Stock Repurchases Are on the Rise — and so Is the Risk Involved

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In recent years, stock repurchases have skyrocketed, partly driven by the cash flow generated by the Tax Cuts and Job Act (TCJA) and the availability of inexpensive debt capital. So-called "buybacks" have become a political hot button, and some lawmakers want to enhance the information companies provide to shareholders about these transactions.

A problematic tendency

Over the last decade, share repurchases by companies have shot up. In 2018, the total value of share repurchases by companies surged to a record $806.4 billion, up 55% from a year earlier, according to a March 2019 report from S&P Dow Jones Indices. The record was more than 36% higher than the previous high-water mark hit in 2007.

In the fourth quarter of 2018, Apple led in buybacks, spending $10.1 billion. Other companies that spent large sums to buy back shares include:

- Oracle ($10 billion)
- Wells Fargo ($7.3 billion)
- Microsoft ($6.4 billion)
- Merck ($5.9 billion)

In May, a letter to the Financial Accounting Standards Board (FASB) was written by Richard Hecht, a former vice president of the New York State Society of CPAs. He criticized the lack of accountability for stock repurchase outcomes, stating, "The accounting profession has stuck its head in the sand to avoid dealing with this major issue. I feel strongly that if the accounting profession, through the FASB, continues to ignore this issue, it will pay a heavy price."

If the stock market collapses, Hecht believes companies that borrowed funds to repurchase stock at today's relatively high market values might not be able to repay the debt. This could lead to another corporate debt crisis, similar to the financial crisis of 2007.

Change is a must

Stock repurchases by a company are reported as "treasury stock" on the equity section of the balance sheet under current U.S. generally accepted accounting principles (GAAP). Stock repurchases by a company are reported as "treasury stock" on the equity section of the balance sheet. Buybacks are reported at historic cost, without any subsequent evaluation to record whether the stock was purchased at a reasonable price.

To help shareholders gauge whether management made or lost money on the use of shareholder funds to buy back a company's own common stock, Hecht wants the FASB to revise the current accounting method for recording stock buybacks.

If corporate funds are used to buy publicly traded stock in a third corporation, it's valued at current market value. "Why is stock in your own corporation treated differently? There is hardly any accounting literature in the ASCs and ASUs dealing with the value of treasury stock," said Hecht.

Concern is mounting that a historic cost framework to report stock buybacks is problematic. Using historic cost creates a situation in which the book value of treasury stock differs significantly from the stock's current fair market value.

The FASB steps in

On May 8, FASB members discussed share repurchases, including various SEC requirements for reporting buybacks during a meeting. However, the FASB decided not to add a project to its agenda to address this issue.

Meanwhile, Congress is considering legislation aimed at providing more information on buybacks and potentially preventing companies from buying back stock on the open market. (See "Recent bill calls for action on stock repurchases.")