SOUTH-WESTERN
CENGAGE Learning

CHAPTER 12

DISCUSSION QUESTIONS

1. There are several reasons for a firm to make investments in assets not directly related to the primary operations of its business (that is, investments in assets other than property, plant, equipment, and inventory). Companies usually make short-term investments because of a temporary surplus of cash. They make long-term investments either because they believe that purchased investments provide a good return on money invested or because they want to gain influence or control over investee companies.

2. According to IFRS 9, debt securities are classified into three categories: (1) FVTPL financial assets-Debt (2) FVTOCI Financial Aaets-Debt (3) amortized cost financial assets. Equity securities are classified into two catagories: (1) FVTPL financial assets-Equity (2) FVTOCI Financial Aaets-Equity In addition, investments should applied equity method when the company has significant influence over the investees.

3. A financial asset will be classified as FVTPLFinancial Assets-Debt if the investor's purpose of holding the securities is neither to collect interest and principal nor to collect interest and sell. A financial assets will be classified as FVTPLFinancial Assets-Equity if the company does not make an irrevocable option to measure the equity investments as fair value through other comprehensive income.

4. A financial asset will be classified as amortized cost if the investor intends to collect the interest and the principal, not for selling purpose. This criterion means that only debt financial assets can be classified as amortized cost, as equity financial assets typically do not mature. If a debt financial asset is classified as amortized cost, any premium or discount associated with the financial asset must be amortized over the life of the debt financial asset.

5. To be classified as an investment accounted for using equity method, an investor must typically own between 20 and 50% of the outstanding common stock of the investee. Ownership of between 20 and 50% generally indicates the ability of the investor to significantly influence the operations and decisions of the investee.

6. When a security is sold, the seller must have several pieces of information to properly account for the transaction. The seller must know the selling price as well as the historical cost of the financial asset. The difference between these two amounts results in a gain or loss on the sale.

7. The valuation adjustment account is used to value both FVTPL and FVTOCI financial assets at their market value. FVTPL and FVTOCI financial assets are initially recorded at their historical cost, and as their value changes, the historical cost remains the same on the books. To reflect market values on the books, the valuation adjustment account is used to record both increases and decreases in value. A separate valuation adjustment account is used for both FVTPL and FVTOCI financial assets.

8. When selling the securities to the third party, the major difference between FVTOCI Financial Aaets -Debt and FVTOCI Financial Aaets-Equity is whether the other comprehensive income recording the fair value changes can be reclassified to profit or loss. Unrealized gains or losses on FVTOCI Financial Aaets -Debt can be reclassified to gains and losses from sale of FVTOCI Financial Aaets -Debt. However, FVTOCI Financial Aaets -Equity can not be reclassified, and it should be reclassified into retained earnings.

9. Accounting for changes in the value of FVTOCI financial assets is similar to the procedures applied when accounting for FVTPL financial assets with one important difference. Instead of recording any gains or losses which is included in net income, unrealized gains or losses are recorded in an equity account, Unrealized Gains or Losses on FVTOCI Financial Assets. Thus, the journal entry to record unrealized changes in value always contains the equity account

and the valuation adjustment of FVTOCI financial assets account.

10. The valuation adjustment account can be further adjusted; however, the adjustment account should always report the total net change in the value of the financial asset. For example, if a financial asset that cost $200 rose in value to $300 during the first period and then to $350 during the second period, the valuation adjustment account would show a balance of $150 at the end of the second period.

11. Changes in the value of amortized cost and investments accounted for using the equity method are not accounted for on the books of the investor. For amortized cost financial assets, the investor intends to hold the investments for interest and principal, and as a result, changes in value will not affect the eventual maturity value of the financial asset. For investments with the equity method, the investor is holding the stocks for the purpose of being able to influence the operating decisions of the investee on a long-term basis. Thus, temporary changes in value of investments with the equity method are ignored for accounting purposes.

PRACTICE EXERCISES

PE 12–1 (LO1) Why Companies Invest in Other Companies

The correct answer is B.

a. True. Most cases of companies investing in other companies are to invest excess cash.
b. False. Investing in other companies will not necessarily eliminate risk in other investments.
c. True. By investing in other companies, the investing company can gain influence over the operations of another company.
d. True. When one company owns a significant portion of another company, the owner company can essentially control the operations of the owned company.

PE 12–2 (LO2) Classifying a Security

The correct answer is C. Amortized cost financial assets are always considered debt securities. FVTPL and FVTOCI financial assets can sometimes be considered debt. True to their name, investments accounted for using the equity method are always considered equity securities.

PE 12–3 (LO2) Investment Accounted for Using the Equity Method

The correct answer is A. An entity is presumed to have significant influence upon the operations of another company when it owns 20 to 50% of the outstanding voting stock.

PE 12–4 (LO2) Valuation of Securities

The correct answers are A and C. Investment accounted for using equity method are valued at cost adjusted for changes in the net assets of the investee. Amortized cost financial assets are valued at amortized cost.

PE 12–5 (LO3) Accounting for Amortized Cost Financial Assets at Par

Jan. 1		
Amortized Cost Financial Assets, Ropa Co.	50,000	
Cash		50,000
July 1		
Cash	2,000	
Interest Revenue		2,000

PE 12–5 (LO3) (Continued)

Dec. 31		
Cash	2,000	
Interest Revenue		2,000
Cash	30,000	
Amortized Cost Financial Assets, Ropa Co.		25,000
Gains from Sale of Amortized Cost Financial Assets		5,000

PE 12–6 (LO3) Accounting for Amortized Cost Financial Assets at Par

July 1		
Amortized Cost Financial Assets, Milkyway Image Co.	50,000	
Cash		50,000
Dec. 31		
Cash	3,000	
Interest Revenue		3,000
Cash	18,000	
Losses from Sale of Amortized Cost Financial Assets	2,000	
Amortized Cost Financial Assets, Milkyway Image Co.		20,000

PE 12–7 (LO4, LO5, LO6) Accounting for the Purchase of FVTPL and FVTOCI Financial Assets

FVTPL Financial Assets—Debt	40,000	
FVTPL Financial Assets—Equity	55,000	
FVTOCI Financial Assets—Debt	23,000	
FVTOCI Financial Assets—Equity	106,000	
Cash		224,000
Purchased various financial assets.		

PE 12–8 (LO4, LO5, LO6) Accounting for the Return Earned on an Investment

Cash	12,000	
Interest Revenue		6,500
Dividend Revenue		5,500
To record interest and dividends earned on financial assets.		

PE 12–9 (LO4, LO5, LO6) Accounting for the Sale of Securities

Losses on FVTPL Financial Assets—Equity	5,000	
Valuation Adjustment for FVTPL Financial Assets—Equity		5,000
Cash	50,000	
Valuation Adjustment for FVTPL Financial Assets—Equity ..	5,000	
FVTPL Financial Assets—Equity		55,000
To record the sale of Security 1 with original cost of $55,000 for $50,000.		

PE 12–10 (LO5) Changes in Value of FVTPL Financial Assets

Valuation Adjustment for FVTPL Financial Assets	750	
Gains on FVTPL Financial Assets		750
To recognize the increase in value of the FVTPL financial asset ($24,250 – $23,500 = $750).		

PE 12–11 (LO4, LO6) Changes in Value of FVTOCI Financial Assets

Valuation Adjustment for FVTOCI Financial Assets-Debt	400	
Unrealized Gains or Losses on FVTOCI Financial Assets-Debt		400
Unrealized Gains or Losses on FVTOCI Financial Assets-Equity	800	
Valuation Adjustment for FVTOCI Financial Assets-Equity		800
To record change in value of FVTOCI financial assets (Security 1 increased in value by $400, and Security 2 declined in value by $800).		

PE 12–12 (LO5) Subsequent Changes in Value of FVTPL Financial Assets

Losses on FVTPL Financial Assets 6,000		
Valuation Adjustment for FVTPL Financial Assets	6,000	
To adjust the valuation adjustment account to required ending balance.		

