

# 13<sup>TH</sup> ANNUAL CEP AND SILICON VALLEY NASPP SYMPOSIUM

MARCH 28, 2017

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



## Equity Compensation Spring Training Workout!

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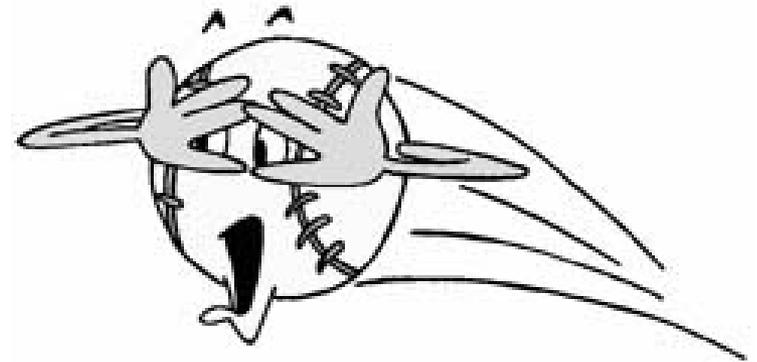
# Spring Training Practice Drills

- Adjusting to Awkward Plan Design
- Conquering SOX Controls
- Navigating the Auditor Relationship
- Tackling the Proxy Statement
- Changing Service Providers Successfully
- Handling Problematic Trades



# Adjusting to Awkward Plan Design

- Why didn't they ask me before they designed a plan that's almost impossible to administer?



# Adjusting to Awkward Plan Design

- How can plan design can cause unintended consequences?
- When can the plan design cause unfavorable tax outcomes?
- What can I do if the administration cost and effort is greater than the perceived value?



# Adjusting to Awkward Plan Design

- How can plan design cause unintended consequences?
  - Awarding annual restricted stock grants that vest at year-end can lead to:
    - Having to move shares each year in a very short timeline
    - If you allow sell-for-tax, employees could have capital gains/losses in a separate year from the income
    - Payroll may not be able to timely report the income and remit the tax
  - Providing a purchase plan with an employer match based on shares purchased by employees
    - Employees can 'pledge' previously purchased shares towards purchase
    - If they sell pledged shares previous to employer match, they forfeit the match
    - Good idea and may promote ownership and engagement, but administratively burdensome



# Adjusting to Awkward Plan Design

- When can the plan design cause unfavorable tax outcomes?
  - ESPP offered to foreign employees under same US ESPP umbrella
    - Typically not considered tax-qualified locally
    - Can trigger tax at purchase for employees
    - May also be a burden for HR and Payroll to calculate and deduct tax at grant; leads to a pre-purchase step in Payroll
  - Corporate tax deductions permitted under Section 162(m) may be disallowed:
    - Performance-based compensation exception invalid if plan allows for vesting on retirement, involuntary termination, or term for good reason
    - The plan has gone through a modification for non-corporate event reasons



# Adjusting to Awkward Plan Design

- What can I do if the administration cost and effort is greater than the perceived value?
  - Document the issues and present them to your boss or other decision makers
  - Be objective in your analysis; you will need to have a compelling case
  - Look for changes that can be made in the grant agreement, company practices or policies, rather than those that require a plan amendment
  - Be patient; changes to plan design can take a long time to enact, especially if the problems are written into the plan document



# Conquering SOX Controls

- Why, oh why do I have to do this?

- Misbehavior from a few companies, i.e. Enron and Worldcom created a need for more regulations around public company accounting
- The Sarbanes-Oxley Act of 2002 was passed in response to the need for tighter regulations
  - Rep. Oxley wrote a bill and it passed in the house
  - Sen. Sarbanes wrote a bill that passed the Senate
  - A committee was formed to merge into a single bill
- The bill, which contains eleven sections which cover responsibilities of a public corporation's board of directors, adds criminal penalties for certain misconduct, and required the SEC to create regulations to define how public corporations are to comply with the law.



# Conquering SOX Controls

- What is a SOX Narrative?
- How can I make the process easier and more efficient?
- What can I learn from the process?



