13TH ANNUAL CEP AND SILICON VALLEY NASPP SYMPOSIUM

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SANTA CLARA UNIVERSITY • CERTIFIED EQUITY PROFESSIONAL INSTITUTE • SILICON VALLEY CHAPTER-NASPP

Are You Ready for the Season?

Early Adopter Insights and Tips for Implementing the New Stock-based Compensation Accounting Rules

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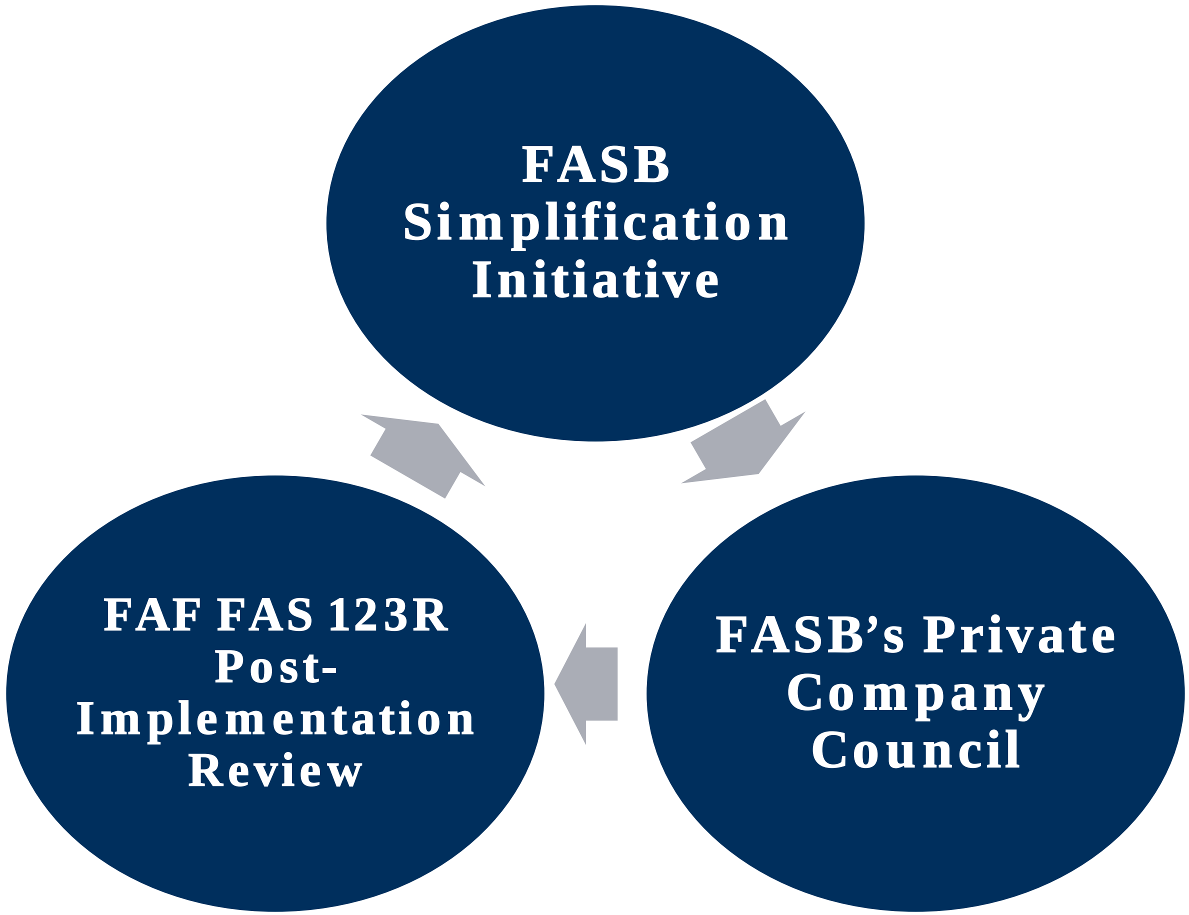
Agenda

- Why the Change?
- Implementation Considerations
- Employee Stock-Based Payment Accounting
- Sample Disclosures

Why the Change?

