Solution Manual for Advanced Financial Accounting 10th Edition Christensen Cottrell Baker 0078025621 9780078025624

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Solution Manual:

REPORTING INTERCORPORATE INVESTMENTS AND CONSOLIDATION OF WHOLLY OWNED SUBSIDIARIES WITH NO DIFFERENTIAL

ANSWERS TO QUESTIONS

Q2-1 (a) An investment in the voting common stock of another company is reported on an equity-method basis when the investor is able to significantly influence the operating and financial policies of the investee.

(b) The cost method normally is used for investments in common stock when the investor does not have significant influence and for investments in preferred stock and other securities. The cost method may also be used by the parent company for bookkeeping purposes when the investor owns a controlling interest because the investment account is eliminated in the consolidation process.

Q2- 2* Significant influence occurs when the investor has the ability to influence the operating and financial policies of the investee. Representation on the board of directors of the investee is perhaps the strongest evidence, but other evidence such as routine participation in management decisions or entering into formal agreements that give the investor some degree of influence over the investee also may be used.

Q2-3* Equity-method reporting should not be used when (a) the investee has initiated litigation or complaints challenging the investor's ability to exercise significant influence, (b) the investor signs an agreement surrendering important shareholder rights, (c) majority ownership is concentrated in a small group that operates the company without regard to the investor's desires, (d) the investor is not able to acquire the information from the investee, or (e) the investor tries and fails to gain representation on the board of directors.

Q2-4 The balances will be the same at the date of acquisition and in the periods that follow whenever the cumulative dividends paid by the investee equal or exceed the investee's cumulative earnings since the date of acquisition. The latter case assumes there are no other adjustments needed under the equity method for amortization of differential or other factors.

Q2-5 When a company has used the cost method and purchases additional shares which cause it to gain significant influence, a retroactive adjustment is recorded to move from a cost basis to an equity-method basis in the preceding periods. Dividend income is replaced by income from the investee and dividends received are treated as an adjustment to the investment account.

Q2-6 An investor considers a dividend to be a liquidating dividend when the cumulative dividends received from the investee exceed a proportionate share of the cumulative earnings of the investee from the date ownership was acquired. For example, an investor would consider a dividend to be liquidating if it purchases shares of another company in early December and receives a dividend at year-end substantially in excess of its portion of the investee's net income for December.

Q2-7 Liquidating dividends decrease the investment account in both cases. All dividends are treated as a reduction of the investment account when equity- method reporting is used. When the cost method is used and dividends are received in excess of a proportionate share of investee earnings since acquisition, they are treated as a reduction of the investment account as well.

Q2-8 A dividend is treated as a reduction of the investment account under equity-method reporting. Unless it is a liquidating dividend, it is treated as dividend income under the cost method.

Q2- 9 Dividends received by the investor are recorded as dividend income under both the cost and fair value methods. The change in the fair value of the shares held by the investor is recorded as an unrealized gain or loss under the fair value method. The fair value method differs from the equity method in two respects. Under the equity method the investor's share of the earnings of the investee are included as investment income and dividends received from the investee are treated as a reduction of the investment account.

Q2-10* When the modified equity method is used, a proportionate share of subsidiary net income and dividends is recorded on the parent's books and an appropriate amount of any differential is amortized each period. In some situations, companies also choose not to make adjustments for intercompany profits and the amortization of the differential. Under the fully adjusted equity method, the parent's books also are adjusted for unrealized profits and any other items that are needed to bring the investor's net income into agreement with the income to the controlling interest that would be reported if consolidation were used.

Q2-11 A one-line consolidation implies that under equity-method reporting the investor's net income and stockholders' equity will be the same as if the investee were consolidated. Income from the investee is included in a single line in the investor's income statement and the investment is reported as a single line in the investor's balance sheet.

Q2-12* The term modified equity method generally is used when the investor records its portion of the reported net income and dividends of the investee and amortizes an appropriate portion of any differential. Unlike the fully adjusted equity method, no adjustment for unrealized profit on intercompany transfers normally is made on the investor's books. (In some situations, companies also choose not to amortize the differential.) When an investee is consolidated for financial reporting purposes, the investor may not feel it is necessary to record fully adjusted equity method entries on its books since income from the investee and the balance in the investment account must be eliminated in preparing the consolidated statements.

Q2-13* The investor reports a proportionate share of an investee's extraordinary item as an extraordinary item in its own income statement.

Q2-14 An adjusting entry is recorded on the company's books and causes the balances reported by the parent or subsidiary company to change. Eliminating entries, on the other hand, are not recorded on the books of the companies. Instead, they are entered in the consolidation worksheet so that when the amounts included in the eliminating entries are applied, the appropriate balances for the consolidated entity are reported.

Q2-15 Each of the stockholders' equity accounts of the subsidiary is eliminated in the consolidation process. Thus, none of the balances is included in the stockholders' equity accounts of the consolidated entity. That portion of the stockholders' equity claim assigned to the noncontrolling shareholders is reported indirectly in the balance assigned to the noncontrolling shareholders.

Q2-16 Additional entries are needed to eliminate all income statement and retained earnings statement effects of intercorporate ownership and any transfers of goods and services between related companies.

Q2-17 Separate parts of the consolidation worksheet are used to develop the consolidated income statement, retained earnings statement, and balance sheet. All eliminating entries needed to complete the entire worksheet normally are entered before any of the three statements are prepared. The income statement portion of the worksheet is completed first so that net income can be carried forward to the retained earnings statement portion of the worksheet. When the retained earnings portion is completed, the ending balances are carried forward and entered in the consolidated balance sheet portion of the worksheet.

Q2-18 None of the dividends declared by the subsidiary are included in the consolidated retained earnings statement. Those which are paid to the parent have not gone outside the consolidated entity and therefore must be eliminated in preparing the consolidated statements.

Q2-19 Consolidated net income includes 100 percent of the revenues and expenses of the individual consolidating companies arising from transactions with unaffiliated companies.

Q2-20 Consolidated retained earnings is that portion of the undistributed earnings of the consolidated entity accruing to the parent company shareholders.

Q2-21 Consolidated retained earnings at the end of the period is equal to the beginning consolidated retained earnings balance plus consolidated net income attributable to the controlling interest, less consolidated dividends. Under the fully adjusted equity method, consolidated retained earnings should equal the parent company's retained earnings.

Q2-22 The retained earnings statement shows the increase or decrease in retained earnings during the period. Thus, income for the period is added to the beginning balance and dividends are deducted in deriving the ending balance in retained earnings. Because the consolidation worksheet includes the retained earnings statement, the beginning retained earnings balance must be entered in the worksheet.

SOLUTIONS TO CASES
C2-1 Choice of Accounting Method

a. The equity method is to be used when an investor has significant influence over an investee. Significant influence normally is assumed when more than 20 percent ownership is held. Factors to be considered in determining whether to apply equity-method reporting include the following:

1. Is the investee under the control of the courts or other parties as a result of filing for reorganization or entering into liquidation procedures?
2. Does the investor have representation on the board of directors, or has it attempted to gain representation and been unable to do so?
3. Has the investee initiated litigation or complaints challenging the investor's ability to exercise significant influence?
4. Has the investor signed an agreement surrendering its ability to exercise significant influence?
5. Is majority ownership concentrated in a small group that operates the company without regard of the wishes of the investor?
6. Is the investor able to acquire the information needed to use equity-method reporting?

b. When subsidiary net income is greater than dividends paid, equity-method reporting is likely to show a larger reported contribution to the earnings of Slanted Building Supplies. If 20X4 earnings are negative or less than dividends distributed in 20X4, the cost basis is likely to result in a larger contribution to Slanted's reported earnings.

c. As the investor uses more of its resources to acquire ownership of the investee, and as the investor has a greater share of the investee's profits and losses, the success of the investee's operations may have more of an impact on the overall financial well-being of the investor. In many cases, the investor will want to participate in key decisions of the investee once the investor's ownership share reaches a certain level. Also, use of the equity method eliminates the possibility of the investor manipulating its own income by influencing investee dividend distributions, as might occur under the cost method.

C2-2 Intercorporate Ownership

MEMO

To: Chief Accountant
Most Company

From: ______ ______, CPA

Re: Equity Method Reporting for Investment in Adams Company

The equity method should be used in reporting investments in which the reporting company has a significant influence over the operating and financing decisions of another company. In this case, Most Company holds 15 percent of the voting common stock of Adams Company and Port Company holds an additional 10 percent. During the course of the year, both Most and Port are likely to use the cost method in recording their respective investments in Adams. However, when consolidated statements are prepared for Most, the combined ownership must be used in determining whether significant influence exists. Both direct and indirect ownership must be taken into consideration. [ASC 323-10-15-6 through 15-8]

A total of 15 percent of the voting common stock of Adams is held directly by Most Company and an additional 10 percent is controlled indirectly though Most’s ownership of Port Company. Equity-method reporting for the investment in Adams Company therefore appears to be required.

If the cost method has been used by Most and Port in recording their investments during the year, at the time consolidated statements are prepared, adjustments must be made to (a) increase the balance in the investment account for a proportionate share of the investee’s reported net income (25 percent) and reduce the balance in the investment account for a proportionate share of the dividend paid by the investee, (b) include a proportionate share of the investee’s net income in the consolidated income statement, and (c) delete any dividend income recorded by Most and Port.

Primary citation
ASC 323-10-15-6 through 15-8

C2-3* Application of the Equity Method

MEMO

To: Controller
Forth Company

From: ______ ______, CPA

Re: Equity Method Reporting for Investment in Brown Company

This memo is prepared in response to your request regarding use of the cost or equity methods in accounting for Forth's investment in Brown Company.

Forth Company held 85 percent of the common stock of Brown Company prior to January 1, 20X2, and was required to fully consolidate Brown Company in its financial statements prepared prior to that date [**ASC 810**]. Forth now holds only 15 percent of the common stock of Brown. The cost method is normally used in accounting for ownership when less than 20 percent of the stock is directly or indirectly held by the investor.

Equity-method reporting should be used when the investor has "significant influence over operating and financing policies of the investee." While 20 percent ownership is regarded as the level at which the investor is presumed to have significant influence, other factors must be considered as well. [ASC 323-10-15-6 through 15-8]

Although Forth currently holds only 15 percent of Brown's common stock, the other factors associated with its ownership indicate that Forth does exercise significant influence over Brown. Forth has two members on Brown's board of directors, it purchases a substantial portion of Brown's output, and Forth appears to be the largest single shareholder by virtue of its sale of 10,000 shares to each of 7 other investors.

These factors provide strong evidence that Forth has significant influence over Brown and points to the need to use equity-method reporting for its investment in Brown. Your office should monitor the activities of the standard setting bodies with respect to consolidation standards [www.fasb.org]. Active consideration is being given to situations in which control may be exercised even though the investor does not hold majority ownership. It is conceivable that your situation might be one in which consolidation could be required.

Primary citations
APB 18, par. 17; ASC 323-10-15-6 through 15-8
ASC 810

C2-4 Need for Consolidation Process

After the financial statements of each of the individual companies are prepared in accordance with generally accepted accounting principles, consolidated financial statements must be prepared for the economic entity as a whole. The individual companies generally record transactions with other subsidiaries on the same basis as transactions with unrelated enterprises. In preparing consolidated financial statements, the effects of all transactions with related companies must be removed, just as all transactions within a single company must be removed in preparing financial statements for that individual company. It therefore is necessary to prepare a consolidation worksheet and to enter a number of special journal entries in the worksheet to remove the effects of the intercorporate transactions. The parent company also reports an investment in each of the subsidiary companies and investment income or loss in its financial statements. Each of these accounts must be eliminated as well as the stockholders' equity accounts of the subsidiaries. The latter must be eliminated so that only the parent's equity remains. This is because only the parent's ownership is held by parties outside the consolidated entity.

C2-5 Account Presentation

MEMO

To: Chief Accountant
Prime Company

From: ______ ______, Accounting Staff

Re: Combining Broadly Diversified Balance Sheet Accounts

Many manufacturing and merchandising enterprises excluded finance, insurance, real estate, leasing, and perhaps other types of subsidiaries from consolidation prior to 1987 on the basis of "nonhomogeneous" operations. Companies generally argued that the accounts of these companies were dissimilar in nature and combining them in the consolidated financial statements would mislead investors. **ASC 810** specifically eliminated the exception for nonhomogeneous operations. **ASC 810-10- 65-1** affirms the requirement for consolidating entities in which a controlling financial interest is held.

Prime Company controls companies in very different industries and combining the accounts of its subsidiaries may lead to confusion by some investors; however, it may be equally confusing to provide detailed listings of assets and liabilities by industry or other breakdowns in the consolidated balance sheet. The actual number of assets and liabilities presented in the consolidated balance sheet must be carefully considered, but is the decision of Prime's management.

