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Chapter 2

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

Multiple Choice Questions

1. If Push Company owned 51 percent of the outstanding common stock of Shove Company, which reporting method would be appropriate?

- A. Cost method
- B. Consolidation
- C. Equity method
- D. Merger method

Answer: B

Learning Objective: 02-01

Topic: Accounting for Investments in Common Stock

Blooms: Remember

AACSB: Reflective Thinking

AICPA: FN Reporting

Difficulty: 1 Easy

2. Usually, an investment of 20 to 50 percent in another company's voting stock is reported under the:

- A. Cost method
- B. Equity method
- C. Full consolidation method
- D. Fair value method

Answer: B

Learning Objective: 02-01

Topic: Accounting for Investments in Common Stock

Blooms: Remember

AACSB: Reflective Thinking

AICPA: FN Reporting

Difficulty: 1 Easy

3. From an investor's point of view, a liquidating dividend from an investee is:

- A. A dividend declared by the investee in excess of its earnings in the current year.
- B. A dividend declared by the investee in excess of its earnings since acquisition by the investor.
- C. Any dividend declared by the investee since acquisition.
- D. A dividend declared by the investee in excess of the investee's retained earnings.

Answer: B

Learning Objective: 02-02

Topic: The Cost Method

Blooms: Remember

AACSB: Reflective Thinking

AICPA: FN Decision Making

Difficulty: 1 Easy

4. Which of the following observations is NOT consistent with the cost method of accounting?

- A. Investee dividends from earnings since acquisition by investor are treated as a reduction of the investment.
- B. Investments are carried by the investor at historical cost.
- C. No journal entry is made regarding the earnings of the investee.
- D. It is consistent with the treatment normally accorded noncurrent assets.

Answer: A

Learning Objective: 02-02

Topic: The Cost Method

Blooms: Remember

AACSB: Reflective Thinking

AICPA: FN Decision Making

Difficulty: 1 Easy

5. On January 1, 20X9 Athlon Company acquired 30 percent of the common stock of Opteron Corporation, at underlying book value. For the same year, Opteron reported net income of \$55,000, which includes an extraordinary gain of 40,000. It did not pay any dividends during the year. By what amount would Athlon's investment in Opteron Corporation increase for the year, if Athlon used the equity method?

- A. \$0
- B. \$16,500
- C. \$4,500
- D. \$12,000

Answer: B

Learning Objective: 02-03

Learning Objective: Appendix 2A

Topic: The Equity Method

Topic: Investor's Share of Other Comprehensive Income

Blooms: Understand

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

The following data applies to Questions 6 - 8:

On January 1, 20X8, William Company acquired 30 percent of eGate Company's common stock, at underlying book value of \$100,000. eGate has 100,000 shares of \$2 par value, 5 percent cumulative preferred stock outstanding. No dividends are in arrears. eGate reported net income of \$150,000 for 20X8 and paid total dividends of \$72,000. William uses the equity method to account for this investment.

6. Based on the preceding information, what amount would William Company receive as dividends from eGate for the year?

- A. \$62,000
- B. \$21,600
- C. \$18,600
- D. \$54,000

Answer: C

Learning Objective: 02-03

Learning Objective: Appendix 2A

Topic: The Equity Method

Topic: Additional Requirements of ASC 323-10

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

7. Based on the preceding information, what amount of investment income will William Company report from its investment in eGate for the year?

- A. \$45,000
- B. \$42,000
- C. \$62,000
- D. \$35,000

Answer: B

Learning Objective: 02-03

Learning Objective: Appendix 2A

Topic: The Equity Method

Topic: Additional Requirements of ASC 323-10

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

8. Based on the preceding information, what amount would be reported by William Company as the balance in its investment account on December 31, 20X8?

- A. \$100,000
- B. \$123,400
- C. \$120,400
- D. \$142,000

Answer: B

Learning Objective: 02-03

Learning Objective: Appendix 2A

Topic: The Equity Method

Topic: Additional Requirements of ASC 323-10

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

The following data applies to Questions 9 – 11:

On January 1, 20X4, Timber Company acquired 25% of Johnson Company's common stock at underlying book value of \$200,000. Johnson has 80,000 shares of \$10 par value, 6 percent cumulative preferred stock outstanding. No dividends are in arrears. Johnson reported net income of \$270,000 for 20X4 and paid total dividends of \$140,000. Timber uses the equity method to account for this investment.

9. Based on the preceding information, what amount would Timber Company receive as dividends from Johnson for the year?

- A. \$23,000
- B. \$35,000
- C. \$37,500

- D. \$92,000

Answer: A

Learning Objective: 02-03

Learning Objective: Appendix 2A

Topic: The Equity Method

Topic: Additional Requirements of ASC 323-10

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

10. Based on the preceding information, what amount of investment income will Timber Company report from its investment in Johnson for the year?

- A. \$140,000
- B. \$67,500
- C. \$55,500
- D. \$35,000

Answer: C

Learning Objective: 02-03

Learning Objective: Appendix 2A

Topic: The Equity Method

Topic: Additional Requirements of ASC 323-10

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

11. Based on the preceding information, what amount would be reported by Timber Company as the balance in its investment account on December 31, 20X4?

- A. \$200,000
- B. \$220,500
- C. \$232,500
- D. \$255,500

Answer: C

Learning Objective: 02-03

Learning Objective: Appendix 2A

Topic: The Equity Method

Topic: Additional Requirements of ASC 323-10

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

The following data applies to Questions 12–16:

On January 1, 20X7, Yang Corporation acquired 25 percent of the outstanding shares of Spiel Corporation for \$100,000 cash. Spiel Company reported net income of \$75,000 and paid dividends of \$30,000 for both 20X7 and 20X8. The fair value of shares held by Yang was \$110,000 and \$105,000 on December 31, 20X7 and 20X8 respectively.

12. Based on the preceding information, what amount will be reported by Yang as income from its investment in Spiel for 20X8, if it used the equity method of accounting?

- A. \$7,500
- B. \$11,250
- C. \$18,750
- D. \$26,250

Answer: C

Learning Objective: 02-03

Topic: The Equity Method

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

13. Based on the preceding information, what amount will be reported by Yang as balance in investment in Spiel on December 31, 20X8, if it used the equity method of accounting?

- A. \$108,250
- B. \$118,750
- C. \$100,000
- D. \$122,500

Answer: D

Learning Objective: 02-03

Topic: The Equity Method

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

14. Based on the preceding information, what amount will be reported by Yang as income from its investment in Spiel for 20X7 if it used the fair value option to account for its investment in Spiel?

- A. \$17,500
- B. \$12,500
- C. \$11,250
- D. \$7,500

Answer: A

Learning Objective: 02-05

Topic: The Fair Value Option

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

15. Based on the preceding information, what amount will be reported by Yang as income from its investment in Spiel for 20X8 if it used the fair value option to account for its investment in Spiel?

