University of California, Merced

Report to the Chancellor
For the year ended June 30, 2008

PRICEWATERHOUSECOOPERS

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October 10, 2008

Mr. S. M. Kang
Chancellor
University of California, Merced
P.O. Box 2039
Merced, CA 95344

In planning and performing our audit of the financial statements of the University of California (the "University") which included our procedures at Merced (the "Campus") as of and for the year ended June 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered its internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the University's internal control over financial reporting. Accordingly, we do not express an opinion on the University's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses as defined in the recent amendment to AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, of the *AICPA Professional Standards* and shown below:

> Control deficiency – a deficiency in internal control over financial reporting 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 misstatements on a timely basis.
>
> Significant deficiency - a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the company's financial reporting.
>
> Material weakness - a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

Professional auditing standards require that we communicate to The Regents Committee on Audit any significant deficiencies or material weaknesses identified during our audit as evaluated based upon the University's consolidated financial statements. Because this evaluation is made in relation to the consolidated financial statements, the campus-specific observations and recommendations addressed in this letter are not classified using the above criteria for the purposes of this communication. However, it is important to note that while a control deficiency identified at any one of the University's campuses or medical centers may not rise to the level of a significant deficiency or a material weakness at the consolidated University level for purposes of the 2008 audit, if that deficiency recurs in subsequent years, it has the potential to rise to a significant deficiency or material weakness at the consolidated level, as a result of being unaddressed by the individual campuses or medical centers. In this circumstance, the matter would need to be formally communicated to the Committee on Audit at that time.

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Please refer to the enclosed for the details of the observations and recommendations, including items which we believe will be important to your operations in future years.

This letter is intended solely for the information and use of the audit committee, management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

If you would like any further information or would like to discuss any of the issues raised, please contact Lee Overstreet, Merced Campus engagement partner, at (916) 930-8545.

Very truly yours,

PricewaterhouseCoopers LLP

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Current year comments

1. Department General Ledger Reconciliation Reviews

Observation

To ensure departmental expenses are valid and accurately reported, the Campus requires each department to review departmental general ledger reconciliation reports on a monthly basis and provide an annual certification to document the department's approval of expenses reported to the Accounting department. While we noted the performance of monthly reconciliations throughout the year, no evidence was available to support the timeliness of the monthly reconciliation and the review or approval of the final reconciliation. However, we did note that the reconciliation reports are time stamped for the day they are printed, which would suggest timely performance of their review.

Recommendation

We recommend the departments formally document the timeliness of their monthly reviews and evidence the approval of the reconciliation reviews. Some campuses within the University of California are moving towards an electronic review process where documentation of the date and person reviewing is documented within the system at the individual transaction level as well as the general ledger balance to support monthly general ledger balances. If performed manually, the Campus could document monthly reviews via a checklist form which states the procedure performed, the signature of the individual performing the procedure, and the date the procedure was performed. Because this is a monthly process, a single form could be used to document the general ledger accounts reviewed and date of those reviews. If a manual process was implemented we would recommend oversight (e.g. departments mail the checklist form to a designated individual) to ensure the departments are performing the review.

We also recommend that along with the general ledger review, departments be required to certify that they have recorded all necessary accruals or deferrals as part of their fiscal close process.

Management's Response

The Campus Accounting Office performs periodic reviews of the reconciliations performed within the departments and has found a generally high level of compliance with the requirement for monthly reconciliations. The fact of the high compliance is supported by the small number of accounting transfers and almost complete avoidance of late transfers also tested for by the auditors. The Campus Accounting office will work with the Departments to insure dating of the reconciliations at the time they are performed.

2. Fixed Asset Inventory Counts

Observation

On a biennial basis, departments are required by the University of California's policies and procedures to conduct a physical inventory of equipment in the care and/or custody of each department. Upon completion of the physical inventory, the Department Equipment Coordinator must submit the results of the physical inventory to the Accounting Manager who reviews and approves the results. The purpose of the inventory is to ensure the Campus Equipment Database is up to date, the Campus maintains physical custody over all assets owned, and ensures that the amounts recorded in the Campus' general ledger

accounts are accurate and complete. During our testing, we noted not all of the Departments reported back their results of the physical inventory to the Accounting Manager. In addition, based on our testing, no evidence could be provided that the physical inventories for all of the Departments required to perform an inventory count were performed.

Recommendation

We recommend that the Campus ensure the counts are performed and documented.

Management Response

While inventories are required on a biennial basis the Campus has initiated an annual process due to the frequent movement of equipment and inventory items. We agree that the Campus needs to continue to strengthen the controls over the inventory process and work more closely with the Department Equipment Coordinators to achieve a higher level of compliance with recording and monitoring equipment location and assignment. The Accounting Manager has held two training sessions this fiscal year towards that end and will continue to monitor compliance with these requirements.

3. Reconciliation of Student Tuition and Fees

Observation

To ensure that student tuition and fees are accurately reported in the general ledger, on a monthly basis, the Director of Student Business Services reviews a reconciliation of the Registrar's Headcount to detail codes in the Banner System and to the general ledger, including a reconciliation of other charges through the Banner System to the general ledger. Based on our understanding, the Banner System is a student information system that gives the Campus administrator access to and control of student information. During our testing of controls, we noted that the Campus is not performing this control.

Recommendation

To support the completeness, accuracy and validity of revenues and fees recorded in the Campus' general ledger system, we recommend Student Business Services perform the control listed above.

Management Response

We agree with the observation and recommendation. The Student Business Services office has been working on completing such a reconciliation since March of this calendar year. The implementation of the Banner Student Information System at the campus has been difficult and there has been a lack of access to some detail system reports and the detail file structure. The first two reconciliations were completed just subsequent to the end of the audit fieldwork and the Student Business Services office has been instructed to perform such reconciliations twice each semester going forward.

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VICE PRESIDENT—FINANCE

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April 24, 2009

CONTROLLERS

Subject: A-133 Audit Report Finding – Untimely Cost Transfers

At the Controllers' Meeting on April 9, 2009, I talked to you about the plan to discuss the issue of untimely cost transfers with the Vice Chancellors—Research and to solicit their support in resolving the issue. Jorge Ohy and I had the opportunity to discuss the issue with the Vice Chancellors-Research during their meeting on April 16, 2009. Listed below are the corrective actions discussed with the Vice Chancellors-Research.

The Vice Chancellors-Research recognize the importance of resolving this issue and fully support the following action to be taken immediately by all campuses:

1. Each campus should implement controls to identify and restrict the transfer of costs to federal funds if the transfer is processed more that 120 days from the close of the month in which the original costs were incurred.

2. Each campus should implement special review and approval procedures to allow transfer of costs to be processed after the 120 day period when appropriate. The approval procedure should clearly identify specific conditions when approval is warranted.

3. Campuses should continue discussions with the stakeholders, including the Accounting Office, Research Office, P.I.s and MSOs to:

    a. Raise their awareness of the importance of timely cost transfers,
    b. Identify additional procedures, action or best practices that can lead to enhanced compliance, and
    c. Analyze and develop a comprehensive approach to compliance at each campus, including identification and formulation of systems, procedures and project administration support models required for compliance.

Anne C. Broome
Vice President—Finance

cc: Vice Chancellors Research