EXPANDED MATERIAL

LO8 Understand the basics of consolidated financial statements.

- Consolidated financial statements are prepared when a parent has control over another company (as is usually true with ownership of more than 50%).
- All of the assets, liabilities, revenues, and expenses of the parent and the majority-owned subsidiaries are added in preparing the consolidated financial statements.

Key Terms & Concepts

- amortized cost (AC) financial assets, 505
- debt securities, 504
- equity method, 506
- equity securities (stock), 504
- fair value through other comprehensive income (FVTOCI) financial assets—debt, 505
- fair value through other comprehensive income (FVTOCI) financial assets—equity, 506
- fair value through profit or loss (FVTPL) financial assets—debt, 505
- fair value through profit or loss (FVTPL) financial assets—equity, 506

Review Problem

Investments in Debt and Equity Securities

On January 1, 2018, Schultz, Inc., purchased the following securities. According to Schultz's business model and the intention to influence the decisions of the investees, Schultz classifies the securities as follows:

Security	Type	Classification	Cost
1	Debt	FVTPL financial assets	$2,500
2	Debt	FVTPL financial assets	1,500
3	Equity	FVTPL financial assets	1,750
4	Debt	FVTOCI financial assets—debt	4,300
5	Equity	FVTOCI financial assets—equity	2,750

On March 31, one-half of Security 2 was sold for $900. During the year, interest and dividends were received as follows:

Security	Interest	Dividends
1	$200	
2	85	
3		none
4	435	
5		$200

The following fair market values are available on December 31, 2018. Schultz had no balance in its valuation adjustment accounts on January 1, 2018.

Security	Market Value
1	$2,400
2	950
3	1,600
4	4,250
5	2,900

Required:

Record all necessary journal entries to account for these investments during 2018.

Solution:

To account for these investments, four events must be accounted for:

1. The initial purchase on January 1.
2. The sale of one-half of Security 2 on March 31.
3. The receipt of interest and dividends during the year.
4. The changes in value as of December 31.

1. The initial purchase:

Jan. 1	FVTPL Financial Assets—Debt	4,000	
	FVTPL Financial Assets—Equity	1,750	
	FVTOCI Financial Assets—Debt	4,300	
	FVTOCI Financial Assets—Equity	2,750	
	Cash		12,800
	To record the purchase of FVTPL and FVTOCI financial assets.		

2. The sale of one-half of Security 2 on March 31:

Mar. 31	Valuation Adjustment for FVTPL Financial Assets—Debt	150	
	Gains on FVTPL Financial Assets—Debt		150

Mar. 31	Cash	900	
	FVTPL Financial Assets—Debt		750
	Valuation Adjustment for FVTPL Financial Assets—Debt		150
	Sold one-half of Security 2 ($750 carrying amount) for $900. Recorded the $150 gain from sale of the security ($900 – $750).		

3. The receipt of interest and dividends during the year:

	Cash	920	
	Interest Revenue		720
	Dividend Revenue		200
	Received $720 in interest during the year and $200 in dividends.		

Note: Even if cash were not received by year-end, the interest and dividends earned would need to be recorded, with the offsetting debit to a receivable account(s).

4. The changes in value as of December 31, 2018:

Dec. 31	Valuation Adjustment for FVTPL Financial Assets—Debt	100	
	Gains on FVTPL Financial Assets—Debt		100

Dec. 31	Losses on FVTPL Financial Assets—Equity	150	
	Valuation Adjustment for FVTPL Financial Assets—Equity		150
	To account for the difference between carrying amount ($3,250/ $1,750) and fair market value ($3,350/ $1,600) of FVTPL Financial Assets		

Dec. 31	Unrealized Gains or Losses on FVTOCI Financial Assets—Debt	50	
	Valuation adjustment for FVTOCI Financial Assets—Debt		50

Dec. 31	Valuation adjustment for FVTOCI Financial Assets—Equity.	150	
	Unrealized Gains or Losses on FVTOCI Financial Assets—Equity		150
	To account for the difference between carrying amount ($4,300/ $2,750) and fair market value ($4,250/ $2,900) of FVTOCI financial assets		

Put it on Paper

Discussion Questions

1. Why do firms invest in assets that are not directly related to their primary business operations?
2. What are the three different classifications of debt and the four different classifications of equity securities?
3. When will a security be classified as "FVTPL"?
4. What types of securities can be classified as "amortized cost financial assets"?
5. To be classified as an investment accounted for using the equity method, the investor must typically own at least a certain percentage of the outstanding common stock of the investee. What is that minimum percentage? That percentage of ownership represents the investor's ability to do what?
6. When a security is sold, what information must be known to account for that transaction?
7. What does the valuation adjustment account represent?
8. What is the major difference between FVTOCI financial assets—debt and FVTOCI financial assets—equity when selling the securities to the third party?
9. How are changes in the value of FVTOCI financial assets accounted for on the books of the investor?
10. What is the process for adjusting the value of an FVTPL or FVTOCI financial asset after a valuation account has been established?
11. Why aren't changes in the value of amortized cost financial assets and investments accounted for using the equity method on the books of the investor?

Practice Exercises

PE 12-1
LO 1

Why Companies Invest in Other Companies

Which one of the following is *not* a primary reason companies invest in other companies?

a. To earn return on excess cash
b. To eliminate risk in other investments
c. To gain influence over another company
d. To gain control over another company

PE 12-2
LO 2

Classifying a Security

Which one of the following types of investments is *always* an example of a debt security?

a. FVTOCI financial assets
b. FVTPL financial assets
c. Amortized cost financial assets
d. Investment accounted for using the equity method

PE 12-3
LO 2

Investment Accounted for Using the Equity Method

What is the general rule for what percentage an entity must own in another company to account for the investment using the equity method?

a. The entity should own 20% to 50% of the other company's outstanding voting stock.
b. The entity should own 5% to 10% of the other company's outstanding voting stock.
c. The entity should own 50% to 90% of the other company's outstanding voting stock.
d. The entity should own 10% to 20% of the other company's outstanding voting stock.

