

The Regents of the University of California

COMPLIANCE AND AUDIT COMMITTEE

September 13, 2017

The Compliance and Audit Committee met on the above date at the Price Center, San Diego campus.

Members Present: Regents Anguiano, Lemus, Makarechian, Newsom, Pérez, Sherman, and Zettel; Advisory members Anderson, Graves, and White; Chancellors Blumenthal, Gillman, Khosla, and Yang; Expert Financial Advisor Juline, Staff Advisor Valdry

In attendance: Assistant Secretary Lyall, General Counsel Robinson, Chief Compliance and Audit Officer Bustamante, Provost Brown, Executive Vice President and Chief Financial Officer Brostrom, Executive Vice President and Chief Operating Officer Nava, Vice Presidents Andriola and Duckett, and Recording Secretary Johns

The meeting convened at 10:10 a.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 July 12, 2017 were approved.

2. **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.]

Director of Healthcare Compliance and Systemwide Privacy Vanessa Ridley presented information on two health system risk priority areas in the University's 2017-18 Ethics and Compliance Program Plan, pharmacy services and patient privacy. In pharmacy services, the current compliance plan identified two main areas for systemwide assessment and mitigation. The first was the 340B Drug Pricing Program, a federal program that allows certain safety net healthcare providers including UC to purchase outpatient drugs from manufacturers at discount prices. The University uses these savings to care for its vulnerable patient populations. In recent years, there has been increased federal government auditing of and Congressional interest in 340B program compliance. The University would pursue internal reviews to identify any internal risks for non-compliance. Another area for assessment is controlled substance diversion, which has also been the object of increased government auditing and enforcement in recent years by agencies such as the U.S. Drug Enforcement Administration and the California State Board of Pharmacy. Conflicts of interest in the healthcare arena have also been identified as an emerging

priority, and this area would be added to the Office of Ethics, Compliance and Audit Services (ECAS) work plan.

Regent Sherman requested clarification of the 340B program. Ms. Ridley responded that participants must enroll in this program and adhere to a number of compliance standards. Regent Sherman asked if the discount pricing is passed on to the end consumer. Ms. Ridley responded that UC can use these savings in a variety of ways. The program is intended for safety net providers, who are meant to use the savings to offset the cost of non-sponsored care that they provide.

ECAS was also focusing on health privacy compliance, and had implemented a new governance structure with the goal of increasing intercampus communication, enhancing vendor management, developing common tools for monitoring privacy in electronic health records, and ensuring compliance with the Health Insurance Portability and Accountability Act (HIPAA). A newly formed UC Health Privacy Committee would meet monthly.

Regent Makarechian asked how UC educates or provides training to campus mental health counselors regarding patient privacy and disclosure rules, especially in the context of lawsuits, requests for information, or subpoenas. Ms. Ridley responded that this depends on the local compliance program. In the realm of mental health services, campus health centers would most often work with their health information management departments on responding to subpoenas or requests for information. She could provide more specific information on student health disclosures. Regent Makarechian stressed that this would be good information for the Regents to have and understand, given that laws about disclosure are subject to change.

Committee Chair Zettel concurred that training is very important and an ongoing challenge. She asked if it was difficult to develop common tools for privacy monitoring of electronic health records, given that different locations are using different software systems. Ms. Ridley responded in the affirmative, noting that as UC moves toward a common vendor, Epic, there would be new opportunities.

3. **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 on results of two systemwide audits. Both focused on adherence to newly implemented systemwide requirements. The Office of Ethics, Compliance and Audit Services (ECAS) had completed its first annual audit of the Fair Wage/Fair Work Plan. This plan was implemented in October 2015, and requires that all UC employees working more than 20 hours per week, and contractors working for UC, be paid at least the UC fair wage, which had started at \$13 per hour and was increasing to \$15 per hour over the course of three years. The full increase would be achieved the following month. The audit focused on internal procedures to ensure that suppliers comply with the Plan requirements. In general, locations had made progress in

implementing the Fair Wage/Fair Work Plan, but additional corrective action was required to ensure compliance. Several locations lacked adequate processes to identify, track, and follow up with suppliers to ensure that they are performing annual audits and submitting required certifications to UC in a timely manner. Locations had already begun implementing corrective actions and Internal Audit would be tracking these actions. The next annual audit of the Fair Wage/Fair Work Plan was scheduled for spring 2018.

