

July 7, 2015

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0742

Subject:*Health Sciences Faculty Compensation
Audit & Management Advisory Services Project 2015-20*

The final audit report for *Health Sciences Faculty Compensation, Audit Report 2015-20*, is attached. We would like to thank all members of the department for their cooperation and assistance during the audit.

Because we were able to reach agreement regarding corrective actions to be taken in response to the audit recommendations, a formal response to the report is not requested. The findings included in this report will be added to our follow-up system. We will contact you at the appropriate time to evaluate the status of the corrective actions.

UC wide policy requires that all draft audit reports, both printed and electronic, be destroyed after the final report is issued. Because draft reports can contain sensitive information, please either return these documents to AMAS personnel or destroy them at the conclusion of the audit. We also request that draft reports not be photocopied or otherwise redistributed.

David Meier
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Attachment

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UC San Diego

AUDIT & MANAGEMENT ADVISORY SERVICES

Health Sciences Faculty Compensation July 2015

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Project Number: 2015-20

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Health Sciences Faculty Compensation Project 2015-20

I. Background

Audit & Management Advisory Services (AMAS) has completed a review of Health Sciences Faculty Compensation (HSCP) as part of the approved audit plan for Fiscal Year 2014-15. This report summarizes the results of our review.

The University California (UC) Health Sciences Compensation Plan (HSCP), formalized in Academic Personnel Manual (APM) Section 670, was implemented to provide a common faculty compensation and administrative framework within which a participating Health Sciences Professional School can compensate its faculty according to the competitive requirements of each discipline. It outlines the elements of faculty compensation and describes practices for managing and reporting professional services income generated by its participants. Participants are members of the Health Sciences faculty holding University funded appointments greater than 50 percent time¹ in any of the following series: Professor, Professor-In-Residence, Professor of Clinical __ (e.g. Medicine), Adjunct Professor, Acting Professor, Health Sciences Clinical Professor, Visiting Professor, Dean, and other titles approved by the president.

The School of Medicine (SOM) and Skaggs School of Pharmacy and Pharmaceutical Sciences (SSPPS) developed and adopted HSCP local implementing procedures (HSCP Implementation Procedures). Each department subsequently developed a compensation plan (Department Compensation Plan) to define its approach to complying with the HSCP and the local Implementation Procedures. HSCP Implementation Procedures and Department Compensation Plans govern the calculation of components of compensation, the annual salary negotiation process, and the disposition of professional and miscellaneous other income for Health Sciences Faculty participating in the HSCP.

Departmental Compensation Plans incorporate input from its faculty and approval by the Vice Chancellor for Health Sciences (VCHS) and School Dean, and provide details for the following:

- good standing criteria²;
- base salary scale;
- manner in which additional compensation is negotiated;
- methodology for calculating incentive/bonus compensation (when applicable), and the frequency of payment;
- department requirements on occasional outside professional activities; and
- applicable policy on paid and unpaid leaves (including paid leave for disability) and sabbaticals.

¹ Faculty members with an appointment of 50% or less may be allowed to participate upon the recommendation of the Department Chair and the approval of the Vice Chancellor Health Sciences (VCHS).

² Good Standing Criteria will include expectations related to their academic series, departmental expectations related to service, and expectations related to generation of salary support and to shared expenses. *APM 670-10*

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HSCP participants negotiate their annual salary with their Division Head or Department Chair in accordance with Department procedures. Proposed compensation for the coming fiscal year is then communicated in writing to each HSCP participant by July 1, which includes base salary, additional compensation, and methodology for calculating incentive compensation. HSCP participants are entitled to receive base salary, which is considered to be covered compensation by the University of California Retirement Plan (UCRP). Base salary is broken down according to the following categories:

- X (Salary Scale 0 only, and may be charged to State General Funds)
- X' (Amount above X up to and including Scale 3)
- Y' (Amount above X' up to and including Scale 9)

Base salary is the approved rate on the HSCP salary scales (0-9) and associated with the faculty member's academic rank, step and assigned Academic Programmatic Unit (APU)³. Every APU is assigned annually to a HSCP salary scale⁴. The Department Chair is required to submit annually to the Dean the name of any faculty who has moved from one APU to another, and the reason for transition. Movement from one APU to another must be approved by the Dean and must be based on a significant change in duties or a change in department.

HSCP participants are eligible for additional negotiated compensation (Y), and/or incentive/bonus compensation based on clinical, consulting, or other miscellaneous earnings (Z) in accordance with fund source restrictions. Neither the Y nor Z components are considered covered compensation for UCRP purposes. Faculty must be in good standing in order to receive additional compensation.

