Investments

الاستثمارات

Accounting for investments in securities (debt and equity)

Financial investments consist of the purchase of securities includeDebit investments (bonds) , and Equity investments (shares) for the purpose of achieving economic benefits such as profits, interest, gains on the sale of investment, as well as exerting influence or control over the investee companies.

International Accounting Standards Board (IASB) requires that companies classify investments in securities into two measurement categories depending on their circumstances.

1- Amortized cost and

2- Fair value

First of all we need to understand what the following terms do mean:

Amortized cost: is the initial recognition amount of the investment minus repayments, plus or minus cumulative amortization and net of any reduction for uncollectibility.

Fair value: is the amount for which an asset could be exchanged between knowledgeable willing parties in an arm's length transaction.

Accounting for investments in debt securities:

Investments by companies in bonds issued by government or non-governmental entities in order to obtain periodic and fixed interest, and these investments are divided into the following forms.

Types of Debt investments (Bonds)

Held-for-collection Bonds	Investments that the company wishes to hold to the maturity date in order to obtain the interests.
Not held-for-collection Bonds	Investments acquired by the company in order to sell and trade these investments in the short term.

Accounting treatment for debt investments (bonds):

The accounting treatment for investing in bonds is determined according to the following two main criteria: first, the intention of the company in the purchase the bonds for the purpose of selling and trading or for the purpose of keeping them to the maturity date.

The second criterion is contractual cash flow characteristics of the investment which it means the clarity of future cash flows.

The following schedule explains the measurement method and unrealized gains or losses on acquisition.

Types of Bonds	**valuation method**	**Unrealized gains or losses on acquisition**	**Effects on income statement**
Held-for-collection Bonds	Amortized cost	Not recognized	1- Interests for acquisition 2- Gain & loss of sale bonds
Not held-for-collection Bonds	Fair value	Recognize it at income statement within other expenses & revenue item	1- Interests for acquisition 2- Gain & loss of sale bonds

Accounting for debt investments (bonds) by using amortized cost method:

The amortized cost method is used in accounting for the bonds that the company intends to hold to maturity. Thus, only bonds (not shares) can be placed under this classification. In addition, these bonds are placed in this classification according to two conditions, the first conditions is a positive intention by the company to hold the bonds until the maturity date. The second condition is the financial ability of the company to hold the bonds until the maturity date.

Example (1): In 1/1/2013 Baghdad company purchased bonds with a par value of ID 5000000 and an interest rate of 10% per annum, With Interest receivable December 31 of each year. Note that the company intends to keep the bonds until maturity date on 1/1/2018.

Required:

1- Prepare the journal entry at the date of the bond purchase.

2- Prepare the journal entry to record the interest received and the amortization for 2013.

3- Prepare the journal entry to record the interest received and the amortization for 2014.

Solution:

1/1/2013

Debit investment (investment in Bonds) 5000000

Cash 5000000

31/12/2013

Cash (10% * 5000000) 500000

Investment interest revenue 500000

31/12/2014

Cash (10% * 5000000) 500000

Investment interest revenue 500000

Example (2): In 1/1/2014 Baghdad company purchased bonds with a par value of ID 1000000 and an interest rate of 8% per annum, With Interest receivable in 1/1 and 1/7 of each year. Note that the company intends to keep the bonds until maturity date on 1/1/2017.

Required:

Prepare the journal entries for the years 2014, 2015, 2016, and 2017

Solution:

1/1/2014 Debit investment 1000 000

Cash 1000 000

In 1/7/2014 the company received interest for 6 months of amount ID 40 000 which are computed as following:

1000 000* 8% * 6/12= ID 40 000 and the company record the following entry

1/7/2014

Cash 40 000

Investment interest revenue 40 000

On December 31, there will be interest revenue due for six months related to 2016 has not been received, so that the company will record the following entry;

31/12/ 2014

Accrued investment interest revenue 40 000

Investment interest revenue 40 000

In 1/1/2015 when the Baghdad Co. received the accrued interest revenue the following entry will be recorded;

1/1/2015

Cash 40 000

Accrued investment interest revenue 40 000

1/7/2015

Cash 40 000

Investment interest revenue 40 000

31/12/2015

Accrued investment interest revenue 40 000

Investment interest revenue 40 000

In 2016, Baghdad continues to record entries in the same manner.

