

University of California
Audit and Communications Plan
For the year ending June 30, 2007



February 14, 2007

To The Regents' Committee on Audit
University of California

Dear Committee Members,

We appreciate the opportunity to discuss the University of California's business issues and your expectations of PricewaterhouseCoopers as your independent auditors.

We are pleased to present you our audit plan, which includes our communication strategy, a summary of our mutual understanding between you and others within your organization and PricewaterhouseCoopers, an analysis of key risks, our audit approach, reporting and audit timetable and other matters. Discussion of our plan with you ensures our PricewaterhouseCoopers engagement team members understand your concerns and that we agree on mutual needs and expectations to provide the highest level of service quality. Our approach is responsive to the many changes affecting the University of California.

If you have any questions regarding this plan please contact Joan Murphy, engagement partner, at 415-498-7690.

Yours truly,

PricewaterhouseCoopers LLP

Table of Contents


	Page
Our Objectives	1
Communications Plan	2
Developments Affecting your Business	3 - 6
Terms of Engagement	7
Audit Approach	8
Audit Plan: Risk Analysis	9 - 17
Perspectives on Fraud Risk	18
Related Parties	19
Reporting Timetable	20
Engagement Team	21
Appendices:	
PwC Principles and Practices	
Independence	
Corporate Governance: Roles and Practices	
Glossary of Acronyms	

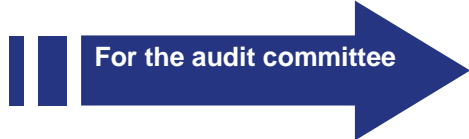
The matters raised in this and other reports that will flow from the audit are only those which have come to our attention arising from, or relevant to, our audit that we believe need to be brought to your attention. They are not a comprehensive record of all the matters arising, and in particular we cannot be held responsible for reporting all risks in your business or all internal control weaknesses. This report has been prepared solely for your use and should not be quoted in whole or in part without our prior written consent. No responsibility to any third party is accepted as the report has not been prepared for, and is not intended for, any other purpose.