- A. \$11,250
- B. \$2,500
- C. \$6,250
- D. \$7,500

Answer: B

Learning Objective: 02-05

Topic: The Fair Value Option

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

16. Based on the preceding information, what amount will be reported by Yang as balance in investment in Spiel on December 31, 20X8, if it used the fair value option to account for its investment in Spiel?

- A. \$105,000
- B. \$118,750
- C. \$100,000
- D. \$122,500

Answer: A

Learning Objective: 02-05

Topic: The Fair Value Option

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

17. A change from the cost method to the equity method of accounting for an investment in common stock resulting from an increase in the number of shares held by the investor requires:

- A. only a footnote disclosure.
- B. that the cumulative amount of the change be shown as a line item on the income statement, net of tax.
- C. that the change be accounted for as an unrealized gain included in other comprehensive income.
- D. retroactive restatement as if the investor always had used the equity method.

Answer: D

Learning Objective: 02-03

Topic: Changes in the Number of Shares Held

Blooms: Remember

AACSB: Reflective Thinking

AICPA: FN Reporting

Difficulty: 1 Easy

18. Under the equity method of accounting for a stock investment, the investment initially should be recorded at:

- A. cost.
- B. cost minus any differential.
- C. proportionate share of the fair value of the investee company's net assets.
- D. proportionate share of the book value of the investee company's net assets.

Answer: A

Learning Objective: 02-03

Topic: The Equity Method

Blooms: Remember

AACSB: Reflective Thinking

AICPA: FN Decision Making

Difficulty: 1 Easy

19. Which of the following observations is consistent with the equity method of accounting?

- A. Dividends declared by the investee are treated as income by the investor.
- B. It is used when the investor lacks the ability to exercise significant influence over the investee.
- C. It may be used in place of consolidation.
- D. Its primary use is in reporting nonsubsidiary investments.

Answer: D

Learning Objective: 02-03

Topic: The Equity Method

Blooms: Remember

AACSB: Reflective Thinking

AICPA: FN Decision Making

Difficulty: 1 Easy

(Note: This is a Kaplan CPA Review Question)

20. On July 1, 20X4, Denver Corp. purchased 3,000 shares of Eagle Co.'s 10,000 outstanding shares of common stock for \$20 per share. On December 15, 20X4, Eagle paid \$40,000 in dividends to its common stockholders. Eagle's net income for the year ended December 31, 20X4, was \$120,000, earned evenly throughout the year. In its 20X4 income statement, what amount of income from this investment should Denver report?

- A. \$12,000
- B. \$36,000
- C. \$18,000
- D. \$6,000

Answer: C

Learning Objective: 02-03

Topic: The Equity Method

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

21. On October 1, 20X7, Chicago Corporation purchased 6,000 shares of Buffalo Company's 15,000 outstanding share of common stock for \$25 per share. On December 15, 20X7, Buffalo paid \$120,000 in dividends to its common stockholders. Buffalo's net income for the year ended December 31, 20X7 was \$300,000, earned evenly throughout the year. In its 20X7 income statement, what amount of income from this investment should Chicago report?

- A. \$12,000
- B. \$30,000
- C. \$48,000
- D. \$120,000

Answer: B

Learning Objective: 02-03

Topic: The Equity Method

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

(Note: This is a Kaplan CPA Review Question)

22. On January 2, 20X5, Well Co. purchased 10 percent of Rea, Inc.'s outstanding common shares for \$400,000. Well is the largest single shareholder in Rea, and Well's officers are a majority on Rea's board of directors. As a result, Well is able to exercise significant influence over Rea. Rea reported net income of \$500,000 for 20X5, and paid dividends of \$150,000. In its December 31, 20X5, balance sheet, what amount should Well report as investment in Rea?

- A. \$385,000
- B. \$450,000
- C. \$400,000
- D. \$435,000

Answer: D

Learning Objective: 02-03

Topic: The Equity Method

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

23. On January 2, 20X1, Pencil Co. purchased 15 percent of Eraser, Inc.'s outstanding common shares for \$500,000. Pencil is the largest single shareholder in Eraser and is able to exercise significant influence over Eraser. Eraser reported net income of \$400,000 for 20X1 and paid

dividends of \$100,000. In its December 31, 20X1, balance sheet, what amount should Pencil report as investment in Eraser?

- A. \$485,000
- B. \$500,000
- C. \$545,000
- D. \$560,000

Answer: C

Learning Objective: 02-03

Topic: The Equity Method

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

(Note: This is a Kaplan CPA Review Question)

24. The Jamestown Corporation (Jamestown) reported net income for the current year of \$200,000 and paid cash dividends of \$30,000. The Stadium Company (Stadium) holds 22 percent of the outstanding voting stock of Jamestown. However, another corporation holds the other 78 percent ownership and does not take Stadium's wants and wishes into consideration when making financing and operating decisions for Jamestown. What investment income should Stadium recognize for the current year?

- A. \$6,600
- B. \$0
- C. \$44,000
- D. \$50,600

Answer: A

Learning Objective: 02-03

Topic: The Equity Method

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

25. Clocktower Corporation reported net income for the current year of \$370,000 and paid cash dividends of \$50,000. Slide Company holds 40 percent of the outstanding voting stock of Clocktower. However, another corporation holds the other 60 percent ownership and does not take Slide's wants and wishes into consideration when making financing and operating decisions for Clocktower. What investment income should Slide recognize for the current year?

- A. \$0
- B. \$20,000
- C. \$128,000
- D. \$148,000

Answer: B

Learning Objective: 02-03

Topic: The Equity Method

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

The following data applies to Questions 26-28:

Grant, Inc. acquired 30 percent of South Co.'s voting stock for \$200,000 on January 2, 20X4. Grant's 30 percent interest in South gave Grant the ability to exercise significant influence over South's operating and financial policies. During 20X4, South earned \$80,000 and paid dividends of \$50,000. South reported earnings of \$100,000 for the six months ended June 30, 20X5, and \$200,000 for the year ended December 31, 20X5. On July 1, 20X5, Grant sold half of its stock in South for \$150,000 cash. South paid dividends of \$60,000 on October 1, 20X5.

(Note: This is a Kaplan CPA Review Questions)

26. What amount should Grant include in its 20X4 income statement as a result of the investment?

- A. \$15,000
- B. \$24,000
- C. \$50,000
- D. \$80,000

Answer: B

Learning Objective: 02-03

Topic: The Equity Method

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

(Note: This is a Kaplan CPA Review Questions)

27. In Grant's December 31, 20X4, balance sheet, what should be the carrying amount of this investment?

- A. \$224,000
- B. \$200,000
- C. \$234,000
- D. \$209,000

Answer: D

Learning Objective: 02-03

Topic: The Equity Method

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

(Note: This is a Kaplan CPA Review Questions)

28. In its 20X5 income statement, what amount should Grant report as a gain from the sale of half of its investment?

- A. \$35,000
- B. \$24,500
- C. \$30,500
- D. \$45,500

Answer: C

Learning Objective: 02-03

Topic: The Equity Method

Topic: Changes in the Number of Shares Held

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

29. What portion of the subsidiary stockholders' equity account balances should be eliminated in preparing the consolidated balance sheet?

