Par Value Method

Those who advocate accounting for treasury shares at par (or stated) value adhere to the theory that the purchase or other acquisition of treasury shares is, in effect, a constructive retirement of those shares. Inasmuch as the shares cannot be an asset, they must represent a retirement or at least a reduction of outstanding stock. Because outstanding shares are shown at par, they reason, the reacquired shares must be carried at par to indicate the proper reduction in stock outstanding.

PURCHASE OF TREASURY STOCK

To illustrate the accounting for treasury stock using the par value method, assume that Ho Company has issued 100,000 shares of $1 par value common stock at a price of $10 per share. In addition, it has retained earnings of $300,000. The stockholders’ equity section on December 31, 2001, before purchase of treasury stock is as follows:

<table>
<thead>
<tr>
<th>Stockholders’ equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paid-in capital</td>
</tr>
<tr>
<td>Common stock, $1 par value</td>
</tr>
<tr>
<td>100,000 shares issued and outstanding</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
</tr>
<tr>
<td>Total paid-in capital</td>
</tr>
<tr>
<td>Retained earnings</td>
</tr>
<tr>
<td>Total stockholders’ equity</td>
</tr>
</tbody>
</table>

On January 20, 2002, Ho Company acquires 10,000 shares of its stock at $11 per share. The entry to record the reacquisition is:

\[
\begin{align*}
\text{January 20, 2002} \quad & \\
\text{Treasury Stock} & 10,000 \\
\text{Paid-in Capital in Excess of Par} & 90,000^1 \\
\text{Retained Earnings} & 10,000 \\
\text{Cash} & 110,000 \\
\end{align*}
\]

Under the par value method, the acquisition cost of treasury shares is compared with the amount received at the time of their original issue. The Treasury Stock account is debited for the par value (or stated value) of the shares, and a pro rata amount of any excess over par (or stated value) on original issuance is charged to the related Paid-in Capital account. Any excess of the acquisition cost over the original issue price is charged to Retained Earnings and may be viewed as a dividend to the retiring stockholder. If, however, the original issue price exceeds the acquisition price of the treasury stock, this difference is credited to Paid-in Capital from Treasury Stock and may be viewed as a capital contribution from the retiring stockholders.

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1This amount could be charged to Paid-in Capital from Treasury Stock if a balance existed in that account from previous transactions.
In the Ho Company example, because there was only one previous issuance of common stock (at $10 per share), the average price received is the same as the original issue price. Therefore, the $9 original excess over par per share is used to determine the total reduction in Paid-in Capital in Excess of Par. More typically, the average excess over par originally received per share is computed by dividing the total paid-in capital in excess of par from all original issuances of common stock by the number of common shares issued.

The stockholders’ equity section for Ho Company after purchase of the treasury stock is as follows:

<table>
<thead>
<tr>
<th>Stockholders’ Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paid-in capital</td>
</tr>
<tr>
<td>Common stock, $1 par value, 100,000 shares issued</td>
</tr>
<tr>
<td>Less: Treasury stock (10,000 shares at par)</td>
</tr>
<tr>
<td>Common stock outstanding</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
</tr>
<tr>
<td>Total paid-in capital</td>
</tr>
<tr>
<td>Retained earnings</td>
</tr>
<tr>
<td>Total stockholders’ equity</td>
</tr>
</tbody>
</table>

Under the par value method, treasury stock is reported in the balance sheet as a deduction—at par value of $10,000—from issued shares of the same class. Note also that additional paid-in capital is $90,000 less and retained earnings is $10,000 less than before the treasury stock transaction.

**SALE OR RETIREMENT OF TREASURY STOCK**

Treasury stock is usually sold or retired. If the treasury shares are sold or retired, the accounting treatment is similar to that accorded any original issuance of stock.