# Conquering SOX Controls

- **What is a SOX Narrative**

- It describes key processes and how they should be completed
- This is your narrative – you own it – so make it work for you
- Who does what and when it is due
- Know how your deliverables fit in with others' deliverables
- If a control isn't working, seems outdated or you have new processes, you may need to re-write the control

- **How can I make the process easier and more efficient?**

- Make a checklist for each Key Control and test them
- Use the checklist to keep you on time and on target
- Know what you need and have it ready and test it in-house before the auditors arrive



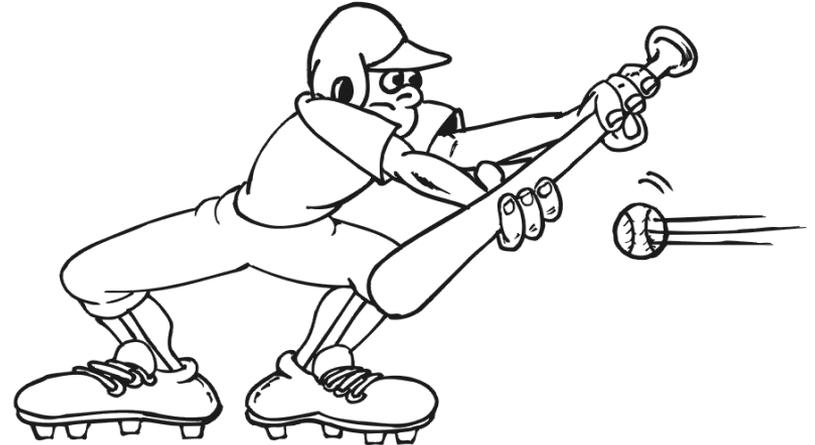
# Conquering SOX Controls

- **How can I make the process easier and more efficient?**
  - Your narrative should be a dynamic document
  - Whenever change take place, check your narrative and Key Controls to see if the change impacted them
  - Regularly review and update your controls to reduce risk
- **What can I learn from the process?**
  - Work with your colleagues to understand how their controls mesh with yours and how your departments fit together
  - Work closely with your Internal Auditors in the design and implementation of your SOX narrative and controls
    - Helps protect the company, employees and shareholders
    - Makes your life easier and less complicated



# Navigating the Auditor Relationship

- **An arm's length relationship – whose arm and how long is it?**
  - Your external auditor is not your teammate. External auditors have their own professional and ethical obligations, none of which include helping you get a raise.
  - Your external auditors are required to stay beyond the reach of personal influence or control, not just trusting the company's fairness and integrity. You should do the same.



# Navigating the Auditor Relationship

- How should you prepare?
- What should you provide?
- What should you avoid?



# Navigating the Auditor Relationship

- How should you prepare?

- Get your internal auditor's help (if you have one)
- Be ready to explain your procedures every year
- Regularly review your procedures (more detailed)
- Regularly review SOX testing documentation (less detailed)

- What should you provide?

- Create a checklist of documents needed for your audit file
- Review audit files before giving to the auditor
- Locate or complete missing items
- Be prepared to explain unusual documentation or transactions – make notes!



# Navigating the Auditor Relationship

- What should you avoid?
  - Don't provide draft items – final documents only
  - Don't confuse internal auditor with external auditor
  - Don't answer questions not asked
  - Don't provide documents not requested
  - Don't add unnecessary detail
  - Don't comment on company's policies or practices



# Tackling the Proxy Statement

- What is this proxy statement thing, and how did I get stuck with it?
  - Description of proposals for stockholder vote that includes extensive executive and director compensation data and analysis.
  - Governed by SEC Regulation 14A and Regulation S-K Item 402

	1	2	3	4	5	6	7	8	9	TOTAL
REALISTS	2	0	1	4	2	1	0	6	2	0
IDEALISTS	0	0	0	0	0	0	0	0	0	1

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# Tackling the Proxy Statement

- Who prepares the proxy statement?
- What equity compensation information is needed for it?
- What are some pitfalls to avoid?



# Tackling the Proxy Statement

- Who prepares the proxy statement?
  - Legal? Accounting? Financial Reporting? Outside counsel?
  - Coordinate timelines for draft circulation, review and filing
  - Identify internal sources to provide necessary information
- What equity compensation information is needed for it?
  - Beneficial ownership table: equity ownership of Section 16 officers and directors as of latest practicable date, including options and awards exercisable in 60 days
  - Summary Compensation Table: Named Executive Officer (NEO) stock and option awards earned (not awarded) in each of past 3 fiscal years



# Tackling the Proxy Statement

- What equity compensation information is needed for it? (cont.)
  - Grants of Plan-Based Awards: NEO stock and options **awarded in fiscal year**, including exercise price and grant date fair value (without forfeiture inputs)
  - Outstanding Equity Awards at Fiscal Year End: (**held at fiscal year end**)
    - NEO options exercisable and unexercisable, option price and expiration date
    - NEO stock awards vested, not vested and market value
    - NEO equity incentive plan awards vested and not vested
  - Option Exercises and Stock Vested: NEO options exercised and stock acquisitions **transacted in fiscal year**, including value realized
  - Potential payments upon termination: acceleration of equity awards intrinsic value **as of fiscal year end**
  - Director Compensation Table: director stock and option awards fair value **granted in fiscal year**



