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Accounting for dividends payable in capital stock of no par value

Anonymous

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If property is not retired from service before the expiration of its estimated average useful life, the amount of the surplus from appreciation of such property will have been extinguished upon its retirement. If, however, through obsolescence, inadequacy, or other extraordinary cause, property is retired before the expiration of the estimated average useful life, a charge should be made against surplus from appreciation in order to take out of that account the amount of the surplus from appreciation on the particular property retired which had not theretofore been taken out. If we were to be precise in determining the remaining surplus from appreciation on a given piece of equipment, we should have to find out the amount by which that particular piece of property had been appreciated and deduct from this appreciation the amount that had been charged thereto covering this particular equipment. But since we have adopted the policy of writing off the appreciation on the basis of the average rate of appreciation and the average estimated remaining life of each class of property, we shall use an average in determining the remaining surplus from appreciation in the case of property retired from service.

Before we can determine the amount to be charged against surplus from appreciation covering such property retired from service, we shall have to consider the amounts relating to machinery as a whole. Continuing with amounts used in previous examples, let us assume that:

The machinery was appraised at............		$100,000
There was accrued depreciation at the date of appraisal of..............	$50,000	
The depreciation for the ensuing year was..........................	10,000	60,000
Therefore the depreciated replacement cost at the end of the year is..........		$40,000
or 40% of the appraised replacement cost.		

It follows that if all the machinery were to be retired at that time, 40% of the appraised replacement cost would have to be written off. According to a previous example, 20% of all charges for depreciation of machinery must be made against the surplus from appreciation.

Assume that a machine with an appraised replacement cost of $500 is retired at the end of one year after the appraisal. The charge to surplus from appreciation would be computed as follows:

20% of 40% of $500, or $40

While it may not be strictly accurate to use averages in determining the charge to surplus from appreciation in the event of retirement of property before the expiration of its estimated useful life, this method seems to be the only practicable one and is sufficiently accurate.

Accounting for Dividends Payable in Capital Stock of No Par Value

ALTHOUGH the nature of a stock dividend payable in par-value stock has been questioned from time to time, the accounting entries necessary to record such transactions never have occasioned any difficulty. In the case of a stock dividend payable in stock without par value, however, there is some doubt as to the amount of surplus, if any, to be transferred to the capital account.

The purposes for which a stock dividend is declared are not always clear. Presumably a certain portion of the accumulated profits is to be capitalized. It may be that the stock carries too high a market value for trading purposes and new stock is distributed to reduce each share's proportionate part of the total equity. Or it may be that the directors do not care to pay out a cash dividend, and so a stock dividend is declared. Regardless of purpose, the effect of a stock dividend payable in par-value stock always is to reduce the amount of surplus available for future cash dividends by capitalizing an amount of surplus equivalent to the total par value of the stock paid out. This, however, is not necessarily true of dividends payable in stock without par value.

Just as with other matters concerning

no-par stock, the treatment of no-par stock dividends in the accounts depends in part upon the laws of the state involved. In those states providing for a stated value upon stocks with no par value, such stated value would, for the present purpose, be analogous to par value. The proper amount of surplus to be transferred to capital under these circumstances would seem to be the stated value per share times the number of shares distributed.

There may be some doubt as to whether this entry is required in case the board of directors already has transferred a sufficient amount of surplus so that the stated capital is equivalent to or exceeds the aggregate stated values of all the shares outstanding after the dividend distribution is made. In the absence of a provision for stated values, it would seem that the board of directors could transfer any amount, or no amount, of surplus to stated capital, especially in view of the fact that boards of directors have considerable power in determining the prices at which no-par-value shares shall be issued and in some instances have the power to determine how the consideration received shall be allocated as between capital and surplus. In case no amount is transferred, however, the question might be raised as to whether the legal requirements have been met concerning the consideration received for the dividend shares.

Although it seems desirable that some amount of surplus should be capitalized when no-par-value shares are issued as a dividend, there still remains the matter of selecting the method of ascertaining this amount to be transferred to capital. Among the methods which have been suggested are those based on market value, book value, and the average consideration received from previous sales of no-par stock.