ECAS had also completed a systemwide audit of outside professional activities for senior administrators. He recalled that Regents Policy 7707, Senior Management Group Outside Professional Activities, had been amended in July 2016 with new approval and reporting requirements and new limits on compensated activities. This audit focused on adherence to policy requirements during calendar year 2016. The audit found general adherence to policy, but that controls should be strengthened to ensure that requests for approval are reviewed in a timely manner and appropriately documented.

Mr. Hicks also reported that two weeks prior, the Legislature had approved a State audit of the University's handling of sexual harassment cases. The audit had begun earlier that week with an entrance conference at the Office of the President. The State Auditor was envisaging the release of a final report in summer 2018.

Regent Pérez raised questions about the Fair Wage/Fair Work Plan. He cited an August 15 letter to then Interim Chief Compliance and Audit Officer John Lohse from UC Berkeley Audit and Advisory Services staff, and quoted a statement to the effect that suppliers on the campuses were not yet compliant. In a random sample of five vendors, none had been certified. Regent Pérez expressed concern about the audit's showing that vendors were not in compliance, and about the fact that a campus chief procurement officer can provide an exception for a vendor for the first year. This was an unacceptable option. Mr. Hicks responded that there was a period of review during the audit fieldwork. At the beginning of the fieldwork, there were only limited processes in place to identify, track, and monitor contracts. In the course of the audit there was significant improvement to these processes. Mr. Hicks acknowledged that the University could not claim that there was general compliance; there was a need for improvement. Regent Pérez asked if there had been no compliance until the ECAS intervention. Mr. Hicks responded that there had been very limited compliance.

Regent Pérez requested clarification regarding the campuses' option of waiving the requirement. Mr. Hicks responded that the local chief procurement officer can grant a waiver. During the course of the audit, procurement offices systemwide implemented stricter procedures for the granting of these exceptions, including a standard form that needs to be signed and that explains the justification for the action. To date, there had been no guidance on when such a waiver can be granted; this has been at the discretion of the local procurement officer.

Regent Pérez asked about the role and responsibility of the Committee or the full Board for this option of non-compliance for a full year. Committee Chair Zettel responded that the recent report of the California State Auditor was a mandate to make improvements. The

Committee must track how the University would address the Auditor's concerns. She stated that a systemwide policy with tighter controls might be desirable in this case, but the issue needed to be studied.

Regent Pérez expressed concern about reports that some campuses were choosing to displace employees rather than implementing the Fair Wage/Fair Work Plan. Mr. Hicks responded that he had received feedback from the campuses concerning opportunities for improvement, guidance on implementation of Fair Wage/Fair Work Plan requirements, and the process for granting exceptions. He anticipated that there might be policy changes. Internal Audit would ensure that requirements were being fulfilled.

Regent Pérez asked if this option to waive a policy requirement was anomalous, or if it existed with regard to other policies. Mr. Hicks responded that it was his understanding that the University avoids blanket exception approval practices. In this case, there should be instance-by-instance review to determine if an exception is warranted. He believed that there had been more exceptions granted for this Plan than for other UC programs and policies. Regent Pérez requested information on the number or rate of exceptions to the requirements of the Fair Wage/Fair Work Plan, to determine if the Plan was being subverted by these exceptions. Committee Chair Zettel reflected on the desirability of an appropriate balance between local campus autonomy in making certain decisions and consistency in UC policies and practices.

Regent Makarechian asked if an escalation process had been followed in this case. Mr. Hicks responded that Internal Audit would follow the appropriate escalation process if it did not receive adequate cooperation. This item was not being currently tracked; this audit had only recently been completed. Implementation of the Fair Wage/Fair Work Plan had begun in October 2015. A year needed to elapse before the first auditing was required, in early 2017.

