INVESTMENTS: SHORT, LONG-TERM / DEBT AND EQUITY

I. **Key Concepts and Terms**:

A. **Investments:** Investments are classified as current (short term) or noncurrent (long term) and include both debt and equity instruments. Prior to SFAS 115 there was no GAAP for investments in debt securities.

1. Investment GAAP
   a. Prior to the issuance of FASB Statement No. 115, investments in marketable equity securities (MES) were accounted for by the lower of aggregate cost or market (LACM) method (SFAS 12). There were **no defined GAAP for investments in debt securities**.
      1. The use of the LACM method was widely criticized for two reasons.
         a. LACM was not a relevant value because it did not reflect the liquidity of MES when the FMV exceeded the cost; (therefore, more funds could be obtained through a sale in the current market than was indicated by the balance sheet).
         b. LACM allowed companies to engage in what was often referred to as "gains trading." Gains trading meant that companies would sell those securities that had a FMV above cost so that the realized gain on the sale would be included in income.

   b. **SFAS 115 was issued to address these issues and to issue GAAP for debt investments.** SFAS 115 was adopted by a 5-to-2 majority with the dissenters arguing that all investments should be reported at FMV and all unrealized holding gains and losses included in income.
      1. SFAS 115 is summarized on the following page with explanations for the FASB's position and rationale for establishing three categories of investment with differential treatment of holding gains and losses.

B. **Types of Investments**:

1. Investments in Debt Securities:
   a. Debt securities are the generally the bonds of another company. Investments in debt securities are both marketable and nonmarketable. The current portion of investments in debt are listed in the current asset portion of the balance sheet and the noncurrent portion is listed in the long-term asset section of the balance sheet.
   b. Investments in debt securities are generally made to gain yield through the receipt of dividends, capital appreciation, or interest income.

2. Investments in Marketable Equity Securities (MES):
   a. Marketable equity securities are investments in the equity securities of other companies.
      1. Equity securities represent an ownership interest (or the right to acquire an ownership interest, i.e. a stock right or warrant) in the investee company. Because equity securities represent ownership interests, they allow the holders (owners) to exercise control over management.

      2. They are marketable in that they are traded on a daily basis on some stock exchange and as a result may be easily converted into cash. SFAS-12, paragraph #7 states that MES are limited to outstanding equity securities and other similar securities not subject to a maturity or a call date. Consequently, preferred stock that is redeemable at the discretion of the investor is not considered MES; redeemable preferred stock is treated as a receivable by the investing company and as a debt by the issuing company.

   b. Investments in MES are generally made to gain yield through stock appreciation, dividends or to control the investee company if sufficient stock is purchased.

C. **Accounting for investments in Debt Securities**: The accounting problems created by investments in debt securities involve

- The classification of the debt investments
- Recognition of holding gains and losses and the valuation of the investment at the reporting date,
- The recognition of holding gains and losses,
- The accounting for premiums and discounts and
- The accounting for purchases between interest dates.

> Note that all investments (like all assets) are recorded at their "FULL COST" which is defined as all costs normal and necessary to acquire the asset and prepared for it's intended use. Direct Acquisition costs such as legal and accounting fees are expensed in the current period…

Background of SFAS 115: The FASB Rationale and Dissenting Opinions

SFAS 115 caused controversy over four issues:

1. **FMV is Required for Trading Securities and Securities Available for Sale (but not for Securities Held to Maturity**

FASB Rationale:

a. Reporting MES at FMV assists users in evaluating the performance of a company's investment strategies and increase the comparability of balance sheets;

b. FMV of investments also provides a better indication of the financial flexibility, or solvency, of companies, particularly financial institutions for which a large portion of their assets are such securities.

c. In a liquidity shortage, the FMV of investments is the amount available to cover a company's obligations.

d. FMV of debt securities held to maturity is not relevant. If a debt security is held to maturity, the maturity value will be realized and any interim unrealized holding gains and losses will reverse, therefore no cash flow change has occurred. (two dissenting Board members argued that FMV would be preferable for these debt securities).

e. The FASB made the held-to-maturity category restrictive.

1. the use of the amortized cost method must be justified by management for each investment in a debt security
2. each acquisition requires management to establish the positive intent and ability to hold the security to maturity (which is not the same as the absence of an intent to sell) Note: the initial classification involves judgments by management that may prove to be incorrect; the judgment may be changed in future periods by unforeseen circumstances and result in a reclassification of the security

2. **FMV is not required for certain liabilities;**

FASB Rationale:

a The desirability of requiring certain liabilities to be reported at FMV because they are "mirror images" of the assets was supported by financial institutions which manage their interest rate risk by coordinating their holdings of financial assets and liabilities. This position argued that financial statements would provide a more relevant view of a company's exposure to risk if some liabilities were also reported at FMV. They felt that recognizing FMV on only one side of their portfolio introduces an inappropriate bias into their financial statements.

b. <u>The FASB rejected the FMV reporting of liabilities because:</u>

1 it could not be agreed which liabilities should be reported at FMV;

2 difficulties in obtaining a reliable value of the liabilities the that do not trade in an established market; nonfinancial companies do not manage risk in the same way, and use the proceeds from borrowing to invest in physical and intangible assets that are not reported at FMV.

Note: The FASB admitted that this conclusion represents a compromise, and one dissenter voted against adoption of SFAS 115 partly for this reason.

3. **Reporting of Unrealized Gains and Losses** (unrealized holding gains and losses are reported in the income statement for trading securities but directly in stockholders' equity for securities available for sale)

FASB Rationale:

1. Because trading securities are actively managed, income measurement for those securities is more relevant if it includes the results of changes in FMV (i.e. unrealized holding gains and losses). The result is that income includes the results of economic events that occur in the period and provides a better measure of the company's return on investment.
2. Including unrealized holding gains and losses in income for securities available for sale would create an unnecessary volatility into reported income. When the intent is to hold securities for a long period, it is likely that any unrealized holding gains and losses will offset before the sale occurs. Therefore including those gains and losses in income would also create an unnecessary volatility in income. The FASB concluded that unrealized holding gains and losses on securities available for sale should not be included in income but instead be reported as a component of stockholders' equity.

4. **Classification of Securities is Based on Management Intent**.