- A. Common stock
- B. Additional paid-in capital
- C. Retained Earnings
- D. All of the balances are eliminated

Answer: D

Learning Objective: 02-06

Topic: Overview of the Consolidation Process

Blooms: Remember

AACSB: Reflective Thinking

AICPA: FN Decision Making

Difficulty: 1 Easy

30. The consolidation process consists of all the following except:

- A. Combining the financial statements of two or more legally separate companies.
- B. Eliminating intercompany transactions and holdings.
- C. Closing the individual subsidiary's revenue and expense accounts into the parent's retained earnings.
- D. Combining the accounts of separate companies, creating a single set of financial statements.

Answer: C

Learning Objective: 02-06

Topic: Overview of the Consolidation Process

Blooms: Remember

AACSB: Reflective Thinking

AICPA: FN Decision Making

Difficulty: 1 Easy

The following data applies to Questions 31 - 34:

Beta Company acquired 100 percent of the voting common shares of Standard Video Corporation, its bitter rival, by issuing bonds with a par value and fair value of \$150,000. Immediately prior to the acquisition, Beta reported total assets of \$500,000, liabilities of \$280,000, and stockholders' equity of \$220,000. At that date, Standard Video reported total assets of \$400,000, liabilities of \$250,000, and stockholders' equity of \$150,000. Included in Standard's liabilities was an account payable to Beta in the amount of \$20,000, which Beta included in its accounts receivable.

31. Based on the preceding information, what amount of total assets did Beta report in its balance sheet immediately after the acquisition?

- A. \$500,000
- B. \$650,000
- C. \$750,000
- D. \$900,000

Answer: B

Learning Objective: 02-07

Topic: Consolidation Worksheets

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

32. Based on the preceding information, what amount of total assets was reported in the consolidated balance sheet immediately after acquisition?

- A. \$650,000
- B. \$880,000
- C. \$920,000
- D. \$750,000

Answer: B

Learning Objective: 02-07

Topic: Consolidation Worksheets

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

33. Based on the preceding information, what amount of total liabilities was reported in the consolidated balance sheet immediately after acquisition?

- A. \$500,000
- B. \$530,000
- C. \$280,000
- D. \$660,000

Answer: D

Learning Objective: 02-07

Topic: Consolidation Worksheets

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

34. Based on the preceding information, what amount of stockholders' equity was reported in the consolidated balance sheet immediately after acquisition?

- A. \$220,000
- B. \$150,000
- C. \$370,000
- D. \$350,000

Answer: A

Learning Objective: 02-07

Topic: Consolidation Worksheets

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

The following data applies to Questions 35 – 38:

Alpha Company acquired 100 percent of the voting common shares of Gamma Corporation by issuing bonds with a par value and fair value of \$200,000. Immediately prior to the acquisition, Alpha reported total assets of \$600,000, liabilities of \$370,000, and stockholders' equity of \$230,000. At that date, Gamma reported total assets of \$500,000, liabilities of \$300,000, and stockholders' equity of \$200,000. Included in Gamma's liabilities was an account payable to Alpha in the amount of \$50,000, which Alpha included in its accounts receivable.

35. Based on the preceding information, what amount of total assets did Alpha report in its balance sheet immediately after the acquisition?

- A. \$1,100,000
- B. \$1,000,000
- C. \$800,000
- D. \$1600,000

Answer: C

Learning Objective: 02-07

Topic: Consolidation Worksheets

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

36. Based on the preceding information, what amount of total assets was reported in the consolidated balance sheet immediately after acquisition?

- A. \$600,000
- B. \$800,000
- C. \$1,050,000
- D. \$1,150,000

Answer: C

Learning Objective: 02-07

Topic: Consolidation Worksheets

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

37. Based on the preceding information, what amount of total liabilities was reported in the consolidated balance sheet immediately after the acquisition?

- A. \$370,000
- B. \$670,000
- C. \$820,000
- D. \$870,000

Answer: C

Learning Objective: 02-07

Topic: Consolidation Worksheets

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

38. Based on the preceding information, what amount of stockholders' equity was reported in the consolidated balance sheet immediately after acquisition?

- A. \$200,000
- B. \$230,000
- C. \$380,000
- D. \$430,000

Answer B

Learning Objective: 02-07

Topic: Consolidation Worksheets

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

The following data applies to Questions 39 - 41:

Parent Co. purchases 100 percent of Son Company on January 1, 20X1, when Parent's retained earnings balance is \$520,000 and Son's is \$150,000. During 20X1, Son reports \$15,000 of net income and declares \$6,000 of dividends. Parent reports \$105,000 of separate operating earnings plus \$15,000 of equity-method income from its 100 percent interest in Son; Parent declares dividends of \$40,000.

39. Based on the preceding information, what is Parent's post-closing retained earnings balance on December 31, 20X1?

- A. \$485,000
- B. \$505,000
- C. \$525,000
- D. \$600,000

Answer: D

Learning Objective: 02-07

Topic: Consolidation Subsequent to Acquisition

Blooms: Understand

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

40. Based on the preceding information, what is Son's post-closing retained earnings balance on December 31, 20X1:

- A. \$141,000
- B. \$150,000
- C. \$159,000
- D. \$165,000

Answer: C

Learning Objective: 02-07

Topic: Consolidation Subsequent to Acquisition

Blooms: Understand

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 1 Easy

41. Based on the preceding information, what is the consolidated retained earnings balance on December 31, 20X1?

- A. \$470,000
- B. \$585,000
- C. \$600,000
- D. \$759,000

Answer: C

Learning Objective: 02-07

Topic: Consolidation Subsequent to Acquisition

Blooms: Understand

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

The following data applies to Questions 42 – 44:

Phips Co. purchases 100 percent of Sips Company on January 1, 20X2, when Phips' retained earnings balance is \$320,000 and Sips' is \$120,000. During 20X2, Sips reports \$20,000 of net income and declares \$8,000 of dividends. Phips reports \$125,000 of separate operating earnings plus \$20,000 of equity-method income from its 100 percent interest in Sips; Phips declares dividends of \$35,000.

