

14.4: Investments in Bonds

A company may invest in the bonds of another corporation if it has no immediate need for its cash, just like it can invest in another corporation's stock. An investor in bonds is lending money to another corporation. A separate account that mentions the unique name of the corporation for each bond investment is used.

For example, a company might invest in the bonds of three other corporations and use *Investment in ABC Bonds*, *Investment in Home Depot Bonds*, and *Investment in Delta Airlines Bonds* as their three distinct asset account names.

There are five possible journal entries related to investing in bonds, as follows:

1. Purchase the bonds investment
2. Record the semi-annual interest receipts
3. Amortize the discount or premium
4. Adjust to fair value
5. Sell the bonds investment

Investments in bonds are accounted for in three different ways, depending on how long the investor intends to hold the investment. Bonds are classified as one of three types of securities.

- The debt is classified as (a) **held-to-maturity** when the investor has the intent and ability to hold the bond full term.
- The debt is classified as (b) **trading** when the intent is to sell it in the short term for profit and own it less than one year.
- The debt is classified as (c) **available-for-sale** when it is neither held-to-maturity nor trading.

The investment in bonds accounts appear in the assets section of the balance sheet. Those that are classified as trading securities to be sold or traded within one year are current assets. Held-to-maturity and available-for-sale securities that are intended to be owned for more than one year are categorized as long-term investments.

Bonds have a face value, which is the amount that will be repaid on the maturity date. In the example that follows, the face amount is \$5,000,000. In addition, the bond investment will show a contract rate, which is the percent of interest that will be paid annually to investors. In the example, the interest rate is 8%. Bonds also are in effect for a stated period of time and have a maturity date. In the example, the term of the bonds is four years, so the maturity date is December 31, 2021. On that date, investors are repaid the face amount of the bond investment.

4.10.1 Held-to-Maturity Securities

Bond investments are classified as held-to-maturity when the investor has the intent and ability to hold the bond full term. Two versions of the journal entries related to investing in held-to-maturity bond securities are illustrated side by side in the journal entries that follow. The transactions on the left illustrate transactions for bond investments purchased at a discount. On the right are journal entries for bonds purchased at a premium. Explanations are included.

Held-to-maturity bond securities appear under the Long-Term Investments caption in the assets section of the balance sheet. They are reported at their amortized cost, as explained below. They are not adjusted to fair value.

1A. Purchase the Bond Investment of Held-to-Maturity Securities

Bonds may be purchased for their face amount. They may also be purchased at either a discount or a premium; that is, for less or more than the face amount, respectively. If the contract interest rate that the issuing corporation is offering is less than the going market rate, investors purchase the bonds at a discount (for less than face amount). If the contract interest rate that the issuing corporation is offering is more than the going market rate, investors purchase the bonds at a premium (for more than face amount).

The following bonds are purchased on January 1, 2018.

At a Discount (market rate is lower)				At a Premium (market rate is higher)			
1/1/2018 Your Corporation purchases \$5,000,000 of four-year, 6% ABC Co. bonds for \$4,700,000. (The bond investment is purchased at a discount of \$300,000).				1/1/2018 Your Corporation purchases \$5,000,000 of four-year, 6% ABC Co. bonds for \$5,300,000. (The bond investment is purchased at a premium of \$300,000).			
Account	Debit	Credit		Account	Debit	Credit	

▲	Investment in ABC Stock		4,700,000			▲	Investment in ABC Bonds		5,300,000		
▼	Cash			4,700,000		▼	Cash			5,300,000	
▲ <i>Investment in ABC Bonds</i> is an asset account that is increasing .						▲ <i>Investment in ABC Bonds</i> is an asset account that is increasing .					
▼ <i>Cash</i> is an asset account that is decreasing .						▼ <i>Cash</i> is an asset account that is decreasing .					
Ledger account balance:						Ledger account balance:					
Investment in ABC Stock						Investment in ABC Stock					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit
		4,700,000		4,700,000				5,300,000		5,300,000	

2A. Record Interest for Semi-Annual Interest Receipts for Held-to-Maturity Securities

The corporation that issued the bond securities pays interest to the investor semi-annually, or every six months. The issuing company pays semi-annual interest on June 30 and December 31 each year. The amount is determined by multiplying the face amount of the bonds by half of the annual contract rate.

