Investments

Type of investment securities:

First: Investments in debt securities (Bonds)

Second: Investments in equity securities (Sharers)

Investments in debt securities (Bonds): represent a creditor relationship with another entity. Debt securities include government securities, municipal securities, corporate bonds convertible debt, and commercial paper. Companies group investments in debt securities into three separate categories for accounting and reporting purposes:

• **Held-to-maturity**: Debt securities that the company has the positive intent and ability to hold to maturity.

• **Trading**: Debt securities bought and held primarily for sale in the near term to generate income on short-term price differences.

• **Available-for-sale**: Debt securities not classified as held-to-maturity or trading securities.

Accounting for Debt Investments by Category:

Category	Valuation	Unrealized Holding Gains or Losses	Other Income Effects
Held-to-maturity	Amortized cost	Not recognized	Interest when earned; gains and losses from sale.
Trading securities	Fair value	Recognized in net income	Interest when earned; gains and losses from sale.
Available-for-sale	Fair value	Recognized as other comprehensive income and as separate component of stockholders' equity	Interest when earned; gains and losses from sale

Amortized cost: is the acquisition cost adjusted for the amortization of discount or premium, if appropriate.

Fair value: is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Accounting for Debt Investments:

Debt investments are investments in government and corporation bonds. In accounting for debt investments, companies make entries to record (1) the acquisition, (2) the interest revenue, and (3) the sale

Recording Acquisition of Bonds:

At acquisition, the cost principle applies. Cost includes all expenditures necessary to acquire these investments, such as the price paid plus brokerage fees (commissions), if any.

To illustrate the accounting for a debt investment at amortized cost, Assume, for example, that A.B. Corporation acquires 50 Asia Inc. 8%, 10-year, $1,000 bonds on January 1, 2012, for $54,000, including brokerage fees of $1,000. The entry to record the investment is:

Jan. 1	Debt Investments	54000	
	Cash		54000
	(To record purchase of 50 Doan Inc. bonds)		

Recording Bond Interest:

The Doan, Inc. bonds pay interest of $2,000 semiannually on July 1 and January 1 ($50000× 8% × ½). The entry for the receipt of interest on July 1 is:

July 1	Cash	2000	
	Interest Revenue		2000
	(To record receipt of interest on Doan Inc. bonds		

If A.B. Corporation's fiscal year ends on December 31, it accrues the interest of $2,000 earned since July 1. The adjusting entry is:

Dec. 31/2012 Interest Receivable 2000

Interest Revenue 2000

(To accrue interest on Doan Inc. bonds)

A.B. reports Interest Receivable as a current asset in the balance sheet. It reports Interest Revenue under “Other revenues and gains” in the income statement.

A.B. reports receipt of the interest on January 1 as follows

Jan. 1/2013 Cash 2000

Interest Receivable 2000

(To record receipt of accrued interest)

Recording Sale of Bonds:

Assume, for example, that A.B. Corporation receives net proceeds of $58,000 on the sale of the Doan Inc. bonds on January 1, 2013, after receiving the interest due. Since the securities cost $54,000, the company realizes a gain of $4,000. It records the sale as:

Jan. 1 Cash 58000

Debt Investments 54000

Gain on Sale of Debt Investments 4000

(To record sale of Doan Inc. bonds)

Example: Baghdad Corporation had the following transactions pertaining to debt investments.

Jan. 1 Purchased 30, $1,000 Hillary Co. 10% bonds for $30,000, plus brokerage fees of $900. Interest is payable semiannually on July 1 and January 1.

July 1 Received semiannual interest on Hillary Co. bonds.

July 1 Sold 15 Hillary Co. bonds for $15,000, less $400 brokerage fees.

(a) Journalize the transactions, and (b) prepare the adjusting entry for the accrual of interest on December 31.

