

**UNIVERSITY OF CALIFORNIA, DAVIS  
AUDIT AND MANAGEMENT ADVISORY SERVICES**

**UC Davis Health  
Health Sciences Faculty Compensation  
Audit & Management Advisory Services Project #17-03**

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**Health Sciences Faculty Compensation  
AMAS Project #17-03**

**MANAGEMENT SUMMARY**

**Background**

The School of Medicine (SOM) compensates faculty in health sciences according to terms defined in department-specific compensation plans. The nature of each plan is determined by several authorities:

1. The University of California Office of the President (UCOP) provides a policy framework<sup>1</sup>;
2. The SOM Compensation Advisory Committee (CAC), in consultation with a wide range of UC Davis and UCDHS leadership, develops implementing procedures;
3. The UCDHS office of Academic Personnel develops a template Plan; and
4. Each department and division in the SOM negotiates specific contractual provisions.

The distinguishing feature of this compensation plan, as compared to plans for faculty outside of the SOM, is that total compensation derives from three major sources: base salary, negotiated additional compensation, and incentive payments.

*Base Salary*

Base salary is referred to as the X component of total compensation. It is made up of two sub-components: X and X'. X is the rate shown on the UCOP Health Sciences Compensation Plan Salary Scales, corresponding with a faculty member's academic rank and step. X' is the product of X and is a multiplier associated with the Academic Programmatic Unit (APU) to which a faculty member is assigned. Individual faculty members are assigned to APUs by departmental leadership with the approval of the CAC.

*Negotiated Additional Compensation*

Negotiated additional compensation is referred to as the Y component of total compensation. The purpose of the Y component is to supplement the X component, so that a faculty member may earn market value for work performed. In order to achieve this purpose, the CAC requires that a compensation plan's Y methodology include a recognized benchmark and objective criteria for measurement.

The X and the Y components together constitute regular salary.

*Bonus Payments*

Bonus payments are referred to as the Z component of total compensation. The purpose of the Z component is to promote clinical productivity, and to compensate faculty for extra work performed.

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<sup>1</sup> APM-670 SALARY ADMINISTRATION: Health Sciences Compensation Plan

**Purpose and Scope**

As part of the FY2017 Audit Plan, Audit & Management Advisory Services (AMAS) conducted a review of compensation practices for faculty in the UC Davis School of Medicine (SOM). The purpose of this review was to determine whether:

1. Compensation is administered accurately, so that faculty receive the correct pay;
2. Practices related to compensation are compliant with relevant laws, regulations, and/or policies; and
3. Faculty are satisfied with their level of involvement and their perceived level of fairness in the compensation process.

The scope of this review included compensation plans for health sciences faculty as executed in all UC Davis SOM departments and divisions. This review did not encompass compensation for staff physicians. Additionally, this review did not consider issues related to outside professional income.

To conduct our review we:

1. Reviewed departmental compensation plans to identify and evaluate differences;
2. Interviewed departmental leadership including Chairs and Chief Administrative Officers (CAOs) to collect feedback on successes and challenges to specific plan elements;
3. Interviewed leadership in the office of Academic Personnel and the CAC to understand the plan process and identify obstacles to efficient administration;
4. Distributed a survey to physicians included in the Health Sciences Compensation Plan to evaluate satisfaction with compensation practices and identify opportunities for improvement;
5. Consulted with the UCOP Offices of Academic Personnel and General Counsel to ensure compliance with federal regulations;
6. Compared a sample of compensation agreements to Payroll records to verify that regular pay was distributed accurately;
7. Conducted walkthroughs of the bonus compensation negotiation, calculation, and approval processes to evaluate the effectiveness of accounting controls and the accuracy of payments; and
8. Compared a sample of faculty compensation rates to recognized benchmarks to evaluate implementation of benchmarking standards.

**Conclusion**

Flexibility in the health sciences faculty compensation process allows departmental leadership to structure plans that they believe best serve the business needs of their individual disciplines. Standardized elements in the process are intended to ensure that federal and University of California requirements are satisfied, UC Davis and UCDHS missions are furthered, and SOM administration is able to provide an appropriate level of oversight. The difficulty in implementing effective compensation plans lies with finding an optimal balance of flexibility and standardization.

We compared payroll records to faculty members' Appendix IIs<sup>2</sup> and found that payroll processes ensure that distributions are consistent with the negotiated portions of salaries (X and Y components). Additionally, we verified that related practices are performed under guidance from UC Davis Health System Counsel and the UC Office of General Counsel, and are compliant with relevant authority.

