

The Regents of the University of California

COMMITTEE ON COMPLIANCE AND AUDIT

May 10, 2016

The Committee on Compliance and Audit met on the above date at the Sacramento Convention Center, 1400 J Street, Sacramento.

Members Present: Regents Gorman, Oved, Sherman, and Zettel; Ex officio member Lozano; Advisory member Chalfant; Staff Advisors Acker and Richmond

In attendance: Regents Davis, Pérez, and Rendon, Regents-designate Ramirez and Schroeder, Faculty Representative Hare, Secretary and Chief of Staff Shaw, General Counsel Robinson, Chief Compliance and Audit Officer Vacca, Executive Vice President and Chief Financial Officer Brostrom, Vice Presidents Budil and Sakaki, Chancellors Block, Blumenthal, Hawgood, Khosla, Leland, and Yang, Acting Chancellor Hexter, and Recording Secretary Johns

The meeting convened at 1:50 p.m. with Committee Chair Zettel presiding.

1. APPROVAL OF MINUTES OF PREVIOUS MEETING

Upon motion duly made and seconded, the minutes of the meeting of March 24, 2016 were approved.

2. INTERNAL AUDIT ACTIVITIES REPORT

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

Systemwide Deputy Audit Officer Matthew Hicks reported that in late January, the University's internal audit program held its All Auditors Forum, which is held about every two years. He briefly described the Forum program.

Cyber security remains a key priority. There are plans to build a systemwide cyber security audit team. This area requires specialized subject matter expertise and in part, UC has relied on external firms. The internal team would have three full-time equivalents to deliver that expertise.

Committee Chair Zettel asked when this team might be formed. Chief Compliance and Audit Officer Vacca responded that she hoped the team would begin work by June or July, the start of the fiscal year.

Mr. Hicks related that another focus of work had been the implementation of the UCPath system. The internal audit program assisted with the first deployment of UCPath at the

Office of the President and would support future deployments. One current activity was a systemwide audit of construction work. He anticipated that the results of this audit would be reported in the next quarter.

Committee Chair Zettel asked about the status of UCPATH development. Mr. Hicks responded that the initial deployment was successful. One of the conclusions reached after the deployment was that internal audit needed to be engaged earlier in the process. Ms. Vacca added that internal audit was partnering with UCPATH and would be involved with future deployments and with the operation of UCPATH.

Committee Chair Zettel asked if the internal audit program would be working with PricewaterhouseCoopers (PwC) in some of its areas of focus. Ms. Vacca responded that internal audit usually works with the external auditor by providing status updates and incorporates PwC observations into its plans.

3. DRAFT INTERNAL AUDIT PLAN FOR 2016-17

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

Systemwide Deputy Audit Officer Matthew Hicks emphasized the breadth of internal audit plans, which cover not only financial controls, but governance, risk management, and regulatory and operational issues. He outlined the time frame in which the audit plan is developed. Risk assessment takes place at all UC locations. Input comes from interviews with management and senior leadership, and from financial and data analysis, among other sources. Chief Compliance and Audit Officer Vacca noted that development of the campus audit plans proceeds parallel to the systemwide plan; campus plans are then incorporated into the systemwide plan.

Mr. Hicks outlined areas of emphasis in the draft internal audit plan for 2016-17, which encompasses traditional risk areas as well as current UC strategic initiatives. Efforts in cyber security would include advisory support for risk assessment in this area and working with an external provider to deliver penetration testing. With regard to the University's program of strategic sourcing, internal audit would seek to identify when and why UC employees do not use strategic contracts for purchasing.

Regent Davis referred to UC Berkeley's and UC Davis' collaborative relationships with academic institutions in China. He expressed concern about the risk posed by these relationships and hoped that UC's internal audit program would monitor how well the University is managing that risk.

Staff Advisor Acker asked about the topic of diversity, equity, and inclusion in the internal audit plan. Mr. Hicks responded that internal audit can provide value by evaluating the initiatives put in place by management, to ensure they are achieving the intended objectives. Ms. Vacca added that internal audit can ensure that hiring practices

are fair. Mr. Hicks noted that data analytics can serve as a powerful tool, preferable to anecdotal evidence, for ensuring that certain outcomes have been achieved.

Regent Sherman asked about operational controls that would be applied to ensure that strategic sourcing is used for purchasing. Mr. Hicks responded that one location performed an audit focused on strategic sourcing contracts to ascertain if employees were making purchases from competitors or using strategic contract vendors but not at the rates negotiated by the University. This is an area where UC might be losing significant amounts of potential savings. Auditing of this area would take place on the individual and macro levels to determine the extent to which employees might be bypassing strategic sourcing vendors.

Regent-designate Ramirez asked what the internal audit plan would entail for student housing and population density. Mr. Hicks responded that it was still too soon to provide specific information about this.

Committee Chair Zettel asked about how data on sexual assault and student safety were being gathered and analyzed. Ms. Vacca responded that the internal audit program had not yet been engaged in analyzing data on this topic, but would become involved at a future point.

Committee Chair Zettel asked if the Committee would be briefed throughout the year on audit issues such as cyber security. Ms. Vacca responded in the affirmative.

Regent Davis referred to the University's recent efforts to promote strategic collaborations among its five medical centers. He urged the internal audit program to assess the success of these strategic collaborations. Mr. Hicks responded that this would be taken into consideration. Committee Chair Zettel suggested that an audit report on the clinical enterprise might be presented at a future meeting of the Committee on Health Services.

4. **ETHICS AND COMPLIANCE ACTIVITIES REPORT**

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

Systemwide Deputy Compliance Officer David Lane provided an update on some key areas in implementation of the University's annual compliance plan. In the area of policy development and implementation, UC issued a new Policy on Sexual Violence and Sexual Harassment on January 1. An important feature of the new policy is its redefinition of "prohibited conduct." The policy mandates annual training for faculty, staff, and students, and designates all UC employees as mandated reporters for student incidents. Other systemwide policies and guidance are being developed. The Clery Act is a federal statute that requires crime statistic reporting by colleges and universities. UC is developing a systemwide policy to help campuses with this reporting. Two other initiatives were under way to improve safety on campuses: a video security policy to

ensure that campus security video cameras are used appropriately, and guidance to prevent abusive conduct other than sexual violence or harassment.

Committee Chair Zettel requested clarification of the guidance for prevention of abusive conduct, asking if it concerned working relationships between employees and between management and staff, and if it would include educational opportunities and positive corrective actions. Mr. Lane responded that this was correct. The guidance, to be based on best practices, would deal with conflict resolution, bullying, and harassment. Bullying and harassment are sometimes a key reason that some individuals leave UC employment.

Mr. Lane then noted that UC's international activities are extensive. The UC compliance program has initiated an ongoing international compliance workgroup, examining systemwide functions and risk areas. The program is developing an online portal with resources and information on regulations and risks. In the past year, the program completed a seven-part webinar series on international compliance, organized by UC faculty and researchers, with over 600 registrants. He recalled that UC had mandated sexual harassment prevention training for all UC employees, beginning in January, with training to be completed by May 1. Data from the campuses indicated a high rate of compliance, close to 100 percent. UC has also mandated cyber security training. Training for sexual harassment prevention and cyber security would be translated and offered in Spanish and Mandarin Chinese.

5. EXTERNAL AUDIT PLAN FOR THE YEAR ENDING JUNE 30, 2016

The President of the University recommended that the PricewaterhouseCoopers (PwC) external audit plan and fees for the University for the year ending June 30, 2016, as shown on pages 13 and 27 of Attachment 1, respectively, be approved.

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

Associate Vice President Peggy Arrivas introduced PricewaterhouseCoopers (PwC) representatives Michael Schini, lead engagement partner for the University's audit, and Michael MacBryde, lead engagement partner for the audit of the medical centers. The scope of the audit recommended by management was the same as for prior years.

Mr. Schini stressed his organization's hope that the transition to PwC would be executed smoothly. Many of the same team members who performed PwC's 2013 audit of the University would work on the current audit, individuals with institutional knowledge. PwC's audit plan would focus on four significant elevated risks – revenue, possible risk of management overriding of controls, alternative investments, and construction. He drew attention to two Governmental Accounting Standards Board (GASB) pronouncements, Statement 72 and Statement 80, and expressed confidence in PwC's ability to work with the Office of the President on implementing them.