# Tackling the Proxy Statement

- What are some pitfalls to avoid?
  - Understand fair market value vs. fair value vs. intrinsic value
  - Note reporters and reporting periods for each table
  - Some data is as of latest practicable date
  - Be aware of footnote detail required (holdings, type of ownership, vest/release schedules)



# Changing Service Providers Successfully

- Changing service providers may be scary or exciting depending on your lens
  - You have to think about data, processes, training, communications, security, and on and on...
- It is important to understand the solutions and services available with the new provider
  - Review the contract
  - Consider processes you can change, to take advantage of the benefits



# Changing Service Providers Successfully

- Who should be included in project planning and implementation?
- How do you prepare participants for the change?
- How much time needs to be set aside?



# Changing Service Providers Successfully

- **Who should be included in project planning and deployment?**
  - For payroll, start early to facilitate discussion on automation of payroll feeds
  - What does your transfer agent need for outsourced plan providers?
  - Avoid a last minute scramble and include Finance during the implementation to review expense reports and build a transition plan
- **How do you prepare participants for the change?**
  - Take the time to customize the portal, communications to your company and plan language
  - Make sure there are clear guides for 'how do I...' activate my account, download my statement, exercise or sell shares
  - Provide instructions on how to handle previously released or exercised shares
    - Can they keep shares with your previous provider?



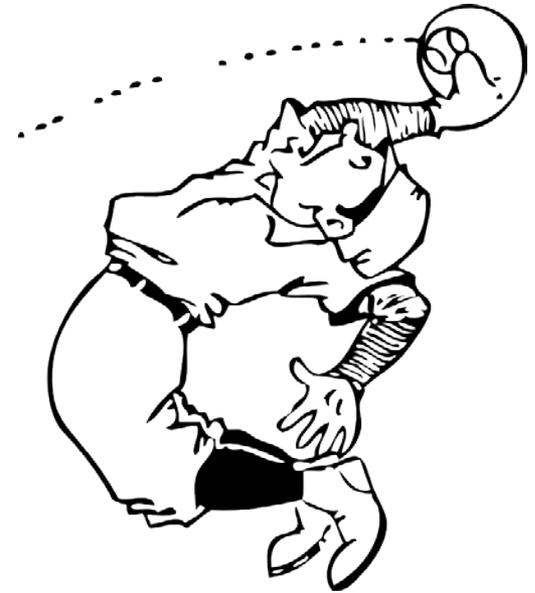
# Changing Service Providers Successfully

- How much time should I set aside?
  - Spend up-front time to consider the full picture
  - Review all existing processes and look for opportunities to improve efficiency
  - Run or request a copy of all your favorite reports and save them locally before losing access to your old provider's system
  - Consider whether you want to allow time for running two systems in parallel
  - There will always be things you did not plan for, so allow some cushion



# Handling Problematic Trades

- Regardless of how careful we, are sometimes things go wrong
  - Don't panic – it happens to all of us
- How do I identify if a trade is problematic?
  - The trade doesn't settle as it should
  - You get a call from an upset participant
  - The broker contacts you
- Now what do I do?!
  - Take a deep breath
  - And don't panic



# Handling Problematic Trades

- Who do I turn to for help?
- What do I tell my company (boss)?
- What do I tell the employee?



# Handling Problematic Trades

- Who do I turn to for help?

- Work with the broker
  - Identify their process – do you have to complete forms, get the participant's signature, get your manager's signature?
  - What is the timing? Is the process different if the trade is settled versus not settled
  - Who or what caused the trade to take place, and who pays for it?
- Stay in constant communication with the broker while the process is taking place

- What do I tell my company (boss)?

- Provide details: the who, what, when, where, and why of the trade
- Make sure you include any costs involved and who is responsible for paying



# Handling Problematic Trades

- What do I tell the employee?
  - Be honest but sympathetic
  - Expect the employee to be upset
  - Tell the employee the steps you are taking and how long it will take to complete them
  - If reversing a trade can actually benefit the employee, lead with that
  - If the reversal will negatively impact the employee, explain the situation and then just listen
  - Let the employee vent and express his or her frustrations
  - Remember that you have to continue working with this person, so arguing could damage your working relationship



# Questions

- Questions about topics covered...
- Topics that have not been covered...
- And see you at the reception!



# Speaker Contact Information

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