PRACTICE MULTIPLE-CHOICE QUESTIONS

**12-1.** (LO 1)

Which of the following is **not**a primary reason why corporations invest in debt and equity securities?

(a) They wish to gain control of a competitor.

(b) They have excess cash.

(c) They wish to move into a new line of business.

(d) They are required to by law.

**Answer**

(d) They are required to by law.

**12-2.** (LO 2)

Debt investments are initially recorded at:

(a) cost.

(b) cost plus dividends.

(c) par value.

(d) face value.

**Answer**

(a) cost.

**12-3.** (LO 2)

Hanes Company sells debt investments costing £26,000 for £28,000, plus accrued interest that has been recorded. In journalizing the sale, credits are to:

(a) Debt Investments and Loss on Sale of Debt Investments.

(b) Debt Investments, Gain on Sale of Debt Investments, and Interest Receivable.

(c) Share Investments and Interest Receivable.

(d) No correct answer is given.

**Answer**

(b) Debt Investments, Gain on Sale of Debt Investments, and Interest Receivable.

**12-4.** (LO 3)

Anatolian A.S. receives net proceeds of [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)42,000 on the sale of share investments that cost [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)39,500. This transaction will result in reporting in the income statement a:

(a) loss of [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)2,500 under “Other income and expense.”

(b) loss of [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)2,500 under “Operating expenses.”

(c) gain of [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)2,500 under “Other income and expense.”

(d) gain of [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)2,500 under “Operating revenues.”

**Answer**

(c) gain of [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)2,500 under “Other income and expense.”

**12-5.** (LO 3)

The equity method of accounting for long-term investments in shares should be used when the investor has significant influence over an associate and owns:

(a) between 20% and 50% of the associate's ordinary shares.

(b) 20% or more of the associate's ordinary shares.

(c) more than 50% of the associate's ordinary shares.

(d) less than 20% of the associate's ordinary shares.

**Answer**

(a) between 20% and 50% of the associate's ordinary shares.

**12-6.** (LO 3)

Assume that Horicon NV acquired 25% of the ordinary shares of Sheboygan NV on January 1, 2017, for €300,000. During 2017, Sheboygan Corp. reported net income of €160,000 and paid total dividends of €60,000. If Horicon uses the equity method to account for its investment, the balance in the investment account on December 31, 2017, will be:

(a) €300,000.

(b) €325,000.

(c) €400,000.

(d) €340,000.

**Answer**

(b) €325,000.

**12-7.** (LO 3)

Using the information in Question 6, what entry would Horicon make to record the receipt of the dividend from Sheboygan?

(a) Debit Cash and credit Revenue from Share Investments.

(b) Debit Cash Dividends and credit Revenue from Share Investments.

(c) Debit Cash and credit Share Investments.

(d) Debit Cash and credit Dividend Revenue.

**Answer**

(c) Debit Cash and credit Share Investments.

**12-8.** (LO 3)

You have a controlling interest if:

(a) you own more than 20% of a company's ordinary shares.

(b) you are the president of the company.

(c) you use the equity method.

(d) you own more than 50% of a company's ordinary shares.

**Answer**

(d) you own more than 50% of a company's ordinary shares.

**12-9.** (LO 4)

Which of the following statements is **not true**? Consolidated financial statements are useful to:

(a) determine the profitability of specific subsidiaries.

(b) determine the total profitability of companies under common control.

(c) determine the breadth of a parent company's operations.

(d) determine the full extent of total obligations of companies under common control.

**Answer**

(a) determine the profitability of specific subsidiaries.

**12-10.** (LO 5)

At the end of the first year of operations, the total cost of the trading securities portfolio is ￦120,000,000. Total fair value is ￦115,000,000. The financial statements should show:

(a) a reduction of an asset of ￦5,000,000 and a realized loss of ￦5,000,000.

(b) a reduction of an asset of ￦5,000,000 and an unrealized loss of ￦5,000,000 in the equity section.

(c) a reduction of an asset of ￦5,000,000 in the current assets section and an unrealized loss of ￦5,000,000 in “Other income and expense.”

(d) a reduction of an asset of ￦5,000,000 in the current assets section and a realized loss of ￦5,000,000 in “Other income and expense.”

**Answer**

(c) a reduction of an asset of ￦5,000,000 in the current assets section and an unrealized loss of ￦5,000,000 in “Other income and expense.”

**12-11.** (LO 5)

At December 31, 2017, the fair value of non-trading securities is €41,300 and the cost is €39,800. At January 1, 2017, there was a credit balance of €900 in the Fair Value Adjustment—Non-Trading account. The required adjusting entry would be:

(a) Debit Fair Value Adjustment—Non-Trading for €1,500 and credit Unrealized Gain or Loss—Equity for €1,500.

(b) Debit Fair Value Adjustment—Non-Trading for €600 and credit Unrealized Gain or Loss—Equity for €600.

(c) Debit Fair Value Adjustment—Non-Trading for €2,400 and credit Unrealized Gain or Loss—Equity for €2,400.

(d) Debit Unrealized Gain or Loss—Equity for €2,400 and credit Fair Value Adjustment—Non-Trading for €2,400.

**Answer**

(c) Debit Fair Value Adjustment—Non-Trading for €2,400 and credit Unrealized Gain or Loss—Equity for €2,400.

**12-12.** (LO 5)

In the statement of financial position, a debit balance in Unrealized Gain or Loss—Equity is results in a(n):

(a) increase to equity.

(b) decrease to equity.

(c) loss in the income statement.

(d) loss in the retained earnings statement.

**Answer**

(b) decrease to equity.

**12-13.** (LO 6)

Short-term debt investments must be readily marketable and expected to be sold within:

(a) 3 months from the date of purchase.

(b) the next year or operating cycle, whichever is shorter.

(c) the next year or operating cycle, whichever is longer.

(d) the operating cycle.

**Answer**

(c) the next year or operating cycle, whichever is longer.

**\*12-14.** (LO 7)

Pate Company pays £175,000 for 100% of Sinko's ordinary shares when Sinko's equity consists of Share Capital—Ordinary £100,000 and Retained Earnings £60,000. In the worksheet for the consolidated statement of financial position, the eliminations will include a:

(a) credit to Investment in Sinko Share Capital—Ordinary £160,000.

(b) credit to Excess of Book Value over Cost of Subsidiary £15,000.

(c) debit to Retained Earnings £75,000.

(d) debit to Excess of Cost over Book Value of Subsidiary £15,000.

**Answer**

(d) debit to Excess of Cost over Book Value of Subsidiary £15,000.

**\*12-15.** (LO 7)

Which of the following statements about intercompany eliminations is **true**?

(a) They are not journalized or posted by any of the subsidiaries.

(b) They do not affect the ledger accounts of any of the subsidiaries.

(c) They are made solely on the worksheet to arrive at correct consolidated data.

(d) All of these answer choices are correct.

**Answer**

(d) All of these answer choices are correct.

**\*12-16.** (LO 7)

Which one of the following statements about consolidated income statements is **false**?

(a) A worksheet facilitates the preparation of the statement.

(b) The consolidated income statement shows the results of operations of affiliated companies as a single economic unit.

(c) All revenue and expense transactions between parent and subsidiary companies are eliminated.

(d) When a subsidiary is wholly owned, the form and content of the statement will differ from the income statement of an individual corporation.

**Answer**

(d) When a subsidiary is wholly owned, the form and content of the statement will differ from the income statement of an individual corporation.

QUESTIONS

**12-1.** What are the reasons that corporations invest in securities?

**12-2.** (a) What is the cost of an investment in bonds?

(b) When is interest on bonds recorded?

