



OFFICE OF THE
Auditor General
of British Columbia

**British Columbia
Crown Corporations
Executive Compensation
Arrangements –**
A Work in Progress

November 2009

Library and Archives Canada Cataloguing in Publication Data

British Columbia. Office of the Auditor General.

British Columbia Crown Corporations Executive Compensation Arrangement : a work in progress / Office of the Auditor General of British Columbia.

(Report ; 2009/2010: 4)

Includes bibliographical references and an index.

ISBN 978-0-7726-6220-0

1. Corporations, Government--British Columbia--Officials and employees--Salaries, etc.--Auditing. 2. Government executives--Salaries, etc.--British Columbia--Auditing. 3. Finance, Public--British Columbia--Auditing. I. Title. II. Series: British Columbia. Office of the Auditor General. Report ; 2009/2010: 4.

JL432.Z13E9 2009

352.2'66267243909711

C2009-906757-9



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The Honourable Bill Barisoff
Speaker of the Legislative Assembly
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Dear Sir:

I have the honour to transmit herewith to the Legislative Assembly of British Columbia my 2009/2010 Report 4: British Columbia Crown Corporations Executive Compensation Arrangements — A Work in Progress.

John Doyle, MBA, CA
Auditor General of British Columbia

Victoria, British Columbia
November 2009

copy: Mr. E. George MacMinn, Q.C.
Clerk of the Legislative Assembly

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Auditor General's Comments



John Doyle
Auditor General

Government has established clear direction for Crown corporations to manage executive compensation, and continues to increase transparency in this area. Recently, government established a framework with compensation caps for Crown corporation Chief Executive Officers (CEOs).

When these caps were introduced the compensation arrangements for existing CEOs were grandfathered for the duration of their appointments, and many CEOs currently earn more than the cap amount. As a result, the system is in transition, and further work is needed to align compensation packages with the established framework. However, because most appointments are for indefinite terms, we do not know when all compensation caps will be implemented.

Because this topic is important to British Columbians, continued departure from the framework may negatively impact public observations and impressions. Given that continuous improvement should always be a goal, I am pleased to provide some recommendations and guidance based on best practices to enhance further the management of executive compensation. Government acknowledges that the recommendations are consistent with the next steps in the development of their framework, has already begun implementing some of the recommendations, and has committed to the remainder.

I would like to thank the staff at the Public Sector Employers' Council Secretariat and the Crown corporations included in our review for their cooperation and assistance provided to my Office during this work.

A handwritten signature in black ink that reads "John Doyle". The signature is fluid and cursive, with the first and last names being the most prominent.

John Doyle, MBA, CA
Auditor General of British Columbia

Victoria, British Columbia
November 2009



Auditor General's Comments

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Executive Summary

Executive Summary

Crown corporations in this province manage important public resources and services that British Columbians expect from their government. Recruiting and retaining talented managers is critical to ensuring these corporations operate effectively in the public interest. Executive remuneration is a tool used to attract and retain good leaders and motivate exceptional performance.

Both the government of British Columbia and Crown corporation boards play a role in planning and managing total executive compensation.

Audit purpose and scope

The purpose of this audit was to determine whether the government of British Columbia and a sample of Crown corporations have established appropriate structures and processes to ensure that Crown corporation executive compensation is well managed. Included within the scope were the Public Sector Employers' Council and British Columbia Crown corporations.

As part of the project, we also developed better practice guidance related to executive compensation and performance-related pay. This work is presented in Appendix B.

Overall conclusion

Both the provincial government and Crown corporations have established clear direction to manage executive compensation, but improvements are required to foster consistent executive compensation planning and management. Because of the relative newness of government executive compensation caps, it will be several years before the limits are fully implemented. In the meantime, practices to ensure executive compensation policies are followed need to be strengthened. Public disclosure of executive compensation is currently better than other Canadian jurisdictions, but improvements could be made.

Executive Summary

Key findings and recommendations

Government has provided high-level direction for Crown corporation executive compensation, but not the mechanisms to ensure it is consistently followed

We expected government to have established clear direction and effective processes to plan and manage Crown corporation executive compensation in British Columbia.

We found that it has done this through the Public Sector Employers Act and two formal guidelines: “A Guide to Excluded and Executive Compensation in the BC Public Sector” and “Public Sector Executive Compensation Reporting Guidelines”. Recently, government also posted formal guidelines on performance-related pay on their website.

At the same time, however, we found that:

- the bodies set-up to provide a forum for human resource management and labour relations issues are not operating effectively;
- formal records of decision on compensation plan approvals are not maintained; and
- government has not been monitoring to ensure that approved compensation plans are being followed.

Consequently, we have made recommendations to address each of these topics.

Government limits on executive compensation for Crown corporations will take several years to be fully implemented

The provincial Cabinet set formal limits on total CEO compensation in 2007. We found that these caps were established without government consulting Crown corporation boards or providing them with the criteria used. As well, the corporations do not feel government is effectively balancing centralized control with the need for decentralized choice and flexibility.

Just over half (54%) of current Crown corporation CEOs are earning more than the provincial caps set in 2007 because those individuals were already in the positions before the new limits took effect. As Appendix A shows, most Crown corporation CEOs have indefinite term employment contracts. Therefore, this situation will

Executive Summary

continue until new CEOs are hired into those positions—a situation that will take several years to fully resolve.

Crown corporation CEO compensation limits were communicated confidentially to each Crown corporation, and are not available for public review.

Since establishing the caps, government has approved one exception. In this case, the rationale for the approval was not formally documented.

Crown corporations have, for the most part, established frameworks to manage executive compensation in keeping with government direction

We found Crown corporation processes to manage executive compensation to be generally consistent with good practice and the direction provided by government. Crown corporations do have policies and procedures in place, and board roles and responsibilities have been defined.

However, the human resources committee of one Crown board did not keep minutes of its deliberations and decisions—this is not considered good practice.

We also found processes in place to establish employee performance expectations and evaluate results, but these processes were not fully followed in all instances.

As well, although Crown corporations regularly commission independent reviews of their compensation plans, not all include provisions to have performance-related pay programs evaluated to ensure their effectiveness. We have recommended that periodic reviews be conducted to ensure performance-related programs continue to achieve their intended objectives.

Most Crown corporations have aligned performance pay to organizational goals and objectives, but the link between results and pay was not always evident

Of the six Crown corporations reviewed, most provided evidence to show that employee performance plans clearly aligned with organizational goals and objectives, and that performance payments were only made to the extent that performance expectations were met. We found two Crown corporations, however, that did not adequately document linkages between performance plans

Executive Summary

and payment results. We therefore recommended that Crown corporations clearly demonstrate the link between performance payments and actual performance.