Regent-designate Graves asked if students would have input into the audit of UC response to sexual harassment cases mentioned earlier. Mr. Hicks explained that this would be an audit by the California State Auditor, not the University. Regent Pérez expressed his view that nevertheless, there should be opportunities for student engagement in the discussion. Committee Chair Zettel responded that this suggestion could be pursued.

4. **REPORT ON INDEPENDENT ASSESSMENT OF AUDIT IMPLEMENTATION PLANS**

[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.]

Kurt Sjoberg of Sjoberg Evashenk Consulting recalled that his firm was engaged to conduct the independent consulting review of the Office of the President's (UCOP) implementation of the State Auditor's recommendations. The UCOP working groups addressing the various areas of the State Auditor's report had been very cooperative. Sjoberg Evashenk Consulting had met with nine of the ten working groups and observed the work process.

All the meetings were well organized, with clear review of actions taken and identification of current goals and key staff responsible for accomplishing these goals. It was not Sjoberg Evashenk Consulting's role to advise the University on how to formulate statements or achieve these tasks, but UCOP staff had asked them about audit-related matters. He noted that the involvement of campuses and chancellors, and their ability to respond to these issues were important in the implementation of the State Auditor's recommendations. This process of involvement was now in the beginning stages. Each set of recommendations made by the State Auditor was unique, and some would take longer to implement than others. Mr. Sjoberg stated that there were no issues of concern regarding the University's ability to meet the State Auditor's deadlines. Sjoberg Evashenk Consulting had been involved in benchmarking and identifying peer groups. It would be issuing another report at the end of the current month.

Regent Makarechian noted that the issue of UC compensation levels was important to the Legislature and the Governor. He asked if the University should educate the State Auditor's Office about its compensation practices and the competitive market it operates in. Mr. Sjoberg responded that the State Auditor's analysis had not compared UC with a broad range of comparators, for example with other Association of American Universities (AAU) institutions. From the perspective of an auditor it would be important for UC, in choosing its comparators, not to cherry-pick particular institutions. Mr. Sjoberg stated his view that the AAU list would be able to stand the test of the State Auditor. However, certain UC positions are similar to positions at State agencies or in the private sector. Some analysis would refer to non-academic peer groups or highlight regional costs for certain skill sets, such as information technology.

Regent Makarechian argued that certain UC positions are focused on profitability and the bottom line; it was not fair to compare these with State positions. He stressed that only a relatively small portion of the University's budget comes from tuition revenues or State appropriations, while a large portion comes from the medical centers or other profit centers within UC. Mr. Sjoberg responded that some State enterprises, such as Covered California, might be appropriate comparators for UC enterprises.

Committee Chair Zettel requested confirmation that the UCOP working groups were collaborative, with a fair exchange of ideas. Mr. Sjoberg responded by emphasizing the extraordinary dedication of UCOP in responding to this audit.

5. **STATE AUDIT OF CONTRACTED EMPLOYEES AND CONTRACTING PRACTICES**

Executive Vice President and Chief Financial Officer Brostrom began the discussion by noting that the State Audit of UC contracted employees and contracting practices had resulted in two reports, one focused on service contracts, and the other focused on the UCPath project and information technology (IT) contracting.

Systemwide Deputy Audit Officer Matthew Hicks explained that the State audit of contracted employees and contracting practices had been approved by the Joint Legislative

Audit Committee in May 2016. Audit fieldwork began in November 2016 and lasted approximately nine months, concluding in July 2017. During this time, State auditors made multiple visits to the Office of the President (UCOP) and visited six campuses, as well as the UCPath Center. The report on UCPath and IT contracting was released on August 24, and the report on UC service contracts was released on August 26.