Committee Chair Zettel underscored the importance for PwC of coming to this audit with a fresh perspective, and for the University of ensuring that its processes are compliant and exemplary. She asked about the new GASB pronouncements. Mr. Schini responded that the University had already begun preparing for compliance with the pronouncements, and PwC was comfortable with UC's plans. Committee Chair Zettel thanked PwC for including an appendix to its audit plan, a report on perspectives on higher education in 2015.

Executive Vice President and Chief Financial Officer Brostrom thanked PwC for its responsiveness at a challenging moment for the University.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board.

6. **UPDATE ON STATE AUDIT OF BUDGET, ENROLLMENT, AND EXECUTIVE COMPENSATION**

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

Executive Vice President and Chief Financial Officer Brostrom recalled that the California State Auditor had released a report on the University in March. This report focused on admissions, academic qualifications of resident and nonresident students, UC's adherence to the California Master Plan for Higher Education (Master Plan), the Working Smarter initiative, tracking and monitoring State fund expenditures, and UC's efforts to align funding across the campuses, a process sometimes referred to as "rebenching."

Mr. Brostrom emphasized that, contrary to an assertion in the State Auditor's report, the enrollment of nonresident students at UC has not displaced California residents. Enrollment of California resident students is the first priority of UC admissions; nonresidents are enrolled in addition to, and not instead of, California residents. Enrollment of California undergraduates depends on UC's commitment to the Master Plan and on State funding. Growth in nonresident enrollment has not constrained the University's ability to enroll growing numbers of California residents. The revenue generated from nonresident students was a critical source that enabled UC to maintain resident enrollment during the fiscal crisis and funding cuts by the State. If UC had not increased nonresident enrollment, there would not have been sufficient revenue to maintain California resident enrollment. Most campuses in the California State University (CSU) system do not attract many applicants from outside California. During the fiscal crisis, CSU made the difficult decision to turn away tens of thousands of qualified students. This was the kind of difficult choice faced by public universities across the U.S. during the recession. UC took an approach of increasing nonresident enrollment combined with aggressive savings and efficiencies, believing this to be the best way to maintain California resident enrollment and address fiscal challenges.

The University disagrees with conclusions in the State Auditor's report about staff growth. The report cites growth in staff and salaries at UC. The UC workforce grew by 15 percent between 2005-06 and 2014-15, a period of economic strain. The report fails to recognize that 72 percent of this growth was attributable to the health sciences and the growth of UC's medical centers. During this period, medical center revenues and their overall operations grew by 91 percent. In contrast, the number of staff supported by State funds and tuition declined by 17 percent over this period. In addition, UC embarked on aggressive initiatives to institute new business practices, cut costs, and seek alternative sources of revenue to help the campuses achieve their core mission. Some of these efforts were part of the Working Smarter initiative. The report questions the validity of savings achieved through Working Smarter and suggests that these savings cannot be documented, while in fact the efficacy of several programs has been verified and substantiated by external auditors, actuaries, and other third parties. One example of a program that generated fiscal impact was in the area of asset management. Even before the fiscal crisis, UC evaluated its working capital assets to determine how much liquidity it needs. At that time, all UC's working capital was invested in its Short Term Investment Pool (STIP), which is invested in a way to ensure sufficient liquidity. UC determined that many of its assets could be moved into a new investment vehicle, the Total Return Investment Pool (TRIP), which offers higher returns and less liquidity. This investment opportunity has been tremendously successful. Over the past five years, TRIP averaged 5.6 percent in returns, while STIP averaged 1.8 percent. Since the inception of TRIP, cumulative returns have resulted in hundreds of millions of dollars in additional revenue for campuses and medical centers. UC currently had more invested in TRIP than in STIP. There were other examples of substantiated savings for other programs in the Working Smarter portfolio.

Associate Vice President Stephen Handel commented that the State Auditor's report focuses a great deal of attention on the admission of nonresident students to UC. Many of the State Auditor's findings are based on faulty foundational assumptions, leading to inaccurate conclusions. The University increased its admissions of nonresident students during a time when enrollment growth for California residents slowed because of the absence of State enrollment funding. Mr. Handel stressed that 85 percent of UC's enrolled students are California residents. California residents are far more likely than nonresidents to be admitted to the University and to a campus of their choice. All California residents who meet UC standards receive at least one offer of admission. UC makes this commitment despite growing demand – for the fall 2016 term, the University received applications from over 203,000 high school and community college students. The report accurately notes that demand for a UC education has increased dramatically, but fails to note adequately that the State's commitment to fund the Master Plan has not kept pace. The report recommends that UC reduce the number of nonresident students to create more space for residents, but Mr. Handel explained that this approach would not achieve the desired result. Nonresident students support the cost of education for California students, providing funding necessary maintain enrollment of California students. California enrollment growth at UC depends on State funding. The current admissions cycle was a case in point. The Legislature's approval the previous year of enrollment growth funding had allowed one of the largest enrollment increases in recent

UC history. In fall of the previous year, UC announced its plans to enroll 5,000 more California undergraduates in the current year, and another 5,000 in the next two years, assuming new enrollment growth funding. Enrollment growth in 2016 would be concentrated at the three campuses that also happen to enroll the most nonresidents – UC Berkeley, UCLA, and UC San Diego. When the State supports enrollment growth, UC responds.

The University's admissions policy requires nonresident students to be at least as qualified as resident students and holds nonresidents to a higher minimum grade point average (GPA) standard simply to be considered. UC provides no guarantee of admission to any nonresident student. Nevertheless, the report suggests that UC faculty weakened admissions policy in 2011 to engineer greater nonresident enrollment and make it easier for nonresidents to gain admission. The documents UC submitted to the State Auditor show this conclusion to be inaccurate. The principal faculty committee with responsibility for admissions policy, the Academic Senate's Board of Admissions and Relations with Schools, emphasized that its chief focus in revising admissions policy was to uphold the idea of merit through comprehensive review processes, in spite of fiscal pressures to select nonresidents, and to continue to articulate UC's commitment to California residents. The report draws a number of erroneous conclusions about the qualifications of nonresident students. It claims that UC admitted thousands of nonresident students who were less qualified than the upper half of California resident students UC admitted. In this case, the State Auditor did not review a variety of academic factors; the State Auditor examined only two of UC's 14 comprehensive review factors. GPA and test scores are important but provide only a partial insight into the qualifications of students for college. GPA in particular is a problematic measure when comparing student achievement across the U.S. and internationally, since grading systems and criteria differ. In contrast, standardized test scores from nonresident and international students are far easier to evaluate. Mr. Handel displayed a chart showing that nonresident students had higher average SAT test scores than California residents over several years on most campuses. This information was made available to the State Auditor but it was not included in the final report. UC does not and according to its policy may not reject students on the basis of a single factor. UC admissions policy seeks to admit students who will succeed academically, and both nonresident and resident students clearly achieve this.

Competition for admission has increased for all students applying to UC, which is understandable, given that applications have increased for 12 years in a row. State funding for enrollment has not grown commensurately. The report implies that while some California resident students are not admitted to the campus of their choice, most nonresidents are. There is no evidence to support such an implication. The overall admission rate for California residents is 71 percent, and 55 percent for nonresidents. Nearly half of all nonresident applicants are denied at every campus they apply to. Nor do nonresidents have greater access to more campuses. Available data show that California residents are more likely to be admitted to one or more, two or more, or three or more campuses. For California residents who are not admitted to the campus of their choice,

unlike nonresidents, UC guarantees a place in the system through its referral process. No out-of-state or international students are considered in this referral process.

The State Auditor's report raises important public policy questions, but it also raises questions for prospective students and their families. Mr. Handel emphasized UC's foremost commitment to California residents. UC's guarantee to find a place in its system for every qualified California resident student is one it takes seriously, a guarantee that has bettered the lives of thousands of students, and that UC has maintained despite State budget cuts. This guarantee is not extended to nonresidents. UC's comprehensive review admissions policy ensures that all applicants receive a thorough review of their accomplishments using a variety of criteria, well beyond GPA and test scores. The University's action to enroll 5,000 more resident undergraduates in the current year addresses most of the concerns expressed in the report. There are significant benefits when the State partners with UC to increase enrollment for Californians.