PE 12-4
LO 2

Valuation of Securities

Which two of the following classifications of securities are valued at fair value on a company's balance sheet?

a. FVTOCI financial assets
b. Investments accounted for using the equity method
c. FVTPL financial assets
d. Amortized cost financial assets

PE 12-5
LO 3

Accounting for Amortized Cost Financial Assets at Par

Tai Ping Carpets International Company had the following transactions in 2018.

Jan.	1	Purchased bonds of Ropa Corporation for NT$50,000 as a long-term investment. The 10-year bonds pay interest every year at a rate of 8% and the market rate is 8%.
July	1	Received semiannual interest on Ropa Co. bonds.
Dec.	1	Received semiannual interest and sold half of bonds for $30,000.

Prepare journal entries to record transactions during 2018.

PE 12-6
LO 3

Accounting for Amortized Cost Financial Assets at Par

On July 1, 2018, Central Pictures Corporation purchased 50 $1,000 amortized cost bonds of Milkyway Image Company. The bond was classified as amortized cost. The bonds mature in five years and pay interest at an annual rate of 12%. The market rate was 12%. On December 31, Central Pictures sold twenty bonds for $18,000.

Prepare journal entries to record transactions during 2018.

PE 12-7
LO 4
LO 5
LO 6

Accounting for the Purchase of FVTPL and FVTOCI Financial Assets

Viella Company purchased the following securities with cash:

Security	Type	Classification	Cost (including Broker's Fees)
1	Equity	FVTPL financial assets	$ 55,000
2	Equity	FVTOCI financial assets—equity	106,000
3	Debt	FVTOCI financial assets—debt	23,000
4	Debt	FVTPL financial assets	40,000

Make the necessary journal entry (or entries) to record the purchase of these securities.

PE 12-8
LO 4
LO 5
LO 6

Accounting for the Return Earned on an Investment

Refer to the data in PE 12-7. Viella Company received the following interest and dividends from its securities investments during the year:

Security	Interest	Dividends
1		$1,500
2		4,000
3	$1,000	
4	5,500	

Make the necessary journal entry (or entries) to record the receipt of interest and dividends during the year.

PE 12-9 LO 4 LO 5 LO 6

Accounting for the Sale of Securities

Refer to the data in PE 12-7. Near the end of the year, Viella Company sold Security 1 for $50,000. Make the necessary journal entry (or entries) to record the sale.

PE 12-10 LO 5

Changes in Value of FVTPL Financial Assets

At the end of the year, Viella Company had the following securities:

Security	Classification	Historical Cost	Market Value (December 31)
1	FVTOCI financial assets—debt	$52,000	$52,400
2	FVTOCI financial assets—equity	12,300	11,500
3	FVTPL financial assets	23,500	24,250

Make the necessary journal entry (or entries) to record the change in value of the company's FVTPL financial asset (Security 3).

PE 12-11 LO 4 LO 6

Changes in Value of FVTOCI Financial Assets

Refer to the data in PE 12-10. Make the necessary journal entry (or entries) to record the change in value of the company's FVTOCI financial assets—debt and FVTOCI financial assets—equity.

PE 12-12 LO 5

Subsequent Changes in Value of FVTPL Financial Assets

At the end of 2019, D'Espagne Company owned the following financial asset (which was originally purchased during 2018 for $60,000 and had a market value at the end of 2018 of $64,000). The company purchased the stock not for trading purpose, nor did it make an irrevocable choice to classify the investment as an FVTOCI financial asset.

Classification	Historical Cost	Market Value (December 31, 2019)
FVTPL financial assets—equity	$60,000	$58,000

Make the necessary journal entry (or entries) to record the change in value of the financial asset in 2019.

PE 12-13 LO 6

Accounting for FVTOCI Financial Assets—Equity

Assume that Eslite Bookstore purchased 15% of the 20,000 shares of Yuen Foong Paper Company at a cost of NT$30 per share on January 4, 2018. On June 30, Yuen Foong declared and paid a $80,000 dividend. On December 31, Yuen Foong reported net income of NT$5,800,000 during 2018 and the market price of Yuen Foong Paper Company was NT$28 per share. The shares are classified as FVTOCI financial asset—equity.

Prepare the entries needed to record the transactions.

PE 12-14 LO 7

Accounting for Investments Using the Equity Method

Manwill Company owns 40% (30,000 shares) of Hall Company's voting stock. Since Manwill has a significant interest in Hall, it uses the equity method of accounting for the investment. Hall reported the following information for the year:

1. Hall earned net income of $80,000.
2. Hall paid dividends of $20,000.
3. Hall's stock value increased from $40 to $45.

Make the necessary journal entry (or entries) to record the change in value of Manwill's investment in Hall.

PE 12-15 LO 7

Accounting for Investments Using the Equity Method

On January 2, 2018, Goldenliva Company purchased 25% (5,000 shares) of Howard Hotel for NT$100,000. On July 30, Howard Hotel declared and paid an NT$40,000 dividend. On December 31, Howard Hotel reported net income of NT$1,750,000.

Make the entries necessary to record the transactions during 2018.

