

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

Senior Management Incentive Plans:  
Office of the Chief Investment Officer Annual Incentive Plan  
Audit No. P25A004  
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# Executive Summary

## Introduction

As part of the University of California Office of the President (UCOP) 2024–25 fiscal year audit plan, Internal Audit completed a review of the Office of the 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 the OCIO employees responsible for attaining key objectives. 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.

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.

The University retained Mercer, a human resources consulting firm, to recommend new investment performance standards for fiscal year 2023–24. Once the AOC approved these standards, Mercer reviewed the updated AIP award calculation model to take into account the changed investment performance standards. The model contains investment and participant performance measures and results classified into three levels: threshold, target, and maximum.

The AIP Administrative Guidelines (Guidelines) serve to assist all involved parties in the application of the AIP provisions. The Guidelines may change from year to year to reflect the AOC-approved changes to the Plan or processes. Various UC departments provide additional data. UCOP Human Resources (OPHR) and the OCIO provide data including participant names, salaries, performance measure weightings, and participant qualitative performance ratings, which the CIO approves. The Office of the Chief Financial Officer (OCFO) enters investment performance data provided by State Street Bank and the remaining data is entered by Systemwide Human Resources Executive Compensation Unit (SWHR Executive Compensation).

For Investment Officers and more senior positions, awards are payable in three annual installments comprised of 50 percent in the current Plan year, 25 percent in the next year, and 25 percent in the year thereafter, plus interest. Interest is based on the quarterly Short-Term Investment Pool (STIP) rate of return. Other participants receive 100% payouts 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, Executive Vice President and Chief Financial Officer, Vice President of Human Resources, and Associate Vice President of Total Rewards. The Regents delegated to the AOC authority to approve nonmaterial Plan changes. Material or substantive changes require the approval of the President and the Regents' Investments Committee. The Regents also delegated to the AOC authority to review and approve participant performance objectives and award recommendations. Performance objectives and award recommendations for the CIO are under the purview of the Board of Regents and require its approval. The Chief Compliance and Audit Officer (CCAO) is responsible for periodic auditing and monitoring of the Plan, as appropriate.

## **Objectives and Scope**

The primary objectives of this audit were to assess the accuracy of fiscal year 2023–24 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. For Plan participants' performance ratings, we relied on management's documented evaluations.

We reviewed the fiscal year 2023–24 award calculations and verified eligible participants.

For each participant, we verified the following:

- Fiscal year 2023–24 actual salary earnings
- AIP award opportunity percentages
- Performance measure weightings
- Subjective performance rating
- Award opportunity

We reviewed the fiscal year 2023–24 payout calculations and verified:

- Award amounts for each participant
- Fiscal year 2021–22 and fiscal year 2022–23 deferred award payouts for investment officer level and above
- Spreadsheet formulas used for calculations for fiscal years 2023–24, 2022–23, and 2021–22 components of the payout calculation, including interest allocations
- Interest amounts used in the payout calculations tied to the amounts provided by State Street
- Payout amount for each participant included on the Payment List, prepared by the OCIO for the Payroll Office, agreed to the payout calculation

For the fiscal year 2024–25 plan year, we verified that the AOC approved:

- Participant list
- Participant qualitative objectives
- Investment performance standards (objectives)
- AIP document changes

As part of our audit, we also performed:

- An evaluation of annual investment performance results against source documents provided by State Street.
- A trend analysis of participant awards and noted that the percentage of participants who rated higher than meets expectations (solid performance) in Fiscal Year 2023–24 was 62% (21 out of 34 participants), which is a slight decrease compared to 68% (21 of 31 participants) in Fiscal Year 2022–23.

## **Overall Conclusion**

A detailed plan and guidance have been created for the administration of the AIP and the AOC approved all of the documents it was required to review for fiscal year 2024–25. Nevertheless, we identified minor errors in a few calculations of the fiscal year 2023–24 AIP award payouts, criteria and proposed awards that should have been disclosed, and as was the case in previous years, certain documentation necessary for completion of the audit was not readily available.

We noted the following observations which are presented in order of their significance:

- A few Plan participants' base earnings and resulting incentive awards were incorrectly calculated
- A table showing the relationship between performance ratings and individual award opportunity levels was not disclosed
- The AOC did not provide the President and the Regents' Investment Committee with a list of award recommendations before they were scheduled to be paid, as required by the Plan
- Certain documentation was not readily available

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

## Observations and Action Plans

### 1. A Few Plan Participants' Base Earnings and Resulting Incentive Awards Were Incorrectly Calculated

A few Plan participants' base earnings, on which their incentive awards were based, were incorrectly calculated. Two participants took unpaid leave during the Office of the President's winter curtailment, which reduced their earnings for that pay period. However, because the format of the payroll information report provided to Executive Compensation did not make it clear that the amounts associated with curtailment should be subtracted from their base pay, the calculations of their regular earnings were not reduced as they should have been. Compounding the miscalculation, the line items that accounted for this leave were then added to these participants' reported regular earnings, resulting in base earnings amounts for the calculation of their incentive awards that were slightly higher than appropriate. In total, the first individual's calculated base earnings were \$5,142 higher than they should have been, and the second individual's calculated base earnings were \$2,394 higher than they should have been.

In addition, retroactive vacation pay was not added to a third participant's regular earnings, resulting in a calculated base earnings amount that was slightly lower than appropriate. In total, their calculated base earnings were \$405 less than they should have been.

