

CFO SECRETS

Due Diligence Handbook

Part IV: ESOP/ Equity-Based Compensation

Equity-based compensation in general and ESOP's (Employee Share Option Plans) in particular are something of a triple threat. They are equity, an area of supreme interest to potential investors or acquirers. They are part of employee compensation, an area of supreme interest to your employees. They are frequently subject to strict, detailed and flat-out confusing tax codes and other regulations. And thanks to all of the above, they are teeming with endless forms, paperwork and details—all of which must be tracked. And a good chunk of which you will need to provide as part of a due diligence process.

WHAT THEY ASKED FOR	IN PLAIN ENGLISH THIS MEANS....
OPTION/SHARE PLANS FOR EMPLOYEES	
A copy of all share option or employee stock purchase plans of the Company and all amendments to the foregoing.	<p>You should have an option plan for your company, together with country-specific appendices for each country. Even if you are currently only in one country, you might have a “global” plan plus an appendix for grants in the country you operate in; this allows you to easily add new countries as needed. If you have more than one plan (e.g. your original plan expired and you established a new one or you just have multiple plans) provide both.</p> <p>In addition, you may also be asked to provide copies of templates of standard documents related to your option plans. These would include templates such as option award documents, proxies, option exercise forms, repurchase agreements and other standard documents and forms. Generally, these supporting forms will also be approved by the Board as part of the ESOP set up.</p> <p>Your legal counsel should have copies of your plan documents and can assist in helping you figure out what to provide.</p> <p>For more on ESOP's, see here. For a listing of articles on all things option related see here.</p>
<p>Copies of the documents filed with the ITA or any other relevant tax authority in order to approve the plans, including the following documents: “Trust Deed”; “Request for Appointing a Trustee”; “Notice of Grant” and the plans and relevant agreements.</p> <p>Copies of ITA or other relevant tax authority approval of the plans, including the Trustee's approval</p>	<p>Certain countries require that ESOP's and supporting documentation be submitted for government approval and/or registered with the government in order to obtain tax-advantaged status. Depending on local practices, you might receive a formal approval document from the relevant authority. In other cases, a lack of response might indicate approval.</p> <p>For more on tax-advantaged plans, see here.</p>
Copies of signed trust agreements by and between the company and the trustees for the plans	<p>Certain tax-advantaged ESOP's in Israel require that a trustee hold in escrow options and shares issued under the plan for two years. A condition for these to be released is that all related tax liabilities be paid. You will need to enter into an agreement with an Israeli-qualified trustee. If you are signed up, but don't have the agreement, your trustee should be able to provide a copy.</p> <p>For more on Israeli tax-advantaged ESOP plans (including trustees), see here.</p>
Copies of tax rulings obtained by the company in relation to stock option plans (if applicable)	<p>In addition to the initial approval of the plan, you may need the local tax authority to approve elements of the plans or certain transactions. For example, in the UK one submits share valuations to HMRC (the tax authority) for review and approval. Alternatively, you might want to correct a error to a grant and request that the local tax authority recognize it as still being under a given tax route. You will want to provide the relevant forms/ requests in addition to the approval.</p>

<p>Copies of option and share purchase agreements between the company and employees, consultants, directors, or other services providers (granted/signed with each grant) with respect to the plans. These should include reverse vesting/ repurchase agreements.</p>	<p>Like with most contracts, when you grant options or shares or sell shares, you need to sign off the recipient/ purchaser on documentation outlining the terms of the deal. This should include all supporting documents, such as a proxy.</p> <p>In the case of share purchase agreements, you will want to make sure that you have a copy of the payment as well (e.g. check copy or wire transfer advice).</p> <p>For more on option terms and terminology, see here or here.</p> <p>For more on reverse vesting and repurchase agreements, see here.</p>
<p>Copies of exercise notices</p>	<p>In order to exercise their options, employees will generally need to fill out paperwork for the sale, sign off on a proxy, if they haven't already and pay for the shares. You want to make sure that you have all of this documentation on hand. For the payment, save a copy of the check or wire transfer advice. If the payment was by a payroll deduction, save a copy of the relevant paystub where you can see the deduction for the shares.</p> <p>For more on proxies, see here.</p>
<p>Lists (in Excel) of stockholders and holders of other securities, including options, warrants and other securities convertible into equity securities of the Company. Please also provide the tax route according to which the securities were granted, issuance dates, original issuance price, strike price and vesting terms, amount of vested and unvested securities, termination date (if applicable), dates of deposit of each equity award with the trustee, including any such securities that have expired or been exercised or terminated. Please include a separate column, regarding the list, for the deposit of the board resolutions and the deposit of the option agreements with the trustee in order to ascertain complete compliance with the requirements of Section 102.</p>	<p>One chart to rule them all! See here for a template of an option rollforward chart which includes all the details a due-diligence reviewer's heart could desire.</p> <p>Note that there are a lot of details; your best bet is to make sure you are tracking all option plan activity on a real-time basis. Do not wait for due-diligence to try to compile all this historical data. Not only can you use this chart for your annual audit or for reconciliations with your trustee, but you should, as it's a great backup check.</p>
<p>Any board or shareholder resolutions regarding grants of options to employees.</p>	<p>You should have already provided all Board and shareholder resolutions in any event (see Part I- Corporate Matters). You can either send over the relevant resolutions again (probably a waste of time) or just note that these were provided with the rest of the Board minutes. That being said, if you have a Compensation or similar committee which approves options, make sure that you note that in the file name (e.g. Comp Comm 1.8.15), which makes it easier for those to be found.</p> <p>For more on Board and Shareholder Resolutions see here. For more on Board committees, see here.</p>