**12-3.** Tino Martinez is confused about losses and gains on the sale of debt investments. Explain to Tino (a) how the gain or loss is computed, and (b) the statement presentation of the gains and losses.

**12-4.** Kolkata Company sells Gish's bonds costing Rs40,000 for Rs45,000, including Rs500 of accrued interest. In recording the sale, Kolkata books a Rs5,000 gain. Is this correct? Explain.

**12-5.** What is the cost of an investment in shares?

**12-6.** To acquire Kinston plc shares, R. Neal pays £63,200. What entry should be made for this investment?

**12-7.** (a) When should a long-term investment in ordinary shares be accounted for by the equity method?

(b) When is revenue recognized under this method?

**12-8.** Rijo SA uses the equity method to account for its ownership of 30% of the ordinary shares of Pippen Packing. During 2017, Pippen reported a net income of €80,000 and declares and pays cash dividends of €10,000. What recognition should Rijo Corporation give to these events?

**12-9.** What constitutes “significant influence” when an investor's financial interest is below the 50% level?

**12-10.** Distinguish between the cost and equity methods of accounting for investments in shares.

**12-11.** What are consolidated financial statements?

**12-12.** What are the classification guidelines for investments at a statement of financial position date?

**12-13.** Tina Eddings is the controller of Mendez SLU. At December 31, the company's investments in trading securities cost €74,000. They have a fair value of €70,000. Indicate how Tina would report these data in the financial statements prepared on December 31.

**12-14.** Using the data in Question 13, how would Tina report the data if the investment were long-term and the securities were classified as non-trading?

**12-15.** Hashmi Company's investments in non-trading securities at December 31 show total cost of £195,000 and total fair value of £205,000. Prepare the adjusting entry.

**12-16.** Using the data in Question 15, prepare the adjusting entry assuming the securities are classified as trading securities.

**12-17.** What is the year-end accounting treatment of the account Unrealized Loss—Equity?

**12-18.** What purposes are served by reporting Unrealized Gain or Loss—Equity in the equity section rather than including it in income?

**12-19.** Altoona Wholesale Supply owns shares in Key Ltd. Altoona intends to hold the shares indefinitely because of some negative tax consequences if sold. Should the investment in Key be classified as a short-term investment? Why or why not?

**\*12-20.** (a) What asset and equity balances are eliminated in preparing a consolidated statement of financial position for a parent and a wholly owned subsidiary?

(b) Why are they eliminated?

**\*12-21.** Yinhu Company pays HK$318,000,000 to purchase all the outstanding ordinary shares of Lia Ltd. At the date of purchase, the net assets of Lia have a book value of HK$290,000,000. Yinhu's management allocates HK$20,000,000 of the excess cost to undervalued land on the books of Lia. What should be done with the rest of the excess?

BRIEF EXERCISES

**BE12-1.** *Journalize entries for debt investments*.

(LO 2)

Kimmel Industries AG purchased debt investments for CHF50,000 on January 1, 2017. On July 1, 2017, Kimmel received cash interest of CHF1,600. Journalize the purchase and the receipt of interest. Assume that no interest has been accrued.

**BE12-2.** *Journalize entries for share investments*.

(LO 3)

On August 1, Paul Company buys 1,000 ordinary shares of Merlynn for €35,700. On December 1, Paul sells the share investments for €40,000 in cash. Journalize the purchase and sale of the ordinary shares.

**BE12-3.** *Record transactions under the equity method of accounting*.

(LO 3)

Kayser Company owns 25% of Plano Company. For the current year, Plano reports net income of €190,000 and declares and pays a €40,000 cash dividend. Record Kayser's equity in Plano's net income and the receipt of dividends from Plano.

**BE12-4.** *Prepare adjusting entry using fair value*.

(LO 5)

The cost of the trading securities of Hardy Company at December 31, 2017, is £62,000. At December 31, 2017, the fair value of the securities is £59,000. Prepare the adjusting entry to record the securities at fair value.

**BE12-5.** *Indicate statement presentation using fair value*.

(LO 5, 6)

For the data presented in BE12-4, show the financial statement presentation of the trading securities and related accounts.

**BE12-6.** *Prepare adjusting entry using fair value*.

(LO 5)

Amazonas SA holds as a long-term investment non-trading share securities costing R$72,000. At December 31, 2017, the fair value of the securities is R$66,000. Prepare the adjusting entry to record the securities at fair value.

**BE12-7.** *Indicate statement presentation using fair value*.

(LO 5, 6)

For the data presented in BE12-6, show the financial statement presentation of the non-trading securities and related accounts. Assume the non-trading securities are non-current.

**BE12-8.** *Prepare investments section of statement of financial position*.

(LO 5, 6)

Gurnee Limited has the following long-term investments: (1) Ordinary shares of Kornas Co. (10% ownership) held as non-trading securities, cost £108,000, fair value £115,000. (2) Ordinary shares of Kozanecki OAO. (30% ownership), cost £210,000, equity £270,000. Prepare the investments section of the statement of financial position.

**\*BE12-9.** *Prepare partial consolidated worksheet when cost equals book value*.

(LO 7)

Paula Company acquires 100% of the ordinary shares of Shannon Company for €190,000 cash. On the acquisition date, Shannon's ledger shows Share Capital—Ordinary €120,000 and Retained Earnings €70,000. Complete the worksheet for the following accounts: Paula—Investment in Shannon, Shannon—Share Capital—Ordinary, and Shannon—Retained Earnings.

**\*BE12-10.** *Prepare partial consolidated worksheet when cost exceeds book value*.

(LO 7)

Data for the Paula and Shannon companies are given in BE12-9. Instead of paying €190,000, assume that Paula pays €200,000 to acquire the 100% interest in Shannon Company. Complete the worksheet for the accounts identified in BE12-9 and for the excess of cost over book value.

**DO IT! REVIEW**

**DO IT! 12-1.** *Make journal entry for bond purchase and adjusting entry for interest accrual.*

(LO 2)

Kurtyka Ltd. had the following transactions relating to debt investments:

Jan. 1, 2017 Purchased 50, £1,000, 8% Nordica Company bonds for £50,000. Interest is payable annually on January 1.

Dec. 31, 2017 Accrued interest on the Nordica Company bonds.

July 1, 2017 Received interest from Nordica Company bonds.

July 1, 2017 Sold 30 Nordica Company bonds for £28,700.

(a) Journalize the transactions, and (b) prepare the adjusting entry for the accrual of interest on December 31, 2018.

**DO IT! 12-2.** *Make journal entries for share investments*.

(LO 3)

Presented below are two independent situations:

1. Lorfeld Ltd. acquired 10% of the 500,000 ordinary shares of Northbrook Corporation at a total cost of €11 per share on June 17, 2017. On September 3, Northbrook declared and paid a €160,000 dividend. On December 31, Northbrook reported net income of €550,000 for the year.

2. Saa Ltd. obtained significant influence over McCarthy Company by buying 30% of McCarthy's 100,000 outstanding ordinary shares at a cost of €18 per share on January 1, 2017. On May 15, McCarthy declared and paid a cash dividend of €150,000. On December 31, McCarthy reported net income of €270,000 for the year.

Prepare all necessary journal entries for 2017 for (a) Lorfeld and (b) Saa.

**DO IT! 12-3.** *Make journal entries for trading and non-trading securities*.

(LO 5)

Some of Quinghai Lake Limited's investment securities are classified as trading securities and some are classified as non-trading. The cost and fair value of each category at December 31, 2017, were as follows.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Cost** |  | **Fair Value** |  | **Unrealized Gain (Loss)** |
| Trading securities | ¥96,000 |  | ¥84,900 |  | ¥(11,100) |
| Non-trading securities | ¥59,100 |  | ¥63,200 |  | ¥ 4,100 |

At December 31, 2016, the Fair Value Adjustment—Trading account had a debit balance of ¥2,200, and the Fair Value Adjustment—Non-Trading account had a credit balance of ¥7,750.

