California State University

It Needs to Strengthen Its Oversight and Establish Stricter Policies for Compensating Current and Former Employees

REPORT NUMBER 2007-102.1, NOVEMBER 2007

California State University's response as of November 2008

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the compensation practices of the California State University (university).[1] Specifically, the audit committee asked us to identify systemwide compensation by type and funding source, to the extent data are centrally maintained and reasonably consistent among campuses. The audit committee also asked us, subject to the same limitations, to categorize by type and funding source the compensation of highly paid individuals receiving funds from state appropriations and student tuition and fees. In addition, for the most highly paid individuals, the audit committee asked us to identify any additional compensation or employment inducements not appearing in the university's centrally maintained records, such as those recorded in any employment agreements with the university. Further, the audit committee asked us to review any postemployment compensation packages and identify the terms and conditions of transitional special assignments for highly paid individuals, including top executives and campus presidents, who left the university in the last five years. Finally, the audit committee asked us to determine the extent to which the university's compensation programs and special assignments are disclosed to the board of trustees (board) and to the public, including the types of programs that exist, the size and cost of each, and the benefits that participants receive. To the extent that this information is available and is not publicly disclosed, the audit committee asked us to include these items in our report.

Finding #1: The university has not developed a central system sufficient for monitoring compliance with its compensation policies.

The chancellor's office establishes systemwide compensation policies but does not have a system in place that allows it to adequately monitor adherence to those policies and to measure their impact on university finances. Specifically, the chancellor's office does not maintain systemwide compensation data by type and funding source, either by individual or in total. The lack of this data impairs the ability of the chancellor's office to provide effective oversight of the university's compensation programs. The executive vice chancellor and chief financial officer (executive vice chancellor) indicated that it was never the intent of the chancellor's office to have detailed systems in place to monitor employee payments and to ensure that payments are consistent with policy, as it believes that is a campus responsibility. Accordingly, the financial tools available to the chancellor's office for payroll purposes reflect its view that campuses are delegated the authority and responsibility to monitor compliance with university

[1] The audit committee also requested that we review the university's hiring practices and employment discrimination lawsuits. The results of our review of these areas were included in a separate report (2007-102.2), which we issued in December 2007.

Audit Highlights . . .

Our review of the California State University's (university) compensation practices revealed the following:

- *The university has not developed a central system enabling it to adequately monitor adherence to its compensation policies or measure their impact on university finances.*
- *Average executive compensation increased by 25.1 percent from July 1, 2002, through June 30, 2007, with salary increases contributing the most to the growth.*
- *The board of trustees (board) has justified increasing executive salaries on the basis that its executives' cash compensation, excluding benefits and perquisites, lags those of comparable institutions, but concerns have been raised about the methodology used.*
- *The university has three executive transition programs that provide postemployment compensation packages to departing executives, in addition to the standard retirement benefits available to eligible executives.*
- *Some Management Personnel Plan employees received questionable compensation after they were no longer providing services to the university or while they were transitioning to faculty positions.*
- *The discretionary nature of the university's relocation policy can result in questionable reimbursements of costs for moving household goods and closing costs associated with selling and purchasing residences.*

policy. The executive vice chancellor cited the standing orders of the board and the board's statement of general principles as the general policy basis for this delegation. Although we recognize that campuses have primary responsibility for implementing compensation policies, it is important for the chancellor's office to have sufficient data to ensure that the campuses appropriately carry out their responsibilities.

To provide effective oversight of its systemwide compensation policies, the university needs accurate, detailed, and timely compensation data. The university should create a centralized information structure to catalog university compensation by individual, payment type, and funding source. The chancellor's office should then use the data to monitor the campuses' implementation of systemwide policies and to measure the impact of systemwide policies on university finances.

University's Action: Partial corrective action taken.

