8-1966

Accounting Practices and Ethics of Corporate Stock Reacquisitions

Allen W. McConnell

17

ACCOUNTING PRACTICES AND ETHICS OF CORPORATE STOCK REACQUISITIONS

by

Allen W. McConnell

B.S. in Business Administration

Accounting Major

University of North Dakota 1965

An Independent Study Report

Submitted to the Faculty

of the

University of North Dakota

in partial fulfillment of the requirements

for the Degree of

Master of Science

Grand Forks, North Dakota

August
1966

This independent study report submitted by Allen W. McConnell in partial fulfillment of the requirements for the Degree of Master of Science in the University of North Dakota is hereby approved by the Committee under whom the work has been done.

Chairman

Dean of the Graduate School

TABLE OF CONTENTS

LIST OF TABLES

ABSTRACT

Corporate stock reacquisitions have brought about the question of proper accounting methods to be used when reporting and accounting for treasury stock, and the ethical consequences of such reacquisitions.

This study included the examination of articles written by noted members of the accounting and legal professions. The research also included the examination of surveys conducted for the American Institute of Certified Public Accountants regarding the ethics of and accounting for treasury stock reacquisitions.

During recent years stock reacquisitions have risen in both the total number of shares and the dollar value of stock repurchased. There are two main methods of accounting for treasury stock. The "contraction of capital" theory which is advocated by the American Accounting Association and a "capital element awaiting ultimate disposition" which is advocated by the American Institute of Certified Public Accountants.

It is important for a company to use the method of purchasing stock which would least affect its market value. The use of proper accounting methods, adequate disclosure of purchasing plans and results of stock reacquisitions can make such repurchases profitable to both the corporation and its stockholders.

INTRODUCTION

Treasury stock has been defined as, "when a company's own stock, paid for and issued, is reacquired and held in the name of the company."[1] Treasury stock may be acquired in three ways: (1) by purchase, (2) in satisfaction of a claim, and (3) by donation from stockholders.

This paper is primarily concerned with the accounting methods and ethical problems connected with the purchase of treasury shares. These questions have been enlarged by the increased action in stock reacquisitions.

The increase in stock reacquisitions has led to changes in methods of accounting and reporting treasury holdings in corporate financial statements. Also this increased trading has led to new legislation in the area of corporation acts regarding stock reacquisitions in order to give more protection to corporate stockholders and creditors.

Ethically, stock reacquisition brings up questions in such areas as: (1) adequate disclosure, (2) avoidance of conflict-of-interest,

---

[1] Harry Simons and Wilbert E. Karrenbrock, Intermediate Accounting (4th ed.; Cincinnati, Ohio: South-Western Publishing Company, 1964), p. 611.

(3) whether management is using privileged information to take advantage of stockholders, and (4) the proper method to be used when making the repurchase.

CHAPTER I

DEVELOPMENT OF TREASURY STOCK HOLDINGS

About thirty to thirty-five years ago much discussion and action regarding treasury stock holdings was taking place. During the 1930's treasury stock holdings were quite popular among major corporations.

In 1938, the American Institute of Accountants employed the services of Sanders, Hatfield and Moore to conduct a survey to determine the extent corporations had reacquired their own corporate stock. They examined the balance sheets of five hundred corporations for the four year period, from 1933 to 1937. They found that over three hundred balance sheets contained items of reacquired shares.

The R. J. Reynolds Tobacco Co. in its 1933 financial statements reported a profit of $5,000,000 on the disposal of its treasury stock. This company also reported that, "prior to its sale, the cost of acquiring the shares, $18,000,000 was carried as an asset under the heading Investments in Non-Competitive Companies, etc., the exact nature being disclosed by a footnote."[2]

---

[2]Calvin H. Rankin, "Treasury Stock: A Source of Profit or Loss," Accounting Review, XIV, March, 1940, p. 71.

It was also during the middle thirties that accountants changed their views on methods of accounting and reporting treasury stock holdings. During these years the method of carrying treasury stock as an asset began to lose its popularity until today it is an almost nonexistent approach.