Mr. Brostrom commented on the State Auditor's report on UC service contracts. A significant portion of the State Auditor's fieldwork in this area focused on the University's compliance with its own guidelines related to employee displacement resulting from contracting for services. To satisfy this objective, the State Auditor reviewed 31 service contracts at three different campuses. Two of these contracts resulted in the displacement of UC employees. For these two contracts, the State Auditor found that UC did not fully adhere to all requirements in its guidelines. As a result, the State Auditor recommended that UCOP take measures to more actively enforce compliance with displacement guidelines, and recommended changes to UC guidelines and procedures. In response, the University has committed to revising the displacement guidelines, and examining more closely the costs and benefits of employee displacement. Overall, the State Auditor found that UC adheres to its procurement policies when entering into service contracts. The State Auditor identified opportunities to improve controls and refine policy language related to the use of contract amendments and exemptions from competitive bidding. The University agreed with this recommendation, and would review its contracting policy to identify appropriate changes and work to improve controls systemwide to ensure consistency and policy compliance. Finally, with respect to contracting processes, while the State Auditor acknowledged that the P200 procurement program had led to significant improvements in UC procurement, the Auditor found that UC could do more to create further process efficiencies, and recommended that UC finalize a plan to implement a centralized contract database and measures to better substantiate and monitor benefits from procurement initiatives. In advance of the audit, UC had already recognized the need for this contract system, and had agreed to complete both a detailed project plan and improve documentation and tracking of benefits related to the P200 program and procurement in general.

Regent Pérez suggested that the Regents invite the State Auditor to come to present findings to help inform the Regents' action. Committee Chair Zettel expressed her approbation for this idea.

Regent Newsom referred to UCSF's recent contracting out for IT workers. He emphasized that it had been disgraceful that these UC employees trained their replacements. It was extraordinary that as part of a severance process, employees were required to sit next to people who would replace them. He expressed the hope that this would not happen again. He asked if the University would continue to use the H-1B visa process for contracting out. Mr. Brostrom responded that the UCSF contract was one of the contracts reviewed by the State Auditor. UCSF had carried out extensive due diligence on contracting out. He acknowledged that UCSF could have done a better job of conforming to guidelines. New guidelines and training would help alleviate these issues. Regent Newsom stated his understanding that it was now UC policy not to use the H-1B visa process for contracting

out, and requested clarification of the current policy. Mr. Brostrom responded that he would verify UC's policy or practice.

Regent Newsom again stressed that the training of their replacements UC employees were forced to carry out was reprehensible and repugnant, and expressed his disapproval of this attempt by UC to secure cheaper labor.

Regent Makarechian reflected on the tremendous pressures on the University to reduce costs, the criticism directed at UC for some of its labor actions, and the question of how these should be balanced. Mr. Brostrom responded that the University has guidelines for contracting out work that is temporary, seasonal, or that requires specific expertise that UC does not need to keep in house permanently. Detailed cost-benefit analysis is required to show the reasons for contracting out. Contracting out can produce cost savings and reduce the cost of education.

Regent Makarechian asked about the contract decision-making process. Mr. Brostrom responded that contracts over \$100,000 that result in employee displacement come to UCOP for approval.

Regent Makarechian asked Chancellor Khosla about his view on these conflicting pressures on the University. Chancellor Khosla responded that to date he had not had to make a decision about in-house employees versus contracting out. In IT, UC San Diego was seeking to reduce costs by reducing headcount, making fewer hires but hiring more highly skilled individuals.

Regent Pérez expressed frustration, noting that summaries presented to the Regents may lead one to normalize or rationalize activities that have raised concerns. He asked if in the two contracts involving employee displacement reviewed by the State Auditor, the Auditor had found that the University acted in a way not consistent with its policy. Mr. Brostrom responded in the affirmative.

Regent Pérez noted that the IT employee displacement at UCSF occurred at the medical center, and suggested that it did not result in a reduction in the cost of education. Mr. Brostrom responded that two-thirds of medical center net margins flow to UC's health sciences schools.

Regent Pérez stressed that UC's overall action in this case violated its policy. Mr. Brostrom responded that UCSF had made several presentations to UCOP on its plan for contracting out, although not in written form. The violation was more in form than in substance.