Dissenters Argued:

1. Classifying securities into three categories (Trading, Available for Sale and Hold to Maturity), each of which has different accounting principles, and using management intent as a criterion to distinguish among the categories may result in an inconsistent application of the principles. Companies with three identical securities could account for those securities using three different accounting methods and may create a lack of comparability between the financial statements.
2. Transfers between categories, also based partly on management intent and judgment, allow for management of earnings because the gain (or loss) is included in income.

FASB Rationale:

1. Despite these points, the overall relevance of the financial statements would be improved as a result of securities being classified subject to managerial intent and the resulting increase in comparability.

a. <u>Potential Problem area</u>: Two dissenters were concerned that SFAS 115 does not eliminate or address the possibility of "gains trading". The realized gain on a sale is the difference between the selling price and the cost of the security, and is included in income. A company may tend to avoid selling a security classified as available for sale when its FMV is less than its cost. That sale would result in the recognition of a realized loss in the income statement, whereas if the company continues to hold the security, the decline in value is included in stockholders' equity. The decision not to sell avoids any income recognition of the decline in value. **Thus companies are still able to "manage" the amount of income that they report by selecting which securities to sell**. The two dissenters were concerned that the Statement does not prevent this practice.

<u>FAIR VALUE OPTION</u> : In response to these criticisms, recent decisions by the FASB allow investor companies the option to report most financial instruments at FMV and report all holding gains and losses on these securities to the income statement.

1. The decision to value an investments at FMV is made on an individual investment basis and is irrevocable.
2. The Fair Value Option can be applied to both debt and equity instruments

1. **Classification of debt investments:** Investments in debt or equity securities fall into one of three portfolios:
   a. **Trading Portfolio:** Debt or Equity securities purchased as short-term investments and intended for sale in the near term; Trading involves active and frequent buying and selling of securities and the intent to make a profit on short-term differences in price
   b. **Available-for-Sale Portfolio**:
      1. Debt securities not classified as hold-to-maturity
      2. Debt or Equity securities not classified as trading
   c. **Hold-to-Maturity:** Securities that management has the positive intent and ability to hold to maturity.
      1. Only debt securities are classified as hold-to-maturity.

Note: Equity securities may only be classified as Trading or Available for sale
Debt securities not classified as Hold-to-Maturity must be classified as either Trading or Available-for-sale

2. **Recognition of Holding Gains/Losses and the Valuation of the investments at the reporting date**

Portfolio	Valuation at Recording Date	Treatment of Unrealized Holding Gains/Losses	Other Income Effects
Trading	Fair Market Value FMV= the price that would be received in an orderly transaction between market participants at the measurement date	All revenue aspects of trading securities are recognized on Income Statement	Interest income Gains/Losses on sale (all effects on I/S)
Available-for-Sale	Fair Market Value	Holding Gains/Losses are recognized on the Balance Sheet Assets section as an Available-for-Sale portfolio adjustment and in the SHE section as an unrecognized holding gain/loss	Interest income Gains/Losses on sale (all effects on I/S)
Hold-to-Maturity	Amortized Cost (Cost +/- amortization of premiums/discounts)	No Recognition	Interest income Gains/Losses on sale (all effects on I/S)

3. **Valuation of the Investment at Acquisition and at the recording date**
   a. Accounting for premiums and discounts on debt investments:
      1. Debt securities are seldom purchased at a price equal to book value because bonds with a stated interest rate higher (or lower) than prevailing market rate for comparable instruments will sell at a premium (or discount) and these premium/discounts must be amortized over the life of the bond so that on the bonds maturity date, the carrying value of the bond will equal the book value of the bond.
         a. amortization of premium/discounts on bond investments decrease/increase the interest revenue recognized by the investor
      2. Amortization of premiums/discounts on bond investments must use the effective interest method unless the difference between effective interest and straight-line interest is immaterial.
      3. Interest that accrues between interest dates is not part of the purchase price of the bonds and must be separately recorded.
   b. Accounting Procedures (bonds purchased at a premium or discount on the interest date)

1. Date of Acquisition: Record the investment at full cost*.

Investment in Bonds of XYZ Co (including premium or discount)..	xxxxx	
Cash.....		xxxxx

2. Receipt of Dividend:

Cash.....	xxxxx	
Investment in bonds (to reflect amortization of discount).....	xxxxx**	
Investment in bonds (to reflect amortization of premium)...		xxxxx**
Interest revenue.....		xxxxx

*Full Cost: All normal and necessary costs to obtain the bonds except SEC, Stock Issuance Costs and direct acquisition costs

** one or the other of these entries depending on whether the investment was at premium or discount

Example 1: Accounting for Bonds Acquired on the interest Date:

1. On January 1, 20x1 Shane, Inc. purchases bonds with a par value of $80,000 and a stated interest rate of 8% in the open market.
2. The price Shane paid for the bonds will yield a return of 6%
3. The bonds will mature on 12/31/x6
4. Shane incurred purchase commissions of $500.
5. The bonds pay interest semi annually on 7/1 and 12/31

Required:

What price did Shane pay for the bond in order to obtain a yield of 6%? (Show Computations) 1.

PV of Sum:	($56,110.39)
PV of Annuity:	($31,852.81)
	($87,963.20)
Face Value	80,000.00
Premium on Bond Inv	($7,963.20)
Purchase Price of Bond	87,963.20
Add: Purchase Commission	500
Total Cost of Bond	88,463.20

Recall that the price paid for a bond is the sum of the present value of the annuity and the present value of the sum.

Note that the purchase commission is not part of the price of the bond, it is a purchase expense and expensed in the year of purchase

2. **Present the amortization table for the bond investment:**

	Date	8.00% Interest Payment	6.00% Effective Interest	Amortization	(Premium) Discount	Carrying Value	
0	1/1/01				(7,963)	87,963	80,000
1	7/2/01	3,200	2,639	561	(7,402)	87,402	80,000
2	1/1/02	3,200	2,622	578	(6,824)	86,824	80,000
3	7/2/02	3,200	2,605	595	(6,229)	86,229	80,000
4	1/1/03	3,200	2,587	613	(5,616)	85,616	80,000
5	7/2/03	3,200	2,568	632	(4,984)	84,984	80,000
6	1/1/04	3,200	2,550	650	(4,334)	84,334	80,000
7	7/1/04	3,200	2,530	670	(3,664)	83,664	80,000
8	12/31/04	3,200	2,510	690	(2,974)	82,974	80,000
9	7/1/05	3,200	2,489	711	(2,263)	82,263	80,000
10	12/31/05	3,200	2,468	732	(1,531)	81,531	80,000
11	7/1/06	3,200	2,446	754	(777)	80,777	80,000
12	12/31/06	3,200	2,423	777	0	80,000	80,000