42. Based on the preceding information, what is Phips' post-closing retained earnings balance on December 31, 20X2?

- A. \$305,000
- B. \$410,000
- C. \$430,000
- D. \$465,000

Answer: C

Learning Objective: 02-07

Topic: Consolidation Subsequent to Acquisition

Blooms: Understand

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

43. Based on the preceding information, what is Sips' post-closing retained earnings balance on December 31, 20X2?

- A. \$108,000
- B. \$120,000
- C. \$132,000
- D. \$140,000

Answer: C

Learning Objective: 02-07

Topic: Consolidation Subsequent to Acquisition

Blooms: Understand

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 1 Easy

44. Based on the preceding information, what is the consolidated retained earnings balance on December 31, 20X2?

- A. \$402,000
- B. \$410,000
- C. \$430,000
- D. \$562,000

Answer: C

Learning Objective: 02-07

Topic: Consolidation Subsequent to Acquisition

Blooms: Understand

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

45. The main guidance on equity-method reporting, found in ASC 323 and 325 requires all of the following except:

- A. The investor's share of the investee's extraordinary items should be reported.
- B. The investor's share of the investee's prior-period adjustments should be reported.
- C. Continued use of the equity-method even if continued losses results in a zero or negative balance in the investment account.
- D. Preferred dividends of the investee should be deducted from net income before the investor computes its share of investee earnings.

Answer: C

Learning Objective: Appendix 2A

Topic: Additional Requirements of ASC 323-10

Blooms: Remember

AACSB: Reflective Thinking

AICPA: FN Reporting

Difficulty: 1 Easy

The following data applies to Questions 46 –50:

On January 1, 20X4, Plimsol Company acquired 100 percent of Shipping Corporation's voting shares, at underlying book value. Plimsol uses the cost method in accounting for its investment in Shipping. Shipping's retained earnings was \$75,000 on the date of acquisition. On December 31, 20X4, the trial balance data for the two companies are as follows:

Item	Plimsol Co.		Shipping Corp.	
	Debit	Credit	Debit	Credit
Current Assets	\$100,000		\$ 75,000	
Depreciable Assets (net)	200,000		150,000	
Investment in Shipping Corp.	125,000			
Other Expenses	60,000		45,000	
Depreciation Expense	20,000		15,000	
Dividends Declared	25,000		15,000	
Current Liabilities		\$ 40,000		\$ 25,000
Long-Term Debt		75,000		50,000
Common Stock		100,000		50,000
Retained Earnings		150,000		75,000
Sales		150,000		100,000
Dividend Income		15,000		
	<u>\$530,000</u>	<u>\$530,000</u>	<u>\$300,000</u>	<u>\$300,000</u>

46. Based on the information provided, what amount of net income will be reported in the consolidated financial statements prepared on December 31, 20X4?

- A. \$100,000
- B. \$85,000
- C. \$110,000
- D. \$125,000

Answer: C

Learning Objective: Appendix 2B

Topic: Consolidation and the Cost Method

Blooms: Understand

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

47. Based on the information provided, what amount of total assets will be reported in the consolidated balance sheet prepared on December 31, 20X4?

- A. \$425,000
- B. \$525,000
- C. \$650,000
- D. \$630,000

Answer: B

Learning Objective: Appendix 2B

Topic: Consolidation and the Cost Method

Blooms: Understand

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

48. Based on the information provided, what amount of retained earnings will be reported in the consolidated balance sheet prepared on December 31, 20X4?

- A. \$235,000
- B. \$210,000
- C. \$310,000
- D. \$225,000

Answer: A

Learning Objective: Appendix 2B

Topic: Consolidation and the Cost Method)

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

49. Based on the information provided, what amount of total liabilities will be reported in the consolidated balance sheet prepared on December 31, 20X4?

- A. \$525,000
- B. \$115,000
- C. \$125,000
- D. \$190,000

Answer: D

Learning Objective: Appendix 2B

Topic: Consolidation and the Cost Method

Blooms: Understand

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

50. Based on the information provided, what amount of total stockholder's equity will be reported in the consolidated balance sheet prepared on December 31, 20X4?

- A. \$190,000
- B. \$335,000
- C. \$460,000
- D. \$310,000

Answer: B

Learning Objective: Appendix 2B

Topic: Consolidation and the Cost Method

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

The following data applies to Questions 51 - 52:

Parent Company purchased 100 percent of Son Inc. on January 1, 20X2 for \$420,000. Son reported earnings of \$82,000 and declared dividends of \$4,000 during 20X2.

51. Based on the preceding information and assuming Parent uses the cost method to account for its investment in Son, what is the balance in Parent's Investment in Son account on December 31, 20X2, prior to consolidation?

- A. \$416,000
- B. \$420,000
- C. \$424,000
- D. \$498,000

Answer: B

Learning Objective: Appendix 2B

Topic: Consolidation and the Cost Method

Blooms: Understand

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

52. Based on the preceding information and assuming Parent uses the equity method to account for its investment in Son, what is the balance in Parent's Investment in Son account on December 31, 20X2, prior to consolidation?

- A. \$416,000
- B. \$420,000
- C. \$424,000
- D. \$498,000

Answer: D

Learning Objective: Appendix 2B

Topic: Consolidation and the Cost Method

Blooms: Understand

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

The following data applies to Questions 53 – 54:

Pone Company purchased 100 percent of Sone Inc. on January 1, 20X9 for \$625,000. Sone reported earnings of \$76,000 and declared dividends of \$8,000 during 20X9.

53. Based on the preceding information and assuming Pone uses the cost method to account for its investment in Sone, what is the balance in Pone's Investment in Sone account on December 31, 20X9, prior to consolidation?

- A. \$617,000
- B. \$625,000
- C. \$633,000
- D. \$693,000

Answer: B

Learning Objective: Appendix 2B

Topic: Consolidation and the Cost Method

Blooms: Understand

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

54. Based on the preceding information and assuming Pone uses the equity method to account for its investment in Sone, what is the balance in Pone's Investment in Sone account on December 31, 20X9, prior to consolidation?

- A. \$617,000
- B. \$625,000
- C. \$633,000
- D. \$693,000

Answer: D

Learning Objective: Appendix 2B

Topic: Consolidation and the Cost Method

Blooms: Understand

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 2 Medium

Essay Questions:

55. A cash dividend returns assets to the stockholders while reducing corporate liquidity. Why are not all cash dividends considered to be "liquidating dividends"? In your response include a discussion of how an investor accounts for a liquidating dividend.

Answer:

A dividend represents earnings of a company being returned to its shareholders. A liquidating dividend occurs when an investee declares dividends in excess of the earnings from the purchase date of the investment. An individual investor must treat a liquidating dividend associated with its investment as a return of capital and reduce the investment account accordingly. It is possible for blocks of stock acquired at different times to have different amounts associated with a potential liquidating dividend.

Learning Objective: 02-02

Topic: The Cost Method

Blooms: Understand

AACSB: Communication

AICPA: FN Decision Making

Difficulty: 2 Medium

56. Dear Corporation acquired 100 percent of the voting shares of Therry Inc. by issuing 10,000 new shares of \$5 par value common stock with a \$30 market value.

Required:

1. Which company is the parent and which is the subsidiary?
2. Define a subsidiary corporation.
3. Define a parent corporation.
4. Which entity prepares consolidated worksheet?
5. Why are consolidation entries used?

