The Regents of the University of California

COMPLIANCE AND AUDIT COMMITTEE
November 17, 2021

The Compliance and Audit Committee met on the above date at UCSF-Mission Bay Conference Center, 1675 Owens Street, San Francisco and by teleconference meeting conducted in accordance with California Government Code §§ 11133.

Members Present: Regents Anguiano, Cohen, Elliott, Makarechian, Park, Pérez, Sures, and Zaragoza; Advisory members Horwitz and Pouchot; Chancellors Christ, Gillman, Hawgood, Khosla, and Yang; Staff Advisor Lakireddy; Expert Financial Advisor Schini

In attendance: Secretary and Chief of Staff Shaw, General Counsel Robinson, Chief Compliance and Audit Officer Bustamante, Executive Vice President and Chief Financial Officer Brostrom, Executive Vice President Byington, Executive Vice President and Chief Operating Officer Nava, Vice President Lloyd, Chancellor Block, and Recording Secretary Johns

The meeting convened at 9:55 a.m. with Committee Chair Elliott presiding.

1. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

Upon motion duly made and seconded, the minutes of the meeting of July 21, 2021 were approved, Regents Anguiano, Elliott, Makarechian, Park, Pérez, Sures, and Zaragoza voting "aye."[1]

2. **ETHICS, COMPLIANCE AND AUDIT SERVICES ANNUAL REPORT 2020–21**

[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.]

Chief Compliance and Audit Officer Bustamante introduced this item. He outlined the scope of the Office of Ethics, Compliance and Audit Services (ECAS). ECAS works with the ten campuses, the six health centers, and the Lawrence Berkeley National Laboratory. In addition, Mr. Bustamante served on audit committees for the Los Alamos and Lawrence Livermore National Laboratories. Compliance personnel on the campuses had reporting relationships to campus senior leadership and, through Mr. Bustamante, to the Regents. ECAS also had a series of strategic relationships with other compliance partners throughout the UC system.

Mr. Bustamante presented a model of three lines of defense with regard to essential roles and duties for risk and compliance; this represented a best practice framework for

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

governance, risk, and compliance issues. The first line of defense was day-to-day risk management and controls performed by business operating units, who manage risk directly. The second line of defense oversees risk and compliance activities for the organization. These functions develop and maintain risk and compliance policies, identify and monitor new and emerging risks, and provide guidance and training for business units regarding risk in the system. The third line of defense is the independent assurance function, which has the highest level of independence, reporting to the governing board. It provides independent assurance that risk management throughout the system is working effectively. The University needed to have all three lines of defense functioning well in order to address risk. ECAS is not an operational unit but is located in the second and third lines of defense.

In order to determine how to allocate limited resources, the University performs an annual risk assessment to identify the top compliance risks facing the system. The assessment looks for incidents with a high degree of likelihood to occur and which would cause a high degree of harm to the institution. This process is forward-looking; the goal is to identify and address issues before they result in harm to the institution. In the process for fiscal year 2020–21, UC identified and focused on a number of risk areas. These areas were diverse and extended throughout UC operations.

Interim Systemwide Director of Compliance Irene Levintov discussed components of UC's compliance program. One of the most essential elements was the development and maintenance of effective training. She presented information on completion rates for key mandatory training programs for UC employees, both faculty and staff. Two programs concerned conflict of interest: one was a general compliance briefing and another was specifically designed for researchers. Both programs discuss key concepts, such as UC's ethical values, standards of ethical conduct, policies related to financial management and conflict of interest, the mechanisms available to all employees to report potential instances of non-compliance and other concerns, and the protections afforded to whistleblowers under University policy. The briefing for researchers also covers research-specific topics, as required by certain funding agencies.

Training programs on sexual violence and sexual harassment (SVSH) for staff and supervisors were mandated by State law and UC policy. California law requires one hour of SVSH training for staff every two years, and two hours for supervisors and faculty every two years. Cyber security training was an annual requirement for all UC employees and was designed to ensure that all employees understand common security risks and practices and employee roles and responsibilities in protecting institutional information.

In addition to required courses, ECAS provides training and guidance through collaborations or in response to specific requests for assistance from UC locations. The ECAS compliance function seeks to identify emerging risks, designs materials to address these risks, and answers stakeholder questions on policy and compliance. This work results in problem-solving, compliance alerts, and suggestions for process improvement.

