

## Proxy Reporting Pitfalls

For those of you who missed our January 2009 webcast, here is a selection of helpful tips, reminders, and gotchas discussed by our expert panelists, Mark Borges of Compensia and Jennifer Namazi, of SOS.

### Reg S-K, Item 201: Equity Compensation Plan Information

This table is a summary of shares in outstanding grants and shares remaining within your plans available for grant, segregating shareholder-approved from non-shareholder-approved plans. Beginning in 2002, this table must be included in annual reports on Form 10-K, as well as in your proxy statements in years when you are submitting a compensation plan for security holder action.

1. Remember that RSUs should be included in the "shares outstanding" column (a) but their prices should not be weighted in to the "exercise price" (column (b)) since that would skew the results. Instead footnote them, discussing the RSUs that have been excluded.
2. RSAs should not be included in "to be issued" since they have already been issued (at the time of grant).
3. For acquired plans, remember that if they were approved by the acquired company shareholders, but not by your shareholders and you will grant future awards from the plans, they should be included in the "not approved" row of the table. If you will not issue future grants from the plan, however, you can include them in the "approved" row.

### Reg S-K, Item 402(a)(3): Whom To Include

1. All Principal Executive Officers (PEOs) and Principal Financial Officers (PFOs) that served during the year. Note: Some have asked why the SEC didn't use the much more common "CEO" and "CFO" terms. Well, probably because they didn't want companies to exclude someone who was acting in the capacity of a CEO or CFO because they didn't necessarily have that title. Using a less common term makes it clear that it's about the role the executive plays, not the specific title they have.
2. The three most highly-compensated executive officers other than the PEO and PFO. Tip: Make sure to add up all sources of earning except Change in Pension Value and Nonqualified Deferred Compensation before you choose the "three top" for your NEOs. Some practitioners have reported forgetting to include expense accrued for grants of options or restricted stock and thereby nearly reporting on the wrong people.
3. Up to two more former officers, who would have been included, but were not serving in that role at the end of the fiscal year. Tip: Be sure to include any severance pay when computing "three top" for your former NEOs.

### Reg S-K, Item 402 (c): Summary Compensation Table

This table lists the last three years of data for each of the Named Executive Officers (NEOs). For stock options and stock awards, the value shown is the amount of expense accrued for grants during the fiscal year. Some pointers when it comes to this amount:

1. Do not reduce the amount by the estimated forfeiture rate.
2. However, if an actual forfeiture (cancellation prior to vesting) occurred during the fiscal year, it should be included in this amount (as a negative number).
3. All other rules of accrual under FAS 123(R) apply here, for example:
  - a) Acceleration of accrual for retirement eligible participants (if the participant will keep the shares after retirement). Note that this will make it more likely that retirement eligible

executives will qualify as NEOs, since any grant they receive would be recognized in-full in the year of grant.

- b) Liability awards (generally cash-settled grants) require mark-to-market accruals
- c) Performance awards, only include accruals if achievement of target is probable

### **Reg S-K, Item 402 (d): Grants of Plan-based Awards Table**

This table shows one row for each grant to each NEO during the year, including the grant-date fair value of the award in the final column. A few tips include:

1. If your company does not use closing market value to set exercise price for options, and your option prices are less than the closing value, be sure to add an additional column noting the closing price for the grant date.
2. If your company performed a repricing or option exchange during the last fiscal year, don't forget to include any incremental expense for the new grant in the grant-date fair value column.
3. If your performance awards have a target and a maximum award amount, the SEC has recently clarified that it should reflect the maximum grant-date fair value in column (I), rather than the target grant-date fair value.

### **Reg S-K, Item 402 (e): Outstanding Equity Awards at Fiscal Year-end Table**

This table summarizes all the outstanding awards, but segregates them into Exercisable, Unexercisable, Not Vested, and Unearned (performance grants with criteria not yet achieved). The first three terms pertain to time/service-based grants, while "unearned" is reserved for performance grants. And the added wrinkle for restricted stock (and units) is that you also compute and report their market value as of the end of the fiscal year (not the grant-date fair value, but the market value as of the end of the year).

### **Reg S-K, Item 402 (g): Director Compensation Table**

Generally, all the same rules apply to the Director table that apply to the Summary Comp Table in terms of equity compensation: you include the expense accrued without reducing it for estimated forfeitures. However, in addition, since there are no "grants" or "exercise/vest" tables for directors, you will also footnote the grant-date fair value for any new grants, assumptions used for the fair value calculations, and any incremental expense for modifications.

### **General Pointers for a Perfected Proxy:**

#### **Get Smart(er)**

Don't just hand over numbers, as requested by your legal or SEC reporting group. Ask for the context in which the numbers will appear and become familiar with the regulations that require the disclosures. Miscommunication due to differences in terminology are a lot more common than you might think, so understanding the context (and the regulations) is key to your success.

#### **Talk to Your Vendor**

Most stock plan systems/software have specific reports that are designed to help you complete your proxy tables, so if you're unaware of these reports, ask your vendor about them. A little time of time spent gaining this knowledge is likely to save you hours of compiling data from various sources and lots and lots of frustration.

#### **Plain English**

You shouldn't need a law degree (or need to be a CPA or a CFP) to understand the proxy statements. The SEC encourages readability and "plain English" in your disclosures. Ask a third party, who wasn't involved in compiling the proxy statement, to review it to help ensure its understandability

Questions or comments? Please email us at [xtra@sos-team.com](mailto:xtra@sos-team.com)

### **About Stock & Option Solutions**

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