The university reports that the board continues to believe that it is appropriate to delegate authority to campus presidents to monitor employee pay transactions. The board does not believe that it is necessary for the chancellor's office to monitor this information. However, in order to improve transparency, the chancellor will review presidential recommendations for vice presidential compensation, including salary, salary increases, bonuses, and supplemental compensation, from all fund sources, upon initial appointment and in subsequent years, and will provide an annual report to the board on such compensation each fall. The university also reports that in April 2008 it provided training to almost 600 employees who enter salary and payroll data at all 23 campuses on the coding of salary payments. In addition, the university created a business process model to provide guidance to campuses on required steps when entering data, and enhanced its personnel/payroll transaction form to reduce the possibility of coding errors. The university states it is in the process of identifying any employees who were required to attend the training, but did not, and will ensure that any such individuals receive the training. The university states that once this process is complete, its office of the university auditor will review the new business process model and the changes to the personnel/payroll transaction form to determine their effectiveness. Finally, the office of the university auditor will also conduct periodic audits to ensure the proper coding of payments. However, although such steps may be beneficial, they do not satisfy the need for centralized oversight of the university's compliance with its systemwide compensation policies.

Finding #2: The board has continually justified increasing executive salaries on the basis that its executives' cash compensation lags that of comparable institutions.

Average executive compensation increased by 25.1 percent from July 1, 2002, through June 30, 2007. Because this increase was greater than that of other employee classifications, we examined the growth in the various components that make up executive compensation—salaries, housing allowances, and automobile allowances—over the five-year period. We found that salary increases contributed the most to this growth, with the board approving salary increases on three separate occasions. The salary increases for executives ranged from an average of 1.68 percent to 13.7 percent. The board has continually justified increasing executive salaries on the basis that its executives' cash, or salary, compensation lags behind that of comparable institutions. However, as early as October 2004, the California Postsecondary Education Commission (commission), the entity that was involved with executive compensation studies until that time, raised concerns that the methodology used in making such comparisons did not present a complete picture of the value of individual compensation packages because it did not consider benefits and perquisites provided to executives, which can be substantial. Despite these concerns and the absence of further commission involvement in surveys of executive compensation, the university proceeded to use a consulting firm to perform surveys of the comparison institutions using the questioned methodology. Further, documents indicate that the board approved executive salary increases in October 2005 and January 2007 based only on the lag in cash compensation.

The commission and the Legislative Analyst's Office (legislative analyst) expressed further concerns in 2007 about the existing methodology used in these types of comparisons. Nevertheless, in September 2007 the board granted its executives another raise averaging 11.8 percent. Further, the chancellor recommended that the board adopt a new formal executive compensation policy and that the board continue to have a salary target focused on the average cash compensation for similar positions at comparable institutions. In response to these recommendations, the board adopted a new executive compensation policy and resolved that it aims to attain parity for its executives and faculty by fiscal year 2010–11.

We asked the chancellor's office why the university continued to justify increases in compensation for its executives based on a methodology that has been questioned by the commission and the legislative analyst. The chancellor's office responded that the university did not believe it appropriate to deviate from a methodology that was agreed upon years ago by the various interested parties, including the commission and the legislative analyst. However, as these are now the same parties that are raising concerns, we believe it is time for the university to work with the interested parties to develop a more appropriate methodology that considers total compensation.

We recommended that the board consider total compensation received by comparable institutions, rather than just cash compensation, when deciding on future salary increases for executives, faculty, and other employees. The university should work with interested parties, such as the commission and the legislative analyst, to develop a methodology for comparing itself to other institutions that considers total compensation. If the university believes it needs a statutory change to facilitate its efforts, it should seek it.

University's Action: Partial corrective action taken.

The university agrees that total compensation must reflect salary and the range of benefits available to different employee categories in order to make accurate comparisons to the marketplace. In addition, the university reports that it has initiated conversations with the legislative analyst, the commission, the Department of Finance, and legislative staff regarding the methodology and comparison institutions to be used for calculating compensation comparisons. The university also states that, working with an outside consultant, it will produce an executive and faculty total compensation report that will be presented to the board in the fall of 2009. Finally, the university will produce this report every five years, and more frequently if necessary, and will expand the report to include all employee groups.

Finding #3: The university has generous postemployment compensation packages for departing executives.