Chairman Lozano recalled that during the fiscal crisis, the University lost more than \$1 billion in funding in 18 months. A reduction in revenue of this magnitude forced UC to make difficult decisions. The University doubled tuition in the period from 2007 to 2011, and this became unsustainable for students and their families. UC could have responded to the situation by reducing the number of students but decided to continue to provide access to California students by increasing nonresident enrollment. This action also allowed the University to freeze resident tuition for six years. UC clearly gives preference to California students in its admissions policy. The State Auditor plays a vital role and the University welcomes review of its activities. In this case there was real disagreement about interpretation of the facts. UC was required to respond to the report, and this was an opportunity for UC to demonstrate its ongoing commitment to California students and to working with the Legislature and the Governor to ensure funding for California student enrollment.

Regent Sherman asked about a scenario under which UC would not have increased nonresident enrollment and would not have received this tuition revenue. He asked how many California resident students would not have been able to attend UC, if this had been the case. Mr. Brostrom responded that revenue from nonresident supplemental tuition was currently approximately \$728 million. When UC began to increase nonresident enrollment, this revenue was less than \$300 million. While it is difficult to relate this additional revenue of about \$428 million to specific numbers of California students, because other factors are involved, it probably made it possible for tens of thousands of California students to attend UC.

Regent Sherman requested confirmation that the University would not have run a deficit on purpose in order to admit California students. Mr. Brostrom responded that even without enrolling more California students, UC could still have run a deficit. Mr. Handel emphasized the University's interest in enrolling California students.

Regent Davis encouraged the University to respond to the State Auditor in a way that was not defensive and adversarial, but collaborative where possible, and to offer alternative

approaches to addressing the State Auditor's concerns. UC could demonstrate how increased State funding would allow more California students to attend the campus of their choice. Mr. Brostrom responded that UC spent several months working with the State Auditor's team. There were many areas of agreement, such as transparency and reporting. The State Auditor supports the University's approach to rebenching. Mr. Handel added that the way the report was presented in the news media was not helpful to the University, which seeks to partner with the State.

Regent Davis observed that the University's response to the State Auditor was a unique opportunity to highlight the importance of building and completing the campus at UC Merced, a project with significant positive impact on the lives of Californians. Mr. Brostrom noted that the University was receiving final bids on the Merced 2020 Project. UC Merced was a remarkable campus with a sense of optimism and energy.

Regent-designate Schroeder encouraged UC to communicate the information that had been discussed to the general public and to alumni, because many people had been misinformed by headlines in the news media.

Regent Oved expressed concern about the fact that discussions about these matters that had taken place over the past months had included negative discourse about nonresident students. The State Auditor's report appeared to view nonresident students merely as numbers and failed to recognize their contributions, other than financial, to the University.

Regent Pérez stated that UC should not disparage the work of the State Auditor. The report should be the basis for a broad-based discussion with the Board about its response to the State Auditor's recommendations. The University must do a better job of explaining the quality of its nonresident students. He stated his view that the presence of nonresident students at UC adds to the value of education for all students, and stressed the educational value of having these students, rather than the financial value. The fact that nonresident students are not distributed evenly among campuses is a matter that should be discussed.

The meeting adjourned at 3:15 p.m.

Attest:

Secretary and Chief of Staff

University of California Audit and Communications Plan

*For the Year Ending
June 30, 2016*





Members of The Regents
Committee on Compliance and Audit
University of California

May 2, 2016

Dear Members of the Committee on Compliance and Audit:

We are pleased to have the opportunity to meet with you on May 10, 2016 to present our 2016 Audit Plan for the University of California (the "University"). This report presents to you our audit and communications plan as well as a summary of our understanding of expectations and responsibilities between us, our audit approach, service deliverables, audit and reporting timetable and other matters. Discussion of our plan with you ensures our engagement team members understand your concerns, and that we agree on mutual needs and expectations to provide the highest level of service quality. Our plan has been developed to provide the University with an efficient, high quality audit which addresses the key risks and business issues of the organization.

The higher education environment continues to be complex, with increasing expectations about performance, accountability, and value from many different constituents, including students, parents, regulators, donors, and federal and state governments. Our goal has and continues to be understanding and delivering upon your expectations and providing you with the best possible service and value.

In addition, we have included our most recent thought leadership publications that we believe you will find helpful – *Perspectives in Higher Education 2015*, which provides a summary of the more pressing issues impacting the higher education sector, as an attachment to this plan.

We are pleased to be again serving as the University's independent auditor. We appreciate the opportunity and look forward to meeting with you to present this report, address your questions and discuss any other matters of interest to the Committee on Audit and Compliance. Please feel free to contact Michael Schini at (408) 817-4345 or Michael MacBryde at (415) 498-7140 with any questions you may have.

Very truly yours,

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

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Executive Summary

This executive summary is provided to highlight the key points in this service plan such as our assessment of significant risks and new events impacting the 2016 audit. The remainder of our service plan provides additional detail on these items as well as the PwC client service team, an overview of our top-down, risk-based audit approach, our audit responses to significant risk, and our plan for continuous, two-way communication and reporting to the Committee and management. The University of California system and its stakeholders expect us to deliver a high quality audit and that is our number one goal as your auditor. PwC has a significant focus on audit quality and continuous improvement in our audit processes-- we are continually standardizing, simplifying and automating through technology to enhance audit quality while improving the experience for you as well.

You also expect an audit that makes the best use of your time. So as we enter our planning activities for the 2016 audit, we look at how we can audit more efficiently while delivering quality and keeping you apprised of the audit and financial reporting impacts caused by changes to your organization, operating environment, regulatory developments and new accounting standards.

Current year considerations--what's new for 2016

As you know, we were formerly the auditors of the University of California but have not served in this role for the past two years. Although we have had a two year break in service, we have brought back a significant number of members from our past team who will allow us to build upon things that have worked well in previous years and enhance our approach from lessons learned. The commonality of our team leadership will allow a smooth transition back to PwC. On the other hand, we will commit to bring a fresh perspective to our audit from selected new team members and also enhancements in the PwC audit approach over the past two years.

Our efforts will include (some of which we have already begun to perform):

- Building upon our previously obtained understanding of the University's processes, controls and relationships throughout the University to reduce management's time supporting the audit. In fact, we have already begun to coordinate the 2016 audit with the many stakeholders and locations and plan to utilize work across teams to avoid duplication in procedures performed.
- Enhancing our project management tools and techniques to manage our audits most effectively.
- Ensuring continuous communication with management throughout the audit process to avoid late surprises.
- Focusing on phasing of our audit work throughout the year to balance the workload and reduce year-end crunch.

- Accelerating our Uniform Guidance federal award audit procedures to better leverage the compliance work into our financial statement audit and to ensure a succinct conclusion to the Uniform Guidance audit.
- Incorporating information technology (IT) and data management tools to improve our engagement management capabilities allowing us to be more efficient on the engagement.
- Significantly upgrading our audit documentation capabilities through technology to standardize audit procedures and documentation templates which also allows us to be more efficient.

Looking forward: The impact of business, regulatory and financial reporting changes

We will continue to bring a forward looking perspective to the audit and adapt it to the changing facts and circumstances in your business and regulatory environment. Below we highlight some of the changes that will impact your audit from 2016 and beyond.

- Regulatory developments, such as the impact of the first full year of compliance with the Uniform Guidance. For 2016, OMB's Uniform Guidance requires all entities that receive federal funding to implement a formal control framework (such as COSO) and requires that, as part of our audit, the implementation of this framework is tested. As new documentation becomes available, we will review it, perform walkthroughs and provide feedback where appropriate. This also impacts the controls we identify and are required to test to ensure that the organization meets its compliance requirements over the use of federal funds.

Two other changes will impact the 2016 audit process. The first expands the scope for independent auditors, requiring the independent auditor to test at least one Type B program (non-research or non-student financial aid programs that are less than a prescribed materiality). The second expands the information required to be included on the data collection form that will impact the procedures we are required to perform.

