Financial Accounting
Chapter 13(a) & 14(a)
Accounting for Investments

I) Accounting for Investments

A) Why do firms make investments?
1. Temporarily idle cash - invest short term.
2. Accomplish some long-term program or plan
   a. Long-term price appreciation
   b. Supplier/customer relations
   c. Ownership for control purposes

B) Possible classifications for investments
1. As to time frame
   a. Temporary - readily marketable and intended to be converted into cash.

   b. Long-term - some longer term objective for investment

2. As to type
   a. Equity securities
   b. Debt securities

II.) Short-term investments (temporary investments)

A) Contrast with cash equivalents

B) Very easy to convert these into cash

C) Acquired to maximize return on assets

D) Initial investment is recorded at cost
1. Cost includes any brokerage fees
   a. Journal entry— Marketable Securities XXX
      Cash XXX
      i. Interest or dividends received on investment is revenue

b. Classification of temporary investments
   i. Trading portfolio—securities are actively managed. Bought with intent to resell in near future. Hopefully sell for more than cost.
   ii. Available for sale portfolio—not bought with intent to resell in near future, but will sell if need for cash arises.

2. Both trading and AFS securities should be reported at Market Values in the Balance Sheet.
   a. Use “Fair Value Adjustment” account to adjust cost.
      i. Journal entry if market value is less than cost: Unrealized holding gain or loss XXX
         Fair Value Adjustment XXX
b. For trading portfolio, “Unrealized holding gain or loss” is reflected in net income.

c. For AFS portfolio, “Unrealized holding gain or loss” is shown in the equity section of the balance sheet.
   1. The “unrealized gain or loss” associated with the AFS portfolio is included in the measurement of comprehensive income.
      a) Comprehensive income—includes changes in equity from nonowner sources.

d. If security is later sold, the realized gain or loss is determined by comparing selling price (net of brokers fees) to cost.

III) Long-term Investments

A) Accounting for investments in Debt Securities

1. Record acquisition at cost - includes brokerage fees
   a. Does not include accrued interest purchased separately.

2. Classifications:
   a. Trading
   b. Available for Sale
   c. Held to Maturity

3. Record interest income as earned
   a. Note for long-term debt securities - the discount or premium, if any, affects interest revenue
      i. Premium - decreases interest revenue
      ii. Discount - increases interest revenue

4. If sold - selling price vs. carrying amount of bonds determines gain or loss

5. Reporting amounts in balance sheet will be discussed later

B) Accounting for investments in Equity Securities

1. Proper accounting treatment for stock investments (equity securities) depend on extent of ownership.
   a. If < 20% - Fair Value method (Cost method)
   b. If 20% - 50% - Equity method
      i. Presumption is that investor has ability to exercise significant influence.
   c. If > 50% - Consolidated financial statements

2. Fair Value method (cannot exercise significant influence)
   a. Record investment at cost
   b. Dividends received are reported as income
   c. Balance sheet reporting will be discussed later
   d. If sold - difference between selling price and cost is gain or loss.
3. Equity method (have ability to exercise influence over investee)  
   a. Record investment at cost  
   b. Record your share of investees net income (increase investment account)  
   c. Receipt of cash dividends are reflected as a reduction in the investment account.

4. Receipt of stock dividends or stock splits requires no formal entries.  
   a. However does reduce the cost per share of your investment

III) Valuation and reporting of investments

A) Debt Securities  
   1. Held to maturity investments are reported at amortized cost  
   2. Trading and available-for-sale securities are reported at FMV

B) Classifications for reporting purposes for equity investments accounted for under the fair value method.  
   1. Trading - report at FMV. Unrealized gain or loss in net income  
   2. Available for sale - report at FMV unrealized gain or loss adjusted through equity

C) Journal entries made to adjust to FMV are the same as illustrated previously.

D) Presentation of unrealized gain or loss on available-for-sale investments

**Stockholder's Equity**

| Common Stock | $3,000,000 |
| Retained Earnings | $1,300,000 |
| Total Paid in capital & retained earnings | $4,300,000 |
| Less: Unrealized loss on available for sale investments | ($150,000) |
| Total Stockholder's Equity | $4,150,000 |

IV) Consolidated Financial Statements

A) One corporation owns more than 50% of another corporation.  
   1. Parent - subsidiary relationship

B) Each corporation is a separate legal entity and keeps its own accounting records.

C) Separate records are "consolidated" into one set of financial statements which is presumed to be more meaningful.  
   1. For consolidation purposes, the assets and liabilities of each corporation is added together and the investment account on the parent's books is eliminated against the subsidiary's equity accounts.

   2. All intercompany transactions are eliminated as consolidated financial statements should only reflect transactions with "outside" parties.

   3. If the parent owns less than 100% of the subsidiary stock the portion of the subsidiary owned by others is shown as "minority interest."  
      a. Normally shown just above equity section in Balance Sheet.