Answer:

1. Dear is the parent and Therry is the subsidiary.
2. A subsidiary is an entity in which another entity, the parent company, holds a controlling financial interest.
3. A parent company holds a controlling financial interest in another company.
4. The parent, Dear, prepares the consolidated worksheet.
5. Consolidation entries are used to adjust the amounts reported by the parent and all of the subsidiaries to reflect the amounts that would be reported if the separate legal entities were a single company.

Learning Objective: 02-06

Topic: Overview of the Consolidation Process

Blooms: Understand

AACSB: Reflective Thinking

AICPA: FN Decision Making

Difficulty: 1 Easy

57. On January 1, 20X9, Zigma Company acquired 100 percent of Standard Company's common shares at underlying book value. Zigma uses the equity method in accounting for its ownership of Standard. On December 31, 20X9, the trial balances of the two companies are as follows:

Item	Zigma Co.		Standard Co.	
	Debit	Credit	Debit	Credit
Current Assets	\$238,000		\$95,000	
Depreciable Assets	300,000		170,000	
Investment in Standard Co.	100,000			
Other Expenses	90,000		70,000	
Depreciation Expense	30,000		17,000	
Dividends Declared	32,000		10,000	
Accumulated Depreciation		\$120,000		\$ 85,000
Current Liabilities		50,000		30,000
Long-Term Debt		120,000		50,000
Common Stock		100,000		50,000
Retained Earnings		175,000		35,000
Sales		200,000		112,000
Income from Standard Co.		25,000		
	<u>\$790,000</u>	<u>\$790,000</u>	<u>\$362,000</u>	<u>\$362,000</u>

Required:

1. Prepare the consolidation entries needed as of December 31, 20X9, to complete a consolidation worksheet.
2. Prepare a three-part consolidation worksheet as of December 31, 20X9.

Problem 57 (continued):

Answer:

1.

Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Beginning Book Value	85,000		50,000		35,000
+ Net Income	25,000				25,000
- Dividends	(10,000)				(10,000)
Ending Book Value	100,000		50,000		50,000

Basic consolidation entry:

Common Stock	50,000
Retained Earnings	35,000
Income from Standard Co.	25,000
Dividends Declared	10,000
Investment in Standard Co.	100,000

Optional accumulated depreciation consolidation entry:

Accumulated Depreciation	75,000
Depreciable Assets	75,000

(T-Accounts not required)

	Investment in Standard Co.		Income from Standard Co.	
Beginning Balance	85,000			
100% Net Income	25,000			25,000 100% Net Income
		10,000 100% Dividends		
Ending Balance	100,000		25,000 Ending Balance	0
		100,000 Basic	25,000	
	0			

Problem 57 (continued):

2.

	Zigma Co.	Standard Co.	Consolidation Entries		Consolidated
			DR	CR	
Income Statement					
Sales	200,000	112,000			312,000
Less: Other Expenses	(90,000)	(70,000)			(160,000)
Less: Depreciation Expense	(30,000)	(17,000)			(47,000)
Income from Standard Co.	25,000	0	25,000		0
Net Income	105,000	25,000	25,000	0	105,000
Statement of Retained Earnings					
Beginning Balance	175,000	35,000	35,000		175,000
Net Income	105,000	25,000	25,000	0	105,000
Less: Dividends Declared	(32,000)	(10,000)		10,000	(32,000)
Ending Balance	248,000	50,000	60,000	10,000	248,000
Balance Sheet					
Current Assets	238,000	95,000			333,000
Depreciable Assets	300,000	170,000		75,000	395,000
Less: Accumulated Depreciation	(120,000)	(85,000)	75,000		(130,000)
Investment in Standard Co.	100,000			100,000	0
Total Assets	518,000	180,000	75,000	175,000	598,000
Current Liabilities	50,000	30,000			80,000
Long-Term Debt	120,000	50,000			170,000
Common Stock	100,000	50,000	50,000		100,000
Retained Earnings	248,000	50,000	60,000	10,000	248,000
Total Liabilities & Equity	518,000	180,000	110,000	10,000	598,000

Learning Objective: 02-07

Topic: Consolidation Worksheets

Blooms: Apply

AACSB: Analytic

AICPA: FN Measurement

Difficulty: 3 Hard

58. In the absence of other evidence, common stock ownership of between 20 and 50 percent is viewed as indicating that the investor is able to exercise significant influence over the investee. What are some of the other factors that could constitute evidence of the ability to exercise significant influence?

Answer:

APB stated that these include:

1. Representation on board of directors
2. Participation in policy making
3. Material intercompany transactions
4. Interchange of managerial personnel
5. Technological dependency
6. Size of investment in relation to concentration of other shareholdings

Learning Objective: Appendix 2A

Topic: Determination of Significant Influence

Blooms: Remember

AACSB: Communication

AICPA: FN Decision Making

Difficulty: 1 Easy

59. On January 1, 20X7, Plimsol Company acquired 100 percent of Shipping Corporation's voting shares, at underlying book value. Plimsol uses the cost method in accounting for its investment in Shipping. Shipping's reported retained earnings of \$75,000 on the date of acquisition. The trial balances for Plimsol Company and Shipping Corporation as of December 31, 20X8, follow:

Item	Plimsol Co.		Shipping Corp.	
	Debit	Credit	Debit	Credit
Current Assets	\$160,000		\$115,000	
Depreciable Assets (net)	180,000		135,000	
Investment in Shipping Corp.	125,000			
Other Expenses	85,000		60,000	
Depreciation Expense	20,000		15,000	
Dividends Declared	30,000		15,000	
Current Liabilities		\$ 25,000		\$ 20,000
Long-Term Debt		75,000		50,000
Common Stock		100,000		50,000
Retained Earnings		210,000		100,000
Sales		175,000		120,000
Dividend Income		15,000		
	<u>\$600,000</u>	<u>\$600,000</u>	<u>\$340,000</u>	<u>\$340,000</u>

Required:

- Provide all consolidating entries required to prepare a full set of consolidated statements for 20X8.
- Prepare a three-part consolidation worksheet in good form as of December 31, 20X8.

Problem 59 (continued):

Answer:

1.

Basic consolidation entry:

Common Stock	50,000
Retained Earnings	75,000
Investment in Standard Co.	125,000

Dividend consolidation entry:

Dividend Income	15,000
Dividends Declared	15,000

2.

