



University of California

Annual Report on Internal Audit Activities 2005 - 2006

ANNUAL REPORT ON INTERNAL AUDIT ACTIVITIES

2005 - 2006

I. Executive Summary - Introduction	3
II. Audit Program Analysis	9
III. Audit Services Results & Management Corrective Actions	14
IV. Investigation Activities	23
V. Staffing and Other Benchmark Analyses	27
VI. Strategic Plan	31
Appendix 1 Past Due Management Corrective Actions	33
Appendix 2 Internal Audit Organizational Chart	38

ANNUAL REPORT ON INTERNAL AUDIT ACTIVITIES

2005 - 2006

Executive Summary - Introduction

This Annual Report on Internal Audit Activities presents various summary level and analytical information regarding the University of California Internal Audit Program for Fiscal Year 2005-2006 (FY06). The objective of this report is to communicate the results of our Audit, Advisory Service, and Investigation efforts and, through interpretation of these results, comment on the University's internal control environment. The twelve campus/national laboratory and UCOP Internal Audit Directors prepared annual reports for their local audit committees and leadership which underlie this systemwide annual report.

During FY06, we continued the emphasis on follow-up activities to ensure timely corrective action on audit findings. We closed nearly 1,900 management corrective actions (MCAs) and reduced by 25% the number of open items as compared to the prior June 30th. Over the past two years, we have closed over 5,000 management corrective actions.

With the creation of our Audit Tracker database, last year we were able to report on delinquent MCAs for those items that we considered to be of the highest risk. Throughout the year, effort was made to address these open conditions, and we reported the status of those 67 items periodically to The Regents' Committee on Audit as well as to the local audit committees. As of October 2006, there are 36 remaining delinquent MCAs with high risk exposure, including 12 outstanding from the previous year. There are a variety of business reasons for the delays, principally long-term IT solutions and resource constraints. All of these past due corrective actions have been brought to senior management attention and are subject to active plans for completion.

A complete listing of the high risk past due items is provided in Appendix I to this report.

ANNUAL REPORT ON INTERNAL AUDIT ACTIVITIES

2005 - 2006

Highlights

During FY06, the UC Internal Audit Program:

- Rendered nearly 700 audit, advisory services, and investigation products resulting in over 1,600 recommendations for improvements to internal controls that were agreed upon with management.
- Reduced the number of open MCAs as follows:
 - ✦ Beginning MCA Number – **1,147**
 - ✦ MCAs added – **1,609**
 - ✦ MCAs closed – **1,897**
 - ✦ Current open inventory of MCAs – **859**
- Met acceptable targets for productivity (87%), completion of the audit plan (69%), coverage of matters assessed as high risk (71%) but fell short of the target for core audit coverage (15% versus target of 20-33% for three to five year cyclical coverage of core topics)
- Executive Compensation and Senior Management Group (SMG) Travel & Entertainment – Spent approximately 12,000 hours on compensation and Travel & Entertainment reviews for the senior management group (SMG). The final report was presented to The Regents in May 2006 and added to the body of knowledge driving reforms on a number of fronts.

ANNUAL REPORT ON INTERNAL AUDIT ACTIVITIES

2005 - 2006

Highlights (cont'd)

- Experienced a 23% decline in investigation hours and a 46% decline in the number of completed investigations. Despite this fact, the number of open investigations being tracked at year-end remained relatively constant (88 cases versus 87 last year). The volume of hotline calls on new matters increased 62% from 112 to 182.
- Ethics - Worked closely with the Office of General Counsel (OGC) in performing audits of selected policies related to ethics on an attorney/client privileged basis. Our reports were issued to OGC in June 2006.
- Ethics Program—Continued to assist in the development of the Ethics Briefing Program, which is on track for November 2006 roll-out.
- The University Auditor's Office formed an Auditor's Investigation Workgroup that is comprised of a representative from each campus and national laboratory internal audit office. This group was established as a vehicle to provide training and promote an exchange on investigation issues within Internal Audit.
- Conducted a number of campus internal audit Quality Assurance reviews, and sponsored a New Auditor Orientation session for newly hired campus and laboratory auditors.

ANNUAL REPORT ON INTERNAL AUDIT ACTIVITIES

2005 - 2006

Summary and Conclusions

We believe the University of California Internal Audit Program continues to be a significant element of the University's overall control structure and a positive influence on the control environment. A robust program of work was carried out during the year to assist management and The Board of Regents, a substantial portion of which was responsive to current events.

In conjunction with the nearly 700 completed Audit, Advisory Services and Investigation projects, we identified no conditions that we believed to represent material deficiencies in internal controls to the University system as a whole from a financial standpoint. Further, while we acknowledge that management has ultimate responsibility for establishing internal controls to manage risks, we identified no circumstances in which we believe that management's decisions resulted in the acceptance of unreasonable levels of risk.

Based on our FY06 work, we can assert the following as being generally true with no reportable exceptions:

1. Management of the University is cognizant of their responsibility for internal controls and takes seriously the need for controls and accountability.
2. There is respect for the objectives of the Internal Audit Program; a high level of cooperation is received, and there is no interference with either the accomplishment of our tasks or our responsibilities to report to The Regents.
3. Managers actively participate in the identification of risks and work collaboratively with Internal Auditors to address issues raised during Audits, Advisory Services engagements, and Investigations.
4. Management is comfortable seeking out Internal Audit for advice and consultation on matters with internal control implications.
5. Matters of importance are reported to The Regents.

While the internal controls of the University are judged to be reasonably effective in relation to the objectives and limitations of internal controls, the events of the year in the executive compensation area are a reminder of the variety of risks in a public institution, not all of which lend themselves to precise financial measurement or are material in strictly financial terms. The importance of an ethical and compliant culture as a foundation for the policies and procedures that constitute our internal control structure are appropriately the focus of significant current attention. The wide-spread dissemination of information about UC's Standards of Ethical Conduct and the establishment of a system-wide compliance function are important new initiatives that complement other initiatives of the past decade (e.g., audit program enhancement, controllers' program and Business Officers Institute).

ANNUAL REPORT ON INTERNAL AUDIT ACTIVITIES

2005 - 2006

Summary and Conclusions

Audits of Information Technology (IT)

In FY06, we reported a substantial increase in the number of IT audit findings, resulting in the initiation of 244 new IT MCAs. This compares with 119 MCAs for 2005 and 128 MCAs for 2004. The largest number of these IT MCAs are focused on IT security, including the security of University networks.

Some of the specific findings included:

- A lack of a process to delete users who should no longer have access to the system
- A lack of a procedure for responding to network intrusions
- Users sharing login IDs
- Failure to “patch” computers timely
- Not reviewing security/audit logs for suspicious activity
- Not using firewalls to protect computer systems
- Not enforcing minimum standards for computers using University networks

While the University has taken steps to improve security, including revising the security policy and the appointment of security offices at each campus, our audits indicate there remains work to be done. Some of the efforts started and needing continued attention include: allocation of sufficient resources to security; assignment of responsibility for security; identifying where sensitive information is stored; identifying the risks to that information, including IT risks; implementing controls to protect that information; and training employees about their responsibility to keep sensitive information secure.

ANNUAL REPORT ON INTERNAL AUDIT ACTIVITIES

2005 - 2006

Challenges

The traditional challenges of recent years are still present and are significant. Maintaining an adequately staffed Internal Audit Program continues to be chief among them. While turnover at 13% was below our historical average, we operated with an average of 13 fewer auditors (approximately 10%) than planned for the second consecutive year. Competitive compensation is the number one recruitment challenge because UC compensation for auditors has not kept pace with market conditions in the wake of the demands in the auditing profession caused by Sarbanes-Oxley and related influences. On the positive side, we have been able to retain our most senior people, the location Internal Audit Directors, and the staffing shortfall is across the system so the shortage is not acute at any individual location. However, coupled with the growth of the University, budget cuts of the early 2000's that further stressed the internal control environment, and rising expectations, the resource shortfall hampers our ability to provide the desired level of assurance.

In addition to the traditional challenge, the most significant contemporary challenge relates to the combining of the Internal Audit Program and the new Compliance Program being established under the newly created position of Vice President—Chief Compliance and Audit Officer. Sustaining a strong Internal Audit Program is of paramount interest to the existing auditors while also contributing to an enhanced compliance function. The Internal Audit Program is committed to strengthening the governance structure of the University while preserving the appropriate role and responsibilities of management for internal controls.

II. Audit Program Analysis

The tables and charts contained in the following section show the summary and distribution of Audit Program efforts for the year by type of service (Audits, Advisory Services and Investigations) and across functional areas of the University. They demonstrate the breadth of coverage and areas of greatest concentration.

We believe this distribution represents a reasonable deployment of resources and demonstrates our primary commitment to the program of regular audits, availability for advisory services and responsiveness to the needs of investigations without undue intrusion on the audit program. We also believe the distribution along functional lines is reasonably balanced in relation to relative risk.

As a result of the creation of Los Alamos National Security, LLC (LANS), effective June 1, 2006, the LANL audit department no longer reports to the University Auditors' Office. The following program analysis includes actual information for the LANL audit department through May 31, 2006.

II. Audit Program Analysis

Projects	FY06 <u>Plan</u>	FY06 <u>Actual</u>	Prior <u>Year</u>
<u>Audits</u>			
Audit Program Hours	128,959	125,740	111,687
Number of Completed Projects	384	335	324
Average hours per completed project ⁽¹⁾	284	349	336
<u>Advisory Services</u>			
Advisory Service Hours	37,015	29,391	33,609
Number of Distinct Projects	79	208	223
Average hours per completed project ⁽¹⁾	172	117	152
<u>Investigations</u>			
Investigation Hours	33,658	26,630	34,522
Number of Completed Investigations	N/A	146	271
Average hours per completed project ⁽¹⁾	N/A	145	128
<u>Summary</u>			
Total Audit, Ad Serv., and Inv. hours	199,632	181,761	179,818
Total Number of Completed Projects	N/A	689	818
Average hours per completed project ⁽¹⁾	N/A	236	217
Number of projects per auditor	N/A	5.4	6.4
Percent of Audit Plan Completed	100%	69%	70%

⁽¹⁾ Not calculated from the above due to projects in process at beginning and end of period.

