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## Classification

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Law (Section 664, as amended by L. 1924, Chapter 221) makes the act of purchasing stock a misdemeanor when the stock is purchased in the absence of surplus, viz.:

"A director of a stock corporation, who concurs in any vote or act of the directors of such corporation, or any of them, by which it is intended . . . to apply any portion of the funds of such corporation, except surplus, directly or indirectly, to the purchase of shares of its own stock, is guilty of a misdemeanor."

Delaware, the arch-crusader for freedom of corporate action, has drawn her law without specific reference to surplus, but apparently with the same effect:

"Every corporation under this chapter shall have the power to purchase, hold, sell and transfer shares of its own capital stock, provided that no such corporation shall use its funds or property for the purchase of its own shares of capital stock when such use would cause any impairment of the capital of the corporation."

The Ohio statutes are more definite. They provide as follows:

"A corporation may purchase shares of any class issued by it: . . . (c) To the extent of the surplus of the aggregate of its assets over the aggregate of its liabilities plus stated capital, when authorized by the affirmative vote of the holders of two-thirds of each class outstanding, . . . . A corporation shall not purchase its own shares except as provided in this section, nor when there is reasonable ground for believing that the corporation is unable, or by such purchase, may be rendered unable to satisfy its obligations and liabilities."

In the Ohio statutes, the purpose of the restrictive provision is made clear. Surplus is defined. The danger of permitting other procedure is indicated in the reference to creditors. The intent obviously is to prevent stockholders from withdrawing their capital in a form which is liquid, unless such liquidity is the result of their own efforts, and not something advanced by creditors. If cash, or other current assets, in excess of the amount of surplus, were used to buy the stock of the corporation, current creditors might be left with only physical property or other assets of questionable value available to satisfy their claims.

Two principles logically may be advocated on the foregoing grounds in connection with the purchase by a corporation of its own capital stock: first, the stock so acquired should be treated as an adjustment of the capital stock account, and not as an asset; second, that an amount equal to the purchase price be transferred out of surplus, and be made unavailable for appropriation as dividends.

Various problems are created in practice by different kinds and classes of capital stock and by corporate and accounting practices. Some capital stock has par value. Other stock has no par value. Preferred stocks have various features which raise serious questions concerning the respective positions of preferred and common shareholders in relation to surplus. Common capital stock sometimes is acquired by donation. Both preferred and common stocks may be purchased at either a premium or a discount. Some of the problems attending these matters will be discussed in an article to follow in the next Bulletin.

## Classification

**C**LASSIFICATION comes to the fore again because of consideration which it has had and is to have by the two national accountancy bodies, namely, The

American Society of Certified Public Accountants and the American Institute of Accountants.

The latter body, after deliberating on the matter for five years, has decided, through the action of its council, not to adopt any classification at this time and the officers of the Institute have been instructed to prepare for publication a statement setting forth the reasons for such action.

The American Society of Certified Public Accountants, through its board of directors, has several times approved the principle of classification and through the distribution of reports of its Committee on Classification has attempted to inform the practicing accountants of the country through their various state societies. Further, The American Society of Certified Public Accountants has made a place on the program at the forthcoming convention, in order that the subject of classification and certification may be presented in open meeting and discussed by the members present.

It would be too much to expect or to hope that accountants at large would adopt any classification without due consideration. Generally speaking, accountants are thoughtful individuals who reach conclusions and have opinions. With such a large number of individuals thinking about a matter, it is natural that opinions should differ. It is natural, too, that individuals whose opinions have reached the stage of conviction should contend for their opinions.

No good could have come of hasty action concerning classification. But this possibility already has been removed, because deliberations concerning classification have been well seasoned with research, and the experience of trial, error, and correction. It is amazing to have classification brushed aside by some as being theoretical when it is based on a careful study of five thousand actual engagements. It is astounding that any one should cast aspersions upon classification as being impracticable when it has been successfully tried out on twenty-five

thousand additional engagements. Where is the individual whose opinion, unsupported by research and test, may be put forth convincingly in opposition to classification which has resulted from such practical measures? Where is the practitioner who, without investigation or thought, has the assurance to dismiss the subject of classification because some one tells him it is a fancy?

This organization needs no sales talk on the subject of classification. It has long since adopted a classification which works successfully day in and day out and brings contentment to the organization. Further, this organization was under no duty to offer its classification to the profession at large. In so doing, it was motivated by a desire to help the profession. In other words, having found something which was helpful to itself, this organization was glad to pass it on to other members of the profession who might see in classification the many advantages which it has.

But inasmuch as this organization has made public its classification and various and sundry individuals, firms, state societies, etc., have the matter under consideration, this firm feels that it has a further duty to gather and, in turn, spread all possible information on the subject.

Probably the outstanding advantage of classification is that it permits of a definite understanding with the client, before the service is begun, of the character and scope of the work. Secondly, it affords a basis for the development of detailed procedures under the different types of service. Thirdly, it provides a common language concerning the services of certified public accountants for the benefit of the accountants, their clients, bankers, lawyers, appraisers, engineers, etc., etc. If these advantages were not sufficient, there might be added a further one, namely, that classification will help to educate the accountants already in the profession as well as students who are preparing to enter the profession from the various schools.