It is important to recognize that the notes to the consolidated financial statements are regarded as an integral part of the financial statements and Prime Company is required to include in its notes to the financial statements certain information on its reportable segments [**ASC 280-10**]. Because of the diversity of its ownership, Prime may wish to provide more than the minimum disclosures specified in the guidance. Segment information appears to be used quite broadly by investors and permits the company to provide sufficient detail to assist the financial statement user in gaining a better understanding of the various operating divisions of the company.

You have requested information on those situations in which it may not be appropriate to combine similar appearing accounts of two or more subsidiaries. The following is a partial listing of such situations: (a) the accounts of a subsidiary should not be included along with other subsidiaries if control of the assets and liabilities does not rest with Prime Company, as when a subsidiary is in receivership; (b) while the assets and liability accounts of the subsidiary should be combined with the parent, the equity account balances should not; (c) negative account balances in cash or accounts receivable should be reclassified as liabilities rather than being added to the positive balances of other affiliates if there is no right of offset in the underlying bank accounts, and (d) assets pledged for a specific purpose and not available for other use by the consolidated entity generally should be separately reported.

Primary citations:
ASC 810
ASC 280-10
ASC 810-10-65-1
Secondary sources:
ASC 810

C2-6 Consolidating an Unprofitable Subsidiary

MEMO

TO: Chief Accountant
Amazing Chemical Corporation

FROM: ___________ ___________, Accounting Staff

Re: Consolidation of Unprofitable Boatyard

This memo is intended to provide recommendations on the presentation of the boatyard in Amazing Chemical's consolidated financial statements. Amazing Chemical Corporation currently has full ownership of the boatyard and should fully consolidate the boatyard in its financial statements. Consolidated statements should be prepared when a company directly or indirectly has a controlling financial interest in one or more other companies. [ASC 810-10-10-1 and ASC 810-10-65-1]. Amazing Chemical appears to be following generally accepted accounting procedures in fully consolidating the boatyard in its financial statements and should continue to do so.

The operations of the boatyard appear to be distinct from the other operations of the parent company and its losses appear to be sufficient to establish it as a reportable segment [**ASC 280-10-50**]. While the operating losses of the boatyard may not be evident in analyzing the consolidated income statement, a review of the notes to the consolidated statements should provide adequate disclosure of its operations as a reportable segment. The financial statements for the current period should contain these disclosures and if prior period statements have not included the boatyard as a reportable segment it may be necessary to restate those statements.

Failure of the president of Amazing Chemical to receive approval by the board of directors for the purchase of the boatyard and his subsequent actions to keep information about its operations from the board members appears to be a serious breach of ethics. These actions by the president should immediately be brought to the attention of the board of directors for appropriate action by the board.

Primary citations:
ASC 810-10-10-1
ASC 810
ASC 280-10-50
ASC 810-10-65-1

SOLUTIONS TO EXERCISES

E2-1 Multiple-Choice Questions on Use of Cost and Equity Methods [AICPA Adapted]

1. **a –** Cash dividends received will never cause an *increase* in the investment account under either method.

   (b) *Incorrect*. A cash dividend is recorded as dividend income and does not affect the investment account under the cost method. Under the equity method, dividends *reduce* the investment account.
   (c) *Incorrect.* A cash dividend is recorded as dividend income and does not affect the investment account under the cost method.
   (d) *Incorrect.* Under the equity method, dividends *reduce* the investment account.

2. **a –** Because the ownership in Amal Corporation is less than 20%, the cost method should be applied. Accordingly, the $1,500 dividend received from Amal is recorded as dividend revenue.

   (b) *Incorrect*. Stock dividends are not recorded as income.
   (c) *Incorrect.* The cash dividend received from B&K is not recorded as dividend revenue because it is accounted for under the equity method.
   (d) *Incorrect.* The stock dividend and cash dividend from B&K are not recorded as dividend revenue.

3. **a –** Under the equity method, net income increases the investment account while dividends decrease it. Because net income was greater than the dividends declared, this results in a net increase in the investment account. Under the cost method, the investment would not be altered, and thus would be lower than it would be under the equity method.

   (b) *Incorrect*. This would only be true if the dividends were less than the net income.
   (c) *Incorrect.* It doesn't matter when the dividends are paid; as soon as they are declared they act as a reduction to the investment under the equity method.
   (d) *Incorrect.* It doesn't matter when the dividends are paid; as soon as they are declared they act as a reduction to the investment under the equity method.

4. **b –** Under the equity method the company records a share of the affiliate net income as income for the company. This increases the net income of the company which increases earnings per share.

   (a) *Incorrect*. An increase in income affects long-term assets, not current assets or current liabilities, so it would have no effect on the current ratio.
   (c) *Incorrect.* The assets would be higher so asset turnover would decrease. No other turnover ratios would be affected.
   (d) *Incorrect.* The affiliate company's profitability would not decrease the book value per share of the company, it would increase it since retained earnings would increase with the recognition of income from the subsidiary.

5. **d –** Since these are liquidating dividends they would decrease the investment account under the cost method, and decrease the investment account under the equity method.

(a) *Incorrect.* Dividends usually decrease the investment account under the equity method so there would be an effect.
(b) *Incorrect.* Dividends usually decrease the investment account under the equity method so there would be an effect.
(c) *Incorrect.* Since these are liquidating dividends they would decrease the investment account under the cost method so there would be an effect.

6. **d –** The amount of dividends not in excess would be considered dividend income.

(a) *Incorrect.* There would be at least some dividend recorded.
(b) *Incorrect.* Since these are liquidating dividends a portion of the dividends will go to reduce the investment account thus not all of the dividends received will be income.
(c) *Incorrect.* The portion of dividends received in excess of the share of earnings would cause a reduction in the investment account.

E2-2 Multiple-Choice Questions on Intercorporate Investments

1. **b –** Equity method reporting is used when an investor gains significant influence over the operating and financing decisions of the investee. Typically, this is satisfied by maintaining 20% or more of the voting stock, but can also be obtained by other contractual obligations or circumstances.

(a) *Incorrect.* Voting shares can be obtained without gaining significant influence (i.e. less than 20%) and thus the equity method is not typically used.
(c) *Incorrect.* Purchasing goods and services would not constitute significant influence over the company, and thus does not result in the equity method being applied.
(d) *Incorrect.* This would result in a write-down of the investment, and does not correlate to the use of the equity method.

2. **c –** Under the equity method, net income from the investee causes an increase to the investment, while dividends declared by the investee causes a reduction.

(a) *Incorrect.* This simply represents the historical cost of the investment. It must be adjusted for the income and dividends declared by the investee.
(b) *Incorrect.* Dividends declared by the investee cause a reduction to the investment, not an increase.
(d) *Incorrect.* Net income reported by the investee causes an increase to the investment, not a decrease.

E2-3 Multiple-Choice Questions on Applying Equity Method [AICPA Adapted]

1. **d –** $250,000 + ($100,000 x 0.30) – ($10,000 x 0.30) = $277,000

2. **c –** 20X9 investment income: $650,000 * 30% = $195,000, 20X8 adjustment: ($600,000 * 10%) – ($200,000 * 10%) = $40,000.

3. **d** – Because income is greater than the amount of dividends declared, the equity method would have resulted in a higher balance in the investment account, net earnings, and retained earnings than under the cost method.

   (a) *Incorrect.* Because the investor's portion of income ($40,000) is greater than the portion of dividends ($4,000), using the cost method would only result in an earnings increase of $4,000 from dividend revenue rather than $40,000. Thus, both net earnings and retained earnings would be understated.
   (b) *Incorrect.* The cost method does not record any increase to the investment account, thus its balance would be understated when compared to the equity method.
   (c) *Incorrect.* The cost method causes and understatement to the investment account, net earnings and retained earnings.

4. **d** – Under the equity method, dividends by the investee are recorded with a credit to the investment account, not to dividend revenue. By wrongly classifying this entry, the investment is overstated, and retained earnings are also overstated.

   (a) *Incorrect.* Because the dividend entry was recorded incorrectly, the financial position will not be correctly stated.
   (b) *Incorrect.* Because the dividends were recorded as dividend revenue, retained earnings would be overstated.
   (c) *Incorrect.* Currently, the investment is overstated because the dividends declared should have resulted in a reduction to the investment account.

E2-4 Cost versus Equity Reporting

a. Winston Corporation net income – cost method:

20X2	$ 100,000	+	.40($30,000)		$112,000
20X3	$ 60,000	+	.40($60,000)		84,000
20X4	$ 250,000	+	.40($20,000	+ $25,000)	268,000

[a] Dividends paid from undistributed earnings of prior years ($70,000 + $40,000 - $30,000 - $60,000 = $20,000) and $25,000 earnings of current period.

b. Winston Corporation net income – equity method:

20X2	$ 100,000	+	.40($70,000)	$128,000
20X3	$ 60,000	+	.40($40,000)	76,000
20X4	$ 250,000	+	.40($25,000)	260,000

E2-5 Acquisition Price

Balance at date of acquisition:

a. Cost method $54,000 + $2,800 = $56,800
b. Equity method $54,000 - $2,000 = $52,000

			Change in Investment Account	
Year	Net Income	Dividends	Cost Method	Equity Method
20X1	$ 8,000	$15,000	$(2,800)	$(2,800)
20X2	12,000	10,000		800
20X3	20,000	10,000		4,000
Change in account balance			$(2,800)	$ 2,000

E2-6 Investment Income

a. (1) Ravine Corporation net income under Cost Method:

20X6	$ 140,000	+	0.30($20,000)	=	$146,000
20X7	$ 80,000	+	0.30($40,000)	=	$ 92,000
20X8	$ 220,000	+	0.30($20,000 + $10,000)	=	$229,000
20X9	$ 160,000	+	0.30($20,000)	=	$166,000

[a] Dividends paid from undistributed earnings of prior years ($30,000 + $50,000 - $20,000 - $40,000= $20,000) and $10,000 earnings of current period.

(2) Ravine Corporation net income under Equity Method:

20X6	$ 140,000	+	0.30($30,000)	=	$149,000
20X7	$ 80,000	+	0.30($50,000)	=	$ 95,000
20X8	$ 220,000	+	0.30($10,000)	=	$223,000
20X9	$ 160,000	+	0.30($40,000)	=	$172,000

b. Journal entries recorded by Ravine Corporation in 20X8:

(1) Cost method:

Cash	12,000	
Dividend Income		9,000
Investment in Valley Stock		3,000

(2) Equity method:

Cash	12,000	
Investment in Valley Stock		12,000

Investment in Valley Stock	3,000	
Income from Valley		3,000

E2-7 Investment Value

The following amounts would be reported as the carrying value of Port's investment in Sund:

20X2	$184,500	=	$180,000	+	($40,000 x 0.30)	-	($25,000 x 0.30)
20X3	$193,500	=	$184,500	+	($30,000 x 0.30)		
20X4	$195,000	=	$193,500	+	($5,000 x 0.30)		

E2-8* Income Reporting

Journal entry recorded by Grandview Company:

Investment in Spinet Corporation Stock	36,000	
Income from Spinet Corporation		24,000
Extraordinary Gain (from Spinet Corporation)		12,000

E2-9 Fair Value Method

a. Cost method:

Operating income reported by Mock	$90,000
Dividend income from Small ($15,000 x 0.20)	3,000
Net income reported by Mock	$93,000

b. Equity method:

Operating income reported by Mock	$90,000
Income from investee ($40,000 x 0.20)	8,000
Net income reported by Mock	$98,000

c. Fair value method:

Operating income reported by Mock	$90,000
Unrealized gain on increase in value of Small stock	16,000
Dividend income from Small ($15,000 x 0.20)	3,000
Net income reported by Mock	$ 109,000

E2-10 Fair Value Recognition

a. Journal entries under the equity method:

(1)	Investment in Lomm Company Stock	140,000	
	Cash		140,000
	Record purchase of Lomm Company stock.		
(2)	Cash	7,000	
	Investment in Lomm Company Stock		7,000
	Record dividends from Lomm Company: $20,000 x 0.35		
(3)	Investment in Lomm Company Stock	28,000	
	Income from Lomm Company		28,000
	Record equity-method income: $80,000 x 0.35		

b. Journal entries under fair value method:

(1)	Investment in Lomm Company Stock	140,000	
	Cash		140,000
	Record purchase of Lomm Company stock.		

(2)	Cash	7,000	
	Dividend Income		7,000

Record dividends from Lomm Company: $20,000 x 0.35

(3)	Investment in Lomm Company Stock	34,000	
	Unrealized Gain on Increase in Value of Lomm Stock		34,000

Record increase in value of Lomm stock: $174,000 - $140,000

E2-11* Investee with Preferred Stock Outstanding

Journal entries recorded by Reden Corporation:

(1)	Investment in Montgomery Co. Stock	288,000	
	Cash		288,000

Record purchase of Montgomery Co. stock.