Why the Change?



High-Level Overview of Changes

Area Affected	Amendment	Transition
Accounting for Income Taxes	Excess tax benefits/deficiencies recognized as income tax expense/benefit in income statement upon vesting/settlement Excess tax benefits recognized regardless if benefit reduces taxes payable	Prospective Modified Retrospective
Classification of Excess Tax Benefits on Cash Flows	Operation cash flow	Prospective or Retrospective
Minimum Statutory Withholding	Withholding up to employee's maximum statutory rate	Modified Retrospective
Classification of Employee Taxes Paid on Cash Flows	Financing cash flow	Retrospective
Accounting for Forfeitures	Accounting policy election: estimate or account for when occur	Modified Retrospective

Who is Impacted and When?

Public entities	All other entities
Annual and interim periods beginning after December 15, 2016	Annual periods beginning after December 15, 2017 and interim periods beginning after December 15, 2018
Early adoption is permitted for any entity in any interim or annual period; however, all amendments must be adopted at the same time	

Implementation Considerations

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Implementation Considerations

- Earnings per Share (EPS) Impact
- Disclosures Changes
- Change in Process or Policy
- Administration
- Tax Compliance
- Industry Peers
- Stock Administration System
- Street Guidance/Forecast Adjustment

Who Should Be Involved

- Stock Administration
- Accounting & Financial Reporting
- Payroll
- Tax
- Legal
- Auditors

Employee Stock-Based Payment Accounting

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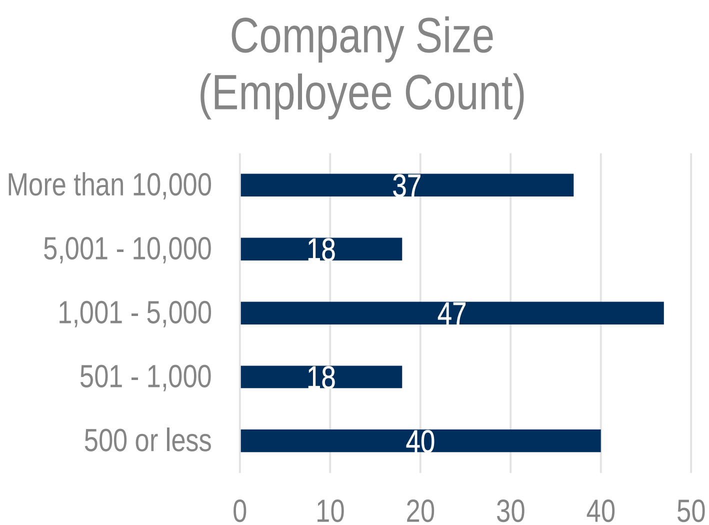
Early Adopter Study Findings

- A sample of 160 identified companies who have early adopted ASU 2016-09 based on public Form 10-Q and 10-K filings



Industry	# of Sampled Companies
Asset and Wealth Management	8
Automotive	4
Banking and Capital Markets	17
Energy	5
Entertainment, Media & Communication	7
Health Services	3
Industrial Products	31
Insurance	2
Pharmaceuticals/Life Sciences	29
Power and Utilities	8
Retail and Consumer	22
Technology	24

