

The logo for UC Irvine, featuring the letters 'UC' in a large, bold, serif font, followed by 'IRVINE' in a smaller, all-caps, serif font. A vertical line separates the 'UC' from 'IRVINE'.The text 'INTERNAL AUDIT SERVICES' in a serif font, arranged in two lines. A vertical line is positioned to the left of the text.

# Health Sciences Compensation Plan

*Internal Audit Report No. I2016-208*

January 3, 2017

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January 3, 2017

**CARL SMITH  
DIRECTOR OF ACADEMIC AFFAIRS AND FACULTY COMPENSATION  
SCHOOL OF MEDICINE - ACADEMIC AFFAIRS**

**RE: Health Sciences Compensation Plan Audit  
No. I2016- 208**

Internal Audit Services has completed the review of the Health Sciences Compensation Plan and the final report is attached.

We extend our gratitude and appreciation to all personnel with whom we had contact while conducting our review. If you have any questions or require additional assistance, please do not hesitate to contact me.

*Mike Bathke*

Mike Bathke  
Director  
UC Irvine Internal Audit Services

Attachment

C: Audit Committee  
Alan Goldin, Associate Vice Chancellor for Academic Affairs

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## I. MANAGEMENT SUMMARY

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In accordance with the audit plan, Internal Audit Services (IAS) conducted a review of the Health Sciences Compensation Plan (Plan) within the School of Medicine (SOM). The review was limited to the policies and processes related to income earned by faculty members outside professional activities. The review disclosed some internal control and compliance weaknesses that should be improved to minimize risks and ensure compliance with University policies and procedures and best business practices. The following concerns were noted.

**Outside Professional Activity Income Not Reported** – Eleven faculty members (29 percent) reviewed did not report all of their outside professional activity income that exceeded their annual earnings threshold into the Plan as required by policy, leading to over \$114,000.00 in lost revenue to SOM. This observation is discussed in section V.1.

**Assessment Errors and Overpayments** – IAS noted multiple assessment rate errors on outside professional activity income related to the established Dean’s Office and/or department assessment policies, leading to over and under assessments of income. In addition, IAS noted several payments related to income generated from outside professional activity paid to faculty members as incentive/bonus compensation (Z payment) that were for more than what was deposited. Further details related to these observations are provided in section V.2.

**Oversight** – The Dean’s Office does not have a process in place to properly track, monitor, and reconcile all income earned from outside professional activities by faculty members. The Dean’s Office did not review some Z payment requests submitted by departments. Therefore, under/over payments went undetected. These observations are discussed in section V.3.

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## II. BACKGROUND

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The purpose of the Plan is to provide a common administrative framework within which each participating SOM department can compensate its faculty according to the competitive requirements of each discipline. Academic Personnel Manual (APM) 671 defines which outside professional activities must be disclosed to the University, approved prior to engagement, and/or reported annually as well as defines the disposition of income earned from such activities.

Income generated from outside professional activities as well as other activities is distributed as an incentive/bonus compensation or “Z” payment beyond the base and negotiated compensation as described in a department’s Plan guidelines. The department must submit a request for such distributions to the Dean’s Office for review and approval for disbursement and all department and division operating expenses should be paid prior to the distribution of “Z” compensation. The “Z” payments are categorized into one of the five description of service (DOS) codes: HSZ – income generated from patient revenue; HSC - income generated by outside consulting such as consulting, expert witness, medical record review, etc.; HST – income to compensate faculty for additional teaching duties; HSA - income to compensate faculty for additional administrative duties; and HSR - income to compensate faculty for additional research duties. This reviewed was limited to HSC compensation.

The description of the methodology used to determine HSC compensation such as the assessment rates applied to income for various activities or duties are also presented in the Plan guidelines. The guidelines also state that earnings from outside professional activities that exceed the annual threshold be deposited to the Plan.

It should also be noted that there was a key transition in the Dean’s Office. A new Director of Finance took charge of the Z payment reviews in 2015 and will be working with the SOM faculty committee to address the audit findings.

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## III. PURPOSE, SCOPE, AND OBJECTIVES

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The objective of the audit was to evaluate whether or not faculty members and management were generally in compliance with APM-670 and the Plan

guidelines. The scope of the review focused on the outside professional income reported, deposited, reviewed/approved, and disbursed in fiscal year 2014.

Based on the assessed risks, the following audit objectives were established for the schools/departments selected for further review.

1. Determine if there is a process in place to track, monitor, and maintain supporting documentation for income received from outside professional activities to ensure amounts exceeding the threshold were properly determined and assessed in accordance to Plan guidelines.
2. Determine if total gross income generated from outside activities exceeded the income threshold, and if so, determine if the excess income was properly reported and deposited to the Plan as required by policy.
3. Determine if faculty members and related departments properly documented and reported income generated from outside activities.
4. Determine if payments related to outside professional activity income were properly documented, calculated, reviewed, and approved prior to disbursement.

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#### **IV. CONCLUSION**

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Based on our review, the SOM Dean's Office has established processes in place to ensure that income from outside professional activities are properly and accurately disbursed to faculty members. However, IAS identified compliance issues and concerns in the areas of depositing and distributing as well as the oversight of disbursing outside professional activities income.

Observation details and recommendations were discussed with management, who formulated action plans to address the issues. These details are presented below.

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## V. OBSERVATIONS AND MANAGEMENT ACTION PLANS

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### 1. Outside Professional Activity Income Not Reported

#### Background

The Plan guidelines for each of the departments in SOM states that income from outside professional activities must be deposited to the Plan if they exceed the annual threshold of \$40,000.00 or 20 percent of a faculty members base salary per fiscal year.