⁽²⁾ Three to five year cycle

⁽³⁾ Prior year ending head count includes 20 FTE for LANL

N/A - Not applicable to Plan Data

Table 1

People	FY06 <u>Plan</u>	FY06 <u>Actual</u>	Prior <u>Year</u>
Authorized	150	151	151
Average Actual Filled	140	127	128
Percent Filled	93%	84%	85%
Ending Head count ⁽³⁾	143	117	132
Turnover	N/A	13%	15%
Training hours per auditor	64	74	78
<u>Available Hours</u>			
Gross Available Hours	293,156	267,203	271,523
Net Available Hours*	248,123	223,247	228,356
Percent of Net to Gross	84.6%	83.5%	84.1%
<i>* Reduced by vacation, illness, holiday, etc.</i>			
<u>Distribution of Net Available Hours</u>			
Administration and Training	32,164	28,797	34,014
Direct Hours	<u>215,959</u>	<u>194,450</u>	<u>194,342</u>
Net Available Hours	248,123	223,247	228,356
Productivity Percent	87.0%	87.1%	85.1%
<u>Distribution of Direct Hours</u>			
Audits	128,959	125,740	111,687
Advisory Services	37,015	29,391	33,609
Investigations	33,658	26,630	34,522
Audit Support	<u>16,327</u>	<u>12,689</u>	<u>14,524</u>
Total Direct Hours	215,959	194,450	194,342

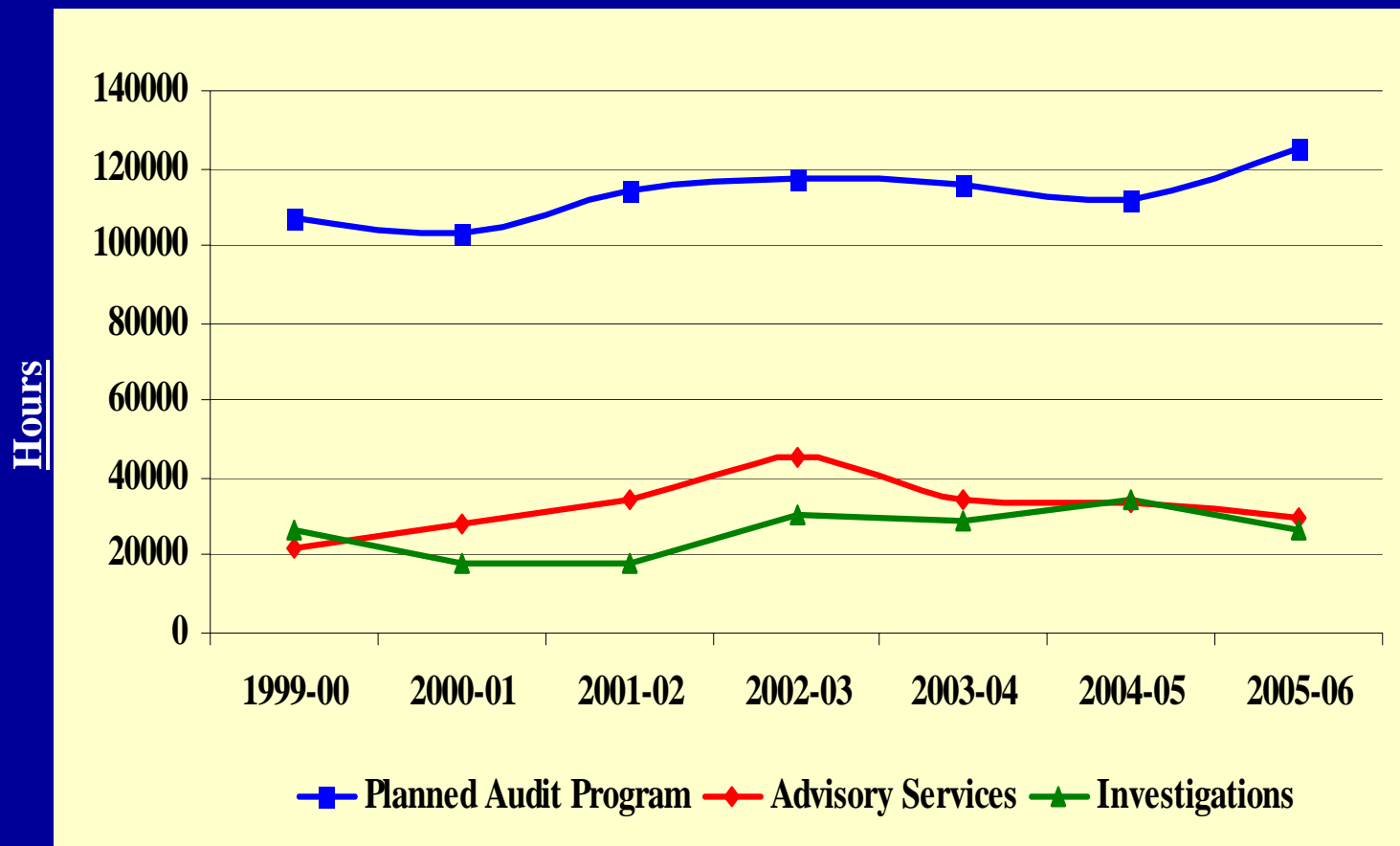
Table 2

Other	Plan	Actual	Prior <u>Year</u>
Coverage of Core Audit Hours ⁽²⁾	20-33%	15%	16%
Coverage of High Risk	80%	71%	75%

Table 3

II. Audit Program Analysis

The chart below distributes effort by service type (7-Year Trend).



This chart demonstrates that our continued primary emphasis is the program of regular audits. It also depicts a positive downward trend in investigations and the inability to raise the investment in advisory services because of other demands, principally special audit work in FY06.

Chart 1

II. Audit Program Analysis

The chart below distributes Audit, Advisory Service, and Investigation hours by functional area and service type.

<u>Functional Area</u>	<u>Audits</u>	<u>Advisory Services</u>	<u>Invest.</u>	<u>Total</u>	<u>%</u>	<u>Prior Year</u>	<u>%</u>
Financial Management	34,252	4,181	7,466	45,899	25%	53,032	29%
Campus Research Depts & Instruction	10,895	2,635	8,003	21,533	12%	20,865	12%
Lab Research Programs & Processes	7,612	4,653	3,581	15,846	9%	10,883	6%
Human Resources and Benefits	11,517	1,127	1,230	13,874	8%	4,463	2%
Health Sciences, Research, Instr., & Clin Sv	10,403	789	1,847	13,039	7%	22,661	13%
Information Technology & Communications	8,265	3,033	196	11,494	6%	11,390	6%
Research and Compliance	7,795	1,450	963	10,208	6%	16,808	9%
Auxiliary, Bus & Employee Support	8,108	237	1,487	9,832	5%	8,569	5%
Ethics	6,011	-	-	6,011	4%	1,031	1%
Facilities, Construction and Maintenance	3,855	36	622	4,513	2%	6,294	4%
Risk Management	3,443	364	133	3,940	2%	5,190	3%
Development and External Relations	3,206	369	352	3,927	2%	2,654	1%
Office of the President	1,351	206	750	2,307	1%	3,656	2%
Budget and Planning	295	569	-	864	1%	771	1%
Sub-Total	117,008	19,649	26,630	163,287	90%	168,267	94%
No Functional Category (mainly follow up)	<u>8,732</u>	<u>9,742</u>	<u>-</u>	<u>18,474</u>	<u>10%</u>	<u>11,551</u>	<u>6%</u>
Total	<u>125,740</u>	<u>29,391</u>	<u>26,630</u>	<u>181,761</u>	<u>100%</u>	<u>179,818</u>	<u>100%</u>
Percent	69.2%	16.1%	14.7%	100%			
Planned Percent	60.2%	19.5%	20.3%	100%			
Prior Year Percent	62.1%	18.7%	19.2%	100%			

II. Audit Program Analysis

Common High Risk and Core Business Areas addressed:

- Network Security
- Executive Compensation
- Physician Receivables
- Lab Cost Allowability
- Logical Security
- Effort Reporting
- Hospital Clinics
- Medical Billings and Receivables
- Cashiering Controls
- Travel and Entertainment
- HIPAA Security
- Compliance Program
- Ethics Policies
- Contracts and Grants
- Hospital Receivables
- Physical Security
- Accounts Payable
- Effort Reporting
- Procurement Cards
- Fund Raising/Gift Processing

This listing shows some of the contemporary risks considered to be high risk in FY06, e.g., IT network and physical security, compliance programs and IRB's/human subjects research, as well as the core business activities most frequently included in our local audit programs during FY06, such as cashiering, hospital receivables and procurement. The audit plans attempt to blend coverage of both contemporary risks and core business activities.

Chart 3

III. Audit Services Results & Management Corrective Actions

In 2004, we began using a tool called **Audit Tracker** to enhance our follow-up procedures. The Audit Tracker system aggregates, at each location and on a systemwide basis, all of the audit recommendations and agreed upon Management Corrective Action plans designed to improve controls. This database affords us the ability to track and to communicate timely the status of open recommendations and MCAs. Audit Tracker is also intended to provide an improved capability to search for common themes and, over time, trends in the auditors' observations about the University control environment.

Audit Tracker has been extremely effective in helping us to more aggressively manage the MCAs, thus promoting more timely risk mitigation as demonstrated below:

	FY05	FY06
Beginning MCA Number	2,665	1,147
MCAs added	1,928	1,609
MCAs closed	3,446	1,897
Open inventory of MCAs	<u>1,147</u>	<u>859</u>

In two years, we have reduced the number of open items by more than 1800, reducing open items to the equivalent of six months' average audit recommendation volume from approximately a year and a half. The following pages provide analyses of both the MCAs resulting from FY06 Audit, Advisory Service and Investigation work (1,609 items) as well as thematic analysis of the 7,987 MCAs tracked since the inception of Audit Tracker.

After the broader analyses, data is provided regarding the items that remain open, with special attention to those past their due dates for completion and rated as the highest relative risks.

III. Audit Services Results & Management Corrective Actions

The charts and table below display the functional area distribution of the 1,609 MCAs produced in FY06 and a comparison to the effort expended in these areas.

Distribution of FY06 MCAs

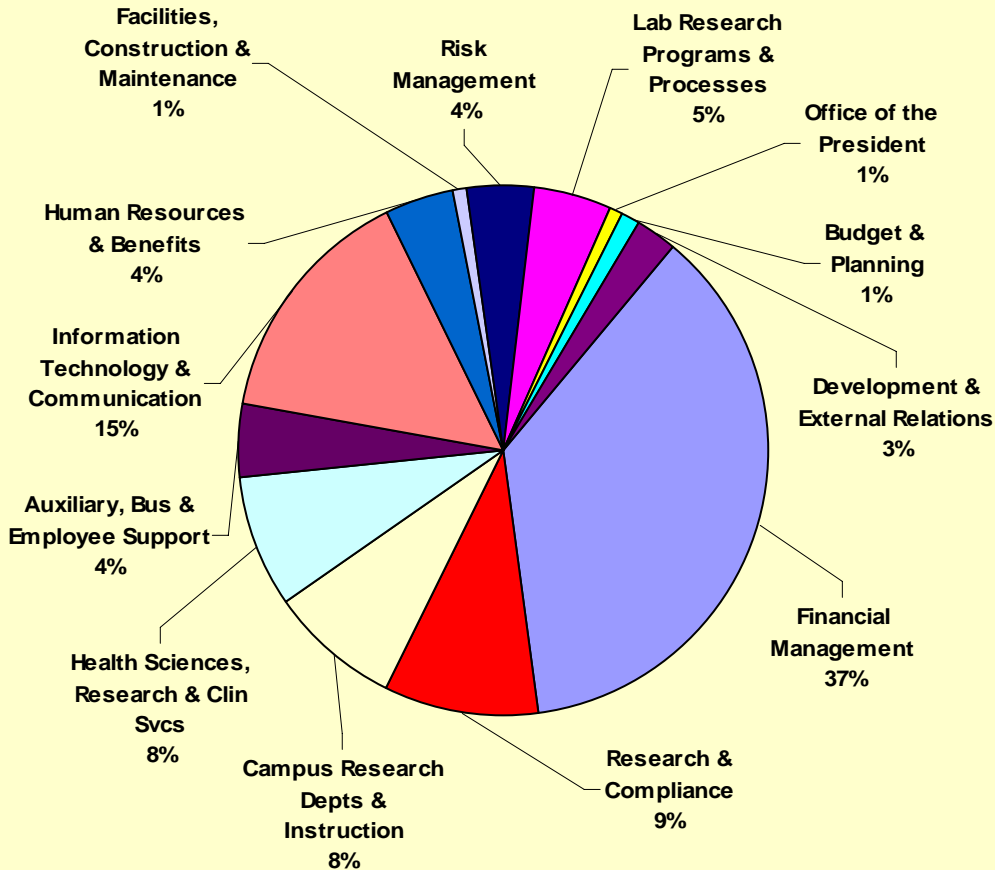


Chart 4

Comparison of MCAs and Hours

Functional Area	MCA %	Hours %
Financial Management	37%	28%
Information Technology	15%	7%
Research & Compliance	9%	6%
Campus Research Depts & Instr	8%	13%
Health Sciences	8%	8%
Laboratories	5%	10%
Auxiliary, Bus & Employee Support	4%	6%
Risk Management	4%	2%
Human Resources & Benefits	4%	9%
Development & External Relations	3%	2%
Budget & Planning	1%	1%
Facilities, Construction & Maintenance	1%	3%
Office of the President	1%	1%
Ethics*	-	4%