Record the bond investment and interest for year 1

1. Date of Acquisition: Record the investment at full cost*.

Investment in Bonds of XYZ Co (including premium or discount).	87,963	
Interest Receivable.....	500	
Cash.....		88,463

2. Receipt of Dividend:

Cash.....	3,200	
Investment in bonds (to reflect amortization of discount).....	xxxxx**	
Investment in bonds (to reflect amortization of premium)...		561**
Interest revenue.....		2,639

Remember, only one of these entries will be present; this case is a premium

Example 2. **Purchases of debt investments between interest dates with a premium or discount**:

a. When bonds are purchased between interest dates, the purchase price must be allocated between the purchased interest receivable and the cost of the bonds

b. Accounting Procedures (bonds purchased between interest dates)

1. Date of Acquisition: Record the investment at full cost*.

Investment in Bonds of XYZ Co (full cost less interest rec).....	xxxxx	
Interest receivable.....	xxxxx	
Cash.....		xxxxx

*Full Cost: All normal and necessary costs to obtain the bonds

2. Receipt of Dividend:

Cash.....	xxxxx	
Interest receivable.....		xxxxx
Interest revenue.....		xxxxx

Bond Investment Example

On April 1, 20x1 Shane, Inc. purchases bonds with a par value of $100,000 and a stated interest rate of 12% in the open market for $102,000, which included a brokerage commission of $500. Interest on the bonds is payable on June 30 and December 31, and the bonds mature on December 31, 20x2. Shane uses straight line amortization on the basis of materiality.

Required: --Present the journal entries required for years x1 and x2.
--Show supporting computations for all numerical data.

Interest Receivable = 100,000 x 12% x 3/12
= 3,000
Cost of bonds = 102,000-3,000-500 = 98,500

Solution:

Record the Purchase on April 1, 20x1:

Investment in Bonds.(record the bonds at full cost).....	98,500*	
Brokerage commissions.....	500	
Interest receivable ($100,000 x .12 x 3/12 yr).....	3,000	
Cash.....		102,000

* Note that these bonds are purchased at a discount of $1,500 ($100,000 face less $99,000 cost)

Record the receipt of interest and amortization of bond discount on June 30, 20x1:

Cash ($100,000 x .12 x 6/12 yr).....	6,000	
Investment in bonds ($1,500 x 3/21).....	214	
Interest receivable... ($100,000 x .12 x 3/12 yr).....		3,000
Interest revenue (plug).....		3,214

Record the receipt of interest and amortization of bond discount on December 31, 20x1:

Cash.....	6,000	
Investment in Bonds ($1,500 x 6/21).....	429	
Interest revenue (plug).....		6,429

Record the receipt of interest and amortization of bond discount on June 30, 20x1:

Cash ($100,000 x .12 x 6/12 yr).....	6,000	
Investment in bonds ($1,500 x 6/21).....	429	
Interest receivable..... ($100,000 x .12 x 3/12 yr).....		6,000
Interest revenue (plug).....		3,249

Record the receipt of interest and amortization of bond discount on December 31, 20x2:

Cash ($100,000 x .12 x 6/12 yr).....	6,000	
Investment in bonds ($1,500 x 6/21).....	429	
Interest receivable..... ($100,000 x .12 x 3/12 yr).....		6,000
Interest revenue (plug).....		3,429

Important considerations applicable to investments in Debt Securities:

Hold-to-Maturity Investments:

Debt securities should only be classified as Hold-to-Maturity (HTM) if the investor has **both the *intent* and *ability* to hold the securities to maturity**

The following conditions preclude the investor from classifying an investment as HTM:
If changes in any of the following would could force a sale of the investment:

- Market interest rates
- Prepayment risks
- Liquidity requirements
- Availability of and yield on alternative investments
- Funding sources and terms
- Foreign currency risk

The following changes may be present without raising doubt about an investor's intent or ability to classify an investment as HTM:

- Evidence of a significant deterioration in the issuer's creditworthiness
- A change in tax law that eliminates or reduces the tax-exempt status of interest on the debt security (*not* a change in tax law that revises the marginal tax rates applicable to interest income)
- A major business combination or major disposition of a component of the entity that necessitates the sale or transfer of held-to-maturity securities to maintain the enterprise's existing interest rate risk position or credit risk policy
- A change in statutory or regulatory requirements significantly modifying either what constitutes a permissible investment or the maximum level of investments in certain kinds of securities, thereby causing an enterprise to dispose of a held-to-maturity security
- A significant increase in the industry's capital requirements by the regulator that causes the enterprise

Transfers between Portfolios: Transfers are usually infrequent, but if they do occur apply the following guidance:

- Transfers *from* the Trading Portfolio: The unrealized gain or loss at the date of transfer will already have been recognized in income and should *not* be reversed.
- Transfers *to* the Trading Portfolio: At the date of transfer, the unrealized holding gain or loss should be reflected in earnings.
- Transfers *to* the Available-for-Sale Portfolio from HTM Portfolio: At the date of transfer the unrealized gain or loss (that would have been recognized had the investment been classified as AFS) should be recognized.
- Transfers *to* HTM Portfolio from the AFS Portfolio: The unrealized holding gain or loss should stay as a component of equity but should be *amortized* over the remaining term of the security using the effective-interest method. Thus, the amortization of the unrealized holding gain or loss will offset (or reduce) the effect on interest income of amortization of the discount or premium related to the transferred security.

Impairments of Debt Securities: A security is impaired if its FMV at the reporting date is less than its adjusted cost (amortization etc.). Rules for impairments are complex but the general rule is that i**mpairments (other than temporary) should be written down to FMV and the loss recognized in current period income**.

Impairments of Equity Securities: A little more complex but the same general rule applies; mitigating factors include how long the security value has been in decline and the prospects of its recovery…For test/problem purposes, if you see words suggesting the impairment is "other than temporary" write it down and recognize loss.

D. **Accounting for investments in MES**: The issue created by investments in MES is related to the fact that stock ownership differs from debt in that it gives the investor an equity interest e.g. ***the potential ability to control the investee company*** by controlling sufficient shares (ownership interest) in the investee company.