The university typically offers its departing executives a transition program that often provides a generous postemployment compensation package. This program is in addition to the standard retirement benefits the university provides to eligible executives, including retirement income, medical and dental coverage, and voluntary retirement savings plans. Although the original transition program has been overhauled a few times, leaving the university with three transition programs currently in use, each departing executive is eligible for the program that was in place at his or her time of appointment. The terms of the transition agreement offered to a departing executive vary with the transition program the executive is eligible for but can include one year of paid leave, lifetime tenure as a trustee professor at a campus, or an alternative agreement negotiated by the chancellor.

In November 2006, after media criticism of existing postemployment compensation packages, the board passed a resolution requiring the chancellor to provide every board member with a copy of each final transition agreement and to submit an annual report summarizing all existing transition agreements. However, the annual report contains no information on the status of accomplishments or deliverables that former executives may have agreed to provide the university as part of their transition agreements, and disclosure does not occur until after the chancellor has reached a final agreement with a departing executive. Although the board has decided not to participate in negotiating transition agreements, it is important that the board continue to monitor the chancellor's administration of the executive transition program to ensure that the agreements departing employees receive are prudent and that intended cost savings are achieved for the university.

We recommended that the board continue to monitor the executive transition programs to ensure that the chancellor administers them prudently and that intended cost savings are achieved for the university. In addition, the board should require the chancellor to include in the transition agreements clear expectations of specific duties to be performed, as well as procedures for the former executives to report on their accomplishments and status of deliverables. Further, the board should require the chancellor to include information in his annual report on the status of accomplishments and deliverables associated with transition agreements.

University's Action: Partial corrective action taken.

The university reports that the chancellor already has begun to include in transition agreements clear expectations regarding specific duties to be performed by executives. In addition, in January 2008, the board adopted a resolution requiring the chancellor to report on progress and deliverables associated with transition agreements in his annual update on executive transitions. In a September 2008 board meeting, the chancellor provided the board a report on executives participating in transition programs. We reviewed this report and noted that there is only one former executive participating in an active transition program. Although the report indicated that the former executive is serving as a trustee professor at the university's Los Angeles campus, it did not include any information on the status of this individual's accomplishments or deliverables.

Finding #4: The university paid questionable compensation to management personnel no longer performing services for the university.

The paid leaves of absence the university provides as part of transition programs are intended only for departing executives. However, the university operates under a very broad policy for granting paid leaves of absence for Management Personnel Plan employees (management personnel). Title 5, Section 42727, of the California Code of Regulations, which addresses professional development, specifies that management personnel may participate in programs and activities that develop, update, or improve their management or supervisory skills. The programs and activities may include "professional leaves, administrative exchanges, academic coursework, and seminars." Management personnel may participate in such programs and activities only after the chancellor or campus president grants approval and only to the extent that funds are available. The regulations do not sufficiently define the criteria that must be met before a paid leave will be granted, and it does not establish time restrictions for a paid leave.

Our review confirms the need for the university to strengthen its regulations and policies in this area. In reviewing a sample of personnel files at the chancellor's office and various campuses, we found instances in which management personnel received questionable compensation after they were no longer providing services to the university or while they were transitioning to faculty positions. For example, we found that one individual, who received compensation totaling $102,000 during a seven-year leave on the premise that he was gaining experience that would benefit the university on his return, never returned to university employment. We also noted that one individual was granted a future leave of absence with pay to transition from an administrative position to a faculty position.

We recommended that the university work through the regulatory process to develop stronger regulations governing paid leaves of absence for management personnel. The improved regulations should include specific eligibility criteria, time restrictions, and provisions designed to protect the university from financial loss if an employee fails to render service to the university following a leave. Further, the board should establish a policy defining the extent to which it wants to be informed of such leaves of absence for management personnel.

University's Action: Partial corrective action taken.

At a September 2008 meeting, the board approved a resolution to add Section 42729 to Title 5 of the California Code of Regulations that would govern paid leaves of absences for management personnel. In October 2008 this new regulation became operative and established eligibility criteria and time restrictions for such leaves of absence. However, this new regulation does not include any provisions to protect the university from financial loss in the event an employee fails to render service to the university following a leave. Also, in its periodic responses to our report, the university did not address our recommendation that the board establish a policy defining the extent to which it wants to be informed of leaves of absence for management personnel.

