

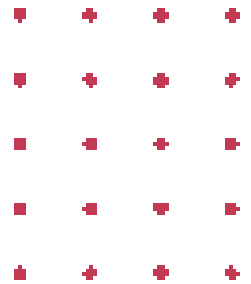
The PwC audit

For when trust matters

Report to the **Committee on Compliance and Audit
of the Board of Regents**



University of California
November 14, 2024



This report and the information that it contains is intended solely for the information and use of those charged with governance and, if appropriate, management, and is not intended to be, and should not be used by anyone other than these specified parties.



The PwC Audit

For when trust matters

October 25, 2024

Dear Members of the Committee on Compliance and Audit of the Board of Regents (the Committee) of the University of California (the University or UC):

We are pleased to submit our Report to the Committee related to the results of our FY2024 audits (hereinafter referred to as "the audit") of the financial statements of the:

- Business-type activities (the University)
- Aggregate discretely presented component units (the affiliated Foundations)
- Aggregate remaining fund information
- Each of the five individual University of California Medical Centers: Davis, San Francisco, Los Angeles, Irvine and San Diego (collectively, the Medical Centers)
- University's Defined Benefit Plans
- University of California Retirement Savings Program (UCRSP)
- University of California Retirement Plan Schedule of Cash Contributions

Our report includes a summary of the results of our audit work to date and other required communications. The results of the audit of the University's affiliated Foundations, including campus foundations, and Fiat Lux Risk and Insurance Company are reported directly to those component units' audit committees.

This report has been prepared in advance of our meeting and prior to the completion of our procedures. Other matters of interest to the Committee on Compliance and Audit may arise, which we will bring to your attention at our meeting.

We look forward to presenting this report on your PwC Audit. If you have any questions or wish to discuss any other matters prior to our meeting, please do not hesitate to contact me at will.cobb@pwc.com.

Very truly yours,



Will Cobb
Engagement Partner

Cc: Nathan Brostrom, Executive VP – Chief Financial Officer



What's inside

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Audit results





Status of our audit



Significant changes to the audit plan

We presented our planned audit approach, including our preliminary risk assessment, and related scoping considerations to the Committee on May 15, 2024. Throughout the audit we continuously evaluate the appropriateness of our audit strategy.

Refer to pages 9 and 10 for information regarding the key assumptions used in the determination of the acquisition values of assets acquired and liabilities assumed at the UCI, UCLA, and UCSD Medical Centers.

There were no other significant changes to the planned audit approach:



Audit reports

We expect to issue our unqualified reports upon completion of the remaining open items.



Remaining items to complete

We have performed the appropriate procedures in accordance with our audit plan to address the identified risks. Open items include:

- Keeping current procedures, including legal update procedures
- Receipt of signed management representation letters



OMB Uniform Guidance

The audit of the University's compliance with federal award requirements for FY2024 in accordance with OMB Uniform Guidance is scheduled to be completed in early 2025. The federal filing deadline for this report is March 31, 2025.



Audit risks and results

Particularly sensitive accounting estimates – Net patient accounts receivable is over/understated due to management's judgment in recording material out-of-model adjustments (Medical Centers' audits)

Description of estimate

Medical Center net patient service revenue and related accounts receivable are reported at the estimated net realizable amounts from patients and third-party payors, including Medicare, Medi-Cal and others, for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors.

Significant assumptions

Assumptions used in the estimate are driven by the historical cash collections for payors, assessment of any changes to existing agreements, considerations around recent trends, and determination of the aging and composition of unpaid receivables.

Management's process for developing estimates

Management's patient accounts receivable valuation process at the Medical Centers involves the use of historical liquidation analyses. Management utilizes the historical liquidation analyses, along with consideration of other current economic and payor-specific information, as key assumptions in making its estimates for the contractual allowance and allowance for doubtful accounts at period end. This process is consistent with prior periods.