Source: PWC Early Adoption Study as of 22-August-2016

Forfeitures

- Current Guidance versus Amended Guidance

Estimate of forfeitures required

→

Policy election

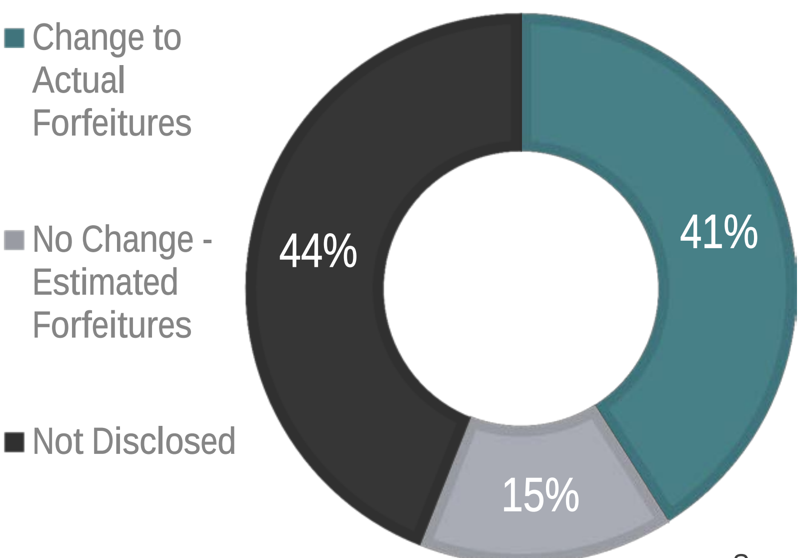
Estimate forfeitures **OR**

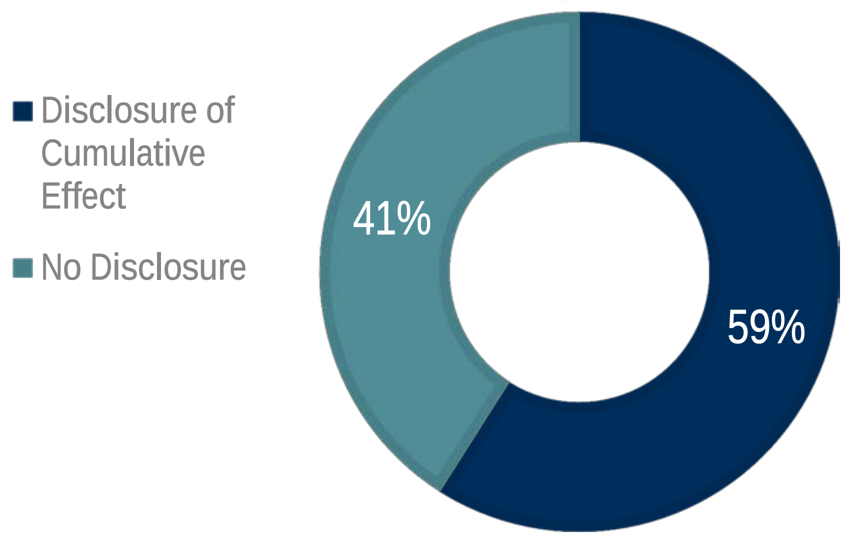
Account for forfeitures when they occur

- Implementation Considerations
  - Tracking forfeiture estimates can be complex and costly
  - Actual forfeiture approach will result in greater expense earlier in award life
  - Retained earnings charge upon policy election
  - The impact for the “now” vs. the “future”
  - Peer group comparability
- Transition
  - Modified retrospective

Accounting for Forfeitures: Early Adopter Study Findings

- Of the 160 early-adopters, 41% chose to account for forfeitures as they occur and 15% chose to continue estimating forfeitures under the current guidance.
- 44% companies did not explicitly disclose their policy election (though we might infer from the lack of disclosure that these companies chose to continue their policy of estimating forfeitures).
- 59% of the early-adopters that changed their forfeiture accounting policy election disclosed the cumulative effect adjustment recorded to retained earnings.