Once this entry is posted, Valuation Adjustment for FVTPL Financial Assets will have the required $2,000 credit balance as follows:

Valuation Adjustment for FVTPL Financial Assets

12/31/2018	4,000		
		Adjustment	6,000
		12/31/2019	2,000

PE 12–13 (LO6) **Accounting for FVTOCI Financial Assets-Equity**

Jan. 4		
FVTOCI Financial Assets—Equity, Yuen Foong Paper Co..	90,000	
Cash		90,000
June 30		
Cash..	12,000	
Dividend Revenue		12,000
Dec. 31		
Unrealized Gains or Losses on FVTOCI Financial Assets—Equity, Yuen Foong Paper Co.	6,000	
Valuation Adjustment for FVTOCI Financial Assets—Equity, Yuen Foong Paper Co.		6,000

PE 12–14 (LO7) **Accounting for Investments Using the Equity Method**

Investment Accounted for Using the Equity Method, Hall Company	32,000	
Share of Income from Associates		32,000
To recognize Manwill's portion of Hall's net income ($80,000 × 0.40 = $32,000).		
Cash	8,000	
Investment Accounted for Using the Equity Method, Hall Company		8,000
To recognize Manwill's portion of Hall's dividends paid ($20,000 × 0.40 = $8,000).		

No entry is made for market value adjustments under the equity method of accounting for investments.

PE 12–15 (LO7) **Accounting for Investments Using the Equity Method**

Jan. 2		
Investment Accounted for Using the Equity Method, Howard Hotel	100,000	
Cash		100,000
July 30		
Cash	10,000	
Investment Accounted for Using the Equity Method,		

Howard Hotel		10,000
Dec. 31		
Investment Accounted for Using the Equity Method, Howard Hotel	437,500	
Share of Income from Associates		437,500

EXERCISES

E 12–1 (LO2, LO7) Long-Term Investments Using the Equity Method

1. The equity method of accounting probably should be used for Corporation A stock because Danbury, Inc.owns 25% of the outstanding voting stock. This investment is considered large enough that Danbury, Inc., can exercise a significant influence over the operations of Corporation A. Without further information, it should be assumed that significant influence is exercised over Corporation A.

   Corporation B stock should be accounted for as FVTOCI-Equity because all nonvoting stock purchased as an investment, regardless of the percentage of ownership, is accounted for by the FVTOCI-Equity method (without voting rights, significant influence is not possible), and because Danbury plans on holding the financial asset for more than one year.

2. Journal entries

Acquisition:

Investment Accounted for Using the Equity Method	1,920,000	
Cash		1,920,000
Purchased 40,000 shares of Corporation A common stock (40,000 × $48).		
FVTOCI Financial Assets —Equity	1,120,000	
Cash		1,120,000
Purchased 5,000 shares of Corporation B nonvoting preferred stock (5,000 × $224).		

Announcement of earnings:

Investment Accounted for Using the Equity Method	95,000	
Share of Income from Association		95,000
To recognize proportionate share of Corporation A earnings for the year ($380,000 × 0.25).		

No entry for Corporation B.

Dividends received:

Cash	48,000	
Investment Accounted for Using Equity Method		48,000
Received $0.60-per-share cash dividend from Corporation A ($1.20 × 40,000).		
Cash	25,000	
Dividend Revenue		25,000
Received $5.00-per-share cash dividend from Corporation B ($5.00 × 5,000).		

E 12–1 (LO2, LO7) (Continued)

Market value effects:
No entry for Corporation A.

Unrealized Gains or Losses on FVTOCI Financial Assets—Equity	30,000	
Valuation Adjustment for FVTOCI Financial Assets—Equity		30,000
To recognize the investment in Corporation B stock at market [($224 – $218) × 5,000 shares].		

(*Note:* This entry assumes that the decline in value is not permanent. Corporation B stock is considered alone because Corporation A is being accounted for using the equity method.)

3. Sale:

Cash	28,000	
Investment Accounted for Using Equity Method		25,788*
Gains from Sale of Investments in Associates		2,212
Sold 500 shares of Corporation A common stock (500 × $56).		

*($1,920,000+$95,000-$48,000)x(500/40,000)=$25,788(rounded)

E 12–2 (LO5) Investment in FVTPL Financial Assets—Journal Entries

2018				
July	1	FVTPL Financial Assets—Equity, Bateman Company	7,700	
		Brokerage Fees	600	
		Cash		8,300
		Purchased 350 shares at $22 per share plus $600 commission.		
Oct.	31	Cash	700	
		Dividend Revenue		700
		Received a $2.00 per share dividend on 350 shares of Bateman Company stock.		
Dec.	31	FVTPL Financial Assets—Equity, Bateman Company	1,050	
		Valuation Adjustment for FVTPL Financial Assets—Equity, Bateman Company		1,050
		To reduce FVTPL financial assets to market ($7,700 – $6,650).		

E 12–2 (LO5) (Continued)

2019			
Feb. 20	Valuation Adjustment for FVTPL Financial Assets —Equity, Bateman Company	1,225	
	Gains on FVTPL Financial Assets—Equity, Bateman Company		1,225
	Cash	4,550	
	Valuation Adjustment for FVTPL Financial Assets —Equity, Bateman Company		700
	FVTPL Financial Assets—Equity, Bateman Company		3,850
	Sold 175 shares [(175 shares × $26 = $4,550); one-half of original cost of $7,700 is $3,850].		
Oct. 31	Cash	385	
	Dividend Revenue		385
	Received a $2.20 per share dividend on 175 shares of Bateman Company stock.		
Dec. 31	Valuation Adjustment for FVTPL Financial Assets —Equity, Bateman Company	1,750*	
	Gains on FVTPL Financial Assets—Equity, Bateman Company		1,750
	To increase FVTPL financial assets to market given a credit balance in the valuation adjustment account of $525. Cost = $7,700 – $3,850 = $3,850; market = $29 × 175 shares = $5,075.		

*Previous credit balance in Valuation Adjustment account—$525; required debit balance in Valuation Adjustment account—$1,225. Adjustment to Valuation Adjustment account requires a debit of $1,750.

E 12–3 (LO5) Investment in FVTPL Financial Assets—Journal Entries

July	16	FVTPL Financial Assets—Equity, Eli Corporation	60,000	
		Brokerage Fees	2,400	
		Cash		62,400
		Purchased 4,000 shares.		
Sept.	23	Cash	5,000	
		Dividend Revenue		5,000
		Received a cash dividend of $1.25 per share on 4,000 shares of Eli Corporation stock.		
	28	Valuation Adjustment for FVTPL Financial Assets—Equity, Eli Corporation	2,000	
		Gains on FVTPL Financial Assets—Equity, Eli Corporation		2,000
		Cash	31,750	
		Losses on FVTPL Financial Assets—Equity, Eli Corporation	250	
		Valuation Adjustment for Fair Value through Profit or Loss Financial Assets—Equity, Eli Corporation		2,000
		FVTPL Financial Assets—Equity, Eli Corporation		30,000
		Sold 2,000 shares at $16 per share—paid a commission of $250. [Cash = ($16 × 2,000) – $250; investment cost = $60,000 × 1/2; gain = $31,750 – $30,000].		
Dec.	31	Valuation Adjustment for FVTPL Financial Assets—Equity, Eli Corporation	2,700	
		Gains on FVTPL Financial Assets—Equity, Eli Corporation		2,700
		To increase value of financial assets to market [$16.35 × 2,000 shares – ($60,000 – $30,000) = $2,700].		

E 12–4 (LO5) **Investment in FVTPL Financial Assets**

1.

Security	Cost	Market Value (December 31, 2018)
A	$ 400,000	$ 200,000
B	200,000	225,000
C	500,000	600,000
Total	$1,100,000	$1,025,000

A loss of $75,000 ($1,025,000 – $1,100,000) would be recognized, reducing net income to $825,000 ($900,000 – $75,000).

2.

Security	Cost	Market Value (December 31, 2018)
A	$ 400,000	$ 350,000
B	200,000	225,000
C	500,000	600,000
Total	$1,100,000	$1,175,000

If the market value of Security A were $350,000, net income would be increased by $75,000 ($1,175,000 – $1,100,000). Net income would be reported at $975,000 ($900,000 + $75,000).