1. **The methodology utilized for investment valuation is determined by two factors**:
   a. the type of stock owned (voting or non voting) and
   b. the amount of stock owned

Characteristics	Level of Ownership	Reporting Method	Portfolio	Valuation	Treatment of Holding Gains/Losses
No significant Influence Non-voting Voting	all levels < 20%	FMV FMV	Trading Available-for-Sale	FMV FMV	Income Statement Balance Sheet
Significant Influence Voting only	20 to 49%	Equity (APB 18)	Available-for-Sale	Equity Method	Holding Gain/Losses not recognized; % of Investee NI to Investor NI
Controlling Interest Voting: Control not exercised Voting: Control exercised	50% or more	Equity Consolidation	Available-for-Sale	Consolidated Financial Statements	Holding Gain/Losses Not Recognized; % of Investee NI to Investor NI

2. **Equity Investments of < 20% or any amount of non-voting common stock: FMV ACCOUNTING**
   a. Investments of less than 20% of the voting securities are deemed insufficient to control the actions of the investee company. (Some companies issue a special non-voting common stock. All levels of ownership for non-voting stock).

   b. Investments < 20% may be classified as **Trading** or **Available-for Sale** based on the intent of management
      1. **Trading Portfolio**:
         a. Income effects:
            1. Dividends: Recognized as dividend revenue
            2. Sale of Securities: gains and losses recognized in current year income
         b. Unrealized Holding Gains/Losses
            1. Recognized in current year income
      2. **Available-for-Sale (AFS) Portfolio**
         a. Income effects:
            1. Dividends: Recognized as dividend revenue
            2. Sale of Securities: gains and losses recognized in current year income
         b. Unrealized Holding Gains/Losses
            1. Not recognized in current year income; Recognized as "Other Income" in SHE

   c. **MES Accounting Procedures (cost/FMV method)**:
      1. Date of Acquisition: Record the investment at full cost.

Same entry for both Trading and AFS Portfolios

Investment in MES of XYZ Co..... xxxxx*
FMV of Cash or other consideration given..... xxxxx
FMV of liabilities assumed..... xxxxx
* Includes capitalized acquisition costs (except SEC and Stock Issuance Costs)

      2. End of the accounting period:
         a. Compute difference in aggregate portfolio value from cost;

Trading Portfolio
If Loss has occurred:
Unrealized Holding Gain/Loss-Income.... xxxx
Trading Portfolio Adjustment to FMV xxxx

If Gain has occurred:
Trading Portfolio Adjustment to FMV xxxx
Unrealized Holding Gain/Loss-Income xxxx

Available-for-Sale Portfolio
If Loss has occurred:
Unrealized Holding Gain/Loss-Equity.... xxxx
AFS Portfolio Adjustment to FMV xxxx

If Gain has occurred:
AFS Portfolio Adjustment to FMV xxxx
Unrealized Holding Gain/Loss-Equity xxxx

3. record dividends received:
   Cash..... xxxxx
      Dividend revenue..... xxxxx

Note that the dividend revenue goes to income under FMV accounting (< 20% investments); this will not be the case under Equity Method (investments >20% <50%)

Cost/FMV Method Example

--on 1/1/x1 purchases 10% (5,000 shares) of the outstanding shares of Y common ($5 par) for $12/share
--on 1/1/x1 purchases 4000 shares of Z preferred (fully redeemable, $10 par) for $20/share
--The market values for the next three years was as follows:

12/31/x1	Y c/s $10.00 Z p/s $21.00
7/15/x2	unexpectedly sold 1000 shares of Z p/s at $24/share
12/31/x2	Y c/s $10.50 Z p/s $22.00
7/31/x3	Y c/s $ 5.00 clearly not a temporary decline
12/31/x3	Y c/s reclassified as short term with a market value of $4.00 per share

REQUIRED: Present all necessary journal entries and supporting computations.

SOLUTION: COST/FMV METHOD EXAMPLE

If securities were in the Trading Portfolio

1/1/x1 Trading Portfolio 140,000
   Cash..... 140,000
To record long term investment in Y c/s:
(5,000 @ $12/sh = $60,000) and Z p/s (4000 @ $20/sh = $80,000)

12/31/x1 Unrealized Holding Gain/Loss-Income 6,000
   Trading Portfolio Adjustment to FMV 6,000

Security	Shares	Cost	Market	Unrealized Gain (loss)
Y	5,000 @ $12	$ 60,000	$ 50,000	($10,000)
Z	4,000 @ $20	$ 80,000	$ 84,000	4,000
		$140,000	$134,000	($ 6,000)

7/15/x2 Cash..... 24,000
   Trading Portfolio 20,000
   Unrealized Holding Gain/Loss-Income 4,000
To record sale and realized gain on sale of 1000 shares of Z p/s @ $24

12/31/x2 Trading Portfolio Adjustment to FMV 4,500
   Unrealized Holding Gain/Loss-Income 4,500
Adjust accounts to lower of aggregate cost or market

Security	Shares	Cost	Market	Unrealized Gain (loss)
Y	5,000 @ $12	$ 60,000	$ 52,500	($7,500)
Z	3,000 @ $20	$ 60,000	$ 66,000	6,000
		$120,000	$118,500	($ 1,500)

Note that the adjustment is to have the portfolio reflect the ***cumulative*** gain or loss…
Recall that we initially recorded a loss of $6,000. The current cumulative loss is $1,500 and the adjustment to get from $6,000 to $1,500 is $4,500

7/31/x3 Unrealized Holding Gain/Loss-Income 35,000
   Trading Portfolio Adjustment to FMV 35,000
To record permanent decline in FMV of Y c/s (5000 x $12-$5)

12/31/x4 No special entry if already in the Trading Portfolio

If Securities were in the Available-for-Sale Portfolio

AFS Portfolio 140,000
   Cash..... 140,000

Unrealized Holding Gain/Loss-Income 6,000
   AFS Portfolio Adjustment to FMV 6,000

Cash..... 24,000
   AFS Portfolio 20,000
   Unrealized Holding Gain/Loss-Equity 4,000

AFS Portfolio Adjustment to FMV 4,500
   Unrealized Holding Gain/Loss-Income 4,500

Unrealized Holding Gain/Loss-Income 35,000
   AFS Portfolio Adjustment to FMV 35,000

Trading Portfolio..... 20,000
Unrealized Holding Gain/Loss-Income 5,000
   AFS Portfolio 25,000
To record change in classification from AFS to Trading Portfolio

Note that permanent changes in value or changes in classification cause holding gains/losses to be recognized in current year NI

c. **MES Accounting Procedures (EQUITY METHOD)**:

	COST	EQUITY
Investment Account	Record at Full Cost Adjust for Liq. Div or sale only (except as noted in requirement 4 below)	Record at Full Cost Adjust for: + % of investee income - % of investee dividends - amortization of cost > BV - amortization of purchased GW
Revenue Recognition	limited to: cash dividends received liquidating dividends Holding Gains/Losses in Trading Portfolio	affected by any item that affects investee income.