All of the Crown corporations we examined are making efforts to develop meaningful performance measures that are consistent with good practice. Making sure all performance measures are consistently SMART (specific, measureable, achievable, relevant, time-based) is an area for continual improvement and we have made a recommendation to help guide this.

Crown corporation executive compensation reporting is generally consistent with good practice

We found that the Crown corporation compensation disclosures generally met the government's guidelines. The presentation of information varied among Crown corporations and not all elaborated on their compensation philosophy or compensation objectives. However, we also found that Public Sector Employers' Council Secretariat does not review compensation disclosures to ensure they comply with government's expectations. For consistency and to ensure good practice, we believe monitoring is important and have recommended that the Secretariat ensure the disclosures comply with the guidelines.

Government does not require Crown corporation boards to review and sign off on disclosure statements before public release. Given the accountability of each board for its compensation decisions, we have recommended that board chairs sign the compensation disclosures.

Response from Government

The Public Sector Employers Council is pleased to receive and respond to the Office of the Auditor General's report on Crown corporation executive compensation.

Public sector executive compensation is a challenging area requiring both prudence with public funds and provision of sufficient compensation, appropriately structured, to attract the calibre of person needed to lead complex organizations whose services are important to British Columbians. Public sector corporations and agencies often have budgets in the hundreds of millions of dollars and thousands of employees responsible for delivering services such as health care, education, electrical power generation and distribution, transit, automobile insurance and public housing. Taxpayers have the right to expect high quality executives to be working on their behalf and this requires balancing prudent use of public funds with adequate executive compensation. The report acknowledges this challenge while identifying opportunities for process improvements. Government must ensure that the process of setting compensation is transparent, that public sector employer boards of directors are accountable for their decisions on executive compensation, and that the public has access to clear information about compensation paid to senior executives in the public sector.

Government agrees with the report's finding that the disclosure policy for public sector executive compensation in British Columbia meets a high standard. British Columbia's compensation disclosure requirements are modeled on those of the Canadian Securities Administrators. Their requirements provide high standards in compensation disclosure. Government also agrees that improvements can be made in how Crown agency executive compensation is administered both in government and in the agencies themselves.

Progress has already been made in implementing the Office of the Auditor General's recommendations. This includes:

- making available pay for performance guidelines. These will be a useful resource to agency boards in British Columbia, both public and private (<http://www.aved.gov.bc.ca/PSEC/executivecompensation.htm>);

Response from Government

- updating and clarifying compensation guidelines and processes (<http://www.aved.gov.bc.ca/PSEC/executivecompensation.htm>); and
- improving the formal documentation of requests and the communication of decisions related to those requests.

Government accepts the report's recommendations and expects to implement those not already in place over the coming year. These recommendations are consistent next steps in the development of the Government's compensation framework or are improvements to it and, as such, they will be implemented. Implementation measures will include:

- consultation with public sector employers on the principles guiding any future changes to government's decision-making framework in this area;
- government support and encouragement of Crown agency boards to:
 - review regularly their compensation plans to ensure that they continue to support their intended objectives and
 - when those plans involve re-earnable incentive pay, ensure that incentives support long and short term objectives and are tied to performance;
- introduction of a monitoring function in government to verify that CEO compensation is within approved compensation plans; and
- adjustment of government's disclosure policy to include a requirement for board endorsement of disclosed compensation statements.

Detailed Report

Background

Corporate executives in both the public and the private sectors earn a great deal more than the average worker. The higher earnings are usually tied to the skill set these executives offer in managing significant resources on behalf of shareholders or taxpayers.

Nevertheless, the size of some executive compensation packages and complexity of the arrangements have concerned many observers in the media and the public in recent years. These concerns have increased demand for greater transparency and accountability for the compensation paid to corporate executives.

What is executive compensation and what does it include?

Executive compensation is how senior employees within organizations are remunerated and rewarded for the services they provide. Public sector compensation packages involve many different components (see Exhibit 1).

Exhibit 1

Components of executive compensation

Compensation Component	Definition
Base salary	<ul style="list-style-type: none"> ■ Pay calculated at an annual or monthly rate
Short- and long-term incentive (or “performance-based pay”)	<ul style="list-style-type: none"> ■ One-time payment for meeting previously established short- or long-term performance objectives
Bonus	<ul style="list-style-type: none"> ■ An amount of money given in addition to normal pay in recognition of exceptional performance, but not tied to specific performance objectives
Perquisites (or “perks”)	<ul style="list-style-type: none"> ■ An extra right or privilege attached to employment. Examples: <ul style="list-style-type: none"> — car allowance and paid parking — interest-free loan — paid administrative leave — club or professional membership
Pension Plan	<ul style="list-style-type: none"> ■ Income provided at retirement. Some organizations, in addition to a standard pension plan, offer a second, supplementary pension plan to executives
Other benefits	<ul style="list-style-type: none"> ■ In addition to all or some of the above, other benefits include: <ul style="list-style-type: none"> — medical and dental benefits — extended health benefits — disability and life insurance — vacation and sick leave benefits — Canada Pension Plan — employment insurance — workers’ compensation
Compensation protection	<ul style="list-style-type: none"> ■ Typically, a severance plan to compensate a person’s early job termination

Source: Compiled by the Office of the Auditor General of British Columbia

Detailed Report

How are executive compensation levels determined?

Many factors can be combined and used to guide and determine the compensation rates for an executive. These include:

- size and type of organization;
- complexity of the organization's operations;
- financial significance (revenue and assets);
- level of strategic importance to the province;
- knowledge and specialized skill requirements; and
- comparative rates of pay for similar positions provincially, inter-provincially and federally, and compared with those in the private sector.

How much do Crown corporation CEOs earn compared with private sector CEOs in British Columbia, as well as other workers in the province?

In 2008/09, the average total compensation of the top five highest paid private sector CEOs in British Columbia was \$8.7 million. The average total compensation for the top five highest paid Crown corporation CEOs was \$540,000.

Compensation paid to CEOs is significantly higher than that earned by most Canadians. According to the most recent Canadian Census (2006), British Columbia's full-time median employment income in 2005 was \$42,230.

Reasons given to explain the higher compensation CEOs receive include the skills and experience they offer, the level of responsibility they must assume, and the complexity of the job to be performed. It has also been argued that the pool of experienced individuals available to fill such positions is small and therefore to attract and retain the qualified individuals, competitive compensation offerings are required.

Detailed Report

Why is it important to review levels of executive compensation?

There is no one way to establish an executive compensation framework. However, the problem of wage inflation—occurring as a result of unchecked efforts to make compensation rates competitive—has become a major concern. Much has been written about this in the media in Canada and internationally. In the United States, where CEO compensation rates are increasing at a much faster pace than for other employee groups, the federal government recently introduced measures in an attempt to address the issue of wage inflation.