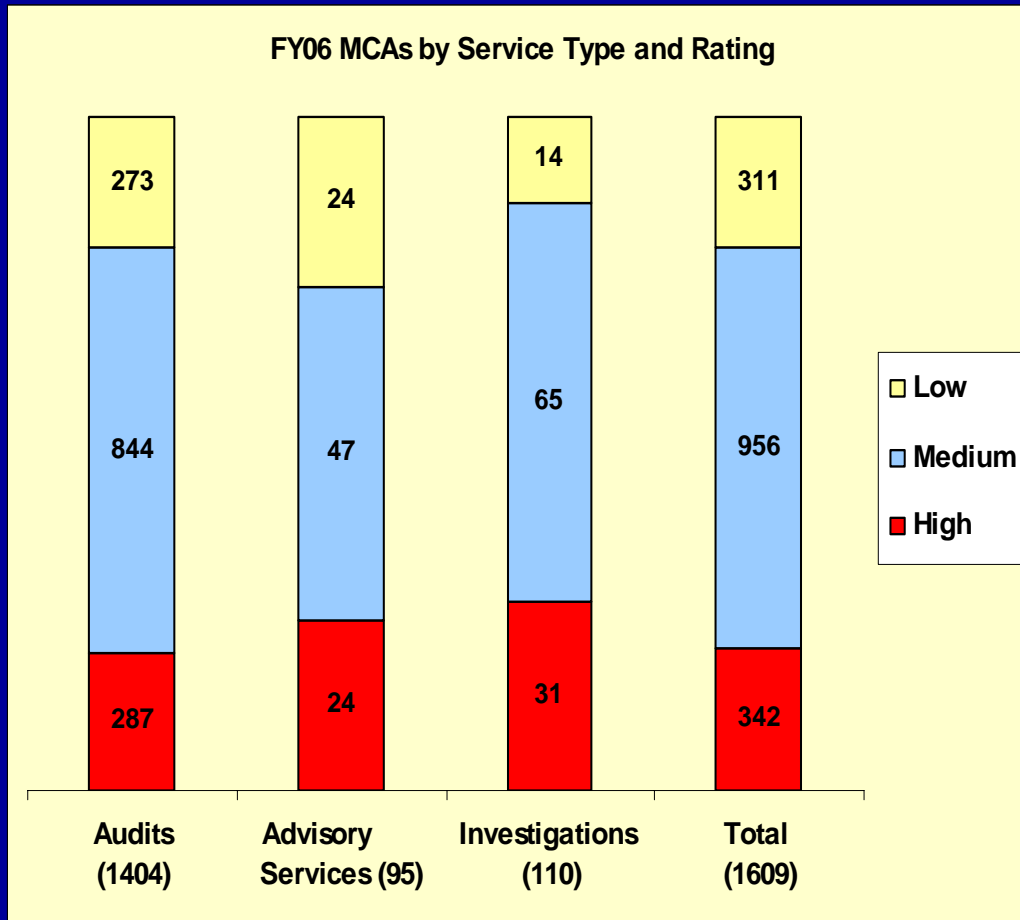
Table 4

The above comparison depicts generally high correlation between effort and corrective actions with some core business areas (Financial Management and Information Technology) and high risk areas (Research and Compliance) proving to provide more opportunity for strengthening controls.

*MCAs for Ethics not added as of 6/30/06.

III. Audit Services Results & Management Corrective Actions

The chart below shows the risk rating of the 1,609 MCAs for FY06 by service type.



Each audit finding and its associated MCA is given a rating of high, medium or low risk by the auditors. This judgment is made in a local context, and items identified as high do not necessarily convey material deficiencies or risks beyond the operating environment in which found. A primary objective of this classification is to drive a greater sense of urgency in completing the corrective action and completion of audit follow-up.

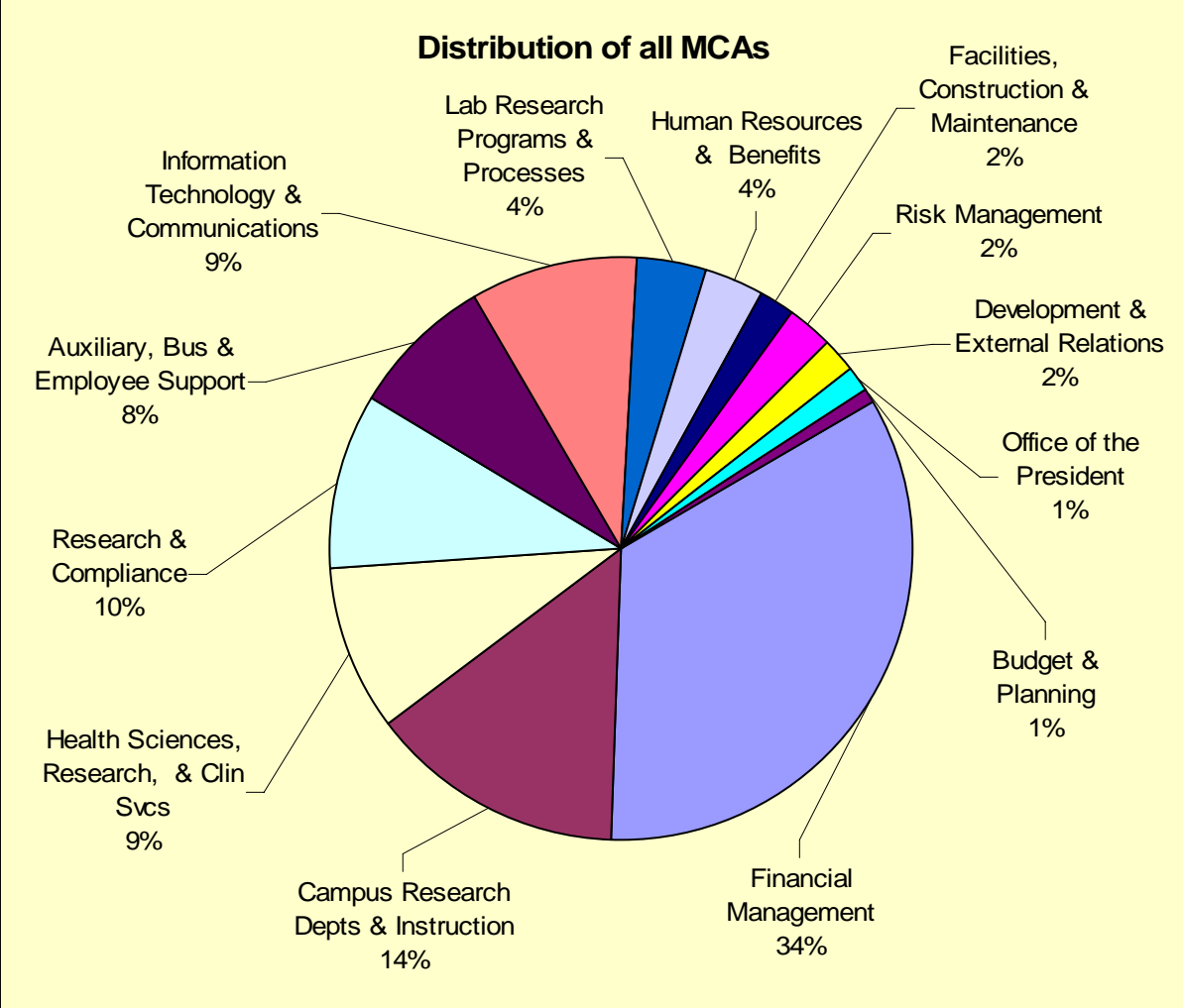
High risk MCAs would include those that are systemic or have a broad impact, have contributed to a significant investigation finding, are reportable conditions under our professional literature, create health or safety concerns, involve senior officials, create exposure to fines, penalties or refunds or are otherwise judged as significant control issues.

The findings and recommendations resulting from the audits of SMG Compensation and Travel & Entertainment are all considered high risks for follow-up tracking purposes.

Chart 5

III. Audit Services Results & Management Corrective Actions

The chart below displays the functional area distribution of the entire population of MCAs since inception (7,987).



Whereas Chart 4 displayed the MCA distribution for MCAs generated in FY06, Chart 6 displays the functional audit area distribution for the entire population of MCAs. Table 5 below compares the distribution percentage for all MCAs to the FY06 percentage, which remained comparable.

Functional Area	ALL	FY06
Financial Management	34%	37%
Campus Depts & Instruction	14%	8%
Research & Compliance	10%	9%
Health Sciences	9%	8%
Information Technology	9%	15%
Auxiliary, Bus & Employee Support	8%	4%
Human Resources & Benefits	4%	4%
Laboratories	4%	5%
Risk Management	2%	4%
Development & External Relations	2%	3%
Facilities & Construction	2%	1%
Office of the President	1%	1%
Budget & Planning	1%	1%

