

BUS 312 TRANSPARENCIES
Chapter 12

INVESTMENT CLASSIFICATIONS

Held-to-maturity: a security for which the company has the intent and ability to hold until maturity.

Trading securities: a security bought and held mainly for the purpose of selling it in the near term. Applicable mainly to banks.

Available-for-sale: securities that are not in either of the other two categories.

TRADING SECURITIES (DEBT OR EQUITY)

- Record initially at cost.
 - * If purchased between interest dates, interest must be paid to the seller for the period since the last interest date until the date of sale.
- Report changes in FMV.
 - * FMVs reported on the balance sheet.
 - * Gains and losses on changes in FMV, *both realized and unrealized*, reported in income.
- Any dividends or interest received reported in current income.

EXAMPLE 1

<u>October 8</u>		
Investment in stock--trading	57,500	
Cash		57,500
<u>November 15</u>		
Cash	1,100	
Dividend income		1,100
<u>December 31</u>		
Investment in stock--trading	350	
Unrealized holding gain or loss (income)		350
<u>January 8</u>		
Cash	57,950	
Investment in stock--trading		57,850
Realized gain on sale of investment		100

AVAILABLE-FOR-SALE EQUITY SECURITIES

BUS 312 TRANSPARENCIES
Chapter 12

- Record initially at cost.
- Report changes in FMV.
 - * FMVs reported on the balance sheet.
 - * *Realized* gains and losses reported in current income.
 - * *Unrealized* gains and losses on changes in FMV reported as an adjustment to stockholders' equity.
- Any dividends received reported in current income.

EXAMPLE 2

The October 8 and November 15 entries would be the same (except that investment account is labeled differently).

December 31

Investment in stock (AFS)	350	
Unrealized holding gain or loss (equity)		350

January 8

Cash	57,950	
Unrealized holding gain or loss (equity)	350	
Investment in stock (AFS)		57,850
Realized gain on sale of investment		450

AVAILABLE-FOR-SALE DEBT SECURITIES

- Record initially at cost (no premium/discount accounts).
- Report changes in FMV.
 - * FMVs reported on the balance sheet.
 - * *Realized* gains and losses reported in current income.
 - * *Unrealized* gains and losses on changes in FMV reported as an adjustment to stockholders' equity.
- Any interest received reported in current income.
- Amortize premium or discount over the remaining life.
 - * For a premium, income recognized < cash received.
 - * For a discount, income recognized > cash received.
 - * Effective interest method usually required.

**BUS 312 TRANSPARENCIES
Chapter 12**

EXAMPLE 3

Date	Interest Revenue	Cash Receipt	Discount Amortization	Carrying Value
1-1-04				\$924,183
12-31-04	\$92,418	\$80,000	\$12,418	936,601
12-31-05	93,660	80,000	13,660	950,261
12-31-06	95,026	80,000	15,026	965,287
12-31-07	96,529	80,000	16,529	981,816
12-31-08	98,184	80,000	18,184	1,000,000
Total	\$475,817	\$400,000	\$75,817	

EXAMPLE 3

January 1--purchase of bonds

Investment in bonds	924,183	
Cash		924,183

December 31--receipt of interest/amortization of discount

Cash	80,000	
Investment in bonds*	12,418	
Interest revenue		92,418

*eventually this will bring the amortized cost up to par

Dec. 31--unrealized gain (for loss, accounts would be reversed)

Investment in bonds	63,399	
Unrealized holding gain or loss (equity)		63,399

HELD-TO-MATURITY DEBT SECURITIES

- Record initially at cost.
- Changes in FMV not recognized.
 - * Amortized cost reported on the B.S.
 - * *Realized* gains and losses reported in income.
- Any interest received reported in current income.
- If bonds purchased at a premium or discount, amortize over the remaining life of the bonds.

COST METHOD

BUS 312 TRANSPARENCIES
Chapter 12

- Record initially at cost.
- Changes in FMV not recognized.
 - * Amortized cost reported on the B.S.
 - * *Realized* gains and losses reported in income.
- Any dividends or interest received reported in current income.
- If bonds purchased at a premium or discount, amortize over the remaining life of the bonds.

EQUITY METHOD (APB Opinion 15)

- Record initially at cost.
- Investment account increased for the proportionate share of income.
- Investment account reduced for:
 - * Dividends received.
 - * Amortization of excess depreciation (FMV-BV).
(Investment revenue also reduced.)

