

April 10, 2006

Ms. Nancy M. Morris  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-9303

**Proposed Rule: Executive Compensation and Related Party Disclosure  
(Release Nos. 33-8655; 34-53185; IC-27218)  
Commission File No. S7-03-06**

Dear Ms. Morris:

Ernst & Young LLP is pleased to respond to the request for comment by the Securities and Exchange Commission (the Commission or the SEC) on its proposal *Executive Compensation and Related Party Disclosure* (the Proposed Rule). We firmly believe that the determination of executive and director compensation, and the authorization and monitoring of related person transactions, are important aspects of corporate governance, and we support the Commission's efforts to improve the clarity and completeness of disclosures in these areas. However, the Commission has proposed that the amount and timing of executive and director compensation disclosed supplementally should vary from the respective amounts recognized as compensation expense in the registrant's financial statements. We are concerned that the proposed disclosures would not provide investors with the "clearer and more complete picture" that the Commission is seeking. Accordingly, we recommend that the amount and timing of executive and director compensation to be disclosed should be consistent with the recognition and measurement of compensation for financial accounting and reporting purposes. Our specific comments on the Proposed Rule follow.

**Summary Compensation Table**

We support the objective of transparent disclosure of all compensation earned by named executive officers, particularly compensation that derives its value from a registrant's stock (such as stock, option, and similar awards). However, we believe the best way to achieve this objective is to align the amount and timing of the compensation reported in the proposed Summary Compensation Table (SCT) with the recognition and measurement of compensation cost in the registrant's financial statements. Accordingly, we do not agree that the entire fair value of share-based awards should be reported as compensation in the SCT in the year of grant. Instead, we recommend that the SCT report compensation derived from share-based awards consistent with the recognition of compensation cost under Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (Statement 123(R)).

We believe that the proposed SCT treatment of share-based awards could be misleading and confusing for investors. To the extent that a share-based award includes vesting or other service-related conditions, we believe that the SCT should report the associated compensation over the requisite service period, consistent with Statement 123(R). Otherwise, reporting the grant date fair value of an award as compensation in the SCT in the year of grant would overstate compensation earned related to service rendered for the year. We are concerned that the alternate reporting approach proposed by the SEC might confuse the discussion and analysis of compensation policies and practices. Investors should reasonably expect that compensation reported in the SCT would be consistent with the corresponding amounts included in the registrant's financial statements.

Similarly, we believe that the SEC should clarify its expectations as to whether the amounts disclosed for a named executive officer should be based on (1) assumptions (e.g., expected term, forfeitures) for the related employee group used in the registrant's Statement 123(R) calculation of share-based compensation cost, or (2) assumptions specific to each named executive officer. In our view, disclosure in the SCT should be based on the same assumptions, including any subsequent changes in estimates, that the registrant uses under Statement 123(R) for purposes of financial accounting and reporting.

Moreover, we believe all elements of compensation disclosed in the SCT should reflect the corresponding amounts reported in the registrant's annual financial statements. For example, in our view, the Salary and Bonus columns in the SCT should present the corresponding amounts recorded in the registrant's financial statements for the respective year. That is, we believe the SCT should report the bonus recognized and accrued in the registrant's financial statements. If the bonus paid after issuance of the financial statements differs from the amount accrued, the difference should be reported in the SCT in the subsequent year, similar to the accounting treatment. If necessary, proposed Item 5.02(e) of Form 8-K could provide current disclosure of a material difference between the amounts accrued and subsequently paid. Similarly, a footnote to the SCT could disclose the amounts of reported compensation related to adjustments of prior year accruals.

Aligning the SCT with financial accounting and reporting also would require different treatments than proposed related to stock awards accounted for as liabilities, as well as for modifications of prior grants of option awards. As proposed, stock awards accounted for as liabilities would be reported in the SCT in the year of grant at their grant date fair value, and subsequent adjustments to the related liability would not be reported in the SCT. In our view, awards that are accounted for as a liability under Statement 123(R) and remeasured at fair value at each reporting date should be presented in the SCT based on the associated compensation cost recognized in the registrant's annual financial statements. As proposed, when a prior option award is repriced or otherwise materially modified, the SCT would report the total fair value of the modified award in the year of modification. In our view, this approach would result in the SCT "double counting"

as compensation the grant date fair value of the original award. Instead, we recommend that the SCT report the compensation cost associated with the modified award that would be recorded under Statement 123(R), which requires any unrecognized compensation cost remaining from the original grant-date fair value measurement, plus the incremental fair value resulting from the modification, to be recognized as compensation cost over the remaining service period.