Our Objectives

Audit objectives

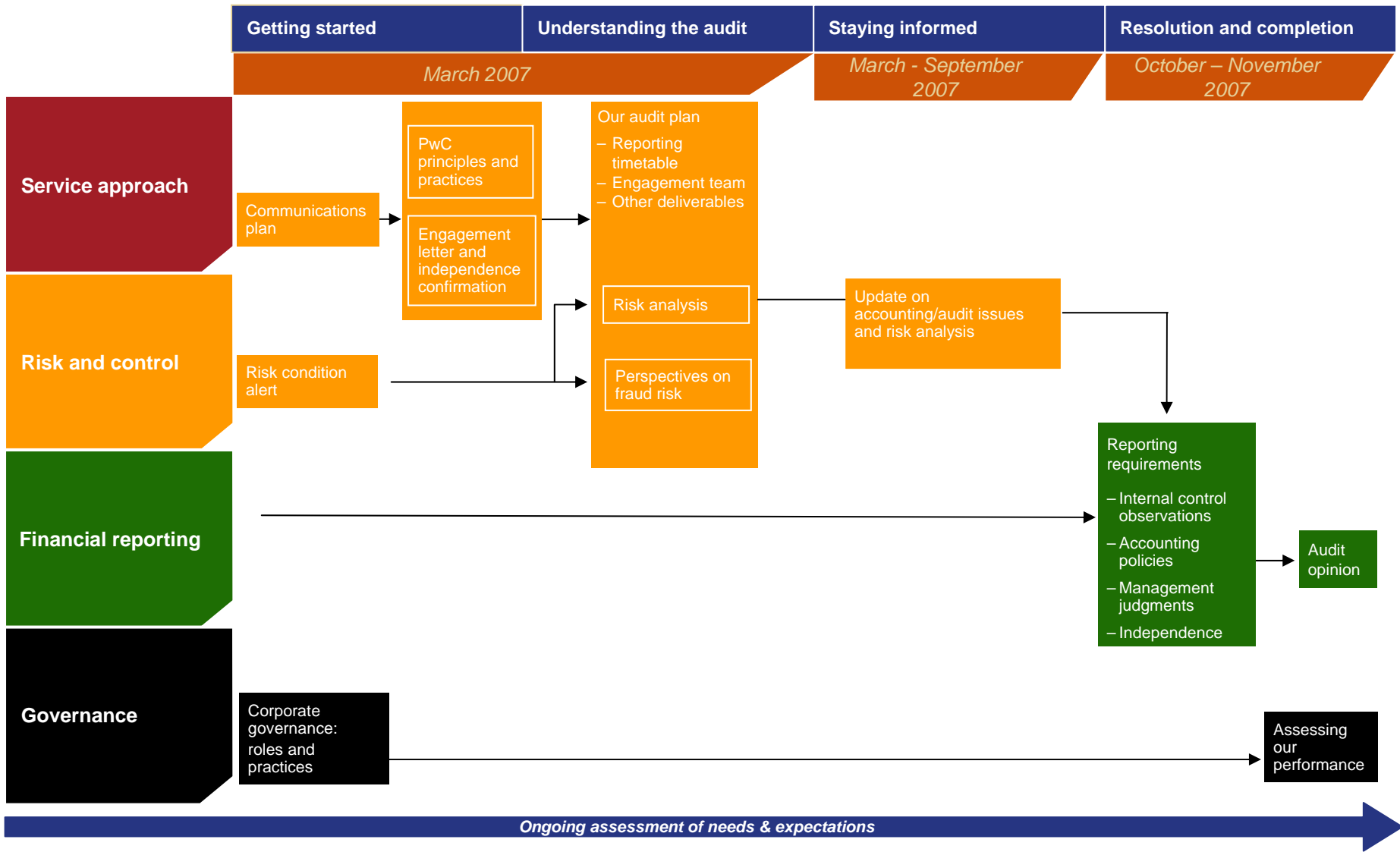
Our audit is directed towards delivering our services at three levels:

- 
 - independent opinions and reports that add credibility to financial information released by the University of California

- 
 - assistance to The Regents' Committee on Audit in discharging its corporate governance and compliance responsibilities

- 
 - observations and advice on financial reporting and business issues from senior professionals who have in-depth understanding of your business and industry, including sharing experience on industry best practice issues

Communications Plan



Developments Affecting your Business

Based upon discussion with management and our understanding of the University of California (the “University”) and the higher education industry, we note the following recent developments. As applicable, these matters are considered in developing our audit approach, as discussed in this report:

Regulatory

Government Auditing Standards

The Government Accountability Office (GAO) has issued an exposure draft of its *Government Auditing Standards (GAS)*, or Yellow Book. Some of the proposed changes are to comply with changes in AICPA auditing standards, such as those related to workpapers. In addition, there are changes made to emphasize ethics, simplify and clarify the rules on non-audit services and to better define the standards for performance audits. The proposed revisions include conforming changes to use the same definitions of internal control deficiencies as contained in SAS 112. The proposals also include more visible reporting of restatements of financial statements in reports issued under GAS, and establish requirements in this area beyond those of the AICPA.

The GAO also issued a draft revised A-133 Compliance Supplement that includes proposed changes to the scope of testing for certain federal award programs. The University participates in one of these programs (at UCLA) which is the direct lending program. The revised compliance supplement requires this program be audited as part of the A-133 audit regardless of the magnitude of the dollars involved. Accordingly, our A-133 audit for the University’s fiscal year 2007 will include testing of compliance for this particular program.

