

THE REGENTS OF THE UNIVERSITY OF CALIFORNIA  
OFFICE OF ETHICS, COMPLIANCE AND AUDIT SERVICES



1111 Franklin Street, 5th Floor • Oakland, California 94607-5200 • (510) 987-0479 • FAX (510) 287-3334

Alexander Bustamante  
SENIOR VICE PRESIDENT  
CHIEF COMPLIANCE AND AUDIT OFFICER

February 2, 2023

**CHIEF INVESTMENT OFFICER BACHHER  
VICE PRESIDENT LLOYD  
DIRECTOR FERNANDEZ**

**RE: Final Report Project No. P23A007: Senior Management Incentive Plans: Office of the Chief Investment Officer Annual Incentive Plan**

Attached is a copy of the final report for: Audit Services Project No. P23A007 Senior Management Incentive Plans: Office of the Chief Investment Officer Annual Incentive Plan. With the issuance of this final report, please destroy any previous draft versions. We very much appreciate the assistance provided to us by you and members of your staff during our review. If you should have any questions please feel free to contact me at 510-987-9646 (email: [matthew.hicks@ucop.edu](mailto:matthew.hicks@ucop.edu)).

A handwritten signature in black ink, appearing to read "Matt Hicks".

Matt Hicks  
Systemwide Deputy Audit Officer

Attachment

cc: Senior Vice President Bustamante  
Executive Vice President Brostrom  
Executive Vice President Nava  
Chief Operating Officer Guimaraes  
Associate Vice President Henderson  
Director Huang  
Systemwide Associate Audit Director Bishin  
Contractor Harrigan

UNIVERSITY OF CALIFORNIA  
ETHICS, COMPLIANCE AND AUDIT SERVICES  
OFFICE OF THE PRESIDENT  
SYSTEMWIDE AUDIT

Senior Management Incentive Plans:  
Office of the Chief Investment Officer Annual Incentive Plan  
Audit No. P23A007  
January 2023

Work Performed by:  
Contract Auditor Harrigan

Work Reviewed by:  
Systemwide Associate Audit Director Bishin  
Systemwide Deputy Audit Officer Hicks

## **Executive Summary**

### **Introduction**

As part of the University of California Office of the President (UCOP) 2022-23 fiscal year audit plan, Internal Audit completed a review of the Office of Chief Investment Officer (OCIO) Annual Incentive Plan (AIP or the Plan).

The purpose of the AIP is to provide a risk variable financial incentive to employees responsible for attaining key objectives in the OCIO. Participants may receive an annual incentive award based on investment performance and individual performance. The AIP Administrative Oversight Committee (AOC) approves participant performance objectives at the beginning of the Plan year. Eligible participants include senior management, professional investment and trading staff, and other key positions in the office as recommended by the Chief Investment Officer (CIO). The Regents Investments Committee approves investment performance objectives.

The AIP Administrative Guidelines (Guidelines) document serves to assist all involved parties in the application of the AIP provisions. The Guidelines may change from year to year to reflect AOC-approved changes to the Plan or processes.

Annually, the Regents approve investment performance benchmarks for asset classes such as global equity, absolute return, liquidity, and others. State Street Bank is the fund custodian, and in addition to safekeeping and recordkeeping for all publicly traded assets, is responsible for calculating investment performance for all such portfolios, and for providing the investment returns of the several market indexes used as benchmarks. It also calculates and provides, for each performance objective, the difference between the portfolio and benchmark return, which is the basis of award calculations.

UC retained Mercer to recommend new investment performance standards for FY 2021-22. Once the Regents approved these, Mercer updated the AIP award calculation model taking into account changes in the investment component. The model is updated as needed when the Plan or Guidelines are updated.

UC Human Resources (HR) and the OCIO are the sources of additional input data such as participant names, salaries, performance measure weightings, and participant qualitative performance ratings, which the CIO approves. The model contains investment and participant performance measures and results (Threshold, Target, and Maximum levels). The Office of the Chief Financial Officer (OCFO) inputs investment performance data provided by State Street Bank and the remaining data is entered by Compensation Programs & Strategy (HR Compensation).

For Investment Officers and more senior positions, awards are payable in three annual payments comprised of 50 percent paid in the current Plan year, 25 percent paid in the next year and 25 percent paid in the year thereafter, plus interest. Interest is based on the three-year average of Global Equity returns. Other participants receive 100% payout in the current year.