We do agree, however, it might be informative to investors and other financial statements users for registrants to disclose the grant date fair value of annual grants of share-based awards, as well as the aggregate grant date fair value of all awards not yet recognized in the registrant's financial statements. To that end, we recommend that the Grants of Performance-Based Awards table and the Grants of All Other Equity Awards table each include a column to disclose the total grant date fair value of share-based awards granted in the most recent year, possibly with footnote disclosure of the period and pattern over which the compensation for each award will be recognized in the registrant's financial statements under Statement 123(R). Similarly, we recommend the Outstanding Equity Awards at Fiscal Year-End table include a column to disclose the amount of grant date fair value of each award that has not yet been recognized in the registrant's financial statements under Statement 123(R), possibly with footnote disclosure of the period and pattern over which the remaining compensation will be recognized in the registrant's financial statements.

### **Increase in Actuarial Value of Defined Benefit Plans**

Under existing rules, the SCT does not report as compensation any cost related to benefits provided under post-employment benefit plans. Proposed Item 402(c)(2)(ix)(G) of Regulation S-K (and proposed Item 402(b)(2)(ix)(G) of Regulation S-B) would require disclosure in the All Other Compensation column of the SCT of "the aggregate increase in actuarial value to the named executive officer of all defined benefit and actuarial pension plans (including supplemental plans) accrued during the registrant's covered fiscal year."

In our experience, such amounts are not readily available or calculable for individual participants in group benefit plans (e.g., defined benefit pension plans accounted for under FASB Statement No. 87, *Employers' Accounting for Pensions* (Statement 87); postretirement healthcare benefits accounted for under FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*). Thus, the proposed disclosure would impose additional costs on registrants to engage actuaries to develop the amounts for SCT disclosure. To the extent that such amounts must be considered in determining the identity of the named executive officers, the scope of the effort and associated cost could extend beyond the named executive officers ultimately disclosed in the SCT. We also observe that the proposed Retirement Plan Potential Annual Payments and Benefits table would disclose information about the undiscounted future value of post-employment annuity benefits being earned by named executive officers. Accordingly, we question whether it is necessary for the SCT to attempt to report with precision

the related cost of all post-employment benefits as earned. Measurement of the increase in “actuarial value” of all benefit plans would involve inherently imprecise estimates and assumptions and would not appear to be justified in light of the related costs. Accordingly, we suggest that the SEC reconsider the scope of the proposed disclosure and consider exempting from SCT disclosure the cost of post-employment benefits other than those provided under individual contracts and plans limited to highly compensated employees and officers, for which the related compensation cost would be reasonably expected to represent a significant element of total individual compensation.

For such benefits, we still are concerned that the term “actuarial value” is unclear. Because “actuarial value” is not a defined or commonly used term, we believe the proposed language would be open to a broad range of interpretation. We recommend the SEC consider using more commonly understood and accepted terms such as either “accumulated benefit obligation” or “projected benefit obligation” as those terms are defined in Statement 87. We also recommend that the SEC clarify what it means by the term “aggregate increase,” which we are similarly concerned is unclear and subject to various interpretations. In keeping with our principal recommendation that the SCT correspond to the registrant’s accounting for financial statement purposes, an alternative would be to require SCT disclosure of specific elements of net periodic pension cost measured under Statement 87 (e.g., service cost; interest cost; amortization of any prior service cost; and amortization of any unrecognized net gain or loss, excluding asset gains and losses not yet reflected in market-related value).

The narrative disclosure to the SCT under proposed Item 402(f)(1)(v) of Regulation S-K would require the registrant to describe the assumptions underlying any determination of an increase in the actuarial value of defined benefit and actuarial plans. We believe that the SEC should clarify its expectations as to whether those assumptions should be (1) the broad-based group assumptions (e.g., mortality tables, discount rate, rate of compensation increases, retirement age, form of retirement benefit) used in the registrant’s Statement 87 calculation of net periodic pension cost, or (2) assumptions specific to each named executive officer. As noted above, we question whether the scope of the proposed disclosure should include benefit plans for which the accounting is based on assumptions related to large groups of participants.

