

THE EXECUTIVE BRIEFING SERIES

Tally Sheets: Tracking Executive Pay in a Changing Environment

Tally Sheets: What are they?

- » **“Snapshot” of executive’s total compensation**
- » **Tool to help Committees understand and evaluate the cumulative effect of pay decisions**
- » **Two types:**
 - Annual: captures value of all compensation and benefits associated with one year’s service
 - Event-driven: captures Company’s total compensation and benefit liabilities/lump sum payments upon termination events
 - Change-in-control (“CIC”)
 - Termination without Cause
 - Retirement, etc.

Tally Sheets: Why bother?

- » **Good governance practice for Committee based on Four A's:**
- » **Audit**
 - Have the plan mechanics been applied as intended?
 - Are there any issues with the assumptions used in pay calculations?
 - Does the audit support/verify current payouts?
- » **Awareness**
 - Do we have a Disney or NYSE on our hands?
 - Have we done our job?
 - Does it really work that way?
- » **Analysis**
 - What is the sensitivity to flex points?
 - What happens if (this) happens?
 - What happens if we change (this)?
- » **Action**
 - Which pay decisions should be tested using tally sheets?
 - Are we competitive in pay levels and mix?
 - Should we change our program?

Tally Sheets: Who's done them?

Past: Limited use

- » **PM&P survey of 102 firms showed that 39% completed tally sheets last year**
- » **Very few companies actually disclose tally sheets (e.g., Morgan Stanley)**

Present: New SEC disclosure rules

- » **Total compensation column in table**
- » **Separate disclosure of payments upon CIC and early/regular retirement**

Future: More robust tool

- » **Fully integrated with Committee decision processes**

Tally Sheets: What's included?

- » **Under new SEC proposed disclosure rules, Summary Compensation Table will become an annual tally sheet**

Annual Tally Sheet

- » **Base salary**
- » **Bonus earned**
- » **Grant date fair value of option grants**
- » **Grant date fair value of stock grants**
- » **Cash incentive payouts**
- » **Perquisites**
- » **Incremental annual present value from pension plans**
- » **Incremental annual value from deferred compensation**
- » **All other**

Other Event-Driven Items

- » **Severance payments and age/service credits**
- » **Lump sum retirement and deferred compensation payments**
- » **Final year pro rated bonus**
- » **Transaction bonuses**
- » **Excise tax gross-up**
- » **Benefit/welfare continuation**
- » **Consulting arrangements**
- » **Other payments upon CIC and/or termination**

Tally Sheets: What else is needed?

- » **SEC focus on single number is incomplete and could be misleading**
- » **Full integration with Committee decision processes involves:**
 - Event-driven scenario modeling
 - Reconciliation of annual pay actions with event-driven payouts
 - Pay-for-performance relationship
 - Multi-year impact, especially potential for geometric payout progression
 - Pay mix

Tally Sheets: What's best practice?

- » **Emerging “best practices” are based on SEC proposal and prodding from institutional investors (e.g., ISS)**
- » **Frequency of review by Compensation Committee**
 - Upfront investment, maintenance/vigilance thereafter
 - Material actions, e.g., new incentive plan, new contract, etc.
 - At least once a year
- » **Required interaction with management and consultants**
 - Tally sheets should not be prepared “in a vacuum”
 - Input assumptions are often critical
- » **Executives to be reviewed may include:**
 - Executives normally within Committee purview
 - “Top Five” proxy officers (maybe plus three)
 - Reporting structure – CEO, CFO, COO, BU Presidents, etc.
 - Section 16(b) officers
 - Key employees under Section 409A

Tally Sheets: What to do now?

» **Get started now**

- Inputs may be hard to collect
- Information may be difficult to analyze
- External resources may be needed

» **Use outcome to support preparation of CD&A**

- Pay-for-performance relationship
- Role and importance of each pay element
- Reasonableness of pay decisions
- Better understanding of the programs and potential payouts