Report on Audit # 13-120 Compliance with Regents' Rules and Regulations for Highly Compensated Individuals

We have completed our audit of the University of Texas Health Science Center at Houston (UTHealth) Compliance with Board of Regents' Rules and Regulations for Highly Compensated Individuals. This audit is part of our fiscal year 2013 audit plan. This audit was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing.

BACKGROUND

Highly compensated individuals are defined by the Regents' Rules and Regulations as those, other than key executives, with annual salaries of $500,000 or above. Salaries from $500,000 to $999,999 must be approved by the Executive Vice Chancellor for Health Affairs. Salaries of $1,000,000 or more must be approved by the Board of Regents (BOR). In either case, the employing institution is responsible for providing documentation to the Executive Vice Chancellor that the compensation was established in accordance with the Systemwide policy for establishing the compensation for Highly Compensated Personnel. These requirements are documented in Regents' Rules and Regulations 20204 “Determining and Documenting the Reasonableness of Compensation”. Regents' Rules and Regulations 20204 is implemented through UT System Administrative Policy (UTS) 144 “Establishing Compensation for Highly Compensated Employees”. At the institutional level, UTHealth Handbook of Operating Procedures Policy Number 193 “Salary Administration” (HOOP 193) serves as a general salary administration policy.

UTHealth had 70 individuals who met the definition of highly compensated at the time of this audit. All, except two, were Medical School faculty. Medical School faculty compensation decisions are made within the school and do not include Human Resources. The UTHealth president is considered a key executive and is not subject to Regents' Rules and Regulations 20204.

OBJECTIVE

The objective of this audit was to determine whether UTHealth is following the Board of Regents' Rules, UT System Policy and UTHealth Institutional Policy regarding highly compensated individuals.
SCOPE AND METHODOLOGY

Auditing and Advisory Services (A&AS) reviewed new hires from September 1, 2012 through February 2013 for compliance with Regents’ Rules and Regulations 20204. Budgeted salaries for Fiscal Year (FY) 2013 and unbudgeted salary changes from September 1, 2012 through February 2013 were reviewed for UT System approval.

A&AS also reviewed requests to recruit new faculty, requests for budget changes, budgeted salary reports, salary data and the associated support to determine compliance with applicable policies governing highly compensated individuals.

AUDIT RESULTS

The categories of pay included by UTHealth in determining total compensation were changed in November 2012 to be more inclusive, adding compensation such as incentives. In addition, the processes and controls for ensuring compliance with the rules and policies concerning highly compensated individuals have recently undergone significant changes. We began by working with the various responsible departments to identify, define and document these processes. Through interviews and coordinated meetings, we created a series of flowcharts showing the roles and responsibilities of the various departments involved in hiring highly compensated individuals. These flowcharts were provided to the management involved in the process.

Definition of Total Compensation

A&AS compared the definition of Total Compensation in the various policies. We noted that Regents’ Rules and Regulations 20204 specifically exclude employer contributions to TRS and ORP from the calculation. UTHealth excludes the amount in practice. However, UTS 144 and HOOP 193 both include this amount.

In our opinion, based on limited test work, few individuals would be impacted by the inclusion of employer contributions to retirement plans. Approximately two additional individuals would require UT System approval and two would move from System approval to BOR approval. Compensation Services is working with UT System Human Resources to determine the appropriate definition of total compensation.

Approval of Budgeted Salaries ≥$500,000

Budgeted salaries for highly compensated individuals are reviewed by UT System during the budget review process through several supplemental budget reports. Approval of the salaries is indicated by approval of the budget by the BOR. A&AS compared the FY 2013 budget reports of highly compensated individuals, prepared during the budgeting process, to the actual salary and associated payments for FY 2012. We noted that a few individuals earning more than $500,000 in FY 2012 were not included on the FY 2013 reports. Budget and Financial Reporting determined that at least one of the individuals noted received “On-Call” pay. System guidance is unclear on whether on-call pay should be budgeted at the individual or departmental level and whether this type of pay should follow the “Request for Budget Change” process.
The process for obtaining UT System approval was not implemented by UTHealth until November 2012. However, it has been required by Regents' Rules and Regulations 20204 and HOOP 193 since May 2012. Of the seven new hires in our population, five received appropriate approval.

Approval of Non-budgeted Changes to Salaries >$500,000
Non-budgeted changes to salaries greater than $500,000 require that a Request for Budget Change (RBC) form be completed and sent to UT System for approval. Approval of the RBC serves as UT System approval of the salary. We reviewed salary increases requiring RBC's and found 4 of 15 did not have the required RBC's, though some were subsequently completed.

During our preliminary meetings, the RBC process was not well defined and individuals involved were unsure of their roles and responsibilities. During our work to document this process, the roles were clarified and the process defined. System Data Resources (SDR) is working with the Dean’s office in the Medical School to train users on the RBC process. SDR will monitor the new process for efficacy and make adjustments if needed.

Adequacy of Documentation for New Hires
Regents' Rules and Regulations 20204 states, “Institutions of The University of Texas System are charged with setting compensation levels for Highly Compensated Personnel in such a way that compensation is reasonable and adequate documentation is maintained for supporting the reasonableness of compensation paid. Additionally, UTS 144 states “The compensation of highly compensated employees will be set in such a way that the public will understand that the level of compensation is reasonable when provided with full information on the basis of the compensation decision.”

During the period under review, September 1 2012 through February 2013, seven highly compensated individuals were hired. We performed test work to determine if the required elements were present in the supporting documentation used to determine the initial compensation.

In general, the factors required by UT System were included in the documentation. However, explanations of the decision making process to support the level of compensation were not included. We found that in five of the seven test cases, documentation did not support the level of compensation offered to the individual. For example, documentation of national average salaries was present, but the salary offered was significantly higher. To meet the requirements of the Regents' Rules and Regulations and System Policy, documentation should include an explanation of how the compensation level was determined.
Recommendation 1:
We recommend that a check for adequacy of benchmarking data be added to the new hire process. When situations arise in which we pay higher than the benchmarking average, a clear explanation should be documented.

Management's Response:
Management agrees with the recommendation. For highly compensated individuals (defined as individuals with compensation greater than or equal to $500,000) for which we are required to submit the HCR ("High Compensation Request") template prior to the offer letter being finalized we have added instructions that benchmark data should be added to the template. Such instructions will allow the use of both private and academic benchmarks. Training will be given to the DMOs on how to better communicate regarding compensation levels for highly compensated individuals.

Responsible Party: Dr. Nancy McNiel and Julie Page
Implementation Date: January 1, 2014

CONCLUSION

The process for hiring highly compensated individuals has undergone major changes in the last few months. The current process includes obtaining appropriate UT System approval but the supporting documentation is often not adequate to explain the reasonableness of compensation.

We would like to thank all of the staff and management of Budget and Financial Reporting, Office of the President, Office of the Dean at the Medical School and System Data Resources that assisted us during our review.

Daniel Sherman, CPA CIA
Assistant Vice President

cc: Audit Committee
   Dr. Giuseppe Colasurdo
   Kevin Dillon
   Mike Tramonte
   Eric Fernette
   Dr. Nancy McNiel
   Julie Page

Audit Manager: Sherri Heckendorn, CPA, CISA, Sr. Audit Manager
Auditor Assigned: Cara Saldivar, IT Auditor

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