# AN EXPLORATION INTO THE CONTENT OF THE COMPENSATION DISCUSSION & ANALYSIS DOCUMENT

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**Abstract**

This paper presents the results of a survey of Compensation Discussion and Analysis (CD&A) documents from 32 publicly listed U.S. companies. Our aim was to probe the extent to which companies are providing investors, through the CD&A, with an easy to understand and complete assessment of the compensation provided to their highest paid executives. Using a detailed content analysis, the results show that while companies are complying somewhat with regulatory requirements, they are failing to meet the intent of the CD&A, which is, to provide completeness, transparency and understanding regarding a firm's executive compensation. A number of recommendations for change is also proposed.

**Keywords:** Compensation Discussion and Analysis, CD&A, Board of Directors, Compensation Committee, Corporate Governance

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## Introduction

On July 26, 2006, the United States (US) Securities Exchange Commission (SEC) adopted sweeping changes to its rules for disclosing compensation of executive officers and directors of public companies. The goal was to make the disclosure of executive compensation clear and complete thereby helping investors better understand and assess the compensation regimes of companies in which they invest. The new rules affected disclosure in proxy statements and annual reports. The changes called for the creation of a required new section, known as "Compensation Discussion and Analysis," (CD&A) consisting of a narrative and several tables.

These new rules had been fuelled by demands made during the last decade for heightened scrutiny, a rise in shareholder activism and various financial pressures (Beltrame, 2008; Bigby, 2008; Forbes, 2007; Morgenson, 2007; Urquhart, 2008). Increasingly, concern had been expressed that CEOs were simply being paid too much for their services and that even in the event of failure, they were rewarded with lucrative pay packages[1] (Beltrame, 2008; Morgenson, 2007; Urquhart, 2008). Accordingly, critics sought to hold boards and executives more accountable for their executive compensation actions as well as to improve the roles and responsibilities underlying their principal-agent relationships (Shearman & Sterling, 2007). Shareholders, especially were becoming much more interested and involved in corporate governance. Indeed, in the UK, events at a GlaxoSmithKline (GSK) annual meeting were described as a defining moment for shareholders when an advisory vote was made against the proposed pay package of CEO Dr. Jean-Pierre Garnier.[2] The vote, despite being non-binding, was heard by the board and resulted in significant changes being made to the compensation regime.

It was expected that with the new CD&A rules in place, the topic of executive compensation would now be under an intense magnifying glass and new behaviours would result. Yet, change appears to have been slow in coming. As Janet McFarland (2008) wrote: "the enormous pay schemes for executives have

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[1] This distance was well illustrated in May 2006 when the CEO of Home Depot walked away with upwards of $123 million in compensation and a $210 million retirement package despite furious criticism from shareholders.
[2] (Canadian Coalition for Good Governance, 2007, p. 1)

created irresistible incentives to take undue risks and create quick profits." Her assessment has recently been played out in the subprime write-downs of major financial institutions, where many CEOs received huge severance packages amidst their companies' failures.

The CD&A Solution. The CD&A report and its associated rules were designed to help readers of financial statements identify the objectives of a company's executive compensation program; to better understand how company executives are compensated (i.e. salary, benefits, stock options etc.); and to highlight the most important factors underlying a firm's compensation policies and decisions (Securities and Exchange Commission, October 2006). An essential consideration is that the CD&A must be written in 'plain english'.

After the first round of proxy statements were prepared in accordance with the new guidelines, the SEC examined the CD&As of 350 companies. The following concerns were raised: 1) a lack of "analysis" in the CD&A**s**; 2) a failure to comply with the obligation to disclose specific performance targets used to determine incentive compensation; and 3) poor readability due to **both a** failure to comply with plain English requirements and **the** extensive length of the CD&A.**s**[3] There were also alarms raised that future CD&As might be increasingly subject to "boilerplate" language or disclosures i.e. sections of a CD&A that are non-firm specific but included for "standard language" reporting purposes.