What is the provincial government's role in executive compensation?

In British Columbia, the government is responsible for establishing an overall framework for public sector executive compensation and has done this through legislation, policies and guidelines. The Public Sector Employers Act identifies: who is responsible for executive compensation planning and management, what those individuals must do, and what compensation rules must be followed. Two formal guidelines—“A Guide to Excluded and Executive Compensation in the BC Public Sector” and “Public Sector Reporting Guidelines”—provide additional information.

The Act provides for the creation of a Public Sector Employers' Council (PSEC). The council is to:

- provide strategic direction in relation to human resource management and labour relations;
- advise government on human resource issues; and
- provide a forum for public sector employers to plan solutions to human resource issues.

The Act also provides for the creation of public sector employers' associations to help coordinate compensation planning and management on behalf of the council.

Executive compensation plan approvals and public reporting requirements have also been legislated by government. If a public sector employer makes a change to the terms and conditions of a senior employee's compensation, the employer must first obtain approval for doing so from the CEO of the Public Sector Employers' Council.

In addition to all of this, the government has also set total compensation limits for CEOs in the public sector.

Detailed Report

Who is responsible for planning and managing executive compensation within British Columbia's Crown corporations?

Responsibility for planning and managing executive compensation within British Columbia's Crown corporations is a shared responsibility of each organization's board of directors, its Chief Executive Officer, and its human resources department.

Crown corporation boards develop policies to guide executive compensation planning and management, often establishing a sub-committee of the board dedicated to reviewing human resource plans and providing recommendations for the board's approval.

It is common practice for Crown corporations to commission independent executive compensation reviews to make sure the compensation framework is reasonable compared with rates being offered by like organizations for similar positions.

Audit Purpose and Scope

The purpose of this audit was to determine whether the British Columbia government and a sample of Crown corporations have established appropriate structures and processes to ensure Crown corporation executive compensation is well managed. Specifically, we examined whether:

- the government has established clear direction for Crown corporation executive compensation, including performance pay;
- Crown corporation boards have established appropriate direction, policies and procedures to manage executive compensation and performance pay based on the direction provided by government;
- performance pay is based on performance objectives being aligned with the goals and objectives of the organization;
- performance pay is awarded only to the extent that performance objectives have been met; and
- Crown corporations are fully, clearly and on a timely basis disclosing information to government and the public about executive compensation, including performance pay.

Detailed Report

Included within the scope of this audit were the Public Sector Employers' Council and British Columbia Crown corporations. We focused on the following Crown corporations:

- BC Hydro Corporation
- BC Lottery Corporation
- Tourism BC
- BC Assessment Authority
- BC Securities Commission
- Community Living British Columbia

We reviewed executive compensation planning and management, including executive performance appraisal practices (CEO and senior executives). We did not review executive recruitment, selection and succession management practices. We also did not evaluate the fairness or reasonableness of compensation components and amounts. These are policy decisions that are the prerogative of government and the boards of directors, and based on judgment—it is not for the Auditor General to say what the right amounts are.

To gather additional information to support our audit efforts, we conducted an online survey of 24 Crown corporations as well. In Appendix A we provide information, primarily from publicly available sources, about Crown corporations and their CEO compensation.

As part of this audit, we also developed a better practices guide for executive compensation and performance-related pay (presented in Appendix B).

The audit was carried out in accordance with the standards for assurance established by the Canadian Institute of Chartered Accountants. We carried out the audit from January to July 2009.

Detailed Report

Key Findings

Government has provided high-level direction for Crown corporation executive compensation, but not the mechanisms to ensure it is consistently followed

Legislation and guidelines

Clearly communicating roles, responsibilities and requirements is critical to ensuring effective executive compensation planning and management. We expected government to have established clear direction and effective central government structures and processes to plan and manage total executive compensation in Crown corporations.

We found that government has provided the necessary high-level direction, in most areas, through both the Public Sector Employers Act and two formal guideline documents:

- “A Guide to Excluded and Executive Compensation in the BC Public Sector” and
- “Public Sector Reporting Guidelines”

Additional information and explanation is also provided on the website of the Public Sector Employers’ Council.

Through an online survey we conducted with 24 Crown corporations, most respondents reported they were satisfied that government’s legislation and guidelines regarding executive compensation requirements are clear (see following page).

A majority of respondents were also satisfied that the roles and responsibilities of the Public Sector Employers’ Council pertaining to executive compensation had been clearly communicated (Exhibit 2).

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Exhibit 2:

Satisfaction that PSEC roles and responsibilities have been clearly communicated

Crown Corporation Online Survey

Between March 11 and March 28, 2009, our Office administered an online survey to 24 Crown corporations who are required to follow the Public Sector Employers' Act when managing executive compensation.

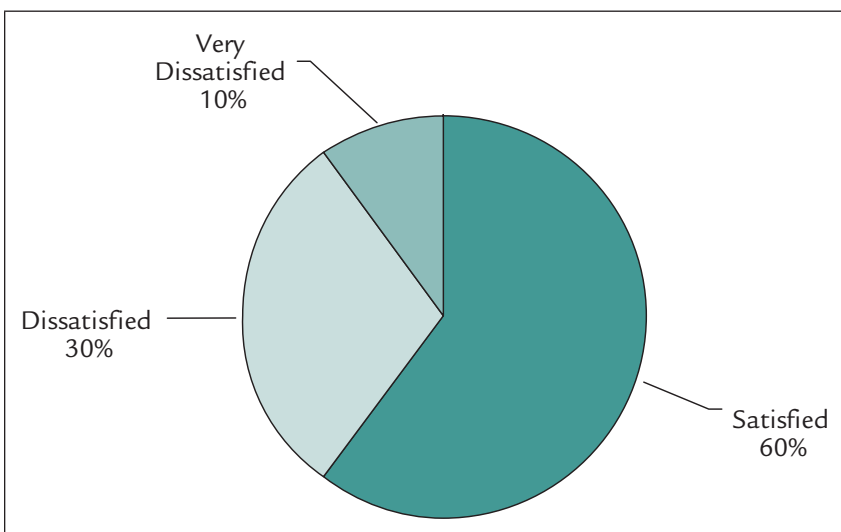
Respondents were asked to answer nine questions pertaining to the clarity of government direction and their views on best practices related to executive compensation and performance pay planning and management.

The survey was sent to board Chairs, CEOs, Board Human Resource Committee (HRC) Chairs and the individuals in charge of corporate human resources (HR).

A total of 81 people were sent the survey and 49 responded (response rate of 60%). There was at least one respondent from each of the 24 Crown corporations.

