

13.3: Analyze and Record Transactions for the Issuance and Repurchase of Stock

Chad and Rick have successfully incorporated La Cantina and are ready to issue common stock to themselves and the newly recruited investors. The proceeds will be used to open new locations. The corporate charter of the corporation indicates that the par value of its common stock is \$1.50 per share. When stock is sold to investors, it is very rarely sold at par value. Most often, shares are issued at a value in excess of par. This is referred to as issuing stock at a premium. Stock with no par value that has been assigned a stated value is treated very similarly to stock with a par value.

Stock can be issued in exchange for cash, property, or services provided to the corporation. For example, an investor could give a delivery truck in exchange for a company's stock. Another investor could provide legal fees in exchange for stock. The general rule is to recognize the assets received in exchange for stock at the asset's fair market value.

Typical Common Stock Transactions

The company plans to issue most of the shares in exchange for cash, and other shares in exchange for kitchen equipment provided to the corporation by one of the new investors. Two common accounts in the equity section of the balance sheet are used when issuing stock—Common Stock and Additional Paid-in Capital from Common Stock. Common Stock consists of the par value of all shares of common stock issued. **Additional paid-in capital** from common stock consists of the excess of the proceeds received from the issuance of the stock over the stock's par value. When a company has more than one class of stock, it usually keeps a separate additional paid-in capital account for each class.

Issuing Common Stock with a Par Value in Exchange for Cash

When a company issues new stock for cash, assets increase with a debit, and equity accounts increase with a credit. To illustrate, assume that La Cantina issues 8,000 shares of common stock to investors on January 1 for cash, with the investors paying cash of \$21.50 per share. The total cash to be received is \$172,000.

$$8,000 \text{ shares} \times \$21.50 = \$172,000 \quad 8,000 \text{ shares} \times \$21.50 = \$172,000$$

The transaction causes Cash to increase (debit) for the total cash received. The Common Stock account increases (credit) with a credit for the par value of the 8,000 shares issued: $8,000 \times \$1.50$, or \$12,000. The excess received over the par value is reported in the Additional Paid-in Capital from Common Stock account. Since the shares were issued for \$21.50 per share, the excess over par value per share of \$20 ($\$21.50 - \1.50) is multiplied by the number of shares issued to arrive at the Additional Paid-in Capital from Common Stock credit.

$$(\$21.50 - \$1.50) \times 8,000 = \$160,000 \quad (\$21.50 - \$1.50) \times 8,000 = \$160,000$$

JOURNAL			
Date	Account	Debit	Credit
Jan. 1	Cash	172,000	
	Common Stock		12,000
	Additional Paid-in Capital from Common Stock		160,000
	<i>To record the issuance of \$1.50 par value common stock for cash</i>		

Issuing Common Stock with a Par Value in Exchange for Property or Services

When a company issues stock for property or services, the company increases the respective asset account with a debit and the respective equity accounts with credits. The asset received in the exchange—such as land, equipment, inventory, or any services provided to the corporation such as legal or accounting services—is recorded at the fair market value of the stock or the asset or services received, whichever is more clearly determinable.

To illustrate, assume that La Cantina issues 2,000 shares of authorized common stock in exchange for legal services provided by an attorney. The legal services have a value of \$8,000 based on the amount the attorney would charge. Because La Cantina's stock is not actively traded, the asset will be valued at the more easily determinable market value of the legal services. La Cantina must recognize the market value of the legal services as an increase (debit) of \$8,000 to its Legal Services Expense account. Similar to recording the stock issued for cash, the Common Stock account is increased by the par value of the issued stock, $\$1.50 \times 2,000$ shares, or \$3,000. The excess of the value of the legal services over the par value of the stock appears as an increase (credit) to the Additional Paid-in Capital from Common Stock account:

$$\$8,000 - \$3,000 = \$5,000 \quad \$8,000 - \$3,000 = \$5,000$$

JOURNAL			
Date	Account	Debit	Credit
Jan. 1	Legal Services Expense Common Stock Additional Paid-in Capital from Common Stock <i>To record the issuance of \$1.50 par value common stock in exchange for legal services provided</i>	8,000	3,000 5,000

Just after the issuance of both investments, the stockholders' equity account, Common Stock, reflects the total par value of the issued stock; in this case, \$3,000 + \$12,000, or a total of \$15,000. The amounts received in excess of the par value are accumulated in the Additional Paid-in Capital from Common Stock account in the amount of \$5,000 + \$160,000, or \$165,000. A portion of the equity section of the balance sheet just after the two stock issuances by La Cantina will reflect the Common Stock account stock issuances as shown in Figure 14.4.

