Journal of Accountancy

Volume 37 | Issue 2 Article 2

2-1924

No Par Value Stock

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The subject of *No Par Value Stock* and its attendant problems has been before accountants and business men for several years and has resulted in a considerable amount of discussion with no very definite conclusions. Up to the present no clear statement has been made setting forth the problems requiring solution in the proper treatment of no par stock.

Before proceeding with a discussion of the problems, let us attempt to determine what they are and how they arise.

In order to approach the subject more directly let us eliminate from consideration no par stock with preference as to principal. It seems to me that the association of the two terms is anomalous and the fact that certain shares have a value which must be paid upon liquidation before anything can be paid on other shares, in effect gives the preference shares a par value and they should be so treated.

What, then, is the essential difference between non-preference shares having a par value and similar shares having no par value, and what problems does this difference create for the accountant?

A search for this supposed difference must result in the conclusion that there is, in reality, none and that consequently the mere issuance of no par stock instead of par value stock does not in itself create any problem for the accountant or warrant different procedure.

The share of no par value stock is a certificate of ownership of one aliquot part of the net assets of a corporation. The share with par value is just that. Both are supposedly issued for value. The par value stock is issued for cash or property to the amount of its face. The value of the cash or property for which the no par value stock is issued immediately attaches itself to the shares.

The capital stock account in either case should represent the value of the assets acquired in consideration for the issue of stock. There is an exception, of course, in the case where a company with par value stock receives cash or property of a value in excess of the face value of shares. If the actual values are to be recorded on the books, this situation necessitates a credit to capital surplus. Such necessity does not exist in respect to companies having no par stock, as there is no arbitrary dollar mark to set a line of demarcation for excess values.

Right here, however, a difficulty has been created, not by the issuance of stock without par value, but by the wording of some of the laws authorizing its issue. Some legislators have not been able to divorce their minds entirely from the old idea of a fixed value attaching to each share of stock. Consequently they have, in some states, written into the law the requirement for "stated value" or "stated capital."

In reflecting this requirement on the books and statements of corporations, two distinct theories have been followed by accountants. The first theory has been that the stated capital requirement in effect gave the so-called no par value stock a par value. Accordingly capital contributions in excess of the stated capital have been credited to surplus. The second theory, and to my mind the more sound, was that this requirement was intended merely to fix a minimum amount which creditors might rely upon being retained in the business. In accordance with this theory all capital contributions have been credited to capital stock, the amount of stated capital being only noted on statements as an item of information.

This appears to me to be the proper procedure. I cannot advocate separating the original contribution of capital in ordinary cases into two parts and styling one part capital and the other surplus. One of the advantages that no par stock offers is the avoidance of this necessity.

The use of the term "stated capital" and the recognition of the amount stated as a separate item on the financial books of many corporations, has resulted in crediting much of the original contribution of capital to surplus account and the subsequent merging of surplus so created with earnings. This has in some instances been followed by the payment of dividends out of the surplus which represented original capital.

Apart from the interpretation which may be placed upon the "stated capital" provision of some of the no par statutes, there seems to be little argument that may be offered to support such a division of original capital.

The theory on which the stock of no par value is issued is that a share of stock represents one aliquot part of the net assets of a corporation. If each share represents one aliquot part, then all of the shares represent the entire net value of the assets contributed for the purposes of the business, together with all of the undistributed earnings.

Some accountants have gone so far, in recognition of this theory, as to show the no par value stock at a value including the entire net worth of the business without segregation of the earned surplus. In so doing the accountant is failing to give all of the facts in relation to the net worth which it is his duty to show.

The duties of an accountant in preparing a balance-sheet of a corporation are:

1—To show the actual assets and all liabilities in significant groups and systematically arranged.

2—To exhibit the net worth in such manner that the portion available for dividends may be distinguished from that portion which represents a more or less permanent investment of stockholders.

Though the laws of some states apparently allow the payment of dividends out of paid-in surplus and out of the capital contributed in excess of "stated capital," it is none the less true that a sound financial policy usually requires that dividends be paid only from earned surplus. It is, therefore, incumbent upon the accountant to show the balance of earned surplus as a distinct division of net worth.

In the event that there is an actual operating deficit it is still desirable to show the contributed capital separately and to deduct therefrom the deficit from operations, clearly stated as such.

The necessity for clearly defining the contributed capital on the balance-sheet is emphasized in Ohio, where, I understand, the law forbids the payment of dividends from any fund received from the sale or disposition of capital stock.

I have thought it best, at the beginning of this discussion, to stress the simplicity which attaches to the construction or set-up of no par stock, and to convey the thought to you that the real difficulty, if any exists, is in preserving a definite separation between contributed capital and earned capital.

The use of "stated capital" on the books and in statements with a consequent credit to surplus for a part of the contributed capital, has not helped in keeping this proper distinction but, to my mind, no great harm will be done if "stated capital" is employed so long as it is grouped with the capital surplus on the statement and the combined total is shown as the contributed capital. However, I cannot see that any useful purpose is served in dividing the original capital.