Developments Affecting your Business (continued)

Operational

- As a public institution, there is increased scrutiny and review of the University's practices and overall financial condition/activities
- Transition issues related to new management arrangements for the Los Alamos National Laboratory and Lawrence Livermore National Laboratory
- Financing of medical centers using pooled revenue bonds
- Expansion and capital needs at medical centers and campuses
- Challenges faced by the academic medical centers due to federal and state reductions in payments for services and challenges in applying reimbursement regulations. Reimbursements and reserves are always an area of audit emphasis. We plan to continue our review of the reserves for Medicare and Medi-cal, as well as other compliance and intermediary issues.
- Oversight and compliance issues relative to the DOE laboratories
- Federal regulatory oversight of research compliance. The federal government is concerned about issues such as subrecipient monitoring, effort reporting and cost transfers. We will consider new developments in our A-133 audit.
- Due to continued growth at UC Merced, in fiscal year 2007, that campus will be subject to an increased audit scope that is consistent with the other UC campuses.

Developments Affecting your Business (continued)

Accounting and Auditing

The following GASB and AICPA pronouncements will have an effect on the University:

- GASB 45 will have a major impact on the financial reporting of post employment benefits. *GASB 45 Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions* covers financial reporting by the University. This statement is effective for the year ending June 30, 2008. While we understand the University does not plan to adopt this standard in the current year, we understand the University has been evaluating the Statement and has an implementation plan. The requirement to adopt accrual accounting will result in a significant liability upon full adoption to the extent the annual required contribution is not funded.
- In September 2006, the GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, effective for the University's fiscal year ending June 30, 2008. The University has elected to early implement this standard in fiscal year 2007. Statement No. 48 requires an analysis of whether proceeds received from selling receivables should be recorded as revenue or as a liability. Consideration will need to be given to whether or not the University retains or relinquishes control over the receivable or future revenues. Sales of receivables at the University primarily relate to the sale of Mortgage Origination Program loans to third parties. The University is currently evaluating the effect that Statement No. 48 will have on its financial statements.

Developments Affecting your Business (continued)

Accounting and Auditing (continued)

- GASB 49, issued in November 2006, will be effective for the University's fiscal year ending June 30, 2009. GASB No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, requires the University to assess existing pollution remediation liabilities when one of five obligating events takes place. These liabilities should be capitalized based on reasonably estimable amounts, utilizing discounted cash flows and probability weighted assumptions. The University is currently evaluating the effect that GASB No. 49 will have on its financial statements.
- The AICPA finalized its Statement on Auditing Standards (SAS 112) entitled *Communicating Internal Control Related Matters Identified in an Audit*. The purpose is to conform with Public Company Accounting Oversight Board (PCAOB) AS-2 guidance and definitions with a goal of enhancing the auditors' ability to identify and communicate to management and audit committees ("those charged with governance") significant deficiencies and material weaknesses (replacing the concept of a "reportable condition") and strengthen the quality of auditor communications concerning internal control matters in a financial statement audit. The standard does not change the overall objective of an audit and while the auditor is not required to search for or identify control deficiencies, frequently control issues come to the attention of the auditor during the audit. The standard requires the auditor to evaluate the significance of the control deficiency in relation to the *potential* for misstatement. We believe that this standard will likely increase the level of control matters reported to the Regents' Committee on Audit due to the lower bar set by the definitions of material weakness and significant deficiency. The statement has significant implications for the OMB Circular A-133 report, as this includes a report on internal control over financial reporting.
- AU 332 regarding the auditing of alternative investments continues to receive considerable attention from auditors of investors as well as investment funds and managers. While we do not anticipate any additional guidance to be issued on this topic, we plan to continue to refine our audit approach to alternative investments to ensure compliance with this auditing standard.