Audit response

Our Medical Center audit engagement teams:

- Reviewed and discussed with management its methodology for evaluating the adequacy of the allowances.
- Validated the reasonableness and historical accuracy of management's methodology through hindsight procedures where the Medical Center engagement teams reviewed FY2024 cash collections related to the June 30, 2023 patient accounts receivable balance.
- Reviewed subsequent cash collections on the accounts receivable balances as of June 30, 2024.
- Developed an independent expectation related to the patient accounts receivable balance as of June 30, 2024.
- Reviewed adjustments made outside of the patient accounts receivable valuation model for reasonableness.
- Tested revenue transactions occurring throughout FY2024.

Based on the results of procedures performed, the amounts recorded and related disclosures are reasonable.



Audit risks and results

Particularly sensitive accounting estimates – Net pension liability

Description of estimate

The net pension liability is measured as the total pension liability, less the plan fiduciary net position. The plan fiduciary net position and changes in plan fiduciary net position have been measured in accordance with guidance in GASB Statement No. 67 and GASB Statement No. 68.

Significant assumptions

Key assumptions as of June 30 include:

- Inflation rate
- Investment rate of return
- Individual salary increases
- Cost-of-living adjustments

Management's process for developing estimates

The University utilized an external actuarial firm to assess the net pension liability to satisfy reporting requirements of GASB Statement Nos. 67 and 68 and industry best practices. Management reviewed the reports received from the actuaries prior to recording any adjustments to the net pension liability. The University also reviews significant assumptions periodically to ensure that future valuations reflect emerging plan experience. While future changes in actuarial assumptions may have a significant impact on the reported results, that does not indicate previous assumptions were unreasonable. This process is consistent with prior periods.

Audit response

The audit engagement team performed testing over key inputs to the net pension liability valuation, including over participant census data. In addition, we utilized internal PwC actuarial specialists to assist in the review of the actuarial methodologies and assumptions used to estimate the net pension liability.

Based on the results of procedures performed, the amounts recorded and related disclosures are reasonable. The difference between expected and actual experience for the individual salary increases assumption for the census data as of June 30, 2023 was not reflected in the actuarial valuation of the net pension liability (and related deferred outflows of resources and pension expense) as of June 30, 2023. Accordingly, in FY2024, the University recorded an out-of-period adjustment to pension expense to correct the balance of deferred outflows of resources. Refer to page 11 for impacts of the out-of-period adjustment, which was determined by management to be immaterial to the financial statements.



Audit risks and results

Particularly sensitive accounting estimates – Net retiree health benefits liability

Description of estimate

The net retiree health benefits liability is determined based upon discounting projected benefit payments based on the benefit terms and legal agreements existing at fiscal year-end and is measured in accordance with guidance in GASB Statement No. 75.

Significant assumptions

Key assumptions as of June 30 include:

- Discount rate
- Inflation rate
- Investment rate of return
- Initial medical trend rate
- Ultimate medical trend rate
- Year ultimate trend rate reached

Management's process for developing estimates

The University utilized an external actuarial firm to assess the net retiree health benefits liability to satisfy reporting requirements of GASB Statement No. 75 and industry best practices. Management reviewed the report received from the actuaries prior to recording any adjustments to the net retiree health benefits liability. The University also reviews significant assumptions periodically to ensure that future valuations reflect emerging plan experience. While future changes in actuarial assumptions may have a significant impact on the reported results, that does not indicate previous assumptions were unreasonable. This process is consistent with prior periods.

Audit response

The audit engagement team performed testing over key inputs for the net retiree health benefits liability valuation, including over participant census data. In addition, we utilized internal PwC actuarial specialists to assist in the review of the actuarial methodologies and assumptions used to estimate the net retiree health liability.

Based on the results of procedures performed, the amounts recorded and related disclosures are reasonable.



Audit risks and results

Particularly sensitive accounting estimates – Government combinations (the University, on behalf of UC Irvine Medical Center, UCLA Medical Center, and UC San Diego Medical Center)

Description of estimate

The University, on behalf of UCI, UCLA, and UCSD, consummated multiple asset purchase agreements with third-parties and acquired various hospitals and associated assets and assumed liabilities in March 2024, March 2024, and December 2023, respectively. These acquisitions were accounted for as government business combinations with assets acquired and liabilities assumed measured at their acquisition values in accordance with GASB Statement No. 69.

