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

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. only bonds (not shares) can be placed under this classification.

Example 3 : In 1/1/2013 Baghdad company purchased bonds with a par value of 5,000,000 ID 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

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 4 : In 1/3/2014 Baghdad company purchased bonds with a par value of 1,000,000 ID and an interest rate of 8% per annum, With Interest receivable 1/July four months after the date of purchase. Note that the company intends to keep the bonds until maturity date on 1/1/2018.

Solution :

The balance of investment interest revenue (26667) is equal 4 months 1,000,000* 8% * 4/12= 26667

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		

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-interest method**
2- **Stated rate method.**

Example 5 : Assume that Robinson Company purchased $100,000 of 8 percent bonds of Evermaster Corporation on January 1, 2016, at a discount, paying $92,278. The bonds mature January 1, 2021, and yield 10%. Interest is payable each July 1 and January .

Required :

1- Prepare the journal entries 2016 .

2- Prepare interest revenue schedule and Bond Discount Amortization-Effective-Interest Method .

Solutions :

1- January 1, 2016

Debt Investments	**92,278**	
Cash		**92,278**

2-

8% Bonds Purchased to Yield 10%

Date	Cash Received	Interest Revenue	Bond Discount Amortization	Carrying Amount of Bonds
1/1/16				$ 92,278
7/1/16	$ 4,000[a]	$ 4,614[b]	$ 614[c]	92,892[d]
1/1/17	4,000	4,645	645	93,537
7/1/17	4,000	4,677	677	94,214
1/1/18	4,000	4,711	711	94,925
7/1/18	4,000	4,746	746	95,671
1/1/19	4,000	4,783	783	96,454
7/1/19	4,000	4,823	823	97,277
1/1/20	4,000	4,864	864	98,141
7/1/20	4,000	4,907	907	99,048
1/1/21	4,000	4,952	952	100,000
	$40,000	$47,722	$7,722	

[a] $4,000 = $100,000 × .08 × 6/12
[b] $4,614 = $92,278 × .10 × 6/12
[c] $614 = $4,614 − $4,000
[d] $92,892 = $92,278 + $614

July 1, 2016

Cash	4,000	
Debt Investments	614	
Interest Revenue		4,614

December 31, 2016

Interest Receivable	4,000	
Debt Investments	645	
Interest Revenue		4,645