

## Drowning in Data

The new compensation disclosure rules deliver plenty of information. Too bad much of it doesn't make sense.

[Michelle Leder](#), CFO Magazine  
July 01, 2007

Months later and you're still recovering from proxy season? No worries: you're not alone. The fact is, anyone who had anything to do with filing a corporate proxy statement this year — the first year under new Securities and Exchange Commission rules designed to improve compensation disclosure — or who actually devoted the time and brain cells needed to review more than one or two proxies, is still shaking from all the caffeine they would have had to ingest.

The extra caffeine, of course, was needed to plow through what many have described as the most stressful proxy season ever. Now that it is essentially over, those who spend large chunks of their time focused on the annual proxy process believe that the really tough work is just beginning. That's because it's hard to find anyone who thinks things went smoothly in 2007. Not SEC chairman Christopher Cox, who has described the newly required Compensation Disclosure and Analysis (CD&A) section at many companies as being "as tough to read as a Ph.D. dissertation" and "a far sight longer than a full-length feature in *The New Yorker*," based on initial review of 40 CD&As by Toronto-based Clarity Communications. Not compensation consultants or corporate attorneys or directors or executives or even bloggers. And especially not investors, the very people the new rules were designed to help.

The big question, though, is what the SEC will do once it's done reviewing the 2007 crop of proxies. Although Cox and others have commented publicly on some aspects of the bunch, most notably their length and inherent confusion, the agency is expected to issue a comprehensive report this fall. Some believe, or perhaps hope, that the confusion may lead to wholesale changes for 2008. Others think that regulators are far more likely to take a carrot-and-stick approach — praising companies that embraced the changes while criticizing the ones that did a highly legalistic dance around them (see "A Season of Revelations" at the end of this article). Then there are those who expect only minor changes to fix the highly unusual problems that cropped up, such as the ability of Marshall & Ilsley Corp. to report that its former CFO, John Presley, made negative \$315,734 in 2006. Indeed, compensation firm Equilar Inc. found that 2 percent of the 900 proxies it reviewed had executives reporting negative compensation.

Yet the very people who have complained the loudest bear much of the responsibility. That includes the SEC, which took too long to make the final guidelines available, gave companies plenty of wiggle room by allowing certain disclosures to be excused as "competitive information," and then changed a key compensation calculation on December 22 — the now infamous "holiday surprise." But the SEC has company: everyone from board compensation-committee members who tried to explain the methods to their madness in the CD&A to journalists who wrote formulaic stories bears some responsibility. Each had a role in muddying the results, which included a much-hyped "total compensation" number that turned out to be useless, and endless pages of footnotes attached to a so-called summary table.

"It's a classic case of too many cooks spoiling the stew," says Patrick McGurn, a corporate-governance expert and special counsel for proxy advisory firm Institutional Shareholder Services.

"These documents were touched by too many people, and many of the disclosures felt like they had been written by committee."

### **Magnifying Glasses Needed**

While proxy writing has always been something of a group effort, the new rules meant that the group was much larger. For one, because the statements had to be filed with the SEC, as opposed to merely being furnished, CFOs had to sign off on documents they probably had little direct involvement with before this year. Add inside and outside counsel, a compensation consultant or two, compensation-committee members, and the corporate secretary to the mix and even relatively small companies probably had close to a dozen people involved.

Little wonder that the typical proxy statement was 25 to 30 percent longer this year. Or that the extra length undoubtedly led to additional costs on everything from billable hours to proofreading — another focus of frustration with the process, especially for smaller companies.

To date, no actual studies of the added costs have been done. But the simple fact that the longer statements and additional costs didn't provide extra clarity means that things should change. At the very top of the list should be the "total compensation" number for each named executive officer (NEO) — a number that, in theory at least, was supposed to outline exactly how much a particular executive made during the previous year. It didn't, mostly because as part of its preholiday merrymaking, the SEC decided to require companies to include the accounting expense of options, as opposed to the options exercised, in the total compensation number. This seemingly minor change caused some companies, like the aforementioned Marshall & Ilsley, to report negative compensation and others to report inflated numbers that were not a reflection of the executive's actual compensation. The disappointment, especially from the investor community, was palpable. In his letter to the SEC, John C. Wilcox, senior vice president for major institutional investor TIAA-CREF, wrote that companies' initial responses may well "have the undesirable effect of undermining important goals of the compensation disclosure rules."

"That number was really supposed to help with transparency, because with greater transparency comes greater accountability," says Julie Gozan, director of corporate governance for New York-based Amalgamated Bank. "But it didn't turn out to be the big change we expected it to be."

