

Accounting 460
CPA Problems
Notes on Stock Rights

1. The term stock right is usually interpreted to mean the right related to each share of old stock. Therefore, a holder of 20 shares of stock who receives the rights to subscribe to 10 new shares is said to own 20 stock rights rather than 10; that is, there is one right per old share irrespective of the new share arrangement.

2. For analytical purposes, it is deemed preferable to make a journal entry upon receipt of stock rights to transfer a portion of the stock investment cost to the stock rights, such as:

Investment in stock rights—X Company	\$xx	
Investment in stock— X company		\$xx

3. The amount allocated to the investment in stock rights is based on the relationship of the fair market value of the stock and the rights. Sometimes the FMV of the rights is not available. Then, the parity value or theoretical value may be used as a basis for allocation.

Formulas for Parity Value:

a. Rights on:
$$PV = \frac{MV - S}{N + 1}$$

b. Ex-rights:
$$PV = \frac{MV - S}{N}$$

Where PV = Parity value

S= subscription price of the stock

N= Number of rights needed to acquire a new share.

Cost of one share	\$100
Market value at date rights were issued:	
Rights	\$ 10
Shares	115
	\$ 125
Cost allocation:	
right: (\$10/\$125)	\$ 8
Share (\$115/125)	92
	\$ 100