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Research Article

How to Account for Debt Investments and Explain How to Account for Share Investments and Reported in Financial Statements?

Zharifah Putri Hasibuan[1], Angela Kezia Sianturi[2], Iskandar Muda[3]

Abstract

In this day and age, many people or companies make decision to invest. Companies have different motivations for investing in the form of debt investments and share investments issued by other companies. The first motivation is to get a high rate of return. Another motivation to invest is to maintain certainty of operation or financial relationship with other companies. The value of debt investments and share investments always fluctuating. The Company can assess its investment at the acquisition price (cost), or at a fair price (fair value), or with which value is lower between the acquisition price and the net realized value (lower of cost or net realizable value). Many argue that fair value assessment is the best way because it shows the cash value that can be expected to be realized. Investors will record debt investment at the time of acquisition, receive interest (including accrued interest) and sell it. Gain/loss on sale is recorded as other income and expense in the income statement. Investors will record share investment at the time of acquisition, receipt dividends and sell them. For the purposes of assessment and reporting as of the date of the financial statements, debt investment divided into two categories: Trading Securities, Held for Collection Securities. Share investments are also divided into two categories: Trading Securities, Non-Trading Securities. In full, the investment assessment for debt investments and for share investments will be explained in more detail.

***Keywords**:* Debt Investments, Share Investments, Financial Statements

1. INTRODUCTION

Investment in the general sense is the entirety of assets other than cash or cash equivalents owned by the company that is expected to be economic benefits in the future in the form of wealth growth through the distribution of investment returns (Santioso, 2018). Investing is one of the most interesting activities nowadays. In developing countries, especially, investment can become a profitable activity for anyone who carries out investment activities,

Investment activities are expected to provide benefits in terms of increasing profits, especially from the capital that has been issued for the investment in the future (Warae et al., 2021). However, investment too is an activity that is faced with various kinds of risks and uncertainty that is difficult for investors to predict or investors. There are three reasons why companies invest. First, because the company has excess cash that is not needed in the near future. This investment will generate income (in the form of interest and dividends) greater than just being deposited in a bank. The

[1,2,3] Universitas Sumatera Utara, Medan, Indonesia

second reason is to generate income from investments. For example, the company invests in shares (Adam, 2020). In addition to the expected dividend, companies also earn income from the difference in the selling price and the purchase price of shares.

The third reason is strategic reasons. The company can buy shares from the customer or supplier company that affects the company. The shares purchased are significant enough, although not enough to control (controlling). It is also up to the company to buy shares (in amounts that are not controlling) other companies or similar industries that will be entered.

Therefore, good science and knowledge about investment is needed so that there are no mistakes in making investments and losses that will occur in the future. The goal of investors to invest their funds in a company is to maximize the return (rate of return) without ignoring the risks it will face.

Hardinugroho, (2012) explained that the return can be in the form of dividend yield or income from the difference in the selling price of the stock against its purchase price (capital gain). This depends on the company's management policy in sharing its profits. The dividend policy of a company involves two mutually exclusive parties conflicting, namely the interests of shareholders who expect dividends with the company's interests in retained earnings.

2. LITERATURE REVIEW

There is two types of financial assets, such as debt investment and equity (shares) investment (Badawi, 2021). Debt investments, such as bonds and mortgages, specify fixed payment, including interest, to the visitor. In a debt investment, either profit or loss, will be recorded as Other Income and Expenses” in the Income Statement for the current year. Shares can also be called as stocks, equities, or securities. Share investments is investment that formed as a shares of other companies (investee). Such as stock, are securities that come with a “claim” on the earnings and/or assets of the corporation.

Debt comes in a variety of forms. It can be public or private, having many potential contractual features, making it an interesting form of financing when it comes to financial reporting. Unlike equity, a debt contract has multiple dials the contracting parties can turn to achieve an overall objective, e.g. pricing, collateral terms, maturity, etc. (Van horne et al, 2008)

When there is excess cash flows, the firms will either pay down debt or invest in marketable securities. When there is insufficient cash flows, the firm will sell marketable securities or draw down on its cash reserves (Shakespeare, 2020). But, bondholders do not gain ownership in the business or have any claims to the future profits of the borrower. The only obligation that the borrower have is to repay the loan with interests. Entities owe an obligation to completely reveal matters concerning their activities to help investors in making informed choices (Arnold, 2021).