1. The Equity Method (APB-18) of recording investments illustrated
   a. SUMMARY OF APB-18
      1. The Equity Method is used to account for investments between 20% and 50% of the outstanding voting MES of a company.
         a. Investments of 20% or more leads to the presumption that the investor can exert significant influence or control over the operations of the investee company.

      2. The equity method may also be used for investments of less than 20% if there is evidence that the investor has the ability to exercise significant influence or control over the investee with the smaller investment.

      3. To the extent that the acquisition cost of the investment exceeds the book value of the investee company, this excess of cost over purchased book value must be allocated to the acquired companies identifiable assets and liabilities such that:
         a. current assets, liabilities and all MES held by the investee company held prior to the purchase are adjusted to their full fair market value;
         b. noncurrent asset accounts are allocated the balance of the excess in such a way that their final valuation is in relation to their relative fair market value;
         c. any remaining excess of cost over book value is allocated to goodwill.

Note: The procedures to accomplish these objectives are frequently referred to as "analyzing the investment". These procedures and the journal entries required by the use of the equity method are illustrated in subsequent examples.

      4. The Investment in MES account must be adjusted by:
         a. "equity in earnings of investee company": purchasing company (investor company) will increase the value of its investment in the MES of the investee company in proportion to its equity interest in the net income of the investee company.
         b. dividends declared by the investee company: the investment account must be decreased by the investors proportionate share of dividends declared.

Full Cost: All costs normal and necessary to acquire the investment excluding SEC other Stock Issuance costs and the direct costs of acquisition such as legal and accounting fees

Investment in MES of XYZ Co.

Record @ full cost Add: Equity in XYZ net income i.e. %(ownership)(XYZ NI)	Less: % XYZ dividends received

      5. The Equity in Earnings of Investee account must be adjusted by:
         a. amortization of the excess of cost over book value of identifiable assets
         b. amortization of purchased goodwill

Equity in XYZ Net Income

NI as computed on XYZ books

add: --amortization of assets with FMV < BV on XYZ books

Less: --amortization of assets with FMV > BV on XYZ books
--amortization of GW created by purchase at a price > FMV of identifiable net assets

6. Accounting Entries:

a. Date of Acquisition: Record the investment at full cost.

Investment in MES of XYZ Co..... xxxxx*
FMV of Cash or other consideration given..... xxxxx
FMV of liabilities assumed..... xxxxx

* Includes capitalized acquisition costs (see explanation below)

1. **Full Cost**: All normal and necessary costs to obtain the shares with the exception of charges incurred with
   a. required SEC fillings
   b. stock issuance costs

These costs are expensed in the year incurred

b. End of the accounting period:

1. Record equity in net income of investee company

Investment in MES of XYZ Co..... xxxxx
Equity in Investee Co. NI (% ownership)(investee NI). xxxxx

2. Amortize the purchase differential between FMV and BV of purchased net assets

Equity in earnings of XYZ (assumes FMV > BV)..... xxxxx
Investment in XYZ..... xxxxx

3. Amortize purchased goodwill

Equity in earnings of XYZ (assumes FMV > BV)..... xxxxx
Investment in XYZ..... xxxxx

4. Record receipt of dividends

Cash..... xxxxx
Investment in XYZ..... xxxxx

EQUITY METHOD EXAMPLE

Dallas purchased 40% of the outstanding common stock of Rhett on 7/1/x1 for $30,000. At that date Rhett's Balance sheet looked as follows:

Asset	Book Value	FMV
Cash	$ 10,000	$ 10,000
Inventory	25,000	30,000
Equipment	40,000	50,000
	$ 75,000	90,000
	========	========
Equities		
Liabilities	$ 25,000	$ 25,000
SHE	50,000	65,000
	$ 75,000	$ 90,000
	========	========

Rhett's earnings were as follows:

Quarter	Amount
1	$ 6,000
2	5,000
3	6,000
4	8,000

Analyze the investment:

Cost.....	$	30,000
Purchased book value (40% of $50,000)....		20,000
Excess of cost over purchased book value.....	$	10,000

Attributable as follows:

FMV accounts: (CA; Liabilities; MS)		
Inventory (current assets).. (.4)(30-25)	$	2,000
NCA:		
Equipment (noncurrent Assets). (.4)(50-40)		4,000
Balance to Goodwill. (plug)		4,000
Excess accounted for	$	10,000

Under the Equity Method CA, All Liabilities and all MS (both debt and equity) must be valued at Fair Market Value (FMV). I will always refer to these Accounts as the FMV Accounts to help you remember this important point….

- Rhett uses FIFO inventory and all goods on hand were sold by 12/21/x1.
- Rhett depreciates equipment at the rate of 10% a year.
- Intangibles are amortized over the maximum time permitted by GAAP.
- Rhett paid dividends of $5,000 on 12/31/1
- Dallas has no intention to sell Rhett shares for the foreseeable future

REQUIRED: PREPARE ALL NECESSARY JOURNAL ENTRIES TO REFLECT THESE FACTS

EQUITY METHOD SOLUTION

Entry at acquisition:

Investment in Rhett	30,000	
Cash.....		30,000

(always recorded at FULL COST
Full cost= all normal & necessary costs except SEC, other stock issuance costs and direct acquisition costs such as legal and accounting fees.

Entry to Record equity in Rhett earnings:

Investment in Rhett	5,600	
Equity in earnings of Rhett.....		5,600
$6,000 + $8,000 (.4) = $5,600		

Entry to amortize excess inventory cost:

Equity in earnings of Rhett.....	2,000	
Investment in Rhett		2,000

Entry to amortize excess equipment value:

Equity in earnings of Rhett.....	200	
Investment in Rhett.....		200
$4,000 x 1/10 x 1/2 year		

Entry to amortize purchased goodwill:

Equity in earnings of Rhett.....	50	
Investment in Rhett.....		50
$4,000 x 1/40 x 1/2 year		

Entry to record receipt of dividend:

Cash.....	2,000	
Investment in Rhett.....		2,000

Short Answer

1. When a corporation owns more than 20 percent of the outstanding voting shares of another corporation, the investor is assumed to be able to exert _____ over the investee and the _____ method of accounting for investments should be utilized.