Salary support for HSCP participants include:

- Compensation Plan Accounts⁵ that include income from professional services, amounts paid by University hospitals or affiliated institutions for services rendered by HSCP participants, and other income required to be included in these fund accounts.
- Funds made available for salary support from University-administered grants and contracts, unrestricted non-State Funds, and gifts or other funds available for such purposes as allocated by the Dean or Chancellor.

Because of the diversity in funding sources and reliability on the flow of revenue, salary calculations and payments for Health Sciences faculty can be complex and involve a considerable amount of planning, review and monitoring. Compliance with the HSCP also requires ensuring compliance with applicable Federal and State regulations and University policies and guidelines associated with faculty pay, such as:

- The National Institutes of Health (NIH) Salary Cap regulations;

³General guidelines for APU formation were issued by the UCOP in November 1999 in APM 670. An APU shall comprise faculty with similar clinical, teaching and research responsibilities.

⁴ Each scale delineates a specific amount for each rank and step.

⁵ APM 670 Appendix C Item c. *Accounts and Sources*.

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- Salary support on State General Funds;
- University of California – Veterans Administration (UC/VA) Split Appointments;
- Salary Adjustments based on merit and promotion; and
- Service contracts and agreements.

UC San Diego Health Sciences developed a summary worksheet of the HSCP, as well as various tools and salary worksheets for calculating faculty compensation, including breakdown of salary components, NIH “cap gap” (the difference in compensation between the NIH salary cap and a faculty member’s base salary), UC/VA effort, and above scale salary, to help departments and SOM units ensure accuracy of the faculty compensation calculations and consistency in application of the HSCP.

SOM and SSPPS departments are responsible for developing an annual budget for compensation plans which should clearly indicate the funding mechanism for all benefits provided according to HSCP. Each department is also expected to maintain a reserve for contingencies as approved by the VCHS. Those funds are monitored monthly by the VCHS⁶.

The VCHS Faculty Compensation unit oversees reviewing and monitoring of HSCP compliance and various aspects of faculty compensation calculation. Since 2010, this unit has been working on developing new and automated tools and processes to improve efficiency, eliminate duplication of effort, and reduce human errors from manual calculations and data entry. Changes in VCHS leadership and business models also required redirection of some of these efforts.

In 2010, SOM piloted a core service center for faculty personnel administration, providing services to three small departments. In July 2014, the core service model expanded to a centralized processing center called Academic Resource Center (ARC). The new ARC included the following four service units that process transactions affecting SOM faculty compensation:

- Academic Recruitment and Appointment
- Reviews
- Personnel Administration
- Compensation and Timekeeping

The Compensation and Timekeeping (ARC-CT) unit processes the approved faculty compensation into the Payroll and Personnel System (PPS) for July 1 implementation, and any changes related to it throughout the fiscal year, which used to be a departmental function. During the same year, a soft mandate required that several departments transitioned to utilizing some or all of the services offered through the various ARC units. As of February 2015, the Department of Medicine also made its transition to the ARC-CT services. The additional complexities in the Department of Medicine faculty compensation required ARC-CT to redesign some of its tools and processes and adopt

⁶ Ref. *SOM & SSPPS Implementation Procedures for HSCP. Section IX.*

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most of this larger department's established procedures and tools. The ARC-CT unit manually audits PPS entries to review accuracy of information entered in the payroll system for the July 1 new salary implementation each year, including changes affecting effort, pay and cost distribution throughout the year. A few tools have been recently automated for efficiency and more frequent review.

II. Audit Objective, Scope, and Procedures

The objective of our review was to assess compliance with HSCP requirements and the accuracy of compensation calculations on a sample basis. In order to achieve our objectives we completed the following:

- Reviewed the HSCP and UCSD local implementing procedures;
- Reviewed available department compensation plans;
- Evaluated the organizational structure of the ARC units that manage faculty compensation;
- Interviewed faculty compensation experts and key personnel in VCHS and ARC-CT unit gather information about current faculty compensation review and compliance monitoring procedures.
- Reviewed SOM tools and documentations related to FY15 Faculty Salary Scales, calculation of NIH cap gap, UC/VA split plan implementation, and available APU listing;
- Met with selected SOM Department Business Officers to gain an understanding of department processes related to faculty compensation planning and management procedures;
- Analyzed SOM procedures for reviewing accuracy of salary components and distribution to available funding sources to ensure that State General Funds are appropriately used;
- Selected a sample of faculty pay and reviewed implementation of new rates in PPS for the current fiscal year, and any changes during the year affecting pay rate, covered compensation calculation, cap gap funding, and leave benefits usage, to ensure these changes were adequately supported and approved.
- Reviewed a sample of non-base components of faculty compensation for the current fiscal year and verified validity of funding sources, and eligibility for pay;
- Evaluated a sample of APU changes and verified whether appropriate approval and documentation were obtained, and that PPS changes were accurate and reflected in a timely manner;
- Reviewed VCHS procedures for monitoring compliance with NIH salary cap requirements and restrictions on use of Federal or State funding to cover salary over this cap;
- Tested a sample of faculty pay with NIH funding sources to evaluate accuracy of cap rate used, and verified whether State and other Federal funding were utilized as cap gap sources; and

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- Tested a sample of reported leave usage to verify that appropriate approval and documentation were obtained.

