If 1,000 Shares Of $5 Par Common Stock Are Reacquired By A Corporation For $12 A Share, By How Much Will

If 1,000 Shares Of $5 Par Common Stock Are Reacquired By A Corporation For $12 A Share, By How Much Will the corporation’s total treasury stock increase, and what are the accounting implications of this reacquisition? Understanding the financial impact of share repurchases is essential for investors, accountants, and corporate managers alike. This article provides a comprehensive analysis of the scenario where a corporation reacquires 1,000 shares of its common stock at a price significantly above its par value, delving into the calculation of the total cost, the effect on equity, and the broader implications for the company's financial statements.

Understanding the Scenario

Before exploring the specifics, it’s critical to understand the fundamental concepts involved in share reacquisition.

What Is Stock Reacquisition?

Stock reacquisition, also known as a share buyback, occurs when a corporation repurchases its outstanding shares from the open market or directly from shareholders. This process reduces the number of shares available to the public and can influence stock price, earnings per share, and overall shareholder value.

Key Details of the Scenario

In the given scenario:
- Number of shares reacquired: 1,000 shares
- Par value per share: $5
- Purchase price per share: $12

Understanding these details helps determine the total cost of reacquisition and the accounting treatment.

Calculating the Total Cost of Reacquisition

The first step is determining how much the corporation spends to reacquire the shares.

Step 1: Calculate the Purchase Price

The purchase price per share is $12, and 1,000 shares are reacquired:

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Total Purchase Cost = Number of Shares × Purchase Price
= 1,000 × $12
= $12,000
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Step 2: Understanding Par Value and Paid-in Capital

Each share has a par value of $5, which is the legal capital per share. The difference between the purchase price and the par value impacts the company's equity accounts.

Step 3: Accounting for the Reacquisition

When shares are reacquired, the company records this transaction by debiting the Treasury Stock account and crediting cash. The treasury stock is a contra-equity account, reducing total shareholders' equity.

The journal entry typically looks like:

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Debit: Treasury Stock (at cost) – $12,000
Credit: Cash – $12,000
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Impact on Shareholders' Equity

The reacquisition impacts the company's balance sheet, specifically its shareholders' equity section.

How Treasury Stock Affects Equity

Treasury stock is recorded at the cost of reacquisition. It reduces total shareholders' equity because it’s a contra-equity account. It does not affect the common stock account directly, which remains at its original par value.

Effect of Reacquisition Price Above Par Value

Since the purchase price ($12) exceeds the par value ($5), the excess amount impacts additional paid-in capital (APIC) or may create a reduction if the APIC account is insufficient.

- Par value per share: $5
- Total par value of reacquired shares: 1,000 × $5 = $5,000
- Excess over par per share: $12 - $5 = $7
- Total excess over par: 1,000 × $7 = $7,000

The journal entries for treasury stock typically involve:
- Debit Treasury Stock for total cost ($12,000)
- Credit Cash for $12,000
- Reduce Additional Paid-in Capital (APIC) if available, or recognize a reduction in other equity accounts.

Accounting Treatment of Treasury Stock

The accounting for treasury stock involves specific rules, especially when reacquisition cost exceeds the original issuance price.

Recording Treasury Stock at Cost

The treasury stock account is recorded at the reacquisition cost, which is $12 per share in our scenario.

Impact on Additional Paid-in Capital

If the company had previously issued shares at a price higher than par, the excess over par is recorded in the APIC account. When treasury stock is reissued or reacquired at a different price, adjustments are made to APIC or retained earnings:

- If treasury stock is reissued at a price higher than its cost, the excess increases APIC.
- If reissued at a lower price, the difference reduces APIC or retained earnings.

In this scenario, since the stock is being reacquired at a price above the original issuance, the treasury stock account increases by $12,000, decreasing total equity.

Broader Financial Implications

The reacquisition of shares affects several key financial metrics and ratios.

Impact on Earnings Per Share (EPS)

Reducing the number of outstanding shares usually increases EPS, potentially making the company's stock more attractive to investors.

Impact on Return on Equity (ROE)

By decreasing shareholders' equity through treasury stock, ROE may increase, affecting investors’ perception of company performance.

Market Perception and Stock Price

Share repurchases often signal management’s confidence in the company's future prospects, possibly leading to an increase in stock price. However, the high purchase price relative to par value might also raise questions about the company’s valuation.

Legal and Regulatory Considerations

Companies must adhere to specific legal requirements when reacquiring shares.

Restrictions on Share Repurchase

- Companies must ensure they have sufficient reserves.
- Reacquisition must not violate solvency or capital adequacy laws.
- Proper disclosures are required in financial statements.