Prepare the required journal entries for each group of securities for December 31, 2017.

**DO IT! 12-4.** *Indicate financial statement presentation of investments*.

(LO 6)

Identify where each of the following items would be reported in the financial statements.

1. Loss on sale of investments in shares.

2. Unrealized gain on non-trading securities.

3. Fair value adjustment—trading.

4. Interest earned on investments in bonds.

5. Unrealized loss on trading securities.

Use the following possible categories:

*Statement of financial position:*

|  |  |
| --- | --- |
| Intangible assets | Equity |
| Property, plant, and equipment | Non-current liabilities |
| Investments | Current liabilities |
| Current assets |  |

*Income statement*:

Other income and expense

*Comprehensive income statement*:

Other comprehensive income

EXERCISES

**E12-1.** *Understand debt and share investments*.

(LO 1)

Mr. Wellington is studying for an accounting test and has developed the following questions about investments.

1. What are three reasons why companies purchase investments in debt or share securities?

2. Why would a corporation have excess cash that it does not need for operations?

3. What is the typical investment when investing cash for short periods of time?

4. What are the typical investments when investing cash to generate earnings?

5. Why would a company invest in securities that provide no current cash flows?

6. What is the typical share investment when investing cash for strategic reasons?

***Instructions***

Provide answers for Mr. Wellington.

**E12-2.** *Journalize debt investment transactions and accrue interest*.

(LO 2)

Floyd Corporation had the following transactions pertaining to debt investments.

Jan. 1, 2017 Purchased 50 8%, £1,000 Petal Co. bonds for £50,000 cash. Interest is payable semiannually on July 1 and January 1.

Dec. 31, 2017 Accrued interest on the Petal Co. bonds.

July 1, 2017 Received semiannual interest on Petal Co. bonds.

July 1, 2017 Sold 30 Petal Co. bonds for £33,500.

***Instructions***

(a) Journalize the transactions.

(b) Prepare the adjusting entry for the accrual of interest at December 31, 2018.

**E12-3.** *Journalize debt investment transactions, accrue interest, and record sale*.

(LO 2)

Brook Company Ltd. purchased 70 Meissner Company AG 9%, 10-year, €1,000 bonds on January 1, 2017, for €70,000. The bonds pay interest annually on January 1. On January 1, 2018, after receipt of interest, Brook Company sold 40 of the bonds for €40,300.

***Instructions***

Prepare the journal entries to record the transactions described above.

**E12-4.** *Journalize share investment transactions*.

(LO 3)

Diann Company Ltd. had the following transactions pertaining to share investments.

Feb. 1 Purchased 600 ordinary shares of Ronn (2%) for £6,200.

July 1 Received cash dividends of £1 per share on Ronn ordinary shares.

Sept. 1 Sold 300 ordinary shares of Ronn for £4,300.

Dec. 1 Received cash dividends of £1 per share on Ronn ordinary shares.

***Instructions***

(a) Journalize the transactions.

(b) Explain how dividend revenue and the gain (loss) on sale should be reported in the income statement.

**E12-5.** *Journalize transactions for investments in shares*.

(LO 3)

Spring Ltd. had the following transactions pertaining to investments in ordinary shares.

Jan. 1 Purchased 2,500 ordinary shares of Angeltide Corporation (5%) for €142,100.

July 1 Received a cash dividend of €2.80 per share.

Dec. 1 Sold 500 ordinary shares of Angeltide Corporation for €31,200.

Dec. 31 Received a cash dividend of €2.90 per share.

***Instructions***

Journalize the transactions.

**E12-6.** *Journalize transactions for investments in shares*.

(LO 3)

On February 1, Minitori Company SpA purchased 500 ordinary shares (2% ownership) of Becker Company for €30.80 per share. On March 20, Minitori Company sold 100 shares of Becker for €2,850. Minitori received a dividend of €1.00 per share on April 25. On June 15, Minitori sold 200 shares of Becker for €7,310. On July 28, Minitori received a dividend of €1.25 per share.

***Instructions***

Prepare the journal entries to record the transactions described above.

**E12-7.** *Journalize and post transactions under the equity method*.

(LO 3)

On January 1, Vince SpA purchased a 25% equity in Morelli SpA for £180,000. At December 31, Morelli declared and paid a £36,000 cash dividend and reported net income of £160,000.

***Instructions***

(a) Journalize the transactions.

(b) Determine the amount to be reported as an investment in Morelli at December 31.

**E12-8.** *Journalize entries under cost and equity methods*.

(LO 3, 5)

Presented below are two independent situations.

1. Chicory Cosmetics acquired 15% of the 200,000 ordinary shares of Racine Fashion at a total cost of €13 per share on March 18, 2017. On June 30, Racine declared and paid a €60,000 dividend. On December 31, Racine reported net income of €122,000 for the year. At December 31, the market price of Racine Fashion was €15 per share. The shares are classified as non-trading.

2. Frank, Ltd., obtained significant influence over Nowak Corporation by buying 30% of Nowak's 30,000 outstanding ordinary shares at a total cost of €9 per share on January 1, 2017. On June 15, Nowak declared and paid a cash dividend of €30,000. On December 31, Nowak reported a net income of €80,000 for the year.

***Instructions***

Prepare all the necessary journal entries for 2017 for (a) Chicory Cosmetics and (b) Frank, Inc.

**E12-9.** *Understand the usefulness of consolidated statements*.

(LO 4)

Edna Company purchased 70% of the outstanding ordinary shares of Damen Limited.

***Instructions***

(a) Explain the relationship between Edna Company and Damen Limited.

(b) How should Edna account for its investment in Damen?

(c) Why is the accounting treatment described in (b) useful?

**E12-10.** *Prepare adjusting entry to record fair value, and indicate statement presentation*.

(LO 5, 6)

At December 31, 2017, the trading securities for Geneva, AG. are as follows.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Security** |  | **Cost** |  | **Fair Value** |
| A |  | CHF17,500 |  | CHF16,000 |
| B |  | 12,500 |  | 14,000 |
| C |  | 23,000 |  | 19,000 |
|  |  | CHF53,000 |  | CHF49,000 |

***Instructions***

(a) Prepare the adjusting entry at December 31, 2017, to report the securities at fair value.

(b) Show the statement of financial position and income statement presentation at December 31, 2017, after adjustment to fair value.

**E12-11.** *Prepare adjusting entry to record fair value, and indicate statement presentation*.

(LO 5, 6)

Data for investments in shares classified as trading securities are presented in E12-10. Assume instead that the investments are classified as non-trading securities. They have the same cost and fair value. The securities are considered to be a long-term investment.

***Instructions***

(a) Prepare the adjusting entry at December 31, 2017, to report the securities at fair value.

(b) Show the statement presentation at December 31, 2017, after adjustment to fair value.

(c) E. Devonshire, a member of the board of directors, does not understand the reporting of the unrealized gains or losses. Write a letter to Ms. Devonshire explaining the reporting and the purposes that it serves.

**E12-12.** *Prepare adjusting entries for fair value, and indicate statement presentation for two classes of securities*.

(LO 5, 6)

Zippydah Company has the following data at December 31, 2017.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Securities** |  | **Cost** |  | **Fair Value** |
| Trading |  | €120,000 |  | €124,000 |
| Non-trading |  | 100,000 |  | 94,000 |

The non-trading securities are held as a long-term investment.

***Instructions***

(a) Prepare the adjusting entries to report each class of securities at fair value.