E 12–5 (LO6) **Investment in FVTOCI Financial Assets-Equity—Journal Entries**

Jan. 14	FVTOCI Financial Assets—Equity, Pinegar Corporation	83,200	
	Cash		83,200
	Purchased 4,000 shares at $20.80 per share.		
Mar. 31	Cash	1,000	
	Dividend Revenue		1,000
	Received a cash dividend of $0.25 per share on 4,000 shares of Pinegar Corporation stock.		
Aug. 28	Valuation Adjustment for FVTOCI Financial Assets—Equity, Pinegar Corporation	2,880	
	Unrealized Gains or Losses on FVTOCI Financial Assets—Equity, Pinegar Corporation		2,880
	Cash	36,160	
	FVTOCI Financial Assets—Equity, Pinegar Corporation		33,280
	Valuation Adjustment for FVTOCI Financial Assets—Equity, Pinegar Corporation		2,880

E 12–5 (LO6) (Continued)

	Unrealized Gains or Losses on FVTOCI Financial Assets—Equity, Pinegar Corporation	2,880	
	Gains from Sale of FVTOCI Financial Assets—Equity, Pinegar Corporation		2,880
	Sold 1,600 shares at $22.60 per share [gain = 1,600 shares × ($22.60 – $20.80) = $2,880].		
Dec. 31	Valuation Adjustment for FVTOCI Financial Assets—Equity, Pinegar Corporation	7,680	
	Unrealized Gains or Losses on FVTOCI Financial Assets—Equity, Pinegar Corporation		7,680
	To increase value of financial assets to market value using valuation adjustment account [2,400 shares × ($24.00 – $20.80) = $7,680].		

E 12–6 (LO6) Investment in Securities

Solitron, Inc. made an irrevocable option to use other comprehensive income to measure the equity investment, so the stock needed to be classified as FVTOCI financial assets-Equity. The journal entries for transactions in the three years are:

2018			
Jan. 17	FVTOCI Financial Assets—Equity, Horner Company	89,500	
	Cash		89,500
	Purchased 2,750 shares.		
May 10	Cash	3,575	
	Dividend Revenue...		3,575
	Received a cash dividend of $1.30 per share on 2,750 shares of Horner Company stock.		
Dec. 31	Unrealized Gains or Losses on FVTOCI Financial Assets—Equity, Horner Company	7,000	
	Valuation Adjustment for FVTOCI Financial Assets—Equity, Horner Company		7,000
	To decrease value of financial assets to market value using valuation adjustment account (2,750 shares × $30.00 = $82,500; $89,500 – $82,500 = $7,000).		

E 12–6 (LO6) (Continued)

2019 May 22	FVTOCI Financial Assets—Equity, Horner Company	30,000	
	Cash		30,000
	Purchased an additional 750 shares for $40 per share.		
July 18	Cash	3,150	
	Dividend Revenue		3,150
	Received a cash dividend of $0.90 per share on 3,500 shares of Horner Company stock.		
Dec. 31	Valuation Adjustment for FVTOCI Financial Assets—Equity, Horner Company	34,500	
	Unrealized Gains or Losses on FVTOCI Financial Assets—Equity, Horner Company		34,500
	To adjust portfolio of FVTOCI *financial assets-Equity to market given a credit balance in the valuation adjustment account from the prior period of $7,000. Market = $147,000 (3,500 shares × $42); Historical cost = $119,500 ($89,500 + $30,000); $147,000 – $119,500 = $27,500, $27,500 + $7,000 = $34,500.*		
2020 June 7	Cash	3,500	
	Dividend Revenue		3,500
	Received a cash dividend of $1.00 per share on 3,500 shares of Horner Company stock.		
Oct. 5	Unrealized Gains or Losses on FVTOCI Financial Assets—Equity, Horner Company	52,500	
	Valuation Adjustment for FVTOCI Financial Assets—Equity, Horner Company		52,500
	Cash	94,500	
	Valuation Adjustment for FVTOCI Financial Assets—Equity, Horner Company	25,000	
	FVTOCI Financial Assets—Equity, Horner Company		119,500

E 12–6 (LO6) (Continued)

Retained Earnings	25,000	
Unrealized Gains or Losses on FVTOCI Financial Assets—Equity, Horner Company		25,000

Dec. 31 No entry.

E 12–7 (LO3, LO4, LO5, LO6) Investment in Bonds and Stock

2018

FVTPL Financial Assets—Debt	2,400	
FVTPL Financial Assets—Equity	3,500	
FVTOCI Financial Assets—Debt	4,200	
FVTOCI Financial Assets—Equity	1,800	
Amortized Cost Financial Assets	11,000	
Cash		22,900
To record the purchase of FVTPL, FVTOCI-Debt, FVTOCI-Equity, and AC financial assets.		
Cash	2,000	
Interest Revenue		1,400
Dividend Revenue		600
Received interest and dividends during the period.		

Sept. 29

Valuation Adjustment for FVTPL Financial Assets—Debt ($1,600 – $1,200)	400	
Gains on FVTPL Financial Assets—Debt		400
Cash	1,600	
FVTPL Financial Assets—Debt		1,200
Valuation Adjustment for FVTPL Financial Assets—Debt		400

Dec. 31

Valuation Adjustment for FVTPL Financial Assets—Debt ($1,700 – $1,200)	500	
Gains on FVTPL Financial Assets—Debt		500
Valuation Adjustment for FVTPL Financial Assets—Equity ($3,600 – $3,500)	100	
Gains on FVTPL Financial Assets—Equity		100

E 12–7 (LO3, LO4, LO5, LO6) (Continued)

Unrealized Gains or Losses on FVTOCI Financial Assets—Debt ($4,200 – $4,000)	200	
Valuation Adjustment for FVTOCI Financial Assets—Debt		200
Valuation Adjustment for FVTOCI Financial Assets—Equity ($1,900 – $1,800)	100	
Unrealized Gains or Losses on FVTOCI Financial Assets—Equity		100

Note: There is no entry to record changes in value of amortized cost financial assets.

E 12–8 (LO3, LO4, LO5) Investment in Securities—Changes in Value

Balances in valuation adjustment accounts as of January 1, 2018:

Valuation Adjustment for FVTPL Financial Assets—Debt		
Historical Cost	$5,400	
Market	4,900	$500 credit
Valuation Adjustment for FVTPL Financial Assets—Equity		
Historical Cost	$2,500	
Market	2,200	$300 credit
Valuation Adjustment for FVTOCI Financial Assets—Debt		
Historical Cost	$4,400	
Market	4,300	$100 credit

Balances that should be in valuation adjustment accounts as of December 31, 2018:

Valuation Adjustment for FVTPL Financial Assets—Debt		
Historical Cost	$5,400	
Market	4,700	$700 credit
Valuation Adjustment for FVTPL Financial Assets—Equity		
Historical Cost	$2,500	
Market	2,400	$100 credit
Valuation Adjustment for FVTOCI Financial Assets—Debt		
Historical Cost	$4,400	
Market	4,500	$100 debit

E 12–8 (LO3, LO4, LO5) (Continued)

Losses on FVTPL Financial Assets—Debt	200	
Valuation Adjustment for FVTPL Financial Assets—Debt		200
To adjust the valuation adjustment account from its $500 credit balance to the required $700 crebit balance.		
Valuation Adjustment for FVTPL Financial Assets—Equity	200	
Gains on FVTPL Financial Assets—Equity		200
To adjust the valuation adjustment account from its $300 credit balance to the required $100 crebit balance.		
Valuation Adjustment for FVTOCI Financial Assets—Debt	200	
Unrealized Gains or Losses on FVTOCI Financial Assets—Debt		200
To adjust the valuation adjustment account from its $100 credit balance to the required $100 debit balance.		

