September 12, 2013

FASB Considers but Rejects Providing Additional Guidance Regarding the Effect of Clawback Provisions on Equity Compensation Awards

On September 4, 2013 the Financial Accounting Standards Board (FASB) considered whether it should add to its agenda a project to provide guidance on whether the presence of a discretionary clawback feature delays the grant date for equity compensation awards. The grant date is important because it is on that date that compensation cost is measured for equity compensation awards.

The FASB decided not to undertake the project at this time because they felt sufficient guidance already exists under Accounting Standards Codification (ASC) Topic 718, which is the accounting standard for equity compensation awards.

In general, ASC Topic 718 provides that contingent features such as clawback provisions, which may cause the recapture of equity compensation profits in specified circumstances, should not be considered when estimating grant-date fair value and should not result in a delayed measurement date. Rather, such features should be accounted for only if and when the contingent event occurs by recognizing income equal to the lesser of the consideration recovered or previously recognized compensation cost with respect to the award.

It is important to note that the above guidance applies with respect to objectively determinable clawback features, which should cover most clawback policies that are triggered in event of financial restatements, erroneous performance criteria, misconduct, violation of restrictive covenants, etc. This accounting treatment should apply notwithstanding the administering body's discretionary authority to invoke or not invoke the clawback policy once the objectively determinable event has occurred.

However, the presence of discretionary authority to invoke or not invoke the clawback policy in the absence of an objectively determinable triggering event could result in a delayed measurement date if such discretion precludes a mutual understanding of the key terms and conditions of the equity award. For example, a delayed measurement date could result in situations where the administering body has the power to decide, at its discretion, whether the clawback policy should be invoked regardless of the presence of an objectively determinable event such as a financial restatement.

Because of this potential for diversity in accounting practice, companies that implement clawback policies should confirm the equity compensation accounting implications with their professional accountants.

Notably, the FASB in justifying its decision not to undertake the project stated that the board would have a chance to review the clawback issue again. That chance will come later this year when the FASB's parent organization, the Financial Accounting Foundation (FAF), commences its post-implementation review of how well the 9-year-old ASC Topic 718 is working.

* * * * * *

General questions about this letter can be addressed to Thomas M. Haines in our Chicago office at 312-332-0910 or by email at tmhaines@fwcook.com. Specific questions should be referred to the company's professional accountants. Copies of this letter and other published materials are available on our website at www.fwcook.com.