(b) Indicate the statement presentation of each class of securities and the related unrealized gain (loss) accounts.

**\*E12-13.** *Prepare consolidated worksheet when cost equals book value*.

(LO 7)

On January 1, 2017, Lennon Corporation acquires 100% of Ono Ltd. for £220,000 in cash. The condensed statements of financial position of the two corporations immediately following the acquisition are as follows.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Lennon Corporation** |  | **Ono Inc.** |
| Plant and equipment (net) | £300,000 |  | £220,000 |
| Investment in Ono Inc. ordinary shares | 220,000 |  |  |
| Current assets | 60,000 |  | 50,000 |
|  | £580,000 |  | £270,000 |
| Share capital—ordinary | £230,000 |  | £ 80,000 |
| Retained earning | 170,000 |  | 140,000 |
| Current liabilities | 180,000 |  | 50,000 |
|  | £580,000 |  | £270,000 |

***Instructions***

Prepare a worksheet for a consolidated statement of financial position.

**\*E12-14.** *Prepare consolidated worksheet when cost exceeds book value*.

(LO 7)

Data for the Lennon and Ono corporations are presented in E12-13. Assume that instead of paying £220,000 in cash for Ono Ltd., Lennon Corporation pays £225,000 in cash. Thus, at the acquisition date, the assets of Lennon Corporation are current assets £55,000, investment in Ono Ltd. ordinary shares £225,000, and plant and equipment (net) £300,000.

***Instructions***

Prepare a worksheet for a consolidated statement of financial position.

PROBLEMS: SET A AND PROBLEMS: SET B

**Problems: Set A**

**P12-1A** *Journalize debt investment transactions and show financial statement presentation*.

(LO 2, 5, 6)

Yuen Long Carecenters Ltd. provides financing and capital to the health-care industry, with a particular focus on nursing homes for the elderly. The following selected transactions relate to bonds acquired as an investment by Yuen Long, whose fiscal year ends on December 31.

|  |  |
| --- | --- |
| **2017** |  |
| Jan. 1 | Purchased at face value HK$2,000,000 of Franco Nursing Centers, Inc., 10-year, 8% bonds dated January 1, 2017, directly from Franco. |
| Dec. 31 | Accrual of interest at year-end on the Franco bonds. |

(Assume that all intervening transactions and adjustments have been properly recorded and that the number of bonds owned has not changed from December 31, 2017, to December 31, 2019.)

|  |  |
| --- | --- |
| **2020** |  |
| Jan. 1 | Received the semiannual interest on the Franco bonds. |
| Jan. 1 | Sold HK$1,000,000 Franco bonds at 105. |
| Dec. 31 | Accrual of interest at year-end on the Franco bonds. |

***Instructions***

(a) Journalize the listed transactions for the years 2017 and 2020.

Gain on sale of debt investments HK$50,000

(b) Show the statement of financial position presentation of the bonds and interest receivable at December 31, 2017. Assume the investments are considered long-term.

**P12-2A** *Journalize investment transactions, prepare adjusting entry, and show statement presentation*.

(LO 2, 3, 5, 6)

In January 2017, the management of Stefan Company SE concludes that it has sufficient cash to permit some short-term investments in debt and share securities. During the year, the following transactions occurred.

Feb. 1 Purchased 600 ordinary shares of Superior for €32,400.

Mar. 1 Purchased 800 ordinary shares of Pawlik for €20,400.

Apr. 1 Purchased 50 €1,000, 7% Venice bonds for €50,000. Interest is payable semiannually on April 1 and October 1.

July 1 Received a cash dividend of €0.60 per share on the Superior ordinary shares.

Aug. 1 Sold 200 ordinary shares of Superior at €57 per share.

Sept. 1 Received a €1 per share cash dividend on the Pawlik ordinary shares.

Oct. 1 Received the semiannual interest on the Venice bonds.

Oct. 1 Sold the Venice bonds for€49,000.

At December 31, the fair value of the Superior ordinary shares was €55 per share. The fair value of the Pawlik ordinary shares was €24 per share.

***Instructions***

(a) Journalize the transactions and post to the accounts Debt Investments and Share Investments. (Use the T-account form.)

Gain on sale of share investments €600

(b) Prepare the adjusting entry at December 31, 2017, to report the investment securities at fair value. All securities are considered to be trading securities.

(c) Show the statement of financial position presentation of investment securities at December 31, 2017.

(d) Identify the income statement accounts and give the statement classification of each account.

**P12-3A** *Journalize transactions and adjusting entry for share investments*.

(LO 3, 5, 6)

On December 31, 2016, Ogallala Associates owned the following securities, held as a long-term investment. The securities are not held for influence or control of the investee.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Ordinary Shares** |  | **Shares** |  | **Cost** |
| Carlene Co. |  | 2,000 |  | £60,000 |
| Riverdale Co. |  | 5,000 |  | 45,000 |
| Raczynski Co. |  | 1,500 |  | 30,000 |

On December 31, 2016, the total fair value of the securities was equal to its cost. In 2017, the following transactions occurred.

Aug. 1 Received £0.70 per share cash dividend on Carlene Co. ordinary shares.

Sept. 1 Sold 2,000 ordinary shares of Riverdale Co. for cash at £8 per share.

Oct. 1 Sold 800 ordinary shares of Carlene Co. for cash at £33 per share.

Nov. 1 Received £1 per share cash dividend on Raczynski Co. ordinary shares.

Dec. 15 Received £0.70 per share cash dividend on Carlene Co. ordinary shares.

31 Received £1 per share semiannual cash dividend on Riverdale Co. ordinary shares.

At December 31, the fair values per share of the ordinary shares were Carlene Co. £32, Riverdale Co. £8, and Raczynski Co. £18.

***Instructions***

(a) Journalize the 2017 transactions and post to the account Share Investments. (Use the T-account form.)

(b) Prepare the adjusting entry at December 31, 2017, to show the securities at fair value. The shares should be classified as non-trading securities.

Unrealized loss £4,100

(c) Show the statement of financial position presentation of the investments at December 31, 2017. At this date, Ogallala Associates has share capital—ordinary £1,500,000 and retained earnings £1,000,000.

**P12-4A** *Prepare entries under the cost and equity methods, and tabulate differences*.

(LO 3)

Control Alt Design Ltd. acquired 30% of the outstanding ordinary shares of Walter Company on January 1, 2017, by paying £800,000 for the 45,000 shares. Walter declared and paid £0.30 per share cash dividends on March 15, June 15, September 15, and December 15, 2017. Walter reported net income of £320,000 for the year. At December 31, 2017, the market price of Walter ordinary shares was £24 per share.

***Instructions***

(a) Prepare the journal entries for Control Alt Design for 2017, assuming Control Alt Design cannot exercise significant influence over Walter. Use the cost method and assume that Walter ordinary shares should be classified as a trading security.

Total dividend revenue $54,000

(b) Prepare the journal entries for Control Alt Design for 2017, assuming Control Alt Design can exercise significant influence over Walter. Use the equity method.

Revenue from investments $96,000

(c) Indicate the statement of financial position and income statement account balances at December 31, 2017, under each method of accounting.

**P12-5A** *Journalize share investment transactions and show statement presentation*.

(LO 3, 5, 6)

The following securities are in Pascual Company SA's portfolio of long-term non-trading securities at December 31, 2016.

|  |  |
| --- | --- |
|  | **Cost** |
| 1,000 shares of Reginald SA ordinary shares | R$52,000 |
| 1,400 shares of Elderberry A/S ordinary shares | 84,000 |
| 1,200 shares of Mattoon AG preference shares | 33,600 |

On December 31, 2016, the total cost of the portfolio equaled total fair value. Pascual had the following transactions related to the securities during 2017.

