

Chapter 5: Short Term Investments & Receivables

- For many companies acct. receivables are the largest current asset
- Short term investments are listed immediately after cash on the balance sheet

Account for Short Term Investment

- **Short term investments / marketable securities** - investments in marketable securities that can be easily converted to cash that a company plans to hold for one year or less
 - Next most liquid asset after cash
- Investments in marketable securities :
 - Trading securities
 - Purpose is to hold for short time then sell for more than it cost
 - Current asset
 - If the market value of the stock we purchased increases, we gain
 - If market value decreases, we have a loss
 - We earn dividend revenue
 - Available-for-sale securities
 - Usually long term unless they mature during that period
 - Held-to-maturity securities
 - Usually long term unless they mature during that period
- Unrealized gains / losses:
 - Say stock increases by \$2,000
 - Gain because the fair value is greater than the cost
 - Gain has same effect as revenue
 - Unrealized gain because we have not sold the securities yet
 - Loss has the same result as an expense
 - Trading securities are reported on balance sheet with current fair value, because that is the price the investor can earn by selling

2012			
Nov 18	Investment in IBM stock	100,000	
	Cash		100,000
	<i>Purchased investment.</i>		

Investment in IBM Stock	
100,000	

Assume that PepsiCo receives a cash dividend of \$4,000 from IBM. PepsiCo records the dividend revenue as follows:

2012			
Nov 27	Cash	4,000	
	Dividend Revenue		4,000
	<i>Received cash dividend.</i>		

2012			
Dec 31	Investment in IBM stock	2,000	
	Unrealized Gain on Investments		2,000
	<i>Adjusted investment to fair value.</i>		

Investment in IBM Stock		Unrealized Gain on Investments	
100,000			
2,000			2,000
102,000			

Unrealized Loss on Investments	5,000	
Investment in IBM Stock		5,000
<i>Adjusted investment to fair value.</i>		

Investment in IBM Stock		Unrealized Loss on Investments	
100,000	5,000	5,000	
95,000			

Reporting on the Balance Sheet and Income Statement

- Balance sheet:
 - Short term investments are current assets
 - Trading securities are reported at current fair market value
- Income statement
 - Investments on debt and equity securities earn interest revenue and dividend revenue
 - Investments create losses and gains
 - Reported as Other revenue, gains, losses

Balance sheet		Income statement	
Current assets.....		Revenues.....	\$ XXX
Cash.....	\$ XXX	Expenses.....	XXX
Short-term investments, at fair value.....	102,000	Other revenue, gains and (losses):	
Accounts receivable.....	XXX	Interest revenue.....	XXX
		Dividend revenue.....	4,000
		Unrealized gain on investment.....	2,000
		Net income.....	\$ XXX

- Realized gains/losses
 - Realized gain/loss happens after investor sells investment
 - Realized gain- sale price is greater than investment carrying amount
 - Realized loss- sale price is less than investment carrying amount
 - Most accountants don't use the word realized its just loss/gain

2013			
Jan 19	Cash	98,000	
	Loss on Sale of Investments	4,000	
	Investment in IBM Stock		102,000
	<i>Sold investments at a loss.</i>		

Investment in IBM Stock		Loss on Sale of Investments	
100,000		4,000	
2,000	102,000		

Ethics and the Current Ratio

- Lending agreements may require company to maintain a specific current ratio
- Current ratio= total assets/total liabilities
- Ways to increase current ratio:
 - Launch major sales effort to increase cash. This offsets liabilities
 - Pay off some liabilities. Current asset and current liabilities will decrease by the same amount
 - Increases ratio when current ratio is already about 1
 - Reclassify long term investments as current assets which increases ratio
 - Unethical if you will keep them for more than a year

GAAP For Revenue Recognition

- Revenue is recognized when it is earned
- Seller has done everything required
- Price is fixed and collection is reasonable assured
- Timing and amount of revenue recognized depends on shipping terms and payment incentives offered to buyer

Shipping terms, sales discounts, sales returns

- Shipping
 - Proper time to recognize sales revenue is when ownership of goods changes hands between buyer and seller
 - Determined by shipping terms in sales contract
 - FOB (free on board)- shipping, ownership happens when goods leave sellers shipping doc
 - FOB- destination, ownership changes at point of delivery to customer
- Sale Discounts
 - Sales discount for early payment to speed up cash flow
 - Ex: 2/10, n/30
 - Seller will discount order by 2% if buyer pays invoice within 10 days
 - Buyer must pay within 30 days