	Plimsol Co.	Shipping Corp.	Consolidation Entries		Consolidated
			DR	CR	
Income Statement					
Sales	175,000	120,000			295,000
Less: Other Expenses	(85,000)	(60,000)			(145,000)
Less: Depreciation Expense	(20,000)	(15,000)			(35,000)
Dividend Income	15,000		15,000		0
Net Income	85,000	45,000	15,000	0	115,000
Statement of Retained Earnings					
Beginning Balance	210,000	100,000	75,000		235,000
Net Income	85,000	45,000	15,000	0	115,000
Less: Dividends Declared	(30,000)	(15,000)	15,000		(30,000)
Ending Balance	265,000	130,000	90,000	15,000	320,000
Balance Sheet					
Current Assets	160,000	115,000			275,000
Depreciable Assets (net)	180,000	135,000			315,000
Investment in Shipping Corp.	125,000		125,000		0
Total Assets	465,000	250,000	0	125,000	590,000
Current Liabilities	25,000	20,000			45,000
Long-Term Debt	75,000	50,000			125,000
Common Stock	100,000	50,000	50,000		100,000
Retained Earnings	265,000	130,000	90,000	15,000	320,000
Total Liabilities & Equity	465,000	250,000	140,000	15,000	590,000

*Learning Objective: Appendix 2B**Topic: Consolidation and the Cost Method**Blooms: Apply**AACSB: Analytic**AICPA: FN Measurement**Difficulty: 3 Hard*

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ch02 Key

1. If Push Company owned 51 percent of the outstanding common stock of Shove Company, which reporting method would be appropriate? A. Cost method
B. Consolidation
C. Equity method
D. Merger method

AACSB: Reflective Thinking
Baker - Chapter 02 #1
Blooms: Remember
Difficulty: 1 Easy

- Learning Objective: 02-01 Understand and explain how ownership and control can influence the accounting for investments in common stock.
2. Usually, an investment of 20 to 50 percent in another company's voting stock is reported under the: A. cost method.
B. equity method.
C. full consolidation method.
D. fair value method.

AACSB: Reflective Thinking
Baker - Chapter 02 #2
Blooms: Remember
Difficulty: 1 Easy

- Learning Objective: 02-01 Understand and explain how ownership and control can influence the accounting for investments in common stock.
3. The main pronouncement on equity-method reporting, APB 19 (ASC 323 and 325) requires all of the following except: A. The investor's share of the investee's extraordinary items should be reported.
B. The investor's share of the investee's prior-period adjustments should be reported.
C. Continued use of the equity-method even if continued losses results in a zero or negative balance in the investment account.
D. Preferred dividends of the investee should be deducted from net income before the investor computes its share of investee earnings.

AACSB: Reflective Thinking
Baker - Chapter 02 #3
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-01 Understand and explain how ownership and control can influence the accounting for investments in common stock.
On January 1, 20X4, Plimsol Company acquired 100 percent of Shipping Corporation's voting shares, at underlying book value. Plimsol uses the cost method in accounting for its investment in Shipping. Shipping's retained earnings was \$75,000 on the date of acquisition. On December 31, 20X4, the trial balance data for the two companies are as follows:

Item	Plimsol Co.		Shipping Corp.	
	Debit	Credit	Debit	Credit
Current Assets	\$100,000		\$ 75,000	
Depreciable Assets (net)	200,000		150,000	
Investment in Shipping Corp.	125,000			
Other Expenses	60,000		45,000	
Depreciation Expense	20,000		15,000	
Dividends Declared	25,000		15,000	
Current Liabilities		\$ 40,000		\$ 25,000
Long-Term Debt		75,000		50,000
Common Stock		100,000		50,000
Retained Earnings		150,000		75,000
Sales		150,000		100,000
Dividend Income		15,000		
	<u>\$530,000</u>	<u>\$530,000</u>	<u>\$300,000</u>	<u>\$300,000</u>

Baker - Chapter 02

4. Based on the information provided, what amount of net income will be reported in the consolidated financial statements prepared on December 31, 20X4? ☐ ☐
- A. \$100,000
C. \$110,000
D. \$125,000

AACSB: Analytic
Baker - Chapter 02 #4
Blooms: Understand
Difficulty: 2 Medium

- Learning Objective: 02-02 Prepare journal entries using the cost method for accounting for investments.*
5. Based on the information provided, what amount of total assets will be reported in the consolidated balance sheet prepared on December 31, 20X4? ☐ ☐
- A. \$425,000
B. \$525,000
C. \$650,000
D. \$630,000

AACSB: Analytic
Baker - Chapter 02 #5
Blooms: Understand
Difficulty: 2 Medium

- Learning Objective: 02-02 Prepare journal entries using the cost method for accounting for investments.*
6. Based on the information provided, what amount of retained earnings will be reported in the consolidated balance sheet prepared on December 31, 20X4? ☐ ☐
- A. \$235,000**
B. \$210,000
C. \$310,000
D. \$225,000

AACSB: Analytic
Baker - Chapter 02 #6
Blooms: Apply
Difficulty: 3 Hard

- Learning Objective: 02-02 Prepare journal entries using the cost method for accounting for investments.*
7. Based on the information provided, what amount of total liabilities will be reported in the consolidated balance sheet prepared on December 31, 20X4? ☐ ☐
- A. \$525,000
B. \$115,000
C. \$125,000
D. \$190,000

AACSB: Analytic
Baker - Chapter 02 #7
Blooms: Understand
Difficulty: 2 Medium

- Learning Objective: 02-02 Prepare journal entries using the cost method for accounting for investments.*
8. Based on the information provided, what amount of total stockholder's equity will be reported in the consolidated balance sheet prepared on December 31, 20X4? ☐ ☐
- A. \$190,000
B. \$335,000
C. \$460,000
D. \$310,000

AACSB: Analytic
Baker - Chapter 02 #8
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-02 Prepare journal entries using the cost method for accounting for investments.

9. From an investor's point of view, a liquidating dividend from an investee is: ☐ ☒
A. A dividend declared by the investee in excess of its earnings in the current year.
B. A dividend declared by the investee in excess of its earnings since acquisition by the investor.
C. Any dividend declared by the investee since acquisition.
D. A dividend declared by the investee in excess of the investee's retained earnings.

AACSB: Reflective Thinking
Baker - Chapter 02 #9
Blooms: Remember
Difficulty: 1 Easy

- Learning Objective: 02-02 Prepare journal entries using the cost method for accounting for investments.
10. Under the cost method of accounting for a stock investment, the differential: ☐ ☒
A. is written off.
B. is amortized.
C. is written down if related to limited-life assets.
D. is not amortized or written off.

AACSB: Reflective Thinking
Baker - Chapter 02 #10
Blooms: Remember
Difficulty: 1 Easy

- Learning Objective: 02-02 Prepare journal entries using the cost method for accounting for investments.
11. Which of the following observations is NOT consistent with the cost method of accounting? ☐ ☒
A. Investee dividends from earnings since acquisition by investor are treated as reduction of investment.
B. Investments are carried by the investor at historical cost.
C. Differential is not amortized or written off.
D. It is consistent with the treatment normally accorded noncurrent assets.