A majority of respondents were staff:

- 12% of respondents were board Chairs
- 16% of respondents were board HRC Chairs
- 31% of respondents were CEOs
- 41% of respondents were HR leads



We also asked respondents to rate the clarity of the direction provided by PSEC Secretariat through the documents it has prepared for public sector employers to use. Overall, respondents rated the clarity of government's documents as being good.

Respondents also suggested areas for improvement. These included giving Crown corporations the opportunity to be more involved in developing executive compensation processes, providing clearer guidance about compensation plan submissions, and conducting more face-to-face communication.

One area where government had not, until recently, provided clear guidance was in relation to the design and implementation of performance-related pay programs. Draft guidelines had been developed but never formalized. On August 25, 2009, however, PSEC revised and formalized their draft guidelines and communicated them to the Crown Corporation Employers Association (CCEA).

Detailed Report

Co-ordinating bodies

The Public Sector Employers' Council was established under the Public Sector Employers Act to "set and coordinate strategic direction in human resource management and labour relations," as well as to "provide a forum to enable public sector employers to plan solutions to human resource issues."

The Act also provides for the creation of public sector employers' associations to help coordinate compensation planning and management with the council. Representatives from these associations—including the CCEA—are members of the council.

We expected to find both that the Public Sector Employers' Council meets regularly and that the CCEA is actively involved in working with the council's Secretariat to carry out the roles and responsibilities outlined in legislation.

In fact, however, we learned that the council has not met in the past two years. Instead it has been the provincial Cabinet that has been setting the strategic direction with its CEO compensation framework.

As well, the CCEA has not been operating as outlined in legislation and, in our view, insufficient attention had been directed at ensuring its effective operation. Currently however, we note efforts are being made to revitalize the CCEA. The organization now has a website that states the organization is in the process of rebuilding.

We recommend that government ensure appropriate mechanisms are in place to resolve executive compensation issues with Crown corporations.

Executive compensation proposal submission and approval process

We expected compensation plan proposals and approval decisions to be well-documented. Instead we found that proposals are submitted in a variety of formats, no formal records of decision are maintained, and that in some cases no documentation exists to substantiate a compensation package's approval by the Minister responsible. Even for compensation proposals not approved, we could find no records to document the reasons for the decisions.

Detailed Report

Insufficient documentation increases the risk of misunderstanding between government and its Crown corporations and the risk of government policy not being followed. Government must ensure it has systems in place to effectively gather standard total compensation proposal information for comprehensive evaluation purposes. Clear records of decisions should also be produced and retained to guarantee effective corporate memory retention.

We recommend that government improve its compensation proposal submission and approval requirements and maintain a formal record of all decisions made.

Compliance with compensation plans

We expected government, through the Public Sector Employers' Council, to have control systems in place to ensure compensation plans are being followed as approved. Instead we found that the council does not have adequate control systems in place to effectively monitor compensation payments and confirm that the terms and conditions of approved compensation plans are being complied with.

Given that the Public Sector Employers' Council does not have approved compensation plans on file for all Crown corporations, and that it was unable to provide us with a clear picture of potential total compensation maximums for CEOs, we concluded that the government does not have adequate systems in place to effectively monitor and ensure compensation plans are being implemented as approved.

Monitoring of executive compensation by the Public Sector Employer's Council could be simplified by using a standard contract structure across all Crown corporations, or by requiring Crown corporations to provide details of financial and non-financial compensation in a standard format. Any process could mirror the format for submission and approval of compensation plans.

We recommend that government put adequate monitoring systems in place to ensure compensation plans are followed as approved.

Detailed Report

Government limits on executive compensation for Crown corporations will take several years to be fully implemented

Total compensation caps for CEOs

The Crown Agencies Secretariat, in collaboration with Treasury Board staff, conducted an internal review of Crown agency executive compensation practices in 2007. Based on the results of their review, they developed a CEO compensation framework and made recommendations to government regarding total cash compensation maximums for Crown agencies. Factors they took into consideration included:

- the current compensation provided to Crown corporation CEOs;
- the current compensation paid to Deputy Ministers;
- pension plans provided to the public service;
- Crown corporation types, financial significance, strategic importance, size and complexity; and
- compensation provided to CEOs of Crown corporations in other jurisdictions across Canada (note: for 11 Crown corporations no comparators were deemed suitable).

For the review, input was also requested from Ministers responsible for each of the Crown corporations. No direct input from Crown corporations was requested. Consultation with major stakeholders is an important component of good decision making. In the case of CEO compensation, the board of directors is responsible for the operation of each Crown corporation, and a key role of carrying-out that responsibility is the hiring of the CEO. Crown corporation boards could have provided valuable information about unique needs of their corporations.

When the Chairs of the Crown corporations were informed of the compensation caps, they were not provided with the rationale used to determine the caps. This, of course, made it difficult for some Crown corporations to understand and accept the caps, or to know on what basis to request an exception to the caps. The high level criteria that will be considered in compensation decisions has now been included in a revised edition of the Guide to Excluded and Executive Compensation in the BC Public Sector issued in July 2009.

Detailed Report

Most CEOs are currently earning more than the caps

Just over half (54%) of current Crown corporation CEOs are being compensated more than the caps that have been set for their positions. CEOs already earning more than the newly implemented caps have been “red circled”—meaning that when these positions become advertised again, government expects new CEOs to be hired within the set compensation limit. As Appendix A shows, most Crown corporation CEOs have indefinite term employment contracts. Therefore, it will take several years to fully implement government’s limits on executive compensation.

Crown corporations may submit requests for an exception to be made to the CEO compensation caps. All exceptions must be approved by both the Premier and the Minister responsible for the Public Sector Employers’ Council. Since 2007, five CEOs have been hired with compensation offers that are within the CEO compensation caps. Only one exception has been granted but no record of decision or formal written approval for a compensation proposal exists. We were informed that the approval in this situation was granted verbally.