Jan. 20 Sold all 1,000 ordinary shares of Reginald Corporation at R$54.80 per share.

28 Purchased 400 R$70 par value ordinary shares of Hachito Corporation at R$79.20 per share.

30 Received a cash dividend of R$1.05 per share on Elderberry ordinary shares.

Feb. 8 Received cash dividends of R$0.40 per share on Mattoon preference shares.

18 Sold all 1,200 preference shares of Mattoon at R$26.30 per share.

July 30 Received a cash dividend of R$1.00 per share on Elderberry ordinary shares.

Sept. 6 Purchased an additional 600 R$70 par value ordinary shares of Hachito Corporation at R$82 per share.

Dec. 1 Received a cash dividend of R$1.35 per share on Hachito ordinary shares.

At December 31, 2017, the fair values of the securities were:

|  |  |
| --- | --- |
| Elderberry A/S ordinary shares | R$64 per share |
| Hachito Ltd. ordinary shares | R$72 per share |

***Instructions***

(a) Prepare journal entries to record the transactions.

Gain on sale of share investments R$2,800

(b) Post to the investment accounts. (Use T-accounts.)

(c) Prepare the adjusting entry at December 31, 2017 to report the portfolio at fair value.

Unrealized loss R$3,280

(d) Show the statement of financial position presentation at December 31, 2017, for the investment-related accounts.

**P12-6A** *Prepare a statement of financial position*.

(LO 5, 6)

The following data, presented in alphabetical order, are taken from the records of Radar Corporation.

|  |  |
| --- | --- |
| Accounts payable | € 240,000 |
| Accounts receivable | 140,000 |
| Accumulated depreciation—buildings | 180,000 |
| Accumulated depreciation—equipment | 52,000 |
| Allowance for doubtful accounts | 6,000 |
| Bonds payable (10%, due 2023) | 540,000 |
| Buildings | 950,000 |
| Cash | 42,000 |
| Dividends payable | 80,000 |
| Equipment | 275,000 |
| Fair value adjustment—non-trading securities (Dr) | 8,000 |
| Goodwill | 200,000 |
| Income taxes payable | 120,000 |
| Inventory | 170,000 |
| Investment in Mara ordinary shares (30% ownership), at equity | 380,000 |
| Investment in Sasse ordinary shares (10% ownership), at cost | 278,000 |
| Land | 390,000 |
| Notes payable (due 2018) | 70,000 |
| Prepaid insurance | 16,000 |
| Retained earnings | 103,000 |
| Share capital—ordinary (€10 par value; 500,000 shares authorized, 150,000 shares issued) | 1,500,000 |
| Share premium—ordinary | 130,000 |
| Short-term investments, at fair value (and cost) | 180,000 |
| Unrealized gain—non-trading securities | 8,000 |

The investment in Sasse ordinary shares is considered to be a long-term non-trading security.

***Instructions***

Prepare a classified statement of financial position at December 31, 2017.

Total assets €2,791,000

**\*P12-7A** *Prepare consolidated worksheet and statement of financial position when cost exceeds book value*.

(LO 7)

Liu Corporation purchased all the outstanding ordinary shares of Yang Plastics, Ltd. on December 31, 2017. Just before the purchase, the condensed statements of financial position of the two companies appeared as follows.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Liu Corporation** |  | **Yang Plastics, Inc.** |
| Plant and equipment (net) | ¥2,100,000 |  | ¥ 676,000 |
| Current assets | 1,480,000 |  | 435,500 |
|  | ¥3,580,000 |  | ¥ 1,111,500 |
| Share capital—ordinary | ¥1,950,000 |  | ¥ 525,000 |
| Retained earnings | 1,052,000 |  | 494,000 |
| Current liabilities | 578,000 |  | 92,500 |
|  | ¥3,580,000 |  | ¥ 1,111,500 |

**Problems: Set B**

**P12-1B** *Journalize debt investment transactions and show financial statement presentation*.

(LO 2, 5, 6)

Cheese Farms is a grower of hybrid seed corn for Steenbergen Genetics Limited. It has had two exceptionally good years and has elected to invest its excess funds in bonds. The selected transactions, shown below, relate to bonds acquired as an investment by Cheese Farms, whose fiscal year ends on December 31.

|  |  |
| --- | --- |
| **2017** |  |
| Jan. 1 | Purchased at face value £400,000 of Stombaugh Corporation 10-year, 6% bonds dated January 1, 2017, directly from the issuing corporation. |
| Dec. 31 | Accrual of interest at year-end on the Stombaugh bonds. Interest is paid on January 1 of each year. |

(Assume that all intervening transactions and adjustments have been properly recorded and the number of bonds owned has not changed from December 31, 2017, to December 31, 2019.)

|  |  |
| --- | --- |
| **2020** |  |
| Jan. 1 | Received the semiannual interest on the Stombaugh bonds. |
| Jan. 1 | Sold £240,000 of Stombaugh bonds at 112. |
| Dec. 31 | Accrual of interest at year-end on the Stombaugh bonds. |

***Instructions***

(a) Journalize the listed transactions for the years 2017 and 2017.

2017: Gain on sale of debt investments $28,800

(b) Show the statement of financial position presentation of the bonds and interest receivable at December 31, 2017. Assume the investments are considered long-term.

**P12-2B** *Journalize investment transactions, prepare adjusting entry, and show statement presentation*.

(LO 2, 3, 5, 6)

In January 2017, the management of Izmir A.S. concludes that it has sufficient cash to purchase some short-term investments in debt and share securities. During the year, the following transactions occurred.

Feb. 1 Purchased 500 ordinary shares of Joy for [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)30,800.

Mar. 1 Purchased 600 ordinary shares of Aurelius for [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)20,300.

Apr. 1 Purchased 40 [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)1,000, 9% Sikich bonds for [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)40,000. Interest is payable annually on October 1.

July 1 Received a cash dividend of [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)0.60 per share on the Joy ordinary shares.

Aug. 1 Sold 300 ordinary shares of Joy at [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)69 per share.

Sept. 1 Received a [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)1 per share cash dividend on the Aurelius ordinary shares.

Oct. 1 Received the interest on the Sikich bonds.

Oct. 1 Sold the Sikich bonds for [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)44,000.

At December 31, the fair value of the Joy ordinary shares was [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)66 per share. The fair value of the Aurelius ordinary shares was [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)29 per share.

***Instructions***

(a) Journalize the transactions and post to the accounts Debt Investments and Share Investments. (Use the T-account form.)

(b) Prepare the adjusting entry at December 31, 2017, to report the investments at fair value. All securities are considered to be trading securities.

Unrealized loss [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)2,020

(c) Show the statement of financial position presentation of investment securities at December 31, 2017.

(d) Identify the income statement accounts and give the statement classification of each account.

**P12-3B** *Journalize transactions and adjusting entry for share investments*.

(LO 3, 5, 6)

On December 31, 2016, Eli Associates owned the long-term investments shown below.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Ordinary Shares** |  | **Share** |  | **Cost** |
| Trowbridge Co. |  | 4,000 |  | €96,000 |
| Holly Co. |  | 5,000 |  | 30,000 |
| Oriental Motors Co. |  | 3,000 |  | 60,000 |

On this date, the total fair value of the securities was equal to its cost. The securities are not held for influence or control over the associates. In 2017, the following transactions occurred.

Aug. 1 Received €0.50 per share cash dividend on Trowbridge Co. ordinary shares.

Sept. 1 Sold 1,500 ordinary shares of Holly Co. for cash at €8.50 per share.

Oct. 1 Sold 600 ordinary shares of Trowbridge Co. for cash at €30 per share.

Nov. 1 Received €1 per share cash dividend on Oriental Motor Co. ordinary shares.