Solution:

(a) Jan. 1 Debt Investments 30900

Cash 30900

July 1 Cash 1500

Interest Revenue 1500…… ($30,000 × 0.10 × 6/12)

July 1 Cash 14600

Loss on Sale of Debt Investments 850

Debt Investments 15450…($30900 × 15/30)

(b) Dec. 31 Interest Receivable 750

Interest Revenue 750… ($15000 × 0.10 × 6/12)

Purchase bounds at higher than or less than their per value:

There are two ways of accounting for premium and discount bonds:

Stated -interest method and effective-interest method

Stated -interest method: When using the Stated -interest method, the discount or premium is amortized to interest expense in equal amounts each period during the life of the bonds.

Schedule of rate and amortize of bonds by using Stated -interest method

Date	Cash Received	Interest Revenue	Bond Discount Or premium Amortization	Carrying Amount of Bonds

Example: A.B.C. Company purchased bonds $110000, 10 percent, five-year bonds on January 1, 2016, with interest payable on July 1 and January 1. (par value= 100000). which results in a bond premium of $10000 Stated -interest method**.**

Instructions:

(a) Journalize the transactions2016,2017 and 2018

(b) Prepare interest Schedule and amortize of bonds by using Stated -interest method.

Solution:

Jan. 1 Debt Investments 110000

Cash 110000

premium Amortization= Bond purchase price - par value

= 110000 – 100000 = 10000… 10000/5= 2000 annually

Schedule of rate and amortize of bonds by using Stated -interest method

Date	Cash Received	Interest Revenue	Bond premium Amortization	Carrying Amount of Bonds
1/1/2016				110000
1/7/2016	5000	4000	1000	109000
1/1/2017	5000	4000	1000	108000
1/7/2017	5000	4000	1000	107000
1/1/2018	5000	4000	1000	106000
1/7/2018	5000	4000	1000	105000
1/1/2019	5000	4000	1000	104000
1/7/2019	5000	4000	1000	103000
1/1/2020	5000	4000	1000	102000
1/7/2020	5000	4000	1000	101000
1/1/2021	5000	4000	1000	100000

1/7/2016: Cash 5000

Interest Revenue 4000

Debt Investments 1000

31/12/2016: Interest Receivable 5000…… or Accrued interest Re.

Interest Revenue 4000

Debt Investments 1000

1/1/2017: Cash 5000

Interest Receivable 5000

Balance Sheet 31/12/2016

Current assets

Interest receivable (Accrued interest revenue) $ 5000

Long-term investments

Debt investments (held-to-maturity) $108000

Example: A.B.C. Company purchased bonds $ 90000, 10 percent, five-year bonds on January 1, 2016, with interest payable on July 1 and January 1. (par value= 100000). which results in a bond discount of $10000 Stated -interest method**.**

Instructions:

(a) Journalize the transactions2016,2017 and 2018

(b) Prepare interest Schedule and amortize of bonds by using Stated -interest method

Solution:

Jan. 1 Debt Investments 90000

Cash 90000

premium Amortization= Bond purchase price - par value

= 90000 – 100000 = (10000)/5= (2000) annually

Schedule of rate and amortize of bonds by using Stated -interest method

Date	Cash Received	Interest Revenue	Bond Discount Amortization	Carrying Amount of Bonds
1/1/2016				90000
1/7/2016	4000	5000	1000	91000
1/1/2017	4000	5000	1000	92000
1/7/2017	4000	5000	1000	93000
1/1/2018	4000	5000	1000	94000
1/7/2018	4000	5000	1000	95000

1/1/2019	4000	5000	1000	96000
1/7/2019	4000	5000	1000	97000
1/1/2020	4000	5000	1000	98000
1/7/2020	4000	5000	1000	99000
1/1/2021	4000	5000	1000	100000

1/7/2016: Cash 4000

Debt Investments 1000

Interest Revenue 5000

31/12/2016: Interest Receivable 4000…… or Accrued interest Re.

Debt Investments 1000

Interest Revenue 5000

1/1/2017: Cash 4000

Interest Receivable 4000

Balance Sheet 31/12/2016

Current assets

Interest receivable (Accrued interest revenue) $ 4000

Long-term investments

Debt investments (held-to-maturity) $92000

At the end of five years, when the bonds are sold in the premium, the discount shall be the entry:

Cash 100000

Debt Investments 100000