Because a separate campus-wide review was performed in relation to Conflict of Commitment and Outside Professional Activities, our scope did not include evaluation of reported income from outside professional activities for SOM and SSPPS departments.

III. Conclusion

Based on our review procedures, we concluded that UC San Diego Health Sciences business practices provide reasonable assurance that faculty compensation meets HSCP requirements, is consistent with established department compensation plans, and complies with applicable Federal and State regulations and other University policies.

The VCHS Faculty Compensation office continues to work with departments and the ARC units to develop additional tools and reports to improve efficiency in reviewing faculty compensation, including updating all department compensation plans for consistency with the local HSCP implementing procedures and other changes within the Health Sciences business model. The departments and ARC-CT rely on each other in ensuring accuracy of faculty salary implemented, fund changes, and other adjustments. As the Health Sciences business model and process for funding faculty compensation evolve, continued focus on use of effective monitoring tools will be important in evaluating compliance and assisting management with fiscal oversight in the new structure.

We identified opportunities for improvement in monitoring salary limitations on NIH funds and determining salaries above the cap from other funding sources; as well as timeliness in processing APU and other related changes affecting calculation of UCRP covered compensation components.

Additional details on opportunities for improvement are discussed in the remainder of this report.

IV. Observations and Management Corrective Actions

A. PPS Updates for APU Changes

We noted a delay in the implementation of newly created APU change for four HSCP participants.

The APU salary scale assignment has a significant impact on benefits calculations. A faculty member at an APU salary scale of 9 is allowed total covered compensation that is 225% of the covered compensation for a faculty member with the same rank and step, at an APU salary scale of 0.

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To allow time for additional clarification concerning the effect of APUs, the VCHS issued a letter dated November 9, 2007 stating that, effective with the Fiscal Year starting July 1, 2007, new APUs would not be approved until further notice. During our review, the suspension was still in effect. However, VCHS management reevaluated the need for the APU suspension on a periodic basis.

We obtained a list of all APU changes in Health Sciences for the FY14 and FY15 and identified four faculty with APU changes to a newly created APU. We noted that in June 2014, a new APU for Health Sciences request was submitted to the Chancellor for approval. The request was approved in December 2014 effective retroactively to July 1, 2014 for four faculty members in the new APU unit. In reviewing faculty compensation for the APU changes, we noted following:

- Implementation had not been completed in payroll system (PPS) as of April 15, 2015 for the 4 members that were moved to newly created APU;
- More than 6 months delay was noted in payroll implementation for a faculty that transitioned to another APU for FY15.

In addition, we noted that for three of the 4 faculty proposed in the newly created APU, the prior salary information indicated on the request sent to the Chancellor for the creation of new APU proposal was inaccurate due to a typographical error. The error occurred because the information supplied to the Chancellor's office for the creation of new APU was not routed to the Director of Faculty Compensation for review to ensure accuracy prior to submission. Although the error had no financial impact to the faculty based on the total negotiated compensation, benefits allocation for covered compensation and the funding requirement for that allocation is impacted and will require some accounting adjustment. Attention to detail and timeliness in processing those changes would help in ensuring adequacy of funding and accuracy of benefit information.

Management Corrective Actions:

1. VCHS has implemented all FY15 changes in APU in PPS as of May 2015 to ensure that elements impacted covered compensation are updated, and that accurate prior year salary information is used for the FY16 budget cycle.
2. VCHS will ensure that secondary review by the Director of Faculty Compensation be performed to validate information on all requests for executive approval to ensure accuracy.

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B. Monitoring of NIH Salary Cap

Additional monitoring of faculty salaries subject to the NIH salary cap could facilitate compliance and the use of University funds to cover the gap in total compensation and agency caps.

