CLIENT SUCCESS STORY: COMPENSATION PLANS

A Client Reaches Its Goal, Retaining Key Employees with an Innovative Plan

Background: AAFCPA's client was a fast-growing high tech / software company that was, at one time, ranked in the top 15 percent of the Inc. 5000. Its long-term strategy was to go public or sell to a buyer that could grow the company and cash out the original investors.

Client Goals: The client wanted to lock in its key employees at the management and executive levels after it had completed a number of rounds of venture financing. Those employees were important to retain in order for the client to reach its ultimate goal of going public or selling its shares for a favorable price to a larger company.

Obstacles and Challenges: After all of the venture financing was completed, the client did not have cash available to issue "stay incentives" that would keep key employees in place. The management team also did not want to burden their financial statements with the implementation of a traditional stock option plan, so as to avoid diluting stockholder's equity with noncash compensation expense. Furthermore, they needed to avoid the traps inherent in non-discrimination testing that can limit or prohibit certain kinds of awards made to highly compensated individuals under some circumstances.

AAFCPAs Solution: By using experience gained from working on compensation plans for both investor-backed and family-owned businesses, and working with the client's CFO and outside counsel, our compensation specialist implemented a restricted stock plan involving a new class of preferred shares. In order to avoid income recognition under Section 83(b) of the Internal Revenue Code, the compensation plan was set up in a manner that prohibited any vesting until the earlier of a liquidating event (such as the sale of the company) or a date far enough into the future that the company would recognize one of its goals by then. Because of this design, there was no immediate income recognition or need to account for the options on the balance sheet, and there was no immediate personal tax implication for management and executive level personnel. Moreover, the plan provided that anyone who left the company prior to vesting would have to surrender their shares, so there was a strong incentive created to stay with the company until the vesting event.

Results: The client was able to retain key people on a tax-advantaged basis until it was acquired by a well-known public company on favorable terms in 2011. At that point, the key employees were able to cash out their preferred shares. Thus, the client achieved its goals of retaining key people until the realization of an exit strategy without having to pay cash incentives, and the compensation incentive plan created no negative impact on the client's financial statements that could hinder the realization of its goals. Everyone involved was very pleased with AAF's solution.

About AAFCPAs: AAFCPAs is an attractive alternative to the Big 4 and National CPA firms. We provide best-value assurance, tax, accounting, and business & IT advisory solutions to nonprofit organizations, commercial companies, and wealthy individuals/estates. Since 1973, AAF's sincere approach to business and service excellence has attracted discerning clients along with the best and brightest CPA and consulting professionals. AAF donates 10% of its net profits annually to nonprofit organizations.

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