- Significant IT implementations, such as UCPATH, will continue to impact our audit scope. During and after implementation, we will continue to hold discussions and perform procedures, as applicable, to ensure the effectiveness of IT controls and consider the level of reliance we can derive for audit support.
- Significant transactions have accounting and reporting implications. We will advise you of the accounting and reporting impacts of such transactions so you can make more informed decisions and eliminate surprises.
- There are numerous new Governmental Accounting Standards Board (GASB) pronouncements that will require implementation in 2016 and beyond. In fiscal year 2016, the University has implemented GASB 72, *'Fair Value Measurement and Application'* and GASB 80, *'Blending Requirements for Certain Component Units'* which

we cover in more detail in section ‘*Assessing New Accounting Pronouncements*’. For all future pronouncements, refer to Appendix D. We will continue to work with you to implement and assess the impacts of these new GASB pronouncements on your financial reporting as part of our audit plan.

Our transition timeline

Using the information we have gained during our recent discussions with management, leveraging our prior knowledge of the University, as well as including recurring team members, we believe we are in a position to “hit the ground running” with respect to the 2016 audit.

Our accelerated transition plan will ensure we are fully coordinated with each location as well as the Office of the President (UCOP) over the next 60 days. We emphasize close coordination with you and continuous communication throughout the transition. In addition, by remaining flexible throughout the transition process and deploying resources appropriately we will make sure the process is as seamless as possible. We will work with management to ensure that our audit is well planned and executed to ensure a smooth and “no surprises” transition.

Our Audit Objectives

As the University's auditor, we are responsible for reporting on numerous financial statements. In performing our audits for 2016, our primary objectives are as follows:

- Perform an audit of the University of California consolidated financial statements, University of California Retirement System financial statements, including the University defined benefit retirement plans, University retirement savings program and report on the University of California Retirement Plan's Schedule of Cash Contributions, University's Captive Insurance Company, bond opinion related to UCLA Medical Center debt agreement and each of the five University Medical Centers, in accordance with generally accepted auditing standards (GAAS) and, as applicable, *Government Auditing Standards* (GAS). In connection with our audits, we will obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.
- Perform an audit of the University's compliance with federal award requirements (OMB Uniform Guidance) in accordance with GAS.
- Communicate in writing to management and the Committee all material weaknesses and significant deficiencies identified during the audit. In addition, communicate in writing to management all deficiencies in internal control, of consequence, over financial reporting identified during the audits.
- Complete other communications required under professional standards to the Committee on a timely basis.

In meeting these objectives, we will do the following:

- Consult with management on a timely basis regarding accounting and financial reporting issues and ensure all matters of significance are reviewed and discussed at the Office of the President and relevant location level.
- Coordinate efforts with management to ensure that all significant financial statement components are subject to sufficient audit coverage.
- Evaluate changes in the University, risk profile and internal controls to determine the nature, timing and extent of our testing of controls and substantive tests.
- Provide relevant expertise to facilitate the resolution of important issues.
- Report the results of our work to management and the Committee, including constructive observations relating to the University's financial processes and controls.

We note that the campus foundations have separate audits of their financial statements and the auditor's reporting on those foundations is directed to the individual foundation audit committees. Accordingly, this Audit and Communications Plan is not focused on the specifics of the campus foundations.

Business, Regulatory and Other Changes Impacting Our Audit

Our 2016 audit plan has been updated to reflect our prior years' experience, changes in the University and current regulatory developments. In forming our 2016 audit plan, we factored in our experience from our most recent 2013 audit of the University, including further enhancing our risk-based approach to the audit and our scoping of significant locations and accounts. We have also taken a "fresh look" at our audit approach and considered areas of the audit that we can perform more efficiently, while still achieving the same effectiveness. We actively keep current with the University through the actions detailed below:

Monitoring Regulatory Developments

- Continuing to monitor developments in federal and state hospital reimbursement mechanisms and their potential effect on the University's Medical Centers;
- Monitoring developments in government contracting regulations and their potential effect on federal contracts held by the University;
- Identifying other regulatory developments which could either affect our audit procedures under a risk-based approach or have longer term implications; and
- Working with management to assess the impact of future technical pronouncements on the University's various financial statements.

Capital Spend / Significant IT Implementations

- Monitoring capital and IT spend for audit implications--with the continuing amount of capital spending, including significant new construction and IT projects (e.g., UCPATH, EPIC), we will obtain an understanding of the University's capital spending programs, evaluate the risks and controls associated with the various programs, and assess the design of those controls. We also consider and evaluate any IT system changes and their impact to our audit scope and consider discrete testing of these expenditures.

Advising on Significant Transactions

- We will provide input to management on the potential accounting impact and reporting treatment for significant transactions such as Merced 2020 and UCLA's sale of its royalty interest connected with a leading prostate cancer medication, Xtandi to Royalty Pharma. This will help management make informed decisions and eliminate surprises.

Assessing New Accounting Pronouncements

Understanding the effect of new GASB standards--the GASB continues to be active in standard setting and has a full agenda of projects as detailed in Appendix D. The University is implementing two new GASB pronouncements in fiscal year 2016, GASB 72, 'Fair Value

Measurement and Application’ and GASB 80, *Blending Requirements for Certain Component Units*’. Refer below for a summary of these two new pronouncements.

Statement No. 72, ‘Fair Value Measurement and Application’

GASB Statement No. 72, *Fair Value Measurement and Application*, establishes a hierarchy of inputs to valuation techniques used to measure fair value. That hierarchy has three levels. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are inputs—other than quoted prices—included within Level 1 that are observable for the asset or liability, either directly or indirectly. Finally, Level 3 inputs are unobservable inputs, such as management’s assumption of the default rate among underlying mortgages of a mortgage-backed security. This Statement requires additional analysis of fair value if the volume or level of activity for an asset or liability has significantly decreased. It also requires identification of transactions that are not orderly. This Statement requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques. Governments should organize these disclosures by type of asset or liability reported at fair value. It also requires additional disclosures regarding investments in certain entities that calculate net asset value per share (or its equivalent).

The requirements of this Statement will enhance comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. This Statement also will enhance fair value application guidance and related disclosures in order to provide information to financial statement users about the impact of fair value measurements on a government’s financial position.

Statement No. 80, ‘Blending Requirements for Certain Component Units’

GASB Statement No. 80, *Blending Requirements for Certain Component Units*, improves financial reporting by clarifying the financial statement presentation requirements for certain component units. This Statement amends the blending requirements established in paragraph 53 of Statement No. 14, *The Financial Reporting Entity*, as amended. This Statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of Statement No. 39, *Determining Whether Certain Organizations Are Component Units*.

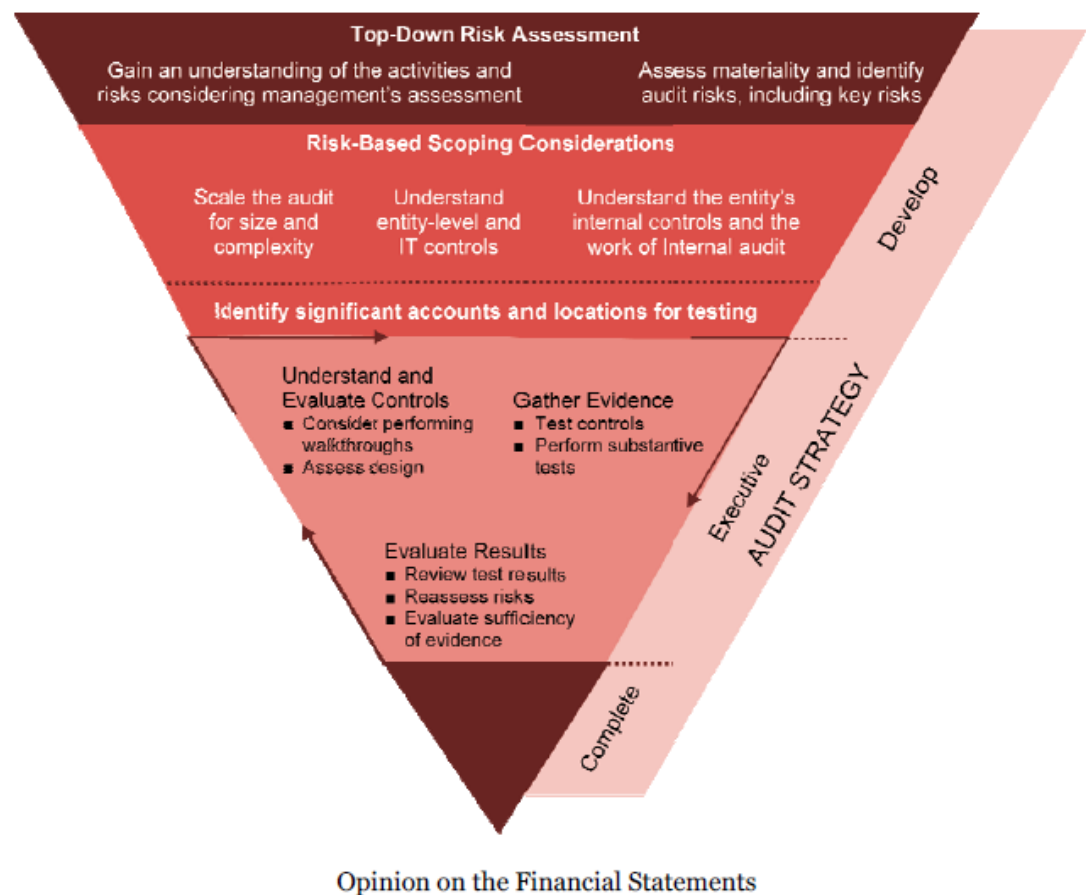
The requirements of this Statement enhance the comparability of financial statements among governments. Greater comparability improves the decision usefulness of information reported in financial statements and enhances its value for assessing government accountability.