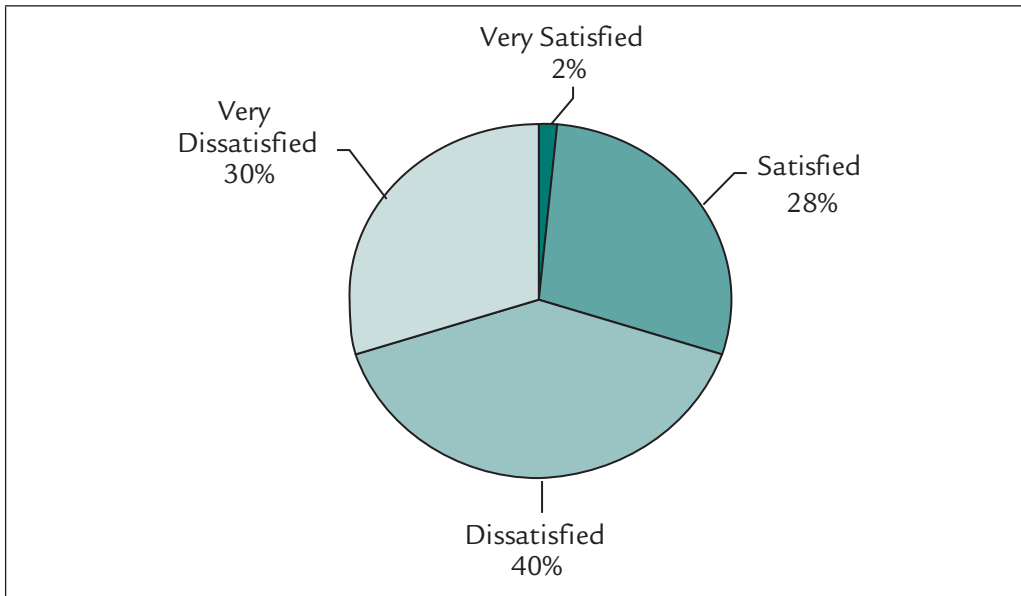
Balancing centralized control with choice and flexibility

Our survey of Crown corporations asked respondents to rate how satisfied they were that the direction provided by government reasonably balances centralized control with decentralized choice and flexibility for Crown corporations to plan and manage executive compensation. A majority of all respondents (70%) were either dissatisfied or very dissatisfied (Exhibit 3).

Detailed Report

Exhibit 3:

Satisfaction with balance of government control versus Crown corporation choice and flexibility



Most board members (66%) said that they were either dissatisfied or very dissatisfied with the balance of control versus flexibility. Additional comments provided by board members (see comments below) show that both government and Crown corporation boards have a role to play in ensuring that competitive executive remuneration is balanced with the prudent use of public funds. Given natural tension exists between these two imperatives, we believe that effective mechanisms to resolve such issues are required.

Sample of board member comments to our online survey

- “Government appoints our Board and requires effective governance practice. PSEC [the Public Sector Employers’ Council] unnecessarily usurps the Board.”
- “The Boards of the commercial Crown corporations should determine compensation as is true in the private sector. It is very hard to compete for talent without being able to set competitive compensation.”
- “The cap on compensation that the government imposed does not seem to take into account competitive salaries in the sector.”

Detailed Report

Crown corporations have, for the most part, established frameworks to manage executive compensation in keeping with government direction

Policies and procedures

Crown corporations are required to plan and manage executive remuneration in a way that is consistent with direction provided by government's framework for compensation.

We found that the six Crown corporations we reviewed do have the necessary policies and procedures in place to manage executive compensation. Board roles and responsibilities have been defined and performance management systems are in place to plan and review executive performance. Although language differs by Crown corporation, the structures and processes are all very similar.

In some of the Crown corporations we reviewed, we still found practices that could be improved, the most notable being a lack of sign-off of performance plans and appraisals by the employee and their supervisor.

Board monitoring of executive compensation

We expected Crown corporation boards to have identified their executive compensation information needs and to be actively using this information for monitoring purposes. We found strong evidence of this occurring in five of the corporations we reviewed. In the sixth case, we could not confirm that the board was actively monitoring executive compensation.

Compensation frameworks

We expected Crown corporations to have, for all executive staff, current compensation arrangements that identified all monetary components—including base pay, performance pay, bonuses and other benefits. The Crown corporations we reviewed did have such compensation frameworks in place.

However, we also found that although the Crown corporations commissioned regular independent reviews of their compensation frameworks to ensure they are market competitive, not all of these reviews evaluated the effectiveness of performance pay programs in meeting corporate objectives.

Detailed Report

We recommend that Crown corporations offering performance-related pay as part of executive compensation conduct periodic reviews to ensure these programs continue to achieve intended objectives.

Most Crown corporations have aligned performance pay to organization goals and objectives, but the link between results and pay was not always evident

Alignment of performance plans to organizational goals

We were looking for evidence that Crown corporations have established performance pay systems that reflect principles of good practice. Good practice includes ensuring that CEO and executive staff performance plans have been clearly aligned to organizational goals, objectives and strategies, and that performance pay is based on a combination of individual, team and corporate performance as well as on SMART performance measurement (specific, measurable, achievable, relevant, time-based). We were also looking for evidence of long-term focus.

We found that most of the Crown corporations we reviewed had ensured clear alignment between performance plans and organizational goals and objectives in 2007/08. The identification of performance measures varied greatly, but all of the Crown corporations provided evidence to show effort is being made to develop performance measures consistent with good practice.

Most performance pay systems focused on individual performance and did not incorporate team performance. Only half factored in corporate performance. The extent to which performance measures reflected principles of SMART measurement was mixed. We concluded that more effort is needed to ensure that all performance measures are consistently SMART.

We found little evidence of a long-term focus in performance measurement.

We recommend that Crown corporations offering performance-related pay as part of executive compensation develop performance measures that reflect the corporation's long- and short-term objectives, and include measures that promote team and corporate results.

Detailed Report

Performance pay based on meeting performance expectations

Performance-related payment calculations should be linked to employee plans and appraisals, showing a clear connection from plans to results and paid incentives. We therefore expected to find well-documented linkages between performance payments, employee plans and appraisals, as well as evidence that pay for performance is provided only if performance expectations have been met.

Of the six Crown corporations we reviewed, four provided evidence to show that performance payments were made only to the extent that performance expectations were met. Two were not able to clearly show the linkages between performance results and performance payments.

We recommend that government require Crown corporations that offer performance-related pay as part of executive compensation to clearly demonstrate and document the link between performance payments and actual performance.

Crown corporation executive compensation reporting is generally consistent with good practice

British Columbia's compensation reporting guidelines

The “Public Sector Executive Compensation Reporting Guidelines,” developed and issued to Crown corporations in 2008, require public sector organizations to disclose all compensation provided to the CEO and the next four highest paid executives. The guidelines direct public sector organizations, including Crown corporations, to:

- identify who is responsible for determining executive compensation;
- explain the organization’s compensation philosophy — how it has been designed and what it is intended to achieve;
- describe and explain its performance-related pay measures and rewards; and
- complete the summary compensation table provided in the guidelines and explain the results.

Detailed Report

We found that the reporting guidelines make clear the government's expectations about the timeliness and completeness of the information to be disclosed. Overall, the accountability requirements are based on good-practice disclosure principles. Compared with the compensation disclosure requirements adopted by Canadian Securities Administrators, British Columbia's guidelines stand up well. Two main differences we noted are that the Canadian Securities Administrators requirements ask for more detailed information about pension plan benefits and they put performance-related pay into a separate section.

We also compared British Columbia's guidelines with the best practices in compensation disclosure issued by the Canadian Coalition for Good Governance in 2008¹ and found that British Columbia's guidelines compared well in terms of communicating the same basic message.