ECAS also designs and delivers training on the most pressing compliance issues. In January, ECAS hosted a national research security symposium. There were 614 UC participants and 1,000 attendees from other universities, the cyber security profession, and government entities. The symposium focused on key cyber security issues related to research data, a roundtable discussion with major funding agencies and other university systems. Over the past year, ECAS also launched two other mandatory courses: clinical privacy training for all UC healthcare employees and training on conflict of interest for researchers, mentioned earlier.

Systemwide Deputy Audit Officer Matthew Hicks discussed ECAS audit activities. He provided statistics on productivity and allocation of effort for the internal audit function. The audit plan completion percentage and the number of reports issued had declined over the last few years. This was mainly due to ECAS' concerted effort to take on larger and more complex emerging risk areas in its audit projects. These types of projects take more time and effort. In terms of numbers of hours, the effort spent on the prior year's cyber security threat detection and identification audit was equivalent to eight average-sized audit projects. While ECAS was not completing as many audit projects as in prior years, ECAS believed that the projects it was completing had greater impact.

There were a number of areas of focus for internal audit this year, including cyber security and the impact of the COVID-19 pandemic. The pandemic had underscored the importance of effective business continuity plans and protocols and presented challenges to ensuring that appropriate internal controls were in place in the transition to remote work. Foreign influence was a risk area that continued to be a priority for the University and the federal government. Last year, UC was one of the first universities to complete an audit on foreign influence. The audit identified several opportunities to strengthen institutional protocols, and management was currently working to implement recommendations from the audit.

ECAS internal audit conducted a number of special audit projects this year. The cyber security audit team completed an extensive audit of the systemwide threat detection and identification program. The audit identified opportunities for improvement in the implementation of threat detection capabilities and opportunities to improve cyber risk governance. The cyber audit team also completed an audit to assess the implementation of updates to UC's information security policy. The audit identified opportunities for improvement in formalizing information security management programs and ensuring that key leadership was appropriately engaged in cyber risk oversight roles as defined in the policy. ECAS has been serving as the independent compliance monitor for the implementation of corrective actions put in place at UCLA in response to allegations of sexual misconduct in the clinical environment.

There was an overall positive trend in the completion of Management Corrective Actions (MCAs) identified in internal audit projects. On average, ECAS internal audit identifies approximately 1,000 MCAs each year. The overall balance of open MCAs had remained level from the prior year, indicating that management was implementing MCAs at roughly the same rate as ECAS was identifying them. There had been a significant decrease in the number of aging MCAs. The number of MCAs 300 days or older had decreased from over 100 three years ago to less than 30 at present and had remained at a low level.

Mr. Bustamante then discussed the ECAS investigation function and the program for whistleblower reports. The total number of incoming reports decreased slightly from fiscal year 2020 to fiscal year 2021. About 230 cases in fiscal year 2021 concerned COVID-19–related allegations. Whistleblower reports come to ECAS' attention in a number of ways. Over the last three years, most allegations were reported through the whistleblower hotline. Having this type of hotline was widely regarded as a best practice. It allows individuals to report matters anonymously if they wish and allows ECAS to query them without learning their identity.

Mr. Bustamante presented three-year trend data on closure of investigations and volume of reports by allegation category. The two largest categories were "discrimination and harassment" and "workplace misconduct." Reports of discrimination and harassment increased by 34 percent over the prior fiscal year, while reports of workplace misconduct decreased by 11 percent, but the number of these latter reports was still higher than in fiscal year 2019. There were several subcategories of workplace misconduct, but the most common allegations concerned bullying by managers and colleagues and unfair employment practices. ECAS offers regular, monthly training for investigators throughout the UC system on a range of investigation issues and best practices.

Regent Cohen noted that none of the mandatory training compliance rates were at 98 or 99 percent. He asked what UC was doing to increase these percentages and if the Regents could expect them to reach 100 percent. Mr. Bustamante responded that rates above 90 percent would be a positive indicator for the University, given attrition and onboarding of new employees. He did not believe that it would be reasonable to expect rates to reach 100 percent. At the Office of the President, completion rates were an element of performance reviews, but there was variation on the campuses in how compliance with training requirements was handled and enforced.

Regent Cohen expressed concern about the systemwide level of compliance with mandatory cyber security training at 78 percent. He urged the chancellors and UC to improve this rate, with completion in the 90 percent range as a goal for the short term.