EXAMPLE 5

<u>May 10, 2004</u>			
Investment in LittleCo.	350,000		
Cash			350,000
<u>December 31, 2004 (entry 1--share of LittleCo.'s net income)</u>			
Investment in LittleCo. (20% × \$320,000)	64,000		
Investment revenue			64,000
<u>December 31, 2004 (entry 2--dividends from LittleCo.)</u>			
Cash (20% × \$100,000)	20,000		
Investment in LittleCo.			20,000
<u>Dec. 31, 2004 (entry 3--amortization of excess depreciation)</u>			
Investment revenue	6,000		
Investment in LittleCo.			6,000
20% of FMV of \$1,500,000 =			300,000

BUS 312 TRANSPARENCIES
Chapter 12

20% of BV of \$1,200,000 difference	$\frac{240,000}{60,000}$ $\div \frac{10 \text{ years}}{6,000 \text{ per year}}$
<u>December 31, 2005 (entry 1--share of LittleCo. net loss)</u>	
Loss on investment	20,000
Investment in LittleCo. (20% × \$100,000)	20,000
<u>December 31, 2005 (entry 2--dividends from LittleCo.)</u>	
Cash (20% × \$25,000)	5,000
Investment in LittleCo.	5,000
<u>Dec. 31, 2005 (entry 3—amort. of excess depreciation)</u>	
Investment revenue	6,000
Investment in LittleCo.	6,000

TRANSFERS BETWEEN CATEGORIES

From trading to held-to-maturity or available-for-sale:

- a. If the unrealized gain or loss *has* been recognized, do not reverse it.
- b. If the unrealized gain or loss has *not* been recognized, recognize it in income as of the date of the transfer.

To trading from held-to-maturity or available-for-sale:

- a. Recognize the unrealized gain or loss at the date of transfer in net income immediately.

From held-to-maturity to available-for-sale:

- a. Recognize the unrealized gain or loss in a separate equity account.

To held-to-maturity from available-for-sale:

- a. Continue to carry the unrealized gain or loss in a separate equity account.
- b. However, the amount should be amortized over the security's remaining life as an adjustment to interest (similar to amortization of premium or discount).

BUS 312 TRANSPARENCIES
Chapter 12

FINANCIAL STATEMENT PRESENTATION

Balance sheet:

Assets:

trading securities	FMV, current
available-for-sale	FMV, current or long-term
held-to-maturity	amortized cost, probably long-term
equity method sec.	adjusted balance in investment acct.

Stockholders' equity:

Balance in unrealized holding gain or loss

Income statement:

- a. Realized G/L on sale of AFS securities.
- b. Basis on which cost was determined in computing realized G/L (i.e., FIFO, specific ID, etc.)
- c. Gross G/L included in earnings from transfers of AFS securities to trading securities.
- d. The change in net unrealized gains and losses on AFS securities that has been included in SE.
- e. The change in net unrealized holding G/L on trading securities that has been included in income.

Statement of cash flows:

- a. Purchases and sales of trading securities are considered operating activities.
- b. Purchases and sales of all other investments are considered investing activities.

Additional disclosures:

For AFS and for HTM securities, describe:

- (1) Aggregate FMV, gross unrealized holding gains, gross unrealized losses, and amortized cost basis by major security type (debt and equity).
- (2) Information about the contractual maturities of debt securities. Maturity information can be combined into appropriate groupings (a minimum of 4).

For any sales of or transfers from HTM securities:

- (1) Amortized cost of the sold or transferred security.
- (2) Related realized or unrealized gain or loss.
- (3) Circumstances leading to the decision to sell or transfer the securities.

TREATMENT PRIOR TO SFAS No. 115

BUS 312 TRANSPARENCIES
Chapter 12

- Investments classified as LT or ST based on mgmt. Intent
- Valuation based on LCM
 - (1) Losses were recognized.
 - (2) Gains were not recognized.
 - (3) Losses on ST portfolio were recognized in income of the current period.
 - (4) Losses on LT portfolio were reflected as a contra-equity account.

The accounting principles that the old rules satisfied were:

- revenue recognition
- conservatism

The problems that existed were:

- a. "Gains trading" by management--securities were shifted between ST and LT portfolios to avoid loss recognition.
- b. Inconsistent treatment of gains and losses.
- c. Increases in FMV were ignored for valuation purposes, so users were not getting relevant information.