ACCOUNTING PRINCIPLES
EXECUTIVE PAY: DIRECTORS NEED TO KEEP ASKING (MORE) QUESTIONS

Chris Bart, Y. Lilian Chan, & Kiridaran Kanagaretnam
DeGroote School of Business, McMaster University

The *Special Report: Ornge Air Ambulance and Related Services* (Office of the Auditor General of Ontario, 2012) reports that the Ministry of Health and Long-Term Care (MOHLTC) has not been obtaining the information it needs to fulfill its oversight responsibilities over Ornge's financial undertakings and operations. Ornge, a government agency reporting to the MOHLTC, is a vital part of Ontario's medical system with a mandate to provide sophisticated medical transport for very ill and critically injured patients, in the air and on the ground. Among the many areas that MOHLTC has failed to oversee with appropriate rigour is the non-disclosure of executive compensation on *The Sunshine List*, a mandatory disclosure of public servants earning over $100,000 under the *Public Sector Salary Disclosure Act 1996 (Amendment 2004)*, since 2007. Indeed, the annual salary of Dr. Chris Mazza, former CEO of Ornge, was only $298,000 in 2007 and increased to over $2 million in 2010/2011 after he told the board that a private firm was trying to poach him (see Donovan, 2012 for details). In January 2012, as a result of this and other problems, Deb Matthews, the Ontario Minister of Health and Long-Term Care, removed Ornge's board and Mazza as CEO.

The Ornge scandal is the most recent case of governance failure in the public sector. Hydro One, Concordia University, and eHealth are examples of other cases where excessive executive compensation and severance payments have raised public outcry. Although the government delegates the decision on executive compensation to public organizations' boards, the Ontario government has also enacted regulations, such as the *Public Sector Salary Disclosure Act 1996 (Amendment 2004)* and *The Excellent Care for All Act, 2010*, to ensure greater accountability of public funds. Hence, it falls to the boards of public organizations to exercise due diligence when assessing and setting compensation levels for their executives.

Boards of many public organizations, including not-for-profits and charitable organizations (e.g., universities, hospitals), are served by individuals who are passionate about their organization's mission. The roles and responsibilities of these directors in public organizations, however, *are no less than those of the paid directors in for-profit organizations.* In fact, duty of care, duty to manage and supervise management, and duty to comply with the incorporating statute are the legal obligations of directors, paid or unpaid, to their organizations (e.g., Carter & Prendergast, 2012). Moreover, directors have the duty to act in good faith, honestly and loyally; duty to avoid conflict of interest; and they duty to continue their obligations to the organization under common law. One way for board directors to fulfill their roles and responsibilities, especially with regard

Chris Bart is Professor of Strategic Management. He is the Founder, Principal, and Lead Professor of The Directors College at McMaster University. He is also the author of the widely acclaimed CICA publication *20 Questions Directors Should Ask About Strategy* and has published over 100 articles, cases, and reviews. Email: bartck@mcmaster.ca .

Y. Lilian Chan is Professor of the Accounting and Financial Management Services Area. She has conducted research on performance measurement, balanced scorecard, and governance in the not-for-profit sector. Her research has been published in academic and professional journals in management accounting and healthcare management.
Email: ylchan@mcmaster.ca .

Kiridaran (Giri) Kanagaretnam is Professor of Accounting and Financial Management Services. His research focuses on bank financial reporting, corporate governance and organizational trust, and related issues. He has published his research in top tier journals in accounting, economics, finance, and international business.
Email: giri@mcmaster.ca .

to exercising their duties of care with due diligence and business judgment rule, is by *asking questions*.

To help in this respect, the Canadian Institute of Chartered Accountants (CICA) has published the *NPO 20 Questions Series* for not-for-profit organizations (NPOs) in addition to its *20 Questions Series* for for-profit organizations. At present, there is no specific set of questions for NPOs on executive compensation. We felt that there was a need for such a list, so we surveyed 47 board members of public sector and NPOs attending a Canadian directors' training program to see what questions they asked from among the suggested *20 Questions directors should ask about executive compensation*. We found that there are five key questions these directors believe needed to be asked (see Bart, Chan, & Kanagaretnam, 2011 for details) out of the 24 questions posed in the guide. They are:

1. Are the respective roles of the board and human resources /compensation committee clearly defined?

2. Where does the responsibility for oversight of executive compensation ultimately reside?

3. Are the directors sufficiently independent for purposes of serving on the human resources/compensation committee?

4. Are the performance measures and standards for the CEO's incentive programs appropriate?

5. Is there a proper process in place to monitor all payments and other benefits received by the CEO?

While these are the top five, only four respondents (8.5%) asked six or fewer questions of the 24 on executive compensation. Accordingly, this sample of board members is relatively active in asking questions about executive compensation in their organizations.

In 2011, the CICA published the second edition of the *20 questions directors should ask about executive compensation* (see http://www.cica.ca/focus-on-practice-areas/governance-strategy-and-risk/not-for-profit-director-series/index.aspx), replacing some of the original questions on the choice of comparator groups for assessing relative compensation with questions related to risk. Indeed, risk has clearly become such a critical issue that board directors are now asked to consider it in eight of the 20 questions in the second edition. These changes also suggest that questions, which directors should ask, are affected by emerging issues and changes in the operating environment.

Board directors of public organizations are expected to have a high level of public accountability, and not just related to executive compensation. Although both Ornge's CEO and board have been removed, it is an ongoing financial fiasco that is costing Ontario taxpayers millions of dollars. So, why did this financial debacle happen in the first place? As commented by *The Globe and Mail* journalist Adam Radwanski, governments have to get serious about corporate governance in public organizations as there are far too many directors, especially those who serve on multiple boards, "unengaged

… and unwilling or unable to *ask necessary questions*" (Radwanski, 2012, para. 5, emphasis added). Why do they not ask those questions? It is simple: either the directors do not know which questions to ask (a matter of competence) or they are afraid to ask them (a matter of character). Either way, the real solution to better governance in public sector organizations begins with better informed and more courageous directors. Taxpayers deserve as much.

Website

CICA. *The NPO 20 Questions Series*. http://www.cica.ca/focus-on-practice-areas/governance-strategy-and-risk/not-for-profit-director-series/index.aspx

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