

2. Available for Sale Securities

The accounting for “available for sale” securities will look quite similar to the accounting for trading securities. In both cases, the investment asset account will be reflected at fair value. If you do not recall the accounting for trading securities, it may be helpful to review that material in the accompanying Current Assets book Part 2.

To be sure, there is one big difference between the accounting for trading securities and available-for-sale securities. This difference pertains to the recognition of the changes in value. For trading securities, the changes in value were recorded in operating income. However, such is not the case for available-for-sale securities. Here, the changes in value go into a special account. We will call this account Unrealized Gain/Loss-OCI, where “OCI” will represent “Other Comprehensive Income.”

2.1 Other Comprehensive Income

This notion of other comprehensive income is somewhat unique and requires special discussion at this time. There is a long history of accounting evolution that explains how the accounting rule makers eventually came to develop the concept of OCI. To make a long story short, most transactions and events make their way through the income statement. As a result, it can be said that the income statement is “all-inclusive.” Once upon a time, this was not the case; only operational items were included in the income statement. Nonrecurring or non operating related transactions and events were charged or credited directly to equity, bypassing the income statement entirely (a “current operating” concept of income).

Importantly, you must take note that the accounting profession now embraces the all-inclusive approach to measuring income. In fact, a deeper study of accounting will reveal that the income statement structure can grow in complexity to capture various types of unique transactions and events (e.g., extraordinary gains and losses, etc.) -- but, the income statement does capture those transactions and events, however odd they may appear.

There are a few areas where accounting rules have evolved to provide for special circumstances/“exceptions.” And, OCI is intended to capture those exceptions. One exception is the Unrealized Gain/Loss - OCI on available-for-sale securities. As you will soon see, the changes in value on such securities are recognized, not in operating income as with trading securities, but instead in this unique account. The OCI gain/loss is generally charged or credited directly to an equity account (Accumulated OCI), thereby bypassing the income statement (there are a variety of reporting options for OCI, and the most popular is described here).

2.2 An Illustration

Let us amend the Current Assets: Part 2 trading securities illustration -- such that the investments were more appropriately classified as available for sale securities:

Assume that Webster Company acquired an investment in Merriam Corporation. The intent was not for trading purposes, control, or to exert significant influence. The following entry was needed on March 3, 20X6, the day Webster bought stock of Merriam:

3-3-X6	Available for Sale Securities	50,000	
	Cash		50,000
	<i>To record the purchase of 5,000 shares of Merriam stock at \$10 per share</i>		

Next, assume that financial statements were being prepared on March 31. By that date, Merriam’s stock declined to \$9 per share. Accounting rules require that the investment “be written down” to current value, with a corresponding charge against OCI. The charge is recorded as follows:

3-31-X6	Unrealized Gain/Loss - OCI	5,000	
	Available for Sale Securities		5,000
	<i>To record a \$1 per share decrease in the value of 5,000 shares of Merriam stock</i>		

This charge against OCI will reduce stockholders’ equity (the balance sheet remains in balance with both assets and equity being decreased by like amounts). But, net income is not reduced, as there is no charge to a “normal” income statement account. The rationale here, whether you agree or disagree, is that the net income is not affected by temporary fluctuations in market value -- since the intent is to hold the investment for a longer term period.

During April, the stock of Merriam bounced up \$3 per share to \$12. Webster now needs to prepare this adjustment:

4-30-X6	Available for Sale Securities		15,000	
	Unrealized Gain/Loss - OCI			15,000
	<i>To record a \$3 per share increase in the value of 5,000 shares of Merriam stock</i>			

Notice that the three journal entries now have the available for sale securities valued at \$60,000 (\$50,000 - \$5,000 + \$15,000). This is equal to their market value (\$12 X 5,000 = \$60,000). The OCI has been adjusted for a total of \$10,000 credit (\$5,000 debit and \$15,000 credit). This cumulative credit corresponds to the total increase in value of the original \$50,000 investment.

The preceding illustration assumed a single investment. However, the treatment would be the same even if the available for sale securities consisted of a portfolio of many investments. That is, each and every investment would be adjusted to fair value.