Source: PWC Early Adoption Study as of 22-August-2016

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Accounting for Income Taxes

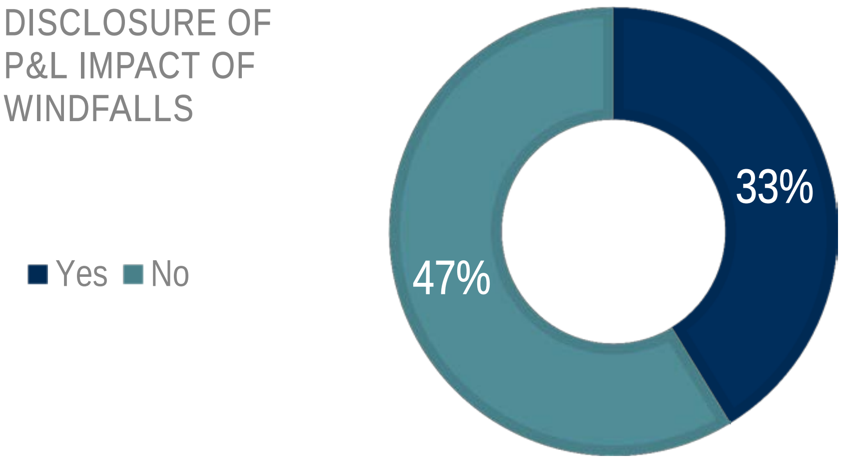
- Current Guidance versus Amended Guidance

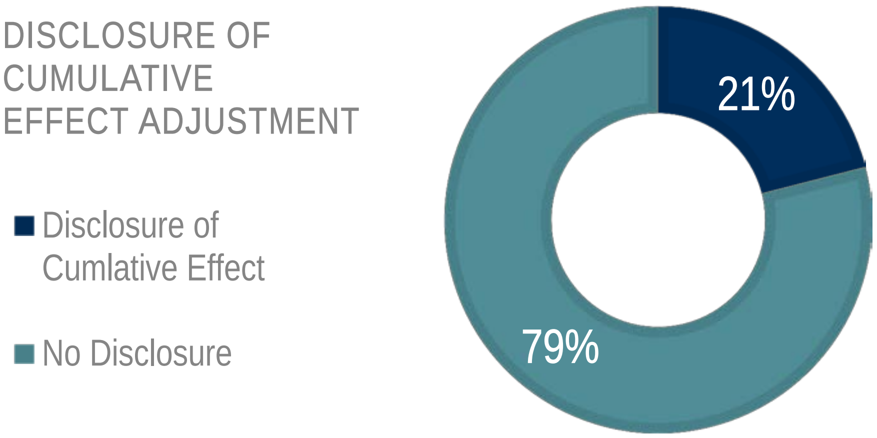
Current Guidance	Amended Guidance
• "Windfalls" recognized in APIC • "Windfall pool" tracking • "Shortfalls" recognized as: 1. APIC, if sufficient pool, or 2. Tax expense	• All "windfalls" and "shortfalls" recognized through income tax expense • Windfalls recognized when excess deduction occurs, not when utilized to reduce cash taxes

- Implementation Considerations
  - Volatility in income, EPS, effective tax rate
  - Consider impact of forecasting income tax impact for future periods
  - More potential for auditor scrutiny
- Transition
  - Excess tax benefits/deficiencies recognized as income tax benefit/expense in income statement upon vesting/settlement - Prospective
  - Excess tax benefits recognized regardless whether benefit reduces taxes payable (subject to valuation allowance considerations) – Modified retrospective

Accounting for Income Taxes: Early Adopter Study Findings

- Of the 160 companies, 53% included footnote disclosure of the amount of excess tax benefit/deficiency recorded in the income statement during the period.
- This impact on income ranged from under $1 million to over $370 million. For some, there is no impact on income because the company is in a net operating loss position with a full valuation allowance.
- With respect to the cumulative-effect adjustment, 21% companies disclosed the amount recorded to opening retained earnings (but note that this only applies to companies that had previously delayed recognition of windfalls).





