

Accounting for investments

lecture 5



Al-Mustaqbal University
College of Administrative Sciences

Department of Accounting



Assistant.lect Hussein Ali Hussein



Accounting for investments

Accounting for investments in securities (**Equity and Debt**)

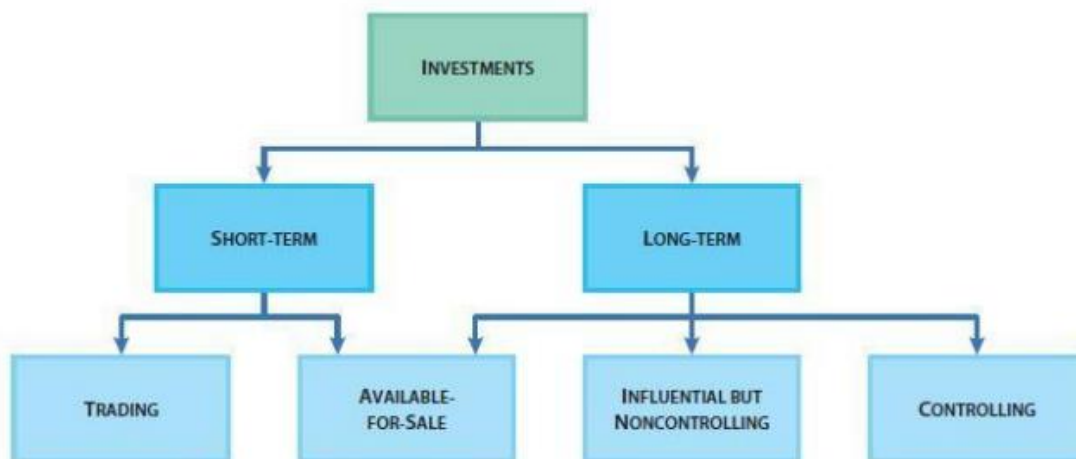
Financial investments consist of the purchase of securities include Debt investments (bonds) , and Equity investments (shares) for the purpose of achieving economic benefits such as profits, interest, gains on the sale of investment, as well as exerting influence or control over the investee companies. International Accounting Standards Board (IASB) requires that companies classify investments in securities into two measurement categories depending on their circumstances.

1- Amortized cost : is the acquisition cost adjusted for the amortization of discount or premium.

2- Fair value : is the price that would be received to sell an asset an orderly transaction between market participants at the measurement date .

Identify the categories of equity securities

Illustration of the classification of short-term and long-term investments for equity securities:



Describe the accounting treatment for short-term investments in equity securities

Example 1 : Nazar Company buys 5,000 shares of **I Company** for \$450,000 (\$90 per share) Fair Value 400,000 and 5,000 shares of **M Company** for \$150,000 (\$30 per share) Fair Value 160,000 on October 25, 2012. The purchase is made for trading purposes—that is, Nazar's management intends to realize a gain by holding the shares for only a short period.

The entry in journal form to record the investment at cost is as follows:

Sol /

Short-Term Equity Investments 600,000

Cash 600,000

(Investment in stocks for trading \$450,000 + \$150,000)

Trading Equity Security Portfolio

December 31, 2012

<u>Investments</u>	<u>Cost</u>	<u>Fair Value</u>	<u>Unrealized Gain (Loss)</u>
I Company	\$450,000	\$400,000	(\$50,000)
M Company	<u>150,000</u>	<u>160,000</u>	<u>10,000</u>
Totals	\$600,000	\$560,000	(\$40,000)

Unrealized Loss on Short-Term Investments 40,000

Fair Value Adjustment (trading securities) 40,000

Example 2 : Nazar Company buys 5,000 shares of **I Company** for \$450,000 (\$90 per share) Fair Value 475,000 and 5,000 shares of **A Company** for \$150,000 (\$30 per share) Fair Value 130,000 on October 25, 2012. The purchase is made for trading purposes—that is, Nazar's management intends to realize a gain by holding the shares for only a short period.

Trading Equity Security Portfolio

December 31, 2013

Investment	Cost	Fair Value	Unrealized Gain (Loss)
I Company	\$450,000	475,000	\$25,000
A Company	\$150,000	130,000	(20,000)
Total	600,000	605,000	5000

Fair Value Adjustment (trading securities) 5000

Unrealized Gain on Short-Term Investments 5000

For example : If Nazar Company receives a cash dividend of \$5,000 on its investment in the common stock of I Company; it records the cash dividend as follows :

December 31, 2013

Cash 5,000

Dividend Revenue 5,000

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
<u>Cash</u>	<u>5000000</u>

31/12/2013

Cash (10% * 5000000)	500000
<u>Investment interest revenue</u>	<u>500000</u>

31/12/2014

Cash (10% * 5000000)	500000
<u>Investment interest revenue</u>	<u>500000</u>

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
<u>Cash</u>	<u>1013333</u>

1/7/2014

Cash	40 000
<u>Investment interest revenue</u>	<u>40 000</u>

<u>Investment interest revenue</u>	
1/3/2014	13333
26667	
	<u>40000</u>
Balance	<u>26667</u>
1/7/2014	40000
	<u>40000</u>

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%				
<u>Date</u>	<u>Cash Received</u>	<u>Interest Revenue</u>	<u>Bond Discount Amortization</u>	<u>Carrying Amount of Bonds</u>
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
	<u>\$40,000</u>	<u>\$47,722</u>	<u>\$7,722</u>	

^a\$4,000 = \$100,000 × .08 × ½

^b\$4,614 = \$92,278 × .10 × ½

^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