Our Audit Approach and Risk Assessment

Our Audit Strategy is based on:

- The use of a top-down, risk-based approach to planning and conducting the audit; and
- The application of well-reasoned professional judgment.

These principles allow us to develop and execute our audit strategy in an effective and efficient manner.



Significant Risks

The designation of significant risks which is required by the professional auditing standards, ensures that we place appropriate emphasis and testing on those areas most likely to cause a material financial reporting misstatement. Accordingly, as part of our audit planning, we identify certain audit areas as subject to significant risk of material financial reporting misstatement in the financial statements based on our knowledge of the University and the industries in which it operates. Such audit areas are subject to inherent or specific risks and complexities, critical accounting policies and/or significant judgments and estimates, as further described in the University's consolidated financial statements, and are key considerations as we develop our current year audit approach. We identified the following significant risks:

- Management override of controls - This is a required significant risk on all audit engagements. We perform testing on the appropriateness of journal entries and other adjustments, significant accounting estimates, and significant and/or unusual transactions to address this risk.
- Fraud risk in revenue - As discussed in this document, in the section titled, *Perspectives on Fraud Risk and Responsibilities*, we have a presumption to consider the fraud risk in revenue as significant, which includes grants and contracts, educational activities and patient service revenue.
- Valuation of alternative investments - The University has complex investments that are recorded at fair value. The underlying assumptions used to value certain of these investments may be judgmental and subject to risk that amounts received in settlement differ significantly from fair value measurements.

For further information on the implications on our audit associated with these risks, refer to Appendix C.

Elevated Risks

In addition to the significant risks identified above, we have identified the areas below that are not considered significant risks but are areas of focus during the audit due to materiality of the balance or complexity/judgment involved in the accounting. Such audit areas are subject to material accounting policies and/or judgments and are considerations as we develop our current year audit approach. For the current year, these consist of the accounting, reporting and controls over construction.

Lastly, we have additional areas of audit emphasis, which are those areas where we do perform procedures due to their size, complexity or judgment. These include:

- Accounting and reporting for actuarially determined estimates (retirement plans and retiree health benefit obligations).
- Accounting for receivables and allowances such as pledges and medical center receivables.

- Determination of which entities are to be included as component units under GASB reporting guidelines due to their significance and the nature of the University's relationship with the entities.
- Notes, bonds payable and commercial paper liabilities.
- Presentation and disclosure of the financial statements.
- Treatment of related party transactions with the University, as applicable to the separately-issued financial statements of the medical centers and benefit plans.

Uniform Guidance Reporting and Compliance Risk

Although not considered a significant risk from a financial reporting standpoint, we also focus our audit procedures on regulatory compliance, including healthcare reimbursements, federal grants, and continued focus on compliance processes and controls over the University's federally sponsored research and financial aid programs. These procedures are performed in connection with our OMB Uniform Guidance audit due to the reputational risk and potential legal ramifications associated with non-compliance.

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 expect that two major programs (research and development and student financial aid) will be subject to our OMB Uniform Guidance audit for the year ending June 30, 2016. We expect that one or two additional programs requiring audit as part of the 2016 Uniform Guidance work will be identified as part of the preparation of the 2016 Schedule of Expenditures and Federal Awards.

Refer to Appendix B for a summary of how we develop our audit strategy and execute our audit.

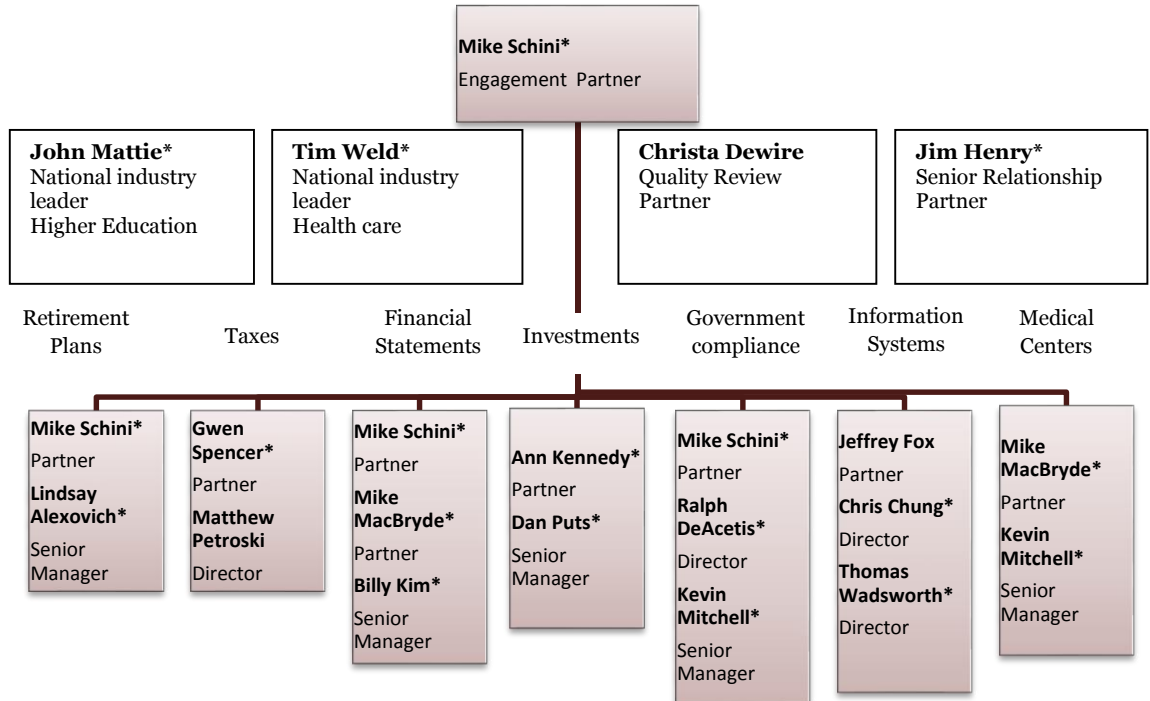
Our Deliverables

As part of our service to the University, we provide advice on emerging accounting and reporting issues and provide certain other services. Refer to the table below for a listing of services we expect to provide. Prior to commencing any other 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.

Audit Opinions	<ul style="list-style-type: none"> ■ Report on the financial statements of the University of California ■ Report on the financial statements of the five Medical Centers ■ Report on the University of California Retirement System ■ Report on the University of California Cash Contributions to the Retirement System ■ Report on the financial statements of the University Captive Insurance Company ■ Bond opinion related to UCLA Medical Center debt agreement ■ Reports in accordance with OMB Uniform Guidance, 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
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 University's Mortgage Origination Program and Supplemental Home Loan Program ■ Agreed-upon Procedures on Intercollegiate Athletic Departments (NCAA requirements) for six campuses
Other Services	<ul style="list-style-type: none"> ■ Review of consolidated Form 990-T of the Regents of the University of California and University of California Retirement Plan ■ Reviews in connection with bond offerings ■ Accounting consultations and other assistance associated with emerging accounting and reporting issues and complex transactions ■ Financial reporting observations
Committee Reporting	<ul style="list-style-type: none"> ■ Audit and communications plan ■ Results of audits and required communications

Client Service Team Composition

While everyone on our team listed below has relevant industry experience in either higher education/not-for-profit, healthcare, benefit plans or investments, we wanted to specifically highlight team members with previous experience serving the University of California as denoted with an asterisk below.



