Executive-Pay Summaries Conceal as They Reveal

New Proxy Tables Don't Include All Options Data

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The first overhaul in 15 years of executive-pay disclosures has been billed as the most transparent window ever into the clubby world of corporate compensation.

But as these filings have begun to roll out publicly, analysts are finding there's a catch.

Due to an accounting loophole for stock options and an eleventh-hour rule change made by securities regulators just before Christmas, some of the biggest names in technology, health care and financial services will be able to cloud what their top executives make.

The anomaly is being discovered by compensation consultants who have been hired by firms to draft these filings. In some cases, it is lowering the compensation figures reported by firms, they said. In others, executives who should be named in the filings as the five highest-paid officers in their companies are being replaced with employees making less.

The Securities and Exchange Commission's first changes to pay disclosures since 1992 were meant to be user-friendly. Shareholders could look at a summary table and easily see what the top executives of a company were taking home in salary, perks, retirement bonuses and stock options.

Now, that summary table "won't give you the full picture," said Brian Foley, a compensation consultant based in White Plains, N.Y. "It misses a big part of the puzzle."

SEC officials said they had no control over which companies used the stock options loophole. But they said the agency's late December rule change will provide more accurate figures in the long run and will better reflect what an executive is making in a given year. Although the summary table may not provide full information on options, that data will be included elsewhere in the filing, they said.

No issue in the SEC's history has generated as much interest as the new executive-pay disclosures, Chairman Christopher Cox said last year, adding that the agency had received more than 20,000 comments about it from businesses, trade groups and investor advocates.

While hailing the new filings as a breakthrough, several academics and analysts were critical in interviews of the way the disclosures handle stock options. They also questioned whether the average shareholder could page through these filings to link different tables and charts.

"The proxies will provide you three or four times as much information as before," Foley said. "But . . . now you will have to pick through the mess to get the value of the options. It's not going be in plain English."

Employees who are granted stock options can buy a company's stock at a set price within a specific time frame. They then can reap a windfall if the price goes up, but typically they can sell only a portion of these shares each year. This "vesting period" often keeps prized workers from defecting to a rival.

The story behind the loophole began when an accounting rule, FAS 123R, came into effect last year and changed the way companies account for these options.

The rule had a huge impact on the all-important bottom line: If firms gave stock options to executives, they had to subtract the total value of those grants from their earnings that year. Before, options were not counted as an expense.

Suddenly, under FAS 123R, it could appear as if a company's profit took a big hit, especially in industries such as health care and technology in which granting executives hundreds of millions of dollars' worth of stock options is common.

To avoid the appearance of a profit dip, more than 900 companies, including Dell, Sun Microsystems, CBS, J.P. Morgan Chase, Whole Foods Market, Viacom, Corning and Northrop Grumman, sped up the vesting date of their options to occur before FAS 123R took effect, according to a Bear Stearns report. This was neither illegal nor improper under accounting rules.

But the acceleration helped these firms collectively erase about $8 billion of future stock option expenses from their books, meaning they awarded the options but would not have to include the cost in their financial results, according to Bear Stearns.

"Option-vesting acceleration was used as a means to temporarily benefit reported earnings," the report said. The analysis says Dell accelerated the most options -- $591 million in total -- followed by Sun Microsystems, with $400 million.

Then, on the Friday before Christmas, the SEC gave corporations a present: It changed a rule to allow them to report the amount of stock options that vest per year rather than the total value of the options granted to an executive.

One compensation consultant, who has major technology firms as clients, said the difference in reported compensation levels before and after the SEC's December rule change has been striking.

In almost every case, the SEC change and the acceleration of options altered the total amount of compensation reported on the disclosure's summary table. For many firms, the final number was lower. For other companies, at least on paper, it created a different pecking order for the highest-paid executives. The consultant spoke on condition of anonymity because the filings have not yet been released to the public.

The new summary tables are "potentially misleading if you are looking for a single number to guide you. . . . You don't get a picture of what the compensation committee originally intended the compensation to be," he said. "The number that you get is precisely wrong."

Especially in the first year, the compensation expert added, shareholders should be cautious about taking these figures at face value.

SEC officials said shareholders should not rely solely on the summary tables and should read a company's entire filing. They added that if the December rule altered the composition of a company's "top five," the change made the filing more accurate.

"There are still problems . . . but this reporting season, we will know much more about both the amount and the structure of compensation than we've known for a long time," said Lucian Bebchuk, director of the Program on Corporate Governance at Harvard Law School.