There was so much confusion over the total compensation number, in fact, that major news organizations, including the Associated Press, Dow Jones, and Bloomberg, often reported different numbers for the very same executive, making it next to impossible for the casual investor to sort through the differences. In advance of the proxy season, AP even put out a 14-page guide designed to help its reporters interpret proxies. The very first boldfaced warning advised reporters that "our totals may differ from what other news organizations report."

Carthage, Missouri-based diversified manufacturing company Leggett & Platt Inc. experienced the confusion firsthand. In a letter sent to the SEC on April 23, the company's general counsel and secretary complained that just about everyone — from AP to the local paper to the proxy advisory firm Glass Lewis — had gotten the CEO's total compensation number wrong. "By the time we saw the [AP] article, our local newspaper had posted it online and residents in our small community were already posting outraged comments," wrote general counsel Ernest C. Jett. It was particularly frustrating, adds CFO Matthew Flanigan, because Leggett & Platt had warned the SEC in an April 2006 letter that investors would zero in on the total compensation number "in the erroneous belief that they now know exactly what a company pays its top executives."

The confusion wasn't just limited to journalists and investors, either. On the other side of the boardroom door, attorneys and others involved in the process say there was chaos related to the summary compensation table, which was required to detail the total compensation of the five top executives, including the top financial executive. "Up until the print button was pushed, every single number was changing," says Brink Dickerson, a partner at Troutman Sanders in Atlanta

who collects proxies the way some people collect baseball cards. "Because it's included by reference into other SEC documents, you want it to be right. Close doesn't get you to where you want to be."

One problem with the table was that companies were not required to provide any information on 2005 compensation, which made it impossible for all but the most sophisticated number cruncher to compare. In addition, the definition of what qualified as a bonus changed depending on how the bonus was calculated, which enabled hundreds of companies, including Motorola and grocery giant Kroger, to report a blank line where a bonus figure would normally appear. Instead, the "bonus" often wound up getting sprinkled across several columns in the summary compensation table, making it necessary to read the footnotes to figure out what was really going on.

"It may not have been classified as a bonus under the category established by the SEC, but these guys got bonuses," says Paul Hodgson, senior research associate at The Corporate Library.

And then there were the footnotes. Some stretched on for pages or were printed in what the creator of the comic strip "Dilbert" calls "Enron Beelzebub" typeface — so small that it was necessary to blow it up 250 percent to actually read it. Wachovia, for example, needed three pages of footnotes to describe its executive-compensation program — including former vice chairman Wallace Malone's compensation of \$23.6 million, a particularly noteworthy sum given that he left the bank in January 2006. (In fact, Malone's compensation was close to what Wachovia chairman and CEO Ken Thompson made for running the banking giant all year.) The nondisclosure disclosure, which according to one of the footnotes included \$320,000 spent on office space for Malone, might have made Dennis Kozlowski jealous. But it's unlikely that any Wachovia investors, even the most sophisticated ones, took the time necessary to dig in.

### **Purple Prose**

Some of that complexity was supposed to be addressed by the CD&A, which, like the more numbers-oriented Management's Discussion and Analysis in the 10-K, was designed to provide a comprehensive discussion on the various facets of compensation. But what investors often wound up with were pages of information that wasn't anywhere close to the "plain English" that the SEC requested when the rules were announced last summer.

Dickerson, who in mid-May had already read close to 400 CD&As, says the language in many was practically identical. "They all say that their compensation philosophy is to attract and retain top talent while at the same time maximizing shareholder value," he says. "I'm still waiting to read the proxy that says, 'We can't afford a compensation consultant so we looked at three CEOs at similar companies and paid our guy more because we think he's worth it.'"

Length had little relation to clarity. Some of the longer CD&As, including IBM's, where the compensation disclosure accounted for two-thirds of the proxy pages, were actually reasonably easy to understand. Meanwhile, Berkshire Hathaway's CD&A, which at under 500 words was among the shortest, was criticized for being overly simplistic. And when it came to really plain English, the reality, says Dickerson, is that only the *Fortune* 500 came close to concise disclosure, despite the fact that the top 6,000 to 8,000 public companies should have been able to handle the assignment.

"The SEC seemed to think that people could say everything they needed to say in 1,500 words and say it in plain English," says Mark Borges, a principal at Mercer Human Resource Consulting who also writes a blog on CompensationStandards.com. "It's going to take a couple of years to get this right, because there is an instinctive reluctance to putting anything out there that is too far from what a company's peers are doing."