In 1/1/2017 Baghdad Co. received par value amount of debit investment at maturity date, and the company record the following entry;

1/1/2017

Cash 1000000

Debit investment 1000000

Purchase of bonds at different date from dates of interest payment

When bonds are purchased on a date other than the interest payment dates, the company will be required to pay interest to the seller or issuer of the bonds. Additionally, the accrued interest is paid separately to the seller from the purchase price.

Example (3): by using information of example (1), and assume that the bonds purchased at 1/3/2014.

Solution:

In this case, Baghdad Co. will pay two months' interest (January and February) to the seller or issuer.

1/3/2014

Debit investment 1000000

Investment interest revenue (1000000*8%*2/12) 13333

Cash 1013333

1/7/2014

Cash 40 000

Investment interest revenue 40 000

Investment interest revenue

1/3/2014 13333	1/7/2014 40000
26667	
40000	40000
Balance 26667	

□ The balance of investment interest revenue (26667) is equal 4 months(March, April, May, and June)

And the balance come from 1000000* 8% * 4/12= 26667

Purchase bonds at higher or less than their par value

In many cases, bonds are purchased at an amount higher than their par value this amount is called a premium. In other cases, the bonds are purchased at a lower amount which is called a discount. There are two methods to amortize bonds premium and bonds discount which are;

1- Effective rate and

2- Stated rate method.

Example (4): In 1/1/2015 Baghdad company purchased bonds of ID 518000 (par value =ID 500 000) and an interest rate of 8 % per annum, With Interest receivable 1/1 and 1/7 of each year. Note that the company intends to keep the bonds until maturity date on 1/1/2018.

Required:

1- Prepare the journal entries for the years 2015, 2016, 2017, and 2018

2- Prepare interest schedule and bonds amortized schedule and noted that Baghdad Co. is used stated rate method in amortizing bonds.

Solutions:

1/1/2015

Debit investments	518000	
Cash		518000

The Company purchased the bonds at an amount greater than the par value of ID 18000 which represents the purchase premium, and this premium will be amortized over the period between the date of purchase and the maturity date of 36 months, by using stated rate method.

Monthly amortized = 18000 / 36 months = ID 500 per month

Schedule of rates and amortize of bonds by using stated rate method

Date	Cash received	Interest revenue	Amortize premium	Carrying amount of bonds
1/1/2015	___	___	___	518000
1/7/2015	20000	17000	3000	515000
1/1/2016	20000	17000	3000	512000
1/7/2016	20000	17000	3000	509000
1/1/2017	20000	17000	3000	506000
1/7/2017	20000	17000	3000	503000
1/1/2018	20000	17000	3000	500000

1/7/2015

Cash	20000	
Investment interest revenue		17000
Debit investment		3000

31/12/2015

Accrued interest revenue	20000	
Investment interest revenue		17000
Debit investment		3000

1/1/2016

Cash	20000	
Accrued interest revenue		20000

1/7/2016

cash	20000	
Investment interest revenue		17000
Debit investment		3000

31/12/2016

Accrued interest revenue	20000	
Investment interest revenue		17000
Debit investment		3000

The company will continue to record same journal entries for year 2017.

In 1/1/2018 the company will received the amount of bonds, and record the following entry;

1/1/2018

Cash	500000	
Debit investment		500000

Example (5): In 1/5/2016 Baghdad company purchased 4 Debit investments of ID 392 000 (par value per bond =ID 100 000) and an interest rate of 12 % per annum, with Interest receivable 30/6 and 31/12 of each year. Note that the company intends to keep the bonds until maturity date on 31/12/2017.

Required:

1- Prepare the journal entries for the years, 2016, 2017.

2- Prepare interest schedule and bonds amortized schedule and noted that Baghdad Co. is used stated rate method in amortizing bonds.

Solutions:

Accrued interest revenue for the seller = 400000* 12%* 4/12= ID 16000

1/5/2016

Debit investment	392 000	
Interest revenue	16 000	
Cash		408 000

The Company purchased the bonds at an amount less than the par value of ID 8000 which represents the purchase premium, and this premium will be amortized over the period between the date of purchase and the maturity date of 20 months, by using stated rate method.