Medical Center teams

Irvine, Davis, Los Angeles, San Diego, San Francisco

Partners:

Mike MacBryde*
Dave Merriam*
Sara Hyzer

Managers:

Kevin Mitchell*
Billy Kim*
Rick Wang*
Alex Daly
Tanya Suryoutomo

Campus teams

Berkeley, Davis, Irvine, Los Angeles, Merced, Riverside, San Diego, San Francisco, Santa Barbara, Santa Cruz

Partners:

Mike Schini*
Mike MacBryde*
Jill Tregillis Bacon*
Dave Merriam*
Suzanne Fradette
Sara Hyzer

Managers:

Billy Kim*
Sara Mijares*
Jessica Kennedy*
Richard Pineda*
Brett Baker
Scott Dudzik
Morgan Wilson

Key Engagement Team Members

In selecting our team, we focused on those team members with significant, relevant industry experience in areas that are important to the University – the Medical Centers and the benefit plans. We also made every effort to select team members with prior experience serving the University of California as highlighted in the table above. All partners and managers have relevant higher education and/or healthcare experience from past university audits and, in almost all cases, other relevant experience.

Mike Schini, Engagement Leader and Signing Partner

Mike leads and directs our overall engagement team and will sign our audit opinion. He is your primary point of contact and speaks for the firm for all technical decisions and matters related to the audit. Mike will meet regularly with the Committee and be in frequent contact with Office of the President management.

Mike MacBryde, Coordinating Audit Partner & Medical Center Audit Partner

Mike MacBryde will work to support Mike Schini and the overall University engagement team by focusing on identifying and implementing ways to enhance the effectiveness and efficiency of the audit. In addition, Mike will lead the Medical Center audit teams and be the focal point through which all Medical Center matters are addressed and resolved. Mike and the Medical Center teams will work closely with Mike Schini on specific Medical Center-related issues as they arise.

Ann Kennedy, Investments Audit Partner

Ann will resume leading the PwC audit team that serves the Office of the Chief Investment Officer. This team is responsible for performing all audit procedures over the investment portfolios managed by the Office of the Chief Investment Officer. Ann and her team will work closely with Mike Schini on investment issues that may affect the University and UCRS audits.

Jeffrey Fox, IT Controls Partner

Jeffrey will lead the IT Controls team. This team is responsible for addressing risks associated with your IT systems and controls, as well as identifying areas within your IT environment that can assist with enhancing the quality and efficiency of our audit.

Christa Dewire, University Quality Review Partner

Christa will serve as the Quality Review Partners of the University. In this role, she will provide an independent view of the engagement team's judgments related to auditing and technical accounting matters. She will independently assess the audit plan and its execution, including the quality of the financial statements and the appropriateness of our reports.

Relationship Support

Jim Henry, Senior Relationship Partner and PwC's U.S. Leadership Team Member

A member of the firm's U.S. Leadership Team and Strategy Committee and current Market Managing Partner for PwC's Northern California practice, Jim will resume serving as the Senior Relationship Partner on the University engagement. Jim provides the University with access to an independent leadership resource.

John Mattie, PwC's U.S. Higher Education Leader and Tim Weld, PwC's U.S. Healthcare Leader

John and Tim will be resources to you and your engagement team on complex industry issues as well as to be available to the Committee and management to discuss national trends and hot topics.

Use of Specialists

The University operates in a highly complex environment, requiring additional expertise beyond traditional audit resources. During the course of the audits, we will utilize our functional experts to evaluate key areas of your business risks— such as the valuation of self-insured risks and insurance accruals, the valuation of pension and postemployment benefit obligations, valuation of certain investments, and third party settlements. Drawing upon their best practice knowledge, our team will provide points of view related to your business, industry and regulatory compliance.

These specialists also will ensure that we have the right resources to achieve our audit objectives. Accordingly, our PwC engagement team will include the following specialists who will work with our audit teams and management at your business units to assist us in executing our audit:

Area of expertise	Description of service
Financial Services Valuation	Assistance with the evaluation of the fair value of investments and related disclosures
Self Insurance	Review of actuarially determined balances and actuarial models involving self insurance reserves
Compensation and Benefit Plans	Review actuarial assumptions related to compensation programs and benefit plans
Healthcare Reimbursements	Review third party account transactions subject to complex rules and interpretation
Information Technology	Review and testing of IT and application controls
Healthcare Compliance	Provide guidance to Medical Center audit teams and the University regarding healthcare compliance requirements
Regulatory Compliance	Review the University's Uniform Guidance report and provide perspective on federal agencies' monitoring and expectations of award recipients

Multi-location Audit Coordination

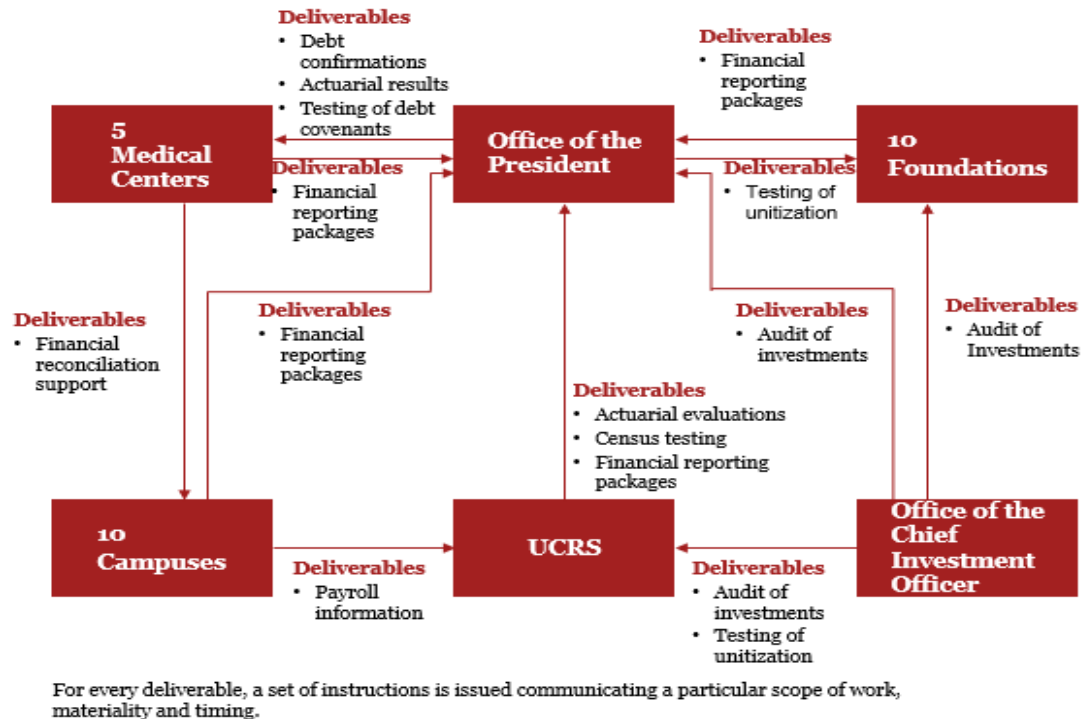
PwC has adopted a consistent approach for our audit procedures at all University and University related entities. We have developed standardized reporting templates and common audit programs and approaches to achieve consistency and effectiveness. As a result, our reporting structure allows for local teams who understand the unique aspect of each entity but who work within the framework of a common reporting structure.

We have taken the following steps to ensure the overall quality of audit engagement:

- Prepared and communicated a centrally determined audit scope and plan.
- Established a framework for continuous communications throughout our engagement teams.
- Adherence to engagement timelines to achieve your reporting objectives.
- Achieved continuity across the majority of engagement team from our most recent audit of fiscal 2013.