Significant assumptions

Key assumptions as of June 30 include:

Personal property

- Reproduction/replacement cost new (*UC Irvine, UCLA, UC San Diego Medical Centers*)
- Physical deterioration (*UC Irvine, UCLA, UC San Diego Medical Centers*)
- Economic obsolescence (*UC Irvine, UCLA, UC San Diego Medical Centers*)
- Floor value (*UC Irvine, UCLA, UC San Diego Medical Centers*)

Real property

- Replacement cost new (*UC Irvine, UCLA, UC San Diego Medical Centers*)
- Physical deterioration (*UC Irvine, UCLA, UC San Diego Medical Centers*)
- Economic obsolescence (*UC Irvine, UCLA, UC San Diego Medical Centers*)
- Seismic retrofit costs / remaining useful lives (*UC Irvine, UCLA, UC San Diego Medical Centers*)
- Inpatient underutilization (*UCLA Medical Center*)
- Functional obsolescence (*UC San Diego Medical Center*)
- Entrepreneurial profit (*UC Irvine, UCLA, UC San Diego Medical Centers*)
- Comparable sales and adjustments (*UC Irvine, UCLA Medical Centers*)
- Capitalization rate in ground lease (*UC Irvine Medical Center*)
- Comparable rents and adjustments (*UC Irvine Medical Center*)
- Market rent growth rate (*UC Irvine Medical Center*)
- Capitalization rate (*UC Irvine Medical Center*)
- Discount rate (*UC Irvine Medical Center*)

Refer to page 10 for additional information regarding the government combinations accounting estimates.



Audit risks and results

Particularly sensitive accounting estimates – Government combinations (the University, on behalf of UC Irvine Medical Center, UCLA Medical Center, and UC San Diego Medical Center – continued

Management's process for developing estimates

The UC Irvine, UCLA, and UC San Diego Medical Centers engaged external appraisal firms to assist in estimating the acquisition value of certain assets acquired and liabilities assumed as of the acquisition date in accordance with the financial reporting requirements of GASB Statement No. 69. Prior to recording any assets acquired or liabilities assumed, management (i) reviewed the data and significant assumptions used in the determination of the acquisition values, (refer to page 9 for the significant assumptions) (ii) reviewed the purchase price allocation performed by the appraisers, and (iii) reviewed the reports received from the appraisers.

Audit response

The Medical Center engagement teams performed the following:

- Performed opening statement of net position balance procedures.
- Engaged PwC valuation specialists to assist in the review of (i) the data and significant assumptions used in the determination of the acquisition values, (ii) the purchase price allocation performed by the appraisers, and (iii) the appraisers' reports.
- Reviewed the presentation and disclosure of the acquisitions in the financial statements.

Based on the results of procedures performed, the amounts recorded and related disclosures are reasonable.

Identified misstatements and corrections – University audit

Entity and Type	Impact to related financial statement line items	Total impact to change in net position (decrease) / increase
University audit	Decrease: <ul style="list-style-type: none"> - Restricted expendable net position of \$924 million 	
Prior year uncorrected misclassification	Increase: <ul style="list-style-type: none"> - Unrestricted net position of \$924 million 	
(No impact on the June 30, 2024 classification)	Description: FY2023 reclassification to correct various items that were previously misclassified according to restrictions. Correction of the FY2023 amounts in the FY2024 comparative financial statements was not made due to immateriality.	No impact
University audit	Increase: <ul style="list-style-type: none"> - Department of Energy receivable (noncurrent) of \$34 million - Deferred outflows of resources of \$642 million - Pension benefits operating expense of \$174 million 	
Out-of-period adjustment ¹	<ul style="list-style-type: none"> - Net pension liability of \$850 million 	\$(174) million ²
(Correction in the current year)	Description: Out-of-period adjustment due to a misstatement in the FY2023 net pension liability related to FY2023 salary increases that was corrected through adjustment in FY2024. Refer to page 7 for additional information.	

