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Revised Executive Compensation Disclosure for Stock and Option Awards

Disclosures about executive officers' and directors' stock and option awards will be more closely aligned to the amounts reported in the financial statements, reflecting earned compensation for the service period as reported in the financial statements, rather than the aggregate grant-date fair value of the awards, under newly adopted amendments to Item 402 of Regulation S-K.¹ The amendments, which are effective upon publication in the Federal Register, affect the amounts included in the calculation of "total compensation" under Item 402, which determines what individuals in addition to the principal executive officer and principal financial officer meet the definition of a "named executive officer."

Summary Compensation and Director Compensation Tables

The new rules affect the amounts presented for stock and option grants in the Summary Compensation and the Director Compensation Tables. Instead of presenting the aggregate grant-date fair value of awards in the tables, which had been required under the original rules adopted in July 2006, companies will present the portion of the fair value of the awards that represents earned compensation for the year as reflected in the financial statements.² The monetary amount of compensation cost is recognized over the requisite service period in accordance with Statement 123R.³ The Stock Awards and Option Awards columns in the Summary Compensation and Director Compensation Tables will include the total compensation cost recognized for the period, including both amounts recorded as compensation expense in the income statement and amounts earned during the period that are capitalized on the balance sheet.

Cash compensation forgone by a named executive officer in return for stock or option awards will be reported as compensation in the Salary or Bonus column of the Summary Compensation Table, rather than the Stock Awards or Options Awards columns with footnote disclosure of the noncash compensation. This might occur, for example, if the officer forgoes a cash bonus in return for a stock or option award.

¹ SEC Release No. 33-8765, Executive Compensation Disclosure, December 22, 2006, available at <http://sec.gov/rules/final/2006/33-8765.pdf>.

² SEC Release No. 33-8732A, Executive Compensation and Related Person Disclosure, August 29, 2006, available at www.sec.gov.

³ FASB Statement 123 (revised 2004), Share-Based Payment, December 2004, available at www.fasb.org.

Equity-Classified Awards. Statement 123R requires the compensation cost related to an equity-classified award to be measured based on its fair value at the grant date, but that cost is recognized for financial-reporting purposes over the period in which the employee is required to provide service in exchange for the award (typically the vesting period). Under the amended rule, if an award with service or performance-based conditions ultimately vests, the amount cumulatively recognized in the Summary Compensation or Director Compensation Table over the requisite service period should equal 100 percent of the grant-date fair value of an equity-classified award.

Liability-Classified Awards. Awards classified as a liability in the financial statements are remeasured at fair value⁴ at each financial-statement reporting date under Statement 123R, and these amounts will also be reflected in the Stock Awards and Option Awards columns. Liability-classified awards base vesting or exercisability on a factor other than a service, performance, or market condition or require or permit cash settlement. These types of awards include awards with cash-based settlement features, certain repurchase features, or other features that do not cause the employee to bear the risks and rewards normally associated with share ownership. For liability-classified awards, the cumulative compensation recognized in the tables over a period of years from the grant date to the settlement date should equal the fair value of the award at the date of settlement.

Service-Based Vesting Conditions. The rule release states that Item 402 disclosures should be determined the same way that employee stock options are valued under Statement 123R, which would typically include estimating forfeitures. The grant-date fair value should be calculated using the same reasonable groupings of individuals for purposes of determining the expected-term assumptions required by Statement 123R. If a company uses more than one group, the table disclosures should be based on the group that includes the named executive officers or directors. However, under the amendments, the compensation cost disclosed in compliance with Item 402 will not include an estimate of forfeitures related to service-based vesting conditions for executive officers. The disclosure will assume that each officer will perform the requisite service to vest in the awards. If the award is forfeited, amounts previously included in the Summary Compensation or Director Compensation Table will be deducted in the period forfeited, with the forfeitures described in a note to the table.

An award made to a named executive officer who is eligible for retirement and entitled to keep the award at retirement is not considered to have a substantive service requirement under Statement 123R. The full grant-date fair value of the award will therefore be included in the Summary Compensation or Director Compensation Table in the year of the grant and will not be spread across future periods.

Performance-Based Vesting Conditions. Statement 123R requires that compensation cost related to awards with performance-based vesting conditions be recognized only if it is probable that the performance condition will be achieved. The same amounts recognized in the financial statements will therefore be disclosed in the Summary Compensation or Director Compensation Table for awards for which it is probable that the performance condition will be achieved. If the performance condition initially is not probable of achievement, it is not reported in the table or as compensation cost under Statement 123R unless it subsequently becomes probable of achievement. At that point, the compensation associated with past service will be included in the table for that period. Compensation will be reversed in the table if achieving the performance condition is no longer considered probable.

Grant of Plan-Based Awards Table

The full grant-date fair value of each award to a named executive officer will be presented in a new column in the Grants of Plan-Based Awards Table. Each award to a director will be presented in a note to the Director Compensation Table at its full grant-date fair value.

If equity-based awards to named executive officers are repriced or materially modified, the incremental fair value of each award, as calculated in accordance with Statement 123R, will be included in the Grant of Plan-Based Awards Table. The same information

⁴ Statement 123R permits a nonpublic company, such as an SEC debt registrant, to use intrinsic value in measuring its liability-classified awards.



for revised awards to directors will be included in a note to the Director Compensation Table. This disclosure is not triggered by revised terms that do not establish a new measurement date under Statement 123R (for example, a modification made in compliance with an anti-dilution provision that requires an equitable adjustment in the event of a recapitalization or similar transaction or a change in the terms of the award that results in an adjustment of the option exercise price as a result of achieving a market condition because the adjustment feature would have been reflected in the grant-date fair value of the award).

Small business issuers are not required to disclose the full grant-date fair value of equity awards to named executive officers or directors.

Effective Date

Compliance with the amended Item 402 requirements is required for proxy statements, information statements, and registration statements filed on or after December 15, 2006 and for Forms 10-K and 10-KSB for fiscal years ending on or after December 15, 2006.

The SEC is accepting comments on the interim final rules for 30 days following their publication in the Federal Register and will consider those comments in determining whether to make changes to the rules.

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