It is true that many business men advocate showing an initial surplus because to their mind the word "surplus" carries with it a sense of strength in connection with a balance-sheet. This is not warranted as it is the amount of capital in the business which gives strength to the financial position and not the amount of such capital which is called surplus.

If my observations have been correct, most of the difficulties, which have been experienced by accountants in their contact with corporations having stock without par value, will be readily solved by following the principle of definitely separating contributed capital from earned capital. It matters little whether or not the contributed capital is separated into stated capital and capital surplus, so long as they remain intact and both are considered as permanent contributions for the uses of the business and provided they are so grouped on the balance-sheet that no confusion exists as to what constitutes contributed capital and earned surplus.

I have been asked to touch briefly on the situations created by the use of stock of no par value in reorganizations.

Reorganizations, I assume, is meant to include those changes in corporate organizations which only involve the issue of no par value stock in place of par value stock previously outstanding. This may be termed an internal reorganization. No great difficulty should be experienced in such a case. The amount of preferred stock, if any, should be shown under capital at its par or redemption value. The common no par stock should be shown at the same value as the stock it replaced, unless the terms of its issue included a transfer of an additional amount from surplus to capital, in which event the higher value should be shown. Any existing capital surplus should be included under capital and the undistributed earned surplus shown separately.

Care should be exercised by attorneys and accountants in drawing up papers in connection with proposed reorganizations, to see that ridiculous situations do not arise. There does not seem to be any good reason for the issuance of preferred stock without par value even though the laws of some states permit it. Difficulties may arise in cases where the stated value absorbs all or the bulk of accumulated surplus. In the event of subsequent losses the corporation may find itself in the position of having thereby depleted its stated capital. While under the laws of certain states a corporation might legally distribute as dividends the excess of assets over liabilities plus its stated capital, any reduction of that amount would make the directors liable for having paid dividends out of capital.

In reorganizations which involve the formation of a new corporation with or without a substantial change in capitalization, the situation confronting the accountant seems in no essential particular to differ from that involved at the incorporation of a new enterprise.

The problem, if any, is not one created by any peculiarity inherent in no par value stock. The aim of the accountant should be to show the initial capital contribution in such a manner that it will be possible, at a later date, to differentiate between such capital and earnings subsequent to reorganization.

As in the case of a new enterprise, it is preferable to credit all of the capital contributed at reorganization to the capital stock account but if a part is credited to surplus, this surplus must be definitely shown as capital surplus and not be merged at a later date with earnings.

There are conditions, however, in some reorganizations which justify an initial surplus available for dividends. Where two or more companies with an earned surplus decide to merge without any material change except merging the capital of the several corporations, it would appear that as the new company is merely continuing the existence of its predecessors, its stockholders do not, by the mere fact of merger, transfer their accumulated earnings to a permanent investment status.

In such a case the same procedure as advocated in internal reorganizations should be followed. The combined capital stock accounts and capital surplus, if any, of the underlying companies should be shown as the capital stock of the new company and the combined earned surplus should be specifically shown as initial earned surplus.

It is apparent, however, that the merger agreement under which the consolidation of such companies is effected should provide specifically for the creation of this initial surplus available for dividends.

A study of the so-called problems raised by the issue of no par value stock forces the conclusion that these problems, if they exist, are susceptible of solution through the application of simple accounting principles mingled with a little common sense.

A study of the practice of corporations with such stock, however, shows that in many cases neither one nor the other has been applied. I have seen the statement of one corporation in which the no par value stock was stated on its balance-sheet in several divisions, each division purporting to show the purpose and value at which a block of stock had been issued. This division is useless and has no value. After the issue of successive lots of no par stock, the consideration or purpose for which they were issued possesses little interest. They are all equally entitled to a share in the company's profits and assets. The essential requirement is that they shall have been issued for value. It is, then, immaterial whether the property acquired was cash, stock in other companies, franchises or physical property.

To illustrate the lack of simple common sense in the use of no par stock, I may cite a case which has been drawn to my attention.

A corporation previously having stock of par value had been in the habit of declaring stock dividends monthly with a consequent transfer from surplus to capital stock. The corporation later changed the form of its capitalization to no par stock. It continued the payment of dividends in stock of the new type but in the resolution authorizing such payment no provision was made for a transfer from surplus to capital stock. It is apparent that the payment of a stock dividend in such a case was meaningless and that the stock issued thereunder was issued without value. As it was given to the existing stockholders, the only effect was to dilute their holdings. The principal aim usually sought in the declaration of stock dividends, namely, the transfer of earned surplus to permanent capital, was not achieved in this case.

I have here a considerable number of statements of corporations having stock of no par value. Some of them bear the certification of prominent accounting firms. It may be of interest to call your attention to the different methods employed on these statements in showing capital and surplus.

Out of a total of thirty-six published financial statements of corporations with stock of no par value there does not seem to have been any attempt in fifteen to segregate earned surplus. In the majority of these cases there will be found two divisions only, viz., capital and surplus. On thirteen of these statements it would appear that earned surplus had been clearly set out as such.