In Canada, regulatory agencies began following the SEC's lead, with proposals offered by the Canadian Securities Administrators (CSA) to implement new disclosure guidelines (See CSA Form 51-102F6 *Statement of Executive Compensation* as well as Consequential Amendments to National Instrument 51-102 *Continuous Disclosure Obligations*). While the proposals were similar to the US, they were initially more "principles-based" than the "prescriptive" US rules (Canadian Coalition for Good Governance, June 2007). Subsequent amendments to the CSA's proposals, however, appeared to push more in the 'prescriptive' direction. In particular, the amendments recommended greater specificity in resolving certain disclosure issues, including more guidance about determining whether the disclosure of particular information would be competitively harmful (Tuzyk, 2008).

Because many Canadian companies inter-list on exchanges in the US and are required to comply with securities regulation in both countries, it would be beneficial if the regulations were consistent in spirit and scope.[4] At the same time, economic, cultural, and existing regulatory differences between these jurisdictions should be taken into consideration. Nevertheless, the CSA proposals were eventually enacted – coming into force with respect to financial years ending on or after December 31, 2008.

**Research Question**

This paper investigates the readability and thoroughness of executive compensation disclosure as provided in the CD&A of a select group of US corporations. Three questions are posed:

1. What information about executive compensation is currently being provided to investors in the CD&As of selected US corporations?
How readable is the CD&A?
2. To what extent does the CD&A provide "boiler-plate" (i.e. non-unique, non firm-specific) disclosures?
3. How might the information provided in the CD&A be modified to better meet investor needs for transparency?

## Methodology

### Sample size and selection

The current study was based on a sample of 32 corporations selected from the Mercer 350 listing of companies 2007. The complete listing of the companies under review can be found in Exhibit 1. The sample selection and size may restrict any claims made in regards to the findings obtained. However, it is argued that this study's tentative findings may raise sufficient concerns to warrant a more widespread and in-depth analysis of CD&As as a new and important governance disclosure document.

### Data Collection

We analyzed and compared the CD&As (obtained from each of the selected firms' proxy statements) across a set of disclosure criteria which were a composite of those recommended by the Securities and Exchange Commission (SEC), the Canadian Securities Administrators (CSA), and best practices obtained

[3] (Shearman & Sterling LLP, 2007, pp. 4,5)
[4] (ICD Blue Ribbon Commission, June 2007, p. vii)

from secondary research sources, such as the Canadian Coalition for Good Governance (CCGG) (http://www.ccgg.ca/guidelines/executive-compensation/). Sixteen executive compensation disclosure criteria were identified for the purposes of this study. A complete listing of them is provided in Exhibit 2.

Each disclosure criterion was assessed within the CD&As for its "presence" and measured using a "yes/no" question. The degree to which each disclosure criterion appeared in the sample of firms was evaluated using frequency analyses.

The "r*eadability"* of the CD&As was measured by processing them through the Flesch-Kincaid reading ease test. The Flesch-Kincaid readability test is one of the most popular and widely utilized tools in assessing the readability of documents over the past fifty years (Foulger, 1977).

The test is extensively used by government agencies to ensure that their information is both readable and clear for internal stakeholders. The test is ubiquitous and can be found bundled in most word processing programs. According to Microsoft's website (http://office.microsoft.com/en-us/help/HP101485061033.aspx):

"(The Flesch-Kincaid) test rates text on a 100-point scale. The higher the score, the easier it is to understand the document. For most standard files, the preferred score should be between 60 and 70. The formula for the Flesch Reading Ease score is:

$$206.835 - (1.015 \times ASL) - (84.6 \times ASW)$$

where:

ASL = average sentence length (the number of words divided by the number of sentences)

ASW = average number of syllables per word (the number of syllables divided by the number of words)

An example of how Flesch-Kincaid scores vary with some well known publications can be found in Exhibit 3.

To determine whether "boiler-plate" language was being used in the sample of CD&As, we examined them using the software program, WCopyfind[5], (see: http://plagiarism.phys.virginia.edu/Wsoftware.html) This software is used traditionally to examine and compare texts for plagiarism and similar language. We used it to test if there was sufficient variability - or whether companies used similar language - in their CD&A disclosures.