Exercises

E 12-1
LO 2
LO 7

Long-Term Investments Using the Equity Method

During January 2018, Danbury, Inc., acquired 40,000 shares of Corporation A common stock for $48 per share. In addition, it purchased 5,000 shares of Corporation B preferred (nonvoting) stock for $224 per share. Corporation A has 160,000 shares of common stock outstanding, and Corporation B has 12,000 shares of nonvoting stock outstanding. Danbury anticipates holding both securities for at least five years.

The following data were obtained from operations during 2018:

	2018
Net income:	
Corporation A	$380,000
Corporation B	160,000
Dividends paid (per share):	
Corporation A	$1.20
Corporation B	5.00
Market value per share on December 31:	
Corporation A	$ 50
Corporation B	218

Required:

1. **Interpretive Question:** What method should Danbury, Inc., use in accounting for the investment in Corporation A stock? Why? What accounting method should be used in accounting for Corporation B nonvoting stock? Why?
2. Prepare the journal entries necessary to record the transactions for 2018.
3. On January 2, 2019, Danbury Inc. sold 500 shares of Corporation A stock at a price of $56 per share. Prepare the entry to record the sale of stock.

E 12-2
LO 5

Investment in FVTPL Financial Assets—Journal Entries

Prepare the journal entries to account for the following investment transactions of Samuelson Company:

2018

July	1	Purchased 350 shares of Bateman Company stock at $22 per share plus a brokerage fee of $600. Because Samuelson held the Bateman stock neither to collect interest and principal nor to collect interest and to sell, the Bateman stock is classified as FVTPL financial asset.
Oct.	31	Received a cash dividend of $2.00 per share on the Bateman stock.
Dec.	31	At year-end, Bateman stock had a market price of $19 per share.

2019

Feb.	20	Sold 175 shares of the Bateman stock for $26 per share.
Oct.	31	Received a cash dividend of $2.20 per share on the Bateman stock.
Dec.	31	At year-end, Bateman stock had a market price of $29 per share.

E 12-3
LO 5

Investment in FVTPL Financial Assets—Journal Entries

In June 2018, Hatch Company had no financial assets but had excess cash that would not be needed for nine months. Management decided to use this money to purchase FVTPL financial assets as a short-term investment. The following transactions relate to the investments:

July	16	Purchased 4,000 shares of Eli Corporation stock. The price paid, including brokerage fees of $2,400, was $62,400.
Sept.	23	Received a cash dividend of $1.25 per share on the Eli stock.
	28	Sold 2,000 shares of Eli stock at $16 per share. Paid a selling commission of $250.
Dec.	31	The market value of Eli stock was $16.35 per share.

Given these data, prepare the journal entries to account for Hatch's investment in Eli stock.

E 12-4
LO 5

Investment in FVTPL Financial Assets

During 2018, JAT Company purchased some securities as a short-term investment. The securities were held for sale purpose and treated as FVTPL financial assets. The costs of the securities and their market values on December 31, 2018, are listed below.

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

JAT had no FVTPL financial assets in the years before 2018. Before any adjustments related to these FVTPL financial assets, JAT had net income of $900,000 in 2018.

1. What is net income (ignoring income taxes) after making any necessary FVTPL financial asset adjustments?
2. What would net income be if the market value of Security A were $350,000?

E 12-5
LO 6

Investment in FVTOCI Financial Assets—Equity—Journal Entries

Bird Beak Corporation made the following FVTOCI financial assets—equity transactions:

Jan.	14	Purchased 4,000 shares of Pinegar Corporation common stock at $20.80 per share.
Mar.	31	Received a cash dividend of $0.25 per share on the Pinegar stock.
Aug.	28	Sold 1,600 shares of Pinegar stock at $22.60 per share.
Dec.	31	The market value of the Pinegar stock was $24 per share.

Prepare journal entries to record the transactions.

E 12-6
LO 6

Investment in Securities

In January 2018, Solitron, Inc. determined that it had excess cash on hand and decided to invest in Horner Company stock. Solitron intends to hold the stock for a period of three to five years and Solitron, Inc. made an irrevocable option to measure the equity investment as fair value through other comprehensive income. The following transactions took place in 2018, 2019, and 2020:

2018		
Jan.	17	Purchased 2,750 shares of Horner stock for $89,500.
May	10	Received a cash dividend of $1.30 per share on Horner stock.
Dec.	31	The market value of the Horner stock was $30 per share.
2019		
May	22	Purchased 750 shares of Horner stock at $40 per share.
July	18	Received a cash dividend of $0.90 per share on the Horner stock.
Dec.	31	The market value of the Horner stock was $42 per share.
2020		
June	7	Received a cash dividend of $1 per share on the Horner stock.
Oct.	5	Sold the Horner stock at $27 per share for cash.
Dec.	31	The market value of the Horner stock was $25 per share.

Classify the financial assets to proper measurements and prepare the journal entries required to record each of these events.

E 12-7
LO 3
LO 4
LO 5
LO 6

Investment in Bonds and Stock

Andrews, Inc., purchased the following securities during 2018. According to Andrews, Inc.'s business model:

Security	Type	Classification	Cost
1	Debt	FVTPL financial assets	$ 2,400
2	Equity	FVTPL financial assets	3,500
3	Debt	FVTOCI financial assets—debt	4,200
4	Equity	FVTOCI financial assets—equity	1,800
5	Debt	Amortized cost financial assets	11,000

During 2018, Andrews received interest of $1,400 and dividends of $600 on its investments. On September 29, 2018, Andrews sold one-half of Security 1 for $1,600. On December 31, 2018, the portfolio of securities had the following fair market values:

Security	Fair Market Value
1	$ 1,700
2	3,600
3	4,000
4	1,900
5	12,000

Andrews had no balance in its valuation adjustment accounts at the beginning of the year. Prepare the journal entries required to record the purchase of the securities, the receipt of interest and dividends, the sale of securities, and the adjustments required at year-end.