E 12–9 (LO3, LO4, LO5) Investment in Securities—Changes in Value

2018			
Dec. 31	Losses on FVTPL Financial Assets	10,000	
	Valuation Adjustment for Fair Value through or or Loss Financial Assets		10,000
	To record decrease in value of FVTPL financial assets of $10,000 ($55,000 – $45,000).		
	Valuation Adjustment for FVTOCI Financial Assets-Debt	10,000	
	Unrealized Gains or Losses on FVTOCI Financial Assets-Debt		10,000
	.... *To record increase in value of FVTOCI financial assets of $10,000 ($90,000 – $80,000).*		
2019			
Dec. 31	Valuation Adjustment for FVTPL Financial Assets	5,000	
	Gains on FVTPL Financial Assets		5,000
	To record increase in value of FVTPL financial assets of $5,000 (prior credit balance in market adjustment account, $10,000; required credit balance of $5,000).		
	Valuation Adjustment for FVTOCI Financial Assets-Debt	3,000	

Unrealized Gains or Losses on FVTOCI Financial Assets-Debt		3,000
To record increase in value of FVTOCI financial assets of $3,000 (required debit balance of $13,000;prior debit balance in valuation adjustment account, $10,000).		

E 12–10 (LO3, LO4, LO5, LO6) Accounting for the Sale of Securities

Valuation Adjustment for FVTOCI Financial Assets-Debt, London Company [$6,400 – ($5,000 + $600)]	800	
Unrealized Gains or Losses on FVTOCI Financial Assets-Debt, London Company		800
Cash	6,400	
FVTOCI Financial Assets-Debt, London Company		5,000
Valuation Adjustment for FVTOCI Financial Asset-Debt, London Company		1,400
Unrealized Gains or Losses on FVTOCI Financial Assets-Debt, London Company	1,400	
Gains from sale of FVTOCI Financial Assets-Debt, London Company		1,400
Valuation Adjustment for FVTPL Financial Assets, Brown Company [$6,300 – ($6,100 – $800)]	1,000	
Gains on FVTPL Financial Assets, Brown Company		1,000
Cash	6,300	
FVTPL Financial Assets, Brown Company		6,100
Valuation Adjustment for FVTPL Financial Assets, Brown Company		200

E 12–10 (LO3, LO4, LO5,LO6) (Continued)

Unrealized Gains or Losses on FVTOCI Financial Assets-Debt, Shaw Company [$8,700 – ($8,400 + $1,000)]	700	
Valuation Adjustment for FVTOCI Financial Assets-Debt, Shaw Company		700
Cash	8,700	
FVTOCI Financial Assets-Debt, Shaw Company		8,400
Valuation Adjustment for FVTOCI Financial Assets-Debt, Shaw Company		300
Unrealized Gains or Losses on FVTOCI Financial Assets-Debt, Shaw Company	300	
Gains from sale of FVTOCI Financial Assets-Debt, Shaw Company		300
Cash	9,800	
Amortized Cost Financial Assets, Robbins Company		7,200
Gains from sale of Amortized Cost Financial Assets, Robbins Company		2,600

E12-11(LO3, LO4, LO5, LO6) Accounting for the Sale of Securities

Valuation Adjustment for FVTOCI Financial Assets-Equity, London Company [$6,400 – ($5,000 + $600)]	800	
Unrealized Gains or Losses on FVTOCI Financial Assets-Equity, London Company		800
Cash	6,400	
FVTOCI Financial Assets-Equity, London Company		5,000
Valuation Adjustment for FVTOCI Financial Asset-Equity, London Company		1,400
Unrealized Gains or Losses on FVTOCI Financial Assets-Debt, London Company	1,400	
Retained Earnings		1,400
Unrealized Gains or Losses on FVTOCI Financial Assets-Equity, Shaw Company [$8,700 – ($8,400 + $1,000)]	700	
Valuation Adjustment for FVTOCI Financial Assets-Equity, Shaw Company		700
Cash	8,700	
FVTOCI Financial Assets-Equity, Shaw Company		8,400
Valuation Adjustment for FVTOCI Financial Assets-Equity, Shaw Company		300
Unrealized Gains or Losses on FVTOCI Financial Assets-Equity, Shaw Company	300	
Retained Earnings		300

E 12–12 (LO7) Accounting for Investments Using the Equity Method

2018			
Jan. 3	Investment Accounted for Using the Equity Method, Toy Kingdom Co.	2,400,000	
	Cash		2,400,000
July 4	Cash	220,000	
	Investment Accounted for Using the Equity Method, Toy Kingdom Co.		220,000
Dec. 31	Investment Accounted for Using the Equity Method, Toy Kingdom Co.	1,875,000	
	Share of Income from Associates		1,875,000
2019			
Jan. 2	Cash	1,240,000	
	Loss from Sale of Investments in Associates	787,500	
	Investment Accounted for Using Equity Method, Toy Kingdom Co.		2,027,500

($2,027,500= ($2,400,000 - $220,000 + $1,875,000)/2)

E 12–13 (LO7) Investments Accounted for Using the Equity Method

Investment Accounted for Using the Equity Method, Horace Corporation	1,840,000	
Cash		1,840,000
Purchased 40,000 shares representing 40% ownership.		
Investment Accounted for Using the Equity Method, Horace Corporation	55,200	
Share of Income from Associates		55,200
To recognize 40% of net income for the period.		
Cash	10,400	
Investment Accounted for Using Equity the Method, Horace Corporation		10,400
To recognize receipt of dividend.		

No entry to adjust to market value.

E 12–14 (LO5, LO6, LO7) Investment in Stock

1.

FVTPL Financial Assets, Novelties, Inc.	150,000	
Cash		150,000
Purchased 20% of the outstanding common stock.		
Cash	3,000	
Dividend Revenue		3,000
Received a dividend from Novelties, Inc., of $3,000.		

No entry relating to Novelties' net income.

Valuation Adjustment of Fair Value through Profit or Loss Financial Assets, Novelties, Inc	8,000	
Gains on Fair Value through Profit or Financial Assets, Novelties, Inc.		8,000
To adjust FVTPL financial assets to market value.		

2.

FVTOCI Financial Assets-Equity, Novelties, Inc.	150,000	
Cash		150,000
Purchased 20% of the outstanding common stock.		
Cash	3,000	
Dividend Revenue		3,000
Received a dividend from Novelties, Inc., of $3,000.		

No entry relating to Novelties' net income.

E 12–14 (LO5, LO6, LO7) (Continued)

	Valuation Adjustment of FVTOCI Financial Assets-Equity, Novelties, Inc.	8,000	
	Unrealized Gains or Losses on FVTOCI Financial Assets-Equity		8,000
	To adjust FVTOCI financial assets-Equity to market value.		
3.	Investment Accounted for Using the Equity Method, Novelties, Inc.	150,000	
	Cash		150,000
	Purchased 20% of the outstanding common stock.		
	Cash	3,000	
	Investment Accounted for Using Equity the Method, Novelties, Inc.		3,000
	To reduce investment account to reflect receipt of dividend using the equity method.		
	Investment Accounted for Using Equity the Method, Novelties, Inc.	4,000	
	Share of Income from Associates		4,000
	To recognize 20% ownership in net income under the equity method.		

No entry related to increase in market value.

E 12–15 (LO7) Investments in Stock—Equity Method

1. 2018

Jan. 1	Investment Accounted for Using Equity the Method, Weiner Company	850,000	
	Cash		850,000
	Purchased 10,000 shares at $85 per share.		
Dec. 31	Cash	46,000	
	Investment Accounted for Using Equity the Method, Weiner Company		46,000
	Received a $4.60-per-share dividend on 10,000 shares.		
Dec. 31	Investment Accounted for Using Equity the Method, Weiner Company	90,000	
	Share of Income from Associates		90,000
	To recognize proportionate share of earnings (0.25 × $360,000).		

E 12–15 (LO7) (Continued)

2. Partial Balance Sheet

Genco Corporation
Partial Balance Sheet
December 31, 2018

Investments and funds:

Investment accounted for using equity the method
(Equity basis: Cost $850,000; Market $790,000)........................ $894,000

The following T-account helps explain the carrying value of the long-term investment.

Investment Accounting for Using Equity the Method

Jan. 1	850,000		
Dec. 31	90,000	Dec. 31	46,000
Bal.	894,000		

3. Sale:

Cash	79,000	
Losses from Sale of Investments in Associates	10,400	
Investment Accounted for Using the Equity Method......		89,400

Sold 1,000 shares of Genco Corporation common stock (1,000 × $79).

