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Debate

Clawbacks for Executive Bonuses

ISSUE: Should executives be forced to give back their bonuses due to accounting restatements?

Executives could be forced to give back their bonuses if their companies are forced to restate their earnings. In a divided vote, the Securities and Exchange Commission voted 3-2 to propose rules that would make public companies revoke the bonuses and incentive-based pay of their executives if there are found to be errors in the company's financial statements. The reasoning behind this proposal is to make sure that executives are not awarded for performance found to be overstated. In the past, executives were forced to return bonuses only if it was found that the company had intentionally reported false information. This proposal would extend it so that executives would have to return bonuses even if it was unintentional.

The government hopes to deter restatements by encouraging executives to examine financial information carefully before reporting. Since 2014 companies have restated financial results 831 times. Approximately 42 of these restatements were negative and impacted the bottom line. Under the new rules, firms with errors in their reports would have to disclose the amount of the bonus owed to the firm by the executive. The executive would have 180 days to return the money. If he or she fails to do so, then the name of the executive will also be released to the public. If the proposal is accepted and companies do not implement these clawback rules, they could be delisted from the stock market.

There is much support for this policy. One benefit would be that it would hold executives more accountable to ensure that their financial statements are accurate. Since clawbacks have only been necessary when erroneous reporting was done intentionally, executives might have been encouraged to overstate earnings in the hopes of not getting caught. This new policy would require clawbacks whether the false reporting was intentional or not. Probably the biggest reason is that executives should not be able to keep bonuses and other incentive pay that they have not earned and should not have been given in the first place.

On the other hand, there are criticisms of the proposal. For instance, the proposal makes it riskier for executives. They might try to mitigate this risk by having their salaries increased to account for any bonus clawbacks they might have to return. Critics of this proposal believe that high incentives are necessary to get the best talent for the executive positions, and that it would be unfair to punish executives if they honestly had no knowledge that the information was incorrect. Finally, 85 percent of Standard and Poor's companies already have clawback policies that exceed the SEC proposal, and 36 percent of firms intend to heighten the use of clawbacks on awards such as bonuses.

There are two sides to every issue:

1. Executives should return their bonuses if errors are found in the company's financial reports even if these errors were not intentional.

2. Forcing executives to return bonuses each time errors are found in the company's financial reports creates too much risk and could be unfair.

Sources:
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