An area of concern to us, however, is that the Public Sector Employers' Council does not require Crown corporation boards to approve compensation disclosures before they are made public. In our view, accountability would be improved if board Chairs were required to sign compensation disclosures.

Do other provinces have Crown corporation disclosure requirements?

- **Alberta:** Yes, salaries and benefits are to be reported in annual reports. It is a government requirement based on a Treasury Board directive.
- **Saskatchewan:** Yes, wages and expenses are published in a Payee Disclosure Report yearly.
- **Manitoba:** Yes, the province's Public Sector Disclosure Act requires disclosure of salary amounts greater than \$50,000 yearly.
- **Ontario:** Yes, the province's Public Sector Salary Disclosure Act requires disclosure of salary amounts and benefits that total \$100,000 or more yearly.
- **Quebec:** Yes, provincial legislation requires state-owned enterprises to disclose base salary, variable pay and benefits in annual reports.
- **New Brunswick:** Yes, the province publishes salary information for Crown agencies on amounts over \$40,000 annually.
- **Nova Scotia:** No requirement.
- **Newfoundland:** No requirement.
- **Prince Edward Island:** No requirement.

Source: Compiled by the Office of the Auditor General based on feedback received from other audit offices

¹ According to the Canadian Coalition for Good Governance, there are four key characteristics of effective disclosure: the information is easy to find, easy to understand, accurate and complete, and given in context so it has meaning.

Detailed Report

Executive compensation reporting

We expected Crown corporation boards to have provided timely and full information to the public.

We reviewed Crown corporation compensation disclosures to see if they covered off the items outlined in the government's guidelines. We found overall they had, but the manner in which the information was reported varied. For Crown corporations to improve their compensation reporting, we would like to see:

- a better discussion of compensation philosophy, principles and objectives;
- more detailed disclosure of performance-related pay measurement design and calculation methodology;
- a disaggregated listing of "All Other Compensation";
- a better description of pension program design;
- disclosure of deferred payments; and
- the signature of the board Chair on all disclosures.

Compliance with guidelines

We expected government to have reviewed compensation disclosures to assess the extent to which the Crown corporations had adhered to the guidelines and correctly communicated information requirements. We found that government had not done this.

When we compared the disclosures to compensation plans, we found some differences. The government gave us explanations for the differences and commented that some Crown corporations had presented information in a manner that was not consistent with the intent of the guidelines. The risk of misinterpretation of the executive compensation reporting guidelines always exists, which is why we feel it is important that government review and assess compensation reports for consistency and compliance with the guidelines.

According to government, however, Crown corporation boards are ultimately responsible for reviewing and approving compensation disclosures. We asked the Crown corporations we visited whether the board had approved the organization's executive compensation disclosure statement before its public release. We found that not all of the Crown corporation boards had.

Detailed Report

The current lack of requirement by the Public Sector Employers' Council that the board sign disclosure statements is an area where we feel improvement is needed. If boards are ultimately responsible for making sure disclosure meets government requirements, then it is imperative for them to provide assurance that the compensation report is fairly presented.

We recommend that the information included in public disclosures of Crown corporation executive compensation be reviewed by the Public Sector Employers' Council Secretariat to ensure the information complies with reporting guidelines.

We recommend that the Chair of Crown corporation boards sign executive compensation disclosure statements, providing assurance that executive payments are in accordance with board-approved compensation plans.

Appendices

Appendix A: Purpose, size, revenue, expenses and executive compensation by Crown corporation in British Columbia, 2008/09

Crown Corporation (Note 1)	Crown Corporation Purpose	Staff FTEs	Revenue (08/09 millions)	Expenses (08/09 millions)	Total CEO Compensation (08/09)	Term of Employment
BC Assessment Authority	British Columbia property assessments	700	76	75	195,785 ²	Indefinite
BC Housing Management Commission	Develop & manage subsidized housing options for those in greatest need	420	627	627	367,120	Indefinite
BC Hydro and Power Authority	Provide energy solutions to customers in an environmentally and socially responsible way	4,483	4,269	3,903	549,923	Indefinite
BC Innovation Council	Science and technology talent development, innovation and commercialization	14	17	22	101,599 ²	3 year term
BC Lottery Corporation	Plan and manage gaming opportunities	585	2,568	1,477	370,973	Indefinite
BC Pavilion Corporation	Public event facilities management - Vancouver Convention Centre & BC Place	151	45	44	597,438	Indefinite
BC Railway Company	Support and facilitate BC Ports Strategy and Pacific Gateway Strategy	30	59	23	494,182	Indefinite
BC Securities Commission	Regulate securities trading in BC	189	32	30	549,092	Indefinite
BC Transit	BC public transportation delivery (outside Greater Vancouver Regional District)	635	229	232	286,215 ²	Indefinite
BC Transmission Corporation	Public electrical transmission system development and operation	367	238	231	463,559	Indefinite
Columbia Basin Trust	Columbia Basin social, economic and environmental planning and development	31	41	33	223,684	Indefinite
Columbia Power Corporation	Power project investment development	41	50	31	278,379	Indefinite
Community Living BC	Provide services to adults and children with developmental disabilities	461	724	723	231,811	Indefinite

Appendix A: Purpose, size, revenue, expenses and executive compensation by Crown corporation in British Columbia, 2008/09

Crown Corporation (Note 1)	Crown Corporation Purpose	Staff FTEs	Revenue (08/09 millions)	Expenses (08/09 millions)	Total CEO Compensation (08/09)	Term of Employment
First Peoples' Heritage, Language, and Culture Council	Promote First Nations languages, arts, and cultures	9	4	4	N/A ³	Indefinite
Forestry Innovation Investment Ltd.	Promote, develop and sustain BC's forest economy	17	26	26	193,334	Indefinite
Homeowner Protection Office	Regulate residential construction and provide consumer protection	35	20	24	242,631	Indefinite
Industry Training Authority	Manage BC's apprenticeship trades training and certification system	14	104	103	230,130	Indefinite
Insurance Corporation of BC	Provide auto insurance to BC motorists, driver and vehicle licensing, and registration	4,779	3,977	3,465	103,710 ²	Indefinite
Knowledge Network	Promote lifelong learning in BC by providing quality educational programming	60	12	12	199,086	3 year term
Legal Services Society	Provide legal aid to people in BC	183	78	82	236,949	Indefinite
Oil and Gas Commission	Regulate oil and gas activities and pipelines in BC	128	30	34	201,710	5 year term
Partnerships BC	Develop projects through public-private partnerships	38	17	15	509,453	Indefinite
Royal BC Museum	Preservation and education on human and natural history of BC	125	21	21	199,779	1 year term
Tourism BC	Promote development and growth in the tourism industry	122	65	65	389,506	Indefinite

Source: Compiled by OAGBC from publicly available sources (except for the Term of Employment column).