Monthly amortized = 8000 / 20 months = ID 400 per month

Schedule of rates and amortize of bonds by using stated rate method

Date	Cash received %12	Interest revenue	Amortize premium	Carrying amount of bonds
1/5/2016	___	___	___	392 000
30/6/2016	24000(16000+8000)	24800(16000+8800)	800	392 800
31/12/2016	24 000	26 400	2400	395 200
30/6/2017	24 000	26 400	2400	397 600
31/12/2017	24 000	26 400	2400	400 000

30/6/2016

Cash	24 000	
Debit investment 6* 400	800	
Investment interest revenue		24 800

31/12/2016

Cash	24 000	
Debit investment	2400	
Investment interest revenue		26 400

The balance of debit investment = 392 000 + 800 + 2400= ID 395 200

30/6/2017

Cash	24 000	
Debit investment	2400	
Investment interest revenue		26 400

31/12/2017

Cash	24 000	
Debit investment	2400	
Investment interest revenue		26 400

In 31/12/2017 the company will received the amount of bonds, and record the following entry;

31/12/2017

Cash	400 000	
Debit investment		400 000

Example (7): (Using **the data of the previous example)** Assume that, Baghdad Co. sold investments on 1/2/2017 for ID 379 000 as well as accrued interest.

Required: Record journal entries for sold transaction?

1/2/2017

Cash (24 000 * 1/6)	4000	
Debit investment (2400 * 1/6)	400	
Investment interest revenue		4400

The balance of debit investment will be 395 200 + 400 = ID 395 600

The sale journal entry will be:

1/2/2017

Cash	397 000	
Debit investment		395600
Gains on sale of investments		1400

Accounting for Debit Investment by using Fair Value method

The fair value method is used in accounting for investments in debt securities (bonds) when the company intends to trade in these bonds to earn profits.

The accounting treatment for these investments does not different from the investments that Held-for-maturity date, Only such investments are assessed and reported at the end of the financial period by using the fair value method.

Example (8): In 1/1/2016 Baghdad Co. purchased 4 debit investments for trading purposes with amount of ID 411500, as well as with the payment of any accrued interest. The par value for one bond is ID 100000 with interest rate of 12% annum, and interest is paid in 1/5 and 1/11 of each year, additionally the maturity date of these bonds are 1/11/2019. The fair value of bonds in 31/12/2016 is ID 409000, and the bonds were sold in 1/6/2017 of ID 408000 with the accrued interest.

Required:
Record any necessary journal entries for the years 2016, and 2017, note that the company uses stated rate method to amortize bond's premium and discount.

Solution:

Accrued interest revenue for the seller = 400000* 12%* 2/12= ID 8000

1/1/2016

Debit investment	411500	
Interest revenue	8000	
Cash		419500

1/1/2016 to 1/11/2019 = 46 months

The premium of bond's purchased = ID 11500

Monthly amortized = 11500 /46 months= ID 250 per month

Date	Cash received	Interest revenue	Amortize premium	Carrying amount of bonds
1/1/2016	___	___	___	411500
1/5/2016	24000 (8000 +16000)	23000 (1000-24000)	1000	410500
1/11/2016	24000	22500	1500	409000
1/5/2017	24000	22500	1500	407500
1/11/2017	24000	22500	1500	406000
1/5/2018	24000	22500	1500	404500
1/11/2018	24000	22500	1500	403000
1/5/2019	24000	22500	1500	401500
1/11/2019	24000	22500	1500	400000

1/5/2016

Cash	24000	
Investment interest revenue		23000
Debit investment		1000

1/11/2016

Cash	24000	
Investment interest revenue		22500
Debit investment		1500

31/12/2016

Accrued interest revenue	8000	
Investment interest revenue		7500
Debit investment		500

Investments	**Cost**	**Fair value**	**Unrealized gains or losses on acquisition**
12% Debit investment	**408500**	**409000**	**500**

Because the fair value higher than cost of ID 500, and in this case Fair value adjustment account will be shown as following;

31/12/2016

Fair value adjustment	500	
Unrealized gains or losses on acquisition		500

At the end of year the debit investment will be shown in balance sheet as of fair value

Balance sheet of the company as of 31/12/2016

Assets		**Liabilities and Owners' equity**
Debit investment	408500	
+ Fair value adjustment	500	
Fair value of Debit investments	409000	