We did identify opportunities to improve on elements in the process. We expect that these improvements will result in better compliance with relevant authority; reduced financial risk for both the organization and individual faculty members; and increased transparency, which should translate to higher faculty morale. This report makes the following recommendations:

- A. In order to facilitate meaningful independent review of the accuracy and appropriateness of bonus Z payments, the office of Health System Academic Personnel should convene a working group to investigate and devise a standard allocation methodology for use by departments;
- B. For multiple reasons discussed in this report, including integrity in the contracting process and preservation of faculty morale, the office of Academic Personnel should define a formal process for annual negotiation, submission, and approval of department-specific compensation plans. This process should include deadlines applicable to departmental, CAC, and Academic Personnel responsibilities;
- C. In order to promote transparency and a perception of fairness in faculty compensation, the office of Academic Personnel should resume a historical practice of preparing reports for the SOM Dean that show and explain a comparison of actual faculty salaries to Association of American Medical Colleges (AAMC) benchmarks.

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<sup>2</sup> Appendix IIs are formal declarations of total negotiated compensation. They are signed annually by the Department Chair and the compensated faculty member.

**Observations, Recommendations, and Management Corrective Actions****A. Administration of Bonus Compensation (Z Payments)**

**The current process for independent review of bonus payments does not provide assurance that they are accurately and fairly calculated.**

Before any excess departmental income Z payments (bonus payments) are distributed to faculty, a CAO applies the formula from the department's compensation plan to calculate bonus amounts. CAOs report that there is often ambiguity in the terms of the compensation plans, and therefore implementing some plans might require discretion in allocating income and expenses among faculty members. This discretion is exercised by the CAOs themselves, potentially but not necessarily in coordination with the department's Chair.

After a bonus Z payment has been calculated for each faculty member, the CAO submits a request for approval to the office of Financial Services. An Analyst in Financial Services verifies that the CAO's methodology is supported by the department's compensation plan and that the faculty member is eligible to receive a bonus Z payment, but does not perform procedures to verify that the proposed payment amounts are accurate. If the Analyst determines that the CAO followed the plan guidelines, s/he forwards a summary of the request for approval to the Associate Dean for Clinical Affairs. S/he does provide supporting documentation to the Associate Dean for Clinical Affairs for all bonus Z payments. The Associate Dean for Clinical Affairs approves payments if it appears that sufficient funds are available in departmental accounts. The Associate Dean does not review the accuracy of the calculations.

Independent review of Z payment calculations is necessary to provide assurance to SOM leadership and faculty that payments are made accurately and fairly.

When interviewed, CAOs reported that the process of calculating bonus payments is very time consuming. Walkthroughs of calculations for individual faculty members conducted by AMAS staff – which required several hours each – confirmed these statements. Approvals from Financial Services, however, are returned very quickly. This has created an awareness among CAOs that their calculations are accepted without in-depth review.

Several CAOs also reported that in recent years faculty members have discovered inaccuracies after independently recalculating their bonus payments. Inaccuracies such as these are difficult to remedy because the department's Z pool will have been expended by the time they are discovered.

The root cause of the inability to conduct meaningful independent review of bonus Z payments is that allocation methodologies differ dramatically across departments. This results in several risks. The most probable risk is that faculty might not be awarded bonus payments in the amounts to which they are entitled. A more significant (if less likely) risk is the opportunity for fraud should a CAO decide to make improper allocations.

### **Recommendation**

The Office of Academic Personnel should convene a working group of stakeholders from the SOM Dean's Office and the departments charged with designing and implementing controls to allow for meaningful independent review of bonus Z payments.

### **Management Corrective Action**

The SOM Dean's office will convene a working group of stakeholders to implement controls as necessary to ensure independent review of bonus Z payments. The group will review best practices and their potential implementation which may include simplification and/or increasing standardization of bonus Z payment methodology across the SOM; better defining Chairs' roles in the calculation and approval process; a mechanism for random audits of calculated Z-payments; and other measures as deemed necessary. Analysis of the issue and formal recommendations will be presented to the SOM Dean by March 15, 2018.

## **B. Timeliness and Transparency in Compensation Plan Development**

### **There are no clear milestones in the annual process for developing compensation plans.**

The annual process of updating and approving compensation plans requires the collaboration of the offices of Academic Personnel, the CAC, and each department's Chair and CAO. Ideally, departmental leadership solicits input from faculty as part of this process.

Faculty begin performance, and departments begin payment on compensation agreements in July of each fiscal year (FY). However, there is no standard for when plans must be finalized. Departmental leaders indicated that it is uncommon for compensation plans (i.e. the contractual bases for the employment relationships) to be finalized by the beginning of the year.