The years that followed showed a decline in the reacquisition of treasury stock. In 1950, a survey of six hundred companies showed that two hundred and thirty of the balance sheets contained treasury stock items. By 1962, out of a survey of six hundred corporations, the number of companies with treasury stock holdings had risen to three hundred and ten.[3] This is an increase of about 13 1/2 percent in twelve years. In the period from 1954 through 1963 six hundred and fifty-one different companies listed on the New York Stock Exchange participated in reacquisitions of their own common stock. These companies represented 53 percent of the 1,214 corporations which are listed on the New York Stock Exchange.[4]

Other indicators of growth are the increases in the number and value of shares which corporations have reacquired in recent years. In 1963 firms listed on the New York Stock Exchange reacquired 26.6

---

[3]American Institute of Certified Public Accountants. Accounting Trends and Techniques; XI, 1963, p. 134.

[4]L. A. Guthart, "More Companies are Buying Back Their Stock," Harvard Business Review, XLIII, March, 1965, p. 42.

million shares. This represented more than a 400 percent increase over the 5.8 million shares which the New York Stock Exchange corporations reacquired in 1954. The increase in the total number of shares purchased rose steadily during the decade from 1954 through 1963. In none of these years was there a decrease in the number of shares reacquired, and the average increase was 19.1 percent. The following charts will help to establish the reacquisition habits of companies listed on the New York Stock Exchange for the years 1954 through 1963.

The dollar value of shares repurchased also showed a tremendous increase. In 1954 the estimated cost of stock reacquisitions was $273.9 million and by 1963 had risen to $1,302.9 million.[5] Although there was a continual increase in the number of shares repurchased it is estimated that the dollar value of such reacquisitions decreased from 1956 to 1957 and again from 1959 to 1960.

The practice of reacquiring corporate stock is not limited to only a few major corporations, nor is it restricted to a specific type of industry. The following are industries which had treasury stock holdings on June 30, 1964: equipment manufacturers, financial institutions, petroleum, chemical, entertainment, publishing, lumber, electrical, and food companies.[6]

---

[5] Ibid., p. 52.

[6] A. Merjos, "Into the Treasury; Many Corporations are Regular Buyers of Their Own Stock," Barrons, XLIV, August 17, 1964, p. 10.

TABLE 1[7]

ROLE OF "ACTIVE" REPURCHASERS

A. Rise in Volume and Activity (1954-1963)

Year	Number of "Active" Companies	Shares Repurchased
1954	43	5,025,313
1955	53	4,184,070
1956	76	6,861,873
1957	80	6,737,705
1958	55	7,426,252
1959	64	9,666,878
1960	91	9,835,123
1961	57	10,332,804
1962	148	19,871,803
1963	130	22,711,427

B. Total Number of Shares Reacquired as a Proportion of Total Trading in "Active" Company Securities on NYSE

Year	Total Trading in Shares of "Active" Repurchasers	Repurchase Proportion
1954	24,301,910	20.5%
1955	37,040,600	11.3
1956	36,882,900	18.5
1957	29,046,200	23.1
1958	38,175,782	19.4
1959	55,074,510	17.5
1960	59,706,440	16.4
1961	87,718,051	11.8
1962	122,990,632	16.1
1963	144,391,410	15.8

[7]Guthart, op. cit., p. 52.

Two major reasons for corporate stock reacquisitions are to enable a company to have stock in the treasury for the following purposes: (1) employee stock option and purchase plans, and (2) acquisitions or mergers of other companies. In the year ended June 29, 1963, Winn-Dixie Stores purchased a net of 76,105 shares of treasury stock which more than offset the 62,823 shares sold to employees during the year.[8] Phillips Petroleum Co. in an agreement, reached in 1964, to acquire Sealright-Oswego Falls Corp. was to give in excess of 700,000 shares of Phillips stock in exchange for 1,666,850 outstanding shares of Sealright. Phillips Petroleum Co. has indicated that all of the necessary shares would come from its treasury.[9]

---

[8] Merjos, op. cit., p. 9.

[9] Ibid.

CHAPTER II

ACCOUNTING METHODS OF HANDLING TREASURY STOCK

TREASURY STOCK AS AN ASSET

About thirty years ago the controversy over the proper method of accounting for treasury stock was that of showing it as an asset or by deducting it from capital. During the thirties the method of deducting treasury stock from capital was used most often but the asset method was used as shown in the following table:

TABLE 2

TREASURY STOCK PRESENTATIONS DURING THE 1930's

Sanders, Hatfield & Moore, Statement of Accounting Principles 90, (1938):

	1933	1934	1935	1936
Deducted from Capital	197	215	217	221
Listed as Asset	159	121	108	86
Total	356	336	325	307

Those who advocated showing treasury stock as an asset reasoned "that the corporation has a choice between purchasing its own shares or stock of another company, and if the stock of another company had been purchased, then it would be shown as an asset."[10] At one time it was also advocated that securities of major corporations were readily marketable in small quantities and therefore it would be acceptable to carry these small quantities as assets. This theory has almost completely disappeared in recent years unless they are going to be used to meet current liabilities.