2. When bonds are purchased at a premium for long-term investment purposes, the amortization of the premium is made with a(n) _____ to the Investment account.

3. _____ investments should be shown in the current asset portion of the balance sheet because they are not expected to be held for a long period of time.

4. When an investor owns less than 20 percent of outstanding voting shares of another corporation it should account for this investment on the _____ basis.

5. Under the cost method of accounting for an investment, the receipt of dividends is credited to the _____ account.

6. The difference between the proceeds from the sale of an investment and the book value of the investment is shown on the _____ as _____ .

7. When the investor owns more than 20 percent, but less than 50 percent of a corporation, he/she is assumed to have the ability over to exercise _____ over this corporation.

8. When bonds are purchased between the interest dates, that portion of the purchase price allocable to the interest should be _____ to the _____ account.

9. When cash dividends received on investments accounted for under the equity method the entry is to debit ___ _____ and _____ .

10. Under the _____ method of accounting for an investment, the investor's share of the earnings of the investee are not recorded by the investor.

True or False

1. The equity method of recording investments should be used if the investor owns less than 20 percent of the investee.

2. The premium paid on the purchase of bonds for investment purposes is credited to Premium on Bonds.

3. Long-term investments are not expected to be disposed of within the current year.

4. The Dividends Earned account is credited when cash dividends are received by an investor that maintains its investment under the cost method.

5. Under the equity method of accounting for an investment in shares, the balance sheet would contain the original cost.

6. The loss on the sale on an investment would be recorded under "Other Losses" on the income statement.

7. Bond interest received is credited to the Bond Interest Earned account.

8. Dividends earned on investments in shares are debited to the Investment account, when the investment is maintained on an equity basis.

9. Bond discounts and premiums are not amortized when the investment is for a temporary period.

10. The market value of a temporary investment is always included in the financial statement data.

11. When the cost method of accounting for investments is used, the investor's share of the investee's earnings is

not recorded.
Problems
Problem 1 (Journal entries/FMV method)
The following data pertain to Moose Ltd. for the year 20x5 in relation to its investment account for 20x5:

Feb. 1 Purchased 30 WWV Co. 8-percent, $1,000, 10-year bonds as a long-term investment. These bonds were acquired at 104.5, plus $50.00 brokerage on their regular interest date, and had 7 years to maturity.

Feb. 10 Purchased 3,000 shares of Mobley Inc. common stock as a temporary investment. The price paid was $15 per share, plus $210 brokerage.

Apr. 15 Received the regular quarterly dividend of $0.50 per share on the Mobley investment.

Jun. 30 Received a 10-percent stock dividend from Mobley Inc.

Jul. 31 Sold the shares received in the Mobley stock dividend of June 30 for $14 per share less brokerage of $60.

Aug. 1 Received the semi-annual interest on WWV bonds.

Oct. 1 Purchased, as a temporary investment, 200 Rock Inc. 6-percent, $1,000, 20-year bonds, interest payable June 1 and December 1 of each year. Price paid was par, plus $400 brokerage.

Nov. 15 Sold the remaining shares of Mobley at $16 per share, less brokerage fees of $100.

Dec. 1 Received semi-annual interest on Rock Inc. bonds.
Required: Prepare the journal entries for these transactions. Moose uses the cost method of accounting for its investments.

Problem 2 (Recording of investment account transactions for cost and equity methods)
On January 2, 20x3, LYC Ltd. purchased 20 percent of the outstanding shares of MDC Inc. for $800,000. MDC Inc. reported the following net incomes, deficits, and dividends:

	NET INCOME (DEFICIT)	DIVIDENDS
20x3	$ 900,000	$ 300,000
20x4	(400,000)	100,000
20x5	1,200,000	500,000
20x6	700,000	350,000
20x7	(600,000)	200,000

Required:
1. Prepare the journal entries to record the investment transactions that LYC Ltd. should record each year under the equity method of recording the investment.
2. What is the balance of the Investment in MDC, Inc account at year end?
3. If LYC had used the cost/FMV method of accounting, what would the balance in the Investment account be?

Problem 3 (Long-term investment in bonds)
On March 1, 20x3, JSTRM Corp. had excess cash on hand, which it intended to use for expansion in 20x6. JSTRM decided to purchase $200,000 of Bozo Inc. 9-percent, 5 year bonds. JSTRM Corp. had the following bond transactions:
20x3
Mar. 1 JSTRM Corp purchased $200,000 of Bozo Inc. 9-percent, 5 year bonds for $209,000, which included accrued interest on the bonds. Interest on the bonds is payable semi-annually on May 1 and November 1, and the mature on May 1, 20x7.
May 1 Received the semi-annual interest and amortized the bond premium.
Nov. 1 Received the semi-annual interest and amortized the bond premium.
Dec. 31 Recorded the year-end adjusting entry.
20x4
Apr. 1 Sold the Bozo Inc. bonds for $212,500, which included accrued interest.

Required: Prepare the journal entries for the bond transactions assuming that Bozo uses straight line amortization of any premium or discount.

Problem 4 (Investments in stocks and bonds) (14 marks)

RJC Ltd. has a large investment portfolio. The investments are considered temporary (short term). The following are RJC Ltd.'s investment transactions in 20x1:

Jan 1. Purchased $1,000,000 of Skunk Inc. 10.5-percent, 10-year bonds. These bonds are to be held until December 1, 20x1. Interest on these bonds is payable each February 1 and August 1. RJC Ltd. paid $1,025,000, plus accrued interest.

Feb 1. Received the semi-annual interest on Skunk Inc. bonds.
25 Purchased 50,000 shares of Bush Corp. at $41, plus $250 brokerage charges.

Apr. 1 Purchased $500,000 of Mammoth Corp. 12-percent, 5-year bonds at 97.6. The bonds are newly issued and have a remaining life of 5 years. Interest on these bonds is payable each April 1 and October 1. Bonds mature April 1, 20x6. These bonds are intended to be held to maturity.

July 15 Received a $2.00 per share cash dividend from Bush Corp.

Aug. 1 Received the semi-annual bond interest on Skunk Inc. bonds.