LA CANTINA Partial Stockholders' Equity Section of the Balance Sheet For the Month Ended December 31, 2020	
Stockholders' Equity	
Common Stock, \$1.50 par value, 20,000 shares authorized, 10,000 issued and outstanding	\$ 15,000
Additional Paid-in Capital from Common Stock	165,000

Figure 14.4 Partial Stockholder's Equity for La Cantina. (attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license)

Issuing No-Par Common Stock with a Stated Value

Not all stock has a par value specified in the company's charter. In most cases, no-par stock is assigned a stated value by the board of directors, which then becomes the legal capital value. Stock with a stated value is treated as if the stated value is a par value. Assume that La Cantina's 8,000 shares of common stock issued on June 1 for \$21.50 were issued at a stated value of \$1.50 rather than at a par value. The total cash to be received remains \$172,000 (8,000 shares × \$21.50), which is recorded as an increase (debit) to Cash. The Common Stock account increases with a credit for the stated value of the 8,000 shares issued: 8,000 × \$1.50, or \$12,000. The excess received over the stated value is reported in the Additional Paid-in Capital from Common Stock account at \$160,000, based on the issue price of \$21.50 per share less the stated value of \$1.50, or \$20, times the 8,000 shares issued:

$$(\$21.50 - \$1.50) \times 8,000 = \$160,000 \quad (\$21.50 - \$1.50) \times 8,000 = \$160,000$$

The transaction looks identical except for the explanation.

JOURNAL			
Date	Account	Debit	Credit
Jan. 1	Cash Common Stock Additional Paid-in Capital from Common Stock <i>To record the issuance of \$1.50 stated value common stock for cash</i>	172,000	12,000 160,000

If the 8,000 shares of La Cantina's common stock had been no-par, and no stated value had been assigned, the \$172,000 would be debited to Cash, with a corresponding increase in the Common Stock account as a credit of \$172,000. No entry would be made to Additional Paid-in Capital account as it is reserved for stock issue amounts above par or stated value. The entry would appear as:

JOURNAL			
Date	Account	Debit	Credit
Jan. 1	Cash Common Stock <i>To record the issuance of no-par common stock for cash</i>	172,000	172,000

Issuing Preferred Stock

A few months later, Chad and Rick need additional capital to develop a website to add an online presence and decide to issue all 1,000 of the company's authorized preferred shares. The 5%, \$8 par value, preferred shares are sold at \$45 each. The Cash account increases with a debit for \$45 times 1,000 shares, or \$45,000. The Preferred Stock account increases for the par value of the preferred stock, \$8 times 1,000 shares, or \$8,000. The excess of the issue price of \$45 per share over the \$8 par value, times the 1,000 shares, is credited as an increase to Additional Paid-in Capital from Preferred Stock, resulting in a credit of \$37,000.

$$(\$45 - \$8) \times 1,000 = \$37,000$$

The journal entry is:

JOURNAL			
Date	Account	Debit	Credit
Jan. 1	Cash	45,000	
	Preferred Stock		8,000
	Additional Paid-in Capital from Preferred Stock		37,000
	<i>To record the issuance of \$8 par value preferred stock for cash</i>		

Figure 14.5 shows what the equity section of the balance sheet will reflect after the preferred stock is issued.

LA CANTINA	
Partial Stockholders' Equity Section of the Balance Sheet	
For the Month Ended December 31, 2020	
Stockholders' Equity	
5% Preferred Stock, \$8 par value, 1,000 shares authorized,	
1,000 shares issued and outstanding	\$ 8,000
Additional Paid-in Capital from Preferred Stock	37,000
Common Stock, \$1.50 par value, 20,000 shares authorized,	
10,000 shares issued and outstanding	15,000
Additional Paid-in Capital from Common Stock	165,000
Retained Earnings	xx

Figure 14.5 Partial Stockholders' Equity for La Cantina. (attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license)

Notice that the corporation presents preferred stock before common stock in the Stockholders' Equity section of the balance sheet because preferred stock has preference over common stock in the case of liquidation. GAAP requires that each class of stock displayed in this section of the balance sheet includes several items that must be disclosed along with the respective account names. The required items to be disclosed are:

- Par or stated value
- Number of shares authorized
- Number of shares issued
- Number of shares outstanding
- If preferred stock, the dividend rate

Treasury Stock

Sometimes a corporation decides to purchase its own stock in the market. These shares are referred to as treasury stock. A company might purchase its own outstanding stock for a number of possible reasons. It can be a strategic maneuver to prevent another company from acquiring a majority interest or preventing a hostile takeover. A purchase can also create demand for the stock, which in turn raises the market price of the stock. Sometimes companies buy back shares to be used for employee stock options or profit-sharing plans.

THINK IT THROUGH

Walt Disney Buys Back Stock

The **Walt Disney Company** has consistently spent a large portion of its cash flows in buying back its own stock. According to *The Motley Fool*, the **Walt Disney Company** bought back 74 million shares in 2016 alone. Read the [Motley Fool article](#) and comment on other options that **Walt Disney** may have had to obtain financing.