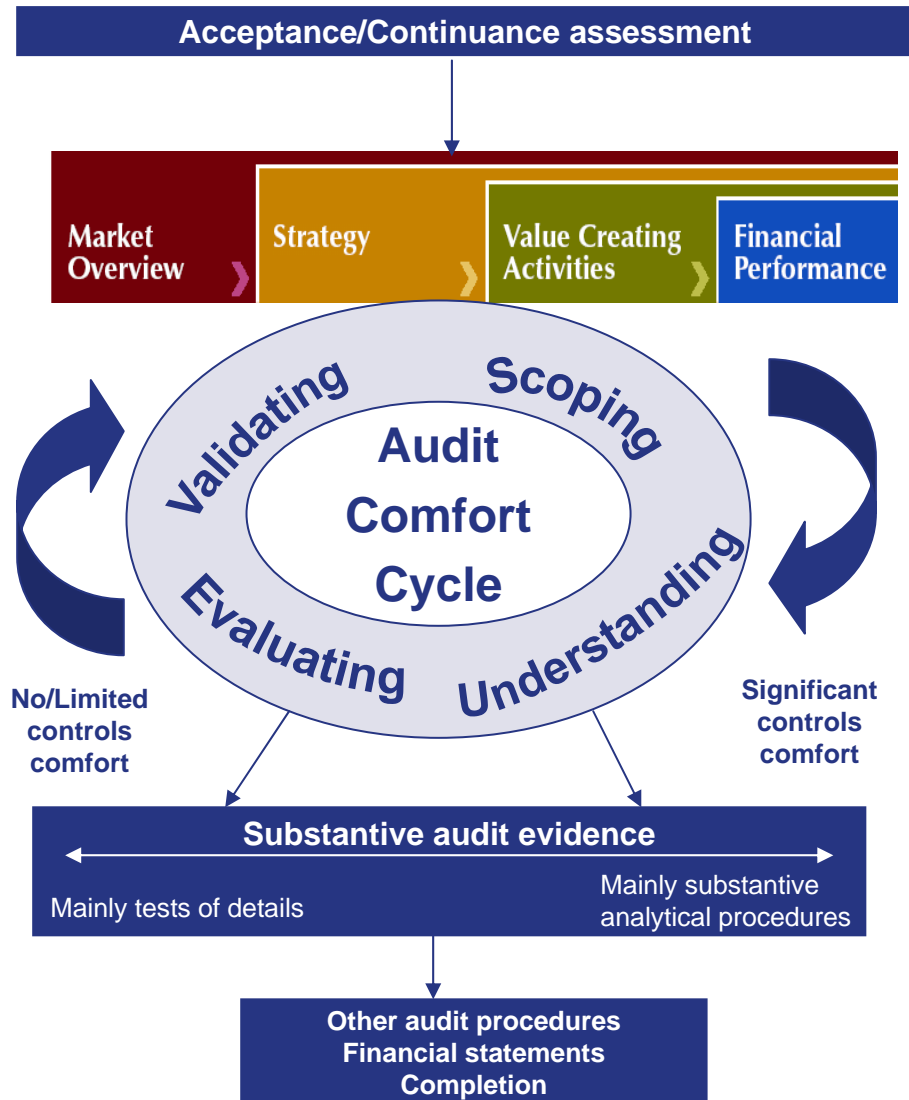
Terms of Engagement

- Our engagement letter sets out the terms of our appointment as auditors of University of California (“UC” or the “University”).
- The engagement letter covers the following matters:
 - Scope of annual audit, including OMB Circular A-133, for the year ending June 30, 2007
 - Our responsibilities and limitations
 - Management’s responsibilities
 - Other documents
- A copy of the engagement letter will be provided to the Chair of the Regents’ Committee on Audit and its Financial Expert Advisor.

Audit Approach

Our audit strategy starts at the same point as the University – with your strategies and objectives. Through discussions with management, we understand your objectives and risks. We then focus our approach on those risks that may materially impact financial statements.

Our “top-down” management discussions not only identify the business objectives and risks, but also key controls in place to manage those risks. We test those management controls. We then determine how we will substantively test significant account balances and classes of transactions.