Sep. 15 Received a 10-percent stock dividend from Bush Corp.

Oct. 1 Received the semi-annual bond interest on Mammoth Corp. bonds, and amortized the bond premium.

Dec 1 Sold the Skunk Corp. bonds for $1,050,000, plus accrued interest.
10 Received a $1.50 per share cash dividend from Bush Corp.
31 Recorded the year-end adjusting entries.

Required: --Prepare the journal entries to record the transactions.
--Use straight line amortization for bond premiums/discounts

SOLUTIONS
Key Concept Comprehension
1. significant influence/equity
2. credit
3. short term investments
4. cost
5. Dividends Earned
6. income statement / other income and loss
7. significant influence
8. debited / Interest Receivable
9. cash/investment
10. cost

SOLUTIONS TO TRUE OR FALSE
1. F The equity method of recording investments should be used if the investor owns more than 20 percent and less than 50 percent of the investee, or has voting influence. The premium paid on the purchase of bonds for investment is included in the debit to the Investment account.
3. T
4. T
5. F Under the equity method of accounting for an investment in shares, the balance sheet amount is adjusted to reflect the change in the equity of the investee since the date of acquisition of the shares.

7. T
8. F Dividends earned on investment in shares are credited to the Investment account, when the investment is maintained on an equity basis.
9. T
10. T
11. T

Solution Problem 1

Feb 1	AFS Investment in WWV Co. Bonds.....	31,400	
	Cash.....		31,400

To record investment in 30 $1,000, 10-year WWV Co. bonds at 104.5, plus $50 brokerage, with 7 years to maturity.
30 bonds x $1,000 = $30,000 x 1.045% = $31,350 - 550 = $31,400

Feb 10	Trading Portfolio: Marketable Securities--Mobley.....	45,000	
	Direct Acquisition costs.....	210	
	Cash.....		45,210

To record temporary investment in 3,000 Mobley Inc. common stock at $15 per share, plus $210 brokerage.
3,000 shares x $15 = $45,000 + $210 = $45,210

Apr 15	Cash.....	1,500	
	Dividend Revenue.....		1,500

To record receipt of regular quarterly dividend of $0.50 per share from Mobley.
3000 shares x $0.50 = $1,500

Memorandum Received 300 shares of Mobley as a 10% stock dividend.
3,000 shares + 300 shares = 3,300 shares

July 31	Cash.....	4,140	
	Trading Portfolio: Marketable Securities--Mobley.....		4,091
	Gain on Sale of Shares.....		49

To record the sale of 300 shares of Mobley common stock for $14 per share less $60 brokerage.
300 shares x $14 = $4,200 - $60 = $4,140
300 shares x ($45,000/3,300) = $13.64; 300 shares x $13.64 = $4,091 (rounded to whole dollars)
$4,140 - $4,091 = $49

Aug 1 Cash..... 1,200
AFS Investment in WWV Co. Bonds..... 100
Bond Interest Earned..... 1,100
To record the receipt of bond interest on WWV bonds and the amortization of the premium on the bonds.
$30,000 x 8% x 6/12 = $1,200
$1,400/14 interest payment periods = $100/period

Oct 1 Trading Portfolio: Marketable Securities--Bonds. 200,000
Brokerage Commission..... 400
Bond Interest Receivable..... 4,000
Cash..... 204,400
To record temporary investment in 200 $1,000, 6% Rock Inc. at par, plus accrued interest and brokerage of $400.
200 bonds x $1,000 - $200,000 + $400 = $200,400
$200,000 x 6% x 4/12 = $4,000
$200,400 + $4,000 = $204,400

Nov 15 Cash..... 47,900
Trading Portfolio: Marketable Securities--Mobley 40,890
Gain on Sale of Shares..... 7,010
To record the remaining shares of Mobley common stock at $16 per share less brokerage of $100.
3,000 shares x $16 = $48,000 - $100 = $47,900
Cost $45,000 - sale July 31, $4,110 = $40,890
$47,900 - $40,890 = $7,010

Dec 31 Cash..... 6,000
Bond Interest Earned..... 4,000
Interest Receivable..... 2,000
To record the receipt of the semi-annual bond interest on Rock bonds.
$200,000 x 6% 6/12 = $6,000

Solution problem 2

Requirement 1: Journal entries under the Equity Method

1/1/x3 AFS Portfolio: Investment in MDC Inc..... 800,000
Cash..... 800,000
To record temporary purchase of MDC stock for $800,000

12/31/x3 AFS Portfolio: Investment in MDC Inc..... 120,000
Cash..... 60,000
Equity in MDC Inc (goes to NI)..... 180,000
To record equity interest in MDC NI less dividend received

NI; 900,000 x (0.2) = 180,000
Div: 300,000 x (0.2) = (60,000)

12/31/x4 Loss on MDC, Inc investment..... 80,000
Cash..... 20,000
AFS Portfolio: Investment in MDC Inc..... 100,000
To recognize loss on investment and decrease the investment in MDC Inc. by 20% of its loss of $400,000.

Note that there are no holding gains/losses on MES investments of 20% or more…
NL: 400,000 x (0.2) = 80,000
Div: 100.000 x (0.2) = 20,000

12/31/x5 AFS Portfolio: Investment in MDC Inc..... 240,000
Cash..... 100,000
Equity in MDC Inc (goes to NI)..... 340,00
To record Dividend and Equity in MDC NI

NI; 1,200,000 x (0.2) = 240,000
Div: 500,000 x (0.2) = 100,000

12/31/x6 AFS Portfolio: Investment in MDC Inc..... 140,000
Cash..... 70,000
Equity in MDC Inc (goes to NI)..... 210,00
To record Dividend and Equity in MDC NI

NI; 700,000 x (0.2) = 140,000
Div: 350,000 x (0.2) = 70,000

12/31/x7 Loss on MDC, Inc investment..... 120,000
Cash..... 40,000
AFS Portfolio: Investment in MDC Inc..... 160,000
To record Dividend and loss on investment due to MDC Inc. Loss of $600,000

2. The balance in the investment account at the end of 20x7 is $870,000 under the equity method

	Investment in MDC Inc.	
20x3	800,000	60,000
	180,000	
Bal.	920,000	
20x4		80,000
		20,000
Bal.	820,000	
20x5	240,000	100,000
Bal.	960,000	
20x6	140,000	70,000
Bal.	1,030,000	
20x7		120,000
		40,000
Bal.	870,000	

3. The balance in the investment account at the end of 20x7 would be $800,000 under the cost method
The investment was recorded at full cost and experienced no liquidating dividends, changes in classification, sales or permanent declines in fair market value.