## Results and Analysis

### The Top Ten Disclosure Items

An examination of the results contained in Exhibit 2 show that a majority of the disclosure criteria for executive compensation is being met by almost all of the firms in the sample. Ten of the 16 criteria (62.5 percent) were found to be 'positively recognized' in 84 percent or more of the firms with two of these criteria (i.e., #1: 'states the objectives of the company's compensation programs'; and #8: 'includes summary compensation table') appearing in 100 percent of the sample. The 10 most popular disclosure criteria were:

| | |
|---|---|
| 1 | States the objectives of the company's compensation programs |
| 2 | Explains each element of compensation |
| 3 | States the benchmark, companies included in the benchmark and selection criteria |
| 5 | States that compensation committee members are independent |
| 7 | Indicates that a compensation consultant was retained and names that consultant |
| 8 | Includes a summary compensation table |
| 9 | Includes an incentive plan rewards table |
| 11 | Includes a director compensation table |
| 13 | For option awards, discloses the dollar amount based on the grant date fair value of the award for a covered financial year and describes the methodology used to calculate the grant date fair value |
| 15 | Does the CD&A explain how peer companies are selected, i.e. the basis for selection and inclusion. |

The following sections describe our observations concerning them.

[5] Software obtained April 2008 from The Plagiarism Resource Site: http://plagiarism.phys.virginia.edu/Wsoftware.html

**Criterion 1:** Among the actual 'compensation objectives' provided in the CD&As, four items dominated: paying for company and individual performance (97 percent); providing for long-term incentives and retention (97 percent); competing for key talent (88 percent); and aligning executive interests with shareholder interests (88 percent). These high scores demonstrate that the companies' 'compensation objectives' did not appear to vary much between organizations – with few CD&As reporting unique ones. While it is laudable that the firms universally complied with the recommendation for disclosure of compensation objectives, their value is diminished given that they are largely indistinguishable between companies.

**Criterion 2:** With only the exception of Berkshire-Hathaway, all firms in the study (97 percent) provided a summary chart in their CD&As '*explaining each element of compensation*' (disclosure criterion #2). Among the elements discussed were: base compensation (97 percent); non-equity incentive plan compensation (94 percent); stock awards (94 percent); option awards (94 percent); and perquisites (90 percent). Interestingly, in the past, firms were often reluctant to reveal the use of perquisites – let alone justify them. The CD&A appears to have changed this. Moreover, several corporations in our sample went into considerable detail to assure investors that this particular expense was used primarily for 'legitimate purposes', such as, executive home security services (e.g., car and driver) and not for lavish (and difficult to explain) lifestyle expenses (e.g. limousines to take the children to school) as was done in the past.

**Criteria 13:** Given the high level with which stock option awards were *explained* (as noted in Criterion 2), it was not either unsurprising or unexpected to find the same high level of disclosure concerning the dollar value of such awards. Ninety four percent of the CD&As in our survey revealed the dollar value of option awards (based on the 'grant date fair value') as well as the methodology used to calculate that value.

**Criteria 5 & 7:** Independence is considered important to ensure objectivity in decision making by members of the board and those who advise them. This 'principle of good governance' appeared to have widespread acceptance on the part of both those directors appointed to the board's compensation committee (91 percent disclosure) and the executive compensation consultant hired to advise that committee (90 percent disclosure).

**Criteria 3 & 15:** A very high number of CD&As (84 percent) disclosed the basis upon which firms were selected for inclusion in a peer group to be used for evaluating the appropriateness of their executives compensation – as well as the peer group list. This shows a high level of compliance with both regulatory and practices. However, there is also an expectation that firms should have a performance peer group based on organizations with similarities in products, services and market size. Our examination of these peer groups revealed that the firms often included ones which appeared to be somewhat unrelated (i.e., the peer groups incorporated firms with very dissimilar products and services) to the activities of the reporting organization (See Exhibit 5). Indeed, it was often noted that the logic of a firm's peer group final selection was either not consistent with the stated selection criteria. In several CD&As for example we found that the selection of peer groups to be highly subjective, often open to interpretation and therefore conceivably manipulation. When this occurs, shareholders are left to wonder whether the selection of the peer group is self serving. Why does a soup manufacturer include a research-intensive pharmaceutical company in their peer group and a soap manufacturer include technology and defence companies in theirs? If such inclusions are justifiable, they need to be better explained in the CD&As of the future.