E 12-8

LO 3 LO 4 LO 5

Investment in Securities—Changes in Value

Sharp, Inc., had the following portfolio of investment financial assets on January 1, 2018:

Security	Type	Classification	Historical Cost	Fair Market Value (1/1/18)
1	Debt	FVTPL financial assets	$2,000	$1,600
2	Equity	FVTPL financial assets	2,500	2,200
3	Debt	FVTPL financial assets	3,400	3,300
4	Debt	FVTOCI financial assets—debt	4,400	4,300
5	Debt	Amortized cost financial assets	3,600	3,500

Appropriate adjustments have been made in prior years. No securities were bought or sold during 2018. On December 31, 2018, Sharp's portfolio of securities had the following fair market values:

Security	Fair Market Value (12/31/18)
1	$1,300
2	2,400
3	3,400
4	4,500
5	3,700

Prepare the necessary adjusting entry (or entries) on December 31, 2018.

E 12-9

LO 3 LO 4 LO 5

Investment in Securities—Changes in Value

Indonesia, Inc., held the following portfolio of securities on December 31, 2018 (the end of its first year of operations):

	Cost	Market Value (12/31/18)
FVTPL financial assets	$55,000	$45,000
FVTOCI financial assets—debt	80,000	90,000
Amortized cost financial assets	75,000	80,000

No additional securities were bought or sold during 2019. On December 31, 2019, Indonesia's securities had a fair market value of:

FVTPL financial assets	$50,000
FVTOCI financial assets—debt	93,000
Amortized cost financial assets	70,000

Prepare the entries required at the end of 2018 and 2019 to properly adjust Indonesia's portfolio of securities.

E 12-10
LO 3 LO 4 LO 5 LO 6

Accounting for the Sale of Securities

Shay Company owns the following securities, which it is interested in selling:

Security	Type	Cost	Valuation Adjustments (net)	Market Price
London Company	FVTOCI financial assets—debt	$5,000	$ 600 increase	$6,400
Brown Company	FVTPL financial assets	6,100	800 decrease	6,300
Shaw Company	FVTOCI financial assets—debt	8,400	1,000 increase	8,700
Robbins Company	Amortized cost financial assets	7,200	None	9,800

Prepare the journal entry to record the sale of these securities.

E 12-11
LO 3 LO 4 LO 5 LO 6

Accounting for the Sale of Securities

Refer to the data of E 12-10, assume the FVTOCI financial assets are equity, instead of debt. Shay Company owns the following securities, which it is interested in selling:

Security	Type	Cost	Valuation Adjustments (net)	Market Price
London Company	FVTOCI financial assets—equity	$5,000	$ 600 increase	$6,400
Brown Company	FVTPL financial assets	6,100	800 decrease	6,300
Shaw Company	FVTOCI financial assets—equity	8,400	1,000 increase	8,700
Robbins Company	Amortized Cost financial assets	7,200	None	9,800

Prepare the journal entry to record the sale of security of London Company and Shaw Company.

E 12-12
LO 7

Accounting for Investments Using the Equity Method

Assume that during 2018, Hong Kong Disneyland Company purchased 40,000 shares of Toy Kingdom Co. stock for $60 per share. Toy Kingdom Co. had a total 160,000 shares of stock outstanding.

1. Prepare journal entries for the following transactions:

Jan.	3	Purchased 40,000 shares of common stock at $60.
July	4	Toy Kingdom declared and paid a $5.5-per-share dividend.
Dec.	31	Toy Kingdom reported net income of $7,500,000.

2. On January 2, 2019, Disneyland Company decided to sell a half of its shares of Toy Kingdom Co. stock for $62 per share. Prepare the journal entry to record the sale.

E 12-13
LO 7

Investments Accounted for Using the Equity Method

On January 3, 2018, Jorgenson, Inc., purchased 40,000 shares of the outstanding common stock of Horace Corporation. At the time of this transaction, Horace has 100,000 shares of common stock outstanding. The cost of the purchase (including brokerage fees) was $46 per share. During the year, Horace reported income of $138,000 and paid dividends of $26,000. On December 31, 2018, Horace's stock was valued at $56 per share. Provide the entries necessary to record the above transactions.

E 12-14
LO 5 LO 6 LO 7

Investments in Stock

Foster Enterprises purchased 20% of the outstanding common stock of Novelties, Inc., on January 2, 2018, paying $150,000. During 2018, Novelties reported net income of $20,000 and paid dividends to shareholders of $15,000. On December 31, 2018, Foster's investment in Novelties stock had a fair market value of $158,000. Assuming this is the only security owned by Foster, prepare all journal entries required by Foster in 2018 assuming:

1. The security is classified as a FVTPL financial asset.
2. The security is classified as an FVTOCI financial asset—equity.
3. The equity method is applied to the investment.

E 12-15

LO 7

Investments in Stock—Equity Method

During 2018, Genco Corporation purchased 10,000 shares of Wiener Company stock for $85 per share. Wiener had a total of 40,000 shares of stock outstanding.

1. Prepare journal entries for the following transactions:

Jan.	1	Purchased 10,000 shares of common stock at $85.
Dec.	31	Wiener declared and paid a $4.60-per-share dividend.
	31	Wiener reported net income for 2018 of $360,000.

2. On December 31, 2018, the market price of Wiener's stock was $79 per share. Show how this investment would be reported on Genco's balance sheet at December 31, 2018, assuming that this is the only stock investment owned by Genco.
3. On January 2, 2019, Genco Corporation sold 1,000 shares of Wiener Company stock at $79 per share. What's the entry to make?