¹ An out-of-period adjustment is a correction of a misstatement that pertains to a prior period but is identified and corrected through recording in the current period. The misstatement can arise from various reasons, such as an error in previously issued financial statements. As such, the misstatement is recorded out-of-period as the impact, individually and in the aggregate, is not considered material to the previously issued, or the current period, financial statements.

² This out-of-period adjustment was also corrected in the FY2024 financial statements for each Medical Center on a proportionate share basis. The impact was to also decrease the change in net position by \$14M (Davis), \$6M (Irvine), \$12M (Los Angeles), \$10M (San Diego), and \$19M (San Francisco), respectively. The Defined Benefit Plans footnote disclosure in the FY2023 University of California Retirement Plan defined benefit obligation balance, presented in the separate University of California Retirement System FY2023 financial statements was similarly misstated.

Identified misstatements and corrections – Other audits

(Note: Materiality levels are lower for the separate opinions and the threshold for reporting misstatements is also lower.)

Entity and Type	Impact to related financial statement line items	Total impact to change in net position (decrease) / increase
UCSF Medical Center audit	Decrease:	
	- Other current liabilities of \$13 million	
	Increase:	
	- Other receivables of \$1 million	
Out-of-period adjustment (Correction in the current year)	- Grants and contracts other operating revenue of \$10 million	
	- Other operating revenue of \$1 million	
	- Hospital fee program grants nonoperating revenue of \$2 million	\$14 million
	- Private gifts, net nonoperating revenue of \$1 million	
	Description: <i>Out-of-period adjustment due to a misstatement in various FY2023 grants and contracts that met the revenue recognition criteria that was corrected through adjustment in FY2024.</i>	
UC Davis Medical Center audit	Decrease:	
	- Other assets of \$57 million	
	- Deferred inflows of resources of \$49 million	
Out-of-period adjustment (Correction in the current year)	- Interest income of \$10 million	
	Increase:	
	- Other operating revenue of \$2 million	\$(8) million
	Description: <i>Out-of-period adjustment for a prior period error in the payment terms of a lease that was corrected through adjustment in FY2024.</i>	

For each of the identified misstatements, on page 11 and above, management determined the impact, individually and in the aggregate, was immaterial to the previously issued FY2023 financial statements. Additionally, where applicable, management determined that correction of these misstatements through out-of-period adjustments in the FY2024 financial statements was immaterial, individually and in the aggregate. We take no exception to management's conclusions.



Other required communications



Other required communications

Matter to report			Comments
	No	Yes	
Independence	✓		In accordance with the AICPA's Code of Professional Conduct, we are required to communicate a breach of external independence requirements to you as soon as possible or in line with a communication protocol that is confirmed in writing. There were no independence matters that occurred or were identified subsequent to our most recent communication provided to the Committee.
Fraud	✓		We did not identify any potential or known fraud.
Non-compliance with laws and regulations	✓		Except for the matters previously disclosed to you by University management, we are not aware of any instances of non-compliance with laws and regulations.
Related Parties	✓		After evaluating the identification of, accounting for, and disclosure of relationships and transactions with related parties, we have identified no significant findings or issues arising during the audit in connection with related parties.
Quality of financial reporting	✓		We have considered the qualitative aspects of the significant accounting policies and practices, and we identified no reportable matters.
			We have evaluated whether the difference between (1) estimates best supported by the audit evidence and (2) estimates included in the financial statements, which are individually reasonable, indicate a possible bias on the part of management. We did not identify any areas of possible bias.
			We have performed an evaluation of whether the presentation of the financial statements and the related disclosures are in conformity with the applicable financial reporting framework, including our consideration of the form, arrangement, and content of the financial statements (including the accompanying notes). We did not identify any instances of non-conformity.