Dec.15 Received €0.60 per share cash dividend on Trowbridge Co. ordinary shares.

31 Received €1 per share semiannual cash dividend on Holly Co. ordinary shares.

At December 31, the fair values per share of the ordinary shares were Trowbridge Co. €23, Holly Co. €7, and Oriental Motors Co. €19.

***Instructions***

(a) Journalize the 2017 transactions and post to the account Share Investments. (Use the T-account form.)

Gain on sale, €3,750 and €3,600

(b) Prepare the adjusting entry at December 31, 2017, to show the securities at fair value. The shares should be classified as non-trading securities.

(c) Show the statement of financial position presentation of the investment-related accounts at December 31, 2017. At this date, Eli Associates has share capital—ordinary €2,000,000 and retained earnings €1,200,000.

**P12-4B** *Prepare entries under the cost and equity methods, and tabulate differences*.

(LO 3)

Tuecke's Concrete acquired 20% of the outstanding ordinary shares of Drew, Ltd. on January 1, 2017, by paying £1,100,000 for 40,000 shares. Drew declared and paid a £0.50 per share cash dividend on June 30 and again on December 31, 2017. Drew reported net income of £600,000 for the year. At December 31, 2017, the market price of Drew's ordinary shares was £30 per share.

***Instructions***

(a) Prepare the journal entries for Tuecke's Concrete for 2017, assuming Tuecke's cannot exercise significant influence over Drew. Use the cost method and assume Drew ordinary shares should be classified as non-trading.

Total dividend revenue £40,000

(b) Prepare the journal entries for Tuecke's Concrete for 2017, assuming Tuecke's can exercise significant influence over Drew. Use the equity method.

Revenue from investment £120,000

(c) Indicate the statement of financial position and income statement account balances at December 31, 2017, under each method of accounting.

**P12-5B** *Journalize share investment transactions and show statement presentation*.

(LO 3, 5, 6)

The following are in Verbitsky's Company's portfolio of long-term non-trading securities at December 31, 2016.

|  |  |
| --- | --- |
|  | **Cost** |
| 700 shares of Sasha OAO ordinary shares | €35,000 |
| 900 shares of Ukraine OAO ordinary shares | 42,000 |
| 800 shares of Zaba OAO preference shares | 22,400 |

On December 31, the total cost of the portfolio equaled total fair value. Verbitsky's Company had the following transactions related to the securities during 2017.

Jan. 7 Sold 700 ordinary shares of Sasha Corporation at €56 per share.

10 Purchased 300 €70 par value ordinary shares of Vanucci Corporation at €78.50 per share.

26 Received a cash dividend of €1.15 per share on Ukraine Corporation ordinary shares.

Feb. 2 Received cash dividends of €0.40 per share on Zaba Corporation preference shares.

10 Sold all 800 preference shares of Zaba Corporation at €26 per share.

July 1 Received a cash dividend of €1.05 per share on Ukraine Corporation ordinary shares.

Sept. 1 Purchased an additional 800 €70 par value ordinary shares of Vanucci Corporation at €75 per share.

Dec.15 Received a cash dividend of €1.50 per share on Vanucci Corporation ordinary shares.

At December 31, 2017, the fair values of the securities were:

|  |  |
| --- | --- |
| Ukraine OAO ordinary shares | €48 per share |
| Vanucci OAO ordinary shares | €72 per share |

***Instructions***

(a) Prepare journal entries to record the transactions.

Loss on sale €1,600

(b) Post to the investment accounts. (Use T-accounts.)

(c) Prepare the adjusting entry at December 31, 2017, to report the portfolio at fair value.

Unrealized loss €3,150

(d) Show the statement of financial position presentation at December 31, 2017, for the investmentrelated accounts.

**P12-6B** *Prepare a statement of financial position*.

(LO 5, 6)

The following data, presented in alphabetical order, are taken from the records of Redlands Enterprises AG.

|  |  |
| --- | --- |
| Accounts payable | CHF 375,000 |
| Accounts receivable | 135,000 |
| Accumulated depreciation—buildings | 270,000 |
| Accumulated depreciation—equipment | 80,000 |
| Allowance for doubtful accounts | 10,000 |
| Bonds payable (10%, due 2027) | 570,000 |
| Buildings | 1,350,000 |
| Cash | 210,000 |
| Dividends payable | 75,000 |
| Equipment | 415,000 |
| Goodwill | 300,000 |
| Income taxes payable | 180,000 |
| Inventory | 255,000 |
| Investment in Bonita Inc. shares (30% ownership), at equity | 900,000 |
| Land | 780,000 |
| Notes payable (due 2018) | 110,000 |
| Prepaid insurance | 25,000 |
| Retained earnings | 480,000 |
| Share capital—ordinary (CHF5 par value; 500,000 shares authorized, 440,000 shares issued) | 2,200,000 |
| Share premium—ordinary | 300,000 |
| Short-term investments, at fair value (and cost) | 280,000 |

***Instructions***

Prepare a classified statement of financial position at December 31, 2017.

Total assets CHF4,290,000

**\*P12-7B** *Prepare consolidated worksheet and statement of financial position when cost exceeds book value*.

(LO 7)

Patel Company Ltd. purchased all the outstanding ordinary shares of Singh Company Ltd. on December 31, 2017. Just before the purchase, the condensed statements of financial position of the two companies were as follows.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Patel Company** |  | **Singh Company** |
| Plant and equipment (net) | €1,882,000 |  | €351,000 |
| Current assets | 1,478,000 |  | 379,000 |
|  | €3,360,000 |  | €730,000 |
| Share capital—ordinary | €1,947,000 |  | €360,000 |
| Retained earnings | 543,000 |  | 280,000 |
| Current liabilities | 870,000 |  | 90,000 |
|  | €3,360,000 |  | €730,000 |

Patel used current assets of €700,000 to acquire the shares of Singh. The excess of this purchase price over the book value of Patel's net assets is determined to be attributable €25,000 to Singh's plant and equipment and the remainder to goodwill.

***Instructions***

(a) Prepare the entry for Patel Company's acquisition of Singh Company shares.

(b) Prepare a consolidated worksheet at December 31, 2017.

Excess of cost over book value €35,000

(c) Prepare a consolidated statement of financial position at December 31, 2017.

**COMPREHENSIVE PROBLEM: CHAPTERS 11 TO 12**

**CP12 Part I** Mindy Feldkamp and her two colleagues, Oscar Lopez and Lori Melton, are personal trainers at an upscale health spa/resort in Madrid. They want to start a health club that specializes in health plans for people in the 50+ age range. The growing population in this age range and strong consumer interest in the health benefits of physical activity have convinced them they can profitably operate their own club. In addition to many other decisions, they need to determine what type of business organization they want. Oscar believes there are more advantages to the corporate form than a partnership, but he hasn't yet convinced Mindy and Lori. They have come to you, a small-business consulting specialist, seeking information and advice regarding the choice of starting a partnership versus a corporation.

***Instructions***

(a) Prepare a memo (dated May 26, 2016) that describes the advantages and disadvantages of both partnerships and corporations. Advise Mindy, Oscar, and Lori regarding which organizational form you believe would better serve their purposes. Make sure to include reasons supporting your advice.

**Part II** After deciding to incorporate, each of the three investors receives 20,000 €2 par ordinary shares on June 12, 2016, in exchange for their co-owned building (€200,000 fair value) and €100,000 total cash they contributed to the business. The next decision that Mindy, Oscar, and Lori need to make is how to obtain financing for renovation and equipment. They understand the difference between equity securities and debt securities, but do not understand the tax, net income, and earnings per share consequences of equity versus debt financing on the future of their business.