The AOC was established to provide oversight of Plan development, governance and interpretation. It is comprised of the Executive Vice President and Chief Operating Officer, the Executive Vice President and Chief Financial Officer, the Vice President - Human Resources, and the Executive Director – Compensation Programs and Strategy. The AOC was also delegated authority by the Regents to approve non-material Plan changes, with material or substantive changes requiring the approval of the President and the Regents Governance Committee. The AOC was also given authority to review and approve participant performance objectives and award recommendations. Performance objectives and award recommendations for the CIO remain under the purview of the Board of Regents, thus requiring its approval. As of September 1, 2020, awards that place an incumbent's total cash compensation at or above \$340,000 are reported to the Regents via the Annual Report on Executive Compensation.

The AOC consults with the Senior Vice President and Chief Compliance and Audit Officer (CCAO) in an independent advisory capacity during its review of Plan participants' objectives and proposed awards. The CCAO assures that periodic auditing and monitoring of the Plan occurs, as appropriate.

## **Objective and Scope**

The primary objectives of the OCIO AIP audit were to assess the accuracy of FY 2021-22 award calculations and annual payouts (including deferred portions of awards) and verify compliance with the Plan. We evaluated the following AIP award criteria for accuracy and compliance: individual participant performance objectives, performance ratings, and payout calculations. In reference to performance ratings, we did not make a judgment on the performance and contribution towards goals. We relied on management's documented evaluation of performance level achievement for Plan participants.

We reviewed the FY 2021-22 award calculations and verified the eligible participants. For each participant, we verified the following:

- FY 2021-22 actual salary earnings
- AIP award opportunity percentages
- Performance measure weightings
- Subjective performance rating
- Award opportunity

We reviewed the FY 2021-22 payout calculations and verified:

- Award amounts for each participant
- FY 2020-21 and FY 2019-20 deferred award payouts for Investment Officer level and above,
- Spreadsheet formulas used for calculations for the FY 2021-22, FY 2020-21, FY 2019-20, components of the payout calculation, including interest allocations,
- Interest amounts used in the payout calculations tied to the amounts provided by State Street, and

- Payout amount for each participant included on the Payroll Payout Worksheet, prepared by the OCIO for the Payroll Office, agreed to the payout calculation.

As part of our audit, we also:

- Verified that the FY 2022-23 participant qualitative objectives were approved by the AOC.
- Performed an annual evaluation of investment performance results against source documents provided by State Street. See Appendix A for further details on the results of this review.
- Verified that any changes made to the AIP, as reflected in the plan document, were appropriately approved and that the AIP Guidelines are consistent.
- Performed a trend analysis of participant awards and noted that the percentage of participants rated higher than meets expectations (solid performance) decreased slightly in FY 2021-22 to 20 of 34 participants or 58.8%, compared to FY 2020-21's 59% (23 participants), and FY 2019-20's 61% (27 participants).

## **Overall Conclusion**

Based on the information provided, we did not identify any errors in the calculations of the FY 2021-22 AIP award recommendations that were presented for approval to the AOC and the Regents Governance Committee. In addition, we did not identify any errors in the final FY 2021-22 payout calculations (50% of current year award plus prior year deferred amounts and related interest for Investment Officer level and above).

We noted the following opportunities for improvement:

### Participant Earnings

- After initial award calculations were made, a question arose regarding earnings and some participant stipends and/or paid family leave amounts that had not been included in earnings for award calculations. Following consultations, including with UC Legal, it was determined that these amounts should have been included. Award amounts were recalculated for 11 participants.
- For two participants, the award calculation was incorrect as their performance ratings were updated by OCIO but not updated in the calculation workbook.
- Two participants' payout calculations included incorrect deferred award amounts.

### Timeliness

- As of October 31, 2022 Internal Audit had not received documentation required to complete the audit:
  - AOC approved FY 2021-22 participant awards
  - AOC approved FY 2022-23 Investment performance standards (objectives)
  - FY 2022-23 AIP Guidelines document which is updated after investment standards are approved
  - FY 2022-23 participant objectives

The last three bulleted items above were also prior year findings. These documents were provided to Audit in December 2022.

- The FY 2022-23 AIP plan document was not posted on-line in a timely manner.

The plan document was posted in November 2022. This was a prior year finding.

For a detailed discussion of these issues, including the management action plans, please refer to the subsequent pages of this report.

# Opportunities for Improvement and Action Plans

## 1. The initial award calculations had several errors.

### a. Earnings amounts were inaccurate.

For eleven participants, earnings amounts used in award calculations did not include stipends or paid family care and bonding leave (PFCB) in their earnings total. Corrections resulted in earnings for these participants increasing by \$1,243 to \$40,256 each. This was identified, researched, and resolved by HR Compensation and Strategy prior to payouts.

PFCB was a new paid benefit as of July 1, 2022. Systemwide HR Compensation consulted with UC Legal regarding including the PFCB earnings and was informed that there was no reason these should be excluded.