PROBLEMS

P 12-1

LO 5

Investments in FVTPL Financial Assets

In December 2018, the treasurer of Toth Company concluded that the company had excess cash on hand and decided to invest in Soren Corporation stock. The company intends to hold the stock for a period of 6 to 12 months and the only purpose for the stock investment is for sale. The following transactions took place:

Jan.	1	Purchased 7,600 shares of Soren Corporation stock for $152,000.
Apr.	24	Received a cash dividend of $1.20 per share on the Soren Corporation stock.
May	5	Sold 2,000 shares of the Soren Corporation stock at $23 per share for cash.
July	21	Received a cash dividend of $1.30 per share on the Soren Corporation stock.
Aug.	9	Sold the balance of the Soren Corporation stock at $15 per share for cash.

Required:

Identify the classification and prepare the appropriate journal entries to record each of these transactions.

P 12-2

LO 5
LO 6

Investment in Securities—Recording and Analysis

The following data pertain to the securities of Linford Company during 2018, the company's first year of operations:

a. Purchased 400 shares of Corporation A stock at $40 per share plus a commission of $200. The security was only for trading purpose.
b. Purchased $6,000 of Corporation B bonds. The purpose of the bond investment was trading.
c. Received a cash dividend of $0.50 per share on the Corporation A stock.
d. Sold 100 shares of Corporation A stock for $46 per share.
e. Received interest of $240 on the Corporation B bonds.
f. Purchased 50 shares of Corporation C stock for $3,500. Linford made an irrevocable election to measure the equity investment as fair value through other comprehensive income.
g. Received interest of $240 on the Corporation B bonds.
h. Sold 150 shares of Corporation A stock for $28 per share.
i. Received a cash dividend of $1.40 per share on the Corporation C stock.
j. Interest receivable at year-end on the Corporation B bonds amounts to $60.

Required:

Classify the securities invested in Corporations A, B, and C, and prepare journal entries to record the preceding transactions. Post the entries to T-accounts, and determine the amount of each of the following for the year:

1. Dividend revenue

2. Interest revenue
3. Net gain or loss from selling securities

P 12-3
LO 5
LO 6

Buying and Selling FVTPL Financial Assets

Iron Company incurred the following transactions relating to the common stock of Bronze Company:

July 14, 2018	Purchased 12,000 shares at $41 per share.
Sept. 4, 2019	Sold 2,100 shares at $46 per share.
Aug. 24, 2020	Sold 1,500 shares at $40 per share.

The end-of-year market prices for the shares were as follows:

Dec. 31, 2018	$38 per share
Dec. 31, 2019	$49 per share
Dec. 31, 2020	$36 per share

Iron classifies the Bronze stock as FVTPL financial assets.

Required:

1. Determine the amount of gain or loss arising from financial assets valuation each year relating to the Bronze stock.
2. How would your answer to part (1) change if the securities were classified as FVTOCI financial assets—equity? Explain.

P 12-4
LO 4
LO 6

Unifying Concepts: Investments in Debt and Equity Securities

On January 1, Heiress Company had surplus cash and decided to make some long-term investments. The following transactions occurred during the year:

Jan.	1	Purchased thirty $1,000, 11% bonds of McComb Corporation at face value. Semiannual interest payment dates are January 1 and July 1 each year. The bonds are classified as FVTOCI financial assets—debt.
Feb.	15	Purchased 3,000 shares of Gordon Corporation stock at $28 per share, plus brokerage fees of $1,100. The stock is classified as FVTOCI financial assets—equity.
July	1	Received a semiannual interest payment on the McComb Corporation bonds.
Sept.	30	Received an annual cash dividend of $1.00 per share on Gordon Corporation stock.
Oct.	15	Sold 1,000 shares of the Gordon Corporation stock at $33 per share.
Dec.	31	Adjusted the accounts to accrue interest on the McComb Corporation bonds.

Required:

1. Prepare journal entries for these transactions.
2. The market quote for McComb Corporation's bonds at closing on December 31 was 103. The Gordon Corporation stock closed at $32 per share. Prepare a partial balance sheet showing all the necessary data for these securities. Assume that Heiress exercises no significant influence over its investees.

P 12-5
LO 5

Investments in Equity Securities

On March 15, 2018, Boston Company acquired 5,000 shares of Richfield Corporation common stock at $45 per share as a long-term investment. Richfield has 50,000 shares of outstanding voting common stock. Boston does not own any other stocks. Boston Company made an irrevocable option to measure the equity investment as fair value through other comprehensive income. The following additional events occurred during the fiscal year ended December 31, 2018:

Dec.	1	Boston received a cash dividend of $2.50 per share from Richfield Corporation.
	31	Richfield Corporation announced earnings for the year of $150,000.
	31	Richfield common stock had a closing market price of $42 per share.

Required:

1. What accounting method should be used to account for this investment? Why?
2. Prepare journal entries for the above transactions.
3. Prepare a partial statement of comprehensive income and balance sheet to show how the investments accounts would be shown on the financial statements.

P 12-6
LO 6

Investments in FVTOCI Financial Assets—Equity

Lindorf Company often purchases common stocks of other companies as long-term investments. At the end of 2018, Lindorf held the common stocks listed. (Assume that Lindorf Company exercises no significant influence over these companies and made an irrevocable option to measure the equity investment as fair value through other comprehensive income; that is, they are classified as FVTOCI financial assets—equity.)

Corporation	Number of Shares	Cost per Share
A	2,500	$ 40
B	2,000	26
C	2,300	153
D	750	75

Additional information for 2018:

Sept. 30 Lindorf received a cash dividend of $1.15 per share on Corporation A stock.
Dec. 31 The market prices were quoted as follows:
Corporation A stock, $35; Corporation B stock, $28;
Corporation C stock, $154; Corporation D stock, $70.