Regent Pérez underscored his concerns about the Regents' comfort and satisfaction with delegations of authority, and ensuring that changes in policy are codified.

Committee Chair Zettel acknowledged that the University needs to tighten up its policies, but cautioned the Regents against becoming so bureaucratic in their approach that

campuses could not exercise sound judgment. She identified disinvestment in education by the State as a significant problem.

Mr. Brostrom then discussed the second report by the State Auditor, focused on the UCPATH project and IT contracting. The key finding concerned the schedule and cost of the UCPATH project. He disputed the Auditor's analysis, which claimed that the implementation costs for the UCPATH project would be \$942 million. At the July 2017 meeting, the University had presented this cost as \$504 million; Mr. Brostrom expressed his certainty that the University's representation of implementation costs was more appropriate. The State Auditor's calculations included operating expenses and financing costs, such as \$130 million for equipment and operations at the UCPATH Center and over \$115 million in financing as part of project costs. The State Auditor also attributed the purchase price of the UCPATH Center and its financing costs entirely to the UCPATH project, even though UCPATH occupies only one floor of the building and pays a lease. The University recognized that the cost of \$504 million was substantially greater than initially projected. The State Auditor's report did not reflect the significant reduction that UC was projecting in operating costs, with 100 fewer employees at the UCPATH Center than initially estimated, equivalent to more than \$12 million in annual operating expenses. In the long term, operating expenses would be more significant for UCPATH than the amortization of implementation costs. The University agreed with certain findings concerning reporting and oversight. The State Auditor recommended development of cost reporting guidelines for UCPATH and other IT projects. Mr. Brostrom stated that UC would implement such reporting for IT projects over \$25 million. The State Auditor also recommended adopting best practices related to project scheduling, integrated plan management, project risk management, and independent validation and verification. The University agreed that these were important elements of project management, although not every element was suited for every project. The University would seek to strengthen and improve IT project management. With respect to IT contract oversight processes, the State Auditor reviewed three campuses and found that they generally followed established vendor payment processes, but noted that the campuses could better define the deliverables associated with these contracts. The Auditor recommended that UCOP work with the campuses to develop a deliverables expectations document. The University found this to be a valid recommendation.

Regent Newsom recalled that the estimates of UCPATH project costs had been quite different a few years earlier. In his view, the present discussion had been about the "normalization of deviancy." The Regents had accepted certain expectations, such as an increase of "only a few" hundred million dollars in the UCPATH project cost. He described this situation as outrageous and a waste of taxpayers' money. This had occurred on the Regents' watch, and the Regents bore part of the responsibility. Regent Newsom anticipated that there would be subsequent adjustments to UCPATH in a year's time, and while these might seem modest at only \$20 million to \$30 million, these were real dollars. Regent Newsom emphasized the need for accountability and greater transparency. He stated that there was no mention on UC's website of the original projected timelines and costs for UCPATH. He expressed confidence that the University would finish this project, and this in itself would be an extraordinary accomplishment. Regent Newsom recalled three IT projects that the

State had abandoned, after spending significant sums of money: the California Case Management System, with projected costs ranging from \$260 million to \$1.9 billion, on which the State spent \$500 million; an upgrade to the State payroll system, with an estimated cost of \$371 million, on which California spent \$254 million; and an IT system upgrade for the Department of Motor Vehicles (DMV), a \$208 million project on which the State spent more than \$100 million. Even after the sums spent on the DMV project, the DMV system was still deemed to be dangerously antiquated and in danger of collapse at any moment. Regent Newsom stated that the University should change its approach to large-scale IT projects. He hoped that serious strategy lessons would be learned from this experience. Mr. Brostrom responded that the University had learned many lessons from this project. The major lesson had been that this is not an IT project, but a business transformation project requiring the development of standard processes. This fact had been ignored for the first two years of the project. UCPATH was more than four years behind schedule, with cost implications for other projects.