Committee Chair Elliott noted that ECAS informs the campuses about their completion rates in the course of the year. He asked that the Committee Chair and Vice Chair also receive this information, and that future reports include a breakdown by campus, not just overall systemwide figures for training completion rates. He also referred to the fact that discrimination and harassment was one of the largest categories of whistleblower reports. He suggested that increased training for supervisors might lead to a decrease in the number of these reports. Mr. Bustamante responded that quarterly reports to the campuses would be provided to the Chair and Vice Chair, and that future reports would include campus numbers.

Chancellor Khosla drew attention to the issue of deficit identification and management. Only discretionary resources could fill deficits, and this created risk for the campus. Deficit accounts were not identified on a regular basis. This problem would become worse with UCPath and Enterprise Systems Renewal implementation on the campuses. He asked that

ECAS be mindful of this issue. Chancellor Khosla also commented that campus chief financial officers are knowledgeable about the accounting systems and know where potential issues might arise, but there was not much flexibility for chancellors and campuses to suggest modifications for ECAS audit plans. Mr. Bustamante responded that ECAS would discuss flexibility on campus audits.

Regent Pérez remarked that not all problems, such as those regarding cyber security, can be addressed with training. He asked about ongoing assessment of the University's success in changing human compliance and how employees were using tools. In the significant cyber attacks that have occurred at UC, there were human deficiencies in acting, based on training. He asked how ECAS could provide a sense of that ongoing progress. Mr. Bustamante responded that intensive auditing in this area would continue. The systemwide audit of threat detection and identification examined systems, processes, and people in an effort to strengthen UC's cyber security environment. ECAS was considering additional areas such as critical infrastructure and emergent technology and was continuing to carry out penetration testing, still one of the top risks and an area of focus for the coming years. ECAS would focus not only on training, but on ensuring that people were doing what they should be doing, that systems were functioning, and that opportunities for improvement were being identified.

Committee Chair Elliott congratulated ECAS on the significant decrease in the number of open MCAs 300 days or older. This number had increased slightly over the course of the last year, and he asked if this was due to difficulties related to the COVID-19 pandemic. Mr. Hicks responded that there were typically ebbs and flows in the closure of MCAs. Some MCAs took longer to complete due to the transition to remote work, such as implementing physical security measures when employees were offsite. Nevertheless, the number of outstanding MCAs 300 days or older continued to remain at a low level.

3. **ANNUAL REPORT OF EXTERNAL AUDITORS FOR THE YEAR ENDED JUNE 30, 2021**

[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 thanked Ruth Satorre, who had served as Interim Systemwide Controller following the retirement of Associate Vice President Peggy Arrivas and worked with controllers throughout the UC system to ensure that this audit was completed on time. Mr. Brostrom also thanked Michael Schini, who had served as Expert Financial Advisor to the Committee and provided extensive reviews of the University's financial statements.

PricewaterhouseCoopers (PwC) representative Will Cobb commented that the PwC audit for the University for fiscal year 2021 was the second audit completed by his team in a remote setting. PwC had made significant investments in technology over the past several years that enabled the satisfactory completion of the audit under challenging circumstances. As indicated in the Required Communications to the Board of Regents, PwC issued an unqualified audit report for the University and unqualified opinions for each of the medical centers and the UC Retirement System. PwC found UC's adoption of a new accounting pronouncement, Governmental Accounting Standards Board (GASB) Statement No. 84 on Fiduciary Activities, to be compliant with the applicable accounting guidance. PwC reported one significant deficiency in internal controls related to the retirement system. This was a recurring significant deficiency surrounding the absence of evidence supporting key information technology general controls. PwC's audit plan was responsive to that control weakness and enabled PwC to complete testing to support the conclusions reached. Mr. Cobb expressed appreciation for management's efforts to facilitate the audit process this year. PwC received full cooperation from management in fulfilling PwC audit requests.

Regent Cohen referred to the significant deficiency regarding Redwood, the retirement recordkeeping system. PwC found that the accuracy rate for the actuarial files was 99.9 percent. He asked if PwC was able to validate this 99.9 percent accuracy and how UC might achieve 100 percent accuracy. Mr. Cobb responded that PwC worked with management to understand potential exposure in this area. There were certain data sets in which an attribute, the active or inactive status of participants, was inappropriately tagged. Management identified the relevant data sets and was able to submit this information to the actuaries to project an estimated misstatement with respect to pension and Other Post-Employment Benefits liability. PwC took these projected misstatements and considered them together with any other estimated differences. When PwC calculated all this together, if found that the impact was de minimis and that the percentages quoted were accurate in terms of total exposure, which was below PwC's posting threshold and clearly trivial in terms of the financial statements. Mr. Cobb believed that there could be a refinement of processes for ensuring the integrity of these records. He noted that some items that PwC reviewed might have been corrected subsequently, before submission to UC's actuaries. Ms. Satorre confirmed that data were sent in July and subsequently corrected in September, as part of ensuring the accuracy of the files submitted to the actuaries. Mr. Brostrom added that the University's work on the Redwood project included measures to reduce inaccuracies and their impact on retirees.