**Criteria 8, 9 and 11:** Despite the widespread presence of 'summary compensation tables' (100 percent), our firms appeared to exercise somewhat more variability when it concerned the information contained in their 'supplementary' tables – such as for incentives (84 percent) and director compensation (94 percent).

**The Low Disclosure Items**

Over one third of the 16 executive compensation disclosure criteria (6 items) were present in 72 percent (or less) of the CD&As examined and three criteria (18.8 percent) were observed to occur in less than 50 percent of the sample. The low frequency disclosure criteria were:

| | **Executive Compensation CD&A Disclosure Criteria** | **Survey Result (Consolidated)** |
|---|---|---|
| 4 | States the role of the CEO in the compensation process | 72% |
| 6 | States that compensation committee has the discretion to reduce the size of any award or payout | 46% |
| 10 | Includes a retirement benefits table | 72% |

| | | |
|---|---|---|
| 12 | Provides a direct link between performance metrics and the compensation awarded (indicates actual results achieved against performance targets | 60% |
| 14 | Does the CD&A explain how compensation, in the covered fiscal year, was determined for each NEO (i.e., the rationale for compensation is clear)? | 44% |
| 16 | Does the CD&A indicate that directors may claw back compensation if it is found that information used in determining compensation was incorrect, e.g. financial results were misstated? | 28% |

**Criterion 4:** It is generally accepted that the personal role of the CEO in determining executive compensation should be kept to an appropriate level – and especially one which reduces the possibility of undue bias or manipulation. Interestingly, the CD&As revealed that 72 percent of the CEOs appear to have had some role in their *executive compensation process* with varying influence on a range of compensation decisions. Specifically, 41 percent of the CD&As disclosed that their CEO had actively participated with the board's compensation committee in setting executive pay; 53 percent of the CEOs were identified as having recommended the compensation for the Named Executive Officers (NEOs); and 44 percent of the CEOs even provided recommendations to the compensation committee for their own total pay package – the latter practice being one which is increasingly frowned upon.

**Criterion 10:** As discussed above, there was not consistent reporting on the supplementary compensation tables in the CD&As. Thus, there appears to be reluctance to disclose both the specific and full range of executive compensation arrangements on the part of some firms. Nowhere was this more evident than in the case of disclosure criterion 10 which concerns retirement benefits. This may have something to do with the fact that when such details are forced to be disclosed, there is often considerable controversy over both their quantum and terms.

**Criterion 12:** For the CD&As in this survey, only 60 percent indicated that there was a direct link between their executives' performance metrics and the compensation actually awarded. Thus, for 40 percent, there was no disclosure on this item. One might speculate that the reason for not doing so was that executives in these latter firms were being rewarded with compensation packages which did not reflect the performance results actually achieved. Either these executives were being 'under rewarded' while achieving above average peer-group results or they were handsomely compensated despite their failure to deliver agreed-upon targets.

At the same time, for those companies that chose to disclose, less than half reported the performance metrics that their executives were originally expected to achieve and instead indicated only the actual performance results. This may be, in large part, due to the current 'looseness' around the specificity of this reporting requirement – which allows companies to be general in their statements (supposedly in order to not compromise their competitive position in the marketplace). Yet, shareholders are at a significant disadvantage with this information asymmetry i.e., shareholders have no means to assess whether reasonable and objective measures/targets were in place to begin with or to compare them in relation to what the executives actually achieved – and were paid.

To be sure, executive compensation is a complicated matter. The CD&A process, however, is challenging boards to re-examine their compensation programs as not done previously because it is forcing more granular compensation disclosure – a topic once highly regarded as secret.