(2)	Cash	6,750	
	Investment in Montgomery Co. Stock		6,750

Record dividend from Montgomery Co.: [$40,000 - ($ 250,000 x .10)] x 0.45

(3)	Investment in Montgomery Co. Stock	31,500	
	Income from Montgomery Co.		31,500

Record equity-method income: [$95,000 - ($250,000 x .10)] x 0.45

E2-12* Other Comprehensive Income Reported by Investee

Journal entries recorded by Callas Corp. during 20X9:

(1)	Investment in Thinbill Co. Stock	380,000	
	Cash		380,000
	Record purchase of Thinbill Company		
(2)	Cash	3,600	
	Investment in Thinbill Co. Stock		3,600
	Record dividend from Thinbill: $9,000 x 0.40		
(3)	Investment in Thinbill Co. Stock	18,000	
	Income from Thinbill Co.		18,000
	Record equity-method income: $18,000 = $45,000 x 0.40		
(4)	Investment in Thinbill Co. Stock	8,000	
	Unrealized Gain on Investments of Investee (OCI)		8,000
	Record share of OCI reported by Thinbill: $8,000 = $20,000 x 0.40		

Closing entries recorded at December 31, 20X9:

(5)	Income from Thinbill Co.	18,000	
	Retained Earnings		18,000
(6)	Unrealized Gain on Investments of Investee (OCI)	8,000	
	Accumulated Other Comprehensive Income from Investee-Unrealized Gain on Investments		8,000

E2-13* Other Comprehensive Income Reported by Investee

Investment account balance reported by Baldwin Corp.		$67,000
Add decrease in account recorded in 20X8:		
Equity-method loss ($20,000 x .25)	$ (5,000)	
Dividend received ($10,000 x .25)	(2,500)	7,500
Deduct increase in account recorded in 20X9:		
Equity-method income ($68,000 x .25)	$17,000	
Dividend received ($16,000 x .25)	(4,000)	
Other comprehensive income reported by Gwin Company ($12,000 x .25)	3,000	(16,000)
Purchase price		$58,500

E2-14 Basic Elimination Entry

Common Stock – Broadway Corporation	200,000	
Additional Paid-In Capital	300,000	
Retained Earnings	100,000	
Investment in Broadway Common Stock		600,000

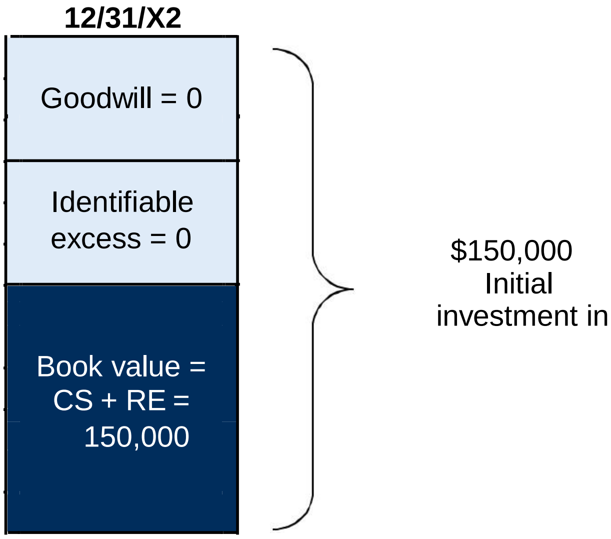
E2-15 Balance Sheet Worksheet

a.

Equity Method Entries on Blank's Books:

Investment in Faith	150,000	
Cash		150,000

Record the initial investment in Faith



Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Ending book value	**150,000**		**60,000**		**90,000**

Basic Elimination Entry

Common stock		
Retained earnings		
Investment in Faith		

Optional accumulated depreciation elimination entry

Accumulated depreciation	**30,000**	
Buildings & equipment		**30,000**

(Since the buildings and equipment are reported net of accumulated depreciation on the balance sheet, this entry will not affect the worksheet. However, if sufficient information had been given, this entry would have made a difference in the worksheet balances for Buildings and Equipment and Accumulated Depreciation. Additionally, this entry would impact any footnote disclosure of the details of Buildings and Equipment.)

E2-15 (continued)

b.

	Blank	Faith	DR	CR	Consolidated
Balance Sheet					
Cash	65,000	18,000			83,000
Accounts Receivable	87,000	37,000			124,000
Inventory	110,000	60,000			170,000
Buildings & Equipment (net)	220,000	150,000	30,000	30,000	370,000
Investment in Faith	150,000			150,000	0
Total Assets	**632,000**	**265,000**	**0**	**150,000**	**747,000**
Accounts Payable	92,000	35,000			127,000
Bonds Payable	150,000	80,000			230,000
Common Stock	100,000	60,000	60,000		100,000
Retained Earnings	290,000	90,000	90,000		290,000
Total Liabilities & Equity	**632,000**	**265,000**	**150,000**	**0**	**747,000**

E2-16 Consolidation Entries for Wholly Owned Subsidiary

a.

Equity Method Entries on Trim Corp.'s Books:

Investment in Round Corp.	400,000	
Cash		400,000

Record the initial investment in Round Corp.

Investment in Round Corp.	80,000	
Income from Round Corp.		80,000

Record Trim Corp.'s 100% share of Round Corp.'s 20X2 income

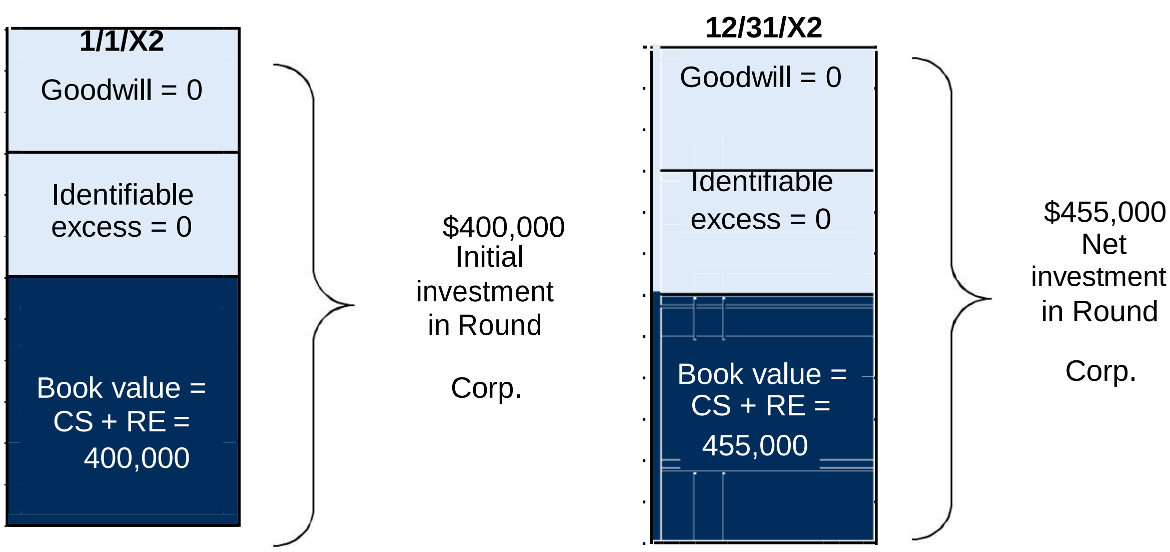
Cash	25,000	
Investment in Round Corp.		25,000

Record Trim Corp.'s 100% share of Round Corp.'s 20X2 dividend

b.

Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Beginning book value	**400,000**		**120,000**		**280,000**
+ Net Income					**80,000**
- Dividends	**(25,000)**				**(25,000)**
Ending book value	**455,000**		**120,000**		**335,000**



E2-16 (continued)

Basic Elimination Entry

Common stock	**120,000**	
Retained earnings	**280,000**	
Income from Round Corp.	**80,000**	
Dividends declared		**25,000**
Investment in Round Corp.		**455,000**

E2-17 Basic Consolidation Entries for Fully Owned Subsidiary

a.

Equity Method Entries on Purple Co.'s Books:

Investment in Amber Corp.	500,000	
Cash		500,000

Record the initial investment in Amber Corp.

Investment in Amber Corp.	50,000	
Income from Amber Corp.		50,000

Record Purple Co.'s 100% share of Amber Corp.'s 20X7 income

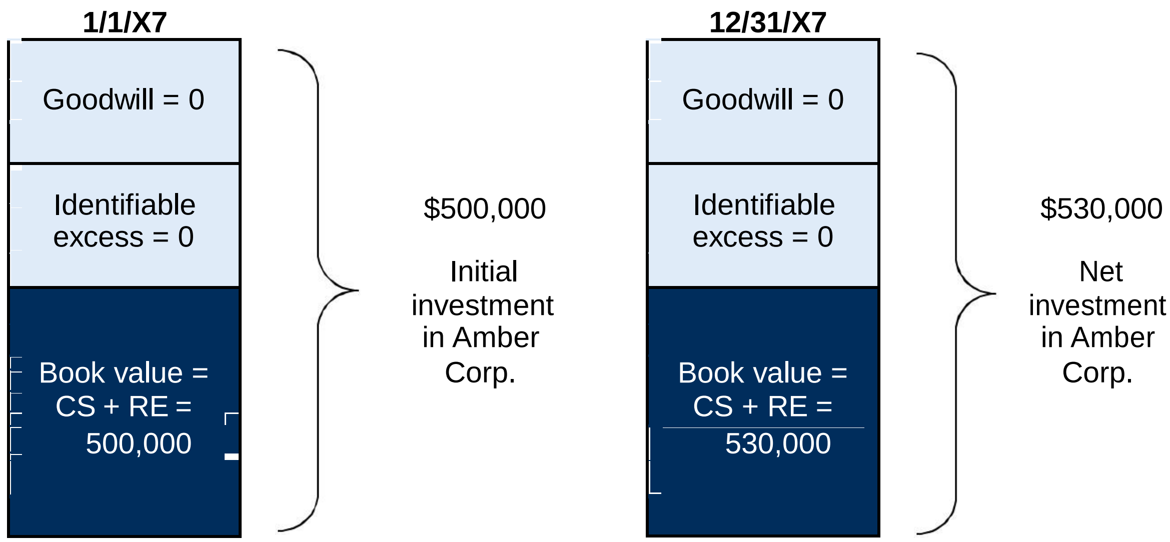
Cash	20,000	
Investment in Amber Corp.		20,000

Record Purple Co.'s 100% share of Amber Corp.'s 20X7 dividend

b.

Book Value Calculations:

	Total Book Value	**= Common Stock**	**+ Retained Earnings**
Original book value	**500,000**	**300,000**	**200,000**
+ Net Income			**50,000**
- Dividends	**(20,000)**		**(20,000)**
Ending book value	**530,000**		**230,000**


1/1/X7
Goodwill = 0
Identifiable excess = 0
Book value = CS + RE = 500,000
$500,000
Initial investment in Amber Corp.
12/31/X7
Goodwill = 0
Identifiable excess = 0
Book value = CS + RE = 530,000
$530,000
Net investment in Amber Corp.

E2-17 (continued)

Basic Elimination Entry

Common stock	300,000	
Retained earnings	200,000	
Income from Amber Corp.	50,000	
Dividends declared		20,000
Investment in Amber Corp.		530,000

	Investment in Amber Corp. (Dr)	Investment in Amber Corp. (Cr)		Income from Amber Corp. (Dr)	Income from Amber Corp. (Cr)	
Acquisition Price	500,000					
Net Income	50,000				50,000	Net Income
		20,000	Dividends			
Ending Balance	530,000				50,000	Ending Balance
		530,000	Basic	50,000		
	0				0	

SOLUTIONS TO PROBLEMS

P2-18 Retroactive Recognition

Journal entries recorded by Idle Corporation:

(1)	Investment in Fast Track Enterprises Stock	34,000	
	Cash		34,000
	Record purchase of Fast Track stock.		

(2)	Investment in Fast Track Enterprises Stock	11,000	
	Retained Earnings		11,000
	Record pick-up of difference between cost and equity income:		

20X2	.10($40,000 - $20,000)		$ 2,000
20X3	.10($60,000 / 2)	$3,000	
	.15[($60,000 / 2) - $20,000]	1,500	4,500
20X4	.15($40,000 - $10,000)		4,500
Amount of increase			$11,000

(3)	Cash	5,000	
	Investment in Fast Track Enterprises Stock		5,000
	Record dividend from Fast Track Enterprises: $20,000 x .25		

(4)	Investment in Fast Track Enterprises Stock	12,500	
	Income from Fast Track Enterprises		12,500
	Record equity-method income: $50,000 x .25		

P2-19 Fair Value Method

	20X6	20X7	20X8
a. Cost method:			
Dividend income	$ 3,000	$ 6,000	$ 4,000
Balance in investment account	$70,000	$70,000	$70,000
b. Equity method:			
Investment income:			
$40,000 x .20	~~$ 8,000~~		
$35,000 x .20		~~$ 7,000~~	
$60,000 x .20			$12,000
Balance in investment account:			
Balance at January 1	$70,000	$75,000	$76,000
Investment income	8,000	7,000	12,000
Dividends received	(3,000)	(6,000)	(4,000)

Balance at December 31	$75,000	$76,000	$84,000

c. Fair value method:

	20X6	20X7	20X8
Investment income:			
Dividends received	$ 3,000	$ 6,000	$ 4,000
Gain (loss) on fair value	19,000	(3,000)	11,000
Total income reported	$22,000	$ 3,000	$15,000
Balance in investment account	$89,000	$86,000	$97,000

P2-20 Fair Value Journal Entries

Journal entries under fair value method for 20X8:

(1)	Investment in Brown Company Stock	85,000	
	Cash		85,000

Record purchase of Brown Company stock.