AACSB: Reflective Thinking
Baker - Chapter 02 #11
Blooms: Remember
Difficulty: 1 Easy

- Learning Objective: 02-02 Prepare journal entries using the cost method for accounting for investments.
12. On January 1, 20X9 Athlon Company acquired 30 percent of the common stock of Opteron Corporation, at underlying book value. For the same year, Opteron reported net income of \$55,000, which includes an extraordinary gain of 40,000. It did not pay any dividends during the year. By what amount would Athlon's investment in Opteron Corporation increase for the year, if Athlon used the equity method? ☐ ☒
A. \$0
B. \$16,500
C. \$4,500
D. \$12,000

AACSB: Analytic
Baker - Chapter 02 #12
Blooms: Understand
Difficulty: 2 Medium

- Learning Objective: 02-03 Prepare journal entries using the equity method for accounting for investments.
On January 1, 20X8, William Company acquired 30 percent of eGate Company's common stock, at underlying book value of \$100,000. eGate has 100,000 shares of \$2 par value, 5 percent cumulative preferred stock outstanding. No dividends are in arrears. eGate reported net income of \$150,000 for 20X8 and paid total dividends of \$72,000. William uses the equity method to account for this investment.

- Baker - Chapter 02
13. Based on the preceding information, what amount would William Company receive as dividends from eGate for the year? ☐ ☒
A. \$62,000
B. \$21,600
C. \$18,600
D. \$54,000

AACSB: Analytic
Baker - Chapter 02 #13
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-03 Prepare journal entries using the equity method for accounting for investments.

14. Based on the preceding information, what amount of investment income will William Company report from its investment in eGate for the year? ☐ ☐
- A. \$45,000
B. \$42,000
C. \$62,000
D. \$35,000

AACSB: Analytic
Baker - Chapter 02 #14
Blooms: Apply
Difficulty: 3 Hard

- Learning Objective: 02-03 Prepare journal entries using the equity method for accounting for investments.*
15. Based on the preceding information, what amount would be reported by William Company as the balance in its investment account on December 31, 20X8? ☐ ☐
- A. \$100,000
B. \$123,400
C. \$120,400
D. \$142,000

AACSB: Analytic
Baker - Chapter 02 #15
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-03 Prepare journal entries using the equity method for accounting for investments.

On January 1, 20X7, Yang Corporation acquired 25 percent of the outstanding shares of Spiel Corporation for \$100,000 cash. Spiel Company reported net income of \$75,000 and paid dividends of \$30,000 for both 20X7 and 20X8. The fair value of shares held by Yang was \$110,000 and \$105,000 on December 31, 20X7 and 20X8 respectively.

- Baker - Chapter 02*
16. Based on the preceding information, what amount will be reported by Yang as income from its investment in Spiel for 20X8, if it used the equity method of accounting? ☐ ☐
- A. \$7,500
B. \$11,250
C. \$18,750
D. \$26,250

AACSB: Analytic
Baker - Chapter 02 #16
Blooms: Apply
Difficulty: 2 Medium

- Learning Objective: 02-03 Prepare journal entries using the equity method for accounting for investments.*
17. Based on the preceding information, what amount will be reported by Yang as balance in investment in Spiel on December 31, 20X8, if it used the equity method of accounting? ☐ ☐
- A. \$111,250
B. \$118,750
C. \$100,000
D. \$122,500

AACSB: Analytic
Baker - Chapter 02 #17
Blooms: Apply
Difficulty: 2 Medium

- Learning Objective: 02-03 Prepare journal entries using the equity method for accounting for investments.*
18. Based on the preceding information, what amount will be reported by Yang as income from its investment in Spiel for 20X7, if it used the fair value method of accounting? ☐ ☐
- A.** \$17,500
B. \$12,500
C. \$11,250
D. \$7,500

AACSB: Analytic
Baker - Chapter 02 #18
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-05 Prepare journal entries using the fair value option.

19. Based on the preceding information, what amount will be reported by Yang as income from its investment in Spiel for 20X8, if it used the fair value method of accounting? ☐ ☐
- A. \$11,250
 - B.** \$2,500
 - C. \$6,250
 - D. \$7,500

AACSB: Analytic
Baker - Chapter 02 #19
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-05 Prepare journal entries using the fair value option.

20. Based on the preceding information, what amount will be reported by Yang as balance in investment in Spiel on December 31, 20X8, if it used the fair value method of accounting? ☐ ☐
- A.** \$105,000
 - B. \$118,750
 - C. \$100,000
 - D. \$122,500

AACSB: Analytic
Baker - Chapter 02 #20
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-05 Prepare journal entries using the fair value option.

21. A change from the cost method to the equity method of accounting for an investment in common stock resulting from an increase in the number of shares held by the investor requires: ☐ ☐
- A. only a footnote disclosure.
 - B. that the cumulative amount of the change be shown as a line item on the income statement, net of tax.
 - C. that the change be accounted for as an unrealized gain included in other comprehensive income.
 - D.** retroactive restatement as if the investor always had used the equity method.

AACSB: Reflective Thinking
Baker - Chapter 02 #21
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-03 Prepare journal entries using the equity method for accounting for investments.

22. Under the equity method of accounting for a stock investment, the investment initially should be recorded at: ☐ ☐
- A.** cost.
 - B. cost minus any differential.
 - C. proportionate share of the fair value of the investee company's net assets.
 - D. proportionate share of the book value of the investee company's net assets.

AACSB: Reflective Thinking
Baker - Chapter 02 #22
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-03 Prepare journal entries using the equity method for accounting for investments.

23. Which of the following observations is consistent with the equity method of accounting? ☐ ☐
- A. Dividends declared by the investee are treated as income by the investor.
 - B. It is used when the investor lacks the ability to exercise significant influence over the investee.
 - C. It may be used in place of consolidation.
 - D.** Its primary use is in reporting nonsubsidiary investments.

AACSB: Reflective Thinking
Baker - Chapter 02 #23
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-03 Prepare journal entries using the equity method for accounting for investments.

Parent Company purchased 100% of Son Inc. on January 1, 20X2 for \$420,000. Son reported earnings of \$82,000 and declared dividends of \$4,000 during 20X2.

Baker - Chapter 02

24. Based on the preceding information and assuming Parent uses the cost method to account for its investment in Son, what is the balance in Parent's Investment in Son account on December 31, 20X2, prior to consolidation? ☐ ☐

- A. \$416,000
- B. \$420,000**
- C. \$424,000
- D. \$498,000

AACSB: Analytic
Baker - Chapter 02 #24
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-04 Understand and explain differences between the cost and equity methods.

25. Based on the preceding information and assuming Parent uses the equity method to account for its investment in Son, what is the balance in Parent's Investment in Son account on December 31, 20X2, prior to consolidation? ☐ ☐

- A. \$416,000
- B. \$420,000
- C. \$424,000
- D. \$498,000**

AACSB: Analytic
Baker - Chapter 02 #25
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-04 Understand and explain differences between the cost and equity methods.