**Criterion 14:** For the most part, the majority of firms have utilized their CD&As to focus discussion on the compensation of the CEO. Notwithstanding that companies are required to disclose the amount, and, where applicable, the formula for each element of named executive officer (NEO) pay, the basis upon which the compensation for the "other" senior executives has not been as well documented. Of the 32 companies in the study, only 44 percent explained compensation for each of the NEOs. Fifty-six percent did not. And where the compensation was explained, formulas were not frequently provided and only the most sophisticated investors would be able to decipher anything about the compensation mechanics.

This will probably change over time. Complete transparency would enable an investor to repeat the compensation committee's calculations to arrive at the same compensation total. However, the current 'veil' indicates again just how sensitive the topic of executive compensation and its disclosure really are. It is worth pointing out though that Proctor & Gamble's CD&A provided one of the more informative disclosures which included a detailed explanation of the compensation packages for their senior executives as well as their peer benchmarks. In so doing, Proctor & Gamble provided a standard for disclosure that was rarely matched in terms of clarity and completeness by the other firms in our sample.

**Criteria 6 and 16:** "Claw backs" are typically recommended when the information used to determine compensation is found to be incorrect. It was noteworthy therefore that a board's commitment to the use of claw backs was the poorest disclosed aspect in the CD&As. Only 28 percent of the firms addressed this issue in their reports. Moreover, where claw back provisions exist, none of the CD&As made mention of them being enforced. Our findings, however, belie a potentially emerging reality for publicly listed organzations. In December 2007, United Health Group had over $1.1 billion in options returned from former executives. This decision was the highest claw back recorded in North America at the time and serves as a warning to executives that boards can – and will - use their authority to recover excessive, undeserved compensation payments (morgenson, 2007). Establishing claw back provisions reaffirms the level of responsibiltiy and authority delgated to the board on behalf of both shareholders and the public.

## Readability Analysis

Each company's CD&A was copied from their proxy statements into Microsoft Word format. The Flesch-Kincaid test was then applied to the text of the CD&A and measured according to the criteria discussed previously. All of the CD&As registered as "very difficult" on the Flesch-Kincaid reading scale with no score over 30 and some as low as 10. The average CD&A scored 21.5. To put this figure into further context, the US Census of 2006 revealed that only 22.7% of the United States population had attained a bachelor degree or higher (US Census Bureau, 2000). Also, according to the National Institute for Literacy (1992), the average American has a level 3 literacy ability which is comparable to a high school education. One of the most important objectives of the CD&A is that it provides 'easy to understand' or 'plain language' disclosure.

Against this criterion, CD&As clearly have failed. Our results put the average readability of the CD&As at a post graduate – or subject specialist – level and only understandable to others knowledge with the subject matter. The current readability of a typical CD&A appears to be beyond that of any lay reader and their complexity represents a significant challenge to even executive compensation specialists. Accordingly, the importance of having CD&As which are understandable to the investing public needs to be reaffirmed and embraced in future iterations of this important document.

## Boilerplate Analysis

Our WCopyfind software analysis of the CD&As found that there was sufficient variability in the wording used to conclude that these documents had avoided using 'template language'. The CD&As under review had at most 6% of their language in common. Under a threshold of 10%, users of this software conclude that the results would be deemed insignificant.

## Conclusions

Executive compensation is currently a very hot topic and the potential avenues of academic investigation are many. This study could be considered a trial plunge into the specific question as to whether CD&A's are meeting society's expectations of transparency regarding executive compensation. Accordingly, the research results presented here should be considered directional in nature and requiring further study before being confirmed as broadly representative of what is currently happening in the market. That said, students of corporate governance in general - and executive compensation in particular - are likely to find the results of the present work both interesting and worthy of future examination.

At its most basic, governance is defined as the structures, processes and behaviors used to control the organization, manage the relationships among key organizational stakeholders and, in so doing, improve organizational performance (Bart, 2004). Compensation is the primary tool used to align interests of management with that of the shareholders. However, ineffective boards have helped produce rogue executives which in turn has lead to egregious compensation and feelings of powerlessness on the part of shareholders. Collectively, this 'perfect storm' has contributed to the current crisis of confidence and a justifiable desire by shareholders to understand what comprises – and justifies – the nature and level of executive compensation. While CD&As aim to increase the amount of information available to shareholders and others, disclosure alone will not improve governance. The key to improved executive compensation practices is a compensation committee and board comprised competent, effective, accountable and independent members.