Required:

1. Illustrate how these investments would be reported on the balance sheet at December 31, 2018, and prepare the adjusting entry at that date.
2. What items and amounts would be reported on the statement of comprehensive income for 2018?
3. Prepare the journal entry for the sale of Corporation D stock for $71 per share in 2019.
4. **Interpretive Question:** Why are losses from the write-down of FVTOCI financial assets—equity not included in the current year's income, whereas similar losses for FVTPL financial assets are included?

P 12-7
LO 4
LO 5
LO 6

Investments in Bonds and Stock

Wilbur Company often invests in the debt and equity securities of other companies as short-term investments. During 2018, the following events occurred:
July 1 Wilbur purchased the securities listed here:

Security	Type	Classification	Cost
1	Debt	FVTPL financial assets	$41,200
2	Equity	FVTPL financial assets	23,940
3	Equity	FVTPL financial assets	51,250
4	Equity	FVTOCI financial assets—equity	21,300

Sept. 30 Wilbur received a cash dividend of $2,460 on Security 2.
Dec. 1 Wilbur sold Security 4 for $18,300.
31 Wilbur received interest of $4,300 on Security 1.
31 The market prices were quoted as follows: Security 1, $40,900; Security 2, $25,550; Security 3, $44,000.

Required:

1. Prepare journal entries to record the events.
2. Illustrate how these investments would be reported on the balance sheet at December 31.
3. What items and amounts would be reported on the statement of comprehensive income for the year?
4. Assume Security 4 is a Debt investment, record the sale transaction in Dec. 1, 2018, and the related part of income statement of the sale.

P 12-8
LO 5
LO 6

Unifying Concepts: Short-Term Investments in Stocks and Bonds

JAG Manufacturing Company produces and sells one main product. There is significant seasonality in demand, and the unit price is quite high. As a result, during the heavy selling season, the company generates cash that is idle for a few months. The company uses this cash to acquire investments. The following transactions relate to JAG's investments during 2018:

Mar.	15	Purchased 1,200 shares of Gates Corporation stock at $21 per share, plus brokerage fees of $815. This stock is classified as FVTPL financial assets because of the trading purpose.
Apr.	1	Purchased $39,000 of 10% bonds of Micro Company. This investment is classified as FVTOCI financial assets—debt.
June	3	Received a cash dividend of $0.75 per share on the Gates Corporation stock.
Oct.	1	Received a semiannual interest payment of $1,950 on the Micro Company bonds.
	10	Sold 400 shares of the Gates Corporation stock at $26 per share less a $295 brokerage fee.
Dec.	31	Recorded $975 of interest earned on the Micro Company bonds for the period October 1, 2018, through December 31, 2018.
	31	The market price of the Gates Corporation stock was $19 per share; the market price of the Micro Company bonds was $38,560.

Required:

Prepare journal entries to record these transactions.

P 12-9
LO 5
LO 7

Long-Term Investments Using the Equity Method

Century Corporation acquired 8,400 common shares of Fidelity Company on January 10, 2018, for $12 per share and acquired 15,000 common shares of Essem Corporation on January 25, 2018, for $22 per share. Fidelity has 60,000 shares of common stock outstanding, and Essem has 50,000 shares outstanding. At December 31, 2018, the following information was obtained about the operations of Fidelity and Essem:

	Fidelity	Essem
Net income	$36,000.00	$100,000.00
Dividends paid per share	0.40	1.00
Market value per share at December 31, 2018	10.00	20.00

Assume that Century Corporation exerted significant influence over the policies of Essem Corporation, but influenced the policies of Fidelity Corporation only to a very limited extent. Century made an irrevocable option to measure the equity investment in Fidelity Company as fair value through other comprehensive income, and Century classified its investment in Fidelity as an FVTOCI financial asset—equity.

Required:

1. How should Century account for its investments in Essem Corporation?
2. Prepare the journal entries for each investment for the year 2018 using the method or methods you selected in part (1).
3. On March 5, 2019, Century Corporation sold 400 shares of Fidelity Company stock. The market value on that day was $12 per share. What is the gain or loss of the sale?

P 12-10
LO 5
LO 6

Investment Portfolio

General Corporation has the following investments in equity securities by December 31, 2018 (there are no existing balances in the valuation adjustment account):

Company	Classification	Shares	Percentage of Shares Owned	Cost	Market Price on 12/31/18
Clarke Corporation	FVTPL financial assets	1,000	2%	$75	$78
Marlin Company	FVTOCI financial assets—equity	4,000	15	34	32
Air Products, Inc.	FVTOCI financial assets—equity	3,000	10	46	43

Required:

1. Prepare any adjusting entries required on December 31, 2018.
2. Illustrate how these investments would be presented on General Corporation's balance sheet on December 31, 2018. The FVTOCI financial assets—equity are expected to be held for two to five years.
3. Prepare the journal entry on April 10, 2019, when General Corporation sold the Clarke Corporation investment for $72 per share.
4. Assume that General Corporation still owns its investment in Marlin Company and Air Products on December 31, 2019; the market prices on that date are $37 for Marlin and $44 for Air Products. Prepare all adjusting journal entries needed on December 31, 2019.

P 12-11
LO 7

Investments in Stocks—Equity Method

On March 20, 2018, Reeder Company acquired 40,000 shares of Needed Industries common stock at $64 per share as a long-term investment. Needed has 100,000 shares of outstanding voting common stock. The following additional information is presented for the calendar year ended December 31, 2018:

Nov.	15	Reeder received a cash dividend of $3.00 per share from Needed Industries.
Dec.	31	Needed announced earnings for the year of $250,000.
	31	Needed Industries common stock had a closing market price of $56 per share.
2019:		
Jan.	6	Reeder sold a quarter of its shares of Needed Industries at a price of $70 per share.