Today treasury stock is not considered an asset. This idea, under certain conditions can be modified. When a company has a bonus agreement with its officers or employees and if they are to meet the liability with treasury shares acquired for cash, the treasury shares may be carried as an asset.

CURRENT ACCOUNTING METHODS

Currently there are two main approaches to accounting for treasury shares. The first approach is sometimes referred to as the "contraction of capital" theory. This method can be viewed two different ways. First treasury stock acquisitions can be viewed as a reduction of capital as though the shares were cancelled. The second view would be that a treasury stock account instead of the capital stock account would be charged for the amount of the reduction in the capital stock. The

---

[10] Harold Freeman, "Accounting for Treasury Shares," University of Cincinnati Law Review, XXIX, Spring, 1960, p. 238.

treasury stock account is then used for the purpose of reporting a reduction in capital stock. The second approach is to consider treasury stock acquisitions as the initial transaction of a financing operation which will lead to future reissuance of the shares. Under this theory the accounting entries are such as to put the ultimate disposition into a state of suspense until the stock has either been resold or cancelled.

TREASURY STOCK UNDER THE "CONTRACTION OF CAPITAL" THEORY

The first approach to the treatment of treasury stock came into prominence when the American Accounting Association changed its view on the matter in about 1948. Its most recently revised version clearly expressed the concept of the contraction of capital theory when it stated it as follows:

> The acquisition of its own shares by a corporation represents a contraction of its capital structure. However, statutory requirements are particularly restrictive in the area of corporate activity and to an important degree, are controlling in the reporting of such transaction. Preferably, the outlay by a corporation for its own shares is reflected as a reduction of the aggregate of contributed capital, and any excess of outlay over the pro-rata portion of contributed capital, as a distribution of retained earnings. The issuance of reacquired shares should be accounted for in the same way as the issuance of previously unissued shares, that is, the entire proceeds should be credited to contributed capital."[11]

In 1938, a special committee of the American Institute of Certified Public Accountants took a similar view when they concluded: . . . . Your committee can see no essential difference between (a) the purchase

---

[11] Simons and Karrenbrock, op. cit., p. 613.

and retirement of a corporation's own common stock and the subsequent issue of common shares, and (b) the purchase and resale of its own corporate stock."[12]

The stand by the American Accounting Association follows more specifically the first method under the contraction of capital theory and would favor debiting the capital stock account rather than the special treasury stock account.

To illustrate this method the following stockholders equity section of X Corporation will be used:

Capital stock - 10,000 shares of $10 Par value stock authorized, issued, and outstanding	$100,000
Premium on Stock	10,000
Retained Earnings	20,000
	$130,000

If X Corporation acquires 1,000 shares at a cost of $13,000 the following entry would be made:

Capital stock	10,000	
Premium on stock	1,000	
Retained earnings	2,000	
Cash		13,000

Under this method treasury stock acquired is reported as a reduction of capital stock.

The stockholders equity section under the first method of the contraction of capital theory would appear as follows after the purchase of

---

[12] Ibid.

treasury shares.

Capital stock - 10,000 shares at $10 Par value stock authorized, issued, and outstanding of which 1,000 shares are being held in the treasury	$ 90,000
Premium on stock	9,000
Retained earnings	18,000
	$117,000

The entries for resale of the treasury shares at par, above and below par are as follows:

Sale at Par

Cash	10,000	
Capital Stock		10,000

Sale above par in the amount of $16,000.

Cash	16,000	
Capital stock		10,000
Premium on stock		6,000

Sale at less than par in the amount of $9,000.

Cash	9,000	
Premium on stock or Retained earnings	1,000	
Capital stock		10,000

For the second method under the contraction of capital approach a treasury stock account is set up and then used to report a reduction in capital stock. If using the same example as before the following entry will show the recording of a purchase of treasury shares under the second method.

Treasury stock	10,000	
Premium on stock	1,000	
Retained earnings	2,000	
Cash		13,000

The entries for the resale of treasury shares under the second method of the contraction of capital approach would be the same as were previously described except that a treasury stock account would be used in place of the capital stock account.