The multi-location engagement team is aligned to the University's geographical organization and mirrors the management control structure of your organization. This structure, coupled with centralized engagement management, leverages the expertise of our local professionals who can respond directly to questions at each location. The following depicts the organization and flow of information among the different component audit teams.

The flow of information from the component auditors to the group auditors



Office of the President and Office of the Chief Investment Officer— Audit procedures are performed as necessary at these locations in order to opine on the financial statements of the University. We also take into consideration in our audit scope for these locations the requirements of the medical centers audits, the UCRS audit and the audits of the campus foundations. In particular, the investment work we perform at the Office of the *Chief Investment Officer* has a wide-sweeping impact on the various University components.

Medical Centers and UCRS - As described throughout this document, we perform audits of the stand-alone financial statements for the five medical centers and the University Retirement System which consists of multiple benefit plans. We rely on those stand-alone audits for purposes of the audit of the University's consolidated financial statements and fiduciary fund financials.

Campuses – We perform specific audit procedures at the campus locations as needed to achieve sufficient coverage to express an opinion on the University's financial statements. We are in the process of determining which locations we will be attending and will update the Committee when that is complete.

Foundations – The audits of the ten campus foundations are performed by separate foundation audit teams. However, as the combined financial statements of the campus foundations are presented discretely in the University’s financial statements, we coordinate with and rely upon the work performed by the campus foundation teams.

Regardless of the extent of audit procedures performed at a location, each location has an assigned partner and manager. Accordingly, our engagement teams have established local points of contact to facilitate the completion of scheduling and planning to support local audit requirements as well as discussion of issues of local interest.

For further discussion of our audit strategy refer to Appendix B.

Audit Timeline

We have developed the following reporting timeline that facilitates the University meeting all of its legal and regulatory requirements. As you can see below, this timeline spans the entire year and represents our commitment to the University throughout the year.

Key Procedures Performed	Timing of Procedures
Transition	
■ Meet with management to introduce PwC teams and update our understanding at the in-scope locations	■ April - May 2016
■ Review predecessor auditor's work papers	■ May 2016
Planning and Audit Management	
■ Meet with management to understand the University's activities and assess risk; and obtain update of operating plans and activities	■ Ongoing throughout the year
■ Assess key audit risks and materiality	■ April 2016
■ Complete understanding of controls and preliminary scoping of accounts, processes and locations	■ April – May 2016
■ Meet with the Committee to discuss service plan	■ May 2016
■ Coordinate with PwC engagement teams and issue instructions for the audits of the University and Medical Center financial statements and benefit plans and Uniform Guidance testing procedures	■ April – May 2016
Execution and Audit Management	
■ Provide consultations on major issues and developments	■ Ongoing throughout the year
■ Perform testing of key monitoring, internal accounting and management controls	■ May – June 2016
■ Evaluate nature, timing and extent of substantive procedures based on controls testing	■ May – June 2016
■ Perform substantive audit procedures at interim for both financial statements and Uniform Guidance audits	■ May – June 2016
■ Perform substantive audit procedures at year end for both financial statements and Uniform Guidance audits	■ August – October 2016
Completion and Audit Management	
■ Issue audit opinions and related financial statements	■ October 2016
■ Meet with the Committee to communicate results of year-end audit and internal control recommendations	■ November 2016
■ Agreed-upon Procedures related to the sale of Mortgage Origination Program and Supplemental Home Loan Program loans	■ October 2016
■ Agreed-upon Procedures on Intercollegiate Athletic Departments	■ November 2016
■ Issue Report on Uniform Guidance Compliance	■ February 2017

Mutual Understanding of Responsibilities

PwC Responsibilities

Our responsibility is to express opinions, based upon our audits, on the University's consolidated financial statements, the University of California Retirement System financial statements; and the five Medical Center financial statements. We conduct our audits in accordance with GAAS and GAS. Those standards require that the auditor obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Accordingly, a material misstatement may remain undetected. Also, an audit is not designed to detect error or fraud that is immaterial to the financial statements. An audit includes obtaining an understanding of internal control sufficient to plan the audit and to determine the nature, timing and extent of audit procedures to be performed. An audit is not designed to provide assurance on internal control or to identify all significant deficiencies. However, as your auditor, we are responsible for ensuring that Committee is aware of any significant deficiencies or material weaknesses that come to our attention.

Our responsibility with respect to other information in documents containing audited financial statements is to read such information and consider whether the information or the manner of its presentation is materially inconsistent with information appearing in the basic financial statements.

Our responsibility with respect to Committee communications is to convey those matters that have come to our attention as a result of the performance of our audit.

Our audit does not relieve management of its responsibilities with regard to the financial statements.

We also are responsible for issuing several agreed upon procedures reports, for purposes of the Mortgage Origination Program and Supplemental Home Loan Program as well as agreed upon procedures at six of the ten campuses covering the National Collegiate Athletic Association Bylaws. These agreed upon procedures engagements and resulting reports are performed in accordance with the attestation standards established by the American Institute of Certified Public Accountants. These procedures do not constitute an examination, but rather are procedures designed in conjunction with the specified parties receiving the reports.

Management's Responsibilities

As part of the audit process, management is responsible for the following:

- Preparing the University's, Medical Centers', and benefit plans' financial statements in accordance with generally accepted accounting policies.
- Establishing and maintaining effective internal control over financial reporting.
- Identifying and ensuring that the University complies with the laws and regulations applicable to its activities.
- Making all financial records and related information available to PwC.
- Providing PwC with a letter that confirms certain representations made during the audits.
- Adjusting the financial statements to correct material misstatements and affirming to PwC in the representation letter that the effects of any uncorrected misstatements aggregated by PwC during the current engagement pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Committee's Responsibilities

As part of the audit process, the Committee is responsible for the following:

- Oversee the reliability of financial reporting including the effectiveness of internal control over financial reporting.
- Review and discuss the annual financial statements for the University, the Medical Centers and the benefit plans and determine whether they are complete and consistent with operational and other information known to Committee members.
- Understand significant risks and exposures and management's response to minimize those risks.
- Understand the audit scope and approve audit and non-audit services.

Communications and Planned Interactions

Our Communications Plan with Management

We communicate with management both in writing and verbally continuously throughout the year. Examples of our ongoing communications include:

- Issues identification and resolution
- Internal Audit planning and coordination
- Meetings with management at Office of the President, Office of the *Chief Investment Officer*, local campuses and Medical Centers
- Discussions of interim audit findings
- Review of draft financial statements
- Year-end clearance meetings
- Planning and scoping discussions

Our Communications Plan with the Committee

Our communications with the Committee are designed to comply with standards established by the American Institute of Certified Public Accountants.

Our formal communications will occur via periodic meetings with the Committee at various stages during the year. As part of these meetings we will communicate with the Committee our service approach and audit plan, and our views on risks and controls, including those over financial reporting and governance. In addition, we will present the results of our audits upon completion.

In addition to our scheduled meetings, we are also available, at any time, to respond to Committee members' questions.

Our Interaction with Internal Audit

Although our objectives and responsibilities are necessarily different from those of Internal Audit, the efforts of both our organizations are very much complementary and provide a combined program of balanced audit coverage for the University. We will meet with Internal Audit to update our understanding of their recent activities and discuss our risk assessment and audit approach.

We consider Internal Audit to be an effective and important element in the University's overall internal control environment. We complete certain procedures when relying on their work, as follows:

- Review on a timely basis Internal Audit reports and management responses.
- Understand the Internal Audit plan, including the nature, timing and extent of work.
- Consider the impact of Internal Audit findings on our audits.

Materiality and Independence

Materiality

We consider both quantitative and qualitative factors in our assessment of materiality. We also assess the metrics used by the users of the financial statements in determining the appropriate base for calculating materiality.

Materiality is defined as *‘the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.’*

We identify and assess the risk of material misstatement at:

- The overall financial statement level, and
- In relation to classes of transactions, account balances and disclosures.

Our determination of materiality is a matter of professional judgment, and is affected by our perception of the financial information needs of users of the financial statements. Therefore, the benchmark we use to calculate materiality varies based on the audit being performed.

For the University’s consolidated financial statements, we use total expenditures as our benchmark. Industry practice is to apply a percentage of 1% to 3% of this benchmark of total expenditures to calculate overall materiality.