Equity investments are a classic example of taking on higher risk of loss in return for potentially higher reward. It can be made or lost with equity investment. Because these wide price swing can be affected by political, social or governmental issues in the home country of the corporation. For a good investment decision, the investor needs to see, completely and correctly understand the possible opportunities of the investment and this investment decision should not be rushed as a bad investment decision can lead companies to bankruptcy (Hoyle, 2011).

All the financial decisions should be based on an assessment of an entity's capacity to generate cash, timetable, and the certainty of its creation. Information on the entity's financial position (balance sheet), performance (from the income statement), and changes in its financial position (from the cash flow statement) provides information to support such decisions (Saxena and Sahoo, 2021). The investment in the debt security will be reported at each balance sheet date at its then current market value.

The initial investment is recorded as an asset on the investing company's balance sheet. The value of this asset will change over time. The investment value will increase when the investee's profit increases. And when the investment records a loss, this is reflected in the investment value. These profits and losses must also be recorded on the income statement. When the investments are acquired with the simple intent of generating profits by reselling the investment in the very near future, such investments are classified as current assets (following cash on the balance sheet).

3. METHODS

1. Debt Investments

According to GAAP, debt investment are classified into:

a. Held to Maturity

   Held to Maturity is debt securities for which the management has both the intent and ability to hold them till maturity. The basic accounting approach when the debt is held till maturity is amortized cost. Amortized cost is that accumulated portion of the recorded cost of a fixed asset that has been charged to expense through either depreciation or amortization.

b. Trading

   Trading securities are investments in the form of debt or equity that the management of the company wants to actively purchase and sell to make profit in the short term with securities they believe are going to increase in price, these securities can be found on the balance sheet at the fair value on the balance sheet date (Thakur).

c. Available for Sale

   Available for Sale investment is debt investment which neither meet the requirements of Held to Maturity and Trading securities. Available for sale securities may be classified as current assets on the balance sheet if they are to be liquidated within one year, or as long-term assets if they are to be held for a longer period of time.

2. Share Investments

For share investment, there are three different approaches to the financial reporting of investments in corporate equity securities: (Dimitriou, 2020)

a. The Cost Method

   Used when an investor possesses only a small percentage of an investee company's outstanding stock, perhaps only a few shares. Often this is true for investing companies that own 20% or less of the other company. This method also used for reporting investments in equity securities when both consolidation and equity method reporting are inappropriate. The cost method is normally accorded noncurrent assets.

b. The Equity Method

   This method can offers a way to accurately reflect a company ownership in another entity. Equity method only applies when the investor owns a high percentage of the associate entity, between 20% and 50% of the stock. Under the equity method, the investor adds its proportionate share in income of the investee to the carrying value of its investment and subtracts its proportionate share of dividends. At the time of disposal, the difference between the carrying value and the sale proceeds is recognized as income or expense. The equity method is accrual basis driven. The investment is recorded at the initial purchase price and adjusted each period for the investor’s share of the investee’s profit or loses and the dividends declared by the investee (CFI Education, 2021) Shareholders’ equity is the initial amount of money invested in a business. In order for the balance sheet to balance, total assets on one side have to equal total liabilities plus shareholders’ equity on the other side. Using the equity method, a company reports the carrying value of its investment independent of any fair value change in the market (Hill, 2020). An investing company recognizes its share of the investee’s profits and losses using the equity method. These figures will be recorded in the following documents: Balance Sheet, Income Statements.

c. Consolidation

This method used whenever a stockholder accumulates more than 50 percent of an organization’s outstanding voting stock. A review of the financial statements of America’s largest organizations indicates that legal control of one or more subsidiary companies is an almost universal practice. PepsiCo, Inc., as just one example, holds a majority interest in the voting stock of literally hundreds of corporations. Prior to the accounting requirements for variable interest entities, many firms (e.g., Enron) avoided consolidation of entities in which they owned little or no voting stock but otherwise were controlled through special contracts (Hoyle et al.,2011).