It should be observed that the reduction of retained earnings for the excess amount over the sum of the debits to capital stock and premium on stock is usually a permanent reduction which is not replaced by subsequent resale of the treasury shares. This follows the idea that the transaction is a distribution to the shareholder of capital, premium on stock and a portion of retained earnings.

The criticism of the first method under the contraction of capital theory is that technically the stock has not been cancelled, and therefore the stated capital is improperly understated. To avoid this objection the second method under this theory was developed. In this manner both the total legal capital stock and the par value of the shares still outstanding are shown.

TREASURY SHARES AS A CAPITAL ELEMENT AWAITING ULTIMATE DISPOSITION

The second main approach of accounting for treasury shares is to show them as though they will eventually be reissued for the purpose of financing an operation. This method also is known as the "cost of treasury shares as offset to the total of surplus and capital."[13]

---

[13] Freeman, *op. cit.*

This treatment received the approval of the American Accounting Association in its tentative statement of accounting principles in 1936. It also meets the requirements of the American Institute of Certified Public Accountants as a gain on the sale of the treasury shares does not result in income or earned surplus but rather it is a capital surplus item.

Also another important argument for this approach is that it abides with most state laws which provide that the legal or stated capital of the corporation may not be reduced by such reacquisition of a corporation's own stock. "Accordingly, purchases are limited to a company's retained earnings, or in some instances to the sum of its retained earnings and additional paid-in-capital balances, and reduce the amount that would otherwise be available for distribution of dividends."[14] In addition the Model Business Corporation Act also corresponds with this approach of accounting for treasury shares.

This approach is often referred to as the cost basis of accounting for treasury shares. By using the same example as was previously explained, the following are the accounting entries for treasury shares under the cost basis. If X Corporation purchases 1,000 shares of its own stock at a price of $13,000 the following entry would be made:

Treasury stock	13,000	
Cash		13,000

The stockholders equity section of X Corporation's Balance Sheet

---

[14]Simons and Karrenbrock, op. cit., p. 611.

would appear as follows after reacquisition of the shares and before they are resold or retired.

Capital stock - 10,000 shares at $10 Par value are authorized, issued, and outstanding of which 1,000 are being held in the treasury	$100,000
Premium on stock	10,000
Retained earnings	20,000
	$130,000
Less: Treasury stock	13,000
Total Stockholders Equity	$117,000

The following entries will exemplify the sale of treasury stock at cost, excess of cost and at a price less than cost.

Sale at Cost

Cash	13,000	
Treasury stock		13,000

Sale in excess of cost in the amount of $16,000.

Cash	16,000	
Treasury stock		13,000
Premium on stock - from the sale of treasury stock in excess of cost.		3,000

Sale at a price less than cost in the amount of $9,000.

Cash	9,000	
Premium on stock or Retained earnings	4,000	
Treasury stock		13,000

This method of accounting is very popular because of its compliance with most state statutes and it shows the amount of stated capital, as treasury stock does not return to the rank of unissued stock until it has been properly retired.

CHAPTER III

ETHICS OF CORPORATE STOCK REACQUISITIONS

The tremendous increase in corporate stock reacquisitions has brought about some questions regarding the ethics of such corporate actions. These questions pertain to legal statutes and accounting methods of recording and reporting stock reacquisitions.

What is ethics? Ethics has been defined as "the recognition of and the responsibility for the realities involved in any relationship."[15] This is an area neither completely black nor completely white.

In the area of business ethics there has been one main development which has made it necessary for the creation of a moral and ethical code. This development has been the separation of ownership and management in our modern business enterprises and which has led to the rise of the professional manager.

The relationship between ethics and the law is an interesting but often an intangible relationship. Generally it is regarded that the law rates as a minimum for ethical standards. William L. Cary makes an

---

[15] Richard A. Stevenson, "Corporate Stock Reacquisitions," Accounting Review, XLI, April, 1966, p. 312.

important distinction between ethics and the law when he writes:

> The law . . . . represents the standards currently imposed by government or quasi-governmental authority. Ethical action, on the other hand, is supposedly motivated by a self-imposed standard, rather than compelled by law. Beyond that, however, the wise counselor will assess the need for ethical restraint because he tends to view it as potential legal restraint; it might be described as 'becoming law'.[16]

When corporate directors make the decision to purchase treasury stock it should be made in the best interest of the stockholders. The two main considerations are: "(1) to see that adequate disclosure is made of the transaction and (2) to see that no conflict-of-interest situations result because of the decision to reacquire stock."[17]

The anti-fraud provisions of the Federal securities laws deal with adequate disclosure and often are used as guides by directors when deciding to reacquire stock for the treasury. The sections of the law which are very important when purchasing treasury stock are rules 10b-5, 10b-6, and 10b-7. Rule 10b-5 is concerned with manipulative and deceptive devices which influence stock prices and also requires disclosure of all material information. Rule 10b-6 deals with the magnitude of trading activity. Rule 10b-7 contains the principles to be used to stabilize the market price of stock.