On the balance of the statements there are some terms which at least, in the absence of further information, are subject to criticism because of their ambiguity.

Case 1

Surplus	
Capital surplus	$62,895,360.00
Further surplus	63,532,976.11

It appears doubtful, in view of the fact that this is a recent consolidation of several companies, that the amount shown as "further surplus" represents undistributed net income since the date of merger.

Case 2

Surplus
General surplus
Appropriated surplus

Inasmuch as the opening balance in the surplus account accompanying this balance-sheet reads "Balance, January 28, 1922, amended by recapitalization consummated September 11, 1922" it may be inferred that "general surplus" above does not wholly reflect earned surplus.

Case 3

Stated capital	$25,500,000.00
Represented by	
75,000 shares 7% cumulative preferred stock, par value $100 each (whereof 14,850 shares have been acquired for retirement) and	
360,000 shares of common stock without nominal or par value. (Out of the authorized issue of 500,000 shares 140,000 shares are reserved for subsequent issue.)	
14,850 shares of 7% cumulative preferred stock, par value $100 each, acquired out of surplus in accordance with provisions of certificate of incorporation and held for retirement	1,485,000.00
	$24,015,000.00
Surplus, including surplus represented by preferred stock acquired for retirement	3,225,796.87

Case 4

Capital stock (without nominal or par value)			
Authorized	3,000,000	shares	
Unissued	196,428	"	
Issued and outstanding	2,803,572	"	
Stated capital			$15,000,000.00
Capital surplus (from conversion of bonds, exchange of stock and acquisition of mining property) less capital distributions			88,341,083.37
Property surplus (stated value of discovery ore)			12,883,524.00
			116,224,607.37
Earned surplus (after deducting depletion)			15,304,985.40

This is an example of the allocation of capital or capital surplus to specific property or values acquired. It will be noted that earned surplus is clearly designated.

Case 5

Capital and surplus	
Class "A" stock, no par value, 100,000 shares	$ 5,000,000.00
Common stock, no par value, 200,000 shares	11,080,201.61

It is evident that this latter amount includes the earned surplus.

Case 6

Capital stock and surplus
- Preferred stock
- Common stock
- Initial surplus, February 15, 1922
- Current surplus as per statement attached

It is very clear from the accompanying statement of current surplus that the amount shown on the balance-sheet represents earned surplus, less distribution, since the date of organization of the company, February 15, 1922, to close of the year.

Case 7

Capital stock		
7% cumulative convertible preferred stock		
(Par value of shares $100 each)		
Authorized	$ 7,000,000.00	
Unissued	765.00	
Issued	6,999,235.00	
Converted into common stock	2,000.00	
Outstanding		$ 6,997,235.00

Common stock without par value				
Authorized		3,000,000	shares	
Unissued		1,767,224⅗	"	
Issued		1,232,775⅖	"	
Reserved for undeposited shares of Atlantic Petroleum Corporation		544	"	
Outstanding		1,232,231⅖	"	35,820,250.38
Surplus				
Unrealized portion of surplus arising from appreciation in value of oil reserves		$ 9,356,613.41		
Surplus arising from operations				
Balance, Dec. 31, 1922	$14,377,531.39			
Net earnings, six months to June 30, 1923, after deducting dividends	2,501,599.11			
	16,879,130.50			
Deduct proportion applicable to stock of subsidiary companies held by public	24,469.79	16,854,660.71		26,211,274.12

Case 8

Capital stock and surplus	
Preferred capital stock, 7% cumulative, authorized and issued, 150,000 shares of $100 each	$15,000,000.00
Common capital stock, authorized and issued, 500,000 shares of no par value and $2,250,000 apportioned to meet charter requirements as to stated capital and surplus	9,301,381.12
	$24,301,381.12

No segregation of earned surplus.

Case 9

Capital, less deficit		
Capital stock		
Preferred 30,000 shares, $100 par		$ 3,000,000.00
Common 876 shares, $100 par	$ 87,600.00	
Common 154,149 shares, no par stated value	10,307,566.09	
Common stock equity before deficit	10,395,166.09	
Deficit, June 30, 1923	3,853,249.25	
Common stock equity after deficit		6,541,916.84
Net worth		$ 9,541,916.84

Case 10

Capital stock and surplus	
Preferred—authorized 70,000 shares of no par value, issued and outstanding, 66,115 shares	$ 7,933,800.00
Common—authorized 150,000 shares of no par value, issued and outstanding 115,700 shares and surplus	8,203,655.66
	16,137,455.66
Capital surplus arising from appraisal of properties	1,890,953.15

No segregation of earned surplus.

Case 11

Capital stock	
Debenture stock 7%	$32,181,600.00
Debenture stock 6%	60,801,000.00
Preferred stock 6%	16,183,400.00
Common stock, no par value—20,646,327 shares issued and outstanding at $10 per share	206,463,270.00
Common stock ($100 par value)	700.00
Total capital stock	315,629,970.00
Surplus over and above $10 per share of no par value common stock	116,198,598.48