Prior to GAAP for equity method investments, firms often used the cost method to account for their unconsolidated investments in common stock regardless of the presence of significant influence.

4. RESULTS AND DISCUSSION

4.1 RESULTS

1. Financial Assets: Investment – Debt Securities

The following information relates to the debt investments of Missouri Company.

1. On February 1, the company purchased 10% bonds of Georgia Co. having a par value of $300,000 at 100 plus accrued interest. Interest is payable April 1 and October 1.
2. On April 1, semi-annual interest is received.
3. On July 1, 9% bonds of Sasha, Inc. were purchased. These bonds with a par value of $200,000 were purchased at 100 plus accrued interest. Interest dates are June 1 and December 1.
4. On September 1, bonds with a par value of $60,000, purchased on February 1, are sold at 99 plus accrued interest.
5. On October 1, semiannual interest is received.
6. On December 1, semiannual interest is received.
7. On December 31, the fair value of the bonds purchased February 1 and July 1 are 95 and 93, respectively.

Instruction:

a. Prepare journal entries necessary (including Dec 31), assuming these investments are managed to profit from changes in market interest rates

b. If Missouri Company classified these as held-for collection investments, explain how the journal entries would be different
c. Assume that Missouri Company elects the Fair Value option for these investments as held-for-collection investments, how will the accounting change?

Answers:

a) Journal Entries

1 Feb Debt Investments 300,000
Interest Revenue 10,000 (4/12 X 0.1 X $300,000)
Cash 310,000

1 AprilCash 15,000
Interest Revenue 15,000 ($300,000 X0 .1 X 6/12)

1 July Debt Investments 200,000
Interest Revenue 1,500 (1/12 X0 .09 X $200,000)
Cash 201,500

1 Sept Cash 61,900
[($60,000 X 99%) + ($60,000 X 0.1 X 5/12)]
Loss on Sale of Debt Investment 600
Debt Investments 60,000
Interest Revenue 2,500 (5/12 X .10 X $60,000)

1 Oct Cash 12,000
[($300,000 – $60,000) X0 .1 X 6/12]
Interest Revenue 12,000

1 Dec Cash 9,000 ($200,000 X 9% X 6/12) Interest Revenue 9,000

31 Dec Interest Receivable 7,500
(3/12 X $240,000 X 0.1) + (1/12 X $200,000 X 0.9)
Interest Revenue 7,500
31 Dec Unrealized Holding Gain or Loss—Income 26,000
Securities Fair Value Adjustment 26,000

Table 1. Debt Investment Portfolio

Investments	Costs	Fair Value	Unrealized Gain (Loss)
Georgia Co.	$240,000	$240,000 x 95% = $228,000	$ (12,000)
Sasha, Inc	$200,000	$200,000 x 93% = $186,000	$ (14,000)
Total	$440,000	$414,000	$ (26,000)

b) All the entries would be the same except the last entry would not be made.
31 Dec Unrealized Holding Gain or Loss—Income 26,000

Securities Fair Value Adjustment 26,000
(this will be irrelevant)

In addition, held-for-collection investments would be carried at amortized cost and not valued at fair value at year-end.

c) If Missouri Company elects the fair value option for these investments, they would need to record an unrealized gain or loss each year. The unrealized gain (loss) would be the difference between the investments amortized cost and their year-end fair value.