At a Discount (market rate is lower) EVERY SIX MONTHS Your Corporation records semi-annual interest received and discount amortized.						At a Premium (market rate is higher) EVERY SIX MONTHS Your Corporation records semi-annual interest received and premium amortized.					
	Account		Debit	Credit			Account		Debit	Credit	
▲	Cash		15,000			▲	Cash		15,000		
▲	Investment Revenue			15,000		▲	Interest Revenue			15,000	
▲ <i>Cash</i> is an asset account that is increasing .						▲ <i>Cash</i> is an asset account that is increasing .					
▲ <i>Interest Revenue</i> is a revenue account that is increasing .						▲ <i>Interest Revenue</i> is a revenue account that is increasing .					
Cash and Interest Revenue amounts = (\$5,000,000 x 6%) / 2						Cash and Interest Revenue amounts = (\$5,000,000 x 6%) / 2					

The investment account balances are not affected by the receipt of the interest. This transaction is recorded every six months as the cash is received for the interest revenue for as long as the investment is held.

3A. Amortization of Discount or Premium for Held-to-Maturity Securities just prior to Financial Statements

If bonds are purchased at a discount or premium, there is a difference between the amount paid for the investment and the face amount. That difference is accounted for over time as Interest Revenue rather than recorded as Interest Revenue all at once at the time of purchase. This process is called amortization; it is similar to depreciation but for non-physical assets. Assume that the investor prepares financial statements at the end of each calendar year. The straight-line method will be used to amortize the discount or premium amount at the end of each year, which involves dividing the discount or premium amount by the number of years in the term of the bond.

At a Discount (market rate is lower)						At a Premium (market rate is higher)						
EVERY YEAR END Your Corporation records semi-annual interest received and discount amortized.						EVERY YEAR END Your Corporation records semi-annual interest received and premium amortized.						
	Account		Debit	Credit				Account		Debit	Credit	
▲	Investment in ABC Bonds		75,000			▼		Interest Revenue		75,000		
▲	Interest Revenue			75,000		▼		Investment in ABC Bonds			75,000	
▲ Cash is an asset account that is increasing .						▼ Interest Revenue is a revenue account that is decreasing .						
▲ Interest Revenue is a revenue account that is increasing .						▼ Investment in ABC Bonds is an asset account that is decreasing .						
Investment amortization amount = (\$5,000,000 - \$4,700,000) / 4 years = \$75,000						Investment amortization amount = (\$5,000,000 - \$5,300,000) / 4 years = \$75,000						
The journal entry above is repeated every year end for a total of four years in the term of the bond.												
The ledgers that follow show the change over time in the carrying amount of the bond investment as the discount or premium is amortized every year.												
With each entry in the investment account’s ledger, the running debit balances moves closer and closer to the face amount of the bonds.												
The debit balance of an investment purchased at a discount continuously increases. The debit balance of an investment purchased at a premium continuously decreases.												
Ledger account balance:						Ledger account balance:						
Investment in ABC Stock						Investment in ABC Stock						
Date	Item	Debit	Credit	Debit	Credit		Date	Item	Debit	Credit	Debit	Credit
1/1/18		4,700,000		4,700,000			1/1/18		5,300,000		5,300,000	
12/31/18		75,000		4,775,000			12/31/18		75,000		5,225,000	
12/31/19		75,000		4,850,000			12/31/19		75,000		5,150,000	
12/31/20		75,000		4,925,000			12/31/20		75,000		5,075,000	
12/31/21		75,000		5,000,000			12/31/21		75,000		5,000,000	

4A. Adjust to Fair Value - Not Applicable for Held-to-Maturity Securities

Held-to-maturity investments are not adjusted to fair value over time since the intent is not to sell them at a gain or loss prior to the maturity date of the bonds. Therefore, there is no journal entry to adjust held-to-maturity investments to fair value.

5A. Alternative #1 - Sell the Bonds Investment of Held-to-Maturity Securities on Maturity Date

Investors receive the full face amount on the maturity date. Held-to-maturity securities are typically repaid on the maturity date, so this is the more common transaction for the repayment.