PROBLEMS

P 12–1 (LO5) Investments in FVTPL Financial Assets

The stock investment is classified as FVTPL Financial Assets because the purpose is for sale.

Jan.	1	FVTPL Financial Assets	152,000	
		Cash		152,000
		Purchased 7,600 shares of Soren Corporation stock at $20 per share.		
Apr.	24	Cash	9,120	
		Dividend Revenue		9,120
		Received a cash dividend of $1.20 per share on 7,600 shares of Soren Corporation stock.		
May	5	Valuation Adjustment for FVTPL Financial Assets	6,000	
		Gains on FVTPL Financial Assets		6,000
		Cash	46,000	
		FVTPL Financial Assets		40,000
		Valuation Adjustment for Fair Value through Profit or Loss Financial Assets		6,000
		Sold 2,000 shares of Soren Corporation stock at $23 per share (2,000 × $23 = $46,000; 2,000 × $20 = $40,000).		
July	21	Cash	7,280	
		Dividend Revenue		7,280
		Received a cash dividend of $1.30 per share on 5,600 shares of Soren Corporation stock.		
Aug.	9	Losses on FVTPL Financial Assets	28,000	
		Valuation Adjustment for Fair Value through Profit or Loss Financial Assets		28,000
		Cash	84,000	
		Valuation Adjustment for Fair Value through Profit or Loss Financial Assets	28,000	
		FVTPL Financial Assets		112,000
		Sold Soren Corporation stock at $15 per share (5,600 × $15 = $84,000; 5,600 × $20 = $112,000).		

P 12–2 (LO5, LO6) Investment in Securities—Recording and Analysis

The stock invested in corporation A and the bond invested in Corporation B were for trading purpose, so they were classified as FVTPL Financial Assets. The stock invested in Corporation C was classified as FVTOCI because the company made an irrevocable option to measure the equity investment as fair value through other comprehensive income.

a.	FVTPL Financial Assets—Equity, Corporation A	16,000	
	Commission Fee	200	
	Cash		16,200
	Purchased 400 shares of Corporation A stock at $40 per share plus $200 commission. Classified as FVTPL financial assets.		
b.	FVTPL Financial Assets—Debt, Corporation B	6,000	
	Cash		6,000
	Purchased $6,000 of Corporation B bonds. Classified as FVTPL financial assets.		
c.	Cash	200	
	Dividend Revenue		200
	Received $0.50 per share dividend on 400 shares of Corporation A stock.		
d.	Valuation Adjustment for FVTPL Financial Assets—Equity, Corporation A	600	
	Gains on FVTPL Financial Assets—Equity, Corporation A		600
	Cash	4,600	
	FVTPL Financial Assets—Equity Corporation A Stock		4,000
	Valuation Adjustment for Fair Value through Profit or Loss Financial Assets—Equity, Corporation A		600
	Sold 100 shares of Corporation A stock at $46 per share [$4,600 – ($16,000 ÷ 4) = $600 gain].		
e.	Cash	240	
	Interest Revenue		240
	Received interest of $240 on Corporation B bonds.		

P 12–2 (LO5, LO6) (Continued)

f.	FVTOCI Financial Assets—Equity, Corporation C	3,500	
	Cash		3,500
	Purchased 50 shares of Corporation C stock. Classified as FVTOCI financial assets-Equity.		
g.	Cash	240	
	Interest Revenue		240
	Received interest of $240 on Corporation B bonds.		
h.	Losses on FVTPL Financial Assets—Equity, Corporation A	1,800	
	Valuation Adjustment for FVTPL Financial Assets—Equity, Corporation A		1,800
	Cash	4,200	
	Valuation Adjustment for FVTPL Financial Assets—Equity, Corporation A	1,800	
	FVTPL Financial Assets, Corporation A Stock		6,000
	Sold 150 shares of Corporation A stock at $28 per share.		
i.	Cash	70	
	Dividend Revenue		70
	Received a cash dividend of $1.40 per share on 50 shares of Corporation C stock.		
j.	Bond Interest Receivable	60	
	Interest Revenue		60
	To record accrued interest on Corporation B bonds.		

P 12–2 (LO5, LO6) (Continued)

Cash

(c)	200	(a)	16,200
(d)	4,600	(b)	6,000
(e)	240	(f)	3,500
(g)	240		
(h)	4,200		
(i)	70		
		Bal.	16,150

FVTPL Financial Assets—Equity, Corporation A

(a)	16,000	(d)	4,000
		(h)	6,000
Bal.	6,000		

FVTPL Financial Assets—Debt, Corporation B

(b)	6,000		

FVTOCI Financial Assets—Equity, Corporation C

(f)	3,500		

Bond Interest Receivable

(j)	60		

Dividend Revenue

		(c)	200
		(i)	70
		Bal.	270

Interest Revenue

		(e)	240
		(g)	240
		(j)	60
		Bal.	540

Gains on FVTPL Financial Assets—Equity, Corporation A

		(d)	600

Losses on FVTPL Financial Assets—Equity, Corporation A

(h)	1,800		

P 12–2 (LO5, LO6) (Continued)

From the T-accounts, it is easy to determine the following balances:

1. Dividend revenue $270
2. Interest revenue $540
3. Net loss of $1,200 ($600 – $1,800)

P 12–3 (LO5, LO6) Buying and Selling FVTPL Financial Assets

1. 2018

   [(market 12,000 × $38) – (cost 12,000 × $41)] = $36,000 loss

   2019

   [(cash 2,100 × $46) – (cost 2,100 × $38)] = $16,800 gain
   [(cash 9,900 × $49) – (cost 9,900 × $38)] = $108,900 gain

   2020

   [(cash 1,500 × $40) – (cost 1,500 × $49)] = $13,500 loss
   [(cash 8,400 × $36) – (cost 8,400 × $49)] = $109,200 loss

2. The answer would change in that the unrealized gains and losses would not be included in net income. Unrealized gains or losses result from changes in market values. With FVTOCI financial assets, the unrealized gains or losses wouldn't be included in net income; instead, they would be shown in the section of other comprehensive income and the equity section of the balance sheet. When FVTOCI financial assets-Equity are sold, the unrealzed gains and losses would move from other comprehensive income to retained earnings, and become realized.

P 12–4 (LO4, LO6) Unifying Concepts: Investments in Debt and Equity Securities

1. Journal entries

Jan. 1		
FVTOCI Financial Assets—Debt, McComb Corporation	30,000	
Cash		30,000
Purchased 30, $1,000 McComb Corporation bonds.		
Feb. 15		
FVTOCI Financial Assets—Equity, Gordon Corporation	85,100	
Cash		85,100
Purchased 3,000 shares of Gordon Corporation stock as a long-term investment.		
July 1		
Cash	1,650	
Interest Revenue		1,650
Received semiannual interest payment for McComb Corporation bonds ($30,000 × 0.11 × 1/2 year).		
Sept. 30		
Cash	3,000	
Dividend Revenue		3,000
Received $1.00-per-share dividend on the investment in Gordon Corporation stock ($1.00 × 3,000 shares).		
Oct. 15		
Valuation Adjustment for Sale of FVTOCI Financial Assets—Equity, Gordon Corporation	4,633	
Unrealized Gains or Losses on FVTOCI Financial Assets—Equity, Gordon Corporation		4,633
($85,100/3 = $28,367; $33,000 - $28,367 = $4,633)		
Cash	33,000	
FVTOCI Financial Assets—Equity, Gordon Corporation		28,367
Valuation Adjustment for Sale of FVTOCI Financial Assets—Equity, Gordon Corporation		4,633
Sold 1,000 shares of Gordon Corporation stock		

P 12–4 (LO4, LO6) (Continued)

Unrealized Gains or Losses on FVTOCI Financial Assets—Equity, Gordon Corporation	4,633	
Retained Earnings		4,633
Dec. 31		
Interest Receivable	1,650	
Bond Interest Revenue		1,650
To recognize the interest on McComb Corporation bonds from July 1 to December 31 ($30,000 × 0.11 × 6/12).		

