are included in the core audit costs for the following years.

⁽²⁾ Primarily fees related to auditing the campus foundations and ASUCLA.

⁽³⁾ Relates primarily to tax compliance, LBNL expanded procedures, UCSF compliance attestation engagement, West Village leasing consultation, UCSF MC IT cost review and UCI MC Eclipsys implementation assessment.

⁽⁴⁾ Relates primarily to tax compliance, CFIA audits, and agreed upon procedures

⁽⁵⁾ Relates to Payroll Assessment/Activity Analysis Survey.

Audit Reports and Services

Audit Scope

PricewaterhouseCoopers has adopted a consistent approach for our audit procedures. We scope our work to perform an audit of the various financial statements. Overall we must achieve sufficient coverage to express an opinion on the University's consolidated financial statements as a result of our audit conducted in accordance with GAAS and GAS as well as on the individual Medical Center and employee benefit plan and related trust financial statements.

A-133 Reporting

Additional procedures are required for performing an audit of compliance with requirements applicable to each major federal program in accordance with GAS. At the time of preparing this report, we have identified two major programs (research and development and student financial aid) that will be subject to our OMB Circular A-133 audit for the year ending June 30, 2012. We expect that one or two additional programs requiring audit as part of the 2012 A133 work will be identified as part of the preparation of the 2012 Schedule of Expenditures and Federal Awards. Should additional major programs be identified that are required to be audited as part of the 2012 A-133 audit, we will alert the Committee of this.

PwC Services to the University

In addition to our audits, we provide advice on emerging accounting and reporting issues and provide certain other services including those listed below. Prior to commencing any services, we are required to obtain preapproval from the Committee or the Committee's designee pursuant to the University's preapproval policy for its independent auditor.

<p>Audit Opinions</p>	<ul style="list-style-type: none"> ■ Report on the consolidated financial statements of the University of California ■ Reports on the financial statements of each of the five Medical Centers ■ Report on the University of California Retirement System ■ Reports in accordance with OMB Circular A-133, including: <ul style="list-style-type: none"> - Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> - Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance
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Internal Control Observations	<ul style="list-style-type: none"> ■ Report to the Committee on control and process deficiencies and observations, including material weaknesses and significant deficiencies (Regents Letter) ■ Reports to the campus Chancellors on control and process deficiencies and observations (Chancellor Letters)
Agreed-Upon Procedures	<ul style="list-style-type: none"> ■ Agreed-upon Procedures related to the sale of Mortgage Origination Program and Supplemental Home Loan Program loans ■ Agreed-upon Procedures related to the 415(m) plans ■ Agreed-upon Procedures on Intercollegiate Athletic Departments (NCAA requirements) for six campuses
Other Services	<ul style="list-style-type: none"> ■ Reviews in connection with bond offerings ■ Accounting consultations and other assistance associated with emerging accounting and reporting issues and complex transactions
Committee Reporting	<ul style="list-style-type: none"> ■ Audit and communications plan ■ Results of audits and required communications