At a Discount (market rate is lower) 12/31/21 ABC Co. redeems the bonds and pays back the face amount of \$5,000,000 to Your Corporation after the full term of the bond.						At a Premium (market rate is higher) 12/31/21 ABC Co. redeems the bonds and pays back the face amount of \$5,000,000 to Your Corporation after the full term of the bond.					
	Account		Debit	Credit			Account		Debit	Credit	
▲	Cash		5,000,000			▲	Cash		5,000,000		
▼	Investment in ABC Bonds			5,000,000		▼	Interest in ABC Bonds			5,000,000	
▲ Cash is an asset account that is increasing .						▲ Cash is an asset account that is increasing .					
▼ Investment in ABC Bonds is an asset account that is decreasing .						▼ Investment in ABC Bonds is an asset account that is decreasing .					
Ledger account balance:						Ledger account balance:					
Investment in ABC Stock						Investment in ABC Stock					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit
1/1/18		4,700,000		4,700,000		1/1/18		5,300,000		5,300,000	
12/31/18		75,000		4,775,000		12/31/18			75,000	5,225,000	
12/31/19		75,000		4,850,000		12/31/19			75,000	5,150,000	
12/31/20		75,000		4,925,000		12/31/20			75,000	5,075,000	
12/31/21		75,000		5,000,000		12/31/21			75,000	5,000,000	
12/31/21			5,000,000		0	12/31/21			5,000,000	0	

5A. Alternative #2 - Sell the Bonds Investment of Held-to-Maturity Securities Prior to Maturity Date

Investors may receive more or less than the face amount of the bond if they sell the investment prior to the maturity date. A gain or loss on the sale may occur. The examples that follow show a bond purchased at a discount that is sold for a gain and a bond purchased at a premium that is sold at a loss. The gain and loss may be reversed for a premium and discount, respectively, as well.

Held-to-maturity securities are typically repaid on the maturity date, so this is the less common transaction for the repayment.

At a Discount (market rate is lower) 12/31/20 Your Corporation sells the bond after three full years for \$4,945,000 when the carrying amount of the investment is \$4,925,000.						At a Premium (market rate is higher) 12/31/20 Your Corporation sells the bond after three full years for \$5,055,000 when the carrying amount of the investment is \$5,075,000.					
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	Account		Debit	Credit			Account		Debit	Credit	
▲	Cash		4,945,000			▲	Cash		5,055,000		
▼	Gain on Sale of Investment			20,000		▼	Loss on Sale of Investment		20,000		
▼	Investment in ABC Bonds			4,925,000		▼	Interest in ABC Bonds			5,075,000	
▲ Cash is an asset account that is increasing . ▲ Gain on Sale of Investment is a revenue account that is increasing . ▼ Investment in ABC Bonds is an asset account that is decreasing .						▲ Cash is an asset account that is increasing . ▲ Loss on Sale of Investment is a revenue account that is increasing . ▼ Investment in ABC Bonds is an asset account that is decreasing .					
Ledger account balance:						Ledger account balance:					
Investment in ABC Stock						Investment in ABC Stock					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit
1/1/18		4,700,000		4,700,000		1/1/18		5,300,000		5,300,000	
12/31/18		75,000		4,775,000		12/31/18			75,000	5,225,000	
12/31/19		75,000		4,850,000		12/31/19			75,000	5,150,000	
12/31/20		75,000		4,925,000		12/31/20			75,000	5,075,000	
12/31/20			4,925,000	0		12/31/20			5,075,000	0	
Ledger account balance:						Ledger account balance:					
Gain on Sale of Investment						Loss on Sale of Investment					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit
12/31/20			20,000		20,000	12/31/20		20,000		20,000	

4.10.2 Purchasing Bond Investments with Accrued Interest and Partial-Year Amortization

In the previous held-to-maturity examples, the investments were purchased on January 1 and sold on December 31. Each year the investor owned the bond securities for the full 12 months of the calendar year.

This, obviously, is not always the case. Bond investments may be purchased and sold any time during the year. Assuming that the investing corporation prepares annual financial statements on December 31 each calendar year, the corporation may need to pro-

rate the amounts received for semi-annual interest and amounts amortized to adjust for a partial year of ownership. The examples below show a comparison of full-year transactions on the left and partial-year transactions on the right.

