[Journal of Accountancy](https://egrove.olemiss.edu/jofa)

Volume 53 | Issue 5 Article 9

5-1932

# Accounting Questions: Balance-Sheet Showing Change in Par Value of Stock; Transfer form Common-Capital-Stock Account to Surplus Account; Additional Charges to Cost Price of Commodities; Percentage for Factory Overhead

# Accounting Questions

[The questions and answers which appear in this section of THE JOURNAL OF ACCOUNTANCY have been received from the bureau of information conducted by the American Institute of Accountants. The questions have been asked and answered by practising accountants and are published here for general information. The executive committee of the American Institute of Accountants, in authorizing the publication of this matter, distinctly disclaims any responsibility for the views expressed. The answers given by those who reply are purely personal opinions. They are not in any sense an expression of the Institute nor of any committee of the Institute, but they are of value because they indicate the opinions held by competent members of the profession. The fact that many differences of opinion are expressed indicates the personal nature of the answers. The questions and answers selected for publication are those believed to be of general interest.—EDITOR.]

### *BALANCE-SHEET SHOWING CHANGE IN PAR VALUE OF STOCK*

*Question:* Will you kindly advise me how to treat the following items on a balance-sheet?

A corporation has an authorized and outstanding capitalization of 1,000 shares of $100 par value each. It desires to return one-half, or $50,000, in cash to its stockholders, representing one-half of the amount paid in by them for stock, and also to change the par value from $100 to $50 a share. All of this has been approved by the stockholders. The charter has been amended and has been approved by the secretary of state. At October 31, 1931, the date of the balance-sheet, nothing has been paid back to the stockholders nor has any of the stock of $100 par value been surrendered for exchange for new stock of $50 par value. I am not concerned with the income-tax question of the return of the money to the stockholders, but I should like to know how the matter should be displayed on the balance-sheet at October 31, 1931. Should it be shown as

1,000 shares par value $100 outstanding................ $100,000

or

1,000 shares par value $50 outstanding................ 50,000?

If the latter, what disposition should be made of the $50,000 that is to be returned to the stockholders?

*Answer No. 1:* As the par value of the stock has actually been reduced to $50 by the filing of a certificate with the secretary of state, in our opinion the balance-sheet should show the capital stock outstanding at $50,000, even though the certificates have not been exchanged nor has the reduction of par value been noted.

The balance-sheet should also indicate that $50,000 is to be distributed to the stockholders. As the distribution has already been authorized by the stockholders, in our opinion the amount of $50,000 should be shown as a liability, properly described.

As an alternative, a pro-forma balance-sheet may be prepared, modified to give effect to the proposed distribution. In such case it should, of course, be made clear in the heading and certificate that effect has been given to a transaction which has not as yet been consummated.

*Answer No. 2:* In our opinion, the situation may be treated in either of two ways:

(1) Present the balance-sheet on the basis of the old arrangement of capital stock and append a footnote to the effect that all necessary legal action has been taken to make a liquidating distribution of 50% of the capital stock and to reduce the par value from $100 to $50, but that the actual exchange of certificates and payment of the liquidating dividend have not yet been consummated.

(2) Give effect to the proposed alteration of capital stock by setting up as a current liability the amount of the liquidating dividend payable and by presenting in the capital-stock section a description of the shares on the revised basis. If this be done the balance-sheet should probably carry some such phrase as this: "Giving effect to reduction of capital stock by changing the par value from $100 to $50 a share, and the declaration of a liquidating dividend of $50; all legal requirements having been complied with but the exchange of certificates not yet effected."

As a matter of fact, as the actual exchange has not yet been effected we believe that the footnote explaining the situation presents the least difficulty and puts the facts fully on record.

## *TRANSFER FROM COMMON-CAPITAL-STOCK ACCOUNT TO SURPLUS ACCOUNT*

*Question:* A corporation is organized under the laws of ——— and the by-laws contain the following paragraph:

"The board of directors shall have power from time to time to fix and determine and to vary the amount of working capital of the corporation and to direct and determine the use and disposition of any surplus over and above the capital stock paid in."

The board of directors has power to allocate to surplus any sums received by the corporation from the sale of its common stock in excess of the amount allocated to capital by the board.

The corporation sells 100,000 shares of its common stock of no par or nominal value at $50 a share (the 100,000 shares being the original issue) and receives $5,000,000 in cash. It credits this $5,000,000 to common-capital-stock account, and subsequently in accordance with the foregoing by-law the board of directors authorizes the transfer of $4,000,000 from common-capital-stock account to surplus account.

In preparing a certified balance-sheet of the corporation subsequent to the date of the transfer, would an accountant be justified in showing the amount of $4,000,000 on the balance-sheet as "surplus paid in" without any comment, or showing it as "surplus arising from sale of common stock in excess of amount allocated to capital stock by directors," or should it be added back to common capital stock outstanding?