Source: PWC Early Adoption Study as of 22-August-2016

Accounting for Income Taxes – Dilutive EPS Impacts

- Current Guidance versus Amended Guidance

How do the proposed amendments impact diluted EPS?	Current Guidance	→	Amended Guidance
	Included in the calculation of assumed proceeds	→	Recognized in the income statement (No longer included in the calculation of assumed proceeds)

- Implementation Considerations
  - No longer excess tax benefits in assumed proceeds under treasury stock method for taxable awards
  - Generally will increase dilutive effect and may have a quarter-over-quarter variation
  - Validate vendor system changes or current abilities
- Transition
  - Prospective

Classification of Excess Tax Benefits on Statement of Cash Flows

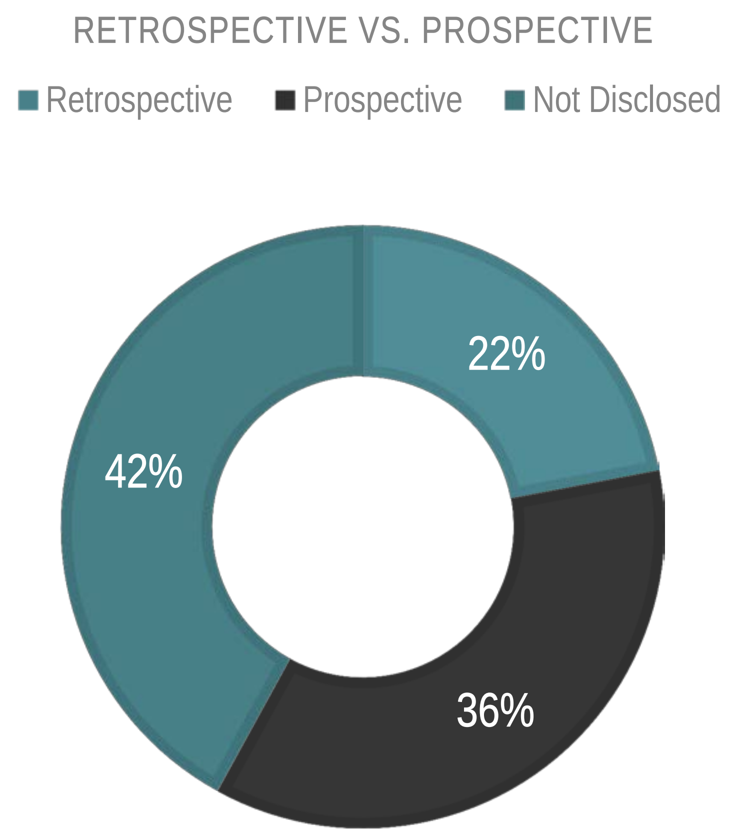
- Current Guidance versus Amended Guidance

Current Guidance		Amended Guidance
Displayed gross as an operating outflow and a financing inflow	→	Combined with other income tax cash flows within operating cash flows

- Implementation Considerations
  - Potential changes to previously reported numbers
  - Considerations for Transition Method due to impact to operating cash flow
- Transition
  - Prospective OR retrospective

Classification of Excess Tax Benefits on Statement of Cash Flows: Early Adopter Study Findings

- Out of the 160 early adopters, 36% of early-adopters applied the update on a prospective basis and 22% on a retrospective basis. The remaining early adopters did not explicitly disclose the nature of application.



Source: PWC Early Adoption Study as of 22-August-2016

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Minimum Statutory Tax Withholding Requirements

- Current Guidance versus Amended Guidance

Does net settlement result in liability classification?