To provide examples of this condition, none of the CAOs surveyed in October 2016 indicated that their FY17 compensation plan had been finalized, and many reported that this does not typically happen until the third quarter. One individual reported that his FY15 compensation plan had not been finalized until July 2016.

Failure to approve compensation plans timely can lead to several undesirable outcomes:

1. The incentive purpose of the compensation plan is undermined if performance measures are not defined before the beginning of the period being measured;
2. Approved compensation plans list the criteria on which a Chair may base Y component negotiations with individual faculty members. These parties cannot effectively negotiate if the acceptable criteria are not approved;

3. When the fiscal year begins before plans are finalized, departments sometimes must commence payments under the assumption that the proposed plan will be approved.<sup>3</sup> If the plan is not approved as proposed, it is possible that the department may have to recover overpayments from faculty;
4. There is a potential enforceability and/or litigation risk, if the contractual terms for the employment relationship are not defined; and
5. Faculty feel excluded from the compensation plan process if negotiation is not a milestone in the plan development process. We distributed a survey to faculty in order to evaluate satisfaction with the compensation process, and one common response was that faculty feel they do not have sufficient opportunity to negotiate the terms of their compensation.

### **Recommendation**

The office of Academic Personnel, in coordination with the Compensation Advisory Committee, should define calendar milestones for the development and finalization of compensation plans.

### **Management Corrective Actions**

1. The office of Academic Personnel will define calendar milestones to make the compensation plan development and review process timely and transparent, create opportunities for effective negotiation, and ensure that compensation plans are finalized before the beginning of the covered fiscal year. Milestones will be defined and presented to the Dean by March 15, 2018, with anticipated implementation by end of FY 19.
2. The office of Academic Personnel will work with the SOM Dean's Office to implement enforcement mechanisms applicable to both its own performance and that of the departments. These mechanisms will be defined by March 15, 2018, and implemented by end of FY 19.

## **C. Visibility of the Relationship between Actual Faculty Salaries and AAMC Benchmarks**

**The SOM Dean currently receives no information to indicate whether departmental practices ensure that faculty receive pay that is commensurate with AAMC benchmarks.**

Historically, the office of Academic Personnel provided the SOM Dean with annual reports that showed a comparison of pay for individual faculty members within each department, and demonstrated the relationship between that pay and the relevant AAMC benchmarks. As a result of recent changes in SOM leadership, this is no longer done. These reports were valuable for the purpose of ensuring transparency and fairness of pay within and across departments.

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<sup>3</sup> While this is not true for bonus Z payments, which are paid only after the end of the fiscal year, it is true for other categories of Z payment, which are paid throughout the year, as earned. One example of this is a Z payment for voluntary assumption of additional on-call duties.

We tested a pilot sample<sup>4</sup> of physician salaries to verify that they bore a relationship to the AAMC benchmarks. We found that 52% of the salaries tested were in the 3<sup>rd</sup> decile<sup>5</sup> or lower, or in the 8<sup>th</sup> decile or higher, and did not fall into a continuous distribution (e.g. bell curve, etc.). Standards do not exist to dictate how closely salaries must adhere to the benchmarks.

We recognize that valid reasons may exist for these apparent discrepancies, because the AAMC benchmarks do not account for all relevant factors. These include professional degrees not typically held by SOM faculty (MPH, MBA, etc.) differences between academic steps (Professor I, II, etc.), and special roles within a department (Chair, etc.). Reports including analysis of these factors would promote transparency and a perception of fairness.

### **Recommendation**

The office of Academic Personnel should report comparative faculty salary data to the Dean in such a way as to provide transparency to stakeholders across the SOM and explain any apparent discrepancies.

### **Management Corrective Action**

The office of Academic Personnel will review prior practices and develop a process for reporting on the relationships of actual salaries to AAMC or other valid benchmarks. These reports will include analysis of apparent discrepancies a) between benchmarks and actual pay for faculty members and b) between the compensation of faculty members who would appear to deserve identical treatment but do not. They will also provide analysis of salary equity within departments based on demographic identifiers. This focused analysis will be conducted on a sample of departments that will rotate annually. The office of Academic Personnel will deliver these reports to the Dean, and will make them available to departments and individual faculty members upon request. The office of Academic Personnel will begin disseminating these reports by March 15, 2018.

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<sup>4</sup> A pilot sample is not statistically significant, but it is random and was designed to test representatives from each faculty series.

<sup>5</sup> One decile is equivalent to ten percentiles. So the “3<sup>rd</sup> decile or lower” includes salaries below the 31<sup>st</sup> percentile, and the “8<sup>th</sup> decile or higher” includes salaries above the 70<sup>th</sup> percentile. We present the data in deciles to reflect AAMC practice.