Chart 6

Table 5

III. Audit Services Results & Management Corrective Actions

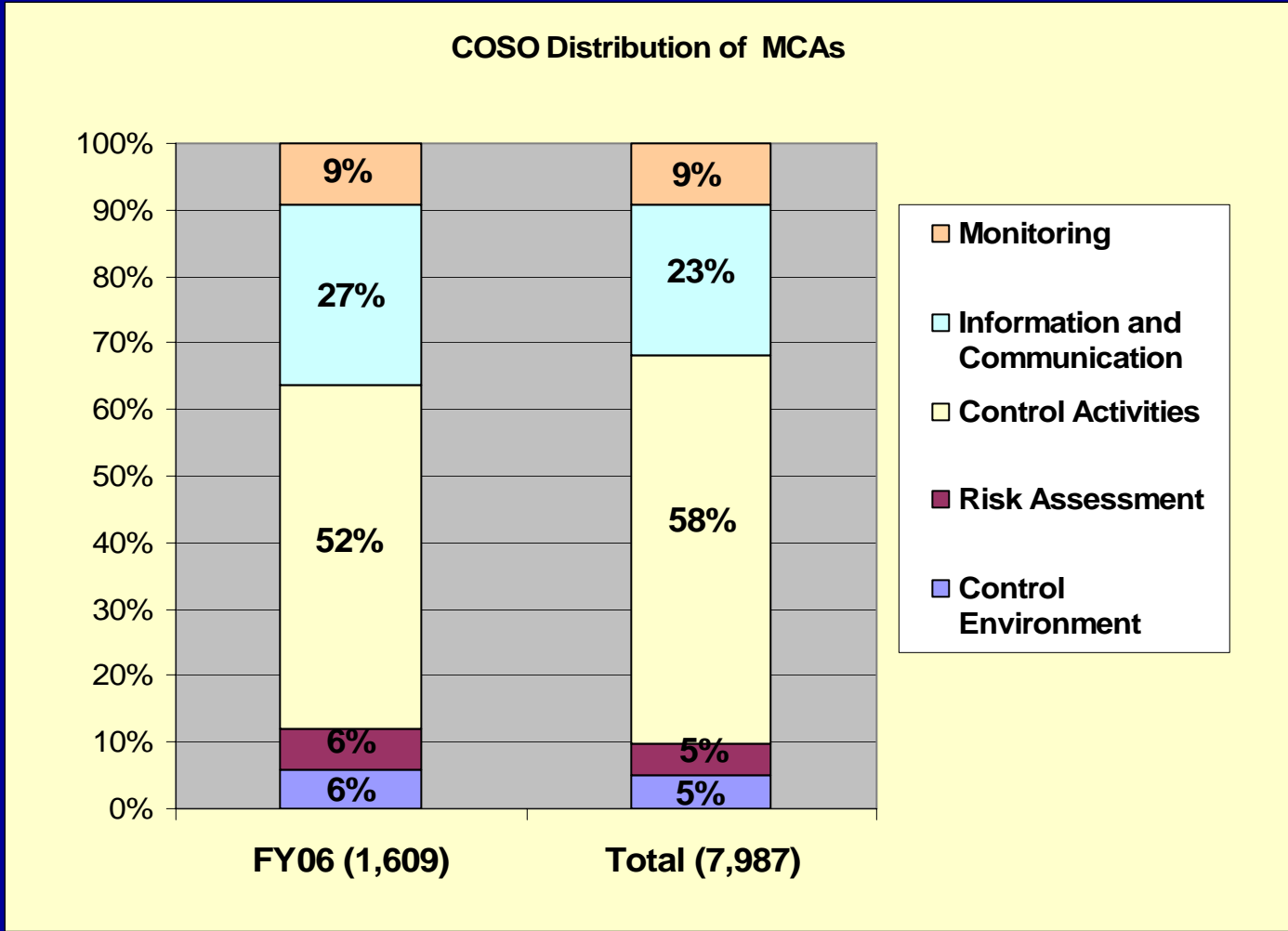
Audit Observations Defined by COSO

As part of the Audit Tracker system, each location categorizes audit observations and MCAs in accordance with the University's adopted internal control framework (COSO). The COSO model provides for the following general categories of controls – each with sub-category detail:

- Control Environment – Sets the tone of the organization. Factors include integrity, ethical values, management's operating style and organization. Findings in this area would include matters such as the absence of a code of ethics.
- Risk Assessment – This is the identification and analysis of relevant risks to achievement of the established objectives. Findings in this area would include, for example, the lack of a process to recognize or mitigate a particular type of risk in the operating environment of the unit.
- Control Activities – These are the policies, procedures, and processes that help ensure the University conducts its business and complies with laws, regulations and University policy. Examples include approval, authorizations, verifications, reconciliations, and segregation of duties among many others. Most findings are in this category because these are the controls most frequently tested by auditors.
- Information and Communication – Includes the identification and communication of operational, financial, compliance, and external information. Data security and integrity issues fall into this category.
- Monitoring – Includes regular management and supervisory activities, as well as financial, operational, and compliance assessments and evaluations. Findings of inadequate supervision or oversight may be a root cause for many other conditions observed.

III. Audit Services Results & Management Corrective Actions

The chart below displays the breakdown of the 5 COSO categories by MCA



Control activities continue to account for the highest frequency of MCAs because of the numerous types of activities encompassed. However, deficiencies in the control environment are typically significant findings. As mentioned elsewhere in this report, during 2006 there was increased attention to Information and Communications, especially as it relates to information security.

Chart 7

III. Audit Services Results & Management Corrective Actions

Status of Completion of Management Corrective Actions

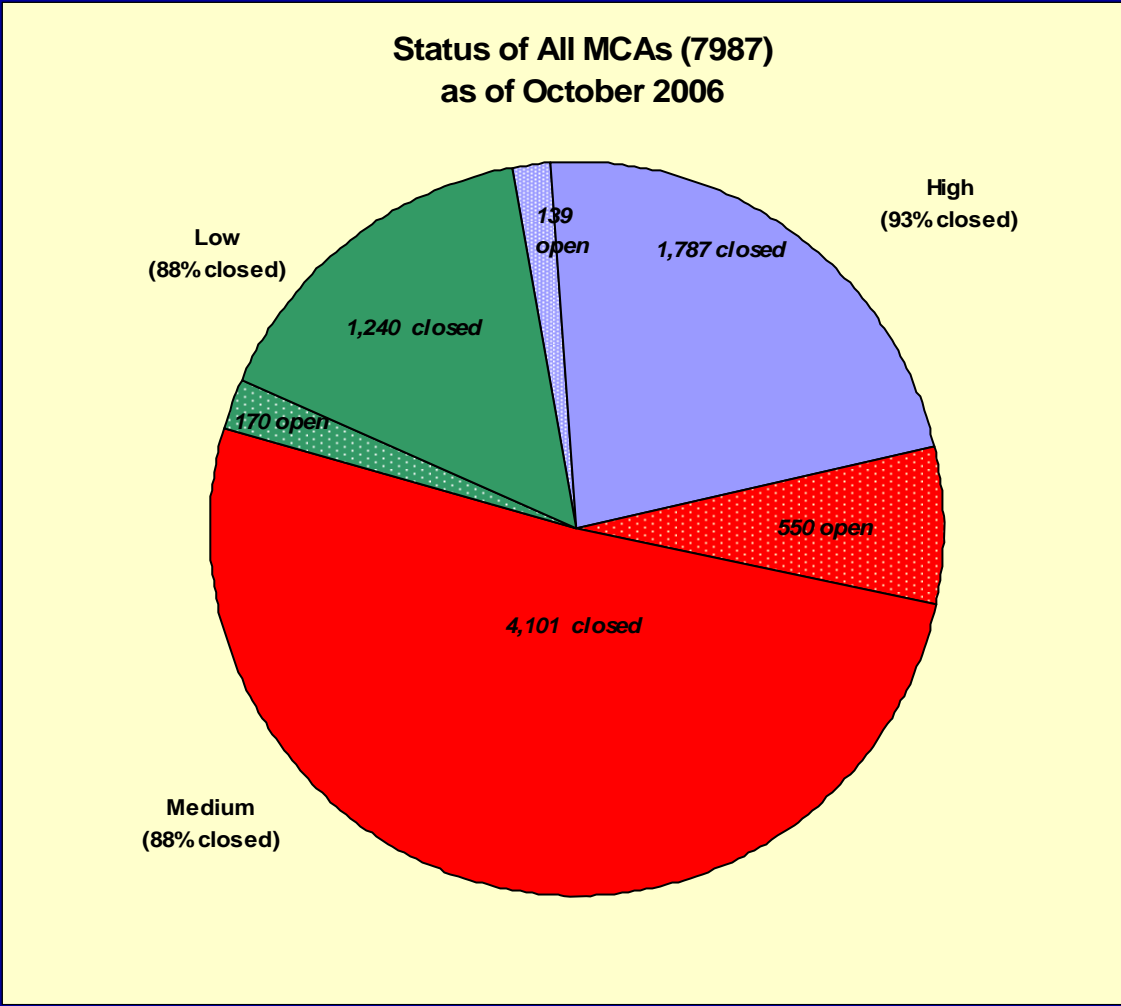
The most fundamental objective of the Audit Tracker system is to facilitate the tracking of MCAs to their timely completion. MCAs are classified initially as open and are only moved to closed status after validation by auditors that the agreed upon corrective actions have been taken and sustainable improvement has been achieved.

The following charts display the completion status for the entire population of MCAs. Part of our analysis includes an aging of the past due items. We believe that reporting the past due corrective actions to campus audit committees, senior management and The Regents' Committee on Audit will raise the visibility in a way that helps ensure timely attention to these matters and reduces the number of unmitigated risks.

Appendix 1 to this report lists the details of the 36 past due items.

III. Audit Services Results & Management Corrective Actions

The chart below shows the status of all 7,987 MCAs



The 93% rate of closure of the High rated MCAs reflects the fact that these are the items with the greatest urgency to bring to closure. Added attention to closing the items ranked as Medium risks is now occurring and can be expected to bring this volume down prospectively.

The volume of open items will always be substantial because of the ongoing nature of our work, although substantial reduction has occurred to date as intended. We expect to be able to establish benchmarks in this area as the Audit Tracker information matures.

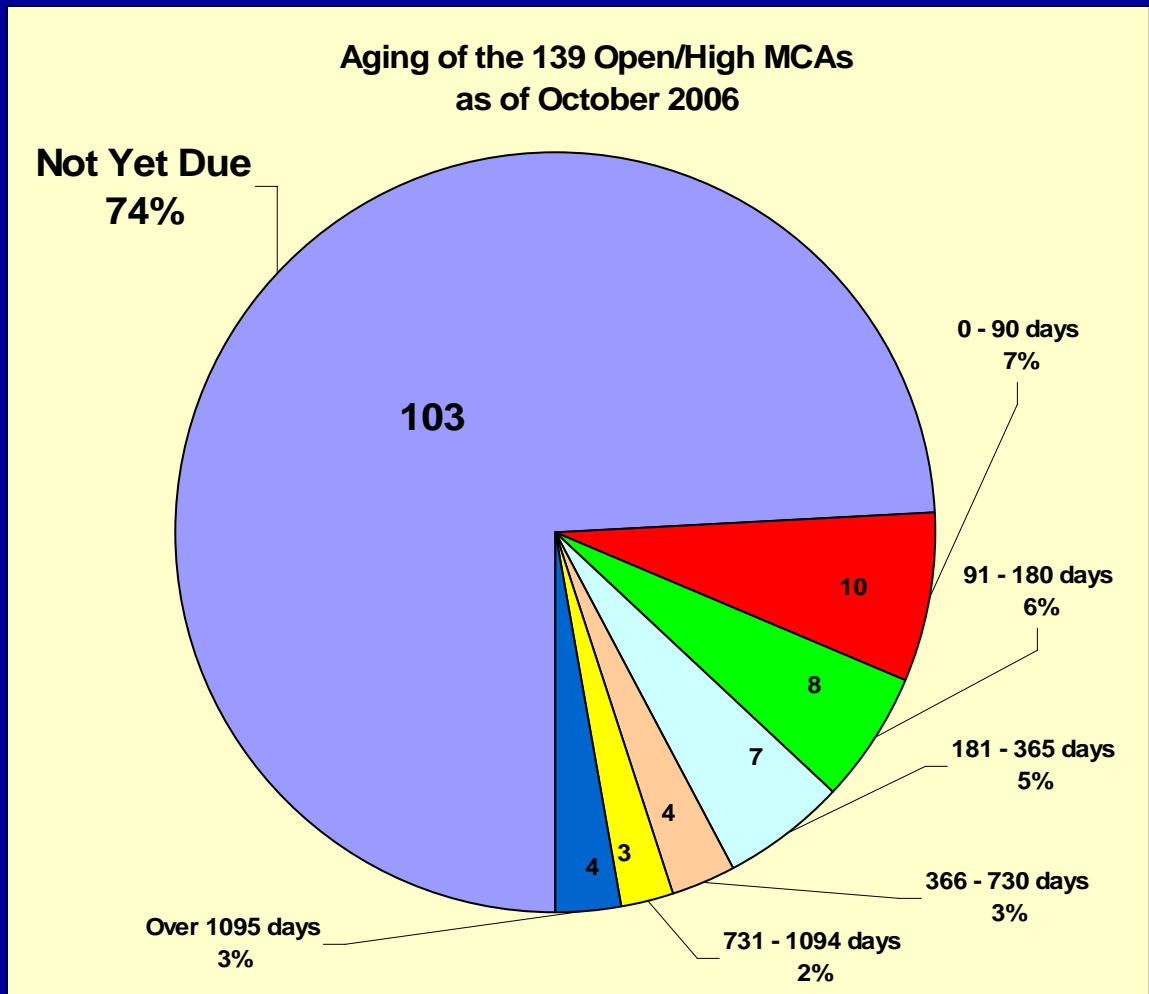
MCA Rating	Open	Closed	Total	% closed
High	139	1,787	1,926	93%
Medium	550	4,101	4,651	88%
Low	<u>170</u>	<u>1,240</u>	<u>1,410</u>	88%
	859	7,128	7,987	