1. Purchase Bonds as a Long-Term Investment

Full Year					Partial Year				
1/1/2018 Your Corporation purchases \$5,000,000 of four-year, 6% ABC Co. bonds for \$4,700,000. (The bond investment is purchased at a discount of \$300,000).					3/1/2018 Your Corporation purchases \$5,000,000 of four-year, 6% ABC Co. bonds for \$4,700,000. (The bond investment is purchased at a discount of \$300,000).				
	Account		Debit	Credit		Account		Debit	Credit
▲	Investment in ABC Bonds		4,700,000		▲	Interest in ABC Bonds		4,700,000	
▼	Cash			4,700,000	▼	Interest Revenue		5,000	
					▼	Cash			4,705,000
▲ <i>Investment in ABC Bonds</i> is an asset account that is increasing . ▼ <i>Cash</i> is an asset account that is decreasing .					▲ <i>Investment in ABC Bonds</i> is an asset account that is increasing . ▼ <i>Interest Revenue</i> is a revenue account that is decreasing . ▼ <i>Cash</i> is an asset account that is decreasing .				

Interest is paid each year on June 30 and December 31. Since Your Corporation will be the owner of the bond on June 30, Your will receive the full six-month payment of \$15,000 (\$5,000,000 x 3%). However, Your is only entitled to one- third of it, or \$5,000, since the investor only owned the bond four months (March, April, May, and June) during the six-month period. The party Your purchased the bond from is entitled to the other two months' worth, or \$5,000.

Therefore, at the time of the closing on the bond on March 1, Your Corporation advances the seller his \$5,000 portion of the \$15,000 interest payment that will be paid on June 30. As you see from the transaction that follows, Your receives the full \$15,000 from the company that issued the bond on June 30, and Your keeps it all—\$10,000 is for the four months when Your owned the bond, and the other \$5,000 is to reimburse Your for the amount it paid the seller on March 1.

2. Receive Semi-Annual Interest Payment on 6/30/18 and 12/31/18

Full Year					Partial Year				
EVERY SIX MONTHS Your Corporation records semi-annual interest received.					EVERY SIX MONTHS Your Corporation records semi-annual interest received.				
	Account		Debit	Credit		Account		Debit	Credit
▲	Cash		15,000		▲	Cash		15,000	
▲	Interest Revenue			15,000	▲	Interest Revenue			15,000
▲ <i>Cash</i> is an asset account that is increasing . ▲ <i>Interest Revenue</i> is a revenue account that is increasing . Cash and Interest Revenue amounts = $(\$5,000,000 \times 6\%) / 2$					▲ <i>Cash</i> is an asset account that is increasing . ▲ <i>Interest Revenue</i> is a revenue account that is increasing . Cash and Interest Revenue amounts = $(\$5,000,000 \times 6\%) / 2$				
Full Year					Partial Year				
EVERY YEAR END Your Corporation amortizes the discount on the investment.					EVERY YEAR END Your Corporation amortizes the premium on the investment.				

	Account		Debit	Credit		Account		Debit	Credit
▲	Investment in ABC Bonds		75,000		▲	Investment in ABC Bonds		62,500	
▲	Interest Revenue			75,000	▲	Interest Revenue			62,500
▲ <i>Investment in ABC Bonds</i> is an asset account that is increasing . ▲ <i>Interest Revenue</i> is a revenue account that is increasing . (\$5,000,000 - \$4,700,000) / 4 years = \$75,000					▲ <i>Investment in ABC Bonds</i> is an asset account that is increasing . ▲ <i>Interest Revenue</i> is a revenue account that is increasing . (\$5,000,000 - \$4,700,000) / 4 years = \$75,000 x 10/12 = 62,500				

The investor can only amortize the discount over the period it owns the bonds. In this partial-year case, the investor can amortize 10 months out of 12 months in the year (March through December).

4.10.3 Selling Bond Investments with Accrued Interest and Partial-Year Amortization

An investor must also pro-rate interest and amortization amounts if it sells the investment during a calendar year.

The examples below show a comparison of full-year transactions on the left and partial-year transactions on the right.