26. What portion of the balances of subsidiary stockholders' equity accounts are eliminated in preparing the consolidated balance sheet? ☐ ☐

- A. Common stock
- B. Additional paid-in capital
- C. Retained Earnings
- D. All of the balances are eliminated**

AACSB: Reflective Thinking
Baker - Chapter 02 #26
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-06 Make calculations and prepare basic elimination entries for a simple consolidation.

27. The consolidation process consists of all the following except: ☐ ☐

- A. Adding together the financial statements of two or more legally separate companies.
- B. Eliminating intercompany transactions and holdings.
- C. Closing the subsidiary's earnings into the parent's retained earnings.**
- D. Combining the accounts of separate companies, creating a single set of financial statements.

AACSB: Reflective Thinking
Baker - Chapter 02 #27
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-06 Make calculations and prepare basic elimination entries for a simple consolidation.

Beta Company acquired 100 percent of the voting common shares of Standard Video Corporation, its bitter rival, by issuing bonds with a par value and fair value of \$150,000. Immediately prior to the acquisition, Beta reported total assets of \$500,000, liabilities of \$280,000, and stockholders' equity of \$220,000. At that date, Standard Video reported total assets of \$400,000, liabilities of \$250,000, and stockholders' equity of \$150,000. Included in Standard's liabilities was an account payable to Beta in the amount of \$20,000, which Beta included in its accounts receivable.

Baker - Chapter 02

28. Based on the preceding information, what amount of total assets did Beta report in its balance sheet immediately after the acquisition? ☐ ☐
A. \$500,000
B. \$650,000
C. \$750,000
D. \$900,000

AACSB: Analytic
Baker - Chapter 02 #28
Blooms: Apply
Difficulty: 2 Medium

Learning Objective: 02-07 Prepare a Consolidation Worksheet

29. Based on the preceding information, what amount of total assets was reported in the consolidated balance sheet immediately after acquisition? ☐ ☐
A. \$650,000
B. \$880,000
C. \$920,000
D. \$750,000

AACSB: Analytic
Baker - Chapter 02 #29
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-07 Prepare a Consolidation Worksheet

30. Based on the preceding information, what amount of total liabilities was reported in the consolidated balance sheet immediately after acquisition? ☐ ☐
A. \$500,000
B. \$530,000
C. \$280,000
D. \$660,000

AACSB: Analytic
Baker - Chapter 02 #30
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-07 Prepare a Consolidation Worksheet

31. Based on the preceding information, what amount of stockholders' equity was reported in the consolidated balance sheet immediately after acquisition? ☐ ☐
A. \$220,000
B. \$150,000
C. \$370,000
D. \$350,000

AACSB: Analytic
Baker - Chapter 02 #31
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-07 Prepare a Consolidation Worksheet

Parent Co. purchases 100% of Son Company on January 1, 20X1 when Parent's retained earnings balance is \$520,000 and Son's is \$150,000. During 20X1, Son reports \$15,000 of net income and declares \$6,000 of dividends. Parent reports \$105,000 of separate operating earnings plus \$15,000 of equity-method income from its 100 percent interest in Son; Parent declares dividends of \$40,000.

32. Based on the preceding information, what is Parent's post-closing retained earnings balance on December 31, 20X1? ☐ ☐
A. \$485,000
B. \$505,000
C. \$525,000
D. \$600,000

AACSB: Analytic
Baker - Chapter 02 #32
Blooms: Understand
Difficulty: 1 Easy

Learning Objective: 02-07 Prepare a Consolidation Worksheet

33. Based on the preceding information, what is Son's post closing retained earnings balance on December 31, 20X1? ☐ ☐
- A. \$141,000
B. \$150,000
C. \$159,000
D. \$165,000

AACSB: Analytic[¶]
Baker - Chapter 02 #3[¶]
Blooms: Understand[¶]
Difficulty: 1 Easy[¶]

Learning Objective: 02-07 Prepare a Consolidation Worksheet.[¶]

34. Based on the preceding information, what is the consolidated retained earnings balance on December 31, 20X1? ☐ ☐
- A. \$470,000
B. \$585,000
C. \$600,000
D. \$759,000

AACSB: Analytic[¶]
Baker - Chapter 02 #34[¶]
Blooms: Understand[¶]
Difficulty: 2 Medium[¶]

Learning Objective: 02-07 Prepare a Consolidation Worksheet.[¶]

35. A cash dividend returns assets to the stockholders while reducing corporate liquidity. Why are not all cash dividends considered to be "liquidating dividends"? In your response include a discussion of how an investor accounts for a liquidating dividend. ☐ ☐

A dividend represents earnings of a company being returned to its shareholders. ☐

A liquidating dividend occurs when an investee declares dividends in excess of the earnings from the purchase date of the investment. An individual investor must treat a liquidating dividend associated with its investment as a return of capital and reduce the investment account accordingly. It is possible for blocks of stock acquired at different times to have different amounts associated with a potential liquidating dividend.

AACSB: Communication[¶]
Baker - Chapter 02 #35[¶]
Blooms: Understand[¶]
Difficulty: 2 Medium[¶]

Learning Objective: 02-01 Understand and explain how ownership and control can influence the accounting for investments in common stock.[¶]

36. In the absence of other evidence, common stock ownership of 20 percent or more is viewed as indicating that the investor is able to exercise significant influence over the investee. What are some of the other factors that could constitute evidence of the ability to exercise significant influence? ☐ ☐

APB stated that these include: ☐

1. Representation on board of directors ☐
2. Participation in policy making ☐
3. Material intercompany transactions ☐
4. Interchange of managerial personnel ☐
5. Technological dependency ☐
6. Size of investment in relation to concentration of other shareholdings

AACSB: Communication[¶]
Baker - Chapter 02 #36[¶]
Blooms: Remember[¶]
Difficulty: 1 Easy[¶]

Learning Objective: 02-01 Understand and explain how ownership and control can influence the accounting for investments in common stock.[¶]

37. Dear Corporation acquired 100 percent of the voting shares of Therry Inc. by issuing 10,000 new shares of \$5 par value common stock with a \$30 market value. ☐

Required: ☐

- 1) Which company is the parent and which is the subsidiary? ☐
- 2) Define a subsidiary corporation. ☐
- 3) Define a parent corporation. ☐
- 4) Which entity prepares consolidated worksheet? ☐
- 5) Why are elimination entries used? ☐ ☐

- 1) Dear is the parent and Therry is the subsidiary. ☐
- 2) A subsidiary is an entity in which another entity, the parent company, holds a controlling financial interest. ☐
- 3) A parent company holds a controlling financial interest in another company. ☐
- 4) The parent, Dear, prepares the consolidated worksheet. ☐
- 5) Elimination entries are used to adjust the amounts reported by the parent and all of the subsidiaries to reflect the amounts that would be reported if the separate legal entities were a single company.

AACSB: Reflective Thinking
Baker - Chapter 02 #37
Blooms: Understand
Difficulty: 1 Easy

Learning Objective: 02-06 Make calculations and prepare basic elimination entries for a simple consolidation.