Chart 8

Table 6

III. Audit Services Results & Management Corrective Actions

The chart below shows the aging statistics of the inventory of 139 Open High Risk MCAs



The majority of the open items (103) are not yet due, however, 36 are past due.

These past due issues have been brought to the attention of senior management and active resolution plans are in process. The goal of reducing these items to a negligible number occasioned by highly unusual circumstances is clearly understood and accepted by all responsible for addressing these items.

Refer to Appendix I for a listing and brief description of these past due MCAs.

Chart 9

IV. Investigation Activities

This section contains charts that display the sources and methods of reporting improper governmental activities allegations which led to audit investigations during FY06, categorizing the type of improper governmental activity alleged, and the outcomes for the investigations completed in FY06.

The University Auditor's Office tracks all investigations that are conducted by the campus, laboratory and the Office of the President Internal Audit Offices. The University of California's Whistleblower Policy governs the reporting and investigation of suspected improper governmental activities. Under this policy, the Chancellor or Laboratory Director appoints a person designated as the Locally Designated Official (LDO) to have the primary responsibility to receive reports of allegation of suspected improper governmental activity. The local Internal Audit Director also receives the reports and the University Auditor gets copied on all hotline reports.

The LDO, in conjunction with the Investigations Work Group (comprised of investigations resources including internal audit), assesses each report for appropriate handling, such as referral to management, assignment for investigation or expanded preliminary assessment before a judgment can be made. Investigations that fall within six criteria enumerated in the Whistleblower Policy are reported to the Office of the President and the University Auditor. The most significant matters are reported individually to The Regents as material events occur and on a quarterly basis.

IV. Investigation Activities

Internal Audit investigations are tracked in a web based application that was designed by the University Auditor's Office and Information Resources and Communication at the Office of the President. The database, which is known as the Investigations Notice (IN) Database, reports on activity for only the University's Internal Audit investigation program. Others, including UC Police, General Counsel, and Human Resources, may also be conducting investigations that are not tracked in this system. The database currently contains records of 569 investigations opened since its inception. It captures a variety of information to assist in case management and serve as an analytical tool. As of October 2006, the University Auditor's Office is tracking 88 open internal audit investigations.

IV. Investigation Activities

The charts below display the sources and complaint methods of the 148 new investigations opened in FY06.

Sources of UC Investigations - FY06

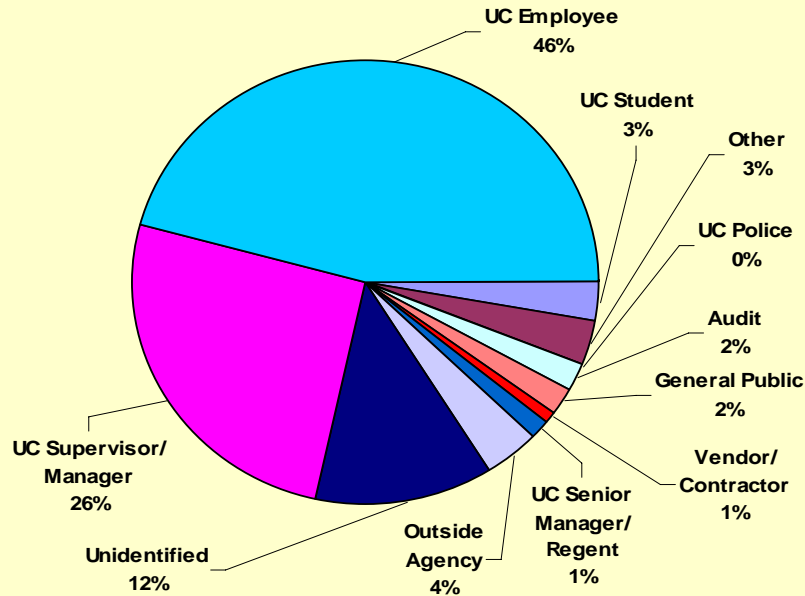


Chart 10

Complaint Methods FY06

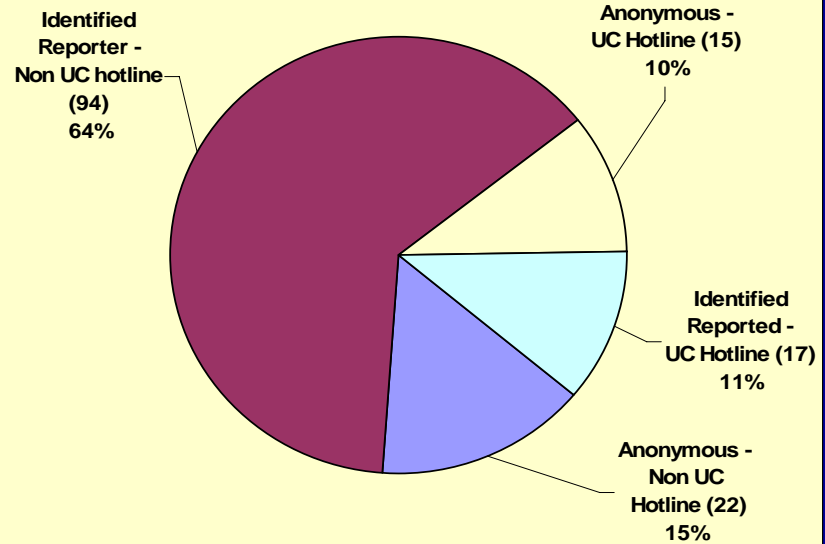


Chart 11

The investigations performed by Internal Audit came from a variety of sources as depicted in Chart 10. In FY06, the hotline service received 575 calls. This was comprised of 182 new reports, 126 follow-up calls and 267 calls of a miscellaneous nature that did not constitute a report of impropriety. Many of the 182 reports involved information that was referred to University management for appropriate review and disposition, referred into another process, (e.g., human resources grievance process) or contained insufficient information on which to proceed. Internal Audit initiated 32 investigations based upon a report received from the hotline service. The information for these reports came from 15 anonymous callers and 17 who identified themselves and provided contact information.

Reporting parties identified themselves in 75% of the complaints received, and just over half of those who used the hotline chose to identify themselves.

IV. Investigation Activities

The charts below display the types of allegations related to the 148 investigations opened in FY06, and the outcome of investigation allegations that closed in FY06.

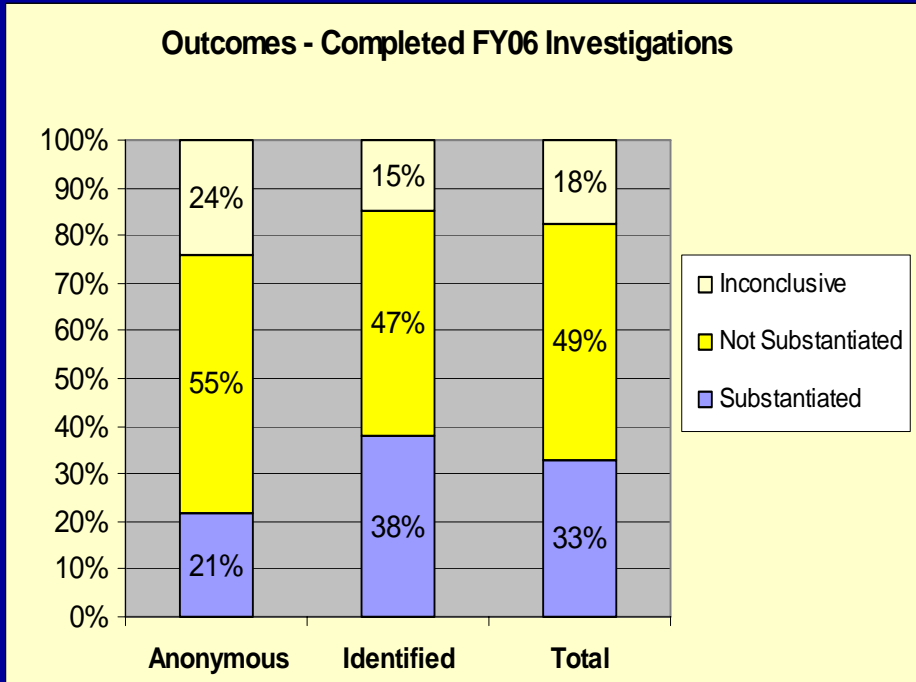


Chart 12

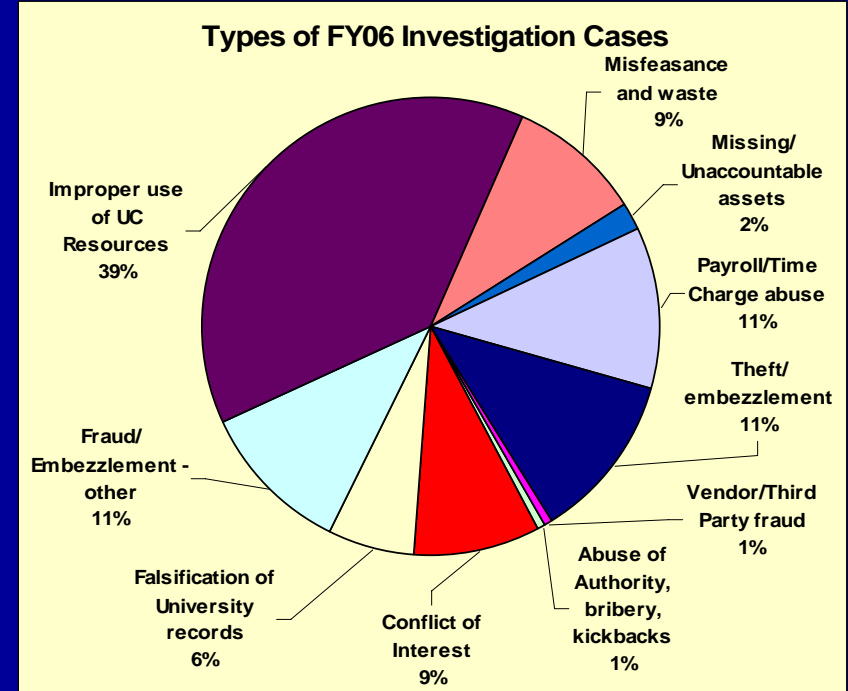


Chart 13

Each investigation in the IN Database reports on one primary allegation and up to 9 secondary allegations (allegation categories depicted in Chart 13). The closed investigations in FY06 identified 283 primary and secondary allegations which were determined to be either substantiated, not substantiated or inconclusive. Chart 12 demonstrates that information from anonymous sources cannot be substantiated or is inconclusive in 79% of the matters reported. Additionally, when the complaining party is identified, the complaint is almost twice as likely to be substantiated.

