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SEC Amends Recently Adopted Executive Compensation Disclosure Requirements

On December 22, 2006, in an effort to provide investors with a more complete and useful picture of executive compensation, the Securities and Exchange Commission (SEC) adopted, as interim final rules, amendments to the recently adopted disclosure requirements for executive and director compensation. The amendments change how stock awards and option awards are to be reported in executive compensation disclosure tables required to be set forth in annual reports on Form 10-K, proxy statements and information statements, and in registration statements that require disclosure pursuant to Item 402 of Regulation S-K. These interim final rules became effective December 29, 2006.

Background

The SEC's executive compensation disclosure rules adopted on July 26, 2006 required stock awards and option awards to be reported in the Stock Awards and Option Awards columns of the Summary Compensation Table in the year of grant at the full grant date fair value computed in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (FAS 123R), rather than as a number of shares or options. The interim final rules instead now require that stock awards and option awards be reported in the Stock Awards and Option Awards columns in the Summary Compensation Table and the Director Compensation Table as the total dollar amount recognized from all awards outstanding for financial statement reporting purposes for the applicable fiscal year in accordance with FAS 123R.

The SEC promulgated these interim final rules because it believes that measuring yearly compensation in this revised manner should provide investors with a clearer view of annual compensation earned by executive officers and the annual compensation cost to a company, consistent with the timing of financial statement reporting. In addition, the changes should eliminate the potential for distortion in identifying

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named executive officers that could occur if the Summary Compensation Table continued to reflect the full grant date fair value of awards, especially because new executive officers are often granted significant equity as of their date of hire. Consequently, a company's identification of named executive officers should be more consistent from year to year, facilitating investors' ability to track year-to-year changes in compensation for the same persons.

The SEC did not do away with the disclosure of the full grant date fair value of awards granted during a fiscal year but instead amended the Grants of Plan-Based Awards Table to add a column showing this amount on a grant-by-grant basis. Because this amount will be disclosed on a grant-by-grant basis, it will provide investors with a more complete view of the compensation decisions made with respect to the last fiscal year and facilitate Compensation Discussion and Analysis disclosure of a company's policies and decisions regarding compensation awarded to, earned by or paid to its named executive officers.

Revisions to Executive and Director Compensation Tables

Set forth below is a discussion of the changes to Item 402 of Regulation S-K as a result of the SEC's adoption of the interim final rules.[1]

Summary Compensation Table

- The dollar amount reported for Stock Awards [column (e)] and Option Awards [column (f)] must be the dollar amount of compensation cost recognized for financial statement reporting purposes with respect to the fiscal year in accordance with FAS 123R, disregarding any estimates allowed for financial statement reporting purposes of forfeitures by named executive officers. Compensation cost must include both the amounts recorded as compensation expense in the income statement for the fiscal year, as well as any amounts earned by an executive officer that have been capitalized on the balance sheet for the fiscal year. This amount includes compensation cost recognized in the financial statements with respect to awards granted in previous fiscal years and the subject fiscal year.

- Compensation cost for awards that do not vest due to the failure to meet the vesting condition or because an executive officer's employment terminates before the award has fully vested must be deducted from the amount reported for Stock Awards [column (e)] and Option Awards [column (f)] for the year of forfeiture and a footnote must be added disclosing such forfeitures.[2]

- The footnote disclosure regarding the FAS 123R valuation assumptions has been revised to require that it also discuss or reference the footnotes to the financial statements or discussion in the Management's Discussion and Analysis of forfeited awards.

- For awards classified as "liability awards" under FAS 123R (*i.e.* awards with cash-based settlement) that are remeasured, or marked to market, at each financial statement reporting date through the date the awards are settled under FAS 123R, the annual change in value of the award must be reflected in Stock Awards [column (e)] and Option Awards [column (f)].[3]

- Compensation cost for awards containing a performance-based vesting condition must be reflected in Stock Awards [column (e)] and Option Awards [column (f)] in compliance with FAS 123R by disclosing the compensation cost only if it is probable that the performance condition will be achieved. If the achievement of the performance condition is not probable at the grant date but becomes probable in a subsequent period, the proportionate amount of compensation cost based on service previously rendered must be disclosed during the period in which achievement of the performance condition becomes probable. Similarly, if the achievement of a performance condition was previously considered probable but in a later period is no longer considered probable, the amount of compensation cost previously disclosed should be reversed during the period in which it is determined that achievement of the performance condition is no longer probable. The amount cumulatively reported in the Summary Compensation Table for awards with service or performance-based conditions that do not vest should ultimately be zero.

- The SEC has also provided transition guidance since FAS 123R became effective for many companies in 2006. Companies are required to utilize the FAS 123R modified prospective transition method for disclosure purposes, whether or not they have adopted that method for financial reporting purposes. Under the modified prospective transition method, a proportionate share of the grant date fair value determined under Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*, of equity awards that are outstanding when FAS 123R was adopted should be recognized in the financial statements over those awards' remaining vesting periods, if any. Liability awards that are outstanding when FAS 123R was adopted must be recognized in the financial statements until those awards are settled, based on the fair values of those awards at each financial statement reporting period under FAS 123R, as well as the portion of the awards that have vested.

- Any amount of salary or bonus that is forgone at the election of the named executive officer in favor of receiving a noncash form of compensation must be reported in Salary [column (c)] or in Bonus [column (d)] with footnote disclosure of the receipt of noncash compensation that refers to the Grants of Plan-Based Awards Table where the stock, option or nonequity incentive plan award elected is reported.

Grants of Plan-Based Awards Table

The new rules add a new column (l), "Grant Date Fair Value of Stock and Option Awards," to this table and require disclosure in this column of information previously required to be disclosed in the Summary Compensation Table. More specifically the new rules require:

- the grant date fair value of each equity award set forth in this table computed in accordance with FAS 123R on a grant-by-grant basis; and

- the incremental fair value of any repriced, whether through amendment, cancellation, replacement or any other means, or materially modified award during the last completed fiscal year computed as of the repricing or modification date in accordance with FAS 123R.

Director Compensation Table

- As in the Summary Compensation Table, the amount reported in Stock Awards [column (c)] and Option Awards [column (d)] must be the dollar amount of compensation cost recognized for financial statement reporting purposes with respect to the fiscal year in accordance with FAS 123R, and all other instructions relating to the revised disclosure in the Summary Compensation Table for executive officers also applies to disclosure in this table.

- The footnote disclosure for equity awards was revised to add to the existing required disclosure setting forth the aggregate number of stock awards and option awards outstanding at the end of the fiscal year:

    - the grant date fair value of each equity award computed in accordance with FAS 123R; and

- for each option or similar instrument for which the company has adjusted or amended the exercise price during the last completed fiscal year, whether through amendment, cancellation or replacement grants or otherwise, or has materially modified such awards, the incremental fair value, computed as of the repricing or modification date in accordance with FAS 123R.

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[1] The text of the new rules is available at here.

[2] This requirement for disclosing the compensation cost relating to forfeitures in the Summary Compensation Table is different from the rules requiring the reporting of forfeitures for financial statement reporting purposes under FAS 123R.

[3] The SEC recognizes that the fluctuations in accounting for both liability and performance rewards could result in the disclosure of a negative number in the Stock Awards or Option Awards column in any given year which would then reduce the Total Compensation reported for an executive officer for that year. However, the SEC also realizes that these calculations will result in ultimately recognizing the actual cost of the award to a company.

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Please contact the Mintz Levin attorney who handles your corporate and securities law matters if you have any questions on these new developments.