(2)	Cash	4,000	
	Dividend Income		4,000

Record dividends from Brown Company: $10,000 x .40

(3)	Investment in Brown Company Stock	12,000	
	Unrealized Gain on Increase in Value of Brown Company Stock		12,000

Record increase in value of Brown stock: $97,000 - $85,000

Journal entries under fair value method for 20X9:

(1)	Cash	6,000	
	Dividend Income		6,000

Record dividends from Brown Company: $15,000 x .40

(2)	Unrealized Loss on Decrease in Value of Brown Company Stock	5,000	
	Investment in Brown Company Stock		5,000

Record decrease in value of Brown stock: $97,000 - $92,000

P2-21* Other Comprehensive Income Reported by Investee a.

Equity-method income reported by Dewey Corporation in 20X5:

Amounts reported by Jimm Co. for 20X5:	
Operating income	$70,000
Dividend income	7,000
Gain on investment in trading securities	18,000
Net income	$95,000
Ownership held by Dewey	x .30
Investment income reported by Dewey	$28,500

b. Computation of other comprehensive income reported by Jimm Co.:

Amount added to investment account in 20X5	$ 37,800
Investment income reported by Dewey in 20X5	(28,500)
Increase due to other comprehensive income reported by Jimm Co.	$ 9,300
Proportion of ownership held by Dewey	÷ 0.30
Other comprehensive income reported by Jimm Co.	$ 31,000

c. Computation of market value of securities held by Jimm Co.

Amount paid by Jimm Co. to purchase securities	$130,000
Increase in market value reported as other comprehensive income in 20X5	31,000
Market value of available-for-sale securities at December 31, 20X5	$161,000

P2-22* Equity-Method Income Statement

a.

Diversified Products Corporation
Income Statement
Year Ended December 31, 20X8

Net Sales		$400,000
Cost of Goods Sold		(320,000)
Gross Profit		$ 80,000
Other Expenses	$(25,000)	
Gain on Sale of Truck	10,000	(15,000)
Income from Continuing Operations		$ 65,000
Discontinued Operations:		
Operating Loss from Discontinued Division	$(15,000)	
Gain on Sale of Division	44,000	29,000
Income before Extraordinary Item		$ 94,000
Extraordinary Item:		
Loss on Volcanic Activity		(5,000)
Net Income		$ 89,000

Diversified Products Corporation
Retained Earnings Statement
Year Ended December 31, 20X8

Retained Earnings, January 1, 20X8	$260,000
20X8 Net Income	89,000
	$349,000
Dividends Declared, 20X8	(10,000)
Retained Earnings, December 31, 20X8	$339,000

b.

Wealthy Manufacturing Company
Income Statement
Year Ended December 31, 20X8

Net Sales		$850,000
Cost of Goods Sold		(670,000)
Gross Profit		$180,000
Other Expenses	$(90,000)	
Income from Continuing Operations of Diversified Products Corporation	26,000	(64,000)
Income from Continuing Operations		$116,000
Discontinued Operations:		
Share of Operating Loss Reported by Diversified Products on Discontinued Division	$ (6,000)	
Share of Gain on Sale of Division Reported by Diversified Products	17,600	11,600
Income before Extraordinary Item		$127,600
Extraordinary Item:		
Share of Loss on Volcanic Activity Reported by Diversified Products		(2,000)
Net Income		$125,600

Wealthy Manufacturing Company
Retained Earnings Statement
Year Ended December 31, 20X8

Retained Earnings, January 1, 20X8	$420,000
20X8 Net Income	125,600
	$545,600
Dividends Declared, 20X8	(30,000)
Retained Earnings, December 31, 20X8	$515,600

P2-23 Consolidated Worksheet at End of the First Year of Ownership (Equity Method)

a.

Equity Method Entries on Peanut Co.'s Books:

Investment in Snoopy Co.	300,000	
Cash		300,000

Record the initial investment in Snoopy Co.

Investment in Snoopy Co.	75,000	
Income from Snoopy Co.		75,000

Record Peanut Co.'s 100% share of Snoopy Co.'s 20X8 income

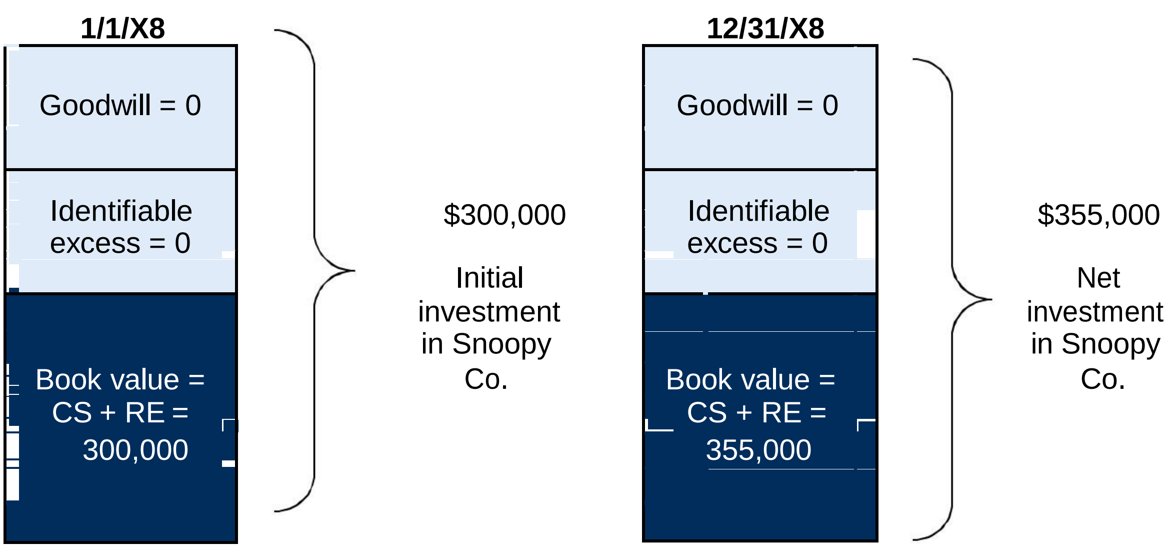
Cash	20,000	
Investment in Snoopy Co.		20,000

Record Peanut Co.'s 100% share of Snoopy Co.'s 20X8 dividend

b.

Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Beginning book value	**300,000**		**200,000**		**100,000**
+ Net Income	**75,000**				**75,000**
- Dividends	**(20,000)**				**(20,000)**
Ending book value	**355,000**		[illegible]		**155,000**



P2-23 (continued)

Basic Elimination Entry

Common stock	200,000	
Retained earnings	100,000	
Income from Snoopy Co.	75,000	
Dividends declared		20,000
Investment in Snoopy Co.		355,000

Optional accumulated depreciation elimination entry

Accumulated depreciation	10,000	
Building & equipment		10,000

The amount of this entry is found by looking at the depreciation expense ($10,000) for the year and the accumulated depreciation at the end of the year ($20,000). The difference must be what was in accumulated depreciation at the date of the acquisition. Note that this assumes there were no sales or other disposals of Building and equipment during the year.

Investment in Snoopy Co.

	Debit	Credit	
Acquisition Price	300,000		
Net Income	75,000		
		20,000	Dividends
Ending Balance	355,000		
		355,000	Basic
	0		

Income from Snoopy Co.

	Debit	Credit	
		75,000	Net Income
		75,000	Ending Balance
Basic	75,000		
		0	

P2-23 (continued)

	Peanut Co.	Snoopy Co.	Elimination Entries DR	Elimination Entries CR	Consolidated
Income Statement					
Sales	800,000	250,000			1,050,000
Less: COGS	(200,000)	(125,000)			(325,000)
Less: Depreciation Expense	(50,000)	(10,000)			(60,000)
Less: Other Expenses	(225,000)	(40,000)			(265,000)
Income from Snoopy Co.	75,000		75,000		0
Net Income	**400,000**	**75,000**	**75,000**	**0**	**400,000**
Statement of Retained Earnings					
Beginning Balance	225,000	100,000	100,000		225,000
Net Income	**400,000**	**75,000**	75,000	0	400,000
Less: Dividends Declared	(100,000)	(20,000)		20,000	(100,000)
Ending Balance	**525,000**	**155,000**	175,000	20,000	**525,000**
Balance Sheet					
Cash	130,000	80,000			210,000
Accounts Receivable	165,000	65,000			230,000
Inventory	200,000	75,000			275,000
Investment in Snoopy Co.	355,000			355,000	0
Land	200,000	100,000			300,000
Buildings & Equipment	700,000	200,000		10,000	890,000
Less: Accumulated Depreciation	(450,000)	(20,000)	10,000		(460,000)
Total Assets	**1,300,000**	**500,000**	**10,000**	**365,000**	**1,445,000**
Accounts Payable	75,000	60,000			135,000
Bonds Payable	200,000	85,000			285,000
Common Stock	500,000	200,000	200,000		500,000
Retained Earnings	**525,000**	**155,000**	175,000	20,000	525,000
Total Liabilities & Equity	**1,300,000**	**500,000**	375,000	20,000	**1,445,000**

P2-24 Consolidated Worksheet at End of the Second Year of Ownership (Equity Method)

a.

Equity Method Entries on Peanut Co.'s Books:

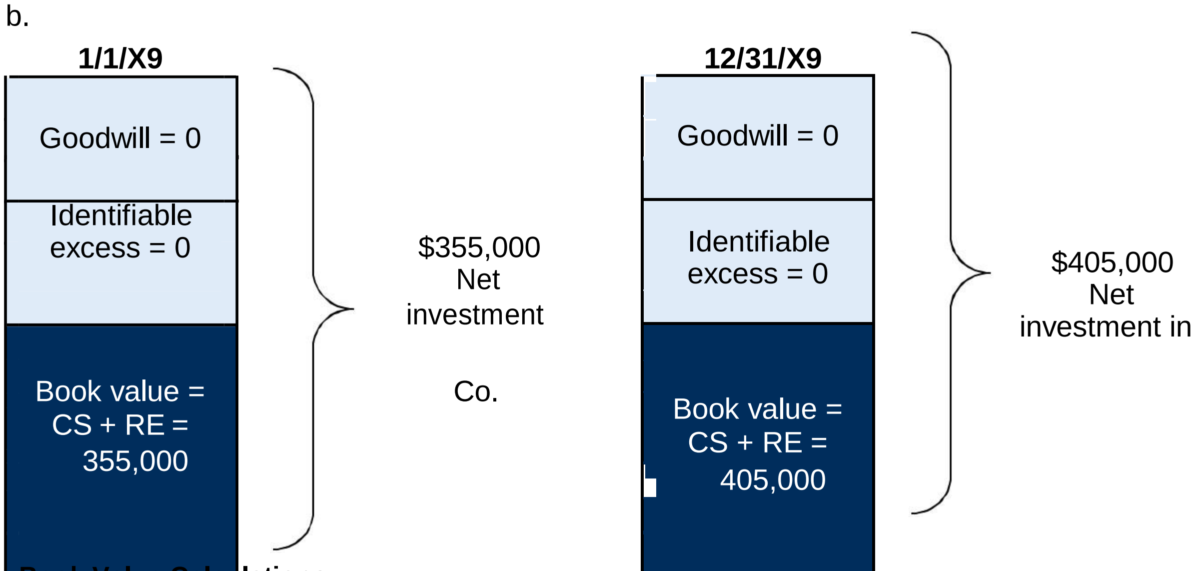
Investment in Snoopy Co.	80,000	
Income from Snoopy Co.		80,000

Record Peanut Co.'s 100% share of Snoopy Co.'s 20X9 income

Cash	30,000	
Investment in Snoopy Co.		30,000

Record Peanut Co.'s 100% share of Snoopy Co.'s 20X9 dividend

b.



Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Beg. book value	**355,000**		**200,000**		**155,000**
+ Net Income					**80,000**
- Dividends	**(30,000)**				[redacted]
Ending book value	**405,000**		**200,000**		**205,000**

P2-24 (continued)

Basic Elimination Entry

Common stock	200,000	
Retained earnings	155,000	
Income from Snoopy Co.	80,000	
Dividends declared		30,000
Investment in Snoopy Co.		405,000

Optional accumulated depreciation elimination entry

Accumulated depreciation	10,000	
Building & equipment		10,000

Note that this entry is carried forward from the previous year (see solution to P2- 23) again assuming that no sales or other disposals of Building and equipment took place during the year.

	Investment in Snoopy Co. (Dr)	Investment in Snoopy Co. (Cr)		Income from Snoopy Co. (Dr)	Income from Snoopy Co. (Cr)	
Beginning Balance	355,000					
Net Income	80,000				80,000	Net Income
		30,000	Dividends			
Ending Balance	405,000				80,000	Ending Balance
		405,000	Basic	80,000		
	0				0	

P2-24 (continued)

	Peanut Co.	Snoopy Co.	Elimination Entries DR	Elimination Entries CR	Consolidated
Income Statement					
Sales	850,000	300,000			1,150,000
Less: COGS	(270,000)	(150,000)			(420,000)
Less: Depreciation Expense	(50,000)	(10,000)			(60,000)
Less: Other Expenses	(230,000)	(60,000)			(290,000)
Income from Snoopy Co.	80,000		80,000		0
Net Income	**380,000**	**80,000**	**80,000**	**0**	**380,000**
Statement of Retained Earnings					
Beginning Balance	525,000	155,000	155,000		525,000
Net Income	**380,000**	**80,000**	80,000	0	380,000
Less: Dividends Declared	(225,000)	(30,000)		30,000	(225,000)
Ending Balance	**680,000**	**205,000**	235,000	30,000	**680,000**
Balance Sheet					
Cash	230,000	75,000			305,000
Accounts Receivable	190,000	80,000			270,000
Inventory	180,000	100,000			280,000
Investment in Snoopy Co.	405,000			405,000	0
Land	200,000	100,000			300,000
Buildings & Equipment	700,000	200,000		10,000	890,000
Less: Accumulated Depreciation	(500,000)	(30,000)	10,000		(520,000)
Total Assets	**1,405,000**	**525,000**	**10,000**	**415,000**	**1,525,000**
Accounts Payable	75,000	35,000			110,000
Bonds Payable	150,000	85,000			235,000
Common Stock	500,000	200,000	200,000		500,000
Retained Earnings	**680,000**	**205,000**	235,000	30,000	680,000
Total Liabilities & Equity	**1,405,000**	**525,000**	**435,000**	**30,000**	**1,525,000**

P2-25 Consolidated Worksheet at End of the First Year of Ownership (Equity Method)

a.

Equity Method Entries on Paper Co.'s Books:

Investment in Scissor Co.	370,000	
Cash		370,000

Record the initial investment in Scissor Co.

Investment in Scissor Co.	93,000	
Income from Scissor Co.		93,000

Record Paper Co.'s 100% share of Scissor Co.'s 20X8 income

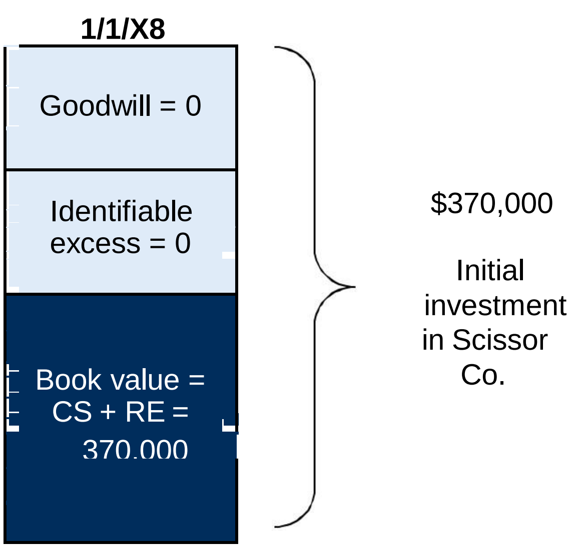
Cash	25,000	
Investment in Scissor Co.		25,000

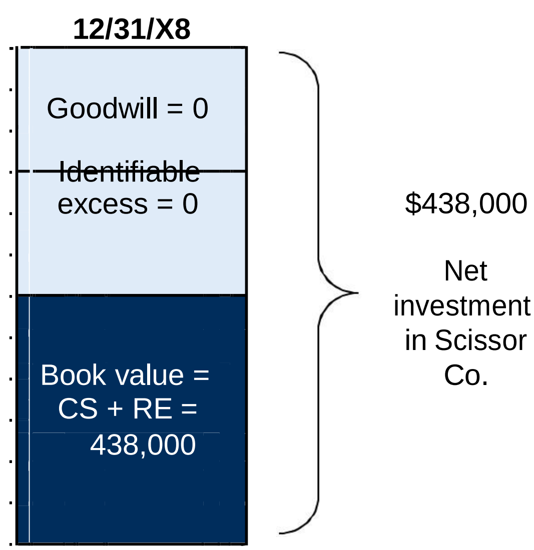
Record Paper Co.'s 100% share of Scissor Co.'s 20X8 dividend

b.

Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Beginning book value	**370,000**		**250,000**		**120,000**
+ Net Income					**93,000**
- Dividends	**(25,000)**				**(25,000)**
Ending book value	**438,000**		**250,000**		**188,000**





P2-25 (continued)

Basic Elimination Entry

Common stock	250,000	
Retained earnings	120,000	
Income from Scissor Co.	93,000	
Dividends declared		25,000
Investment in Scissor Co.		438,000

Optional accumulated depreciation elimination entry

Accumulated depreciation	24,000	
Building & equipment		24,000

The amount of this entry is found by looking at the depreciation expense ($12,000) for the year and the accumulated depreciation at the end of the year ($36,000). The difference must be what was in accumulated depreciation at the date of the acquisition. Note that this assumes there were no sales or other disposals of Building and equipment during the year.

	Investment in Scissor Co. (Dr)	Investment in Scissor Co. (Cr)		Income from Scissor Co. (Dr)	Income from Scissor Co. (Cr)	
Acquisition Price	370,000					
Net Income	93,000				93,000	Net Income
		25,000	Dividends			
Ending Balance	438,000				93,000	Ending Balance
		438,000	Basic	93,000		
	0				0	

P2-25 (continued)

	Paper Co.	Scissor Co.	Elimination Entries DR	Elimination Entries CR	Consolidated
Income Statement					
Sales	800,000	310,000			1,110,000
Less: COGS	(250,000)	(155,000)			(405,000)
Less: Depreciation Expense	(65,000)	(12,000)			(77,000)
Less: Other Expenses	(280,000)	(50,000)			(330,000)
Income from Scissor Co.	93,000		93,000		0
Net Income	**298,000**	**93,000**	**93,000**	**0**	**298,000**
Statement of Retained Earnings					
Beginning Balance	280,000	120,000	120,000		280,000
Net Income	**298,000**	**93,000**	93,000	0	298,000
Less: Dividends Declared	(80,000)	(25,000)		25,000	(80,000)
Ending Balance	**498,000**	**188,000**	213,000	25,000	**498,000**
Balance Sheet					
Cash	122,000	46,000			168,000
Accounts Receivable	140,000	60,000			200,000
Inventory	190,000	120,000			310,000
Investment in Scissor Co.	438,000			438,000	0
Land	250,000	125,000			375,000
Buildings & Equipment	875,000	250,000		24,000	1,101,000
Less: Accumulated Depreciation	(565,000)	(36,000)	24,000		(577,000)
Total Assets	**1,450,000**	**565,000**	**24,000**	**462,000**	**1,577,000**
Accounts Payable	77,000	27,000			104,000
Bonds Payable	250,000	100,000			350,000
Common Stock	625,000	250,000	250,000		625,000
Retained Earnings	**498,000**	**188,000**	213,000	25,000	498,000
Total Liabilities & Equity	**1,450,000**	**565,000**	**463,000**	**25,000**	**1,577,000**

P2-26 Consolidated Worksheet at End of the Second Year of Ownership (Equity Method) a.

Equity Method Entries on Paper Co.'s Books:

Investment in Scissor Co.	107,000	
Income from Scissor Co.		107,000

Record Paper Co.'s 100% share of Scissor Co.'s 20X9 income

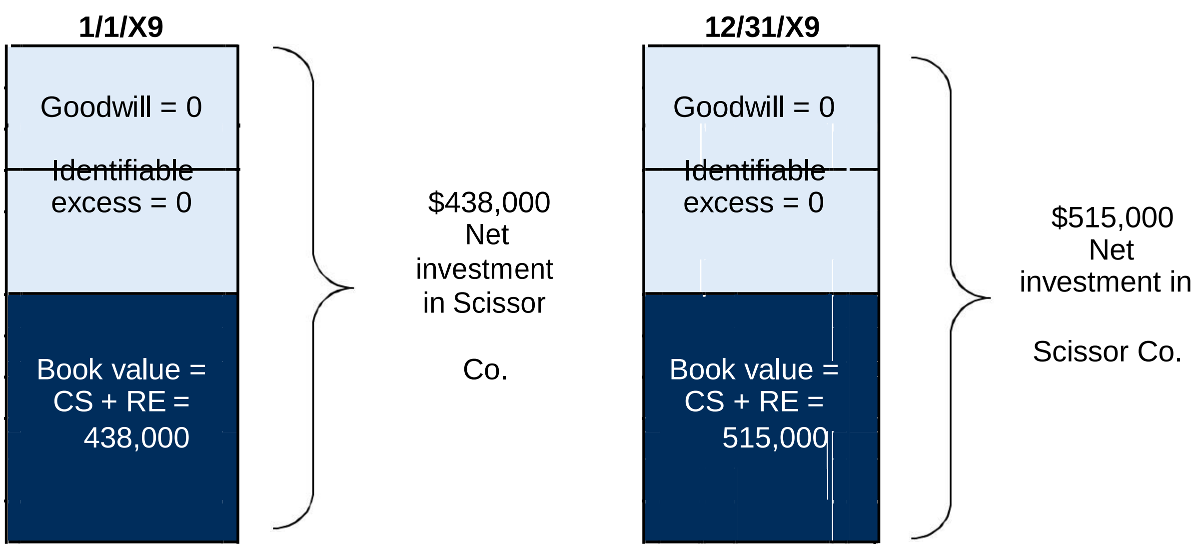
Cash	30,000	
Investment in Scissor Co.		30,000

Record Paper Co.'s 100% share of Scissor Co.'s 20X9 dividend

b.

Book Value Calculations:

	Total Book Value	= Common Stock	+ Retained Earnings
Beg. book value	**438,000**	**250,000**	**188,000**
+ Net Income	**107,000**		**107,000**
- Dividends	**(30,000)**		**(30,000)**
Ending book value	**515,000**	**250,000**	**265,000**



P2-26 (continued)

Basic Elimination Entry

Common stock	**250,000**	
Retained earnings	**188,000**	
Income from Scissor Co.	**107,000**	
Dividends declared		**30,000**
Investment in Scissor Co.		**515,000**

Optional accumulated depreciation elimination entry

Accumulated depreciation	**24,000**	
Building & equipment		**24,000**

Note that this entry is carried forward from the previous year (see solution to P2- 25) again assuming that no sales or other disposals of Building and equipment took place during the year.

	Investment in Scissor Co.			Income from Scissor Co.		
Beginning Balance	**438,000**					
Net Income	**107,000**				**107,000**	**Net Income**
		30,000	**Dividends**			
Ending Balance	**515,000**				**107,000**	**Ending Balance**
		515,000	**Basic**	**107,000**		
	0				**0**	

P2-26 (continued)

	Paper Co.	Scissor Co.	Elimination Entries DR	Elimination Entries CR	Consolidated
Income Statement					
Sales	880,000	355,000			1,235,000
Less: COGS	(278,000)	(178,000)			(456,000)
Less: Depreciation Expense	(65,000)	(12,000)			(77,000)
Less: Other Expenses	(312,000)	(58,000)			(370,000)
Income from Scissor Co.	107,000		107,000		0
Net Income	**332,000**	**107,000**	**107,000**	**0**	**332,000**
Statement of Retained Earnings					
Beginning Balance	498,000	188,000	188,000		498,000
Net Income	**332,000**	**107,000**	**107,000**	**0**	332,000
Less: Dividends Declared	(90,000)	(30,000)		30,000	(90,000)
Ending Balance	**740,000**	**265,000**	**295,000**	**30,000**	**740,000**
Balance Sheet					
Cash	232,000	116,000			348,000
Accounts Receivable	165,000	97,000			262,000
Inventory	193,000	115,000			308,000
Investment in Scissor Co.	515,000			515,000	0
Land	250,000	125,000			375,000
Buildings & Equipment	875,000	250,000		24,000	1,101,000
Less: Accumulated Depreciation	(630,000)	(48,000)	24,000		(654,000)
Total Assets	**1,600,000**	**655,000**	**24,000**	**539,000**	**1,740,000**
Accounts Payable	85,000	40,000			125,000
Bonds Payable	150,000	100,000			250,000
Common Stock	625,000	250,000	250,000		625,000
Retained Earnings	**740,000**	**265,000**	**295,000**	**30,000**	740,000
Total Liabilities & Equity	**1,600,000**	**655,000**	**545,000**	**30,000**	**1,740,000**

P2-27 * Consolidated Worksheet at End of the First Year of Ownership (Cost Method)

a.