The five allegation categories of Improper Use of UC Resources, Fraud, Theft/Embezzlement, Payroll/Time Charge Abuse and Misfeasance/Waste account for 81% of the Internal Audit Investigations. This is similar to the distribution of matters investigated in FY05 which totaled 76% in these same categories for 188 investigations.

V. Staffing and Other Benchmark Analyses

This section contains an analysis of staffing levels by location compared to UC and industry benchmarks. The analysis is based on the authorized staffing levels rather than the number of positions actually filled at any moment in time. For FY06, the Internal Audit Program operated at approximately 84% of authorized capacity due to turnover, and positions left open because of budget constraints. The benchmark analysis is presented in the absence of any generally accepted staffing models for internal audit programs universally or in higher education. However, we believe the analysis demonstrates that UC in total and at its campuses and national laboratories maintain moderately adequately staffed audit functions. The GAIN (Global Auditing Information Network) survey used for comparison purposes was conducted in 2005 by the Institute of Internal Auditors and reflects the results for public higher education institutions.

In addition, this section contains a table of miscellaneous benchmark information for comparison of UC's audit program to industry standard practices.

V. Staffing and Other Benchmark Analyses

The charts below display staffing benchmarks for the campuses and Office of the President.

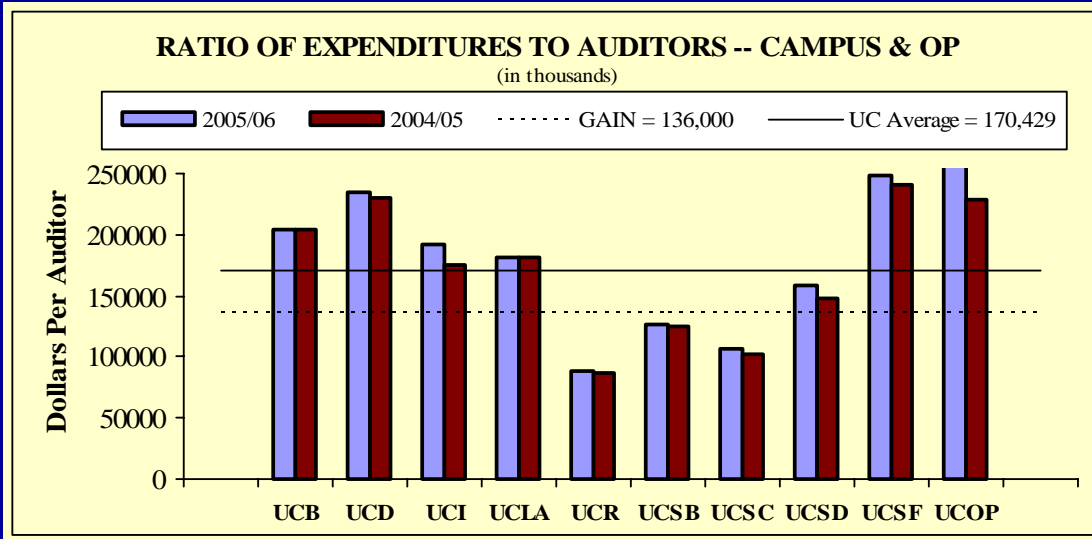


Chart 14

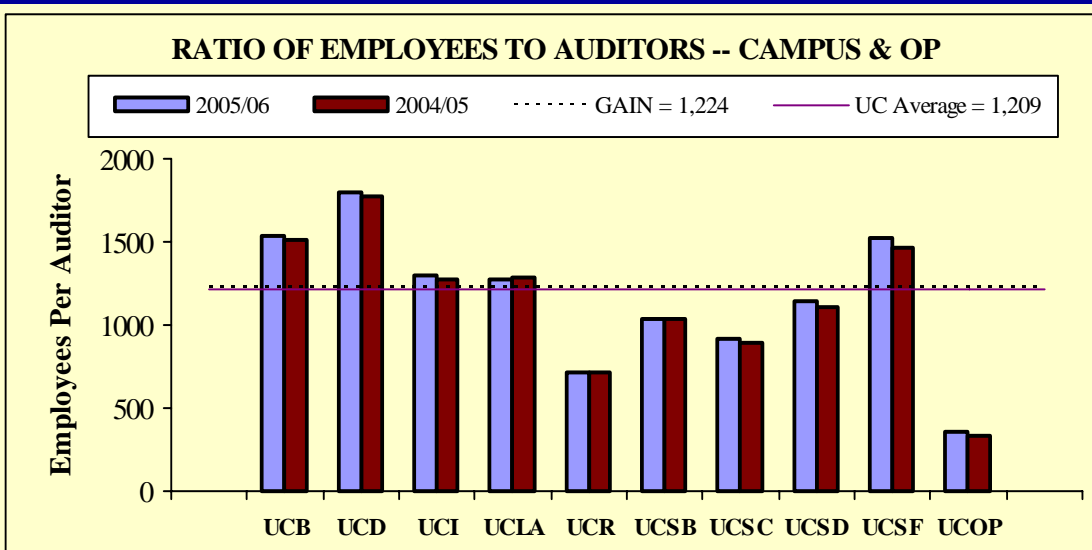


Chart 15

UC in general varies from the GAIN average for expenditures per auditor by a substantial margin, and this gap has widened in recent years. However, when you combine the employee ratio data you can see that UC employees in general are more highly leveraged than our average counterparts. As a result, at only three campuses, UCB, UCD and UCSF, is there some concern regarding staffing adequacy.

In general, the smaller institutions appear to be more well staffed. This is due to the fact that certain audit activities are not directly impacted by size.

Management has used this information in the past to consider augmentation of audit staffing, and we continue to share this information with management at each location for the purpose of assessing the adequacy of the audit program staffing.

V. Staffing and Other Benchmark Analyses

The charts below display staffing benchmarks for the national laboratories.

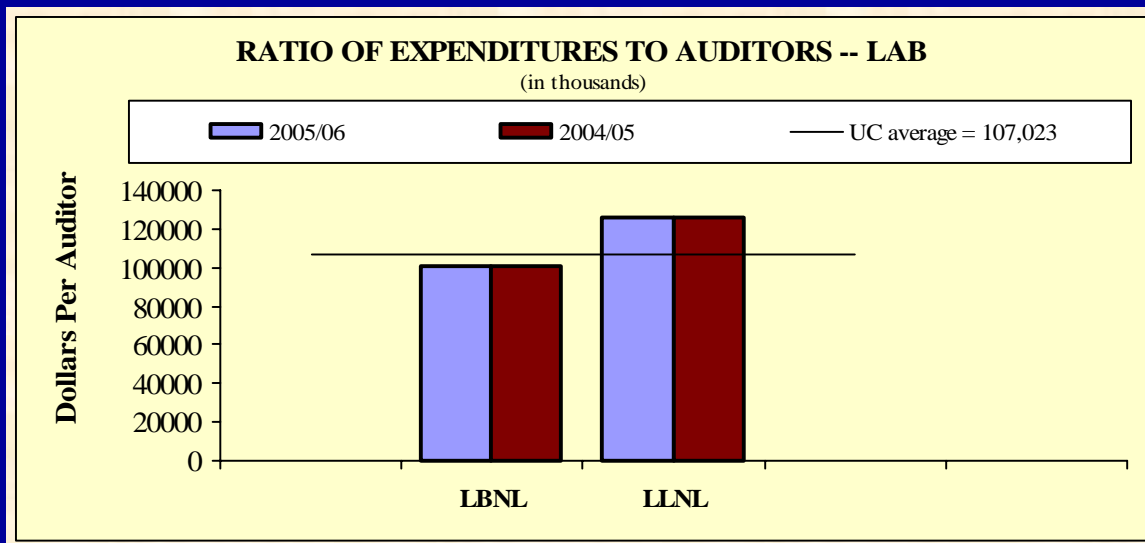


Chart 16

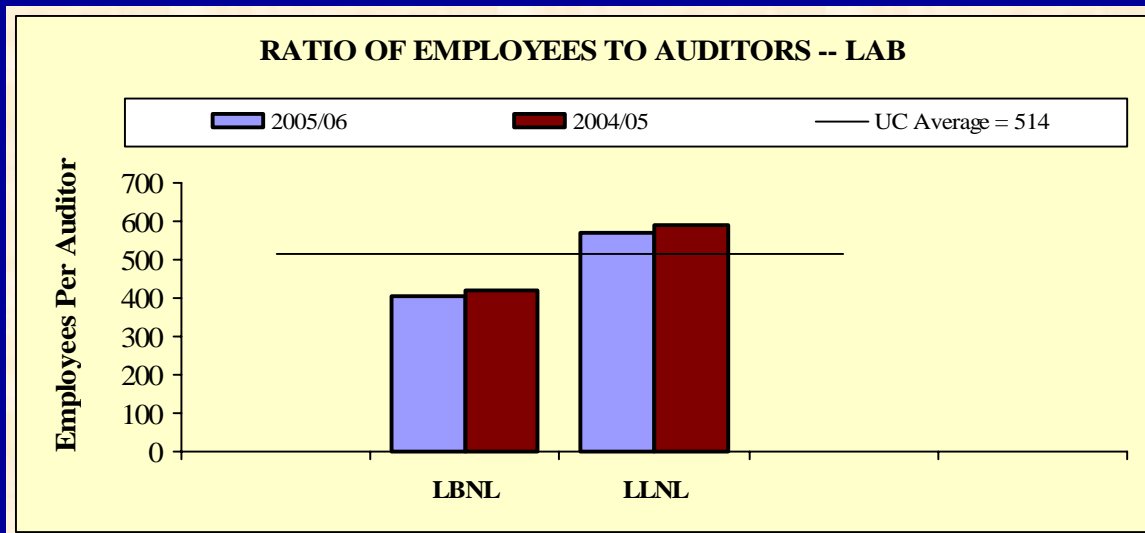


Chart 17

The ratios vary in acceptable degrees and again reflect the tendency for smaller organizations to appear to be better staffed.

There is no readily available benchmark information so the comparison is only between the two UC labs. However, if traditional universal benchmarks were applied, the national labs would appear to be generally well staffed.