Regent Makarechian requested more detail about GASB Statement No. 84 on Fiduciary Activities. Mr. Cobb responded that the effect of this Statement for the University had to do with to funds referred to as "agency funds" held on behalf of other organizations. There were now two new financial statements added to UC's annual financial report: a statement of the net fiduciary position of these agency funds and a statement of changes in the fiduciary net position of the funds. These amounts had always been included in UC's financial statements and had been embedded within the reported assets and outgoing liabilities.

In response to another question by Regent Makarechian, Mr. Cobb explained that the adoption of GASB Statement No. 84 was performed in accordance with accounting standards. This was a new accounting standard applicable for fiscal year 2021, and PwC audited and issued an opinion on the new fiduciary financial statements that had been added to UC's financial report. PwC issued an unqualified opinion on the statements. No adjustments were necessary.

Regent Makarechian asked how many financial statements PwC audits. Mr. Cobb briefly enumerated the components of the PwC audit of the University, which includes the campus foundations and the UC Retirement System. PwC also performs an Office of Management and Budget (OMB) Uniform Guidance audit for federal grants and, under a separate contract, audits the University's captive insurance entity.

Regent Makarechian asked about materiality or other criteria used for identifying and reporting problems. Mr. Cobb responded that, for the OMB Uniform Guidance audit for federal grants, the threshold for findings was $25,000. For audits of UC units, the materiality threshold depended on the unit. The materiality threshold for the University as a whole was higher than for an individual campus foundation. The unit to be audited determined the threshold for reporting.

Regent Makarechian observed that, when UC financial statements are combined, such as the statements for all the medical centers, the materiality threshold becomes high. Mr. Cobb responded that, in the case of the medical centers, although there is one report issued for the medical centers, there is an audit opinion for each medical center; each medical center has a lower, entity-specific materiality threshold.

Regent Makarechian noted that the accounting estimate for the net retiree health liability included a discount rate assumption; however, in the UC Retiree Health Benefit Program, benefits were funded on a pay-as-you-go basis, and these were not vested benefits. He asked how one arrived at a calculation of liability for this program. Mr. Brostrom recalled that the projected pay-as-you-go cash costs for the program for fiscal year 2021–22 were about $347 million. The University had only about $100 million in its Retiree Health Benefit Trust. The University must estimate future liabilities and discount them back at the risk free cost of capital. This determination was based on the index rate for 20-year tax-exempt general obligation municipal bonds. This rate had fallen from 2.21 percent to 2.16 percent. The University was considering liabilities that would extend for periods such as 70 years and discounting them back at 2.2 percent. This was the reason for such a large resulting liability, even though the pay-as-you-go costs were reasonable. While these benefits were not vested, the University must recognize this liability on its balance sheet.

Regent Makarechian referred to information in the PwC report about an uncorrected classification error in the 2020 Statement of Cash Flows concerning $349 million of insurance payment outflows. He asked if this issue had now been corrected. Mr. Cobb responded in the affirmative. He explained that there were no corrected misstatements in the University's 2021 financial statements. There was an uncorrected classification error in the 2020 Statement of Cash Flows. PwC had another comment in that section of the report concerning the standalone UCLA Medical Center audit, a difference related to accumulated depreciation, and the out-of-period correction that occurred to true up that depreciation. These issues had been resolved.

Regent Makarechian asked how the classification error concerning $349 million of insurance payment outflows was made. Ms. Satorre responded that the Office of the President (UCOP), in preparing the financial statements for 2021, reviewed the mapping of accounts to be included in the statement of cash flows. In implementing the consolidation, UCOP realized that the mapping of payments for these insurance payments was made to "other receipts" rather than to "payments to suppliers and utilities." For 2021, the presentation was corrected. Mr. Cobb added that, with regard to a materiality determination, there was no impact on the total operating cash flows.

Regent Makarechian asked if these types of mistakes were occurring on the campuses. Ms. Satorre responded that the source data were data submitted for consolidation. She believed that the manner in which campuses processed their transactions would not affect the central consolidation at UCOP.

The meeting adjourned at 10:45 a.m.

Attest:

Secretary and Chief of Staff