Full Year On January 1, 2016, Your Corporation had purchased \$5,000,000 of four-year, 6% ABC Co. bonds for \$4,700,000. (The bond investment was purchased at a discount of \$300,000). Your amortized the discount on 12/31 at the end of 2016 and 2017. The carrying amount on the investment on December 31, 2017 is \$4,850,000 (\$4,700,000 + \$75,000 for 2016 + \$75,000 for 2017). It is now December 31, 2018 and Your Corporation amortizes the discount to date in 2018 and sells the investment for \$4,875,000. 12/31/18 Your Corporation amortizes the discount on the investment for 2018, just before the sale.					Partial Year On January 1, 2016, Your Corporation had purchased \$5,000,000 of four-year, 6% ABC Co. bonds for \$4,700,000. (The bond investment was purchased at a discount of \$300,000). Your amortized the discount on 12/31 at the end of 2016 and 2017. The carrying amount on the investment on December 31, 2017 is \$4,850,000 (\$4,700,000 + \$75,000 for 2016 + \$75,000 for 2017). It is now April 30, 2018 and Your Corporation amortizes the discount to date in 2018 and sells the investment for \$4,875,000. 4/30/18 Your Corporation amortizes the additional discount on the investment for 2018, just before the sale.				
	Account		Debit	Credit		Account		Debit	Credit
▲	Investment in ABC Bonds		75,000		▲	Investment in ABC Bonds		25,000	
▲	Interest Revenue			75,000	▲	Interest Revenue			25,000
▲ <i>Investment in ABC Bonds</i> is an asset account that is increasing . ▲ <i>Interest Revenue</i> is a revenue account that is increasing . (\$5,000,000 - \$4,700,000) / 4 years = \$75,000					▲ <i>Investment in ABC Bonds</i> is an asset account that is increasing . ▲ <i>Interest Revenue</i> is a revenue account that is increasing . (\$5,000,000 - \$4,700,000) / 4 years = \$75,000 x 4/12 = 25,000				

Ledger account balance:						Ledger account balance:					
Investment in ABC Stock						Investment in ABC Stock					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit
1/1/16		4,700,00		4,700,00		1/1/16		4,700,00		4,700,00	
12/31/16		75,000		4,775,00		12/31/16		75,000		4,775,00	
12/31/17		75,000		4,850,00		12/31/17		75,000		4,850,00	
12/31/18		75,000		4,925,00		4/30/18		25,000		4,825,00	

In the case of the partial year where the investment was sold on April 30, 2018, the seller receives two-thirds of the \$15,000 bond interest amount that the issuing company will pay on June 30. This is because the seller owned the investment four months during the six-month interest period. The buyer pays this \$10,000 to the seller at the closing and the buyer is reimbursed on June 30 when he receives and keeps the full \$15,000 interest payment.

Full Year					Partial Year				
12/31/18 Your Corporation sells the bond after three full years for \$4,875,000 when the carrying amount of the investment is \$4,925,000.					4/30/18 Your Corporation sells the bond after two years and four months for \$4,875,000 when the carrying amount of the investment is \$4,825,000.				
	Account		Debit	Credit		Account		Debit	Credit
▲	Cash		4,885,000		▲	Cash		4,885,000	
▲	Loss on Sale of Investment		50,000		▲	Gain on Sale of Investment			50,000
▼	Investment in ABC Bonds			4,925,000	▼	Investment in ABC Bonds			4,825,000
▲	Interest Revenue			10,000	▲	Interest Revenue			10,000
▲ Cash is an asset account that is increasing . ▲ Loss on Sale of Investment is a loss that is increasing . ▼ Investment in ABC Bonds is an asset account that is decreasing . ▲ Interest Revenue is a revenue account that is increasing .					▲ Cash is an asset account that is increasing . ▲ Gain on Sale of Investment is a gain that is increasing . ▼ Investment in ABC Bonds is an asset account that is decreasing . ▲ Interest Revenue is a revenue account that is increasing .				

Ledger account balance:						Ledger account balance:					
Investment in ABC Stock						Investment in ABC Stock					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit

1/1/16		4,700,00		4,700,00		1/1/16		4,700,00		4,700,00	
12/31/16		75,000		4,775,00		12/31/16		75,000		4,775,00	
12/31/17		75,000		4,850,00		12/31/17		75,000		4,850,00	
12/31/18		75,000		4,925,00		4/30/18		25,000		4,825,00	
12/31/18			4,925,00	0		4/30/18			4,825,00	0	
Ledger account balance:						Ledger account balance:					
Loss on Sale of Investment						Gain on Sale of Investment					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit
12/31/18		50,000		50,000		4/30/18			50,000		50,000

4.10.4 Trading Securities

A bond investment is classified as trading when the investor intends to sell it quickly within one year. Trading bond securities appear in the current assets section on the balance sheet at their fair value. Unrealized gains or losses due to a difference between cost and fair value are reported on the investor's income statement as a component of **comprehensive income** in the *Unrealized Holding Gain/Loss – Net Income* account.