V. Staffing and Other Benchmark Analyses

Other Benchmarks

	<u>UC</u>	<u>Survey</u>		<u>UC</u>	<u>Survey</u>
Professional Staff:			Audit Planning:		
Avg. Years Experience	17.7yrs	19.8yrs	Based on Risk Assessment	Yes	86%
Staff Turnover	13%	19%	Risk Assessment Model	Yes	62%
Training Hours Per Auditor	74hrs	56hrs	Defined Audit Universe	Yes	64%
			Includes Mgmt. Requests	Yes	86%
Distribution of Time:			Audit Expected to Provide Consultations		
Audits	69%	66%	On Operational Matters	Yes	85%
Advisory Services	16%	25%			
Investigations	15%	9%*	Report Drafts Shared with Mgmt.	Yes	99%
Matters Reported to Audit Committee:			Use Customer Satisfaction Survey	Yes	58%
Percent Completion of Plan	Yes	77%			
Productivity Measures	Yes	51%	Reporting Structure:		
Benchmark Comparisons	Yes	50%	Report Functionally to Board		
Organizational Structure	Yes	51%	or Audit Committee	Yes	76%
			Report Administratively to		
			Management	Yes	94%

* GAIN Survey includes many non-health sciences and limited research institutions.

VI. Strategic Plan

Strategic Plan Overview

GOALS

The University Auditor and Campus/Lab Internal Audit Directors have sustained a commitment to continuous improvement of the Internal Audit Program over the years. Towards that end, a strategic plan is established and revised every two years to provide strategic guidance to the Audit Program leadership in these efforts. To address contemporary and emerging risks and issues, and to promote a culture of accountability and integrity, the UC Internal Audit Program has identified the following enduring goals:

- **Operational excellence** – Provide timely, quality, cost-effective products and services with the effective use of resources.
- **Stakeholder/Client Relationships** - Be a proactive, responsive, credible, trusted, respected, business-oriented resource.
- **Innovative Service** - Render customized, creative, cutting-edge, functional, and flexible service improvements grounded in our core competencies.

INITIATIVES

In August 2005, the University Auditor and Campus/Lab Internal Audit Directors developed the following strategic initiatives geared towards strengthening the Internal Audit program:

- **Improve Internal Reporting**
- **Improve Communications**
- **Identify Partnership Opportunities for Corporate Governance**
- **Continuous Monitoring/Auditing**
- **Benchmarking and Staffing**

VI. Strategic Plan

Highlights of Current Initiatives:

- The development of a Comprehensive Audit Reporting and Tracking System (CARTS) is currently underway. The University Auditor's Office is working with our Information Resources and Communication department in an effort to automate a number of our project management and reporting processes. The CARTS project, when fully functional, will be a web-based system that will incorporate a comprehensive time keeping system, automate our risk assessment and planning processes, and generate monthly and quarterly status reports – as well as location ad hoc reports. The CARTS system will also interface with our Audit Tracker database, the Investigation Notices (IN) database used to track investigation statistics, and our employee database.
- Several enhancements to Audit Tracker are also planned within the CARTS project, including improved notification and update capabilities. The new system will send email notifications prior to the due date of corrective actions, and provide a mechanism for management to record progress and completion of the corrective actions, alerting Internal Audit as to management's readiness for our validations efforts.
- With the aid of a consultant, we are developing a web access tool that will continuously surf the internet and download information based on our search criteria. The criteria will focus on current and emerging issues and other issues of concern to the University. The results of the data collection will be made available to all auditors on a real-time basis.
- In an effort to share analytical tools, one location has partnered with their finance group to develop extensive continuous monitoring protocols in the areas of payroll and procurement cards. The tools apply a variety of criteria analysis against real time data in an effort to identify problems, trends, and aid management in decision making and will be shared with all locations.
- A proposal to the Institute of Internal Auditors Research Foundation has been drafted seeking professional assistance to develop an audit staffing model unique to higher education.

Appendix 1 – Past Due MCAs

Location	Report Number	Report Date	Project Name	Finding	Management's Corrective Action	Management's Promised Completion Date	Management's Revised Completion Date
UCSB	00-235	11/30/1998	Accounting Office - General Accounting	Procedures were not in place for reconciling all balance sheet accounts on an established schedule, or verifying that balance sheet accounts under the control of other departments were being reconciled.	The procedure for reconciliation has been created. The procedure is being rolled out to the department with only one departments remaining. General Accounting monitors this process by reviewing the reconciliations from the departments. It is expected that by December 2006 all departments will be properly reconciling balance sheet accounts.	7/1/2005	12/31/2006
UCSB	00-303A	9/20/2001	Recharge Activities - Income & Recharge Committee	The submission and status of rate proposals are not tracked and monitored.	A task force was established to review local income and recharge procedures. Local guidelines and procedures were revised streamlining the process with self certifications and staggered reviews, as well as, addressing issues such as depreciation expense, unrelated business activities, and commercial use of University property. Training of user departments on these procedures is expected to occur prior to next cycle. The next rate and recharge cycle will commence in January with proposals due to the committee by April 2007 with an effective date of July 1, 2007.	7/1/2005	4/30/2007
UCSF	00-004	12/5/2001	ITS Administrative Computing	No formal disaster recovery plan for AC-50, S-15 and EP.	This has become a comprehensive project. The technical side has been completed, consultants working with users are developing and documenting user recovery processes one department at a time. The last department and final test of plans is expected to be finished by March 2007	6/30/2002	3/30/2007
UCOP	02A010	4/16/2002	Conflict of Interest (COI) Administration	Formal orientation/training should be implemented in accordance with the Government Code, and all employees should receive some orientation/training regarding their obligations as government employees.	A tutorial is being developed and required for those covered by applicable laws. A selected vendor is currently developing modules for delivery. The first module covering ethics is expected to be delivered in November 2006. The conflict of interest module is expected in January 2007	1/1/2003	1/31/2007
UCSF	01-007	4/30/2002	PeopleSoft Security Review	PeopleSoft is not covered by an adequate disaster recovery plan.	Same as Project 00-004 above	6/30/2002	3/30/2007
UCSF	01-035	7/17/2002	Accounting-Equipment Management System	A sample shows that 47% of the recorded equipment is missing	The Controllers Office is educating the departments in conjunction with the new software. The software is in a phased implementation to be completed 12/31/2006	12/31/2004	12/31/2006
UCSF	01-035	7/17/2002	Accounting-Equipment Management System	A sample showed that 47% of the recorded equipment is missing	The new system and education also provides for accounting of disposals. See Project 01-035 above	7/1/2004	12/31/2006
UCSF	01-035	7/17/2002	Accounting-Equipment Management System	The biannual equipment inventories are inconsistently performed.	The new online tracking system has been installed, departments are being inventoried. The last department to be inventoried is expected 12/31/2006	12/31/2004	12/31/2006

Appendix 1 – Past Due MCAs

Location	Report Number	Report Date	Project Name	Finding	Management's Corrective Action	Management's Promised Completion Date	Management's Revised Completion Date
UCSF	02-062	11/13/2002	Medical Center OR Supply Utilization	There is insufficient control, tracking and accountability of supplies in the Operating Rooms.	A newly implemented OR tracking module has been implemented. The departments are being added in a phased approach. The last department is expected to be complete by 12/31/2006	6/30/2006	12/31/2006
UCSC	SC-03-96	6/16/2003	School of Engineering Computer Network	SOE account management and network configuration does not comply with University Policy on Information Security. The current SOE Unix network file sharing configuration potentially allows students with greater access than needed.	The project to establish account management is progressing in phases. Phase 1: Installed software to provide identity management, completed. Phase 2: Installed identity management for 80% of SOE users, completion targeted November 30, 2006. Phase 3: Additional security to enhance the identity management software, January 30, 2007. Phase 4: Network File Sharing software (NFS) Version 4 for management of files, March 30, 2007. Finally, Phase 5: Full implementation of NFS Version 4, 100% of SOE managed computers, October 31, 2007.	4/1/2004	10/31/2007
UCR	2003-03	6/27/2003	Academic Conflicts	The annual academic conflict of commitment disclosure reports are not consistently submitted to the Office of the Executive Vice Chancellor and Provost (EVC&P) as required by Policy (APM-025).	The Office of Research has developed a system for monitoring compliance with APM-025, the annual conflict of commitment disclosure process. The system was pilot tested by the Biology department faculty. Campus wide implementation date is targeted for 11/30/2006.	6/27/2004	11/30/2006
UCD	04-33	11/18/2003	Gift Processing Identity Theft	The University Relations (UR) department does not encrypt credit cards information stored in its AIS database. This is not compliant with the VISA Cardholder Information Security Program (CISP).	UR has taken action to be in full compliance with the existing credit security standards except for one standard. The remaining issue involves securing a contract with the company processing credit card payments for UR. UR is working with the General Counsels Office and other departments in getting the needed contract.	1/1/2006	6/30/2007
UCSF	03-060	1/20/2004	IT Interface Engine	There is no control in place to ensure that the source of code for modification is the most recent version of the code.	SourceSafe, the current "version control" software used on other UNIX servers has been implemented and tested for the production machine. Applications are being brought online as upgrades to production modules occur. Full implementation of all applications to Source Safe is expected to be completed by October 2007.	5/31/2004	10/1/2007
UCSF	03-066	1/20/2004	Medical Center Network Security	Authentication and authorization of IT system use originating from both extranet and campus network should be strengthened.	Solutions for authentication and authorization of traffic originating from the campus network have been identified and implemented. There were vendor delays, but implementation is expected to be complete by November	6/30/2006	11/30/2006
UCSF	04-011	8/11/2004	Reconciliation of Account Balances	An adequate aging system is needed for AVR	The PeopleSoft accounts receivable module has been implemented, but not yet rolled out to all departments. Complete roll out to all departments is targeted for 11/30/2006. As an interim solution, a temporary aging report has been implemented.	5/1/2005	11/30/2006

Appendix 1 – Past Due MCAs

Location	Report Number	Report Date	Project Name	Finding	Management's Corrective Action	Management's Promised Completion Date	Management's Revised Completion Date
UCSF	04-015	8/25/2004	Clinical Trial Billing	Salary for clinical trial principal investigators was not charged to the trials commensurate with their actual effort.	The UCSF Administrative Policy 400-14 has been revised to address observation and implemented. Policy is complete as of 10/12/2006, waiting only for posting on the website and broad campus distribution.	11/1/2004	11/30/2006
UCSF	05-038	2/28/2005	Dermatology Post Award Administration	PAR reporting was incomplete.	The University has developed an integrated electronic PAR reporting system with on-line access and compliance reporting that is being rolled out to the campuses. In the interim, the Dept. improved its existing PAR tracking system to address the audit finding.	4/1/2006	12/31/2006
UCD	04-25	3/25/2005	Conflict of Interest/Conflict of Commitment	UCD Policy (PPM 230-05) does not adequately address conflict of interest issues related to research.	PPM 230-05 has been revised and is under review.	1/1/2006	6/30/2007
UCD	04-25	3/25/2005	Conflict of Interest/Conflict of Commitment	UCD does not provide required conflict of interest training for Designated Officials and researchers	The Office of Research is providing special training to those individuals who are on the campus conflict of interest committee. In addition, the campus will be requiring researchers to take the on-line ethics training class which will include a module on conflict of interest. Training all the designated officials and researchers has started and is to be completed by March 2007.	10/31/2005	3/31/2007
UCSB	05-386	3/31/2005	Purchasing Department-Purchase Orders - Core	Management has not established who is responsible for the internal controls over the vendor file.	Administrative Services allocated \$10,000 to Business and Accounting Services jointly to clean-up the vendor file. Management plans to complete vendor file clean-up efforts and assign the responsibilities for continued maintenance by December 31, 2006	7/1/2005	12/31/2006
UCSB	05-386	3/31/2005	Purchasing Department-Purchase Orders - Core	Management has not established who is responsible for the internal controls over the vendor file.	In response to the lack of segregation of job duties for the vendor file, management has an interim control to matching invoices to payment information and released for payment by a separate person. Accounting Services and Control agreed to separate the duties for changes to the vendor file or employ alternative control by December 31, 2006.	7/1/2005	12/31/2006
UCSF	04-020	4/15/2005	Accounting Office Extramural Funds	There is no mechanism or monitoring in place to preclude pre-award charges to other projects.	Extramural accounts began a phased approach to closing award accounts 90 days after award end dates to permit accurate Financial Status Reports (FSRs) in the fall 2006. The campus has been notified and the first quarter's data will be reviewed in Dec 2006 with award accounts to be closed and funds moved by the end of Feb 2007.	7/1/2005	2/26/2007
UCSF	05-009	5/25/2005	Resumption Planning Campus	Recovery Plans for Key Business Systems are not current.	Same as Project 00-004 above	9/1/2005	3/30/2007