Audit Plan: Risk Analysis

Our audit approach is risk based. Assessment and identification of risk is performed throughout the audit process in coordination with senior financial management. We focus on risks that have a potential impact on financial reporting and the financial accounting systems and controls that mitigate those risks.

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Investments (47% of total University assets; 99% of total Retirement System Assets)</p> <ul style="list-style-type: none"> •Are not properly valued. •Do not exist. •Are not reconciled to manager/custodian records. •Contracts, e.g., derivatives, are entered into by University managers without approval and are not known to the Committee on Investments. 	<p>All traded investments are priced using independent pricing services. All non-traded investments priced based upon audit reports, appraisals, pricing models or other available information. Investments are reconciled at least monthly.</p> <p>The University uses strict guidelines to evaluate its managers and evaluates their performance.</p>	<p>We independently reprice a significant portion of all traded investments. All traded investments held by the custodian are confirmed directly with the custodian; non-traded investments are confirmed on a sample basis. We also review and validate management’s valuations of alternative investments and due diligence investing procedures.</p> <p>We review all significant reconciliations and year end portfolios for evidence of non-recorded transactions and contracts. We confirm pending trades and other liabilities.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Investments (continued)</p>	<p>Management maintains investment guidelines to limit the exposure in particular sectors to ensure the quality of the investments purchased and regularly reviews performance of its managers.</p> <p>Management has established controls to ensure that purchase and sale transactions are authorized.</p>	<p>We obtain an understanding of the investment guidelines and review, on a limited sample basis, compliance therewith.</p> <p>We review controls over investments activities, valuations and obtain SAS 70 reports over the custodian.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Capital assets (45% of total University assets)</p> <ul style="list-style-type: none"> • Are not properly initially recorded at cost. • Do not exist. • Are not appropriately depreciated. 	<p>There are specific authorizations required for capital projects. Accounts are subject to monthly reconciliations. Capitalization thresholds, depreciable life guidelines are in place. Periodic inventories are performed of moveable equipment.</p>	<p>We obtain an understanding of the policies and procedures over capital assets. We vouch a sample of capital asset additions and review year end reconciliations. We recompute depreciation on a test basis and perform analytical procedures over depreciation expense. We review results of physical inventories and reconciliation of the subsystem to the general ledger.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Accounts receivable</p> <ul style="list-style-type: none"> •Are not properly categorized. •Do not exist. •Are not properly valued or collectible. 	<p>Accounts receivable are subject to review at year end for collectibility. Overdue accounts are investigated.</p>	<p>We review a sample of accounts receivable for collectibility issues. We review the reconciliation to detail and perform analytical reviews.</p>
<p>Accounts payable and accrued expenses</p> <ul style="list-style-type: none"> •Are not complete or accurate. 	<p>Accounts are reconciled on a monthly or quarterly basis. A year end cutoff is performed to ensure that significant payables are captured.</p>	<p>We perform analytical procedures on balances and review year end reconciliations for all accounts over a given threshold, as well as a sample below the threshold. We perform a search for unrecorded liabilities.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Other assets and liabilities</p> <ul style="list-style-type: none"> • Are not appropriately stated. • Are not reconciled or properly deferred. 	<p>Reconciliations are subject to monthly monitoring and review. Large fluctuations are investigated.</p>	<p>We perform analytical procedures on balances and review reconciliations for all accounts over a set threshold, as well as a sample of those below the threshold.</p>
<p>Revenues and Expenses</p> <ul style="list-style-type: none"> • Are not appropriately categorized. • Are not complete. 	<p>Accounts are reviewed monthly for unusual trends. Budget to actual is monitored.</p>	<p>We vouch selected revenues and expenses in connection with other audit areas. We perform analytics of changes in accounts and consider the work completed by internal audit.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Notes and bonds payable</p> <ul style="list-style-type: none"> • Are not complete or accurate. • Result in non-compliance with terms and conditions. 	<p>Management reviews all agreements for compliance with internal debt policy and covenants. Procedures are in place to ensure payments are made as required.</p>	<p>We independently confirm all significant debt. We review compliance on a sample basis with debt covenants. We review reconciliations to the general ledger, as well as footnote disclosures.</p>
<p>Net assets</p> <ul style="list-style-type: none"> • Are not in the appropriate category. • Are not supported by appropriate detail. 	<p>Management produces a year end detail of net assets by category and ensures that this detail reconciles to the financial statements.</p>	<p>We perform analytical procedures on balances and review year end reconciliations. We review a sample of balances to ensure proper categorization.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Sponsored research</p> <ul style="list-style-type: none"> • Non-compliance exists which would be material to the financial statements or to federal or state programs. 	<p>Management has extensive policies, procedures and training in place to ensure compliance with sponsored research guidelines. This area also receives internal audit attention and review.</p>	<p>We perform analytical review of revenues and expenses. In connection with the A-133 audit, we examine charges to federal and state awards for compliance with federal and state regulations. We consider results of internal audits, regulatory audits and federal regulatory changes.</p>
<p>Hospitals</p> <ul style="list-style-type: none"> • Extensive judgment is required in developing liabilities for contingencies and third party payors. • Complex regulations with changing interpretations make compliance difficult. 	<p>Management focuses on reviewing subjective liabilities and complying with regulatory issues.</p>	<p>We have separate PwC audit teams who specialize in healthcare. Audit procedures focus on reasonableness of estimates, historical results and consistency in application. Regulatory exposures are considered at each hospital.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Financial Reporting</p> <ul style="list-style-type: none"> •Disclosures omitted or not appropriate. •Errors made in basic statements in terms of classification or amounts. 	<p>Draft financial statements are subject to numerous internal reviews prior to completion.</p>	<p>We agree the financial statements to the underlying accounting records. We complete a disclosure checklist to ensure all significant disclosures are made and test disclosures back to underlying support. We obtain a legal letter to understand the nature of any potential claims against the University.</p>
<p>Fraud</p> <ul style="list-style-type: none"> •Misappropriations. •Fraudulent billings to contracts. •Reporting of performance. 	<p>Policies, procedures and controls to ensure segregation of duties, compliance with federal and state regulations, and oversight of managers.</p>	<p>We consider incentives and pressures, have and will continue to expand our interviews, and consider the possibility of fraud in every audit. We also review internal audit reports and are alert for matters that are indicators of fraud.</p>