Solution Problem 3

20x3

Mar 1 AFS Portfolio: Investment in Bozo Inc. 203,000
Bonds Bond Interest Receivable (200,000 x.09 x 4/12) 6,000
Cash 209,000

Purchased $200,000 of Bozo Inc. 9% 5-year bonds, plus accrued interest.
$200,000 x 9% = $18,000/12 months = $1,500/ month
$1,500/ month x 4 months = $6,000

May 1 Cash (200,000 x .09 x 6/12)..... 9,000
AFS Portfolio: Investment in Bozo Inc (3,000 x 2/50) 120
Bond Interest Receivable (reverse original entry)..... 6,000
Bond Interest Earned (plug)..... 2,880

To record receipt of the semi-annual bond interest payment and amortization of the premium on the bonds.
$200,000 x 9% x 6/12 = $9,000
Amortization: $3,000/50 months = $60 x 2 months = $120
(Bonds mature May 1, 20x5; Bonds acquired March 1, 20x1; Total number periods: 50 months)

Nov 1 Cash (200,000 x .09 x 6/12)..... 9,000
AFS Portfolio: Investment in Bozo Inc (3,000 x 6/50). 360
Bond Interest Earned (plug)..... 8,640

To record receipt of the semi-annual bond interest payment and amortization of the premium on the bonds.
Amortization: 6 months x $60 = $360

Dec 31 Bond Interest Receivable (200,000 x .09 x 2/12)..... 3,000
Investment in Bozo Inc. Bonds (3,000 x 2/50)..... 120
Bond Interest Earned (plug)..... 2,880

To Record year-end bond interest accrual and amortization of the bond premium. Nov. and Dec. 2 months x $60 = $120

20x4

Apr 1 Cash..... 212,500
Bond interest earned [(200,000 x .09 x 3/12) - (3,000 x 3/50). 4,320
Bond interest receivable (remove accrued int per Dec 31)..... 3,000
AFS Portfolio: Investment in Bozo Inc (203,000 - 780)..... 202,400
Gain on sale of Bozo Inc bonds (plug)..... 2,780

To Record sale of Bozo Inc. bonds plus accrued interest;

Cost of original investment.....		$ 203,000	
deduct amortization of premium:			
May 1:	120		
Nov 1:	360		
Dec 31:	120		
Apr 1:	180	(780)	
Balance on April 1, 20x4.....			$ 202,220

Computation of Gain/loss on sale:		
Sales price.....	$ 212,500	
Carrying value of bond investment:	$ 202,220	
Add: Accrued interest receivable:	7,500*	209,720
Gain or loss on sale:		$ 2,780

* ($200,000 x .09 x 5/12)

Solution Problem 4

Jan 1	Trading Portfolio: Investment in Skunk Inc. Bonds (Full cost).....	1,025,000	
	Bond Interest Receivable (1,000,000 x .105 x 5/12).....	43,750	
	Cash		1,068,750

To record purchase of temporary investment in Skunk Inc. 10.5% 5-year bonds at 102.5, plus accrued interest.
$1,000,000 x 10.5% x 5/12 = $43,750

Feb 1	Cash (1,000,000 x .105 x 6/12).....	52,500	
	Bond Interest Receivable (remove receivable booked Jan 1).		43,750
	Bond interest Earned (plug).....		8,750

To record receipt of semi-annual bond interest payment from Skunk Inc. $1,000,000 x 10.5% x 6/12 = $52,500

Feb 25	Trading Portfolio: Investment in Bush Corp (50,000 x $41).....	2,050,000	
	Brokerage Commissions.....	250	
	Cash		2,050,250

Purchased 50 000 shares of Bush Corp.at $41, plus $250 brokerage charge. $41 x 50,000 = $2,050,000 + $250 = $2,050,250

Apr 1	Hold-to-Maturity Portfolio: Investment in Mammoth Corp. Bonds ($500,000 x .976)...	488,000	
	Cash		488,000

Purchased $500,000 12% 5-year Mammoth Corp. bonds at 97.6. $500,000 x 97.6% = $488,000

Jul 15	Cash (50,000 x $2).....	100,000	
	Dividends Revenue		100,000

Received $2.00 per share cash dividend from Bush Corp. 50 000 shares x $2.00 = $100,000

Aug 1	Cash (1,000,000 x .105 x 6/12).....	52,500	
	Bond Interest Earned		52,500

Recorded receipt of semi-annual bond interest payment from Skunk Inc.

Sept 15 Memorandum
Received 5,000 shares of Bush Corp. stock as 10 percent stock dividend.

Oct 1	Cash (500,000 x .12 x 6/12).....	30,000	
	Hold-to-Maturity Portfolio: Invest Mammoth Corp. Bonds.(500,000 - 488,000 x 6/60) .	1,200	
	Bond Interest earned (plug).....		31,200

Recorded receipt of semi-annual bond interest payment from Mammoth Corp. and recorded amortization of the bond discount. $12,000 bond discount x 6/60 = $1,200 (5yr life x 12 months = 60 months)

Dec 1	Cash [(1,050,000) + (1,000,000 x .105 x 4/12)].....	1,085,000	
	Bond Interest Earned (1,000,000 x		35,000
	Trading Portfolio: Investment in Skunk Inc. Bonds (@ carrying value)....		1,025,000
	Gain on Sale of Temporary Investment (plug).....		25,000

Recorded the sale of Skunk Inc. bonds at 102.5 plus accrued interest to date. $1,000,000 x 10.5% x 4/12 = $35,000

Dec 10	Cash (55,000 x $1.50).....	82,500	
	Dividend Revenue.....		82,500

Received $1.50 per share cash dividend from Bush Corp. (55,000 shares x $1.50 = $82,500)

Dec 31	Bond Interest Receivable (500,000 x .12 x 3/12).....	15,000	
	Hold-to-Maturity Portfolio: Investment in Mammoth Corp. Bonds (500,000 - 488,000 x 3/60.....	600	
	Bond Interest Earned (plug).....		15,600

Recorded adjusting entry for bond interest due from Mammoth Corp. and amortization of the bond discount.
--Interest Receivable: $500,000 x 12% x 3/12 = $ 15,000
--Amortization of Bond Discount $ 12,000 x 3/60 = $600