Required:

1. **Interpretive Question:** What accounting method should be used by Reeder Company to account for this investment? Why?
2. Prepare journal entries for the transactions and events described.

P 12-12
LO 6
LO 7

Long-Term Investments in Stock—FVTOCI Financial Assets—Equity and Equity Method

The following activities relate to Merrill Company during the years 2018 and 2019:

2018		
Feb.	15	Merrill purchased 10,000 shares of Hendershot Equipment stock for $40 per share.
Dec.	1	Merrill received an $0.80-per-share cash dividend from Hendershot Equipment.
	31	Hendershot Equipment common stock had a closing market price of $37 per share. Hendershot's 2018 net income was $120,000.
2019		
July	1	Merrill sold all 10,000 shares of Hendershot Equipment stock for $42 per share.

Additional information: Hendershot Equipment had 50,000 shares of common stock outstanding on January 1, 2018.

Required:

1. Prepare journal entries to record the transactions assuming:
   a. The securities are classified as FVTOCI financial assets—equity.
   b. The equity method is used.
2. Show the amounts that would be reported on the financial statements of Merrill Company at December 31, 2018, under each assumption.
3. **Interpretive Question:** Can Merrill use equity method to account for its investment in Hendershot Equipment?

Analytical Assignments

AA 12-1
Discussion

Classification of Securities

Memphis Company has just purchased five securities; it intends to hold the stock until the price increases to a sufficiently high level, at which time it plans to sell the stock. In fact, it is unlikely that the company will hold the securities for more than a few months. Nevertheless, Memphis's management has decided to classify the securities as FVTOCI financial assets—debt rather than as FVTPL financial assets. Why is Memphis choosing this type of classification, and would you allow it if you were the auditor?

AA 12-2
Ethics

Is It OK to Strategically Classify Securities?

You have recently been hired as a staff assistant in the office of the chairman of the board of directors of Clefton, Inc. Because you have some background in accounting, the chairman has asked you to review the preliminary financial statements that have been prepared by the company's accounting staff. After the financial statements are approved by the chairman, they will be audited by external auditors. This is the first year that Clefton has had its financial statements audited by external auditors.

In examining the financial statement note on investment securities, you notice that all of the securities that had unrealized gains for the year have been classified as FVTPL financial assets, whereas all of the securities that had unrealized losses have been classified as FVTOCI financial assets. This places all the gains on the statement of comprehensive income and hides all the losses in the equity section of the balance sheet. In a meeting with the chief accountant, he confirms that the securities are not classified until the end of the year and that the classification depends on whether a particular security has experienced a gain or a loss during the year. This policy was adopted, with the approval of the chairman, in order to maximize the reported net income of the company. He says that the investment security classification is based on how management intends to use those securities; therefore, management is free to classify the securities in any way it wishes.

You are uncomfortable with this investment security classification strategy and are dismayed that the chief accountant and the chairman seem to have agreed on this scheme to maximize reported income. You are also worried about what the external auditors will do when they find out about this classification scheme. You have been asked to report to the chairman this afternoon to give your summary of the status of the preliminary financial statements. What should you do?

EXPANDED MATERIAL

Key Terms & Concepts

- non-controlling interest, 533

Put it on Paper — Discussion Questions

12. Under what circumstances should consolidated financial statements be prepared?

13. What financial statement accounts are shown only in consolidated financial statements and never in the financial statements of individual companies?

PRACTICE EXERCISES

PE 12-16
LO 8

Consolidated Financial Statements

Parent Company owns 90% of the outstanding stock of Sub Company. At the end of the year, Sub reports revenues of $240,000 and expenses of $170,000. What will Parent report on its own financial statements as "Income from Sub"? On the consolidated financial statements, how much of Sub's revenues and expenses will be reported?

EXERCISES

E 12-16
LO 8

Consolidated Financial Statements—Balance Sheet

Ecotec Inc. purchased 70% of the outstanding common stock of Beatrix Co. on January 1, 2018, paying $1,750,000. On that day, the balance sheets of the two companies immediately after the purchase are as follows:

(in thousands)	Ecotec	Beatrix
Assets		
Cash	$ 820	$ 520
Other current assets	3,750	2,480
Property, plant, and equipment	2,200	1,700
Investment in Beatrix	1,750	0
Total assets	$8,520	$4,700
Liabilities and Equity		
Current liabilities	$2,450	$1,600
Long-term liabilities	1,550	600
Common stock	1,600	1,000
Retained earnings	2,920	1,500
Total liabilities and equity	$8,520	$4,700

1. Compute the amount that will be disclosed on the consolidated balance sheet as "Non-controlling Interest."
2. Prepare a consolidated balance sheet as of January 1, 2018.

E 12-17
LO 8

Consolidated Financial Statements—Statement of Comprehensive Income

On January 1, 2018, Limbo Inc. purchased 80% of the outstanding common stock of Euphoria Co. at a price of $1,200,000. At the end of 2018, each company prepared separate statements of comprehensive income, which are presented as below.

(in thousands)	Limbo	Euphoria
Sales	$5,440	$1,025
Income from Euphoria	120	0
Interest revenue	95	25
	$5,655	$1,050
Cost of goods sold	3,550	700
Other operating expenses	1,020	175
Interest expense	350	25
Net income	$ 735	$ 150

1. Compute the amount that will be reported on the consolidated statement of comprehensive income as "Non-controlling Interest Income."
2. Prepare a consolidated statement of comprehensive income.
3. Compare Limbo's reported net income with consolidated net income. Explain the relationship.