In North America compensation packages are extremely complicated with base pay often representing less than 10% of the total amount received and the rest comprised of a mix of cash

incentives, stock, stock options and perquisites. The board's compensation committee must, therefore, understand the mechanics and intricacies of executive compensation. The board must also engage with management in setting direction and the targets that impact compensation. While one of the aims of the CD&A is to relate pay to performance, the CD&A cannot affect the setting of appropriate performance targets. Only the board, by the questions put to management (and by the independent advice and information they receive), can evaluate whether executive performance hurdles are set appropriately high.

Based on our observations relative to the 16 disclosure criteria, the following changes are recommended to improve the clarity and completeness of future CD&As. Hopefully, they will be voluntarily adopted before being forced by regulation.

**Establish a Minimum Readability Level**. Given the low level of readability, it almost seems obvious that greater effort needs to undertaken by managements and boards to improve the clarity and understandability of their CD&As. Readers should not need to be subject matter experts or have Ph.Ds to make sense of them. The current disclosure language is an affront to the ordinary shareholder reader and a minimum readability target of 50-60 should responsibly be expected.

**Provide Peer Group Guidelines**. The peer group that a company selects for benchmarking/ comparison purposes can have a huge impact on executive compensation levels. While it was comforting to observe that 84 percent of the firms in our survey reported on the companies included in their peer group, it was discouraging to note what seemed to be a high level of heterogeneity in the make-up for any one particular group. Accordingly, we argue that the basis for selection and inclusion of a company in a peer group needs greater justification and that more/better guidelines should be established for what makes an appropriate peer, e.g. similar corporate economy of scope and scale as well as required CEO skill and technical knowledge.

**Limit Exemptions from Providing Performance Targets**. Companies should not be able to easily exempt themselves from providing specific performance measures. Performance measures should be included unless it can be established that doing so seriously prejudices the business. Where an exemption is allowed, an explanation must be provided in the CD&A and reviewed on an annual basis.

**CEO Does Not Provide Self-Compensation Recommendations.** The board must not rubber stamp or give the appearance of rubber stamping executive compensation. Directors that are engaged with and monitor management should not require – or accept - recommendations from the CEO regarding his or her compensation level.

**Board Training.** To be effective, a company's board of directors must have its shareholders' trust and confidence. The key to securing (and improving) that confidence resides, first and foremost, with having competent and accountable directors. This is especially true in the complex area of executive compensation. Accordingly, today's board members need specialized training and/or proven experience if they are going to diligently carry out their fiduciary duties and responsibilities.

**Board Member Selection.** Consistent with the Canadian Coalition for Good Governance recommendations, shareholders should be given the opportunity to elect individual board members rather than approving a recommended 'slate'. Having such a shareholder veto would enable shareholders to exercise their authority when required skills and/or experience is lacking in an individual board member. Indeed, the current trend in 'say on pay' as an advisory shareholder vote may be a harbinger of the future as shareholders increasingly seek to flex their 'shareholder rights'.

## Biographical notes

Dr. Chris Bart is the world's leading expert on helping organizations develop mission and vision statements that get results. He is the author of the Canadian business #1 best seller, "A Tale of Two Employees and the Person who Wanted to Lead Them" as well as the CICA publication, "20 Questions for Directors about Strategy". He has also published over 100 other articles, cases and reviews. Dr. Bart is currently a Professor of Strategic Market Leadership (Strategy & Governance) at the DeGroote School of Business, McMaster University, Hamilton, Ontario and a principal with Corporate Missions Inc. (www.corporatemissionsinc.com). In 2003 he founded The Directors College, Canada's first university accredited director certification program. He is listed in Canadian WHO'S WHO and in 2009 was awarded the FCA designation.