An important ethical problem and one which encompasses both the

---

[16] <u>Ibid</u>.

[17] <u>Ibid</u>., p. 313.

legal and accounting questions concerning stock reacquisitions is whether the purchase should be made on the open market or by the tender method. A general tender offer involves an advance, public, and complete disclosure of the corporation's intention to purchase shares. All stockholders, presumably, therefore have equal knowledge of the situation and of the management's favorable evaluation of the market price.

When determining which method of purchasing shares is to be used, the corporate directors should consider how large a purchase will be made and the effect it will have on the market price of the remaining shares held by the public. If the reacquisition is made by a tender offer the stockholders will be better informed in regards to the price being paid and the number of shares being repurchased. Under an open market purchase the stockholders may not be as well informed of the repurchase plans and probably would not know the price per share which the company is planning to pay or the size of repurchase which the corporation's directors and management have decided upon. Since stockholders are not as well informed when the company makes its stock reacquisitions under the open market method, this would require a better and broader disclosure of the important aspects of the purchase.

No matter which accounting method is used for recording and reporting treasury stock transactions it should be carried out in a manner which will adequately inform the public of all treasury stock holdings and dealings. The financial statements should be prepared so that the effect of treasury stock holdings can easily be determined by the stockholders and the general public.

Methods of reporting subsequent events can cause many ethical questions to arise. If subsequent events are inadequately disclosed they could leave open more chances for conflict-of-interest on the part of corporate directors and other management personnel. These cases of conflict-of-interest may lead to management decisions which will privately benefit members of management rather than the corporation and the majority of its stockholders.

CHAPTER IV

CONCLUSIONS

The proper method of accounting and presentation of treasury stock has long been a matter of dispute and disagreement within the accounting profession. As was previously indicated the two main theories followed today are the: (1) contraction of capital and (2) a capital element awaiting ultimate disposition.

Important aspects of these two theories are as follows: the contraction of capital theory advocates that the capital stock account be deducted by an amount equal to par or stated value of the stock purchased. Premium on stock should be reduced by a proportionate amount for the shares purchased to the total number of shares issued. The excess of the purchase price over the debits to capital stock and premium on stock should be handled as a debit (or reduction) to retained earnings. This reduction to retained earnings is a permanent deduction and is not replaced by a subsequent sale of the treasury shares. The sale of treasury stock under this method would restore the par value amount to capital stock and to capital surplus if the sale was for an amount in excess of par value. If the sale was for an amount less than par value a debit would be made to premium from the same class of stock, and if not it would be made to retained earnings.

The capital element awaiting ultimate disposition theory advocates that a treasury stock account is to be debited for the cost of the stock reacquired. Under this theory the sale of treasury stock at a gain would establish a premium on stock account from sale of treasury stock. Sale of the treasury stock at a loss would be accounted for by debiting premium on stock from treasury stock transactions or retained earnings if the proper capital surplus account was not available.

The American Institute of Certified Public Accountants prefers the use of the "capital element awaiting ultimate disposition" theory but also accepts the "contraction of capital" theory. The American Accounting Association prefers the "contraction of capital" theory and also considers the "capital element awaiting ultimate disposition" theory as an acceptable approach. The Accounting Research Bulletins published by the American Institute of Certified Public Accounts states that:

> Apparently there is general agreement that the difference between the purchase price and the stated value of a corporation's common stock purchased and retired should be reflected in capital surplus. Your committee believes that while the net asset value of the shares of common stock outstanding in the hands of the public may be increased or decreased by such purchase and retirement, such transactions relate to the capital of the corporation and do not give rise to corporate profits or losses. Your committee can see no essential difference between (a) the purchase and retirement of a corporation's own common stock and the subsequent issue of common shares, and (b) the purchase and resale of its own common

stock.[18]

Since the two theories which have been discussed previously in this chapter are the most popular methods of accounting for treasury stock a comparison of each one's popularity would be in order. A study of six hundred corporations made for the American Institute of Certified Public Accountants, 1962 edition, of "Accounting Trends and Techniques", indicates that of three hundred and fourteen companies with common treasury stock items in the balance sheet, one hundred and ninety-nine use the "capital element awaiting ultimate disposition" theory while eight-two use the "contraction of capital" theory. Also two hundred and fourteen of the three hundred and fourteen use the cost basis of valuation while seventy-five use either par or stated value. The following table is the source of the above information and can be used to make comparisons between years, common, and preferred stock reacquisitions.