These situations were difficult for Executive Compensation to identify because the report used to calculate the base earnings amounts on which incentive awards are based does not contain sufficient information to easily calculate and verify base earnings calculations. Because it does not include both the positive and negative entries associated with certain scenarios, the individual performing the calculations must have knowledge of the nuances of each earnings code and leave type. Further, because new earnings codes are regularly added, their effect must be assessed before they are added, subtracted, or omitted from the base earnings calculations.

#### **Recommendations:**

*Executive Compensation should:*

- a. *Request that the AOC correct the awards paid to the individuals described above.*
- b. *Establish a process to categorize earnings codes for the purpose of calculating base pay and obtain adequate information to validate the correct use of any newly created earning codes.*

#### **Action Plans:**

*The Director of Executive Compensation will:*

- a. *Review the application of unpaid curtailment leave (LVC) and retroactive vacation (9VC) payroll earnings codes to certain fiscal year 2023–24 Plan participant earnings and correct the calculation of those earnings and resulting incentive awards.*
- b. *Create processes to ensure the accuracy of the Plan participant base earnings calculations including:*

- i. *Revise the Plan’s Administrative Guidelines to add a requirement to (a) create a list of payroll earnings codes that identifies those that should be included and commonly used codes that should be excluded from the calculation of the Plan participants’ base earnings on which incentive awards are based and (b) for this purpose annually review any payroll earnings codes that apply to Plan participants and are not on the list.*
- ii. *Obtain from Human Resources Payroll one or more reports with the information necessary to validate the calculation of participant base earnings on which incentive awards are based. These reports should include at a minimum both the positive and negative amounts associated with payroll and leave transactions and a way to validate base earnings, which could be accomplished by obtaining W2 gross earnings information.*

***Target dates:***

- a. *August 31, 2025*
- b. *August 31, 2025*

**2. Some Award Criteria is Not Disclosed**

Award calculations are determined in part by individual qualitative performance ratings. These calculations rely on several related tables that are presented in the Plan and its Guidelines. For example, the Plan includes tables that specify incentive award opportunity levels (the percentages of base salary to be paid as a bonus if predetermined levels of performance are attained) by position. One of these tables is a rating-to-opportunity table that specifies the relationship between individual qualitative performance ratings and incentive award opportunity levels. While this table is in the calculation model, it is not disclosed in the Plan or the Guidelines. If this table is not disclosed it is not clear how one would understand how individual qualitative performance ratings relate to incentive award opportunity levels. Adding this table and regularly comparing the Plan, the Guidelines, and the calculation model could help ensure they are aligned and improve transparency.

***Recommendations:***

*To improve transparency and the continuity of operations, the Administrative Guidelines should:*

- a. *be updated to include a rating-to-opportunity table, and*
- b. *be periodically compared to operations to ensure they align.*

***Action Plans:***

- a. *The Director of Executive Compensation will revise the Plan’s Administrative Guidelines for fiscal year 2024–25 to include the table specifying the relationship between individual qualitative performance ratings and incentive award opportunity levels.*
- b. *The Director of Executive Compensation will periodically review the Plan’s Administrative Guidelines to ensure that it accurately reflects the key aspects of the current award calculation methodology.*

***Target dates:***

a. August 31, 2025

b. August 31, 2025

**3. The AOC did not provide the President and the Regents' Investment Committee with a list of award recommendations**

The Chair of the Regents Investments Committee (Chair) has not been provided with lists of recommended AIP awards, as required by the Plan. According to the Plan document, "The AOC will provide the President and the Chair of the Regents' Investments Committee with a listing of award recommendations before awards are scheduled to be paid." However, we could not find any evidence that this occurred between fiscal year 2015–16 and now. The Director of Executive Compensation told us that when she began employment with the University she was told that there were references in incentive plans to reports that were no longer required, and she also noted that providing this report was not a part of the process that she took over. Nevertheless, the Plan does not reflect this understanding of what is expected.

***Recommendation:***

*The Director of Executive Compensation should take steps to align this aspect of the Plan's administration with the Plan's requirements. This could consist of either providing the information to the individuals required by the Plan or updating the Plan to eliminate this requirement. Until the requirement is removed from the Plan, the Director of Executive Compensation should provide this list in advance of the awards being paid.*

***Action Plan:***

*The Director of Executive Compensation will request that the Regents clarify their preferences and, as appropriate, update the Plan to reflect those preferences or provide the required list of award recommendations.*

***Target date:***

*August 31, 2025*

**4. Certain Documentation was Not Readily Available**

During the course of this review a number of pieces of evidence were not readily available. For example, we did not receive a key piece of evidence justifying the CIO's award until after our fieldwork was completed and we described its absence as a preliminary observation. Additionally, during the past two years certain aspects of this review were not completed because evidence was not available. While this hampers the audit process, of greater concern is the risk that documentation required to justify AIP awards might not be collected and maintained. Best practices describe documentation of processes and transactions, and the proper management and maintenance of documentation and records, as common safeguards to mitigate risks to acceptable levels. The Director of Executive Compensation indicated that there were delays in filing documents because of resource constraints.

***Recommendations:***

*To facilitate the timely collection and maintenance of documentation necessary to calculate and justify AIP awards, a checklist of documents required for the annual operation of the Plan and their due dates should be generated. All relevant documents should be collected in a central repository by those due dates.*

***Action Plan:***

*Executive Compensation will create a checklist of all documents necessary for the annual administration of the AIP, including but not limited to those required by the Plan and Guidelines, and use that list to assess whether all necessary documents are present in a central repository no later than the date awards are paid each year.*

***Target date:***

*August 31, 2025*