Assume a corporation with $500,000 capital, a surplus of $120,000, and 10,000 shares of no-par-value stock outstanding having a market value of $75 a share. A stock dividend of 2,500 shares is declared. To transfer an amount of surplus to capital equivalent to the market value of the new shares issued would not be feasible because of insufficient surplus. The number of shares, 2,500, times the market value a share, $75, is $187,500, while only $120,000 of surplus exists. The same objection holds for the book-value method. In this case the book value is $62 a share, the book value of 2,500 shares being $155,000. Neither market value nor book value can be defended for all instances, because both values change as soon as additional shares have been issued.

Suppose the 10,000 shares had been issued in three blocks, 5,000 shares at $40 a share, 3,000 shares at $56, and 2,000 shares at $66. The average consideration received is $50 a share. To use this figure as the basis for capitalizing surplus would seem to be logical since it is an effort to maintain the same capital value for each share. But even then, as in this case, it cannot be certain that the surplus will be adequate. Furthermore, there may have been interim transfers of surplus to capital so that the capital value of each share exceeds the average consideration received per share. Or, as is permissible in some states, all of the consideration received may not have been allocated to capital. In general, it seems that the amount of surplus to be capitalized should be an amount which would maintain the capital value of each share at approximately the same figure.

The board of directors has the power to capitalize any arbitrary amount of surplus limited only by the amount of surplus available, or, as has been stated above, no amount need be capitalized. The latter procedure is based on the assumption that since no new capital has come into the company, no money entry should be made. Under this theory, the capital account would consist of all actual capital contributions and nothing more. However, in such instance, a stockholder may not dispose of the additional shares received as a dividend without jeopardizing his original investment which is repre-

sented in the capital stock account, because the undiminished surplus may be drawn upon for future cash dividends.

No single method for determining the amount of surplus which should be capitalized when a no-par stock dividend is declared, can be advocated which would be appropriate in all instances. Each case must be treated in the light of the specific facts applicable thereto. If the laws of the state have been complied with, and the action of the board of directors has been in harmony therewith, the accountant can offer his opinion as to what he considers the best procedure for handling no-par-value stock dividends in the accounts, but he cannot insist that any other action be taken.

Book Review

Hatfield, Henry Rand. *Accounting.* (New York, D. Appleton and Company, 1927. 548 p.)

It would indeed be with regret that one would give up such a friend as Hatfield's *Modern Accounting*, if it were not for the fact that *Accounting*, its supplanter, is written by the same author. *Modern Accounting*, published in 1909, was one of the earliest American contributions to accounting literature presenting the theory of accounts as distinguished from bookkeeping technic. That, eighteen years later, this volume should still maintain its high position in the literature of accounting, is sufficient evidence that the frequent reference to this work as an "accounting classic" is well merited.

Accounting is, in some measure, a revision of the author's earlier book. The last two decades, however, have been so fruitful in the progress which has been made that this later volume must be considered something more than an ordinary revision. The author has extended his comments on many of the matters discussed therein and also has introduced new material in two chapters on the consolidated balance sheet and the interpretation of the balance sheet respectively. The introductory chapters on the theory of double entry bookkeeping have been omitted in the present volume.

The book is not an elementary one. It does not attempt to treat the mechanics of bookkeeping. The author has presented the problems of current accounting practice in a dispassionate, rather than argumentative, manner. In view of the fact that there is no uniformity of opinion upon many questions, the author's purpose is, as quoted from the preface to the earlier publication, " . . . to show the existing variations rather than to attempt to formulate rigid rules. The comparative study of accounting practice will, perhaps, be a greater service to accounting science than a more dogmatic treatise." Professor Hatfield accordingly has drawn freely from current practice for his illustrations. The frequent citation of court decisions, the numerous references to other writers, European and American, and to the legal provisions of the European countries, give one the feeling that nothing has been left undone to make the work a thorough one. The tolerant attitude which Professor Hatfield exhibits toward differences of opinion is soothing when compared with arbitrary statements of others that the only correct procedure in a given instance is thus and so.

The theoretical argument, as given on page 162, that depreciation might be considered a function of profits is interesting indeed, especially in the light of the efforts which have been made to eliminate this procedure in practice. As Professor Hatfield later points out, accountants are agreed that to charge off more depreciation in prosperous years and less when profits are less is improper.

Chapters X, XI, and XII on profits and dividends are noteworthy indeed. The argument in favor of permitting a corporation operating wasting assets to pay