Although both theories are acceptable accounting methods, there are probably two main reasons why the "capital element awaiting ultimate disposition" theory has become the most widely used method. This theory meets the requirements of most state statutes, since most states do not allow a reduction of stated capital as the result of a purchase of

---

[18] American Institute of Certified Public Accountants. Accounting Principles Board. Accounting Research and Terminology Bulletins, Copyright 1961, p. 14.

TABLE 3[19]

REACQUISITIONS AND PRESENTATIONS IN RECENT YEARS

Balance Sheet Presentation	"Common" Treasury Stock 1962	1955	1950	"Preferred" Treasury Stock 1962	1955	1950
Within Stockholders' Equity Section:						
Deducted from total of capital stock and surplus ([a]Co. Nos. 160, 240, 421; [b]34, 335, 566)	199	124	103	34	41	36
Deducted from total of capital stock and capital surplus	--	1	1	--	--	--
Deducted from total of capital surplus and retained earnings ([a]Co. Nos. 255, 547).	2	2	1	--	--	--
Deducted from retained earnings ([a]Co. No. 534)	1	5	11	--	1	4
Deducted from issued stock of the same class ([a]Co. Nos. 24, 211, 431; [b]69, 302, 517)	82	77	97	66	48	53
Set forth with issued stock of the same class ([a]Co. No. 366) . . .	1	1	4	--	2	2
In Noncurrent Asset Section:						
Separately set forth therein ([a]Co. Nos. 9, 120, 251, 456, 588; [b]377)	13	10	10	1	1	1
Set forth therein as a part of various special funds or with other assets ([a]Co. Nos. 76, 304)	2	8	2	--	1	1

[a]Refer to Company Appendix Section
[b]Indicates preferred stock

[19]American Institute of Certified Public Accountants. Accounting Trends and Techniques, XVII, 1963, p. 134.

TABLE 3--Continued

Balance Sheet Presentation	"Common" Treasury Stock 1962	1955	1950	"Preferred" Treasury Stock 1962	1955	1950
Set forth in Notes to Financial Statements ([a]Co. Nos. 62, 115, 330; [b]117, 362,370)	14	10	6	4	8	3
Total Presentations	314	238	235	105	102	100
Basis of Valuation						
Per-share value shown at:						
Cost.	214	133	113	38	44	36
Par value	70	49	56	55	38	38
Stated value.	5	8	9	7	4	6
Cost or less than cost	2	2	2	--	--	--
Less than cost.	3	2	3	--	--	--
Carrying value.	--	--	--	1	1	--
Lower of cost or market	--	2	--	--	--	--
Liquidation value	--	--	--	1	1	1
Various other	2	--	4	1	--	1
Per-share value not shown	18	42	48	2	14	18
Total Valuations	314	238	235	105	102	100
Number of Companies presenting:						
Only "common" treasury stock . . .	251	181	182	--	--	--
Both "common and preferred" treasury stock.	59	49	48	59	49	48
Only "preferred" treasury stock . .	--	--	--	38	48	52
Total Treasury Stock	310	230	230	97	97	100
No treasury stock.	290	370	370	180	199	204
No "preferred" stock class.	--	--	--	323	304	296
Total	600	600	600	600	600	600

treasury stock. Only the state of Ohio goes along with the "contraction of capital" theory that stated capital is automatically reduced by an amount which equals the stated capital of the shares reacquired.[20] The "capital element awaiting ultimate disposition" theory also provides a more realistic presentation and disclosure of what has actually taken place in the accounts which effect the stockholders equity section of the balance sheet. This method does not reduce stated capital of the corporation but leaves it at an amount equal to the par or stated value of the issued stock. It was this reasoning which brought about the use of a treasury stock account under the "contraction of capital" theory. However, in this case the treasury stock account is an offsetting account against capital stock. This accounting method still has the effect of reducing and understating the stated capital of the corporation.