Impact on Dividend Policy

Share buybacks can influence dividend policies, as funds used for repurchase are not available for dividends.

Summary of Key Points

- The total cost of reacquisition: $12,000.
- The treasury stock increases by $12,000, recorded as a contra-equity account.
- The excess over par value per share is $7, totaling $7,000, which impacts the company's APIC.
- Reacquisition at a price above par reduces shareholders' equity but can improve certain financial ratios.
- Proper accounting treatment involves debiting treasury stock at cost and crediting cash, with adjustments to APIC if necessary.
- Share repurchases can influence market perception, EPS, and ROE.

Conclusion

Reacquiring 1,000 shares of common stock at $12 per share when the par value is only $5 has significant accounting and financial implications. The total cost of $12,000 reduces shareholders' equity through treasury stock, and the excess over par value impacts the additional paid-in capital account. Such transactions are strategic tools used by corporations to manage capital structure, signal confidence to the market, and optimize financial ratios. Proper understanding of these processes ensures transparent financial reporting and informed decision-making for all stakeholders involved.

If you need further insights into share repurchase strategies, accounting standards, or their impact on financial statements, consulting with a financial advisor or accountant specialized in corporate finance is recommended.

Frequently Asked Questions

If a corporation reacquires 1,000 shares of its $5 par common stock at $12 per share, what is the total cost of the reacquisition?

The total cost is 1,000 shares × $12 = $12,000.

How does reacquiring shares at a price higher than their par value affect the company's financial statements?

Reacquiring shares at $12 per share increases treasury stock on the balance sheet and decreases total shareholders' equity by $12,000, impacting the company's equity structure.

What is the accounting journal entry to record the reacquisition of 1,000 shares at $12 each?

Debit Treasury Stock $12,000; Credit Cash $12,000.

If the par value of the stock is $5, what is the total par value of the 1,000 shares reacquired?

Total par value is 1,000 shares × $5 = $5,000.

What is the impact of reacquiring shares at a price above par on earnings per share (EPS)?

Reacquiring shares reduces the number of outstanding shares, which can increase EPS, but the impact depends on overall net income and other factors.

Can a company reissue the treasury shares purchased at $12 per share for a higher price later? What are the implications?

Yes, a company can reissue treasury shares at a higher price, which can result in a gain that increases equity. However, reissuing at a loss would decrease additional paid-in capital or retained earnings.

If the company reissues the 1,000 treasury shares at $15 per share, what is the gain or loss on reissuance?

The gain is ($15 - $12) × 1,000 = $3,000, which increases additional paid-in capital.

Why might a company choose to reacquire its common stock at a price above par value?

A company may reacquire shares at a premium to reduce the number of outstanding shares, support the stock price, or utilize excess cash, despite paying above par value.

Additional Resources

Understanding the Financial Implications of Reacquiring 1,000 Shares of $5 Par Common Stock at $12 per Share

Reacquiring a company's own stock, often called a share buyback or treasury stock transaction, is a significant corporate financial activity that can influence a company's earnings per share (EPS), stock price, and overall capital structure. When a corporation reacquires 1,000 shares of its common stock with a $5 par value at a purchase price of $12 per share, it raises several questions about the financial impact, particularly concerning the amount by which the company's equity will change.

In this comprehensive review, we will explore the detailed mechanics of such a reacquisition, including the calculations involved, accounting treatment, and broader implications for the company’s financial statements and shareholders.

Fundamental Concepts of Share Reacquisition

Before delving into the specific scenario, it's essential to understand some foundational concepts:

What is a Share Reacquisition?

- Definition: When a corporation buys back its outstanding shares from the open market or shareholders, it reduces the number of shares held by the public.
- Purpose: Companies may repurchase shares to:
- Increase earnings per share (EPS)
- Return surplus cash to shareholders
- Improve financial ratios
- Signal confidence in the company's future prospects
- Support the stock price

Types of Treasury Stock

- Issued but not outstanding: Reacquired shares become treasury stock and are considered issued but not outstanding.
- Impact: These shares are not entitled to dividends or voting rights until reissued or retired.

Par Value and Its Significance

- Par value: A nominal value assigned to each share, here $5.
- Legal Capital: The total par value of issued shares often represents the minimum amount that cannot be distributed as dividends.

Financial Impact of the Reacquisition at $12 per Share

Let's analyze the core question: If 1,000 shares of $5 par common stock are reacquired by a corporation at $12 per share, by how much will the company's financial position change?