Some companies clearly rose to the occasion. Borges says that besides IBM's, Bank of America's, and Amazon.com's disclosures stood out as being particularly useful because the disclosures were

clear and concise and written in something that came close to plain English. But their achievements were countered by far too many companies trying to avoid a detailed explanation of their performance-based compensation programs by clinging to the SEC's exemption on competitive information.

### **What's Next?**

Now that the proxies are filed, it's apparent the SEC will have its hands full digesting the material. How the agency will react is unclear. During a speech on May 3 at the annual Ray Garrett Jr. Corporate and Securities Law Conference in Chicago, SEC Corporation Finance Division director John W. White suggested that there would be flexibility, given that this was the first year. But he also said the SEC would have few problems asking "tough questions" or even requiring companies with insufficient disclosure to make amended filings.

Going forward, CFO Flanigan has a few ideas for improvements, including adding a column detailing what an executive pays for his or her own equity awards as well as a greater focus on readability so that companies "do a better job of distilling the information into what's important." Many of the suggestions were contained in the April 23 letter Leggett & Platt sent to the SEC — one of many the agency is bound to receive as it studies the current disclosure dump and contemplates future changes. After all, this was a major change in terms of reporting requirements, and regulatory changes are rarely well received in most corporate suites. Still, although many companies claimed that the compensation numbers the SEC was expecting don't exist or that the information would enable their competitors to swoop in, most managed to cobble together something. Now they must wait to see if those numbers are deemed good enough.

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### **Will the Spotlight Boost CFO Pay?**

Now that CFO pay has come out of the closet, so to speak, due to the new rules that require publicly traded companies to disclose the compensation of their "principal financial officer," some are beginning to wonder whether this is likely to lead to an escalation in CFO pay.

That's because various studies — including one done recently by Equilar Inc. — found that CFOs are rarely near the top earners at their companies. Indeed, up until the rule change, approximately 20 percent of the *Fortune* 500 didn't even disclose CFO pay, because the CFO wasn't one of the five highest-paid executives. The Equilar study found that total compensation for CFOs at *Fortune* 500 companies was about one-third the total compensation for CEOs, with the median CEO compensation at \$8.1 million in 2006 compared with \$2.6 million for the CFO.

"It's surprising to see how many CFOs still wouldn't make the [summary compensation] chart if it weren't for the new rules," says Mark Borges, a principal at Mercer Human Resource Consulting. "It will be interesting to see if the new rules will wind up driving CFO pay."

Clearly, CFOs have more responsibilities than ever before, the annual proxy statement being just one. How the new rules will affect CFO compensation is a story for next year. But there have already been a few examples of CFOs asking for — and receiving — some of the generous perks that CEOs have enjoyed for years. In early May, for example, Boston Scientific tapped former Zimmer Holdings CFO Sam Leno to serve as its CFO, replacing longtime CFO Larry Best. But it wasn't Leno's compensation that stood out. It was the fact that Boston Scientific agreed to purchase two of Leno's homes for a guaranteed \$1.3 million each. — *M.L.*

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## A Season of Revelations

There were plenty of new disclosures during the proxy season of '07. New rules that required companies to provide greater disclosure on compensation, pensions, perks, and changes in control provisions were the reason that investors learned about the following for the very first time:

- Time Warner disclosed in its 2007 proxy that CFO Wayne Pace had been commuting between his home in Atlanta and the company's offices in New York. The company described the perk as part of the employment contract that Pace signed in the fall of 2001. **Total cost: \$512,000**
- Drugmaker Schering-Plough disclosed purchasing personal security services for chairman and CEO Fred Hassan. Although the amount was smaller than the \$156,000 spent in 2005, the reason was new: the company said its executives "have received threats of personal harm from animal-rights activists." **Total cost: \$134,000**
- United Airlines, which like many legacy airlines faces regular tussles with its labor unions, disclosed that it reimbursed COO Peter McDonald for the cost of negotiating his new employment contract. **Total cost: \$82,056**
- Wild Oats, which received a takeover offer from its larger competitor, Whole Foods, in February, disclosed that former CEO Perry Odak would receive nearly \$2 million in severance and continue to collect his \$500,000 annual salary for the next three years. There was also an unspecified discount at all Wild Oats stores. **Total cost: \$3.5 million (plus whatever he consumes in herbal teas)**
- HSBC, the large bank with dual headquarters in London and Hong Kong, provided HSBC USA chief executive Martin Glynn with a \$177,600 "rent allowance" and another \$150,000 to cover the tax gross up on the free rent. **Total cost: \$327,600**

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Click [here](#) to see the 2007 proxy disclosures for the finance chiefs in the *Fortune* 10.