PROBLEMS

P 12-13
LO 8

Consolidated Financial Statements

Parent Company owns parts of three different subsidiaries. The balance sheets and statements of comprehensive income for these four companies are listed below. Note that, in the financial statements of Parent Company, its ownership interest in the three subsidiaries has been accounted for using the equity method.

		Percentage of the Parent's Ownership		
	Parent	**90% Sub 1**	**60% Sub 2**	**40% Sub 3**
Assets				
Cash	$ 120	$ 40	$ 30	$ 60
Accounts receivable	500	120	90	50
Plant and equipment	1,050	400	160	300
Investment in Sub 1	288			
Investment in Sub 2	78			
Investment in Sub 3	84			
Total assets	$ 2,120	$ 560	$ 280	$ 410
Liabilities	$ 900	$ 240	$ 150	$ 200
Equity	1,220	320	130	210
Total liabilities and equity	$ 2,120	$ 560	$ 280	$ 410
Sales	$ 6,420	$ 3,000	$ 3,000	$ 8,000
Income from Sub 1	360			
Income from Sub 2	480			
Income from Sub 3	160			
Total revenues	$ 7,420	$ 3,000	$ 3,000	$ 8,000
Expenses	(4,200)	(2,600)	(2,200)	(7,600)
Net income	$ 3,220	$ 400	$ 800	$ 400

Required:

1. Prepare a consolidated balance sheet for Parent Company and its subsidiaries.
2. Prepare a consolidated statement of comprehensive income for Parent Company and its subsidiaries.
3. **Interpretive Question:** Return on sales is net income divided by total sales. Without doing any computations, state what would happen to consolidated return on sales if Sub 3 were consolidated rather than accounted for using the equity method. Explain.

Comprehensive Problem Chapters 9–12

Warner Company started business on January 1, 2018. The following transactions and events occurred in 2018 and 2019. For simplicity, information for sales, inventory purchases, collections on account, and payments on account is given in summary form at the end of each year.

2018

Jan.	1	Issued 150,000 shares of $1-par common stock to investors at $15 per share.
	1	Purchased a building for $720,000. The building has a 25-year expected useful life and a $70,000 expected salvage value. Warner uses the straight-line method of depreciation.
Feb.	1	Borrowed $1.8 million from Foley Bank. The loan bears a 9% annual interest rate. Interest is to be paid each year on February 1. The principal on the loan will be repaid in four years.
Mar.	1	Purchased 50,000 shares of Ryan Company for $30 per share for trading purpose. Warner classifies this as an investment in FVTPL financial assets. These securities are reported as a current asset.
July	15	Purchased 55,000 shares of Anson Company for $23 per share. Warner made an irrevocable option to measure the equity investment as fair value through other comprehensive income and classifies this as an investment in FVTOCI financial assets—equity. These securities are reported as a long-term asset.
Nov.	17	Declared a cash dividend of $0.30 per share, payable on January 15, 2019.
Dec.	31	The Ryan Company shares had a market value of $26 per share. The Anson Company shares had a market value of $28 per share.

Summary:

a. Sales for the year (all on credit) totaled $1,080,000. The cost of inventory sold was $576,000.
b. Cash collections on credit sales for the year were $504,000.
c. Inventory costing $648,000 was purchased on account. (Warner Company uses the perpetual inventory system.)
d. Payments on account totaled $600,000.

2019

Jan.	1	Issued $400,000 in bonds at par value. The bonds have a stated interest rate of 10%, payable semiannually on July 1 and January 1.
	1	The estimated useful life and salvage value for the building were changed. It is now estimated that the building has a remaining life (as of January 1, 2019) of 20 years. Also, it is now estimated that the building will have no salvage value. These changes in estimate are to take effect for the year 2019 and subsequent years.
	15	Paid the cash dividend declared in November 2018.
Feb.	1	Warner Company repurchased 15,000 shares of its own common stock to be held as treasury stock. The price paid was $32 per share.
	1	Paid the interest on the loan from Foley Bank.
Apr.	10	Sold all 50,000 shares of the Ryan Company stock. The shares were sold for $25 per share.
July	1	Paid the interest on the bonds.
Oct.	1	Retired the bonds that were issued on January 1. Warner had to pay $380,000 to retire the bonds. This amount included interest that had accrued since July 1.
Nov.	20	Declared a cash dividend of $0.30 per share. The dividend applies only to outstanding shares, not to treasury shares.
Dec.	31	After recording depreciation expense for the year, the building was evaluated for possible impairment. The building is expected to generate cash flows of $18,000 per year for its 19-year remaining life. The building has a current market value of $320,000.
	31	The Anson Company shares had a market value of $19 per share.

Summary:

a. Sales for the year (all on credit) totaled $2.16 million. The cost of inventory sold was $1,140,000.
b. Cash collections on credit sales for the year were $1.848 million.
c. Inventory costing $1,200,000 was purchased on account.
d. Payments on account totaled $1,164,000.

Required:

1. Prepare all journal entries to record the information for 2018. Also, prepare any necessary adjusting entries.
2. Prepare a trial balance as of December 31, 2018. There is no need to show your ledger T-accounts; however, preparing and posting to T-accounts may aid in the preparation of the trial balance.
3. Prepare a statement of comprehensive income for the year ended December 31, 2018, and a balance sheet as of December 31, 2018.
4. Prepare all journal entries to record the information for 2019. Also prepare any necessary adjusting entries.
5. Prepare a trial balance as of December 31, 2019. (As you compute the amounts to include in the trial balance, don't forget the beginning balances left over from 2018.)
6. Prepare a statement of comprehensive income for the year ended December 31, 2019, and a balance sheet as of December 31, 2019.