### b. Two participants' performance ratings were incorrect.

For two participants, their award calculations were incorrect. For one participant, their performance rating had been updated by OCIO and forwarded to HR but HR had not entered the change into the workbook. For another participant, an incorrect rating was due to an input error. Internal Audit noted the rating inconsistencies and notified HR who corrected the entries. If corrections were not made, the participants would have been underpaid \$3,141 and \$13,544 respectively. Initial submission of performance ratings at UC occurs in April (STEP ratings) and the updates to the AIP ratings were the result OCIO taking into consideration performance in Q4.

### c. Two participants' payout calculations included incorrect deferred award amounts.

Last year, Mercer hard-coded two participants' deferred amounts in the calculation workbook. The prior year workbook was updated for FY 2021-22 award calculations, but the hard-coded amounts were incorrectly incorporated into the FY 2021-22 award calculations. If not corrected, this would have resulted in overpayments of \$24,644 and \$55,605. This was noted by Mercer prior to payouts and they provided a corrected calculation work book.

All of the above errors were corrected and awards were updated prior to AOC approval and payouts.

### *Action Plan:*

- a. *HR Executive Compensation will update the AIP Guidelines by documenting the process to be followed when calculating a participant's earnings relevant to AIP awards and will include relevant UCPath Earn Codes. They will also include the process to verify that none of the annual input data is hard coded (see c below).*
- b. *HR Executive Compensation will enter the AIP performance ratings to be included*

*in participant award calculations. They will also request UCOP HR pull a report of the final STEP performance ratings for OCIO after any year-end changes have been processed. HR will reconcile this report with the AIP ratings to determine if any updates to the calculation model are needed. Reconciliation results will be discussed with the OCIO.*

- c. HR Compensation had Mercer correct this error and obtained their agreement that they would not hard code data in the calculation workbook. Going forward, UC will verify that the calculation workbook does not include any hard coded input data.*

***Target dates:***

- a. February 28, 2023*
- b. August 31, 2023*
- c. Completed prior to report issuance.*

**2. Some Plan documents were not provided to audit or posted on a timely basis.**

**a. Internal Audit did not receive some of the documentation required to complete the audit until December 2022:**

- AOC approved FY 2021-22 participant awards.
- FY 2022-23 investment performance standards (objectives). This was a prior year observation with a scheduled due date of March 31, 2022.
- FY 2022-23 AIP Guidelines document that needs to be updated with the above investment standards. This was a prior year observation with a scheduled due date of June 30, 2022.
- FY 2022-23 participant objectives. This was a prior year observation with a scheduled due date of July 31, 2022.

All of the above documents were included in Internal Audit's initial request for documents and were available by September 1, 2022 but were not provided to Internal Audit.

**b. The AIP Plan document was not posted to the web site in a timely manner.**

The FY 2022-23 AIP Plan document was not posted on the UCOP website as of October 31, 2022. By the beginning of each Plan year, July 1, the current year Plan document should be posted. For transparency purposes, the current Plan should be available for participants and interested parties to review.

This was also a prior year finding. Per the schedule developed by HR, the FY 2022-23 plan document was to be posted by June 30, 2022.

Prior to report issuance, the above documents were provided and the AIP plan document was posted.

***Action Plans:***

- a. HR Executive Compensation will utilize the Box file sharing tool as a repository for AIP audit documentation, and after the audit commences, will upload items within two weeks of availability.*
- b. As awards are not paid until September, HR Compensation will leave the prior year plan posted for reference but will also post the current year plan.*

***Target dates:***

- a. August 15, 2023*
- b. July 15, 2023*

## Appendix A

### **Office of the Chief Investment Officer Annual Incentive Plan FY 2021-22 Investment Performance Review Results**

Pursuant to the University of California Office of the Chief Investment Officer (OCIO) Annual Incentive Plan, the Systemwide Vice President of Human Resources, requested the UCOP Office of Audit Services to review the investment data used to perform the OCIO Annual Incentive Plan (AIP) calculations. Accordingly, we obtained the investment benchmark data and the investment performance results and verified they were accurately reflected in the calculation model.

In connection with the FY 2021-22 data provided by State Street Bank that was used in the AIP calculations, we performed the following:

- Obtained the actual performance data for the investments managed by the Office of the Chief Investment Officer, from Human Resources - Compensation Programs & Strategy who received the data directly from the State Street Bank. We verified the basis point differentials between actual performance and benchmarks provided on the spreadsheets were used in the incentive awards calculations.
- Verified that the basis point differentials were accurately transferred to the summary spreadsheets in the calculation model and to the “Exhibit 2: Benchmark Performance - Actual Fiscal Year 2021-2022 Performance” versus Annual Incentive Plan Performance Results.”