For the University’s medical centers’ financial statements, we use total operating revenues as our benchmark. Industry practice is to apply a percentage of 1% to 3% of this benchmark of total operating revenues to calculate overall materiality.

For the University’s benefit plans, we will use either total assets or net assets as our benchmark. Industry practice is to apply a percentage of 0.5% to 3% of these benchmarks to calculate overall materiality.

Independence

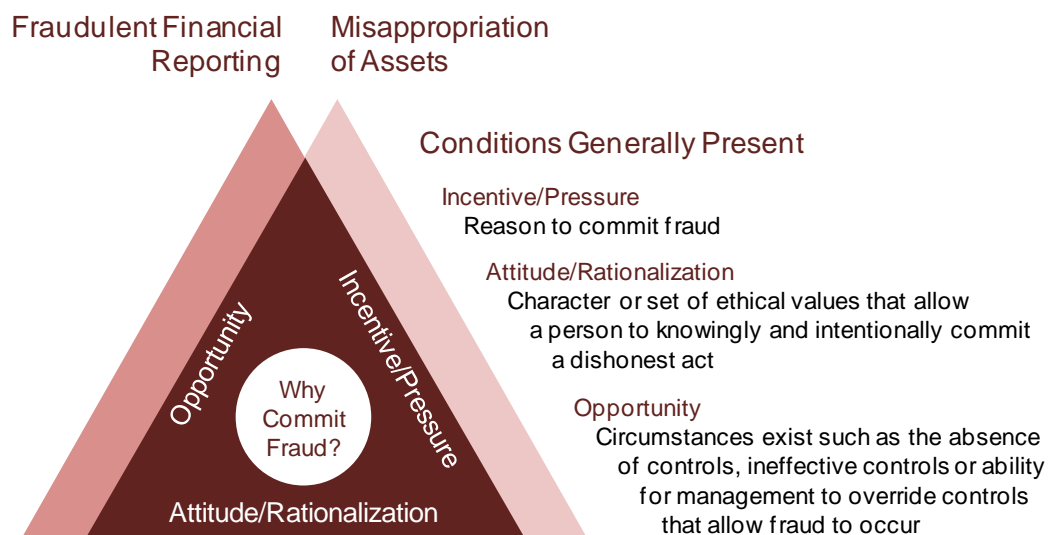
As auditors of the University, we are subject to a variety of standards to ensure our independence, including American Institute of Certified Public Accountants, Governmental Accountability Office and internal PwC standards. Our quality control processes include confirmation of independence by professional staff and training and are established to ensure our continuing independence.

We hereby confirm our independence of the University for the fiscal year ending June 30, 2016. We will reconfirm our independence at the completion of our June 30, 2016 audits for the University.

Perspectives on Fraud Risk

We have a responsibility to plan and perform our audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. In order to fulfill that responsibility, as part of our audits, we are required to gain an understanding of the risk of material misstatement due to fraud at the University and perform certain procedures to respond to the fraud risks identified.

Types of Fraud



Attributes Contributing to Increased Fraud Risk

- Size, complexity and ownership attributes of the University
- Type, significance, likelihood and pervasiveness of the risk

The oversight responsibilities of senior management and the Committee and PwC's responsibilities are outlined below.

Management Responsibilities	<ul style="list-style-type: none"> ■ Design and implement programs and controls to prevent, deter and detect fraud (antifraud programs) ■ Ensure that the University's culture and environment promote honesty and ethical behavior ■ Perform a risk assessment that specifically includes the risk of fraud addressing incentives and pressures, opportunities, and attitudes and rationalization ■ Assess management override of controls and communicate with the Committee
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Committee Considerations	<ul style="list-style-type: none"> ■ Evaluate management’s identification of fraud risks, implementation of antifraud measures, and creation of appropriate “tone at the top” ■ Ensure that senior management implements appropriate fraud deterrence and prevention measures to better protect investors, employees and other stakeholders ■ Investigate any alleged or suspected wrongdoing brought to its attention ■ Challenge management in the areas of non-routine, related party and inter-company transactions
PwC’s Role	<ul style="list-style-type: none"> ■ Plan and perform the audit to provide reasonable assurance that the financial statements are free of material misstatement, whether caused by fraud or error ■ Evaluate whether the University’s programs and controls that address identified risks of material misstatement due to fraud have been suitably designed and placed in operation ■ Evaluate management’s process for assessing effectiveness of antifraud programs and controls ■ Evaluate fraud of any magnitude on the part of senior management and the impact on the control environment
PwC’s Procedures	<p>In order to fulfill our responsibilities related to fraud, we plan to perform the following procedures:</p> <ul style="list-style-type: none"> ■ Inquiries of management, the Chair of the Committee, Internal Audit and others related to knowledge of fraud or suspected fraud, the fraud risk assessment process and how fraud risks are addressed by the University ■ Disaggregated analytical procedures, primarily over revenue ■ Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures to be performed annually ■ Identify and select journal entries and other adjustments for testing ■ Evaluate estimates and assumptions used by management that could have a material impact on the financial statements ■ Review Internal Audit reports and remain alert for matters that are indicators of fraud

Proposed Fees

The University is an important client of PwC, and our fees reflect our commitment to our long-term relationship with the University. Our deep understanding of higher education organizations and more specifically, of the University, enable us to perform the audit efficiently and within a compressed timeframe. These factors contribute to a competitive, cost effective audit. Our proposed fees listed below are inclusive of all out-of-pocket expenses.

Deliverable	June 30, 2016 Fee	
Consolidated Audit	\$	1,405,050
Federal Grants and Contracts	\$	476,200
NCAA Agreed-Upon Procedures	\$	171,690
Consolidated Form 990T	\$	10,551
Medical Center Audits	\$	1,620,050
Retirement Plan Cash Contributions	\$	5,695
UCLA Medical Center Bond Opinion	\$	2,232
Retirement System Audits	\$	247,375
Mortgage Origination Program Agreed-Upon Procedures	\$	37,510
Captive Insurance Company	\$	56,420
Total	\$	4,032,773

Required Communications with the Audit Committee

Matter to be communicated	Auditor's response
Relationships between PwC (or any affiliates of the Firm) and the University (and its affiliates) and other matters that might reasonably be thought to bear on independence	<p>We carefully monitor the independence of our team members. Should we become aware of an independence breach or new circumstance that would affect our ability to complete the audit, we will inform you immediately.</p> <p>There were no relationships or other matters identified that might reasonably be thought to bear on independence.</p>
Communications plan	Our communications plan described above provides an overview of the form, timing and expected general content of communications with management and the Committee on Compliance and Audit.
Significant issues discussed with management prior to appointment or retention	There were no significant issues discussed with management in connection with the appointment of PwC.
Terms of the audit engagement	The terms of the audit engagement, including the objective of the audit and management's and our responsibilities, are set forth in our engagement letter dated April 20, 2016.
Obtain information relevant to the audit	We will inquire of the Committee on Compliance and Audit about whether it is aware of matters relevant to the audit and about the risks of material misstatement.
Summary audit strategy	We will communicate to the Committee on Compliance and Audit the planned audit strategy, including the timing of the audit and the significant risks identified. Matters included in the overall audit strategy include, among other matters, involvement of specialists and the extent of use of the work of internal audit. Refer to Appendix B for a summary of our overall audit strategy.

Matter to be communicated	Auditor's response
Perspectives on fraud risks	<p>We will inquire of the Committee on Compliance and Audit to obtain its views on the risk of fraud and whether the Audit Committee has knowledge of any fraud, alleged fraud, or suspected fraud affecting the entity.</p> <p>We will discuss how the Committee exercises oversight of the entity's assessment of the risks of fraud and the entity's antifraud programs and controls (specifically as it relates to the potential for management to override controls).</p> <p>As you are aware, an audit conducted in accordance with generally accepted standards is designed to consider the risk of fraud that could be material to the financial statements, but it is not designed to detect all instances of fraud. From time to time, we may become aware of immaterial instances of fraud through our inquiries or other procedures. To the extent such instances are significant, we will inquire of management to ensure that these matters have been reported to you under existing reporting protocols. We will inform you of any matters of fraud that is potential material to the financial statements or those that may involve members of senior management.</p>