Although there has been much study and discussion in the area of proper accounting methods regarding treasury stock, it is quite apparent that ethical considerations should be receiving the same attention. These include not only the need for greater consistency in methods of disclosure, but also the avoidance of conflict-of-interest situations, and a careful evaluation of the method of repurchase in relation to the amount of stock to be reacquired.

These ethical aspects of stock reacquisitions are wide open at

---

[20] Freeman, op. cit., p. 243.

the present time. Some managements go to great lengths to properly inform stockholders and the general public that they are not in any way taking advantage of privileged information when they engage in stock reacquisitions. Others feel that there is no inherent ethical conflict between the corporation and its stockholders in the repurchase of its stock. At the present time, the Security Exchange Commission has no specific requirements concerning reacquisition of stock and the body of corporate law concerning this area is not clear regarding the potential conflict-of-interest that may exist.

A corporation in making plans to reacquire stock for the treasury should attempt to use a method of repurchase which will least affect the market value of the stock. Usually when a large purchase is being made the use of a tender offer is the best method.

If the corporate management and its Certified Public Accountant use proper methods to disclose and report such reacquisitions to the stockholders and the public, the repurchase of stock can be profitable to both the corporation and its stockholders.

BIBLIOGRAPHY

American Institute of Certified Public Accountants Accounting Principles. Accounting Research and Terminology Bulletins. Copyright 1961.

American Institute of Certified Public Accountants. Accounting Trends and Techniques. V. 11, 1957, pp. 115-119.

American Institute of Certified Public Accountants. Accounting Trends and Techniques. V. 17, 1963, pp. 133-137.

Bevis, H. W. "Earnings Per Share and the Need for Full Disclosure," Journal of Accountancy, V. 121, February, 1966, pp. 52-5.

Blough, Carman G. "Balance Sheet Presentation of Treasury Shares," Journal of Accountancy, V. 115, April, 1963, pp. 74-5.

Buttimer, Harry. "Statutory Influence on Treasury Stock Accounting," Accounting Review, V. 35, July, 1960, pp. 476-81.

Cartwright, J. "Companies Strengthen Position by Adding to Treasury Holdings," Magazine Wall Street, V. 115, January 9, 1965, pp. 396-8.

Ellis, Charles D. "Repurchase Stock to Revitalize Equity," Harvard Business Review, V. 43, July-August, 1965, pp. 119-28.

Finney, H. A. and Miller, Herbert E. Principles of Accounting Intermediate. Published by Prentice-Hall, Inc., Fifth Edition, Copyright 1958.

Freeman, Harold. "Accounting for Treasury Shares," University of Cincinnati Law Review, V. 29, Spring, 1960, pp. 235-45.

Garrett, Ray. "Treasury Shares Under the Model Business Corporation Act," The Business Lawyer, V. 15, July, 1960, pp. 916-20.

Guthart, L. A. "More Companies are Buying Back Their Stock," Harvard Business Review, V. 43, March, 1965, pp. 40-2 plus.

Lefevre, Thomas V. "How to Avoid the Pitfalls in Stock Redemptions Between Related Corporations," The Journal of Taxation, V. 22, June, 1965, pp. 332-6.

Merjos, A. "Into the Treasury; Many Corporations are Regular Buyers of Their Own Stock," Barrons, V. 44, August 17, 1964, pp. 9-10.

Musselman, D. Paul. "On the Nature of the Gain on Treasury Stock," Journal of Accountancy, V. 17, August, 1940, pp. 104-16,

Rankin, Calvin H. "Treasury Stock: A Source of Profit or Loss," Accounting Review, V. 14, March, 1940, pp. 71-7.

Rudolph, George E. "Accounting for Treasury Shares Under the Model Business Corporation Act," Harvard Law Review, V. 73, December, 1959, pp. 323-31.

Simons, Harry and Karrenbrock, Wilbert E. Intermediate Accounting. Published by South-western Publishing Company, Fourth Edition, Copyright 1964, pp. 611-18.

Sprouse, Robert T. "Accounting for Treasury Stock Transactions: Prevailing Practices and New Statutory Provisions," Columbia Law Review, V. 59, June, 1959, pp. 882-900.

Stevenson, Richard A. "Corporate Stock Reacquisitions," Accounting Review, V. 41, April, 1966, pp. 312-17.