AVAILABLE-FOR-SALE SECURITIES

A bond investment is classified as **available-for-sale** when it is neither held-to-maturity nor trading. Available-for-sale bond securities typically appear under the **Long-Term Investments** caption in the assets section of the balance sheet at their fair value. Unrealized gains or losses due to a difference between cost and fair value are reported on the investor's balance sheet in the stockholders' equity section under the caption **Other Accumulated Comprehensive Income** in the *Unrealized Holding Gain/Loss – Available-for-Sale Securities* account.

Two versions of the transactions related to investing in bonds are illustrated side by side in the journal entries that follow. The transactions on the left illustrate transactions for bond investments classified as trading securities. On the right are transactions for bonds classified as available-for-sale securities. Explanations are included.

1. Purchase the Bond Investment of Trading or Available-for-Sale Securities

Notice in this example that the bonds are purchased on July 1, halfway through the calendar year.

Trading Securities				Available-for-Sale Securities			
7/1/2018 Your Corporation purchases \$5,000,000 of four-year, 6% ABC Co. bonds for their face amount. The investment is classified as a trading security since the investor expects to sell it in approximately 9 months.				7/1/2018 Your Corporation purchases \$5,000,000 of four-year, 6% ABC Co. bonds for their face amount. The investment is classified as an available-for-sale security since the expected sale date is uncertain.			
	Account	Debit	Credit		Account	Debit	Credit

▲	Investment in ABC Bonds		5,000,000			▲	Investment in ABC Bonds		5,000,000		
▼	Cash			5,000,000		▼	Cash			5,000,000	
▲ Investment in ABC Bonds is an asset account that is increasing . ▼ Cash is an asset account that is decreasing .						▲ Investment in ABC Bonds is an asset account that is increasing . ▼ Cash is an asset account that is decreasing .					

Ledger account balance:						Ledger account balance:					
Investment in ABC Stock						Investment in ABC Stock					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit
7/1/18		5,000,000		5,000,000		7/1/18		5,000,000		5,000,000	

2. Record Interest for Semi-Annual Interest Receipts

The corporation that issued the bond securities pays interest to the investor semi-annually, or every six months. The issuing company pays semi-annual interest on June 30 and December 31 each year. The semi-annual amount is determined by multiplying the face amount of the bonds by half of the annual contract rate.

Trading Securities					Available-for-Sale Securities				
12/31/2018 Your Corporation records semi-annual interest received.					12/31/2018 Your Corporation records semi-annual interest received.				
	Account		Debit	Credit		Account		Debit	Credit
▲	Cash		15,000		▲	Cash		15,000	
▲	Interest Revenue			15,000	▲	Interest Revenue			15,000
▲ Cash is an asset account that is increasing . ▲ Interest Revenue is a revenue account that is increasing . Cash and Interest Revenue amounts = $(\$5,000,000 \times 6\%) / 2$					▲ Cash is an asset account that is increasing . ▲ Interest Revenue is a revenue account that is increasing . Cash and Interest Revenue amounts = $(\$5,000,000 \times 6\%) / 2$				

The investment account balance is not affected by the receipt of the interest. This transaction is recorded every six months as the cash is received for the interest revenue for as long as the investment is held.

3. Amortization of Discount or Premium for Trading or Available-for-Sale Securities

There is no discount or premium for either security since the bonds were purchased at their face amounts.

4. Adjust Trading or Available-for-Sale Securities to Fair Value just prior to Financial Statements

Trading securities and available-for-sale securities are adjusted to fair value at least once annually. In these examples, that adjustment will occur on December 31, 2018, just before the financial statements are prepared for the year.

Trading Securities					Available-for-Sale Securities				
12/31/18 The fair value of the trading securities is \$5,010,000.					12/31/18 The fair value of the available-for-sale securities is \$5,010,000.				
	Account		Debit	Credit		Account		Debit	Credit
▲	Investment in ABC Bonds		10,000		▲	Investment in ABC Bonds		10,000	
▲	Unrealized Holding Gain/Loss — Net Income			10,000	▲	Unrealized Holding Gain/Loss — Available-for-Sale			10,000
▲ Investment in ABC Bonds is an asset account that is increasing . ▲ Unrealized Holding Gain/Loss – Net Income is a gain account that is increasing . Amount = \$5,010,000 fair value - \$5,000,000 cost					▲ Investment in ABC Bonds is an asset account that is increasing . ▲ Unrealized Holding Gain/Loss – Available-for-Sale is a gain that is increasing . Amount = \$5,010,000 fair value - \$5,000,000 cost				