Cost Method Entries on Peanut Co.'s Books:

Investment in Snoopy Co.	300,000	
Cash		300,000

Record the initial investment in Snoopy Co.

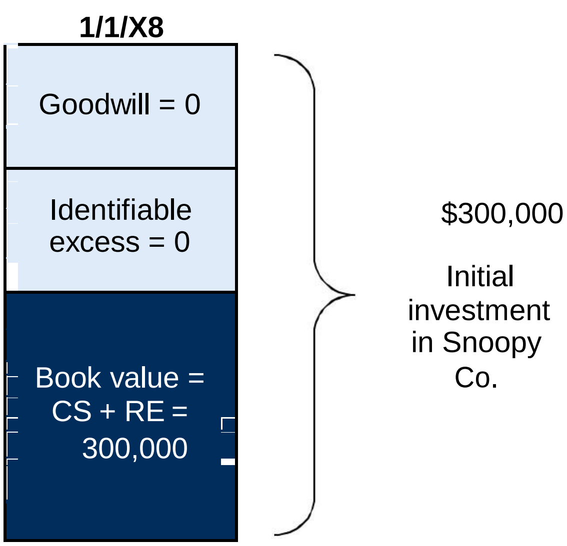
Cash	20,000	
Dividend Income		20,000

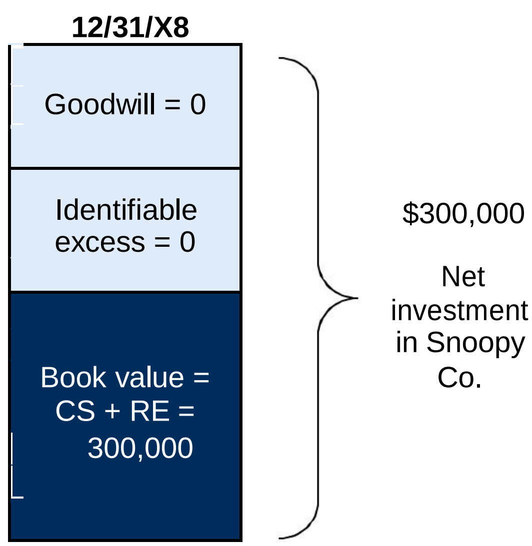
Record Peanut Co.'s 100% share of Snoopy Co.'s 20X8 dividend

b.

Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Original book value	300,000		200,000		100,000





P2-27 (continued)

Investment elimination entry

Common stock	200,000	
Retained earnings	100,000	
Investment in Snoopy Co.		300,000

Dividend elimination

Dividend income	20,000	
Dividends declared		

Optional accumulated depreciation elimination entry

Accumulated depreciation	10,000	
Building & equipment		10,000

The amount of this entry is found by looking at the depreciation expense ($10,000) for the year and the accumulated depreciation at the end of the year ($20,000). The difference must be what was in accumulated depreciation at the date of the acquisition. Note that this assumes there were no sales or other disposals of Building and equipment during the year.

Investment in Snoopy Co.

	Debit	Credit	
Acquisition Price	300,000		
Ending Balance	300,000		
		300,000	Basic
	0		

Dividend Income

	Debit	Credit	
		20,000	Dividends
		20,000	Ending Balance
Basic	20,000		
		0	

P2-27 (continued)

	Peanut Co.	Snoopy Co.	Elimination Entries DR	Elimination Entries CR	Consolidated
Income Statement					
Sales	800,000	250,000			1,050,000
Less: COGS	(200,000)	(125,000)			(325,000)
Less: Depreciation Expense	(50,000)	(10,000)			(60,000)
Less: Other Expenses	(225,000)	(40,000)			(265,000)
Dividend Income	20,000		20,000		0
Net Income	**345,000**	**75,000**	**20,000**	**0**	**400,000**
Statement of Retained Earnings					
Beginning Balance	225,000	100,000	100,000		225,000
Net Income	**345,000**	**75,000**	**20,000**	**0**	400,000
Less: Dividends Declared	(100,000)	(20,000)		20,000	(100,000)
Ending Balance	**470,000**	**155,000**	**120,000**	**20,000**	**525,000**
Balance Sheet					
Cash	130,000	80,000			210,000
Accounts Receivable	165,000	65,000			230,000
Inventory	200,000	75,000			275,000
Investment in Snoopy Co.	300,000			300,000	0
Land	200,000	100,000			300,000
Buildings & Equipment	700,000	200,000		10,000	890,000
Less: Accumulated Depreciation	(450,000)	(20,000)	10,000		(460,000)
Total Assets	**1,245,000**	**500,000**	**10,000**	**310,000**	**1,445,000**
Accounts Payable	75,000	60,000			135,000
Bonds Payable	200,000	85,000			285,000
Common Stock	500,000	200,000	200,000		500,000
Retained Earnings	**470,000**	**155,000**	**120,000**	**20,000**	525,000
Total Liabilities & Equity	**1,245,000**	**500,000**	**320,000**	**20,000**	**1,445,000**

P2-28 * Consolidated Worksheet at End of the Second Year of Ownership (Cost Method) a.

Cost Method Entries on Peanut Co.'s Books:

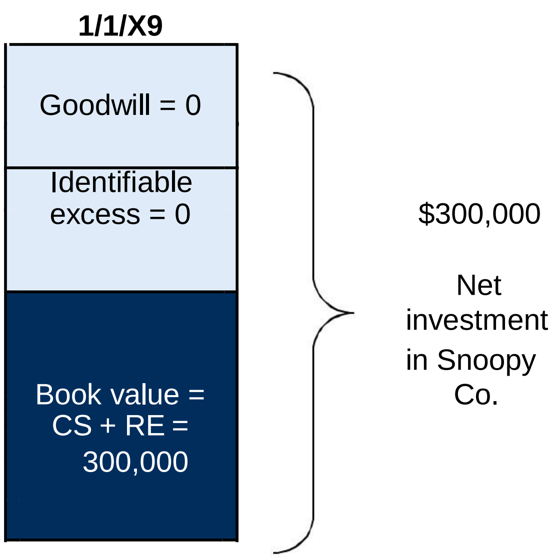
Cash	30,000	
Dividend Income		30,000

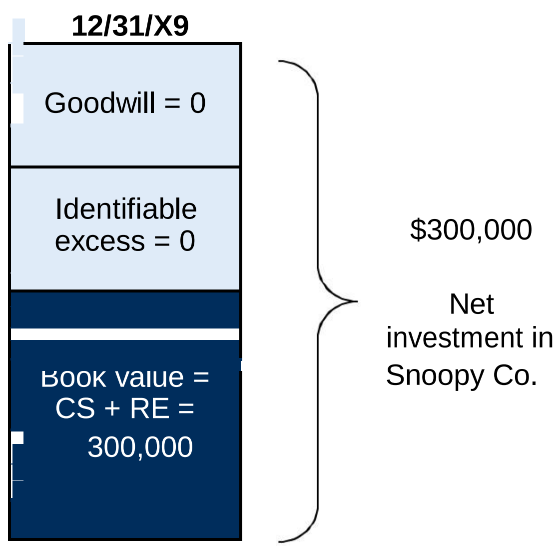
Record Peanut Co.'s 100% share of Snoopy Co.'s 20X9 dividend

b.

Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Original book value	**300,000**		**200,000**		**100,000**





P2-28 (continued)

Investment elimination entry

Common stock	200,000	
Retained earnings	100,000	
Investment in Snoopy Co.		300,000

Dividend elimination

Dividend income	30,000	
Dividends declared		

Optional accumulated depreciation elimination entry

Accumulated depreciation	10,000	
Building & equipment		10,000

Note that this entry is carried forward from the previous year (see solution to P2- 27) again assuming that no sales or other disposals of Building and equipment took place during the year.

	Investment in Snoopy Co. (Dr)	Investment in Snoopy Co. (Cr)		Dividend Income (Dr)	Dividend Income (Cr)	
Acquisition Price	300,000					
					20,000	Dividends
Ending Balance	300,000				20,000	Ending Balance
		300,000	Basic	20,000		
	0				0	

P2-28 (continued)

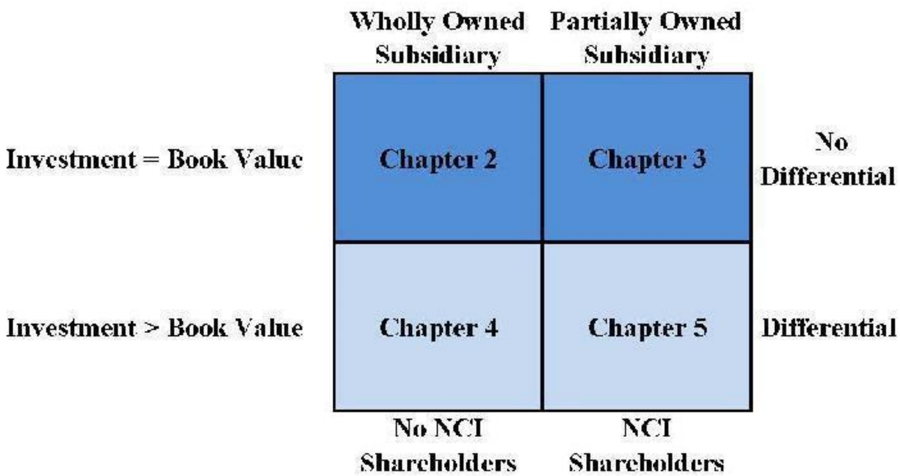
	Peanut Co.	Snoopy Co.	Elimination Entries DR	Elimination Entries CR	Consolidated
Income Statement					
Sales	850,000	300,000			1,150,000
Less: COGS	(270,000)	(150,000)			(420,000)
Less: Depreciation Expense	(50,000)	(10,000)			(60,000)
Less: Other Expenses	(230,000)	(60,000)			(290,000)
Dividend Income	30,000		30,000		0
Net Income	**330,000**	**80,000**	**30,000**	**0**	**380,000**
Statement of Retained Earnings					
Beginning Balance	470,000	155,000	100,000		525,000
Net Income	**330,000**	**80,000**	**30,000**	**0**	380,000
Less: Dividends Declared	(225,000)	(30,000)		30,000	(225,000)
Ending Balance	**575,000**	**205,000**	**130,000**	**30,000**	**680,000**
Balance Sheet					
Cash	230,000	75,000			305,000
Accounts Receivable	190,000	80,000			270,000
Inventory	180,000	100,000			280,000
Investment in Snoopy Co.	300,000			300,000	0
Land	200,000	100,000			300,000
Buildings & Equipment	700,000	200,000		10,000	890,000
Less: Accumulated Depreciation	(500,000)	(30,000)	10,000		(520,000)
Total Assets	**1,300,000**	**525,000**	**10,000**	**310,000**	**1,525,000**
Accounts Payable	75,000	35,000			110,000
Bonds Payable	150,000	85,000			235,000
Common Stock	500,000	200,000	200,000		500,000
Retained Earnings	**575,000**	**205,000**	**130,000**	**30,000**	680,000
Total Liabilities & Equity	**1,300,000**	**525,000**	**330,000**	**30,000**	**1,525,000**

CHAPTER 2

Reporting Intercorporate Investments and Consolidation of Wholly Owned Subsidiaries with No Differential

IMPORTANT NOTE TO INSTRUCTORS

The 10th edition uses a building block approach to our coverage of consolidation in chapters 2 through 5. Chapter 2 introduces our coverage of consolidation in the most basic setting when the subsidiary is either created or purchased at an amount equal to the book value of the subsidiary's underlying net assets.



Chapter 3 explains how the basic consolidation process changes when the parent company owns less than 100 percent of the subsidiary. Chapter 4 shows how the consolidation process differs when the parent company acquires the subsidiary for an amount greater (or less) than the book value of the subsidiary's net assets. Finally, Chapter 5 presents the most complex consolidation scenario (where the parent owns less than 100 percent of the subsidiary's outstanding voting stock and the acquisition price is not equal to the book value of the subsidiary's net assets). In order to facilitate this new approach, we emphasize that this edition includes elimination entries used in consolidation to facilitate the elimination of the investment in a subsidiary in two steps: (1) first the book value portionWebelieveofthe thatinvesthismentapproachandincomeis morefr

intuitivethesubsidiafor ystudentsareeliminated. and (2) then the differential port on of the

investment and income from subsidiary are eliminated with separate entries.