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**Exhibit 1.** Company List

| |
|---|
| American International Group |
| Apple |
| Avon |
| AT&T |
| Bank of America |
| Berkshire-Hathaway |
| Black & Decker |
| Campbell Soup |
| Chevron |
| Citigroup |
| Colgate-Palmolive |
| Conoco-Phillips |
| Exxon |
| Energizer |
| Goldman Sachs |
| General Electric |
| Heinz |
| Hewlett-Packard |
| Kodiak |
| Kraft Foods |
| Marriot |
| Merck |
| Merrill Lynch |
| Morgan-Stanley |
| Nike |
| Oracle |
| Pfizer |
| Proctor & Gamble |
| Wal-Mart |
| Wachovia |
| Wells Fargo |
| Whirlpool |

**Exhibit 2.** CD&A Disclosure Criteria

| | **Executive Compensation Disclosure Criteria** | **Survey Results** |
|---|---|---|
| 1 | States the objectives of the company's compensation programs | 100% |
| 2 | Explains each element of compensation | 97% |
| 3 | States the benchmark, companies included in the benchmark and selection criteria | 84% |
| 4 | States the role of the CEO in the compensation process | 72% |
| 5 | States that compensation committee members are independent | 91% |
| 6 | States that compensation committee has the discretion to reduce the size of any award or payout | 46% |
| 7 | Indicates that a compensation consultant was retained and names that consultant | 90% |
| 8 | Includes a summary compensation table | 100% |
| 9 | Includes an incentive plan rewards table | 84% |
| 10 | Includes a retirement benefits table | 72% |
| 11 | Includes a director compensation table | 94% |
| 12 | Provides a direct link between performance metrics and the compensation awarded (indicates actual result achieved against performance target) | 60% |
| 13 | For option awards, discloses the dollar amount based on the grant date fair value of the award for a covered financial year and describes the methodology used to calculate the grant date fair value | 94% |
| 14 | Does the CD&A explain how compensation, in the covered fiscal year, was determined for each NEO (rationale for compensation is clear)? | 44% |
| 15 | Does the CD&A explain how peer companies are selected, i.e. the basis for selection and inclusion. | 84% |
| 16 | Does the CD&A indicate that directors may claw back compensation if it is found that information used in determining compensation was incorrect, e.g. financial results were misstated? | 28% |

**Exhibit 3.** Publication Examples of Readability

| Reading Ease Rating | Description of Style | Publication[6] |
|---|---|---|
| 100-90 | Very Easy | Dr. Seuss |
| 90-80 | Easy | Comic Strip |
| 70-80 | Fairly Easy | Hardy Boys/Nancy Drew |
| 60-70 | Standard | Reader's Digest |
| 50-60 | Fairly Difficult | Time Magazine |
| 40-50 | | The Economist |
| 30-40 | Difficult | Harvard Law Review |
| 0-30 | Very Difficult | New England Journal of Medicine |

**Exhibit 4.** Peer Group Selection Examples

| Company | Criteria | Peer Group |
|---|---|---|
| Kraft Foods[7] | • Same revenue size<br>• Global focus<br>• Executive position similar in breadth, complexity and scope of responsibility<br>• Competition for same executive talent | Campbell Soup Clorox<br>ConAgra Foods Heinz<br>Johnson & Johnson Sara Lee<br>Kellogg Company<br>Proctor & Gamble<br>Colgate-Palmolive |
| Goldman Sachs[8] | • Compensation of NEO of competitors based on public information<br>• Diluted earnings per share comparison over last 9 months | American Express Wells Fargo<br>Bank of American Wachovia<br>MetLife Blackstone<br>Prudential Och-Ziff<br>Washington Mutual |
| HP[9] | • S&P 500 in IT, Industrial or Consumer staples<br>• Market capitalization >$45 b.<br>• Revenue > $10 b<br>• Part of Towers Perrin executive compensation database | Cisco Pepsi-Co<br>Microsoft Dell<br>UPS Sprint<br>Verizon AT&T<br>General Electric Motorola<br>Proctor & Gamble |

[6] Chart adopted from: Soper, F.J., Dolphin, R., "Readability and Corporate Annual Reports" The Accounting Review April 1964.
[7] Kraft Foods Proxy 2008
[8] Goldman-Sachs Proxy 2008
[9] Hewitt-Packard Proxy 2008