Ledger account balance:						Ledger account balance:					
Investment in ABC Stock (trading)						Investment in ABC Stock (available-for-sale)					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit
7/1/18		5,000,000		5,000,000		7/1/18		5,000,000		5,000,000	
12/31/18		10,000		5,010,000		12/31/18		10,000		5,010,000	

Ledger account balance:						Ledger account balance:					
Unrealized Holding Gain/Loss — Net Income						Unrealized Holding Gain/Loss — Available-For-Sale					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit
12/31/18		10,000		10,000		12/31/18		10,000		10,000	

The following table includes financial statements with select accounts for a company that holds debt investments.

Comprehensive Income Statement		Balance Sheet	
Revenues	\$XXX,XXX	ASSETS	
Expenses	<u>XXX,XXX</u>	Current assets:	
Income from operations	\$XXX,XXX	Trading securities	\$XXX,XXX
Other income and expenses:		Long-term investments:	
Investment Income	XXX,XXX	Available-for-sale securities	XXX,XXX
Gain on sale of investment ³	XXX,XXX	Held-to-maturity securities	XXX,XXX
Loss on sale of investment ³	<u>(XXX,XXX)</u>		
		LIABILITIES	
Net income	\$XXX,XXX		
		STOCKHOLDERS' EQUITY	
Other comprehensive income:		Common Stock	XXX,XXX
Unrealized holding gain/loss on investments ¹	<u>XXX,XXX</u>	Retained Earnings	XXX,XXX
		Other accumulated comprehensive income:	
Comprehensive income	\$XXX,XXX	Unrealized holding gain/loss on available-for-sale securities ²	XXX,XXX

¹ related to trading securities

² related to available-for-sale securities

³ related to held-to-maturity securities

After financial statements are prepared, income statement accounts are closed to Retained Earnings.

Income statement accounts, such as *Unrealized Holding Gain/Loss – Net Income*, are closed to *Retained Earnings* after the financial statements are prepared. *Unrealized Holding Gain/Loss – Available-for-Sale Securities* is a balance sheet account and therefore is not closed.

Trading Securities					Available-for-Sale Securities				
12/31/18 Close the income statement account.									
	Account		Debit	Credit		Account		Debit	Credit
▼	Unrealized Holding Gain/Loss — Net Income		10,000						
▲	Retained Earnings			10,000					

▼ *Unrealized Holding Gain/Loss - Net Income* is a gain set to zero by **decreasing**.
 ▲ *Retained Earnings* is a stockholders' equity account that is **increasing**.

NO JOURNAL ENTRY.

Ledger account balance:						Ledger account balance:					
Investment in ABC Stock (trading)						Investment in ABC Stock (available-for-sale)					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit
7/1/18		5,000,00		5,000,00		7/1/18		5,000,00		5,000,00	
12/31/18		10,000		5,010,00		12/31/18		10,000		5,010,00	

Ledger account balance:						Ledger account balance:					
Unrealized Holding Gain/Loss — Net Income						Unrealized Holding Gain/Loss — Available-For-Sale					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit
12/31/18		10,000		10,000		12/31/18		10,000		10,000	
12/31/18			10,000	0							

5. Sell the Bonds Investment of Trading Securities or Available-for-Sale Securities

The trading securities are sold on March 31, 2019. The available for sale securities are sold on October 31, 2019.

The first step in the sale of each of the debt securities is to bring the carrying amount of the investment to its fair value on the date of the sale. This may also impact the amount of unrealized holding gain or loss balance.

Trading Securities					Available-for-Sale Securities				
3/31/19 Your Corporation sells the bond trading securities when the fair value is \$5,008,000.					10/31/19 Your Corporation sells the bond available-for-sale securities when the fair value is \$5,008,000.				
	Account		Debit	Credit		Account		Debit	Credit
▲	Unrealized Holding Gain/Loss — Net Income		2,000		▲	Unrealized Holding Gain/Loss — Available-for-Sale		2,000	
▼	Retained Earnings			2,000	▼	Investment in ABC Bonds			2,000

▲ *Unrealized Holding Gain/Loss – Net Income* is a loss account that is **increasing**.

