

## **EXECUTIVE COMPENSATION IN THE PUBLIC AND NOT-FOR-PROFIT SECTORS**

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Detailed disclosure of executive compensation has been a fact of life for publicly traded companies in North America since 1994 when the Securities and Exchange Commission (SEC) required the specifics of compensation for the Chief Executive Officer and the four highest paid officers of listed companies to be made available to the public at large. The SEC in 2006 and the Canadian securities exchange commissions in 2008 announced enhanced requirements as a reaction to the suspicious compensation practices associated with the companies embroiled in the accounting scandals of 2002. Even more attention was drawn to disclosure, especially in the financial sector, following the recent financial meltdown.

While all this attention was directed to publicly traded companies, the area of executive compensation disclosure has been evolving in other industry sectors with very little fanfare. What follows is a review of Canadian practices in some of these sectors that have garnered less media coverage:

### **Provincial Public Sector**

Some provinces disclose compensation in a rudimentary way that is of limited use to the public interested executive compensation practices in the public sector. For example, Manitoba requires all government departments and agencies to report compensation for all employees earning more than \$50,000. No central source for this information has been developed; each public service body reports compensation in an annual report of its choice. Another limitation in the usefulness of this information is that only the name of the individual and a single compensation amount for that named employee is revealed.

Nova Scotia also discloses in a similar fashion. All employees earning \$25,000 or more are listed in *The Public Sector Accounts Volume III – The Supplements*. Each provincial government body lists employees eligible for disclosure and, as with Manitoba, only the name of the individual and that person's compensation amount is revealed.

The Ontario Public Sector takes a slightly different approach by issuing a list of public sector high-earners receiving \$100,000 or more per year. Available to the public since 1994 the list contains the name of the employee, position title, name of the organization, cash compensation inclusive of any bonuses received and the compilation of the value of benefits as reported in certain boxes of the employee's T-4 slip. It is interesting to observe that the Ontario list is not directed exclusively to executives and their compensation per se. Any public sector employee earning over the \$100,000 threshold is included. It is not unusual to find entries reporting nurse practitioners who have worked extensive overtime.

The Ontario initiative, although more thorough than other reporting provinces, is beginning to show signs of age, especially due to the increasing number of public sector employees being added as the years go by. At the very least, the Ontario government should reconsider its \$100,000 threshold. Of greater value to the taxpayers of Ontario would be reporting that would target the highest paid public servants, discloses the breakdown of cash compensation and discusses the compensation plans in place that generate these payments.

### **British Columbia Public Sector**

British Columbia has had in force public-sector compensation reporting requirements similar to those of other provinces. In addition, the Province enacted legislation which went into effect in 2008 which requires all government departments, agencies and provincial Crown Corporations to disclose the compensation of their CEO and four highest paid employees along with other requirements similar to the reporting required by publicly traded corporations. A Summary Compensation Table, illustrated below, is similar to those found in private-sector disclosure documents:

#### ***Summary Compensation Table***

Name and Principal Position	Salary (\$)	Bonus (\$)	Incentive Compensation Paid (\$)	Pension (\$)	All Other Compensation (\$)	Total (\$)	Previous 2 Years Totals (\$)

The BC rules also call for a Compensation Discussion and Analysis (CD&A) containing, among other things, a description of the organization's executive compensation strategy, who is responsible for executive compensation decisions and how the compensation payments relate to the organization's performance targets. Although public sector compensation plans are not as complex as those developed by many widely held listed companies, the same overarching topics must be discussed in BC's CD&A.

### **Federal Crown Corporations**

Federally regulated crown corporations are not required to disclose their executive compensation payments or practices with the exception of the Chief Executive Officers of federal crowns. These executives are Privy Council appointees and their compensation levels are established by a disclosed schedule that considers the size and complexity of the corporation they lead and considers the compensation levels of other senior federal public servants. In this way the public is aware of the range of compensation a Crown corporation CEO may earn in a given year. No disclosure is required for any other executives working for Crowns.

We expect this state of affairs to change, given the initiatives the Office of the Superintendent of Financial Institutions (OSFI) has undertaken in the financial sector, specifically with our large banks and insurers. Through its involvement with the Financial Stabilization Board, an international organization of financial regulators with the mandate of dealing with executive compensation issues related to the recent financial meltdown, OSFI has published various guidelines for the financial sector, including its strong support of disclosure that extends beyond securities commission disclosure. Even though OSFI has no regulatory powers over federal crown corporations, the federal government has some crowns that have financial mandates.

As these pressures increase, we expect that executive compensation disclosure in some form is around the corner for federal crown corporations, and that all these corporations, not only the financial ones, will be asked to comply by its governing Ministry.

### **Pension Investment Funds**

Pension plans are private entities working for their members by managing significant funds and providing administrative membership services. These organizations often hold large ownership positions in publicly traded Canadian companies. Through the Canadian Coalition for Good Governance (CCGG) an industry group that has been an outspoken critic of executive compensation practices and through their own independent initiatives, these organizations have pressured Canadian companies to increase the level and quality of disclosure. While they have evolved into shareholder advocates, pension funds are not obliged to disclose their own executive compensation practices.

Some funds have decided to practice what they preach and are now disclosing executive compensation, abiding by the same standards used by the companies in which they invest. While publicly traded companies include executive compensation disclosure in their proxy circulars, you will usually find pension fund disclosure as part of the fund's annual report. A few pension funds that are now disclosing are the Ontario Teachers' Pension Fund, la Caisse de depot de placement du Quebec and CPP Investment Board.

### **Not For Profit Organizations in the United States**

In order to qualify for tax free status, the Internal Revenue Service requires Not for Profits to complete Form 990 on an annual basis. Part VII of this form requires all current officers, trustees and current key employees to be listed. The five highest paid employees earning more than \$100,000 must report their annual cash compensation and an estimate of other compensation. This information is available to the public through the IRS.

No such regulations are in existence in Canada at this time.

### **The Future of Disclosure**

Regulators, shareholders, the media and the public will continue drawing attention to disclosure in the private sector due to elevated compensation levels and the perceived

deficiencies in alignment between executive pay and performance. This scrutiny is attracting attention to the absence of disclosure or the deficiencies in some public sector and not-for-profit organizations. We expect pressures to continue and believe that the British Columbia model will be held up as the blueprint for disclosure in these sectors.

We encourage organizations with broad stakeholder constituencies to begin planning for disclosure. Some organizations have already made this move voluntarily and those early adopters in this area will be viewed as enterprises exhibiting advanced governance practices.

In planning for disclosure, organizations should verify that its executive compensation practices are in order. Disclosure is much easier if you are reporting the outcomes of a well thought out and executed executive compensation program. Here are some of the key steps to undertake:

- Articulate the executive compensation governance charter and ensure governance processes are in place;
- Conduct a review of the enterprise's executive compensation strategy to ensure executive compensation programs are aligned with enterprise goals;
- Ensure compensation structures are established based on sound market-based peer group data;
- Stress-test pay-for-performance programs to ensure the plan components actually behave as they are intended.