#### Observation

To determine if income from outside professional activities was properly reported and deposited to the Plan as required by policy, IAS reviewed annual outside professional activity reports for 38 SOM faculty members and compared them to physician payments reported by pharmaceutical and medical device companies as required by the Sunshine Act. IAS then compared this information to what outside professional activity income was deposited and noted the following observations.

- Nine faculty members in five SOM departments did not deposit any outside professional activity income that exceeded their annual earnings threshold into the Plan. Therefore, \$82,535.89 in income related to the Dean's Office assessment and department assessment was not received.
- Two other faculty members only deposited partial amounts of outside professional activity income that exceeded the threshold into the Plan. Therefore, \$ 31,778.25 in assessment related income was not received.

Reporting of outside professional activities is a self-reporting system so inherent within this system is the risk that faculty members could intentionally/unintentionally not report outside activities. Also, there is no requirement for departments or the Dean's Office to perform monitoring activities except for the review and approval of outside professional activity reports. Therefore, IAS recommends that SOM provide training and consider implementing monitoring activities to ensure compliance with policy.

## Management Action Plan

Additional training will be provided on the procedure and administrative mechanism for disclosure of outside professional activity income beginning in March 2017. IAS will follow-up on the management action plan by September 30, 2017.

## 2. Assessment Errors and Overpayments

### Background

Each SOM department Plan guidelines requires that income from outside professional activities exceeding the annual threshold be charged a five percent Dean's assessment as well as a department assessment, ranging from 5 to 40 percent, before the income is paid back to the faculty member in the form of Z compensation (HSC payment).

### Observation

IAS reviewed Z compensation distributions, focusing on HSC payments in ten SOM departments for the fiscal year ending June 30, 2014 and noted the following observations.

1. Assessment Errors leading to Under/Over Payments – IAS noted multiple assessment rate errors on outside professional activity income related to the established Dean's Office and/or department assessment policies, leading to under and over payments to faculty.
  - In Neurosurgery, a 2.84 percent assessment rate was applied to \$20,000.00 of outside professional activity income instead of the 40 percent tax rate stated in the Plan guidelines, resulting in an overpayment of \$7,432.00.
  - In Radiological Sciences, service agreement income of \$14,825.00 was improperly paid as HSC (should have been HSZ) for ten faculty members in one pay period. In addition, inaccurate assessment rates were applied (assessed 67.38 percent but the department's Plan guidelines noted a total assessment rate of 45 percent) leading to underpayments of \$3,317.84. In the following pay period, the same ten

faculty members income of \$12,736.00 was assessed at a 37.5 percent rate (should have been 45 percent) resulting in overpayments of \$1,910.27.

- In Orthopedic Surgery, IAS noted that monthly income amounts, ranging from \$1,500.00 to \$10,000.00, generated from sales and services agreement work by four faculty members were improperly disbursed as HSC payments. Consequently, the income was not properly assessed, resulting in overpayments of \$9,935.00.
- In Psychiatry & Human Behavior, one faculty member deposited \$21,179.34 in outside income in three pay periods and was assessed 70 percent when a 35 percent assessment rate is noted in the Plan guidelines, resulting in an underpayment of \$7,387.12.
- In Otolaryngology, IAS noted two HSC payments where the entire deposits, totaling \$4,304.11, were distributed as HSC payments without assessing the Dean's Office or department taxes. During the review, the department management stated that the deposits were 2011 Medicare incentive payments that were improperly distributed a second time. However, the department did not substantiate that the HSC payments were duplicate payments by providing appropriate supporting documentation.

## 2. Overpayments

IAS noted three instances in Orthopedic Surgery when the amount disbursed as an HSC payment to the faculty member was more than the check amount that was deposited.

- A \$2,500.00 check was deposited and the corresponding HSC payment was \$4,500.00.
- A \$3,000.00 check was deposited and the corresponding HSC payment was \$3,250.00.
- A \$3,000.00 check was deposited and the corresponding HSC payment was \$3,230.00.

## **Management Action Plan**

SOM Dean's Office is in the process of establishing targeted Z payment training for Z payment preparers and reviewers. This process will begin in March 2017 and will be ongoing as needed. IAS will follow-up on the management action plan by September 30, 2017.

### 3. Lack of Proper Oversight

#### Background

In SOM, the Dean's Office provides oversight in the disbursement of HSC payments. Prior to the disbursement, each department must document and support all payment requests by determining the amount of the deposit that exceeded the income threshold, applying the assessments in accordance with the Plan guidelines, and calculating the earnings distribution amount. The supporting documentation for the HSC payment is then submitted to the Dean's Office for review and approval. Only the Dean's Office has the authority to process distributions of outside professional activities income, after assessment, to the individual faculty member, consistent with applicable University policies and procedures.

#### Observation

The SOM Dean's Office does not have a process in place to properly track, monitor, and reconcile income earned from outside activities by faculty members in each SOM department. For example, the Dean's Office did not perform a reconciliation to determine if the outside activity income deposited to the Plan was also reported on the annual reporting form to ensure that all outside activity income was captured and properly assessed at year-end.

The Dean's Office did not adequately review the Z payment requests submitted by departments. As a result, numerous under/over payments were distributed as requested by the departments.

Proper oversight and review not only ensures compliance with policy and procedures but minimizes the likelihood of errors or policy violations.

#### Management Action Plan

1. The SOM will evaluate the current process for reconciliation of income from outside professional activities for necessary and appropriate changes by March 2017.
2. The Dean's Office recently enhanced the review of Z payment requests, which includes reconciliation of current request to prior payments, and is actively working on developing a new process to include other external

sources for implementation by July 2017. This includes training all staff involved in the process.

IAS will follow-up on the management action plans by September 30, 2017.