Sidebar 3

Award with Clawback Feature

Company B's stock option plan, described in Sidebar 1, requires certain executives to return, without any consideration, all stock acquired in the option plan if that executive resigns his position within three years of exercise and begins employment with a direct competitor. If the executive does not wish to return the stock, or if he has already sold it, the award requires the executive to pay cash equal to the fair value of the shares acquired in the stock option plan. This is sometimes called a "clawback" feature. This contingent feature would not affect the determination of the fair value of the option at the grant date, but is recognized when it occurs.

In 2012, an executive who converted 20,000 options in 2011, as part of the exercise described in Sidebar 1, resigned from Company B and joined Company A, a direct competitor. Accordingly, he returned all 20,000 shares obtained in exercising his options. As of the effective date of his resignation, the stock had a market value of $30 per share.

In this situation, Company B records treasury stock at the fair value (or market value) of the stock acquired, other income (expense) at the fair value of the award at the grant date (offsetting previously recognized cost), and additional paid-in capital as the difference between the two, as indicated in the following journal entry:

Treasury stock (20,000 shares at $30)	$600,000	
Other income (expense) (20,000 shares at $10)		$200,000
Additional paid-in capital		$400,000