2. Partial Balance Sheet

Heiress Company
Partial Balance Sheet
December 31, 20XX

Assets		
Long-term investments: FVTOCI financial assets		
McComb Corporation bonds (at cost)	$30,000	
Gordon Corporation stock (at cost)	56,733	
	$86,733	
Plus: Valuation adjustment—FVTOCI financial assets-Equity, McComb Corporation	900	
Valuation adjustment—FVTOCI financial assets-Equity, Gordon Corporation .	7,267	$94,900*

*$30,000 × 1.03 = $30,900; 2,000 shares × $32 = $64,000; $30,900 + $64,000 = $94,900.

P 12–5 (LO5) Investments in Equity Securities

1. The investment should be accounted for as an FVTOCI financial asset-Equity because Boston Company owns only 10% of the outstanding voting stock of Richfield Corporation and because it is a long-term investment. In this case, the number of shares of stock acquired by the investor is so small that it is unlikely that it can exercise significant influence over Richfield Corporation.
2. Journal entries

2018		
Mar. 15 FVTOCI Financial Assets—Equity	225,000	
Cash		225,000
Purchased 5,000 shares of Richfield Corporation common stock at $45 per share.		

P 12–5 (LO5) (Continued)

Dec. 1	Cash	12,500	
	Dividend Revenue		12,500
	Received a $2.50-per-share dividend on 5,000 shares from Richfield Corporation.		

31 No entry (The investment is accounted for as FVTOCI Financial Assets-Equity.)

31	Unrealized Gains or Losses on FVTOCI Financial Assets—Equity	15,000	
	Valuation Adjustment for FVTOCI Financial Assets—Equity		15,000
	To reduce investments to market.		

3. **Statement of Comprehensive Income**

Other revenues and expenses:
Dividend revenue $12,500

Balance Sheet

Long-term investments:	
FVTOCI financial assets (at cost)	$225,000
Less valuation adjustment for FVTOCI financial assets	(15,000)
	$210,000

P 12–6 (LO6) Investments in FVTOCI Financial Assets-Equity

1. Analysis of cost and market at December 31, 2018

Corporation	Shares	Cost per Share	Total Cost	Market Price per Share	Total Market Value
A	2,500	$ 40	$100,000	$ 35	$ 87,500
B	2,000	26	52,000	28	56,000
C	2,300	153	351,900	154	354,200
D	750	75	56,250	70	52,500
Totals			$560,150		$550,200

P 12–6 (LO6) (Continued)

Lindorf Company
Partial Balance Sheet
December 31, 2018

Noncurrent assets:		
FVTOCI financial assets—equity	$560,150	
Less Valuation adjustment for FVTOCI financial assets—equity	(9,950)	$550,200
Equity:		
Unrealized gains or losses on FVTOCI financial assets—equity		$ 9,950

Adjusting entry at December 31, 2018:

Unrealized Gains or Losses on FVTOCI Financial Assets—Equity	9,950	
Valuation Adjustment—FVTOCI Financial Assets—Equity		9,950
To adjust FVTOCI financial assets to market.		

2. Dividend revenue, $2,875 (from Corporation A stock)
Other comprehensive income:
Unrealized gains or losses on FVTOCI financial assets—equity, $9,950

3.

Valuation Adjustment for FVTOCI Financial Assets—Equity	750	
Unrealized Gains or Losses on FVTOCI Financial Assets—Equity		750
Cash	53,250	
Valuation Adjustment for FVTOCI Financial Assets—Equity	3,000	
FVTOCI Financial Assets—Equity, Corporation D		56,250
Retained Earnings	3,000	
Unrealized Gains or Losses on FVTOCI Financial Assets—Equity		3,000

P 12–6 (LO6) (Continued)

4. Losses on the write-down of FVTOCI financial assets-Equity to market are unrealized, and because the stock is not likely to be sold soon, these losses must be reported in the equity section of the balance sheet. Losses on the write-down of FVTPL financial assets are included in current income because the stock will be sold soon and the likelihood that a loss will be realized is high.

P 12–7 (LO4, LO5, LO6) Investments in Bonds and Stock

1. July	1	FVTPL Financial Assets—Debt	41,200	
		FVTPL Financial Assets—Equity	75,190	
		FVTOCI Financial Assets—Equity	21,300	
		Cash		137,690
		Purchased securities as a short-term investment.		
Sept.	30	Cash	2,460	
		Dividend Revenue		2,460
		Received dividends on Security 2.		
Dec.	1	Unrealized Gains or Losses on FVTOCI Financial Assets—Equity	3,000	
		Valuation Adjustment for FVTOCI Financial Assets—Equity		3,000
		Cash	18,300	
		Valuation Adjustment for FVTOCI Financial Assets—Equity	3,000	
		FVTOCI Financial Assets—Equity		21,300
		Sold Security 4.		
		Retained Earnings	3,000	
		Unrealized Gains or Losses on FVTOCI Financial Assets—Equity		3,000
	31	Cash	4,300	
		Interest Revenue		4,300
		Received interest on Financial Asset 1 debt financial asset.		

P 12–7 (LO4, LO5, LO6) (Continued)

Investments	Cost	Market	Difference between Cost and Market
Security 1	$ 41,200	$ 40,900	$ (300)
Security 2	23,940	25,550	1,610
Security 3	51,250	44,000	(7,250)
Totals	$116,390	$110,450	$(5,640)

Dec. 31	Losses on FVTPL Financial Assets—Debt	300	
	Losses on FVTPL Financial Assets—Equity	5,640	
	Valuation Adjustment of Fair Value through Profit or Loss Financial Assets—Debt		300
	Valuation Adjustment of Fair Value through Profit or Loss Financial Assets—Equity		5,640
	To reduce FVTPL financial assets to market.		

2.

Wilbur Company
Partial Balance Sheet
December 31, 2018

Current assets:		
FVTPL financial assets	$116,390	
Less valuation adjustment of fair value through profit or loss financial assets—Debt	(300)	
Less valuation adjustment of fair value through profit or loss financial assets—Equity	(5,640)	$110,450

3. **Wilbur Company**

Partial Statement of Comprehensive Income
For the Year Ended December 31, 2018

Other revenue:	
Dividend revenue	$2,460
Interest revenue	4,300

P 12–7 (LO4, LO5, LO6) (Continued)

4.	Dec. 1	Unrealized Gains or Losses on FVTOCI Financial Assets—Debt	3,000	
		Valuation Adjustment for FVTOCI Financial Assets—Debt		3,000
		Cash	18,300	
		Valuation Adjustment for FVTOCI Financial Assets—Debt	3,000	
		FVTOCI Financial Assets—Debt		21,300
		Sold Security 4.		
		Losses from the sale of FVTOCI Financial Assets-Debt	3,000	
		Unrealized Gains or Losses on FVTOCI Financial Assets—Debt		3,000

Wilbur Company
Partial Statement of Comprehensive Income
For the Year Ended December 31, 2018

Other expense:	
Losses from the sale of FVTOCI Financial Assets-Debt	3,000

P 12–8 (LO5, LO6) Unifying Concepts: Short-Term Investments in Stocks and Bonds

1.	2018			
	Mar. 15	FVTPL Financial Assets—Equity, Gates Corp.	25,200	
		Brokerage Fee	815	
		Cash		26,015
		Purchased 1,200 shares of Gates Corporation stock at $21 per share.		
	Apr. 1	FVTOCI Financial Assets—Debt, Micro Co.	39,000	
		Cash		39,000
		Purchased $39,000 of 10% bonds of Micro Company.		