Current Guidance		Amended Guidance
Employer's minimum statutory withholding requirements	→	***Employee's*** maximum statutory tax rate in applicable jurisdiction

- Implementation Considerations
  - Accounting guidance and tax compliance may be different
  - Potential process change for withholding based on employee level
  - Changes may be needed to plan documents
  - Change in expense calculation for previous liability awards not yet settled
- Transition
  - Modified retrospective

Tax Withholding Compliance Considerations

- While net settlement up to max rate will be permitted, companies may prefer not to default to this. Developing a consistent and fair approach to determine net settlement on an employee-basis could be a challenge.
- Employer determines withholding rate not employee
- Other income tax withholding at W-4 rate or supplemental rates (25%/39.6%)
- W-4 supplemental can be utilized but may be an administration burden
- Consider bifurcating your population and applying different withholding methods
- Begin reviewing existing award agreements. Many include provisions that do not allow withholding more than statutory minimum.

Poll: Show of Hands!

Given the changes in share withholding and liability accounting treatment; does your company plan to change its current withholding policy on net settled awards?

A) No, we will continue to withhold at minimum, maximum or actual tax rates

B) Yes, we will now withhold at maximum tax rates

C) Yes, we will review our population and choose the most appropriate rate in each given tax jurisdiction

D) Still deciding/not sure

Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting

- Proposed guidance update from the FASB issued November 17, 2016.
- Comment letters are due January 6, 2017.
- Issuers and accounting firms asked the FASB staff for guidance on whether an amendment to an award or plan document that already includes a net settlement feature to permit withholding up to the maximum tax rates constitutes a modification for which the modification guidance in Topic 718 would be applied.
- The Board decided that an entity should not apply modification accounting under Topic 718 on stock compensation if the change to an award does not affect the total current fair value (or total calculated or total intrinsic value, if applied), vesting requirements, or classification of the awards.
- The Board will consider feedback on the proposed ASU at a future meeting.

Net Settlement - Statement of Cash Flows

- Current Guidance versus Amended Guidance
- In the cash flow statement, when displaying cash paid by an employer when directly withholding shares…

No guidance on classification	→	Classified as a financing activity

- Implementation Considerations
  - Diversity in practice today, potential change in policy here
- Transition
  - Retrospective

Practical Expedient – Expected Term

- Current Guidance versus Amended Guidance

Required to estimate period until exercise → Practical expedient "simplified method" to estimate the expected term for certain awards

  - SEC already allows "simplified method" for certain stock options (midpoint between vest and expiration).
  - Amendment codifies acceptability for private companies.

- Transition
  - Prospective

Intrinsic Value - Private Company

- Current Guidance versus Amended Guidance

Current Guidance		Amended Guidance
Not permitted to change from a fair value to intrinsic value measurement	→	One-time election to switch from a fair value to intrinsic value measurement

- Implementation Considerations
  - Provides a ‘second chance’
  - Consider effort require to switch policy election
- Transition
  - Modified retrospective

Sample Disclosures

Companies that have Early Adopted

- Microsoft
- Intercontinental Exchange, Inc.
- IDEX Corp.
- American Software Inc.
- Union Pacific Railroad
- Vascular Solutions
- WABCO Holdings
- 3M
- JP Morgan Chase
- Microchip Technology Inc.
- Google – Alphabet
- Red Hat Inc.
- Salesforce Com Inc.
- L-3 Communications
- Northrop Grumman
- McDonalds Corp
- CMS Energy
- Raytheon
- Groupon, Inc.
- Leggett & Platt Incorporated

Source: PWC Early Adoption Study as of 22-August-2016

Disclosure Considerations

Sample from Microsoft FY16 Q3 Early Adoption

We elected to early adopt the new guidance in the third quarter of fiscal year 2016 which requires us to reflect any adjustments as of July 1, 2015, the beginning of the annual period that includes the interim period of adoption. The primary impact of adoption was the recognition of excess tax benefits in our provision for income taxes rather than paid-in capital for all periods in fiscal year 2016. Additional amendments to the accounting for income taxes and minimum statutory withholding tax requirements had no impact to retained earnings as of July 1, 2015, where the cumulative effect of these changes are required to be recorded. We have elected to continue to estimate forfeitures expected to occur to determine the amount of compensation cost to be recognized in each period.