This information has not been separately audited for this report.

Note 1: Organizations highlighted in green: CEOs are paid more than the cap established by government because contracts have either been grandfathered or approved to be above the cap.

Note 2: Total compensation paid does not reflect full year; CEO hired in 2008 calendar year.

Note 3: CEO total compensation is less than \$125,000, therefore no executive compensation disclosure report was required to be produced.

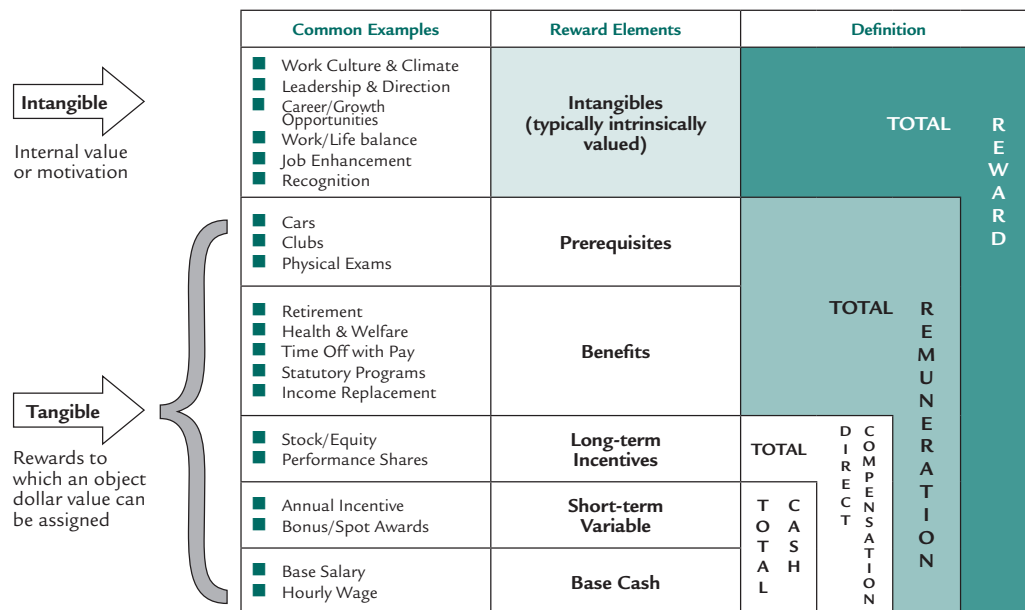
Appendix B: Executive Compensation – Better Practice Guide

The term compensation (often used interchangeably with the term remuneration) means more than simply pay or wages. Compensation refers to “all forms of financial returns and tangible services and benefits that employees receive as part of an employment relationship.”² Organizations bring together these many different forms of compensation to attract and retain good employees and to motivate excellent performance. Increasingly, greater recognition is also being given to non-monetary factors, or “intangibles,” that also affect recruitment and retention efforts.

Exhibit B.1 shows how different forms of monetary and non-monetary forms of compensation come together to form what is known as a “total rewards” (or total compensation) approach to employee compensation. Total rewards includes all the different ways employers can attract, recruit and retain valued employees and foster employee performance excellence through pay and other incentives. Each organization must define for itself the kind of compensation program it wants to offer based on factors unique to its own operating needs.

Exhibit B.1

Model of a Total Rewards Program



Source: Hay Group, *The Manager’s Guide to Rewards* (2007), AMACOM, p. 6.

² Milkovich et al. (2007). *Compensation*. Second Canadian edition. McGraw-Hill Ryerson, p. 4.

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We developed the following set of better practices as a means of helping government and its organizations plan and manage executive compensation and performance-related pay arrangements more effectively. These practices are based on a review of selected literature and on the results of an online survey we conducted with Crown corporation board members and senior management in British Columbia.

Principles of Better Practice

Determining executive compensation components and implementing supporting processes and controls in support of them require good governance, planning and management. Over time, assumptions and general principles of better practice in this area have evolved, as they will no doubt continue to do.

Total rewards — Take both monetary and non-monetary factors into consideration

Compensation is a strategic lever that can be used to recruit, retain and foster effective employee performance. Compensation includes both monetary and non-monetary incentives such as professional development, a healthy work environment and a good work/life balance. It is good practice to take both monetary and non-monetary factors into consideration when developing an organizational employee compensation framework.

Performance-related pay — Link compensation to organizational goals and objectives

Linking compensation to organizational goals and objectives helps motivate employees to achieve planned results. Organizations that have introduced performance pay need to ensure that the linkages between organizational goals and employee performance plans are clear.

Performance-related pay — Consider group as well as individual performance

Overall organizational performance is the combined result of both individual and group efforts. It is therefore good practice to measure individual and group performance, as well as organizational performance, and to provide differentiated compensation based on a weighted combination of these results.

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Performance-related pay — Be SMART when developing performance measures

Individual, group and organizational performance needs to be fairly measured and assessed. To ensure fairness, performance measures should be SMART (that is **s**pecific, **m**easurable, **a**chievable, **r**elevant, and **t**ime-based). It is also considered good practice to include performance measures that have a long-term perspective.

Total rewards — Ensure transparency and accountability

Public transparency and accountability is standard best practice. Compensation disclosures that provide a complete picture of total executive remuneration—including base salary, pension, allowances and other benefits—is a hallmark of better practice.

Putting Principles of Better Practice to Use

Putting the above principles into practice is best done through the design and implementation of effective management structures and controls. A great deal of literature regarding governance³ and managing for results⁴ offers tools and advice to help organizations plan and implement general principles of better practice. The basic underlying message can be summarized as follows:

- **Leadership:** Clearly define and communicate leadership roles and authorities and assume responsibility for doing a good job and achieving results.
- **Plan for performance:** Develop a vision of what you want to achieve and how you are going to achieve it.
- **Monitor and adjust:** Identify issues and problems and address them as they arise along the path to achieving planned goals and objectives.
- **Transparency and accountability:** Openly and honestly report progress in achieving plans because it is easier to address challenges and celebrate success when the work is visible.

³ Auditor General British Columbia. Public Sector Governance – A Guide to the Principles of Good Practices. December 2008

⁴ Auditor General of British Columbia. Building Momentum for Results-Based Management: A Study about Managing for Results in British Columbia. April 2005

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The literature that exists to support effective executive compensation planning and management reflects these common sense messages but also provides tools and advice unique to human resource management. What follows is a guide to using this common sense message to manage executive compensation in the British Columbia Crown agency sector.