Would it alter the conditions if it were ascertained that subsequent to the date of the balance-sheet, the greater part of the $4,000,000 credited to "surplus paid in" had been disbursed to preferred stockholders in the form of dividends?

The company has no other credits to surplus.

*Answer:* We must assume that the question of legality is settled affirmatively by the extraordinary provision which allows the board of directors to "vary the amount of working capital of the corporation."

The question may be divided into two sections, one purely legal and the other accounting. The statement that the directors may from time to time vary the working capital of the company raises a legal point as to whether the term "working capital" means the actual capital of the company and whether this legally authorizes the directors to reduce or increase the capital without the usual legal formalities. We are assuming that it does so and the only point that remains is the method of stating the accounts. The question does not say how long subsequent to the paying in of $50 a share on the issued stock, the directors made the transfer of $4,000,000 to surplus, but we assume this also was justified legally. Even with these assumptions, the powers are, of course, unusual and dangerous. If the transfer to surplus was made practically concurrently with the issue of the stock, we see no objection to designating it as surplus paid in. If, on the other hand, it was made after some time had elapsed, we think it desirable that the surplus should be shown as a transfer from capital account by the board of directors, or, as suggested by the inquirer, as surplus arising from sale of common stock in excess of amount allocated to common stock by directors. We do not see how it could be debited back to the capital stock assuming the legality of the by-laws and a motion of the directors. It would not appear to us that the fact that a portion of the surplus paid in had been distributed as a dividend or applied to operating losses in accordance with the laws of the state of ——— would affect the manner in which the original credit was stated.

## *ADDITIONAL CHARGES TO COST PRICE OF COMMODITIES*

*Question:* Commodities like lead ore, coal, grain, greasy wool, coffee and pulp, purchased f.o.b. point of shipment, are subject to loss of weight in transit. Freight is paid on original gross weight, which includes moisture. Special charges, such as brokers' commissions, weighing and inspection fees, loading and unloading, etc., are incurred. The total outlay divided by the quantity actually received is the unit price which I have found recorded.

Does paragraph 55 (j) of *Verification of Financial Statements:* "If duties, freight, insurance, and other direct charges have been added, the items should be tested to ascertain that no error has been made. Duties and transit charges are legitimate additions to the cost price of goods, but no other factors should be added except in extraordinary circumstances," intend that each of the elements of cost enumerated below (even when adjusted to lower market prices) if set up in a book inventory is to be written off or is to be excluded from a computation of inventory value?

(a) Loss of weight—essence of commodity.
(b) Loss of weight—evaporation of moisture.
(c) Freight on moisture content.

(d) Moisture paid for at price of commodity.
(e) Brokers' or buyers' commissions or expenses or purchasing department expenses.
(f) Weighing and/or inspection fees.
(g) Loading and/or unloading.
(h) Hauling.
(i) Insurance—transit and/or storage.
(j) Cost of foreign exchange.
(k) Additional loss of weight after receipt—either of essence of commodity and/or of moisture.
(l) Storage charges or expenses.

*Answer:* Many commodities like those referred to are purchased today upon the basis of analysis, or if the packages contain foreign elements, they are graded and priced, so that, when the foreign elements are eliminated, the real cost of what is usable is the cost of the lot purchased.

All the items mentioned may, under conditions, enter into the cost of usable product laid down, either in the warehouse to be withdrawn, or in the plant ready for processing; and the auditor or accountant who has these elements to deal with can readily decide whether or not they are properly to be added to an initial invoice in order to bring the commodity to the point where it is to be used. This is covered by paragraph 55, if read in its broadest sense.

### *PERCENTAGE FOR FACTORY OVERHEAD*

*Question:* One of our clients has recently perfected a gas water heater. He has consulted with a manufacturing concern for the probable manufacture of his water heater. This concern has submitted certain manufacturing costs which we would like to compare with similar manufacturing concerns in the United States.

As an aid to discussion, let us suppose that these percentages submitted by the manufacturing concern are as follows:

| | |
|---|---|
| Labor | 50% |
| Material | 25% |
| Factory overhead | 25% |

Our client is particularly interested in the last, namely, factory overhead—25 per cent. Any data that you can furnish us which may be used for comparison would be very much appreciated.

*Answer:* We have gone through our files of clients in similar business and find their overhead ranges from 30 to 45 per cent. of their total manufacturing costs.

Your request states the overhead to be 25 per cent. of the manufacturing cost and also 50 per cent. of the labor cost, which, unless non-productive labor is included in labor cost, is somewhat lower than we find to be the case. Overhead, we find, runs from 60 to 75 per cent. of productive labor in a manufacturing business.

The bid may have been made to fill up a shop and to help carry a part of the overhead burden without profit during the present business depression. In that case the percentages probably are not derived from past experience.