Regent Newsom asked if UC had originally projected \$753 million in savings from UCPATH. Mr. Brostrom responded in the affirmative; this estimate was based on benchmarking of private sector and higher education entities. Regent Newsom asked about progress in garnering these savings. Mr. Brostrom responded that the University would not see direct savings immediately. Savings over time would be achieved through improved business processes and the ability to invest more in faculty and student growth, and less in staff growth. For example, UC Riverside was projecting 15 percent growth in students and faculty; with implementation of UCPATH, the campus believes it can achieve this with staff growth of only one percent, with new staff focused mostly on student services.

Staff Advisor Valdrey asked about the project schedule. Mr. Brostrom responded that implementation was scheduled for December at the pilot campuses – UCLA, the Associated Students UCLA, UC Riverside, and UC Merced. The University was currently engaged in several testing cycles, parallel payroll tests. These would be followed by user acceptance tests. The project was on schedule, with two more implementation waves planned for July and December 2018.

Regent Anguiano stated that, given the significant shift in approach, the Regents should receive a presentation on the progress of the UCPATH pilot deployments by representatives of the pilot locations. She urged the University to focus on cost avoidance, increasing access for students and allowing the University to grow in a cost-effective manner. While cost savings can imply staff reductions, cost avoidance can be promoted through professional development of staff.

Regent Makarechian underscored that the project scope of UCPATH had expanded substantially, including many more than just payroll functions.

6. **UPDATE ON RISK SERVICES AND FIAT LUX CAPTIVE INSURANCE COMPANY**

Associate Vice President Cheryl Lloyd presented and explained a chart outlining the major categories of the University's Risk Services program: workers' compensation, professional liability, general liability, and property. The Fiat Lux Risk and Insurance Company, UC's captive insurance company, was formed in 2012. Since that time, Fiat Lux has expanded its risk financing applications and arrangements, insuring or reinsuring 23 types of risk. Ms. Lloyd described how Fiat Lux functions, with an example of how a medical malpractice claim would be paid. The University's actuary develops premium rates for each line of coverage. The allocations to UC locations are typically based on the most recent five years of exposures and reported losses. Large losses are capped at \$1 million, with the remainder being spread across the risk pool. This prevents one location from being excessively penalized following a catastrophic event.

Executive Vice President and Chief Financial Officer Brostrom briefly discussed the financial impact of Fiat Lux, which had more than \$1 billion in current assets, and about \$900 million in current liabilities. The premium was \$900 million, but a large portion of this reflected the loss portfolio transfer when Fiat Lux was first created. Fiat Lux has generated savings by offering stop-loss insurance to UC Care and the UC Student Health Insurance Plan at significantly lower rates than the commercial market. Fiat Lux also invests its own funds in a portfolio that might earn two to three percent more than assets in other UC portfolios.

Deputy Chief Risk Officer Kevin Confetti provided an overview of UC's cyber insurance program. The University had been purchasing cyber insurance since 2010. Initially, UC was able to purchase only small amounts of insurance. Being in the marketplace early had worked in UC's favor. As losses related to cyber security became more prevalent, UC had already developed relationships with insurers and their cyber experts. Over time, the University has been able to reduce the number of conditions imposed on it while increasing the limits of insurance available for purchase. In the last two years, UC was able to secure policies with no conditions precedent and for significantly higher limits. Insurance markets have been changing in the cyber world, and the University has been pushing insurers to evaluate UC based on its readiness to respond to incidents. UC's readiness had improved greatly, and this was reflected in the ability to obtain increased coverage. In the last fiscal year, this coverage increased to over \$100 million.

Mr. Confetti then briefly described the University's parametric earthquake insurance. Traditional earthquake insurance would be very costly for UC, which has over \$50 billion in property assets. For a number of years, the University had sought a capital markets-based solution; in the past year, UC partnered with a large international insurer who agreed to write just such a policy. The primary purpose of this insurance is to provide bridge funds for rapid business resumption following an earthquake; it is not intended to fund full building repairs.

7. **CYBER INCIDENT RESPONSE PROCESS**

[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.]

This item was deferred.

The meeting adjourned at 11:50 a.m.

Attest:

Secretary and Chief of Staff