P 12–8 (LO5, LO6) (Continued)

June	3	Cash	900	
		Dividend Revenue		900
		Received a $0.75 per share dividend on 1,200 shares of Gates Corporation stock.		
Oct.	1	Cash	1,950	
		Interest Revenue		1,950
		Received semiannual interest on Micro Company bonds ($39,000 × 0.10 × 6/12 = $1,950).		
Oct.	10	Valuation Adjustment for Fair Value through or Loss Financial Assets—Equity, Gates Corp.	2,000	
		Gains on FVTPL or Loss Financial Assets—Equity, Gates Corp.		2,000
		Cash	10,105	
		Brokerage Fee	295	
		Fair Value through or Loss Financial Assets—Equity, Gates Corp.		8,400
		Valuation Adjustment for Fair Value through or Loss Financial Assets—Equity, Gates Corp.		2,000
		Sold 400 shares of Gates Corporation stock at $26. [Cash: (400 shares × $26) – $295 = $10,105]		
Dec.	31	Bond Interest Receivable	975	
		Interest Revenue		975
		Recognized three months' interest on Micro Company bonds ($39,000 × 0.10 × 3/12 = $975).		
	31	Losses on FVTPL Financial Assets—Equity, Gates Corp.	1,600	
		Valuation Adjustment of Fair Value through Profit or Loss Financial Assets—Equity, Gates Corp.		1,600
		To reduce FVTPL financial assets to market.		

P 12–8 (LO5, LO6) (Continued)

31	Unrealized Gains or Losses of FVTOCI Financial Assets—Debt, Micro Co.	440	
	Valuation Adjustment of FVTOCI Financial Assets—Debt, Micro Co.		440
	To reduce FVTOCI financial assets to market.		

	Cost	Market	Gain (Loss)
Gates Corporation stock—FVTPL financial assets	$16,800	$15,200	$(1,600)
Micro Company bonds—FVTOCI financial assets	39,000	38,560	(440)

P 12–9 (LO5, LO7) Long-Term Investments Using the Equity Method

1. The fact that Century exerts significant influence over Essem dictates that this investment should be accounted for using the equity method.

2. Investment in Fidelity Company

2018			
Jan.10	FVTOCI Financial Assets—Equity, Fidelity Co.	100,800	
	Cash		100,800
	To record the purchase of 8,400 shares of Fidelity Company at $12.		
Dec. 31	Cash	3,360	
	Dividend Income		3,360
	To record dividends received from Fidelity Company.		
31	Unrealized Gains or Losses of FVTOCI Financial Assets—Equity, Fidelity Co.	16,800	
	Valuation Adjustment of FVTOCI Financial Assets—Equity, Fidelity Co.		16,800
	To record the write-down of the investment in Fidelity Company to market value.		

P 12–9 (LO5, LO7) (Continued)

Investment in Essem Corporation

2018			
Jan. 25	Investment Accounted for Using the Equity Method, Essem Corp.	330,000	
	Cash		330,000
	To acquire 15,000 shares (30%) of Essem stock at $22 per share.		
Dec. 31	Investment Accounted for Using the Equity Method, Essem Corp.	30,000	
	Share of Income from Associates		30,000
	To record Century's share of Essem Corporation's earnings for 2018 (30% × $100,000).		
31	Cash	15,000	
	Investment Accounted for Using the Equity Method, Essem Corp.		15,000
	To record dividends from Essem.		

3. $16,800 × (400/8400 shares) = $800 (unrealized losses)
($100,800 - $16,800) × (400/8400 shares) = $4,000
$12 × 400 - $4,000 = $800 (unrealized gains)
$800 - $800 = $0(no gain no loss)

P 12–10 (LO5, LO6) Investment Portfolio

1.

Company	Shares	Cost	Market	Classification
Clarke Corporation	1,000	$ 75,000	$ 78,000	FVTPL Financial Assets
Marlin Company	4,000	136,000	128,000	FVTOCI Financial Assets -Equity
Air Products, Inc.	3,000	138,000	129,000	FVTOCI Financial Assets -Equity

2018			
Dec. 31	Valuation Adjustment of Fair Value through Profit or Loss Financial Assets—Equity	3,000	
	Gains on FVTPL Financial Assets—Equity		3,000
	To write FVTPL financial assets up to market [($78 – $75) × 1,000].		

P 12–10 (LO5, LO6) (Continues)

31	Unrealized Gains or Losses of FVTOCI Financial Assets—Equity	17,000	
	Valuation Adjustment of FVTOCI Financial Assets—Equity		17,000
	To write down FVTOCI financial assets to market [($34 – $32) × 4,000 = $8,000; ($46 – $43) × 3,000 = $9,000; $8,000 + $9,000 = $17,000].		

2.

General Corporation
Balance Sheet
December 31, 2018

FVTPL financial assets—Equity	$ 75,000
Add valuation adjustment for FVTPL financial assets—Equity	3,000
	$ 78,000
FVTOCI financial assets—Equity	$274,000
Less valuation adjustment for FVTOCI financial assets—Equity	(17,000)
	$257,000

3.

Apr. 10	Losses on FVTPL Financial Assets—Equity	6,000	
	Valuation adjustment of Fair value through or Loss Financial Assets—Equity		6,000
	Cash	72,000	
	Valuation adjustment of Fair Value through Profit or Loss Financial Assets—Equity	3,000	
	FVTPL Financial Assets—Equity		75,000
	To sell 1,000 shares of Clarke Corporation stock at $72 per share. Original cost, $75 per share.		

4.

Company	Shares	Cost	Market	Classification
Marlin Company	4,000	$136,000	$148,000	FVTOCI Financial Assets-Equity
Air Products, Inc.	3,000	138,000	132,000	FVTOCI Financial Assets-Equity
Totals		$274,000	$280,000	

P 12–10 (LO5,LO6) (Continued)

2019			
Dec. 31	Valuation Adjustment of FVTOCI Financial Assets—Equity	23,000	
	Unrealized Gains or Losses of FVTOCI Financial Assets—Equity		23,000
	To adjust FVTOCI financial assets from a carrying amount of $257,000 ($274,000 – $17,000) to their market value of $280,000.		

P 12–11 (LO7) Investments in Stocks—Equity Method

1. Reeder owns 40% of Needed Industries' common stock. There is a presumption that the percentage of ownership would result in Reeder exerting significant influence over Needed's operating policies. If Reeder actually exerts that degree of influence, it should account for its investment in Needed using the equity method. If, in fact, it cannot exert significant influence, Reeder should account for the investment as an FVTOCI financial asset. Because the problem does not indicate the degree of influence, the following solution is based on the probability that significant influence exists. Therefore, the investment is accounted for using the equity method.

2.

2018			
Mar. 20	Investment Accounted for Using the Equity Method, Needed Industries	2,560,000	
	Cash		2,560,000
	To purchase 40,000 shares (40%) of Needed Industries' common stock at $64.		
Nov. 15	Cash	120,000	
	Investment Accounted for Using the Equity Method, Needed Industries		120,000
	To record a cash dividend received of $3.00 per share on 40,000 shares of Needed Industries' common stock.		
Dec. 31	Investment Accounted for Using the Equity Method, Needed Industries	100,000	
	Share of Income from Associates		100,000
	To reflect an increase in the equity interest in Needed Industries (40% × $250,000 earnings = $100,000).		

P 12–11 (LO7) (Continued)

2019			
Jan. 6	Cash	700,000	
	Investment Accounted for Using the Equity Method, Needed Industries		635,000
	Gains from Sale of Investments in Associates		65,000

P 12–12 (LO6, LO7) Long-Term Investments in Stock—FVTOCI-Equity and Equity Method

1. a. FVTOCI-Equity

2018			
Feb. 15	FVTOCI Financial Assets—Equity, Hendershot Equipment	400,000	
	Cash		400,000
	Purchased 10,000 shares of Hendershot Equipment common stock ($40 × 10,000 shares).		
Dec. 1	Cash	8,000	
	Dividend Revenue		8,000
	Received $0.80-per-share cash dividend from Hendershot Equipment ($0.80 × 10,000 shares).		
Dec. 31	Unrealized Gains or Losses of FVTOCI-Equity Financial Assets—Equity	30,000	
	Valuation Adjustment of FVTOCI Financial Assets—Equity		30,000
	To recognize decline in value of investments ($3 per share × 10,000 shares).		
31	No entry related to Hendershot's net income.		