We elected to apply the presentation requirements for cash flows related to excess tax benefits retrospectively to all periods presented which resulted in an increase to both net cash from operations and net cash used in financing of $31 million and $555 million for the three months and nine months ended March 31, 2015, respectively. The presentation requirements for cash flows related to employee taxes paid for withheld shares had no impact to any of the periods presented in our consolidated cash flows statements since such cash flows have historically been presented as a financing activity.

Adoption of the new standard resulted in the recognition of excess tax benefits in our provision for income taxes rather than paid-in capital of $74 million and $376 million for the three and nine months, respectively.

Disclosure Considerations

Sample from Google FY16 Q1 Early Adoption

In March 2016, the FASB issued Accounting Standards Update No. 2016-09 (ASU 2016-09) "Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." We have elected to early adopt these amendments beginning in the first quarter of 2016. Starting this quarter, stock-based compensation Table of Contents Alphabet Inc. 10 (SBC) excess tax benefits or deficiencies are reflected in the Consolidated Statements of Income as a component of the provision for income taxes, whereas they previously were recognized in equity. Additionally, our Consolidated Statements of Cash Flows now present excess tax benefits as an operating activity, with the prior periods adjusted accordingly. Finally, we have elected to account for forfeitures as they occur, rather than estimate expected forfeitures.

As a result of the adoption of ASU 2016-09, the Consolidated Statement of Cash Flows for the three months ended March 31, 2015 was adjusted as follows: a $105 million increase to net cash provided by operating activities and a $105 million increase to net cash used in financing activities. See Notes 11 and 12 for information regarding the additional impact on our financial statements.

Beginning in Q1 2016, we account for forfeitures as they occur, rather than estimate expected forfeitures. The net cumulative effect of this change was recognized as a $133 million reduction to retained earnings as of January 1, 2016.

In the first quarter of 2016, SBC excess tax benefits of $211 million were reflected in the Consolidated Statements of Income as a component of the provision for income taxes as a result of the early adoption of ASU 2016-09. Please refer to Note 1 for more details regarding the adoption of ASU 2016-09.

Disclosure Considerations

Clorox Updates Fiscal Year 2017 EPS Outlook for Revised Tax Rate Assumptions:

Clorox continues to anticipate delivering 2 percent to 4 percent sales growth in fiscal year 2017, reflecting about 2 percentage points of benefit from the RenewLife acquisition, partially offset by about 2 percentage points of unfavorable foreign currency exchange rates. Excluding the impact of 2 percentage points from unfavorable foreign currency exchange rates, the company continues to anticipate fiscal year sales to grow between 4 to 6 percent.

Clorox continues to anticipate EBIT margin expansion for fiscal year 2017 to be in the range of 25 to 50 basis points, primarily driven by lower selling and administrative expenses, which are expected to be below 14 percent of sales.

Clorox now anticipates its effective fiscal year 2017 tax rate to be between 32 percent and 33 percent versus its previous assumption of 30 percent and 31 percent, reflecting a 2-point reduction versus year ago compared to the previously assumed 4-point reduction from adopting ASU 2016-09. The company's updated assumptions for its fiscal year effective tax rate reflect lower than anticipated exercises of Clorox stock options in the first quarter and the company's revised outlook for full-year stock option exercises. As noted, the company had previously communicated that the benefit to be realized from the adoption of ASU 2016-19 could vary significantly.

Net of all these factors, Clorox now anticipates fiscal year 2017 diluted EPS from continuing operations to be in the range of $5.23 to $5.43, which includes the updated assumption of 10 to 15 cents of benefit to fiscal year EPS from adopting the accounting standards update. Excluding the benefit of adopting the accounting standards update, Clorox continues to anticipate fiscal year 2017 diluted EPS from continuing operations to be in the range of $5.13 to $5.28.

Questions?

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For more information on Accounting Standards Update 2016-09 please go here:

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