Step 1: Calculating the Total Cost of Reacquisition

- Number of shares reacquired: 1,000 shares
- Purchase price per share: $12
- Total cost of reacquisition:

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1,000 \text{ shares} \times \$12 = \$12,000
$$

This is the cash outflow and the amount the company will pay to buy back these shares.

Step 2: Determining the Impact on Equity

- Accounting for treasury stock:
When shares are reacquired, the accounting entry involves debiting treasury stock (a contra-equity account) for the total cost.
- Effect on total equity:
Since treasury stock is a contra-equity account, it reduces total shareholders' equity by the amount paid for the shares.

Step 3: Par Value vs. Purchase Price

- Par value of reacquired shares:

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1,000 \text{ shares} \times \$5 = \$5,000
$$

- Additional paid-in capital (APIC):
The excess over the par value is recorded as a reduction in APIC or as a separate "Paid-in Capital from Treasury Stock" account, depending on the company's accounting policies.

Note:
The difference between the purchase price and the par value is important for the following reasons:
- It affects the journal entries.
- It impacts the company's equity accounts.

Accounting Entries for the Reacquisition

Understanding the proper journal entries is crucial:

Standard Journal Entry at Reacquisition

- Debit: Treasury Stock (for total cost)
- Credit: Cash (for total cost)

Example:

Account	Debit	Credit
Treasury Stock	$12,000	
		$12,000
Cash		$12,000

Note:
- The treasury stock account is a contra-equity account, recorded at the reacquisition cost ($12,000).
- No gain or loss is recognized on reacquisition unless the shares are retired or resold.

Adjustments for Par Value and Additional Paid-in Capital

If the company wants to reflect the par value:

Account	Debit	Credit
Treasury Stock (at par)	$5,000	
Paid-in Capital in Excess of Par	$7,000	
		$12,000

This detailed entry separates the par value component from the excess paid over par, aligning with standard accounting practices.

Implications for Financial Statements

The reacquisition affects multiple parts of the company's financial statements:

Balance Sheet

- Assets:
Cash decreases by $12,000.
- Shareholders' Equity:
- Treasury Stock increases (contra-equity) by $12,000.
- Total shareholders' equity decreases by the same amount.

Net effect:
- Total assets decrease by $12,000.
- Total equity decreases by $12,000.

Income Statement

- The reacquisition itself does not directly impact net income unless associated with expenses or gains from resale.

Statement of Cash Flows

- The cash outflow for purchase is reflected under financing activities or investing activities, depending on the company's classification.

Broader Financial and Strategic Considerations

While the immediate impact is a reduction in cash and equity, companies consider several strategic implications:

Effects on Earnings Per Share (EPS)

- Increase in EPS:
Reducing the number of outstanding shares increases EPS, which can make the stock more attractive.

Impact on Shareholder Value

- Positive signals:
Buybacks often signal management's confidence in the company's future.
- Potential drawbacks:
Excessive buybacks might indicate a lack of growth opportunities or use of surplus cash for non-growth purposes.

Financial Ratios

- Key ratios affected include:
- Debt-to-equity ratio (if financed by debt)
- Return on equity (ROE)
- Price-to-earnings (P/E) ratio

Tax Considerations

- Unlike dividends, share repurchases may have different tax implications for shareholders, influencing investor preferences.

Impact of Reacquisition Price Relative to Market Price

In this scenario, the shares are reacquired at $12 per share, which might be:
- Premium over market value: If the market price is below $12, the company is paying a premium.
- Discount: If the market price is above $12, the company is buying back at a discount, which might be advantageous.

Key Point:
The decision to buy back at $12 per share must consider the company's valuation and strategic goals.

Conclusion: Quantifying the Change in Equity

Summarizing the core question:

> "By how much will the company's financial position change when reacquiring 1,000 shares of $5 par common stock at $12 per share?"

- Total cash outflow:
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\$12,000
$$
- Reduction in shareholders' equity:
$$
\$12,000
$$

Therefore, the company's equity will decrease by $12,000 as a result of the reacquisition.

This straightforward calculation underscores the importance of understanding both the accounting treatment and the strategic implications of stock buybacks.

Final Remarks

Reacquiring shares at a premium over par value is a common corporate maneuver that impacts a company's financial health, investor perception, and future growth potential. Proper accounting ensures transparency and accurate reflection of the company's financial position, while strategic considerations guide the timing and extent of buybacks.

In this case, the key takeaway is that the stock reacquisition at $12 per share for 1,000 shares reduces the company's equity by $12,000, reflecting the cash outlay and the contra-equity nature of treasury stock accounting.

Understanding these dynamics helps investors, analysts, and corporate managers make informed decisions aligned with their financial goals and strategic vision.

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