P 12–12 (LO6, LO7) (Continued)

2019				
July	**1**	**Valuation Adjustment of FVTOCI Financial Assets—Equity**	**50,000**	
		Unrealized Gains or Losses of FVTOCI Financial Assets—Equity		**50,000**
		Cash	**420,000**	
		FVTOCI Financial Assets—Equity Hendershot Equipment		**400,000**
		Valuation Adjustment of FVTOCI Financial Assets—Equity		**20,000**
		Sold long-term investment in Hendershot Equipment ($42 × 10,000 shares = $420,000; $40 × 10,000 shares = $400,000).		
		Unrealized Gains of FVTOCI Financial Assets—Equity	**20,000**	
		Retained Earnings		**20,000**

b. Equity Method

2018				
Feb.	**15**	**Investment Accounted for Using the Equity Method, Hendershot Equipment**	**400,000**	
		Cash		**400,000**
		Purchased 10,000 shares (20%) of Hendershot Equipment common stock ($40 × 10,000 shares).		
Dec.	**1**	**Cash**	**8,000**	
		Investment Accounted for Using the Equity Method, Hendershot Equipment		**8,000**
		Received $0.80-per-share cash dividend from Hendershot Equipment ($0.80 × 10,000 shares).		

P 12–12 (LO6, LO7) (Continued)

	31	No entry to value financial assets at market.		
	31	Investment Accounted for Using the Equity Method, Hendershot Equipment	24,000	
		Share of Income from Associates		24,000
		To recognize proportionate share of Hendershot Equipment earnings for the year ($120,000 × 20%).		
2019				
July	1	Cash	420,000	
		Investment Accounted for Using the Equity Method, Hendershot Equipment		416,000
		Gains from Sale of Investment in Associates		4,000
		Sold long-term investment in Hendershot Equipment ($42 × 10,000 shares = $420,000; $400,000 – $8,000 + $24,000 = $416,000).		

2. Partial statements

Merrill Company
Partial Balance Sheet
December 31, 2018

	FVTOCI Financial Assets-Equity	Equity Method
Investments and funds:		
Investment in common stock	$400,000	$416,000
Less valuation adjustment	(30,000)	
	$370,000	
Equity:		
Unrealized gains or losses of FVTOCI financial assets-Equity	$(30,000)	

P 12–12 (LO6, LO7) (Continued)

Merrill Company
Partial Statement of Comprehensive Income
For the Year Ended December 31, 2018

	FVTOCI Financial Assets-Equity	Equity Method
Other revenue:		
Dividend revenue	$8,000	
Share of Income from Associates		$24,000

3. Merrill should use the equity method only if it exercises significant influence over Hendershot Equipment's operations and dividend policy. The suggested guide for considering significant influence is whether the investor owns at least 20 to 50% of the stock. Because Merrill owns 10,000 shares of Hendershot (20% of the 50,000 total outstanding shares), use of the equity method would be determined by whether Merrill actually exercised significant influence over Hendershot.

ANALYTICAL ASSIGNMENTS

AA 12–1 Classification of Securities

Discussion

Classifying the securities as FVTOCI Financial Assets-Equity will allow any changes in value to be reported only in the equity section of the balance sheet; increases and decreases in the value of FVTPL financial assets must be recognized on the statement of comprehensive income. As the auditor, you should not allow the company to classify what are really FVTPL financial assets in any other way. Accounting rules have been established to give guidance for situations such as this one.

AA 12–2 Is It OK to Strategically Classify Financial Assets?

Ethics

First of all, you need to find out more about the accounting rules. A little research will tell you that the classification of a financial asset should be determined when that financial asset is first acquired, not at the end of the year, and is not based on whether the financial asset experienced a gain or a loss. With this authoritative basis, it will be easier to convince the chairman of the board that the classification policy should be changed. You should point out that the external auditors will almost certainly reject the classification scheme and that the management of Clefton will lose credibility with the auditors if they advocate this shady scheme.

In summary, this is not a time to give a morality lecture to the chairman of the board. You should document the correct accounting treatment, outline the nasty audit consequences if the classification scheme is not changed, and hope that the chairman of the board sees that the only feasible course of action is to tell the chief accountant to adopt a more reasonable investment financial asset classification plan.

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EXPANDED MATERIAL

DISCUSSION QUESTIONS

12. Consolidated financial statements are prepared when a corporation owns more than 50% of the stock of another company (a controlling interest).

13. In the consolidated balance sheet, minority interest is the amount of equity investment made by outside shareholders to consolidated subsidiaries that are not 100% owned by the parent. In the consolidated statement of comprehensive income, minority interest income (shown as a subtraction) reflects the amount of income belonging to outside shareholders of consolidated subsidiaries that are not 100% owned.

PRACTICE EXERCISES

PE 12–16 (LO8) Consolidated Financial Statements

Parent Company will report \$63,000 (\$70,000 × 0.90) as Income from Sub on its own statement of comprehensive income. On the consolidated financial statements, all of Sub's revenue and expenses will be reported. Also reported will be Minority Interest in the amount of \$7,000.

EXERCISES

E 12–16 (LO8) Consolidated Financial Statements—Balance Sheet

1. The minority interest is the amount of equity investment made by outside shareholders to consolidated subsidiaries that are not 100% owned by the parent.

   Minority interest = 0.30 × $2,500 (equity of subsidiary) = $750

2. Ecotec Inc.
   Consolidated Balance Sheet
   January 1, 2018

Assets	
Cash ($820 + $520)	$1,340
Other current assets ($3,750 + $2,480)	6,230
Property, plant, and equipment ($2,200 + $1,700)	3,900
Total assets	$11,470
Liabilities and Equity	
Current liabilities ($2,450 + $1,600)	$4,050
Long-term liabilities ($1,550 + $600)	2,150
Minority interest ($2,500 × 0.30)	750
Common stock	1,600
Retained earnings	2,920
Total liabilities and equity	$11,470

E 12–17 (LO8) Consolidated Financial Statements—Statement of Comprehensive Income

1. Minority interest income reflects the amount of income belonging to outside shareholders of consolidated subsidiaries that are not 100% owned.

   Minority interest income = $150 × 0.20 = $30

2. Limbo Inc.
   Consolidated Statement of Comprehensive Income
   For the Year Ended December 31, 2018
   (in thousands)

Sales ($5,440 + $1,025)	$ 6,465
Interest revenue ($95 + $25)	120
	$ 6,585
Cost of goods sold ($3,550 + $700)	(4,250)
Other operating expenses ($1,020 + $175)	(1,195)
Interest expense ($350 + $25)	(375)

E 12–17 (LO8) (Continued)

Minority interest income ($150 × 0.20)...	(30)
Net income..	$ 735

3. Consolidated net income is always the same as net income reported by the parent if the financial statements are prepared using the equity method. The equity method is sometimes called "one-line consolidation"—it reports the same net income but doesn't give all of the detail that is reported with consolidation.

PROBLEMS

P 12–13 (LO8) Consolidated Financial Statements

1.

Parent Company
Consolidated Balance Sheet

Assets	
Cash ($120 + $40 + $30)	$ 190
Accounts receivable ($500 + $120 + $90)	710
Plant and equipment ($1,050 + $400 + $160)	1,610
Investment in Sub 3	84
Total assets	$2,594
Liabilities	
Liabilities ($900 + $240 + $150)	$1,290
Minority Interest [($320 × 0.10) + ($130 × 0.40)]	84
Equity	
Equity	1,220
Total liabilities and equities	$2,594

2.

Parent Company
Consolidated Statement of Comprehensive Income

Sales ($6,420 + $3,000 + $3,000)	$12,420
Income from Sub 3	160
Expenses ($4,200 + $2,600 + $2,200)	(9,000)
Minority interest income [($400 × 0.10) + ($800 × 0.40)]	(360)
Net income	$ 3,220

3. Return on sales would decrease significantly if Sub 3 were consolidated. This would result from the fact that Sub 3's return on sales is quite low (5% = $400/$8,000). With the equity method, Sub 3's individual return on sales does not impact consolidated return on sales; the only impact comes from Parent's percentage of Sub 3's net income.

SOLUTIONS TO "STOP & THINK"

Stop & Think (p. 503): Why else might companies purchase interests in other companies?

Additional reasons for purchasing an interest in another company might include (1) taking advantage of the economies of scale available with a larger company, (2) the target company (the company being purchased) might be undervalued by the market, (3) the target company's management is inefficient, or (4) preventing a hostile takeover of the target company.