Audit Plan: Risk Analysis (continued)

Risk Area that could materially affect the Financial Statements	Management Controls	Audit Approach
<p>Information Technology</p> <ul style="list-style-type: none"> •Systems could fail on implementation resulting in inaccurate data. •Security could be breached. •Management resources could be distracted based upon time devoted to implementing new systems. 	<p>Management is focused on dealing with issues related to systems.</p>	<p>We will review general computer controls and security as it relates to the general computer environment.</p>
<p>Department of Energy (DOE) Labs</p> <ul style="list-style-type: none"> •Revenues and expenses are consolidated by UC and subject to the risk that amounts are not properly stated. •Contract noncompliance which could be material to the University or could indicate poor financial stewardship of federal resources. 	<p>Management has augmented and enhanced oversight of both DOE labs, including reviews of internal control systems, redefined reporting, and strengthened internal audit presence.</p>	<p>We will perform expanded procedures. Since Lawrence Livermore National Laboratory has restricted access as to particular accounts, we are not in a position to complete a full scope audit; however, we have expanded audit procedures to address items that are not subject to security restrictions.</p>

Perspectives on Fraud Risk



Management:

- Ultimately responsible for developing and maintaining anti-fraud program
- CFO/Controller develop controls to deter and detect fraud
- Internal Audit and Compliance: monitoring and auditing

Audit and Compliance Committee:

- Evaluate management's identification of fraud risk
- Evaluate implementation of fraud controls
- Reinforce "tone at the top"
- Conduct special investigations

External Auditor:

- Evaluates management's programs and controls to deter and detect fraud (SAS 99)
- Reasonable assurance that financial statements are free of material misstatement due to fraudulent financial reporting or misappropriation of assets (SAS 1, 99)




Related Parties

- Current standards and practices require emphasis on auditing related party transactions and communicating with the Committee on Audit in this regard.
- The University's controls over related party transactions include maintaining written policies governing related party transactions and transaction authorization procedures.
- Material related party transactions that came to our attention during the prior financial statement audit include appropriations, contracts and grants received from the state of California, of which the University is a component unit for financial reporting purposes; lease obligations to the state financed by the state revenue bonds; contributions received from and assets held by the University on behalf of the University's foundations and investments of the University of California Retirement System which are managed by employees of the University. All such transactions are disclosed.
- The separate medical center financial statements include disclosure of related party transactions with the University.
- Other related party transactions exist including receipts of contributions by members of the Regents, transactions with affiliated entities such as alumni associations, etc. None of these were deemed material for disclosure purposes by management.

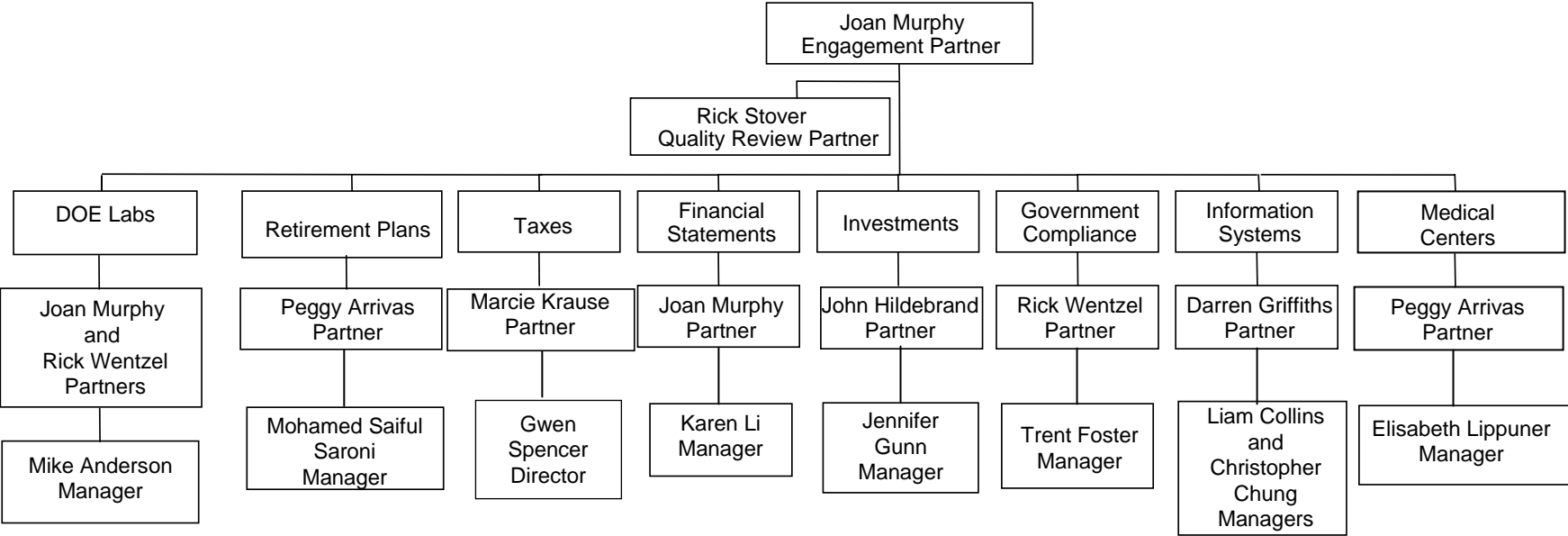
Reporting Timetable

Reporting/deliverables:

Your PricewaterhouseCoopers team works on the engagement throughout the year to provide the University with timely, responsive service. Below are the dates you can expect our reports.