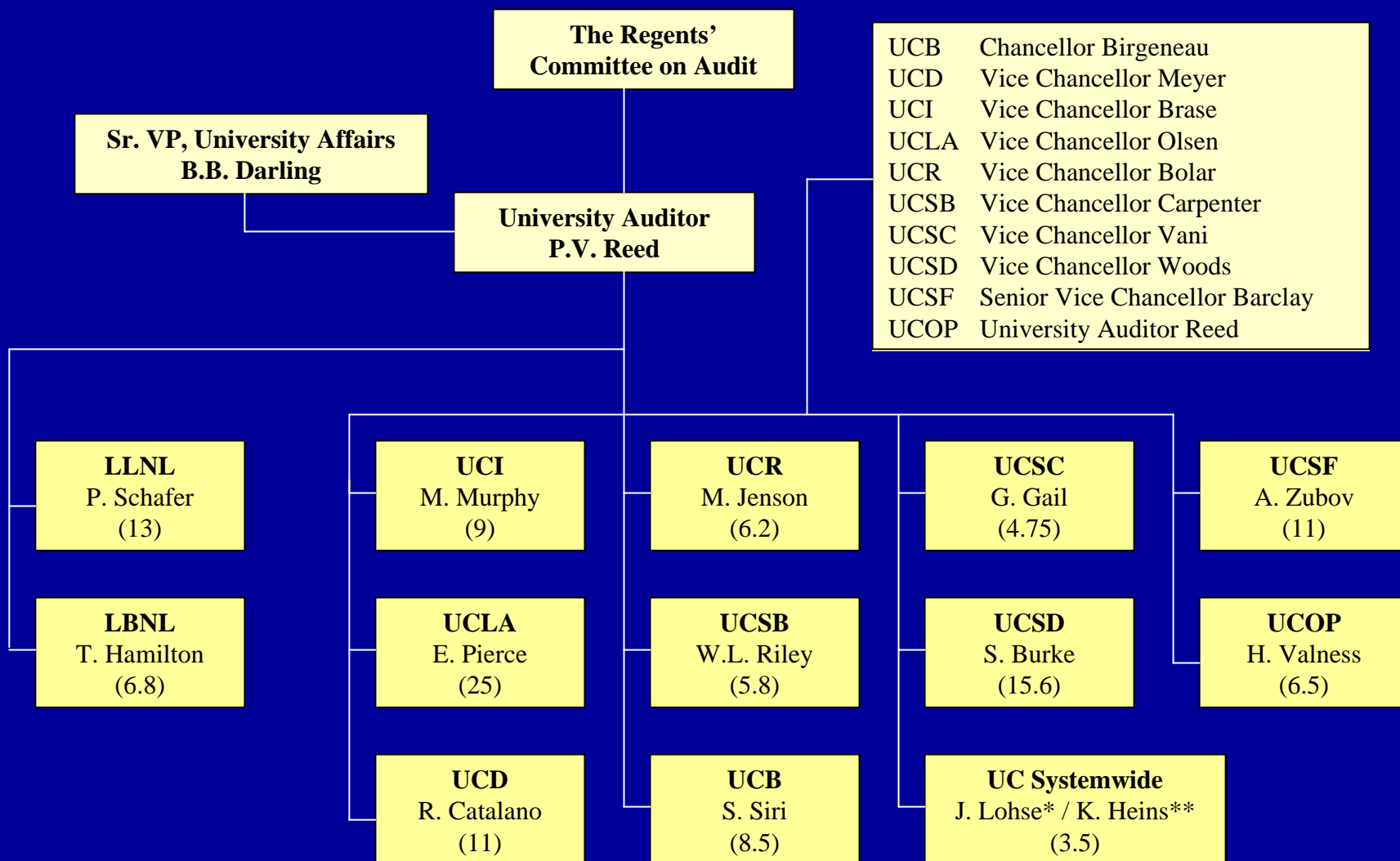
Appendix 1 – Past Due MCAs

Location	Report Number	Report Date	Project Name	Finding	Management's Corrective Action	Management's Promised Completion Date	Management's Revised Completion Date
UCSF	05-002	6/24/2005	Institutional Review Board - Human Subjects	Sponsored Research Awards are not controlled	A RIO database has been developed and procedures implemented to provide appropriate controls. The RIO data is now checked against awards entered into the new administrative research system (RAS) which went live in late spring 2006. Full integration of all systems is not expected to occur until late 2007.	1/31/2006	6/30/2007
UCSF	05-049	6/30/2005	EH & S Controlled Substances	The controlled substance dispensing records are not compliant with applicable Federal, State and University requirements.	Anesthesia drug administration records are entered and retained in the PICIS system. The PICIS system has been installed, and departments are being phased in with the last department expected by 12/31/2006	4/30/2006	12/31/2006
UCSF	05-049	6/30/2005	EH & S Controlled Substances	The controlled substance dispensing records are not compliant with applicable Federal, State and University requirements.	Pharmacy Services will forward summaries to both Anesthesia and Medical Center Operations for follow-up. The new system is being implemented in a phased approach, about half the departments have implemented at 10/15/2006, the remaining will be completed shortly	4/30/2006	11/30/2006
UCSD	2005-23	7/8/2005	Hospital Chargemaster Review	Staff was not trained to act as a backup for CDM Administrator	One additional FTE has been hired to assist the CDM Administrator. The Revenue Management Team is currently being formed and will include the CDM Administrator and selected Hospital administrators.	1/8/2006	1/12/2007
UCSD	2003-82	8/18/2005	UCSD/VA VMRF Agreement	Administration of joint personnel across institutions results in excessive administrative effort and potential risk that employee benefits are compromised. Also, employment liability concerns and effort reporting practices represent significant risk.	Personnel Agreements (PA) restrictions for faculty had been lifted, but the Veterans Medical Research Foundation (VMRF) did not change the requirements for staff. The VMRF change in faculty PA has not yet been published on the VMRF website. The Executive Director is working to ensure that all PA changes are implemented by December 2006.	1/31/2006	12/15/2006
UCSD	2005-04	10/17/2005	Material Transfer Agreements	Current processes and systems, along with proposed policy changes for stem cell research, could be enhanced to provide stronger assurance of accountability for research materials, including human embryonic stem cell lines.	Turnover at the executive level has delayed local corrective actions, but a new VC Research has been appointed, and a new campus process improvement team has recently been charged with evaluating MTA processes. A formal Material Transfer Agreement (MTA) has been drafted and is undergoing a review process.	2/18/2006	10/18/2006
UCSD	2005-04	10/17/2005	Material Transfer Agreements	Current processes and systems, along with proposed policy changes for stem cell research, could be enhanced to provide stronger assurance of accountability for research materials, including human embryonic stem cell lines.	The Embryonic Stem Cell Research Oversight Committee (ESCRO) established a policy to review potential human embryonic stem cell research projects and evaluation of the source of the material to verify that the mechanism for obtaining the material is appropriate. Based on this review, where an MTA may be required the matter shall be referred to OCGA, and information regarding purchased human embryonic stem cell lines shall be coordinated with Purchasing.	2/18/2006	12/15/2006

Appendix 1 – Past Due MCAs

Location	Report Number	Report Date	Project Name	Finding	Management's Corrective Action	Management's Promised Completion Date	Management's Revised Completion Date
UCSD	2005-04	10/17/2005	Material Transfer Agreements	Research animals were transferred from the University to external entities without a formal material transfer agreement.	TechTIPS and Animal Care, in conjunction with the MTA Process Committee is developing a process and specific guidelines to ensure that animals being transferred outside the University are evaluated for intellectual property considerations and the need for an MTA. TechTIPS and Animal Care will inform faculty of proper animal transfer procedures.	2/18/2006	12/15/2006
UCLA	05601201	12/20/2005	School of Dentistry Division of Associated Clinical Specialties	Summary totals for some adjustment categories reported on the December 31, 2004, Financial Allocation report were not supported by transaction detail.	The vendor has been engaged to resolve this problem. The problems was larger than originally scoped. A software upgrade was implemented but did not completely resolve this problem. The vendor is designing and programming a complete solution. In the meantime, the School of Dentistry Finance Office has implemented a reconciliation of report differences.	5/30/2006	12/31/2006
UCLA	05601201	12/20/2005	School of Dentistry Division of Associated Clinical Specialties	The SOE system does not have a specific report to identify accounts with missing charges.	Two existing reports were identified which show the date of the last visit, patient name, patient chart number, and last patient charge of \$0 and/or patient balance of \$0 or less. Some additional documentation on the use of this report is under development and delivery is expected 11/15/2005.	5/30/2006	11/15/2005
UCB	469	4/27/2006	Consolidated Billings: Employee Seps & Other Payroll Liability Acct Recon	When employees cease to work for their campus unit, HRMS staff are not processing the transactions necessary for PPS to terminate employee benefits as required by the HRMS procedures.	A number of key resignations in the Payroll Office and the absence of a Payroll Office Manager delayed the resolution of this finding. A new Payroll Office Manager has been hired and efforts are underway to implement the corrective action. The most serious offending department has been identified and special training provided.	6/30/2006	10/31/2006
UCB	469	4/27/2006	Consolidated Billings: Employee Seps & Other Payroll Liability Acct Recon	When employees cease to work for their campus unit, HRMS staff are not processing the transactions necessary for PPS to terminate employee benefits as required by the HRMS procedures.	Due to the resignation of the Payroll Office's primary information systems specialist the work was delayed. However, the most serious offending department was identified and has been given a special training session.	6/30/2006	10/31/2006
UCR	2005-16	5/18/2006	University/Eastside Community Collaborative (UECC)/Americorps Program Audit	The Memo of Understanding (MOU) among the three partners participating in the AmeriCorps Grant Program had not been finalized as of the date of this report.	The MOU was delayed by the Riverside Unified School District (RUSD) pending a worker's compensation situation with the School of Education. The final draft is being reviewed by RUSD. Once RUSD has reviewed the MOU, it will be forwarded to the Office of Research (OR) to be reviewed and sent to legal counsel.	6/30/2006	12/1/2006

Appendix 2 – University of California Internal Audit Program



Total Professional Staff, including the Director, is in parentheses
 Total Authorized Professional Positions = 127
 (LANL Audit Department not reflected in UC Audit Program)

*Director of Investigations / **Director of IT Audit Services