2.3 Alternative: A Valuation Adjustments Account

As an alternative to directly adjusting the Available for Sale Securities account, some companies may maintain a separate Valuation Adjustments account that is added to or subtracted from the Available for Sale Securities account. The results are the same; the reason for using the alternative approach is to provide additional information that may be needed for more complex accounting and tax purposes. This coverage is best reserved for more advanced courses.

2.4 Dividends and Interest

Dividends or interest received on available for sale securities is reported as income and included in the income statement:

9-15-X5	Cash		75	
	Dividend Income			75
	<i>To record receipt of dividend on available for sale security investment</i>			

2.5 The Balance Sheet Appearance

The above discussion would produce the following balance sheet presentation of available for sale securities at March 31 and April 30. To aid the illustration, all accounts are held constant during the month of April, with the exception of those that change because of the fluctuation in value of Merriam’s stock.

WEBSTER COMPANY					
Balance Sheet					
March 31, 20X6					
ASSETS			LIABILITIES		
Current Assets			Current Liabilities		
Cash	\$ 100,000		Accounts payable	\$ 80,000	
Trading securities	50,000		Salaries payable	10,000	
Accounts receivable	75,000		Interest payable	15,000	
Inventories	200,000		Taxes payable	5,000	
Prepaid insurance	<u>25,000</u>	\$ 450,000	Current portion of note	<u>40,000</u>	\$ 150,000
Long-term Investments			Long-term Liabilities		
Available for sale securities	\$ 45,000		Notes payable	\$ 190,000	
Cash value of insurance	<u>10,000</u>	55,000	Mortgage liability	<u>110,000</u>	<u>300,000</u>
Property, Plant & Equipment			Total Liabilities		
Land	\$ 25,000				\$ 450,000
Buildings and equipment	\$ 150,000		STOCKHOLDERS' EQUITY		
Less: Accumulated deprec.	<u>(50,000)</u>	<u>100,000</u>	Capital stock	\$ 300,000	
		125,000	Retained earnings	170,000	
Intangible Assets			Accumulated other comprehensive income/loss	<u>(5,000)</u>	
Goodwill		275,000	Total Stockholders' Equity		
Other Assets					<u>465,000</u>
		<u>10,000</u>	Total Liabilities and Equity		
Total Assets					<u>\$ 915,000</u>
		<u>\$ 915,000</u>	Total Liabilities and Equity		
					<u>\$ 915,000</u>

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WEBSTER COMPANY					
Balance Sheet					
April 30, 20X6					
ASSETS			LIABILITIES		
Current Assets			Current Liabilities		
Cash	\$ 100,000		Accounts payable	\$ 80,000	
Trading securities	50,000		Salaries payable	10,000	
Accounts receivable	75,000		Interest payable	15,000	
Inventories	200,000		Taxes payable	5,000	
Prepaid insurance	<u>25,000</u>	\$ 450,000	Current portion of note	<u>40,000</u>	\$ 150,000
Long-term Investments			Long-term Liabilities		
Available for sale securities	\$ 60,000		Notes payable	\$ 190,000	
Cash value of insurance	<u>10,000</u>	70,000	Mortgage liability	<u>110,000</u>	<u>300,000</u>
Property, Plant & Equipment			Total Liabilities		
Land	\$ 25,000				\$ 450,000
Buildings and equipment	\$ 150,000		STOCKHOLDERS' EQUITY		
Less: Accumulated deprec.	<u>(50,000)</u>	<u>100,000</u>	125,000	Capital stock	\$ 300,000
				Retained earnings	170,000
				Accumulated other comprehensive income/loss	<u>10,000</u>
Intangible Assets			Total Stockholders' Equity		
Goodwill		275,000			<u>480,000</u>
Other Assets			Total Liabilities and Equity		
		<u>10,000</u>			<u>\$ 930,000</u>
Total Assets		<u>\$ 930,000</u>			<u>\$ 930,000</u>

In reviewing this illustration, note that Available for Sale Securities are customarily classified in the Long-term Investments section of the balance sheet. And, take note the OCI adjustment is merely appended to stockholders' equity.