	Consolidated University financial statements – Opinion Date: September 2007	November 2007
	Retirement System financial statements – Opinion Date: September 2007	November 2007
	OMB Circular A-133 report	February 2008
	Internal control observations	November 2007
	Required communications	November 2007

Engagement Team



Appendix - PwC Principles and Practices

In today's challenging business and corporate reporting environment, we believe it is important that you remain confident about:

- (i) the quality of our audit work
- (ii) our steadfast commitment to independence and quality

We recognize the importance of a strong and effective relationship between the Committee on Audit and the independent auditors.

The PwC Principles & Practices Regarding Our Relationships With Client Audit Committees highlights our values and principles. A copy of this publication is available upon request.

Appendix - Independence Confirmation

We confirm our independence of the University as of February 2007.

Any work that is completed that is not related to the financial statement audit, such as completion of the NCAA agreed-upon procedures and attest work related to compensation is considered for potential conflicts of independence or whether the work would violate the independence standards of the GAO or AICPA. All of the work that we have done for the University beyond the core audit is related to the audit or other attest type work.

Our quality control processes are established to ensure our continuing independence.

We will again reconfirm our independence at the completion of our June 30, 2007 audit.

Appendix - Corporate Governance: Roles and Practices

The Regents' Committee on Audit

- Oversee the reliability of financial reporting including effectiveness of internal control over financial reporting.
- Review and discuss the annual financial statements 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 the risks.
- Understand the audit scope and approve core audit and any consulting services.

Appendix - Corporate Governance: Roles and Practices (continued)

Management

- Properly record transactions in the accounting records, establish and maintain internal control sufficient to permit the preparation of financial statements and information in conformity with GAAP.
- Prepare the financial statements.
- Make available to us, on a timely basis, all of the University's original accounting records and related information and University personnel to whom we may direct inquiries.
- Adjust the financial statements to correct material misstatements; and affirm to us, that the effects of any uncorrected misstatements are immaterial, both quantitatively and qualitatively to the financial statements taken as a whole.
- Provide written representations to us regarding the financial statements and the effectiveness of internal control over financial reporting.
- Ensure the University complies with the laws and regulations applicable to its activities, especially those related to federal and state contracts and awards.

Appendix - Corporate Governance: Roles and Practices (continued)

PricewaterhouseCoopers

- Confirm expectations with The Regents' Committee on Audit and management. Monitor and report actual performance against those expectations.
- Conduct our audit in accordance with auditing standards generally accepted in the United States and Government Auditing Standards.
- Meet with The Regents' Committee on Audit to communicate matters required by professional standards and other matters of interest.
- Support The Regents' Committee on Audit's fiduciary responsibility to ensure the effectiveness of internal controls. Provide observations regarding key business processes and recommendations for improving internal controls.
- Discuss issues and concerns with management as they arise. Report significant matters as soon as they are confirmed.
- Provide management with proactive accounting and regulatory technical advice and provide timely access to PwC accounting and reporting experts to address unusual and non-routine items.
- Provide an accessible, experienced team with appropriate industry and technical expertise and align the team with the University management structure to ensure the effective resolution of issues.

Glossary of Acronyms

A-133	Office of Management and Budget (OMB) Circular A-133
AICPA	American Institute of Certified Public Accountants
AU	AICPA Auditing Standards reference
DOE	Department of Energy
GAAP	Generally Accepted Accounting Principles
GAO	Governmental Accountability Office
GAS	Government Auditing Standards
GASB	Governmental Accounting Standards Board
NCAA	National Collegiate Athletics Association
SAS	AICPA Statement on Auditing Standard



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