

THE DIRECTOR'S TOOLKIT: TALLY SHEETS

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The ongoing COVID-19 pandemic has inflicted unprecedented disruptions across many businesses and industries. As we approach year-end 2020, many Boards are in the throes of planning for executive compensation decisions in respect of this "COVID year," with many grasping for precedent-setting examples and well-articulated principles to support a reasonable position. Even in industries where the business impact of the pandemic has been relatively modest (or positive), there remains significant pressure and scrutiny from stakeholders, and a looming sense of uncertainty about what the future might bring. For all, when faced with difficult decisions, the need for relevant and timely information is greater than ever.

When Boards encounter high-pressure situations, the stress is often compounded by information gaps. Whether the company is in the midst of approving a major pay decision, undergoing a CEO succession, or anticipating a possible change-of-control, having a fulsome understanding of the compensation dynamics at play helps ensure directors make an informed decision. Often is the case where the Board finds itself asking questions it should already have the answers to, and in many cases, the questions can be multi-layered – for example:

Question	Question Behind the Question
Do we have a retention issue?	What is the recent compensation experience of our executives? What is the retention value of their unvested awards?
How truly valuable is our long-term incentive program?	How much do our executives stand to gain (or lose) if our share price increases (or decreases)?
Can we ensure an orderly CEO transition when the time comes?	What are the economic implications if our incumbent CEO were to exit today? In 3-years? In 5-years?
We are heading towards a possible change-of-control; can we keep our executives engaged and motivated?	What are the change-of-control provisions for our executive team and how valuable are they?

Tally Sheets: Unveiling the True Value of Executive Compensation

As the name suggests, Tally Sheets "tally up" the various components of compensation and benefits and provide a comprehensive view of the economics at play in the compensation program. Tally Sheets allow directors to understand how the components of executive pay work together. This information should be reviewed to support the Board's decision-making on critical decisions regarding executive compensation. For example, when contemplating a base salary increase, while the decision in and of itself may seem reasonable and not excessive, the Board should consider the resulting impact to the employee's pension benefits and termination entitlements, which are often tied to base salary.

Tally Sheet Example

The use of Tally Sheets is a Compensation Committee best practice. This all-in-one analysis equips Boards with hindsight for decisions past, and foresight of future possibilities, and serves as a record of the true value of executive compensation. Below is a sample illustration of a Tally Sheet.

Tally Sheet as of June 30, 2020							
Name: John Smith Position: President & CEO				Years of Service: 5.5 Age: 59.4			
Value of Total Annual Compensation (\$000)							
2020 Compensation		Target		Benefits and Perquisites			
Base Salary		\$500		DB Pension		\$131	
Target STIP		\$500		Perquisites		\$57	
Target LTIP				Subtotal - Benefits & Perks		\$188	
PSU		\$500					
RSU		\$250					
Stock Options		\$250					
Subtotal - Total Direct Comp		\$2,000					
VALUE OF TOTAL ANNUAL COMPENSATION		\$2,188					
Value of Total Annual Compensation (\$000)							
Assumed Stock Price		\$20	\$30	\$40	Total LTIP Value at		
Assumed PSU Multiplier		Threshold	Target	Maximum	Vesting/Exercise since Hire Date		
Vested Bonus Deferred DSUs		\$356	\$534	\$712	PSUs		\$2,523
Vested Stock Options (in-the-money)		\$456	\$865	\$2,413	RSUs		\$1,725
Subtotal - Total Vested Value		\$812	\$1,399	\$3,125	Stock Options		\$2,164
					Total		\$6,412
Unvested PSUs		\$224	\$672	\$1,792			
Unvested RSUs		\$421	\$632	\$842			
Unvested Stock Options		\$124	\$486	\$1,862			
Subtotal - Total Unvested Value		\$769	\$1,790	\$4,496			
VALUE OF OUTSTANDING AWARDS		\$1,581	\$3,189	\$7,621			
Employment Change Events (\$000)		Term for Cause	Resignation	Term w/o Cause	Retirement	Death/Disability	CoC Term w/o Cause
Non-Forfeitable Amounts							
Value of Vested DSUs		at \$30/share	\$534	\$534	\$534	\$534	\$534
Value of Vested Stock Options		at \$30/share	\$865	\$865	\$865	\$865	\$865
DB SERP			\$1,284	\$1,284	\$1,284	\$1,284	\$1,284
Subtotal - Amount Already Earned			\$2,683	\$2,683	\$2,683	\$2,683	\$2,683
Payments due to Event							
Cash Severance			\$0	\$0	\$2,000	\$0	\$1,500
LTIP Vesting		at \$30/share	\$0	\$0	\$652	\$1,790	\$1,342
Subtotal - Payments Due to Change Event			\$0	\$0	\$2,652	\$1,790	\$2,842
VALUE OF CONTINGENT LIABILITIES			\$2,683	\$2,683	\$5,335	\$4,473	\$5,525
Employment Change Events summarize the value of an executive's entitlement under different termination scenarios. While this example is very generic, it is important to understand the specific provisions and treatments for your executive.							
Total Value at Vesting/Exercise shows the total wealth accumulation from LTIP awards.							
Value of Outstanding Awards shows the potential value of LTIP at different performance levels.							

Conclusion

As we approach the conclusion of calendar 2020, Board decision-making on executive compensation becomes top-of-mind. For some, the impact of COVID-19 on the compensation program compounds an already strenuous year-end process. Tally Sheets serve as an important tool for Compensation Committees when making critical decisions on executive compensation.

We invite you to reach out to a Hugessen consultant for further information, or for support with addressing the unique circumstances of your organization.

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Hugessen Consulting is an independent consulting firm dedicated to meeting the executive and director compensation consulting requirements of Boards. With offices in Toronto, Calgary, and Montreal, the firm's mission is to be the leading provider of advice on executive compensation, director compensation, performance measurement and assessment, and related governance to the Compensation Committees of companies in Canada and the U.S.

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