

# Watson Enterprises: Accounting for Marketable Equity Securities: Problem Handouts



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# Watson Enterprises: Accounting for Marketable Equity Securities

## Phase 1

Your audit team has been given the assignment of auditing Watson Enterprises, a regional manufacturer of furniture. During the year, Watson offered its first shares stock to the public. It thus must comply with SEC requirements for its accounting.

During the course of your engagement, you discover that Watson had some excess cash on hand during the prior year (2002). The Chief Financial Officer had elected to put this money to use by investing it in stocks of publicly traded companies. When you make inquiries about these transactions, the controller exclaims, "Yes we purchased shares of several companies during the year and we still hold some of them. I don't see any accounting issues here. We simply account for the investments as current assets and hold them on the books at their historical cost. Then when we sell them, we recognize the gains or losses that we have made. That's the way we learned it back at Ohio University when I took accounting in 1975."

The controller tells you that during the year Watson purchased the following securities:

<u>Security</u>	<u>Amount</u>	<u>Price/Share</u>
AVP	1,000 shares	\$20
BA	2,000 shares	\$35
PEP	1,000 shares	\$30

During the year, BA declared and paid a dividend of \$1.50 per share. The other two securities did not pay dividends.

### ***Directions:***

This is a Problem-Based Learning Exercise. Your client wants to know the proper accounting for investments in marketable equity securities. Use the attached PBL worksheet to record what you know and what you need to know to help your client properly account for these investments.



# Watson Enterprises: Accounting for Marketable Equity Securities

## Phase 2

You check *The Wall Street Journal* and find the following stock prices for the end of 2002:

AVP     \$20

BA       \$35

PEP     \$30

During the year, BA declared and paid a dividend of \$1.50 per share. The other two securities did not pay dividends.

### **Directions:**

1. Divide your team into two groups with those holding red suits in one group and those holding black suits and the wildcard in the other.
  1. Students holding black suits—assume the investments are classified as trading securities. Record the year-end journal entries related to investments for 2002. Show the ledger accounts for investments and all related accounts.
  2. Students holding red suits—assume the investments are classified as available-for-sale securities. Record the year-end journal entries related to investments for 2002. Show the ledger accounts for investments and all related accounts.
2. At the instructor's signal, reassemble into your teams and show the other partners the way to complete your part. Compare and contrast the differences.



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## Phase 3

During 2003 Watson Enterprises sold 1,000 shares of BA @ \$25 and purchased 1,000 shares of JNJ @ 85. No dividends were declared or paid by companies in which Watson invested during 2003. At the end of 2003, the following prices were in effect:

A    \$25

B    \$30

P    \$95

P    \$45

During the year, BA declared and paid a dividend of \$1.50 per share. The other two securities did not pay dividends.

### **Directions:**

1. Once again, divide your team into two groups with those holding red suits in one group and those holding black suits and the wildcard in the other. However, this time the pairs will solve the problem for the alternate kind of security.
  1. Students holding black suits—assume the investments are classified as available-for-sale securities. Record the year-end journal entries related to investments for 2003. Show the ledger accounts for investments and all related accounts.
  2. Students holding red suits—assume the investments are classified as trading securities. Record the year-end journal entries related to investments for 2003. Show the ledger accounts for investments and all related accounts.
2. At the instructor's signal, reassemble into your teams and show the other partners the way to complete your part. Compare and contrast the differences.



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## Phase 4

Watson Enterprises has elected to classify all of its securities as available-for-sale, based upon the input that you have previously given to them. They now need to know the disclosure requirements for these securities in 2003.

### *Directions:*

1. Prepare a report that fulfills the reporting requirements for Watson's available-for-sale securities.



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## Phase 5

In March 2004, Watson determines that it wishes to reclassify its holdings in PEP. At the time that they make this determination, PEP is selling for \$50/share.

### ***Directions:***

1. Once again, divide your team into two groups with those holding red suits in one group and those holding black suits and the wildcard in the other.
  - a. Students holding black suits—assume the PEP has previously been classified as trading. Record the journal entry to record the reclassification.
  - b. Students holding red suits—assume the PEP has previously been classified as available-for-sale. Record the journal entry to record the reclassification.
2. At the instructor's signal, reassemble into your teams and show the other partners the way to complete your part. Compare and contrast the differences.



# Watson Enterprises: Accounting for Marketable Equity Securities

## PBL Worksheet: Pertinent, Known Information

Group: \_\_\_\_\_

Date: \_\_\_\_\_

What do we know?	How will what we know help us solve this problem?



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## PBL Worksheet: Additional Information Required

Group: \_\_\_\_\_

Date: \_\_\_\_\_

What do we need to know?	How will what we need to know help us solve this problem?



What have we learned?	