OVERVIEW OF CHAPTER 2

Chapter 2 provides detailed coverage of the accounting and reporting requirements for investments in the common stock of another company. It presents the criteria used in determining when equity method reporting must be applied, and it fully illustrates and compares both the cost method and equity method. While coverage of this topic may seem to replicate materials presented in the typical intermediate accounting sequence, many students do not have an adequate understanding of the entries recorded on the parent company's books and experience problems with the elimination entries needed in the consolidation process as a result.

The discussion of the cost method includes purchases and sales of additional shares subsequent to the initial investment. The discussion of the equity method significantly extends beyond the cost method coverage to include changes in the number of shares held and retroactive application of the equity method when sufficient additional shares of the investee are acquired to attain significant influence.

Chapter 2 also illustrates the use of fair value option. This chapter briefly discusses interests other than investments in common stock (e.g., partnerships) and illustrates the three reporting alternatives (Cost method, Equity method, and Consolidation).

Additional Considerations portion of the chapter discusses how to determine significant influence and accounting for investments in subsidiaries.

We introduce the most basic setting for learning consolidation—when the subsidiary is created or 100% is purchased at book value. In this most simple scenario, there is no differential and there is no need to account for a noncontrolling interest. It allows students to become familiar with the consolidation process in the easiest possible scenario.

Appendix 2A covers many topics that may be more tangential, including accounting for dividends in excess of earnings since acquisition, unrealized intercompany profits, additional requirements under ASC 323-10, and Investors' share of other comprehensive income.

Appendix 2B repeats the consolidation example from the chapter when the parent company uses the cost method instead of the equity method.

LEARNING OBJECTIVES

When students finish studying this chapter, they should be able to:

LO 2-1 Understand and explain how ownership and control can influence the accounting for investments in common stock.
LO 2-2 Prepare journal entries using the cost method for accounting for investments.
LO 2-3 Prepare journal entries using the equity method for accounting for investments.
LO 2-4 Understand and explain differences between the cost and equity methods.
LO 2-5 Prepare journal entries using the fair value option.
LO 2-6 Make calculations and prepare basic elimination entries for a simple consolidation.
LO 2-7 Prepare a consolidation worksheet.

SYNOPSIS OF CHAPTER 2

Reporting Intercorporate Interests and Consolidation of Wholly Owned Subsidiaries with no Differential

Berkshire Hathaway's Many Investments

LO 2-1 Understand and explain how ownership and control can influence the accounting for investments in common stock.

Accounting for Investments in Common Stock

LO 2-2 Prepare journal entries using the cost method for accounting for investments.

The Cost Method
- Accounting Procedures under the Cost Method
- Declaration of Dividends in Excess of Earnings since
- Acquisition Acquisition at Interim Date
- Changes in the Number of Shares Held

LO 2-3 Prepare journal entries using the equity method for accounting for investments.

The Equity Method
- Use of the Equity Method
- Investor's Equity in the Investee
- Recognition of Income
- Recognition of Dividends
- Comparison of the Carrying Amount of the Investment and Investment Income under the Cost and Equity Methods
- Acquisition at Interim Date
- Changes in the Number of Shares Held

LO 2-4 Understand and explain differences between the cost and equity methods.

Comparison of the Cost and Equity Methods

LO 2-5 Prepare journal entries using the fair value option.

The Fair Value Option

LO 2-6 Make calculations and prepare basic elimination entries for a simple consolidation.

Overview of the Consolidation Process

Consolidation Procedures for Wholly-Owned Subsidiaries that are Created or Purchased at Book Value

LO 2-7 Prepare a consolidation worksheet.

Consolidation Worksheets
- Worksheet Format
- Nature of Elimination Entries

Consolidated Balance Sheet with Wholly-Owned Subsidiary
- 100 Percent Ownership Acquired at Book Value

Consolidation Subsequent to Acquisition
- Consolidated Net Income
- Consolidated Retained Earnings

Consolidated Financial Statements—100 Percent Ownership, Created or Acquired at Book Value
- Initial Year of Ownership
- Second and Subsequent Years of Ownership
- Consolidated Net Income and Retained Earnings

Appendix 2A—Additional Considerations Relating to the Equity
- Method Determination of Significant Influence
- Alternative Versions of the Equity Method of Accounting for Investments in Subsidiaries
- Unrealized Intercompany Profits
- Additional Requirements of ASC 323-10
- Investor's Share of Other Comprehensive Income

Appendix 2B—Consolidation and the Cost Method
- Consolidation—Year of Combination
- Consolidation—Second Year of Ownership

NOTES ON POWERPOINT SLIDES

We have attempted to provide PowerPoint slides that will be useful to a broad set of users. Since instructors often have different styles and preferences, we have attempted to include slides that will accommodate different approaches and that can be adapted to classes with different levels of preparation. For example, some instructors prefer to introduce the material before students have read the chapter. We have tried to facilitate these types of introductory discussions by including slides that replicate key points from the chapter. Other instructors expect students to have read the chapter and attempted homework problems before coming to class. As a result, they may not find it useful to review all of the topics in the chapter or to include slides that simply review many of the details they expect students to study before class. However, instructors following this approach often like to use sample exercises and problems built into the slides that allow them to have extended discussions or to facilitate group interaction in class.

If instructors elect to spend two class periods on the same subject, they might find a combination of both styles to be useful by first introducing foundational material before students have read the chapter and studied the topic, followed by an extended discussion the next class period after students have read the chapter and attempted homework problems.

We have tried to develop slides that can facilitate a flexible approach to allow instructors to select the slides that best match their objectives and style for class discussions. This is the reason we are including over 100 slides for some chapters in the text. We do not expect all instructors to use all slides, but the slide files should help support different teaching approaches and allow instructors to select the subset of slides that best matches their specific discussion objectives.

The slides are organized by learning objective. We have included a slide at the beginning of each learning objective to show where the new material begins. Instructors may or may not want to use these learning objective slides in class. We provide them primarily as a way of organizing the material. We also include short multiple choice questions at the end of most learning objectives. Some instructors find it useful to pause periodically during class to assess students' level of understanding. For this reason, we include several ―practice quiz questions‖ that can be used throughout class discussions to engage students, help them focus on key points, or to facilitate group interaction. Finally, we provide longer exercises and problems that many instructors find useful in assessing understanding and encouraging group learning.

LO 2-1 Understand and explain how ownership and control can influence the accounting for investments in common stock.

- Slides 3-7 summarize basic concepts related to LO 2-1. While slide 4 repeats the diagram from the chapter, slide 5 provides a more interactive view of the same concept.
- Instructors should choose slides from this LO that they deem most important to emphasize to their students

LO 2-2 Prepare journal entries using the cost method for accounting for investments.

- Slides 11-21 summarize basic concepts related to LO 2-2 related to the cost method. The simple example in slide 19 allows students to practice cost method journal entries.
- Instructors should choose slides from this LO that they deem most important to emphasize to their students

LO 2-3 Prepare journal entries using the equity method for accounting for investments.

- Slides 25-35 summarize basic concepts related to LO 2-3 related to the equity method. The simple example in slides 31-32 allows students to practice equity method journal entries.
- Instructors should choose slides from this LO that they deem most important to emphasize to their students

LO 2-4 Understand and explain differences between the cost and equity methods.

- Slides 41-45 summarize basic concepts related to LO 2-4 comparing the cost and equity methods. The example in slides 42-45 allows students to practice making journal entries under both methods and to easily compare them.
- Instructors should choose slides from this LO that they deem most important to emphasize to their students

LO 2-5 Prepare journal entries using the fair value option.

- Slide 49 summarizes the fair value option and slide 50 provides an example to allow students to practice the fair value option.

LO 2-6 Make calculations and prepare basic elimination entries for a simple consolidation.

- Slides 52-53 provide a summary of the consolidation process.
- Slide 54 allows the instructor to explain how the worksheet is used to calculate the numbers used in consolidated financial statements.
- Slides 55-56 introduce the concept of elimination entries.
- Slide 57 introduces a comprehensive example to be used to illustrate the consolidation process under the equity method.
- Slide 58 explain the basic elimination entry and slides 59-61 show how to make basic book value calculations used in the basic elimination entry. This series of slides provides the foundation for helping students begin to learn how to prepare consolidated financial statements. Instructors should spend enough time here to ensure that students understand these basic concepts.

LO 2-7 Prepare a consolidation worksheet.

- Slides 63-65 show students how to set up the worksheet. In slide 63 instructors should explain that the first step in preparing a consolidation worksheet is to enter the numbers from trail balances of the parent and subsidiary into the first two columns of the worksheet. In slide 64, we emphasize that the same line items that are subtotaled in the actual financial statements of the companies need to subtotaled in the elimination entry columns. This is a critical point. In slide 65 we ask students to introduce the numbers from the basic elimination entry for the Pea Soup example from the previous section into the worksheet. We emphasize that debits and credits in each sub-section need to be sub-totaled. However, it is critical to help students understand that the articulation in the financial statements also applies to the adjustment columns. Since net income carries down to the statement of retained earnings, the sub totals in the elimination entry adjustment columns must be carried down with the net income number. Likewise, since the ending balance in retained earnings carries down from the statement of retained earnings to the balance sheet, the sub totals in the elimination entry columns must be carried down with the retained earnings ending balances. We spend a few minutes emphasizing the ―mechanics‖ of the worksheet because students who try to work too quickly and skip these important details will inevitably make mistakes in their consolidation column. Emphasize that taking time to pay attention to these details will save students a significant amount of time (and headaches) in the long run.

- Slides 66-71 walk students through the consolidation worksheet one line item at a time. We only do this once in chapter 2. Once students have practiced adding across each row, we assume they can do it on future worksheets. While this may seem like a tedious exercise (and even though this is an advanced financial accounting text), we have found from our experience that students often forget the normal balance in different types of accounts and have trouble remembering whether a debit or credit entry increases or decreases different types of accounts. We find that walking through this exercise one time helps students to remember these basic concepts.
- Slide 72 emphasizes that when the parent uses the fully adjusted equity method, the parent's net income and retained earnings ending balance will always be equal to the corresponding consolidated numbers.
- Slides 73-80 provide a detailed comprehensive consolidation example. We have students work this exercise in small groups in class. Advanced preparation includes either providing students a spreadsheet file or a hard copy similar to slide 73 so that they can work this exercise in class. In slide 74, we ask students to work together to perform the book value calculations. In slide 75, we review the book value calculations and explain which numbers are used in the basic elimination entry. We then ask students to attempt the basic elimination entry in their groups. In slide 76, we show them the answer.
- Slides 77-78 allow the instructor to explain the optional accumulated depreciation elimination entry. The idea is that if the company had purchased property, plant, and equipment assets ―used‖ from another company, the acquiring company would have recorded the assets at their purchase price with zero accumulated depreciation. The acquiring company would not have been concerned with the former owner's cost basis or accumulated depreciation. In purchasing another company, it is also useful to ensure that the fixed assets of the acquired company appear in the consolidated financial statements as if the acquiring company had acquired those assets on the date of acquisition. This elimination entry nets the accumulated depreciation on the date of acquisition against the cost basis, so that they appear as if they were newly acquired (at their net book values) on the acquisition date. This entry essentially allows these assets to start with a ―clean slate‖ on the date of acquisition with no accumulated depreciation.
- Slide 79 allows the instructor to ask students to enter the basic elimination entry into the adjustment columns, calculate their sub-totals, and carry down the net income and retained earnings ending balance adjustments to ensure proper ―mechanics‖ for their consolidation. After having students go through this process with their groups, we show them slide 79 BEFORE having them complete the worksheet. Slide 80 provides the solution.

Appendix 2B

- Slides 82-93 repeat the same consolidation example using the cost method. Some instructors like to show students how to perform a consolidation under the cost method.
- Slides 94-95 summarize differences between the cost and equity methods.

TEACHING IDEAS

1. Students could be asked to write a brief memo discussing why companies would be encouraged to invest in the stock of other companies. A question could be raised as to the trade-off of investing in stock of another company or increasing the capital expenditures of the company for additional fixed assets. What are the economic benefits of investing in another company?

2. Students could be assigned a recent article on investments on the Internet and asked to prepare an executive summary of the article, highlighting its major points for a business executive (e.g., a corporate controller or a partner in a CPA firm) who has not read the article.

3. Students could be asked to review the financial statements of a large public company and write a report on their investments. Students should list the different type of investments, percentage ownership, and method of accounting for the investments.