Leadership—Assign and Assume Responsibility for Doing Good Work

Leadership responsibility for executive compensation within the Crown agency sector of the British Columbia public service is shared by government, boards of directors and senior executive within the Crown agency.⁵ Leadership commitment and clarity of roles and responsibilities are critical to ensuring principles of good executive compensation planning and management are followed.

- **Government:** Clarity of roles and delegated responsibilities starts with the government. Through careful design and communication of legislation, policies and guidelines related to executive compensation, government can clearly communicate roles and responsibilities in relation to executive compensation.
- **Boards of Directors:** The board is responsible for supervising management and for ensuring Crown corporations are managed in keeping with government requirements and good governance practice.⁶ This includes approving executive remuneration policies and procedures. Boards are directly responsible for CEO hiring, performance evaluation and executive succession planning. The creation of a Human Resources sub-committee of the board, independent from management, is considered to be a good practice to ensure effective Human Resource oversight and management on the part of the Board of Directors.⁷
- **CEOs and senior executives:** It is the job of the CEO and senior executives to develop strategic and operational plans to achieve results and realize the vision. Senior executives must work transparently and collaboratively with the board to create a strategic compensation and human resource management plan (or plans) to achieve corporate goals.

⁵ British Columbia Crown Agencies Secretariat. Shareholder's Expectations for British Columbia Crown Agencies. January 2009.

⁶ British Columbia Board Resourcing and Development Office. Best Practice Guidelines: BC Governance and Disclosure Guidelines for Governing Boards of Public Sector Organizations [not dated].

⁷ British Columbia Crown Agencies Secretariat. *Crown Agency Human Resources Committees: A Good Practice Checklist*, [not dated].

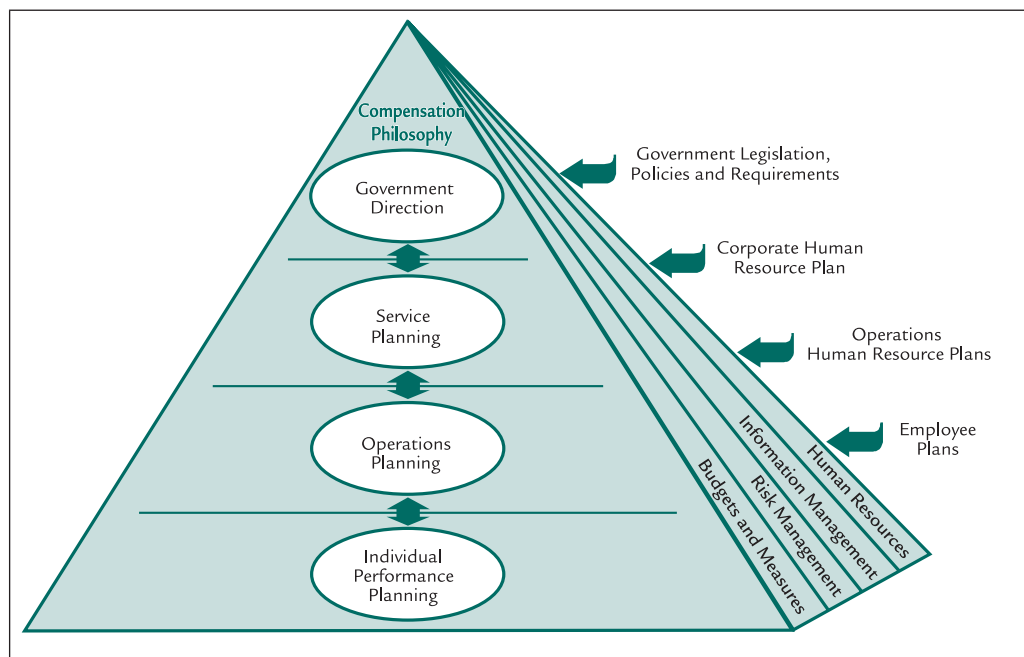
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Planning—Envision where to go and how to get there

Strategic plans combined with operations plans that are aligned to an overarching compensation philosophy help establish an effective framework (or map) to focus and direct efforts toward achieving results (see Exhibit B.2).

Exhibit B.2

Executive compensation framework



Source: Adapted from BC Public Service Agency Corporate HR Plan 2003/04–2005/06

A compensation philosophy is a statement that defines what an organization values and wants to achieve for itself and its employees through compensation. Some important questions to ask when developing a compensation philosophy include:

- **Compensation definition:** What do we want to include in our definition of compensation?
- **External competitiveness:** Who do we compete with for talent? How competitive do we need to be to attract and retain good people? Where do we want to position our base compensation relative to the market place? What can we offer that others cannot?

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- **Internal alignment:** How can we best link compensation to organizational goals and objectives? How much risk should we ask employees to assume and how do we balance that with rewards? What can we afford? How can we make it fair and equitable?
- **Performance measurement:** What kind of data and information do we need to collect? How should we measure performance?

A well-crafted compensation philosophy outlines how the organization has carefully considered the level and mix of compensation and rewards to be offered based on an analysis of the markets the organization competes with for talent. Such a philosophy also describes how total rewards have been internally aligned with the goals and values of the organization to foster and support employee performance excellence in a fair and balanced manner.

Monitoring and adjusting—Recognize and address issues and problems

There is no such thing as perfect. That's why concepts such as Enterprise Wide Risk Management⁸ and Total Quality Management⁹ were developed to help identify and resolve issues and challenges when they arise. The steps involved in risk and quality management are common sense:

- Based on an understanding of the context, identify what can go wrong (or has gone wrong) and what constitutes quality.
- Figure out what can be done to avoid problems from occurring and ensure quality management.
- Determine the organizational impact if a risk should arise or if quality management is not achieved.
- Develop a response plan to address problems when they arise and assure quality results.

Risk management and quality assurance are both proactive and reactive. Being proactive is much more challenging because it requires some creative future thinking—that is what making adjustments is all about. It is better if changes can be made before problems occur rather than after. This requires significant leadership vision, determination and flexibility.

⁸ Standards Australia and Standards New Zealand (2004) AS/NZS 4360:2004, *Risk Management Sydney, NSW*. ISBN 0 7337 5904 1.

⁹ Deming, W.E. (1982). *Out of the Crisis: Quality, Productivity and Competitive Position*. MIT Press.

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Transparency and accountability — Openly and honestly report progress in achieving results

Organizations that embrace transparency and accountability are better respected because they take the time to educate stakeholders about the organization's plans and to provide updates on their efforts to achieve results.

Effective compensation disclosure depends on leadership commitment, thoughtful performance planning and management, and well-designed systems of employee performance measurement and public reporting.

Compensation disclosures that provide a complete picture of total executive remuneration, including linkages to organizational goals and objectives, help stakeholders understand how compensation is used to attract, retain and motivate excellent employee performance and achieve results.