Other required communications

Matter to report	No	Yes	Comments
Alternative accounting treatments		✓	<p>Consistent with prior year, in considering our views on the quality of accounting policies selected, we should note that there are, in general, not many areas in which the University has a choice of alternatives. Some of the more significant areas in which there are alternatives include</p> <ul style="list-style-type: none">• The order of charging restricted vs. unrestricted funds - The University could use a specific order for applying charges to restricted vs. unrestricted funds, e.g., require that restricted funds be used first. The University does not currently dictate an order of use as it provides campuses with budgetary flexibility.• Federal refundable loans - GASB lacks guidance regarding the presentation of refundable loans as either liabilities or as part of net position. The University presents federal refundable loans as liabilities, which we believe is preferable.• Determination of what constitutes cash equivalents for purposes of the cash flows statements - The University has defined cash equivalents as limited to demand deposits. An entity may include in its definition other financial instruments that have original maturities of less than 90 days. <p>We do not consider these accounting elections to be controversial or relating to emerging areas. The University's, retirement plans' and Medical Centers' critical accounting policies are fully disclosed in the notes to their respective financial statements.</p>
Material uncertainties related to events and conditions (specifically going concern)	✓		<p>There were no conditions and events that we identified that indicate that there is substantial doubt about the University's ability to continue as a going concern.</p>



Other required communications

Matter to report	No	Yes	Comments
Other information in documents containing audited financial statements			We are required to communicate to you our responsibility with respect to other information, the procedures performed related to the other information, and the results.
			<p>These standards require that we read other information, whether financial or nonfinancial, included in the annual report and consider whether a material inconsistency exists between the other information and the financial statements and to remain alert for indications that</p> <ul style="list-style-type: none">• A material inconsistency exists between the other information and the auditor's knowledge obtained in the audit, and/or• A material misstatement of fact exists or the other information is otherwise misleading. <p>We assume no obligation to perform procedures to corroborate such other information as part of our audit.</p>
			As it relates to other information included in the annual report, refer to the management representation letter attached for management's written acknowledgment of the document(s) which comprise the annual report and the planned manner and timing of issuance of those document(s). We have completed our procedures over the other information and have not identified uncorrected material inconsistencies, material misstatements or statements that are otherwise misleading.



Other required communications

Matter to report	No	Yes	Comments
Disagreements with management	✓		There were no disagreements with management.
Consultation with other accountants		✓	<p>We are aware of the following consultations certain Medical Center management has had with other accountants about significant accounting or auditing matters:</p> <ul style="list-style-type: none">• UC Irvine and UCLA Medical Centers' management engaged other public accounting firms to assist with the technical accounting related to each Medical Center's acquisition. We take no exception to the conclusions reached in these consultations.
Difficulties encountered during the audit	✓		There were no significant difficulties encountered during the audit.
Difficult or contentious matters	✓		There were no difficult or contentious matters for which we consulted outside the engagement team and we reasonably determined are significant and relevant to those charged with governance regarding the responsibility to oversee the financial reporting process.
Other material written communications		✓	<p>The following material written communications with management have been or will be made available to the Committee:</p> <ul style="list-style-type: none">• Engagement letter (previously provided)• Management representation letters for the aforementioned audits
Other matters	✓		There were no other matters arising from the audit that are significant and relevant to the oversight of the University's, retirement plans', and Medical Centers' financial reporting processes.
PwC Audit Quality Report		✓	Our Audit Quality Report shares how our culture, values, people and processes come together to help us achieve our audit quality objectives. Our Audit Quality Report is included in the Appendices.



Appendices





Appendices

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Sharing PwC Insights

It is customary that we will provide firm-developed thought leadership and relevant insights that encompass not only matters closely related to the audit but also overall business trends and insights. As part of our internal process, we determine if the insight being provided is a service and, if it is, then determine if that service would likely be considered part of the audit service or a separate, non-audit service. Generally, insights that involve analyzing client information and providing advice and recommendations specific to the client are likely to be considered a service. Insights that are considered non-audit services are subject to the Committee on Compliance and Audit's pre-approval process and our Firm's relevant controls.