***Instructions***

(b) Prepare notes for a discussion with the three entrepreneurs in which you will compare the consequences of using equity versus debt financing. As part of your notes, show the differences in interest and tax expense assuming €1,400,000 is financed with ordinary shares, and then alternatively with debt. Assume that when ordinary shares are used, 140,000 shares will be issued. When debt is used, assume the interest rate on debt is 9%, the tax rate is 32%, and income before interest and taxes is €300,000. (You may want to use an electronic spreadsheet.)

**Part III** During the discussion about financing, Lori mentions that one of her clients, Roberto Marino, has approached her about buying a significant interest in the new club. Having an interested investor sways the three to issue equity securities to provide the financing they need. On July 21, 2016, Mr. Marino buys 90,000 shares at a price of €10 per share.

The club, LifePath Fitness, opens on January 12, 2017, and after a slow start begins to produce the revenue desired by the owners. The owners decide to pay themselves a share dividend since cash has been less than abundant since they opened their doors. The 10% share dividend is declared by the owners on July 27, 2017. The market price of the shares is €3 on the declaration date. The date of record is July 31, 2017 (there have been no changes in share ownership since the initial issuance), and the issue date is August 15, 2017. By the middle of the fourth quarter of 2017, the cash flow of LifePath Fitness has improved to the point that the owners feel ready to pay themselves a cash dividend. They declare a €0.05 cash dividend per share on December 4, 2017. The record date is December 14, 2017, and the payment date is December 24, 2017.

***Instructions***

(c) (1) Record all of the transactions related to the ordinary shares of LifePath Fitness during the years 2016 and 2017. (2) Indicate how many shares are issued and outstanding after the share dividend is issued.

**Part IV** Since the club opened, a major concern has been the pool facilities. Although the existing pool is adequate, Mindy, Oscar, and Lori all desire to make LifePath a cutting-edge facility. Until the end of 2017, financing concerns prevented this improvement. However, because there has been steady growth in clientele, revenue, and income since the fourth quarter of 2017, the owners have explored possible financing options. They are hesitant to issue shares and change the ownership mix because they have been able to work together as a team with great effectiveness. They have formulated a plan to issue secured term bonds to raise the needed €600,000 for the pool facilities. By the end of December 2017, everything was in place for the bond issue to go ahead. On January 1, 2018, the bonds were issued for €548,000. The bonds pay semiannual interest of 3% (6% annual) on January 1 of each year. The bonds mature in 10 years, and amortization is computed using the straight-line method.

***Instructions***

(d) Record (1) the issuance of the secured bonds, (2) the interest payment made on December 1, 2018, (3) the interest payment made on January 1, 2019, and (4) the interest accrual on December 31, 2019.

**Part V** Mr. Marino's purchase of the shares of LifePath Fitness was done through his business. The share investment has always been accounted for using the cost method on his firm's books. However, early in 2019 he decided to take his company public. He is preparing an IPO (initial public offering), and he needs to have the firm's financial statements audited. One of the issues to be resolved is to restate the share investment in LifePath Fitness using the equity method, since Mr. Marino's ownership percentage is greater than 20%.

***Instructions***

(e) (1) Give the entries that would have been made on Marino's books if the equity method of accounting for investments had been used from the initial investment through 2018. Assume the following data for LifePath.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **2016** |  | **2017** |  | **2018** |
| Net income | €30,000 |  | €70,000 |  | €105,000 |
| Total cash dividends | € 2,100 |  | €20,000 |  | € 50,000 |

(2) Compute the balance in the Share Investments account (as it relates to LifePath Fitness) at the end of 2018.

MATCHA CREATIONS

**MC12** Mei-ling has been approached by Ken Thornton, a shareholder of The Beanery Coffee. Ken wants to retire and would like to sell his 1,000 shares in The Beanery Coffee, which represents 30% of all shares issued. The Beanery is currently operated by Ken's twin daughters, who each own 35% of the ordinary shares. The Beanery not only operates a coffee shop but also roasts and sells beans to retailers, under the name “Rocky Mountain Beanery.”

Ken has met with Curtis and Natalie to discuss the business operation. All have concluded that there would be many advantages for Matcha & Coffee Creations to acquire an interest in The Beanery Coffee. Despite the apparent advantages, however, Mei-ling and Curtis are still not convinced that they should participate in this business venture.

**Broadening Your Perspective**

Financial Reporting and Analysis

**BYP12-1. Financial Reporting Problem: TSMC Ltd. (TWN)**

The financial statements of TSMC are presented in Appendix A. The complete annual report, including the notes to the financial statements, is available in the Investor section of the company's website at *www.tsmc.com*.

***Instructions***

(a) See Note 4 to the financial statements and indicate what the consolidated financial statements include.

(b) Using TSMC's consolidated statement of cash flows, determine how much was spent for capital acquisitions during the current year.

**BYP12-2. Comparative Analysis Problem: Nestlé S.A (CHE) vs. Petra Foods Ltd. (SGP)**

Nestlé's financial statements are presented in Appendix B. Financial statements of Petra Foods are presented in Appendix C. Complete annual reports, including notes to the financial statements, are available in the Investor Relations sections at *www.nestle.com* and *www.petrafoods.com*.

***Instructions***

(a) Based on the information contained in these financial statements, determine the following for each company.

(1) Net cash provided (used) for investing (investment) activities for the current year (from the statement of cash flows).

(2) Cash used for capital expenditures during the current year.

(b) Each of Nestlé's financial statements is labeled “consolidated.” What has been consolidated? That is, from the contents of Nestlé's annual report, identify by name the divisions that have been consolidated.

**BYP12-3. Real-World Focus**

Most publicly traded companies are examined by numerous analysts. These analysts often don't agree about a company's future prospects. In this exercise, you will find analysts' ratings about companies and make comparisons over time and across companies in the same industry. You will also see to what extent the analysts experienced “earnings surprises.” Earnings surprises can cause changes in share prices.

***Address:* biz.yahoo.com/i/** or go to **www.wiley.com/college/weygandt**

***Steps***

1. Choose a company.

2. Use the index to find the company's name.

3. Choose **Research**.

***Instructions***

(a) How many analysts rated the company?

(b) What percentage rated it a strong buy?

(c) What was the average rating for the week?

(d) Did the average rating improve or decline relative to the previous week?

(e) What was the amount of the earnings surprise percentage during the last quarter?

Critical Thinking

**BYP12-4. Decision-Making Across the Organization**

At the beginning of the question-and-answer portion of the annual shareholders' meeting of Kemper Ltd., shareholder Mike Kerwin asks, “Why did management sell the holdings in UMW Company at a loss when this company has been very profitable during the period Kemper held its shares?”

Since president Tony Chavez has just concluded his speech on the recent success and bright future of Kemper, he is taken aback by this question and responds, “I remember we paid £1,300,000 for those shares some years ago. I am sure we sold these shares at a much higher price. You must be mistaken.”

Kerwin retorts, “Well, right here in footnote number 7 to the annual report it shows that 240,000 shares, a 30% interest in UMW, were sold on the last day of the year. Also, it states that UMW earned £520,000 this year and paid out £160,000 in cash dividends. Further, a summary statement indicates that in past years, while Kemper held UMW shares, UMW earned £1,240,000 and paid out £440,000 in dividends. Finally, the income statement for this year shows a loss on the sale of UMW shares of £180,000. So, I doubt that I am mistaken.”

Red-faced, president Chavez turns to you.

***Instructions***

With the class divided into groups, answer the following.

(a) What dollar amount did Kemper receive upon the sale of the UMW shares?

(b) Explain why both shareholder Kerwin and president Chavez are correct.

