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September 21, 2020

Richard B. Jones, Chairman
Financial Accounting Standards Board
401 Merritt 7 #2
Norwalk, CT 06856-5116

Dear Mr. Jones,

I have recently spent a day attending an accounting and auditing update webinar. The accounting updates took me through many ASU issued by the FASB, some significant and some only applicable to complex financial transactions that most companies do not encounter.

Through all of this, I am dismayed that the FASB has not tackled the significant issue of valuing stock buybacks. In 2018 and 2019, publicly held companies spent an estimated **$2 trillion** on stock buybacks.

The accounting treatment for these buybacks remains recording the value of the stock purchased at cost even though the fair market value of the acquired Treasury stock increases or decreases.

Shareholders are not getting pertinent information on whether the money spent on stock buybacks benefited them. This should not continue. With the amount of corporate (shareholder) funds being used for stock buybacks, shareholders need to know if they benefited and, if so, how much was the benefit compared to the cost.

A primary reason that stock buybacks are so popular is that there is no accounting for the results of the expenditure of corporate and shareholder funds to buy the stock. This is a complicated issue due to the amount of money being spent and the potential for substantial increases or decreases in the market value of Treasury Stock. The question the FASB should consider is how to fairly measure these changes in value and how to report them to shareholders.

Corporations use their assets to buy stock in their company. Even though the Treasury Stock is classified as a contra to Retained Earnings in the equity account, it is still an asset the corporation can use to purchase other assets, such as another company. The current treatment of Treasury Stock does not reflect its status as an asset nor the fair value standard used to value other corporate financial assets.

If the FASB does not address this issue, then politicians will, as many are now mentioning the possibility of outlawing stock buybacks because of its excessive use.

If the results of stock buybacks are measured and reported, I believe their use will decline because management and directors will be and should be held responsible for the success or failure of this expenditure of corporate funds in increasing the value of the corporation and its common stock. If this is not done, a political solution is likely, never a good result.

Very truly yours,

Richard L. Hecht, CPA MBA

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Date: September 1, 2020
From: Richard L. Hecht, CPA MBA
Re: Methods for recognizing the economic results of Stock Buybacks

In my April 20, 2019 memo, I argued for the accounting profession (FASB) to take up the issue of recognizing the economic impact of stock buybacks.

There are several options available to report the economic results of stock buybacks.

The most important issue is to report the economic results to the shareholders, not whether or not these should be included in the income statement of the reporting company. Due to the impact and volatility such reporting could have on the reported net income of the company, footnote disclosure may be a better reporting mechanism; the FASB should decide this.

Here are various options which are not necessarily all inclusive but are a starting point.

1. Compare the cost per share to buy back the company's stock with the per share market value of the stock at the end of the reporting period. I suggest this be done for stock purchased in the current year, the past 3 years and the past 5 years. This would show whether the buyback cost is greater or smaller than the current fair market price. Show the absolute change and percentage change.

2. Multiply the difference between the cost and year end FMV of the stock by the average number of shares outstanding during the period. Compare this to the total expenditure on stock buybacks. This will demonstrate whether the funds expended generated a greater increase in the FMV of the stock than the funds spent on the stock buyback. If the FMV increase is greater, that would demonstrate that shareholders got a return greater than the cost. There is a question whether the income tax that would be paid on the gain should be included in the calculation since many analysts hold the position that the gain in stock price is tax free compared to the use of funds to pay taxable dividends.

3. Calculate the increase in Earnings Per Share (EPS) as a result of the stock buybacks, net of additional interest cost per share for funds borrowed to execute the stock buybacks. This should be done for buybacks in the current year and over the last 3 and 5 year periods to reflect the cumulative effect on EPS of stock buybacks.

4. Multiply the increase or decrease in EPS calculated above by the average PE ratio for the reporting period. This will show the effect the increase in EPS has on the stock price. This does not take into account other factors affecting the stock price, primarily the PE ration and the absolute earnings of the company.

5. Multiply the increase or decrease in the price cause by the change in EPS due to stock buybacks by the average number of shares outstanding. Then compare this to the amount the company spent on stock buybacks. This will show whether the investment by the company in stock buybacks gave shareholders a return greater than the amount of funds the company spent on stock buybacks. This calculation should also be done for 1,3 and 5 years to show the cumulative effect.

6. Show how the stock buybacks were funded by taking the operating cash flow and subtracting capital expenses, company financed acquisitions and dividends. Compare the remainder to the amount spent on stock buybacks. If stock buybacks are greater, then the company borrowed money to fund the buybacks. The borrowed funds should be used as the basis for calculating the per share interest costs to reduce the increase in EPS through stock buybacks in item 3 above.

The economic measurement options noted above are ideas to be discussed as a basis for determining how to report the economic effect of stock buybacks to shareholders. This should be the purview of the FASB; if it does not undertake this issue, eventually the US Congress will. I believe an accounting result will be better than a political result for shareholders.