To the extent that the SCT has previously reported as compensation the cost of benefits earned under a defined benefit plan, we question why the subsequent payment of plan benefits also would be reported in the SCT. (See proposed instruction 2 to Item 402(c)(2)(ix) of Regulation S-K, which would require the All Other Compensation column of the SCT to include “benefits paid pursuant to defined benefit and actuarial plans.”) Requiring SCT disclosure of benefits paid from defined benefit plans could result in the “double counting” of compensation in the SCT. Accordingly, the SCT should disclose payments from benefit plans only if the related compensation cost was not reported in the SCT in an earlier period.

### **Grants of All Other Equity Awards Table**

It is unclear how the Grants of All Other Equity Awards table should disclose an option award that has multiple vesting dates (e.g., an award with ratable monthly vesting over 48 months). Instruction 2 to the proposed table would require a separate line for each award during the most recent fiscal year, but would allow multiple option grants during a single fiscal year to be aggregated into a single line in the table where each grant was made at the same exercise and/or base price and has the same expiration date. However, proposed instruction 2 does not mention vesting date as a condition of aggregation. We recommend the SEC clarify the instruction and modify the proposed table such that, in the absence of “cliff vesting” as of a single date, proposed column (f), Vesting Date, would describe the vesting provisions with footnote disclosure of any provisions that could result in the acceleration of vesting.

We also recommend that the SEC only require the table to disclose the market price of the underlying security on the date of grant if the exercise or base price of the equity award is less than a reasonable market reference price. (See proposed instruction 6 to Item 402(e)(2)(iii) of Regulation S-K, which would require adding a column to the table to disclose closing price if less than the strike price.) In our experience, companies that intend to grant equity awards “at the money” use different practices for setting the strike price (e.g., opening price, closing price, daily average price).

### **Option Exercises and Stock Vested Table**

We recommend that the SEC address transition issues related to disclosures required by the proposed Option Exercises and Stock Vested table. Column (d) of the proposed table would require disclosure of the grant date fair value of exercised option awards and vested stock awards, as previously reported in the SCT. However, the transition provisions in the Proposed Rule would not require registrants to restate SCT disclosures for earlier fiscal years. In addition, Statement 123(R) is only now being adopted by most companies, and most companies appear to be adopting the standard without restating prior periods as permitted under the modified prospective transition method. Accordingly, column (d) should require disclosure of the associated compensation cost measured in accordance with Statement 123(R), regardless of whether such compensation has been previously reported in the SCT or recognized in the registrant’s financial statements. If the Commission adopts our principal recommendation, we note that compensation cost measured in accordance with Statement 123(R) and reported in the SCT could differ from the original grant date fair value of the award due to, among other things, subsequent modifications to the award or changes in estimates related to either forfeitures or multiple performance conditions.

### **Named Executive Officers**

We support the Commission's proposal to amend Regulation S-K to include the principal financial officer as a named executive officer whose compensation would always require disclosure. We recommend that the Commission also amend Regulation S-B in a similar manner. The principal financial officer in a smaller public company also plays an important role in financial accounting and reporting, and the registrant's SEC reports and related certifications. As a result, regardless of the company's size, we believe investors would benefit from the disclosure by each public company of the compensation of its principal financial officer.

### **Retirement Plan Potential Annual Payments Table**

We recommend that the Commission clarify its instructions regarding the proposed Retirement Plan Potential Annual Payments table. First, proposed instruction 3 to the table would require disclosure based on "the form of benefit currently elected by the executive, such as joint and survivor annuity or single life annuity, specifying that form in a footnote." In our experience, most officers are not required to make, and do not make, such an election until just prior to retirement. Accordingly, we recommend that, absent an explicit irrevocable election by the executive, the tabular disclosure should reflect the estimated form of benefit the registrant has assumed for purposes of accounting for the benefit plan in its financial statements.

Second, we recommend that instructions to the table should provide more explicit directions as to the computation of amounts disclosed regarding the estimated annual benefits at both normal and early retirement. Proposed instruction 4 to the table provides that the computation should not assume any compensation increases prior to retirement eligibility. However, the proposed instruction is silent as to whether the computation should assume credits for service rendered prior to retirement. That is, should the table disclose the amount of the deferred vested benefit had the executive terminated employment as of the end of the fiscal year? Or, should the table disclose the expected benefit upon a future "in service" retirement?

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We would be pleased to discuss our comments with the Commission or its staff at your convenience.

Very truly yours,

*Ernst + Young LLP*