Finding #5: The university exercises considerable discretion in paying relocation costs for new employees.

The university has established a broad policy for paying costs related to moving and relocation (collectively referred to here as relocation) for its employees. The policy provides that incoming employees may receive reimbursement for actual, necessary, and reasonable expenses but includes few monetary limits for reimbursable expenses. Further, although the policy identifies the types of expenses that can be reimbursed, it contains clauses permitting the chancellor or campus presidents to grant exceptions. The chancellor determines the amounts of relocation reimbursements for executives, campus presidents, and management personnel in the chancellor's office, and the campus presidents determine the amounts for management personnel and faculty at their respective campuses. Neither the chancellor nor the campus presidents are required to obtain the approval of the board for relocation reimbursements, and they typically do not disclose these payments to the board. The discretionary nature of the university's policy can result in questionable reimbursements for costs, such as those for moving household goods and closing costs associated with selling and purchasing residences. These costs can be considerable. For example, we noted that the university reimbursed one individual for $65,000 in closing costs and $19,000 in moving expenses.

We recommended that the university strengthen its policy governing the reimbursement of relocation expenses. For example, the policy should include comprehensive monetary thresholds above which board approval is required. In addition, the policy should prohibit reimbursements for any tax liabilities resulting from relocation payments. Finally, the board should require the chancellor to disclose the amounts of relocation reimbursements to be offered to incoming executives.

University's Action: Partial corrective action taken.

The university's initial response to our report commented that the board would consider means of strengthening the controls related to the reimbursement of relocation expenses and that it would review the amount of discretion given to system executives and determine the extent to which the board wishes to review or approve any such expenses. However, it does not appear that the board has taken any action to strengthen the university's policy governing the reimbursement of relocation expenses. Rather, the board has simply required the chancellor to disclose the amounts of any such reimbursements offered to incoming executives. For example, at a July 2008 board meeting, the chancellor reported that the university would be reimbursing the new president of the San Jose campus up to $18,775 for the costs of moving his household goods and property from his prior residence. In addition, the chancellor disclosed that the university would reimburse the new president up to $66,577 for brokerage commissions, escrow fees, prepayment penalties, taxes, and other expenses associated with selling his prior residence. These relocation reimbursements are in addition to the new president's starting annual salary of $353,000, university-provided housing, a university-provided vehicle or a $1,000 monthly vehicle allowance, and other standard benefits that the university provides to its executives.

At a September 2008 board meeting, the chancellor reported that he had agreed that the university would reimburse its recently appointed vice chancellor of administration and finance up to $39,758 for the costs of relocating his household goods and property from his prior residence.

In addition, the chancellor disclosed that the university would reimburse the new vice chancellor up to $67,500 for brokerage commissions, escrow fees, prepayment penalties, recording fees, taxes, and other expenses associated with selling his prior residence. In this case, the chancellor also reported that he had agreed to provide the new vice chancellor with temporary housing for up to 60 to 90 days, at the chancellor's discretion. Again, these relocation reimbursements are in addition to the new vice chancellor's starting annual salary of $310,000, a $1,000 monthly vehicle allowance, and other standard benefits afforded to the university's executives.

Finding #6: The university's policy on dual employment is limited.

The university has established a dual-employment policy that allows its employees to have jobs outside the university system as long as no conflicts of interest exist. However, the policy does not require employees to obtain prior approval for outside employment, nor does it require them to disclose that they have such employment. Thus, the university is unable to adequately determine whether employees have outside employment in conflict with their university employment.

The university should work to strengthen its dual-employment policy by imposing disclosure and approval requirements for faculty and other employees, including management personnel. If the university believes it needs a statutory change to facilitate its efforts, it should seek it.

University's Action: Pending.

➲ The university reports that it will continue to work through the collective bargaining process to strengthen the outside employment policy for faculty. The university states that it will adopt for executives and management personnel similar requirements to those adopted for faculty.