2. Financial Assets: Investment – Equity Securities

Table 2. Tara Company had this following portfolio at January 1, 2019

a Company	shares @$15 each	00
son Company	hares @$20 each	00
ompany	hares @$9each	0
trading investments at cost		00
Value Adjustment		0)
trading investment as FV		00

During 2019, this following transactions took place :

1. On February 5 , Olivia Company paid a $2 per share dividend
2. On May 18, Tara Company purchased 100 more shares of Lia Company at $16 per share
3. On June 30, Tara Company sold 300 shares of Johnson Company for $11 per share
4. At December 31, 2019, the shares had the following price per share values : Olivia $17, Johnson $19, Lia $8

Table 3. Journal Entry for this transactions

Date	Transactions	Dr.	Cr.
2019			
Feb 5	Cash	1800	
	Dividend Revenue		1800 (900*$2)
May 18	Equity Investments	1600	
	Cash		1600 (100*16)
June 30	Cash	3300	
	Gain on Sale of Equity Investment		600 (300*($11-$9)
	Equity Investments		2700
Dec 31	Securities FV Adjustment	8500	
	Unrealized Holding Gain (Loss) – Equity		8500

Table 4. Journal Transaction

Investments	Cost	Fair Value	Unrealized Gain
Olivia	$16600	(1000+100) X $17= $18700	$2100
Johnson	$18000	900 X $19= $17100	$(900)
Lia	$1800	(500-300) X $8 = $1600	$(200)
Total of Portfolio	$36400	$37400	$1000
Previous securities FV Adjustment balance – Cr			$(7500)

Securities FV Adjustment – Dr.	$8500

Table 5. Financial Statement

Partial Statement of Financial Position as of	31 December 2019
Investments: Equity Investments, at FV	$37400
Current Assets: Dividend Receivable	$0

4.2. DISCUSSION

1. Financial Assets: Investment – Debt Securities

a. Investments consist of debt (bonds, notes) and equity (shares).
b. The function of the investment is to generate more money / receive contractual cash flow (inflow).
c. Financial Assets consist of cash, equity investment, and contractual right to receive cash from another company

2. Financial Assets: Investment – Equity Securities

a. Equity investments represents ownership of ordinary, preference, or other capital shares
b. Cost includes the price of the security and broker's commission and other fees incidental to the purchase
c. Percentage of Ownership, level of influence, valuation method
   0% - 20% → à little or none → Fair Value
   20% - 50% → significant → Equity
   50% - 100% → control → Consolidation
d. Equity Method Journals:

Purchase

Equity Investments	xxx	
Cash		xxx

Net Income Declaration

Equity Investments	xxx	
Investment Income		xxx

Dividend Payment

Cash	xxx	
Equity Investments		xxx

Declaration of net loss

Investment Loss	xxx	
Equity investments	xxx	

Investment can take the form of debt investment or share investment. Investor will record debt investment at the time of acquisition, receiving interest (including accrual interest) and sell them. Gain/loss when sales are recorded as other income and expense in income statement. Share investment refers to amounts received by the reporting company from transactions with shareholders. Companies can generally issue either common shares or preferred shares. Common shares represent residual ownership in a company and in the event of liquidation or dividend payments, common shares can only receive payments after preferred shareholders have been paid first. In addition to shares being sold for cash as in the previous example, it is also common to see companies selling shares on a subscription basis. In these situations, the buyer usually makes a down payment on purchasing a certain number of shares and agrees to pay the remaining amount at a later date. Dividen payments by companies to its stockholders (shareholders) are completely discretionary. Companies have no obligation whatsoever to pay out dividends until they have been formally declared by the board.

5. CONCLUSION

Debt Investment and Share investment are instruments for investments, can used for described how transaction about investment occurred. Financial statements record the various inflows and outflows of investment for a business. These documents present financial data about a company efficiently and allow analysts and investors to assess a company's overall profitability and financial health.

A balance sheet is the summary of a company's liabilities, assets, and shareholders' equity at a specific point in time. The three segments of the balance sheet help investors understand the amount invested into the company by shareholders, along with the company's current assets and obligations. Shareholders' equity represents the net worth of a company, which is the dollar amount that would be returned to shareholders if a company's total assets were liquidated, and all of its debts were repaid.

Shareholders' equity can be either negative or positive. If it's in positive territory, the company has sufficient assets to cover its liabilities. If it's negative, its liabilities exceed assets, which may deter investors, who view such companies as risky investments. But shareholders' equity isn't the sole indicator of a company's financial health.

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