**BYP12-5. Communication Activity**

Bunge Company Ltd. has purchased two securities for its portfolio. The first is a share investment in Longley Corporation, one of its suppliers. Bunge purchased 10% of Longley with the intention of holding it for a number of years but has no intention of purchasing more shares. The second investment was a purchase of debt securities. Bunge purchased the debt securities because its analysts believe that changes in market interest rates will cause these securities to increase in value in a short period of time. Bunge intends to sell the debt securities as soon as they have increased in value.

***Instructions***

Write a memo to Max Scholes, the chief financial officer, explaining how to account for each of these investments. Explain what the implications for reported income are from this accounting treatment.

**BYP12-6. Ethics Case**

Bartlet Financial Services Company holds a large portfolio of debt and share securities as an investment. The total fair value of the portfolio at December 31, 2017, is greater than total cost. Some securities have increased in value and others have decreased. Deb Faust, the financial vice president, and Jan McCabe, the controller, are in the process of classifying for the first time the securities in the portfolio.

Faust suggests classifying the securities that have increased in value as trading securities in order to increase net income for the year. She wants to classify the securities that have decreased in value as long-term non-trading securities, so that the decreases in value will not affect 2017 net income.

McCabe disagrees. She recommends classifying the securities that have decreased in value as trading securities and those that have increased in value as long-term non-trading securities. McCabe argues that the company is having a good earnings year and that recognizing the losses now will help to smooth income for this year. Moreover, for future years, when the company may not be as profitable, the company will have built-in gains.

***Instructions***

(a) Will classifying the securities as Faust and McCabe suggest actually affect earnings as each says it will?

(b) Is there anything unethical in what Faust and McCabe propose? Who are the stakeholders affected by their proposals?

(c) Assume that Faust and McCabe properly classify the portfolio. At year-end, Faust proposes to sell the securities that will increase 2017 net income, and McCabe proposes to sell the securities that will decrease 2017 net income. Is this unethical?

A LOOK at U.S. GAAP

The accounting and reporting for investments under IFRS and GAAP are very similar.

**Key Points**

* The basic accounting entries to record the acquisition of debt securities, the receipt of interest, and the sale of debt securities are the same under IFRS and GAAP.
* The basic accounting entries to record the acquisition of share investments, the receipt of dividends, and the sale of share securities are the same under IFRS and GAAP.
* Both IFRS and GAAP require that companies determine how to measure their financial assets based on two criteria:
* The company's business model for managing their financial assets; and
* The contractual cash flow characteristics of the financial asset.

If a company has (1) a business model whose objective is to hold assets in order to collect contractual cash flows and (2) the contractual terms of the financial asset gives specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding, then the company should use cost (often referred to as amortized cost).

For example, assume that Mitsubishi (JPN) purchases a bond investment that it intends to hold to maturity (held-for-collection). Its business model for this type of investment is to collect interest and then principal at maturity. The payment dates for the interest rate and principal are stated on the bond. In this case, Mitsubishi accounts for the investment at cost. If, on the other hand, Mitsubishi purchased the bonds as part of a trading strategy to speculate on interest rate changes (a trading investment), then the debt investment is reported at fair value. As a result, only debt investments such as receivables, loans, and bond investments that meet the two criteria above are recorded at amortized cost. All other debt investments are recorded and reported at fair value.

**Similarities**

* Both IFRS and GAAP use the same criteria to determine whether the equity method of accounting should be used—that is, significant influence with a general guide of over 20% ownership. IFRS uses the term **associate investment**rather than equity investment to describe its investment under the equity method.
* Under IFRS, both the investor and an associate company should follow the same accounting policies. As a result, in order to prepare financial information, adjustments are made to the associate's policies to conform to the investor's books. GAAP does not have that requirement.
* Both IFRS and GAAP use held-for-collection (debt investments), trading (both debt and equity investments), and non-trading equity investment classifications. These classifications are based on the business model used to manage the investments and the type of security.
* The accounting for trading investments is the same between GAAP and IFRS. Also, held-for-collection investments are accounted for at amortized cost. Gains and losses on non-trading equity investments (IFRS) are reported in other comprehensive income.
* Unrealized gains and losses related to non-trading securities are reported in other comprehensive income under GAAP and IFRS. These gains and losses that accumulate are then reported in the statement of financial position.

**Differences**

* The basis for consolidation under IFRS is control. Under GAAP, a bipolar approach is used, which is a risk-and-reward model (often referred to as a variable-entity approach) and a voting-interest approach. However, under both systems, for consolidation to occur, the investor company must generally own 50% of another company.
* Under GAAP, companies use Other Revenues and Gains or Other Expenses and Losses in its income statement presentation. Under IFRS, companies will generally classify these items as unusual items or financial items.

**Looking to the Future**

As indicated earlier, both the FASB and IASB have indicated (conceptually) that they believe that all financial instruments should be reported at fair value and that changes in fair value should be reported as part of net income. However, both the FASB and IASB have decided to permit amortized cost for debt investments held-for-collection. Hopefully, they will eventually arrive at fair value measurement for all financial instruments.

**GAAP Practice**

**GAAP Self-Test Questions**

**1.** The following asset is **not**considered a financial asset under both GAAP and IFRS:

(a) trading securities.

(b) equity securities.

(c) held-for-collection securities.

(d) inventories.

**Answer**

(d) inventories.

**2.** Under GAAP, the equity method of accounting for long-term investments in ordinary shares should be used when the investor has significant influence over an investee and owns:

(a) between 20% and 50% of the investee's ordinary shares.

(b) 30% or more of the investee's ordinary shares.

(c) more than 50% of the investee's ordinary shares.

(d) less than 20% of the investee's ordinary shares.

**Answer**

(a) between 20% and 50% of the investee's ordinary shares.

**3.** At the end of the first year of operations, the total cost of the trading investments portfolio is $120,000. Total fair value is $115,000. The financial statements under GAAP should show:

(a) a reduction in the carrying value of the asset of $5,000 in current assets and an unrealized loss of $5,000 in other expenses and losses.

(b) a reduction in the carrying value of the asset of $5,000 in current assets and an unrealized loss of $5,000 in the equity section of the balance sheet.

(c) a reduction in the carrying value of the asset of $5,000 in current assets and an unrealized loss of $5,000 in other comprehensive income.

(d) a reduction in the carrying value of the asset $5,000 in current assets and a realized loss of $5,000 in other expenses and losses.

**Answer**

(a) a reduction in the carrying value of the asset of $5,000 in current assets and an unrealized loss of $5,000 in other expenses and losses.

**4.** Under GAAP, unrealized gains on non-trading share investments should:

(a) be reported as other revenues and gains in the income statement as part of net income.

(b) be reported as other gains on the income statement as part of net income.

(c) not be reported on the income statement or statement of financial position.

(d) be reported as other comprehensive income.

**Answer**

(d) be reported as other comprehensive income.

**5.** Under GAAP, the unrealized loss on trading investments should be reported:

(a) as part of other comprehensive loss reducing net income.

(b) on the income statement reducing net income.

(c) as part of other comprehensive loss not affecting net income.

(d) directly to equity bypassing the income statement.

**Answer**

(b) on the income statement reducing net income.

**GAAP Financial Reporting Problem: Apple Inc.**

**GAAP12-1.** The financial statements of Apple are available in Appendix D. The complete annual report, including the notes to the financial statements, is available at *http://investor.apple.com*.

**Instructions**

(a) Determine the percentage increase for (1) short-term marketable securities from 2012 to 2013, and (2) long-term marketable securities from 2012 to 2013.

(b) Using Apple’s consolidated statement of cash flows, determine:

(1) Purchases of marketable securities during the current year.

(2) How much was spent for business acquisitions, net of cash acquired during the current year.