Every year since 1990, Congress has legislatively mandated a provision limiting the direct salary⁷ that an individual may receive under an NIH grant. The NIH website provides a list of applicable salary caps based on the government fiscal year and award issue date. Depending on the type of grant, the applicable salary limit can be determined by the award issue date and applicable NIH fiscal year for the grant, which can be found on the notice of grant award. The NIH also periodically increases the salary cap rate, through a Notice on Salary Limitation on Grants, Cooperative Agreements, and Contracts. Most recently, on December 30, 2014, NIH issued Notice Number NOT-OD-15-049⁸ which increased the salary cap rate from \$181,500 to \$183,300 for awards issued from January 11, 2015 through September 30, 2015. This notice indicates that while no additional funds will be provided, grantees may rebudget grant funds or charge contracts issued in prior years funds to allow for the salary cap increase, provided funds are available and the increase is warranted and consistent with the institutional base salary.

In addition, APM 667-16 *Additional Compensation: Extramurally Funded Research* indicates that “agency maximum salary caps must be observed and State funds may not be used to pay for any gap in compensation between agency salary caps and total compensation received, other than the HSCP Scale Zero that may result from such maximum amounts.”

VCHS Faculty Compensation reviews and monitors charges to State funds to ensure salary costs charged to these funds do not include cap gap. However, VCHS Faculty Compensation and ARC-CT unit relied on the fund managers (via the department or the Health Sciences Research Service Core (RSC) unit) to identify and apply the appropriate NIH salary cap. Aside from the fund managers, there was no other layer of review performed at the VCHS level to ensure the appropriate NIH salary cap was applied. We noted that the Office of Post Award and Financial Services (OPAFS) recently initiated a process of sending out a quarterly notification to fund managers for salaries that may have been charged to NIH above the salary limitation. RSC and other department business units relied on the notification from OPAFS in identifying salaries that may have been paid above the agency salary limitation. The salaries that were paid using a salary cap lower than the limit were not typically reviewed at another level.

⁷ Ref. NIH Notice Number NOT-OD-15-054 and NOT-OD-15-049

⁸ Preceded by NOT-OD-14-052 on February 10, 2014 which increased the salary cap rate from \$179,700 to \$181,500 for FY 2014 awards issued on January 12, 2014 through September 30, 2014. This notice included the same provisions in NOT-OD-15-049 for implementation of the salary limitation regarding the use of higher cap rate.

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During our review, 11 faculty salaries were judgmentally selected for detailed review of NIH cap rate to determine salary limitation on NIH funded salaries as well as the portion of the salary above NIH cap (cap gap) that required funding from other non-federal and non-State⁹ funding sources. We noted that in each case, fund restrictions were appropriately managed, and State funds were not inappropriately used to cover the cap gap, and that the salaries charged to grants were within the limit as allowed by NIH.

However, we noted inconsistencies among departments when a higher NIH salary cap rate was applied. We noted in our review that four departments applied a higher NIH salary cap at different times after a cap rate increase was issued, and four applied an old and lower cap throughout the period regardless of the change in the applicable NIH cap during the year. AMAS evaluated the four instances where a higher cap rate was used, and found that one department applied the new salary cap rate at the beginning of the fiscal year when negotiated faculty salaries went into effect. Two other departments applied the change to the salaries charged shortly after the new NIH cap went into effect, while another department applied the change several months later.

In general, application of the correct NIH cap is the responsibility of the research award administrators in either the department or the RSC. The application of an incorrect NIH salary cap could result to inadequate funding on other sources, or overpayment of salaries on NIH grants: If a NIH cap is used that is too high, salaries could be overpaid on NIH grants, and if a cap rate is used that is too low, the federal award is not charged its full allowable share of salary, and the University bears an increased burden of funding additional cap gap salary. In addition, there was not a consistent approach to when and whether cap rate increases were applied to faculty salaries charged to NIH grants. The effect of not applying an available cap increase is that the University funding sources may be bearing an increased financial burden in funding cap gaps.

In light of the institutional risk and shared responsibility for monitoring the complex salary arrangements involving faculty who are subject to the cap gap, a more proactive approach in reviewing NIH salary cap may be warranted. This would ensure compliance with policy and regulations, save time and resources required to adjust or correct the errors, and more effectively monitor the need for cap gap funding from a global management perspective.

Management Corrective Action:

VCHS Faculty Compensation office will coordinate with Resource Management Team, OPAFS, the Research Service Core, ARC, and

⁹ University policy prohibits the use of State appropriations, including General Funds, to pay salary above the NIH salary cap on the X', Y' or Y salary components. (Ref. APM 667-16)

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departments to implement additional monitoring controls regarding NIH salary cap rates, and cap gap funding. The group will leverage the FY2016 implementation of new Financial Management and Resource Alignment initiatives to implement additional audit tools for identifying applicable NIH salary caps to ensure restrictions on NIH salary and State funding for salary above NIH cap are implemented correctly.