Acquiring Treasury Stock

When a company purchases treasury stock, it is reflected on the balance sheet in a contra equity account. As a contra equity account, Treasury Stock has a debit balance, rather than the normal credit balances of other equity accounts. The total cost of treasury stock reduces total equity. In substance, treasury stock implies that a company owns shares of itself. However, owning a portion of one's self is not possible. Treasury shares do not carry the basic common shareholder rights because they are not outstanding. Dividends are not paid on treasury shares, they provide no voting rights, and they do not receive a share of assets upon liquidation of the company. There are two methods possible to account for treasury stock—the cost method, which is discussed here, and the par value method, which is a more advanced accounting topic. The cost method is so named because the amount in the Treasury Stock account at any point in time represents the number of shares held in treasury times the original cost paid to acquire each treasury share.

Assume Duratech's net income for the first year was \$3,100,000, and that the company has 12,500 shares of common stock issued. During May, the company's board of directors authorizes the repurchase of 800 shares of the company's own common stock as treasury stock. Each share of the company's common stock is selling for \$25 on the open market on May 1, the date that Duratech purchases the stock. Duratech will pay the market price of the stock at \$25 per share times the 800 shares it purchased, for a total cost of \$20,000. The following journal entry is recorded for the purchase of the treasury stock under the cost method.

JOURNAL			
Date	Account	Debit	Credit
May 1	Treasury Stock Cash <i>To record the purchase of treasury stock for cash</i>	20,000	20,000

Even though the company is purchasing stock, there is no asset recognized for the purchase. An entity cannot own part of itself, so no asset is acquired. Immediately after the purchase, the equity section of the balance sheet ([Figure 14.6](#)) will show the total cost of the treasury shares as a deduction from total stockholders' equity.

DURATECH Partial Stockholders' Equity Section of the Balance Sheet For the Month Ended December 31, 2020	
Stockholders' Equity	
5% Preferred Stock, \$8 par value, 1,000 shares authorized, 1,000 shares issued and outstanding	\$ 8,000
Additional Paid-in Capital from Preferred Stock	37,000
Common Stock, \$1.50 par value, 20,000 shares authorized, 10,000 shares issued, 9,200 shares outstanding	15,000
Additional Paid-in Capital from Common Stock	70,000
Retained Earnings	31,000
	<u>161,000</u>
Treasury Stock (800 shares) at cost	(20,000)
Total Stockholders' Equity	<u>\$141,000</u>

Figure 14.6 Partial Stockholders' Equity Section of the Balance Sheet for Duratech. After the purchase of treasury stock, the stockholders' equity section of the balance sheet is shown as a deduction from total stockholders' equity. (attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license)

Notice on the partial balance sheet that the number of common shares outstanding changes when treasury stock transactions occur. Initially, the company had 10,000 common shares issued and outstanding. The 800 repurchased shares are no longer outstanding, reducing the total outstanding to 9,200 shares.

CONCEPTS IN PRACTICE

Reporting Treasury Stock for Nestlé Holdings Group

Nestlé Holdings Group sells a number of major brands of food and beverages including **Gerber**, **Häagen-Dazs**, **Purina**, and **Lean Cuisine**. The company's statement of stockholders' equity shows that it began with 990 million Swiss francs (CHF) in treasury stock at the beginning of 2016. In 2017, it acquired additional shares at a cost of 3,547 million CHF, raising its total treasury stock to 4,537 million CHF at the end of 2017, primarily due to a share buy-back program.¹⁰

NESTLÉ HOLDING GROUP Consolidated Statement of Changes in Equity For the Year Ended December 31, 2017					
Millions (CHF)	Share Capital	Treasury Shares	Paid-in Capital	Other	Total Equity
Equity as of December 31, 2016	311	(990)	82,870	(16,210)	65,981
Profit for the year			7,538		7,538
Other comprehensive income			252		252
Dividends			(7,468)		(7,468)
Treasury Shares		(3,719)	113		(3,606)
Other		172	869	(961)	80
Equity at December 31, 2017	<u>311</u>	<u>(4,537)</u>	<u>84,174</u>	<u>(17,171)</u>	<u>62,777</u>

Reissuing Treasury Stock above Cost

Management typically does not hold treasury stock forever. The company can resell the treasury stock at cost, above cost, below cost, or retire it. If La Cantina reissues 100 of its treasury shares at cost (\$25 per share) on July 3, a reversal of the original purchase for the 100 shares is recorded. This has the effect of increasing an asset, Cash, with a debit, and decreasing the Treasury Stock account with a credit. The original cost paid for each treasury share, \$25, is multiplied by the 100 shares to be resold, or \$2,500. The journal entry to record this sale of the treasury shares at cost is:

JOURNAL			
Date	Account	Debit	Credit
July 3	Cash Treasury Stock <i>To record the sale of 100 shares of treasury stock at cost</i>	2,500	2,500

If the treasury stock is resold at a price higher than its original purchase price, the company debits the Cash account for the amount of cash proceeds, reduces the Treasury Stock account with a credit for the cost of the treasury shares being sold, and credits the Paid-in Capital from Treasury Stock account for the difference. Even though the difference—the selling price less the cost—looks like a gain, it is treated as additional capital because gains and losses only result from the disposition of economic resources (assets). Treasury Stock is not an asset. Assume that on August 1, La Cantina sells another 100 shares of its treasury stock, but this time the selling price is \$28 per share. The Cash Account is increased by the selling price, \$28 per share times the number of shares resold, 100, for a total debit to Cash of \$2,800. The Treasury Stock account decreases by the cost of the 100 shares sold, $100 \times \$25$ per share, for a total credit of \$2,500, just as it did in the sale at cost. The difference is recorded as a credit of \$300 to Additional Paid-in Capital from Treasury Stock.

JOURNAL			
Date	Account	Debit	Credit
Aug. 1	Cash Treasury Stock Additional Paid-in Capital from Treasury Stock <i>To record the sale of 100 shares of treasury stock above cost</i>	2,800	2,500 300

Reissuing Treasury Stock Below Cost

If the treasury stock is reissued at a price below cost, the account used for the difference between the cash received from the resale and the original cost of the treasury stock depends on the balance in the Paid-in Capital from Treasury Stock account. Any balance that exists in this account will be a credit. The transaction will require a debit to the Paid-in Capital from Treasury Stock account to the extent of the balance. If the transaction requires a debit greater than the balance in the Paid-in Capital account, any additional difference between the cost of the treasury stock and its selling price is recorded as a reduction of the Retained Earnings account as

a debit. If there is no balance in the Additional Paid-in Capital from Treasury Stock account, the entire debit will reduce retained earnings.

Assume that on October 9, La Cantina sells another 100 shares of its treasury stock, but this time at \$23 per share. Cash is increased for the selling price, \$23 per share times the number of shares resold, 100, for a total debit to Cash of \$2,300. The Treasury Stock account decreases by the cost of the 100 shares sold, $100 \times \$25$ per share, for a total credit of \$2,500. The difference is recorded as a debit of \$200 to the Additional Paid-in Capital from Treasury Stock account. Notice that the balance in this account from the August 1 transaction was \$300, which was sufficient to offset the \$200 debit. The transaction is recorded as:

JOURNAL			
Date	Account	Debit	Credit
Oct. 9	Cash	2,300	
	Additional Paid-in Capital from Treasury Stock	200	
	Treasury Stock		2,500
	<i>To record the sale of 100 shares of treasury stock below cost</i>		

Treasury stock transactions have no effect on the number of shares authorized or issued. Because shares held in treasury are not outstanding, each treasury stock transaction will impact the number of shares outstanding. A corporation may also purchase its own stock and retire it. Retired stock reduces the number of shares issued. When stock is repurchased for retirement, the stock must be removed from the accounts so that it is not reported on the balance sheet. The balance sheet will appear as if the stock was never issued in the first place.

YOUR TURN

Understanding Stockholders' Equity

Wilson Enterprises reports the following stockholders' equity:

WILSON ENTERPRISES, INC. Stockholders' Equity Section of the Balance Sheet For the Month Ended December 31, 2020	
Stockholders' Equity	
Preferred Stock, \$100 par value, 10,000 shares authorized, 10,000 shares issued and outstanding	\$ 1,000,000
Common Stock, \$1 par value, 2,000,000 shares authorized, 1,200,000 shares issued, and 1,180,000 shares outstanding	1,200,000
Additional Paid-in Capital	16,800,000
Retained Earnings	3,670,000
	<u>22,670,000</u>
Treasury Stock (20,000 shares)	(240,000)
Total Stockholders' Equity	<u>\$22,430,000</u>

Figure 14.7 Wilson Enterprises, Inc., Stockholders' Equity Section of the Balance Sheet, For the Month Ended December 31, 2020.
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Based on the partial balance sheet presented, answer the following questions:

- At what price was each share of treasury stock purchased?
- What is reflected in the additional paid-in capital account?
- Why is there a difference between the common stock shares issued and the shares outstanding?

Solution

A. $\$240,000 \div 20,000 = \12 per share. B. The difference between the market price and the par value when the stock was issued. C. Treasury stock.

Footnotes

- ¹⁰ Nestlé. "Annual Report 2017." 2017. www.nestle.com/investors/annual-report
- ¹¹ Julie Bort. "Twitter's IPO Created 1,600 New Millionaires and a \$2.2 Billion Tax Bill, Analyst Says." *Business Insider*. November 11, 2013. <http://www.businessinsider.com/twitt...naires-2013-11>

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