Accounting for Realized and Unrealized Gains and Losses on Equity Securities

Unrealized Gain or Loss

As the fair value of the equity security changes during its holding period, the unrealized gain or loss is reported on the income statement as an unrealized holding gain or loss.

In the case of an increase in the fair value, the journal entry will be:

Dr Fair value adjustment (valuation account).....................................X

  Cr Unrealized holding gain (on **income statement**) X

For a decrease in fair value, the entry will be as follows:

Dr Unrealized holding loss (on **income statement**) X

  Cr Fair value adjustment (valuation account)...................................... X

Equity securities are accounted for as a portfolio, and only one journal entry is made each reporting period that recognizes the net unrealized gain or loss on the whole portfolio for the period. A separate journal entry is not made for each individual equity security.

Realized Gain or Loss

When an equity security is sold, the realized gain or loss on the sale is recorded as follows on the sale date (assuming the security increased in value while being held):

Dr Cash (including costs of the transaction).................sales price

  Cr Gain .... balance

  Cr Investment account............................original acquisition price

Note that the realized gain or loss is calculated as follows:

	Amount received for the sale
−	Acquisition cost (original cost of the security
=	**Realized gain or loss**

The **full amount** of the gain or loss during the holding period is reported as "realized gain or loss" on the income statement. **It is not necessary to reverse previously-recognized unrealized gains or losses on the security that has been sold on the sale date.** When an investment has been sold, it will simply not be included in calculating the fair value of all the remaining equity investments in the portfolio at the end of the period. The adjustment to the fair value valuation account that is made at the end of the period for the remaining portfolio as a whole will have the effect of removing the unrealized gain or loss that had been recognized in previous periods on the sold investment.

Example

Here is an example, using a portfolio of equity securities:

	Acquisition Cost	Fair Value June 30, 20X9	Difference
ABC Co. Common Stock-300 shs. purchased Feb. 28, 20X9 @ $20/sh.	$ 6,000	$ 7,000	+$1,000
DEF Co. Common Stock-500 shs. purchased Mar. 30, 20X9 @ $10/sh.	5,000	3,500	− 1,500
GHI Co. Common Stock-600 shs. purchased Apr. 30, 20X9 @ $15/sh.	9,000	10,200	+ 1,200
Totals	$20,000	$20,700	+$ 700

On June 30, 20X9, an interim financial statement is published, the first financial statement published since the purchase of the above securities. The fair value adjustment for these investments will be a $700 holding (unrealized) gain. The journal entry is:

Dr	Fair value adjustment	700	
Cr	Unrealized holding gain		700

On July 31, 20X9, 300 shares of GHI Co. stock are sold for $20 per share. (For simplicity, there were no commissions or other fees.) **Nothing is recorded in the fair value adjustment account or in the unrealized holding gain account on July 31**. The original cost of the 300 shares sold is credited to the investments account to remove the 300 shares from the books. The realized gain recorded when the securities are sold is based on the **original** cost of $15 per share, not the market price on June 30. The entry to record the sale and the realized gain is:

Dr	Cash [300 shs. @ $20]	6,000	
Cr	Realized gain on sale of investments [300 shs. @ $5]		1,500
Cr	Investments [300 shs. @ $15]		4,500

No other trades take place during the period. The next time financial statements are issued is at the end of the year, on December 31, 20X9. On that date, the fair values of the remaining securities are:

	Acquisition Cost	Fair Value Dec. 31, 20X9	Difference
ABC Co. Common Stock-300 shs. purchased Feb. 28, 20X9 @ $20/sh.	$ 6,000	$ 7,500	+$1,500
DEF Co. Common Stock-500 shs. purchased Mar. 30, 20X9 @ $10/sh.	5,000	4,000	− 1,000
GHI Co. Common Stock-300 shs. purchased Apr. 30, 20X9 @ $15/sh.	4,500	7,500	+ 3,000
Totals	$15,500	$19,000	+$3,500

For the remaining stocks in the portfolio, a fair value adjustment amount of $3,500 (debit balance, an increase) is needed to reflect the difference between the fair value and the remaining securities' original cost. The fair value adjustment account already has a debit balance of $700, recorded on June 30. Therefore, the journal entry to be recorded for December 31, 20X9 is for $2,800, the **difference** between $3,500 and $700, as follows:

Dr Fair value adjustment.. 2,800
Cr Unrealized holding gain 2,800

The balance in the fair value adjustment account has been adjusted to the current balance needed to properly report the fair values of the remaining securities. **It was not necessary for any portion of the entry that was made to the valuation account for the June 30, 20X9 reporting date to be reversed in order to record the sale of the 300 shares of GHI**. By adjusting the balance in the valuation account to the current balance needed as of December 31, 20X9, that has been adjusted for. The unrealized holding gain for the year is now $3,500, and that amount represents only the holding gain on the securities that are still held at year end. The unrealized holding gain from June 30 attributable to the 300 shares of GHI that were sold is gone.