DESCRIPTIONS OF CASES, EXERCISES, AND PROBLEMS

C2-1A 20 min. LO 2-2, LO 2-3 E	**Choice of Accounting Method** The criteria used in determining significant influence are reviewed. Students also must specify when investment income will be greater under the cost method and when it will be greater under the equity method. They should also explain why the use of the equity method becomes more appropriate as the percentage of ownership increases.
C2-2 30 min. LO 2-2, LO 2-3 M	**Intercorporate Ownership** Students are required to research current authoritative pronouncements and develop a memorandum to management supporting the use of either the cost or equity method in accounting for the company’s investment. They should support their findings with citations and quotations from the appropriate literature.
C2-3A 30 min. LO 2-2, LO 2-3 M	**Application of the Equity Method** Students must review authoritative pronouncements to determine whether the company should utilize the cost or equity method subsequent to the sale of part of its investment. Students must prepare a memorandum to the controller and outline and support their opinion.
C2-4 25 min. LO 2-6, LO 2-7 M	**Need for Consolidation Process** An effective answer to this case requires an understanding of which balances must be eliminated in order to avoid misstating the consolidated balance sheet totals.

C2-5 25 min. LO 2-1 M	**Account Presentation** Students must research authoritative literature to determine the proper way of combining account balances from different subsidiaries. A memorandum that reports findings and provides the necessary supporting references is required.
C2-6 25 min. LO 2-6, LO 2-7 M	**Consolidating an Unprofitable Subsidiary** An unprofitable venture is currently consolidated with a profitable entity without separately disclosing the loss. Students must research the issue to determine if disclosure is necessary, and describe what type of disclosures will be necessary in the financial statement notes or the management discussion. Reference to authoritative literature must be included in a memorandum to the treasurer.
E2-1 15 min. LO 2-2, LO 2-3 E	**Multiple-Choice Questions on Use of Cost and Equity Methods [AICPA Adapted]** Seven multiple-choice questions deal with basic applications of the cost and equity methods and when each should be used.

E2-2 5 min. LO 2-4 M	**Multiple Choice Questions on Intercorporate Investments** Two multiple-choice questions deal with conceptual issues related to the cost and equity methods.
E2-3 15 min. LO 2-3 M	**Multiple-Choice Questions on Applying Equity Method** [AICPA Adapted] Five multiple-choice questions focus primarily on the computation of equity method income.
E2-4 20 min. LO 2-4 E	**Cost versus Equity Reporting** Students must compute the income to be reported for three years under the (a) cost method and (b) the equity method. Liquidating dividends exist for the cost method.
E2-5 10 min. LO 2-2, LO 2-3 E	**Acquisition Price** Given the net income and dividend payments of an investee for a three-year period and the ending balance in the investment account on the investor's books, the acquisition price paid by the investor is computed under cost and equity method reporting.
E2-6 20 min. LO 2-2, LO 2-3 M	**Investment Income** The investor's income is computed for a four-year period using both the cost and equity methods. Journal entries for the final year are recorded under both methods. Dividends in excess of earnings are paid in the third year.

E2-7 15 min. LO 2-3 E	**Investment Value** Calculation of the investment account balance is required for three consecutive years.
E2-8A 5 min. LO 2-2, LO 2-3 E	**Income Reporting** Separate recognition of an extraordinary gain reported by the investee is required on an investor's books.
E2-9 15 min. LO 2-4, LO 2-5 M	**Fair Value Method** Net income has to be calculated under three methods – cost, equity, and fair value methods.
E2-10 15 min. LO 2-3, LO 2-5 M	**Fair Value Recognition** Journal entries are required for all transactions occurring during the year of purchase assuming that the investor utilizes (1) the equity method and (2) the fair value method.

E2-11A 15 min. LO 2-3, LO 2-5 M	**Investee with Preferred Stock Outstanding** Journal entries must be given for the investor under the equity method. Preferred stock information is provided.
E2-12A 15 min. LO 2-2, LO 2-3 M	**Other Comprehensive Income Reported by Investee** Journal entries must be given for the investor. Operating income and other comprehensive income reported by the investee is provided.
E2-13A 10 min. LO 2-2, LO 2-3 E	**Other Comprehensive Income Reported by Investee** The investee records an operating loss in the first year and a gain in the second year. Dividends are paid in both years. It also reports other comprehensive income in the second year. The balance in the investor’s equity-method investment account is given at the end of the second year. The purchase price must be calculated.
E2-14 20 min. LO 2-7 M	**Basic Elimination Entry** Elimination entry is required assuming acquisition of 100% of an investee's stock.

E2-15 25 min. LO 2-6, LO 2-7 E	**Balance Sheet Worksheet** A simple balance sheet worksheet following the business consolidation is required. An entry for elimination of the investment account and the stockholders' equity balances of the subsidiary is needed.
E2-16 40 min. LO 2-3, LO 2-7 M	**Consolidation Entries for Wholly Owned Subsidiary** Students must prepare journal entries for an acquisition using the equity method. Elimination entries to prepare consolidated financial statements are required.
E2-17 15 min. LO 2-3, LO 2-7 E	**Basic Consolidation Entries for Fully Owned Subsidiary** Journal entries recorded by the parent company and the elimination entries needed to prepare consolidated statements at the end of the first year of ownership are required for a fully-owned subsidiary.
P2-18 20 min. LO 2-2, LO 2-3 H	**Retroactive Recognition** Students must show the journal entries to be recorded on an investor’s books assuming that an increase in the percentage ownership over the past three years requires retroactive application of the equity method.
P2-19 20 min. LO 2-4, LO 2-5 M	**Fair Value Method** Investment income and the balances in the investment account are to be calculated for three years, assuming the cost method, the equity method, and the fair value method.

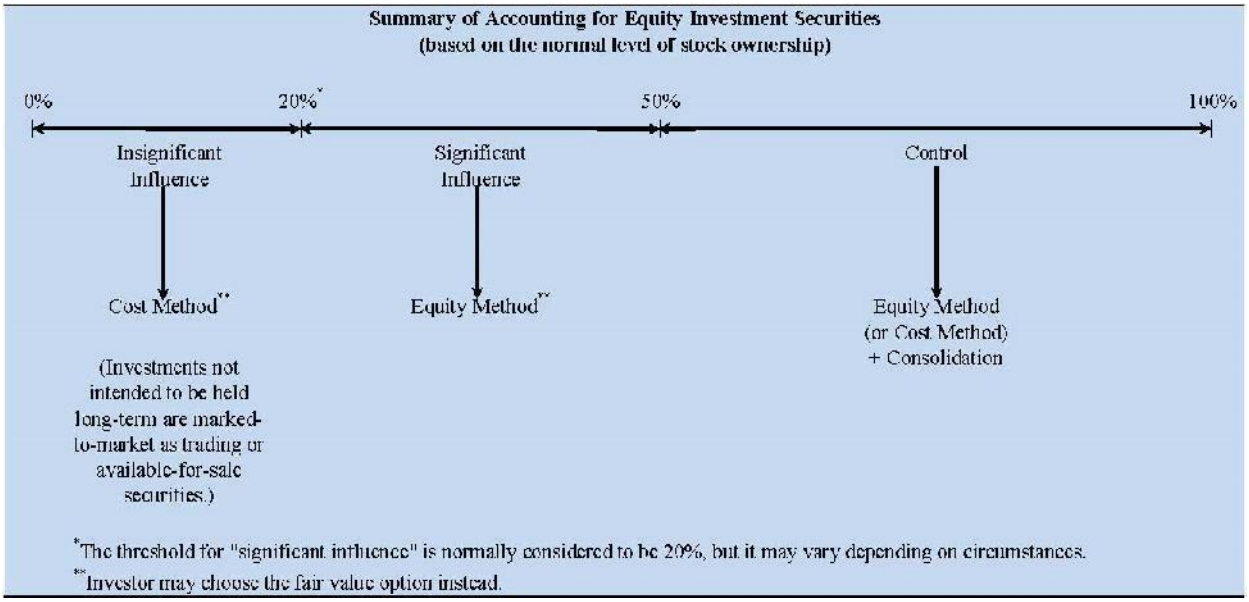
P2-20 15 min. LO 2-5 M	**Fair Value Journal entries** All journal entries made by the investor are required for two years, assuming the usage of the fair value method.
P2-21A 25 min. LO 2-5 H	**Other Comprehensive Income Reported by Investee** An investee reports other comprehensive income during the period. Students must compute the equity-method income reported for the year, the increase in the balance in the investment account for the year, the amount of other comprehensive income reported by the investee, and the market value of the securities reported as available-for-sale by the investee at the end of the year.

P2-22A 45 min. LO 2-3, LO 2-7 H	**Equity-Method Income Statement** An income statement and a retained earnings statement for both the investee and investor must be prepared. The investee has discontinued operations, an extraordinary item, and a cumulative adjustment from a change of accounting principle. This problem presents a good review of income statement disclosures for the investee and the resulting disclosures needed in the financial statements of the investor.
P2-23 30 min. LO 2-3, LO 2-6, LO 2-7 M	**Consolidated Worksheet at End of the First Year of Ownership (Equity Method)** Students are asked to prepare journal entries on a parent company's books at the time of an acquisition and then to prepare a consolidation worksheet at the end of the first year.
P2-24 30 min. LO 2-3, LO 2-6, LO 2-7 M	**Consolidated Worksheet at End of the Second Year of Ownership (Equity Method)** As a continuation of P2-23, students are asked to prepare equity method journal entries on a parent company's books related to the subsidiary and then to prepare a consolidation worksheet at the end of the second year.
P2-25 35 min. LO 2-3, LO 2-6, LO 2-7 M	**Consolidated Worksheet at End of the First Year of Ownership (Equity Method)** Students are asked to prepare journal entries on a parent company's books at the time of an acquisition and then to prepare a consolidation worksheet at the end of the first year.
P2-26 35 min. LO 2-3, LO 2-6, LO 2-7 M	**Consolidated Worksheet at End of the Second Year of Ownership (Equity Method)** As a continuation of P2-25, students are asked to prepare equity method journal entries on a parent company's books related to the subsidiary and then to prepare a consolidation worksheet at the end of the second year.
P2-27B 30 min. LO 2-3, LO 2-6, LO 2-7 M	**Consolidated Worksheet at End of the First Year of Ownership (Cost Method)** This problem uses the same data as provided in P2-23 except that it assumes the parent uses the cost method for subsidiary investments. Students are asked to prepare journal entries on a parent company's books at the time of an acquisition and then to prepare a consolidation worksheet at the end of the first year.

P2-28B 30 min. LO 2-3, LO 2-6, LO 2-7 M	**Consolidated Worksheet at End of the Second Year of Ownership (Cost Method)** This problem uses the same data as provided in P2-24 except that it assumes the parent uses the cost method for subsidiary investments. As a continuation of P2-27, students are asked to prepare any cost method journal entries on a parent company's books related to the subsidiary and then to prepare a consolidation worksheet at the end of the second year.

OTHER RESOURCES

Level of Ownership and Accounting and Reporting



Chapter 2
Investment Example

On July 1, 20X8, A Company purchases a 20 percent ownership interest in B Company for $500. At this date, the book value of B's assets is $2,000 and the fair value of B's depreciable assets is $300 greater than book value. Depreciable assets have a remaining economic life of 10 years. Goodwill is not amortized.
B Company reports net income of $400 for the year, earned evenly throughout the year. Dividends of $300 are declared and paid on December 31.

A. Assume that A Company is able to exert significant influence over B Company.
B. Assume that A Company is unable to exert significant influence over B Company.

7/1/X8	
B's BOOK VALUE ON 7/1/X8	$2,000
Investment cost	$500
Book value ($2,000 x .20)	(400)
Excess of Cost over B.V.	$100
Revalue asset (300 x 0.20)	60
(Depreciated over 10 years)	
Goodwill	$40

A. EQUITY METHOD

Changes in Investment Account and Calculation of End of Period Balance:

Original Cost	$500
Plus: Income from Investment	40
($400 x 0.20 x 0.5 years)	
Less: Amortization	(3)
[($60/10years) x 0.5 years]	
Less: Dividends	(60)
	$477

Income from Equity Investment:

Income from Investment		$40
Less:	Amortization	(3)
		$37

B. COST METHOD

Dividend on December 31:

	Total	20%
Income from 7/1 to 12/31	$200	$40
Dividend on December 31	(300)	(60)
Preacquisition earnings distributed	$(100)	$(20)
(Return of Investment Capital)		

Changes in Investment Account and Calculation of End of Period Balance:

Original Cost:	$500
Less: Return of Capital	(20)
Ending Balance	$480

Income from Equity Investment:

Dividend Income	$40

COMPARISON OF COST AND EQUITY METHODS

Transaction	COST METHOD			EQUITY METHOD		
1.) Acquired stock	Investment	500		Investment	500	
	Cash		500	Cash		500
2.) Investee reports income	--- no entry ---			Investment	40	
				Income-Invest.		40
3.) Investee declares cash dividends	Cash	60		Cash	60	
	Div. Income		40	Investment		60
	Investment		20			
4.) Amortization of differential	--- no entry ---			Income-Invest.	3	
				Investment		3