When the selling price of the shares is greater than par, the difference is credited to Paid-in Capital in Excess of Par. To illustrate, assume that 1,000 shares of treasury stock of Ho Company previously acquired at $11 per share are sold at $15 per share on March 10. The entry is as follows:

<table>
<thead>
<tr>
<th>March 10, 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
</tr>
<tr>
<td>Treasury Stock</td>
</tr>
<tr>
<td>Paid-in Capital in Excess of Par</td>
</tr>
</tbody>
</table>

If the treasury stock is sold at less than par, Paid-in Capital from Treasury Stock is debited. A Discount on Capital Stock is not debited because no contingent liability exists on the part of the stockholders of the reissued shares.

If stock is retired, the par value of the treasury stock and related common stock is reduced. To illustrate, assume that Ho Company retires 5,000 shares of its treasury stock. The entry to record this retirement is as follows:

| Common Stock                                | 5,000  |
| Treasury Stock                              | 5,000  |

The par value method maintains the integrity of the various sources of capital. The cost method avoids identifying and accounting for the premiums, discounts, and other amounts related to the original issue of the specific shares acquired. For that reason, it is the simpler and more popular method.
SUMMARY OF LEARNING OBJECTIVE FOR APPENDIX 15A

16 Explain the par value method of accounting for treasury stock. Under the par value method, the purchase of treasury shares is viewed as a constructive retirement of those shares. Inasmuch as the shares cannot be an asset, they must represent a retirement or at least a reduction of the outstanding stock. Because shares outstanding are shown at par, the reacquired shares must be carried at par to indicate the proper reduction in stock outstanding.

Note: All asterisked Questions, Brief Exercises, Exercises, Problems, and Conceptual Cases relate to material contained in the appendix to the chapter.

QUESTIONS

1 Distinguish between the following types of corporations:
   (a) Public sector vs. private sector.
   (b) Nonstock vs. stock.
   (c) Closed vs. open.
   (d) Listed vs. unlisted.

2 Differentiate between capital in a legal sense, capital in a corporate finance sense, and capital in an accounting sense.

3 Discuss the special characteristics of the corporate form of business that have a direct effect on owners’ equity accounting.

4 In the absence of restrictive provisions, what are the basic rights of stockholders of a corporation?

5 Distinguish between common and preferred stock.

6 Why is the distinction between paid-in capital and retained earnings important?

7 Explain each of the following terms: authorized capital stock, unissued capital stock, issued capital stock, outstanding capital stock, subscribed stock, and treasury stock.

8 Distinguish between paid-in capital and stated capital.

9 What is meant by par value, and what is its significance to stockholders?

10 Describe the accounting for the issuance for cash of no-par value common stock at a price in excess of the stated value of the common stock.

11 When might the Stock Subscription Receivable account be classified as a current asset? As a deduction in the stockholders’ equity section?

12 Describe the accounting for the subscription of common stock at a price in excess of the par value of the common stock.

13 Explain the difference between the proportional method and the incremental method of allocating the proceeds of lump sum sales of capital stock.

14 What are the different bases for stock valuation when assets other than cash are received for issued shares of stock?

15 Explain how underwriting costs and accounting and legal fees associated with the issuance of stock should be recorded.

16 For what reasons might a corporation purchase its own stock?

17 Distinguish between the cost method and the par value method of accounting for treasury stock.

18 Discuss the propriety of showing:
   (a) Treasury stock as an asset.
   (b) “Gain” or “loss” on sale of treasury stock as additions to or deductions from income.
   (c) Dividends received on treasury stock as income.

19 What features or rights may alter the character of preferred stock?

20 Little Texas Inc. recently noted that its 4% preferred stock and 4% participating second preferred stock, which are both cumulative, have priority as to dividends up to 4% of their par value; its participating preferred stock participates equally with the common stock in any dividends in excess of 4%. What is meant by the term participating? Cumulative?

21 Where in the financial statements is preferred stock normally reported?

22 How should preferred stock redeemable by the holder be classified in the financial statements?

23 List possible sources of additional paid-in capital.

24 Goo Goo Dolls Inc. purchases 10,000 shares of its own previously issued $10 par common stock for $290,000. Assuming the shares are held in the treasury with intent to reissue, what effect does this transaction have on (a) net income, (b) total assets, (c) total paid-in capital, and (d) total stockholders’ equity?

25 Indicate how each of the following accounts should be classified in the stockholders’ equity section.