



FOUR FUNDAMENTALS OF FINANCIAL REPORTING FOR EQUITY COMPENSATION

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SPEAKERS



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LEARNING OBJECTIVES

Build the right infrastructure, processes and practices for share-based compensation reporting :



Discover how to make accounting treatment a part of the plan design – not an afterthought



Identify the process efficiencies to avoid bottlenecks during crunch times



Define the key factors for well-structured controls



Arm your team to handle accounting hazards, such as rounding for share withholding, true-ups and forfeitures, and modifications

WHY EQUITY COMP?

1

Align interests

2

Attract and retain top talent

3

Share in long-term value

POLLING QUESTION #1



Currently our stock plan administration is managed using:

- A Excel
- B A Software as a Service solution (SaaS)
- C An outsourcing provider
- D Combination of SaaS and outsourcing
- E Not listed / Not sure

REPORTING BURDEN



Regulatory requirements



Accounting rules



Subjective assessments



Short timeframes



FOUR BEST PRACTICES

1

Make accounting treatment a part of the plan design

2

Build in process efficiencies

3

Well-structured controls

4

Arm your team for accounting hazards



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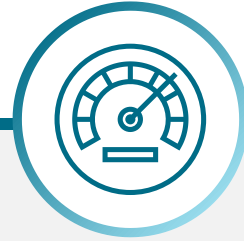
**MAKE ACCOUNTING TREATMENT
A PART OF THE PLAN DESIGN**

DRIVERS OF COMPLEXITY IN PLAN DESIGN



Vehicle

Restricted stock or units?
Stock options?



Vesting Type

Performance-only, time and performance (contingent), or time and performance (accelerated), time based



Performance Metrics

Financial performance, strategic milestones, stock-price performance

DRIVERS OF COMPLEXITY IN PLAN DESIGN



Performance Periods

Annual or multi-year?



Goal-Setting

Relative or absolute terms?



Retirement Eligibility Provisions



Prorated Vesting due to Termination

EXAMPLE

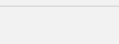
Design and Accounting for Performance Goals

Classification

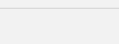
Performance Condition



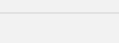
EPS



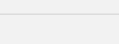
Revenue Target



Market Share



A Change-In-Control



Drug Approval

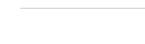
Market Condition



Relative TSR



Stock Price



Absolute TSR



Market Stock Units



Internal Rate of Return
(private companies)



What type of performance award does your company offer?

- A** Performance condition only
- B** Market condition only
- C** Mix of both

- D** Neither
- E** Not sure



SUCCESSFUL PLAN DESIGN

Involve accountants in
design phase

1

Create and run scenarios

2

Test impact of various conditions and outcomes

3

Minimize surprises

4

Agree on interpretations **BEFORE** implementation

5

Determine financial and tax accounting
implications – not just compensation cost



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**BUILD IN PROCESS
EFFICIENCIES**

More information in even shorter timeframes
- race to file 10Q/10K



Processes must be

Structured
Defensible
Efficient
Repeatable



Automation is key

OPTIONS FOR AUTOMATION



Outsource the
Calculations



Build a Custom
Software Solution



Software Installed
On-Site



Software as
a Service

MONTHLY ACTIVITY CHECKLIST



Gather complete information from other departments

(e.g., HR, Legal)



**Audit data monthly:
bad data = incorrect calculations**



Review accounting policies and methodologies



Make sure you understand the calculations and methodology in the accounting reports

(especially before auditors come in)



Seek out any changes to regulations

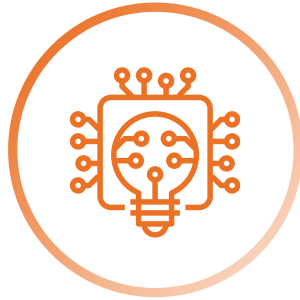


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WELL-STRUCTURED CONTROLS

KEY CONSIDERATIONS

Part 1



IT/Technology Issues

- Capture data accurately and ensure an appropriate segregation of duties
- Be sure that controls for post-dated transactions are adequate



Grants

- Ensure the award meets plan requirements and that the terms of the award are correct
- Verify that grants were approved on a timely basis
- Confirm that employees have been notified promptly



Vesting/Exercise

- Verify that the employee is eligible to receive the award
- Ensure shares are released accurately and promptly to the eligible employee or broker

KEY CONSIDERATIONS

Part 2



Tax & Payroll

- Determine the proper FMV
- Ensure the correct amount was calculated for payroll-tax withholding
- Confirm that IRS reporting and payment requirements have been met



Accounting

- Double-check the information in ASC 718 reports to make sure it's accurate, complete, and valid
- Verify that you have controls for modifications
- Be sure to account for forfeitures



Legal

- Confirm that underlying shares are properly registered
- File SEC Forms 3, 4, and 5
- Design and control your blackout periods



How do you notify your employees that they have been granted equity?



Email



Physical / Paper mailing



Online Portal or Intranet



Other



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ARM YOUR TEAM FOR ACCOUNTING HAZARDS



COMMON “GOTCHAS”

1

Rounding for Share Withholding

2

True-Ups and Forfeitures

3

Modifications

4

Multi-layer performance metrics

5

Acceleration Triggers

ROUNDING FOR SHARE WITHHOLDING/ "EXCESS" WITHHOLDING



Liability accounting required?



What % is tolerable?



Consult with auditor

TRUE-UPS AND FORFEITURES



**True-up
at vesting**

VS



**True-up
at termination**

MATERIAL MODIFICATIONS



Generally trigger modification accounting

- Option exchanges
- Equity restructuring
- Acquisitions
- Other changes to original terms of grant, such as extension of exercise grace period, acceleration of vesting, 409a changes, or allowing an employee to retain options post-termination



Generally do not trigger modification accounting

- Stock split/Spinoff/Equity restructuring with an anti-dilution provision in plan
- Acceleration of vesting unrelated to termination
- Additional features such as permissible exercise methods or name changes

MULTI-LAYER PERFORMANCE METRICS



Combination of performance, market, service conditions



Different fair value measurements for some components of the award



Adds complexity to both financial reporting as well as implementation of data into a software tool

POLLING QUESTION #4



What are your biggest accounting/reporting challenges related to your stock plan?

- A** Rounding for Share Withholding
- B** True Ups and Forfeitures
- C** Modifications

- D** Multi Layer Performance Metrics
- E** N/A

ACCELERATION TRIGGERS

1

Single-Trigger

- Singular event has to happen for shares to become immediately vested
- Most common is a Sale or Change in Control

2

Double-Trigger

- Requires 2 events to take place in order for the acceleration to occur
- Event one is typically a Change in Control or Sale
- Second event is a termination without cause

QUESTIONS



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