Perspectives in higher education

The state of higher education: **Challenges and opportunities in 2024**. Click on the image to read the report



- Colleges and universities continue to deal with financial, compliance and political challenges. In just the past few months, congressional hearings, proposed federal legislation, and investigative inquiries have placed heightened attention on the sector. For instance, the government has continued to focus on such items as diversity in higher education and oversight of discrimination on campus, as well as ongoing discussions on student loan debt relief. On top of legislative acts, demands placed on universities by donors, students and other constituents have added to the pressure on trustees and administrators. The spotlight placed on the industry, compounded by world events, has affected both short- and longer-term institutional strategic and financial plans.
- Responding to the numerous challenges has been difficult. Related to world events, universities have been forced to navigate free speech versus the safety of their students, while informing interested parties of the university's viewpoints on the issues at hand. Crisis communications protocols have been tested, including the timeliness of responses to protests on campus and determining who accurately speaks on behalf of the university. All actions taken have been scrutinized by the press and the public.
- On top of this scrutiny, institutions are faced with a myriad of other items affecting the higher education sector. These items range from the effect that artificial intelligence is having on the learning environment, to the expectations that employees have when coming to work, to the wide variety of challenges within college athletics. In the 2024 edition of Perspectives in Higher Education, we not only highlight these items but also explore such topics as the current public perception of the industry, viewpoints on campus real estate, and the risks and opportunities around sustainability. Finally, we provide our annual update on the happenings in Washington and provide thoughts on how trends within the industry are affecting all institutions.





In our annual Audit Quality Report, read about...

Our reputation for quality is vital to our ability to achieve our purpose, to build trust and solve important problems. **Quality is – and always will be – our number one priority.**



Download our 2024 Audit Quality Report [here](#).

Our **2024 Audit Quality Report** shares how our culture, values, people, and processes come together to help us achieve our quality objectives - further supporting your understanding of our system of quality management. It brings transparency into the health of our audit practice, including many of the factors we consider in evaluating how we are measuring up to our quality expectations and insight into over 20 related transparency data points.

- Our leaders prioritize the delivery of quality service. Quality, ethical behavior, and accountability are regularly reinforced in communications. Our accountability framework specifies expected actions and behaviors, and includes consequences when exceptions occur.
97% of our audit professionals reported receiving consistent messages about the importance of audit quality from leadership*
 - Our independence compliance programs consider independence in both fact and appearance and include systems and processes that support our people in maintaining independence.
Our 300+ independence specialists engaged in 38,000 consultations.*
 - If an independence exception occurs, we determine whether the firm remains objective and impartial and timely communicate the matter to our client.
 - We accept or continue audit relationships only when supported by our assessment of business, litigation, and reputational risks and audit procedures can be satisfactorily designed and executed.
-
- Attracting, retaining, and developing top talent is fundamental to our ability to deliver quality. We're committed to taking action that benefits our profession and builds the future talent pipeline and to maintain a meaningful people experience that supports development for our people and the skills to serve their professional goals.
We hired over 1,800 entry-level and over 50 experienced audit professionals, respectively. Total headcount increased to over 16,000 audit team members.*
 - We continue to embrace more in-person time together to further support the development and needs of our people and enhance team collaboration.
 - Our rewards strategy recognizes the growth and impact of the individual, including their contributions to delivering quality and value. We remain committed to proactively increasing base pay for our audit professionals when needed to align with our ongoing evaluation of market conditions.
Average annual voluntary turnover decreased to 12.7%. Average annual overtime for our associates through directors also decreased.



Glossary

Significant accounting policies and practices

Accounting principles followed by the entity and the methods of applying those principles that materially affect the determination of financial position, cash flows, or results of operations.

Critical accounting policies and practices

A company's accounting policies and practices that are both most important to the portrayal of the company's financial condition and results, and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.

Particularly sensitive accounting estimates

Key assumptions and other sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities. Also may be referred to as key sources of estimation uncertainty.

Significant unusual transactions

Significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual due to their timing, size, or nature

Identified misstatements

Identified misstatements include those that are uncorrected misstatements related to accounts and disclosures that the auditor presented to management and corrected misstatements, other than those that are clearly trivial, related to accounts and disclosures that might not have been detected except through the auditing procedures performed.



Glossary

Material weakness

A deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Significant deficiency

A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

Control deficiency

Exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

- A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met.
- A deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively



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Report to the **Committee on
Compliance and Audit of the Board
of Regents**

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