▼ *Investment in ABC Bonds* is an **asset** account that is **decreasing**.

Amount = \$5,008,000 fair value - \$5,010,000 carrying amount

▲ *Unrealized Holding Gain/Loss – Net Income* is a loss account that is **increasing**.

▼ *Investment in ABC Bonds* is an **asset** account that is **decreasing**.

Amount = \$5,008,000 fair value - \$5,010,000 carrying amount

Ledger account balance:						Ledger account balance:					
Investment in ABC Stock (trading)						Investment in ABC Stock (available-for-sale)					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit
7/1/18		5,000,000		5,000,000		7/1/18		5,000,000		5,000,000	
12/31/18		10,000		5,010,000		12/31/18		10,000		5,010,000	
3/31/19			2,000	5,008,000		10/31/19			2,000	5,008,000	

Ledger account balance:						Ledger account balance:					
Unrealized Holding Gain/Loss — Net Income						Unrealized Holding Gain/Loss — Available-For-Sale					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit
3/31/19		2,000		2,000		12/31/18		10,000		10,000	
12/31/18		10,000		10,000		10/31/19		2,000		8,000	
12/31/18			10,000	0							
3/31/19		2,000		2,000							

The second step in the sale of available-for-sale securities is to transfer the unrealized gain/loss amount from the balance sheet account to the Gain (or Loss) on Sale of Investment account on the income statement so it can be included in the net income amount for the year.

There is no such transfer for trading securities since the *Unrealized Holding Gain/Loss – Net Income* account is already an income statement account.

Trading Securities				Available-for-Sale Securities			
3/31/19 Your Corporation sells the bond trading securities when the fair value is \$5,008,000.				10/31/19 Your Corporation sells the bond available-for-sale securities when the fair value is \$5,008,000. Transfer the unrealized gain.			
Account	Debit	Credit		Account	Debit	Credit	

					▲	Unrealized Holding Gain/Loss - Available-for-Sale	8,000	
					▲	Gain on Sale of Investment		2,000
NO JOURNAL ENTRY.					<p>▲ <i>Unrealized Holding Gain/Loss – Net Income</i> is set to zero by decreasing.</p> <p>▲ <i>Gain on Sale of Investment</i> is a gain that is increasing. Amount = \$5,008,000 fair value - \$5,010,000 carrying amount</p>			

Ledger account balance:						Ledger account balance:					
Investment in ABC Stock (trading)						Investment in ABC Stock (available-for-sale)					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit
7/1/18		5,000,00		5,000,00		7/1/18		5,000,00		5,000,00	
12/31/18		10,000		5,010,00		12/31/18		10,000		5,010,00	
3/31/19			2,000	5,008,00		10/31/19			2,000	5,008,00	
Ledger account balance:						Ledger account balance:					
Unrealized Holding Gain/Loss — Net Income						Unrealized Holding Gain/Loss — Available-For-Sale					
Date	Item	Debit	Credit	Debit	Credit	Date	Item	Debit	Credit	Debit	Credit
3/31/19		2,000		2,000		12/31/18		10,000		10,000	
12/31/18		10,000		10,000		12/1/19		2,000		8,000	
12/31/18			10,000	0		10/31/19			8,000	0	
3/31/19		2,000		2,000							
Ledger account balance:						Ledger account balance:					
						Gain on Sale of Investment					
						Date	Item	Debit	Credit	Debit	Credit
						10/31/19		8,000		8,000	

							10/31/19		8,000		8,000	

The *Unrealized Holding Gain/Loss – Net Income* account appears on the income statement as part of other comprehensive income. It represents that amount of gain or loss on investments that have not yet been sold, but whose fair value is different than their initial cost. A fair value greater than cost represents an unrealized gain; a fair value less than cost represents an unrealized loss. The *Unrealized Holding Gain/Loss – Net Income* account is adjusted before financial statements are prepared to update the unrealized gain or loss amount based on the most current fair value.

The *Gain on Sale of Investment* and *Loss on Sale of Investment* accounts that represent actual gains and losses from the sale of investments is not used for trading securities. This is because the *Unrealized Holding Gain/Loss – Net Income* account is updated just prior to the sale, which at the same time brings the investment account to fair value. Since the cash received equals the fair value amount, there is no gain or loss recognized at that time.

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