APPENDIX A
INVESTMENTS IN OTHER CORPORATIONS

Learning Objectives and Related Assignment Materials

Learning Objectives	*Mini-Exercises*	*Exercises*	*Problems*	*Alternate Problems*	*Cont. Prob.*	*Cases and Projects*
A-1 Analyze and report investments in debt securities using the amortized cost and fair value methods.	1, 2, 3, 4, 5, 6	1, 2, 3, 11	1, 2, 3	1, 2, 3	1	2, 4 7
A-2 Analyze and report passive investments in equity securities using the fair value method.	1, 7	4, 7, 10	3, 4, 5	3, 4, 5	1	1, 2, 3, 7
A-3 Analyze and report investments involving significant influence using the equity method.	1, 8, 9	5, 6, 7	4, 5, 6, 7	4, 5, 6, 7	1	3, 7
A-4 Analyze and report investments in controlling interests.	1, 10	8	8	8		1, 2, 5, 6, 7
Appendix Supplement – Held-to-Maturity Bonds Purchased at Other Than Par Value: Amortized Cost Method		9				

Synopsis of Chapter Revisions

Focus Company: The Walt Disney Company

- ***Updated the Focus Company*, The Walt Disney Company's** illustrations.

- ***Modified*** marginal illustrations of the timing of transactions regarding held-to-maturity, trading securities, and available-for-sale debt and equity investments.
- ***New*** block on accounting for investments in crypto assets.

PowerPoint Slides

Learning Objectives	*PowerPoint® Slides*
A-1 Analyze and report investments in debt securities using the amortized cost and fair value methods.	A-10 through A-30
A-2 Analyze and report passive investments in equity securities using the fair value method.	A-31 through A-41
A-3 Analyze and report investments involving significant influence using the equity method.	A-42 through A-51
A-4 Analyze and report investments in controlling interests.	A-52 through A-59
Appendix Supplement – Held-to-Maturity Bonds Purchased at Other Than Par Value: Amortized Cost Method	A-60 through A-61

Chapter Take-Aways

A-1 A-1 Analyze and report investments in debt securities using the amortized cost and fair value methods.

When management intends to hold an investment in a debt security (such as a bond or note) until it matures, the held-to-maturity security is recorded at cost when acquired and reported at amortized cost on the balance sheet. Any interest earned during the period is reported on the income statement.

If the investments are intended to be held actively, the trading securities are reported at **fair value**, with unrealized gains and losses reported on the income statement.

If the investments in debt securities are not to be held to maturity or actively traded, the available-for-sale securities are reported at **fair value**, with unrealized gains and losses reported on the statement of comprehensive income. When sold, the net unrealized gains/losses for the securities are reclassified from the statement of comprehensive income to realized gains/losses on the income statement.

A-2 Analyze and report passive investments in equity securities using the fair value method.

Acquiring less than 20 percent of the outstanding voting shares of another company's common stock is usually presumed to be a passive investment. These investments are recorded at cost and adjusted to **fair value** at year-end. The resulting unrealized gain or loss is reported on the income statement, the same treatment as trading securities (debt).

Any dividends earned are reported as revenue.

A-3 Analyze and report investments involving significant influence using the equity method.

If between 20 and 50 percent of the outstanding voting shares are owned, significant influence over the affiliate firm's operating and financing policies is presumed, and the equity method is applied. Under the **equity method**, the investor records the investment at cost on the acquisition date. Each period thereafter, the investment amount is increased (or decreased) by the proportionate interest in the income (or loss) reported by the affiliate corporation and decreased by the proportionate share of the dividends declared by the affiliate corporation.

Chapter Take-Aways, continued

A-4 Analyze and report investments in controlling interests.

Mergers occur when one company purchases all of the net assets of another and the target company ceases to exist as a separate legal entity. Mergers and ownership of a controlling interest of another corporation (more than 50 percent of the outstanding voting shares) must be accounted for using the **acquisition method**. The acquired company's assets and liabilities are measured at their fair values on the date of the transaction. Any amount paid above the fair value of the assets less liabilities is reported as goodwill by the buyer.

Finding Financial Information

Balance Sheet

Current Assets

Investments (trading securities (debt) and equity securities if intended to be current)

Noncurrent Assets

Investments (available-for-sale debt securities, equity securities if intended to be noncurrent, and those held for significant influence)

Stockholders' Equity

Other comprehensive income (for unrealized gains/losses in available-for-sale debt securities)

Statement of Comprehensive Income

Net income

Other comprehensive income:

Unrealized gains/losses (from available-for-sale debt securities)

Reclassification of unrealized gains/losses (due to sale)

Income Statement

Under "Other Items":

Dividend and interest revenue

Gains or losses on sale of investments

Net unrealized gains/losses (on trading securities or passive equity investments)

Equity in investee earnings/losses (equity method)

Statement of Cash Flows

Operating Activities:

Net income adjusted for:

Gains/losses on sale of investments

Net unrealized gains/losses (from trading securities and passive equity securities)

Dividends received from equity method investees

Equity in investee earnings/losses (equity

	method) ***Investing Activities*** Purchase/sale of investments
Notes ***In Various Notes*** Accounting policies for investments Details about trading and available-for-sale debt securities, passive equity securities, and equity method investments	

Chapter Outline	Teaching Notes
LO A-1 – Analyze and report investments in debt securities using the amortized cost and fair value methods.	
I. Types of Investments and Accounting Methods	
A. Passive Investments in Debt and Equity Securities	
1. Passive investments are made to earn a return on funds that may be needed for future short-term or long-term purposes.	*Exhibit A.1: Consolidated Balance Sheet (Condensed)*
2. Category includes:	
a. Investments in debt (bonds and notes); always considered passive investments.	
i. If the company intends to hold the securities until they reach maturity, the investments are measured and reported at **amortized cost**. They are classified as noncurrent **held-to-maturity investments**, unless they mature within 12 months (and then they are reported as current assets).	
ii. If they are to be sold before maturity, they are reported using the **fair value method**. If they are actively traded, they are classified as current assets called **trading securities**. Debt securities not intended to be held to maturity or actively traded would be classified as current or noncurrent available-for-sale securities.	
b. Investments in equity securities (stock).	
i. Presumed passive if the investing company owns less than 20% of the outstanding voting shares of the other company.	
ii. The fair value method is used to measure and report the investments, and they would be classified as current or noncurrent investments in equity securities.	
B. Investments in Stock for Significant Influence	

1. Significant influence is the ability to have an important impact on the operating, investing, and financing policies of another company.
    a. Presumed if the investing company owns from 20% to 50% of the outstanding voting shares of the other company.
    b. Other factors may also indicate that significant influence exists.
        i. Membership on the board of directors of the other company.
        ii. Participation in the policy-making processes.
        iii. Evidence of material transactions between the two companies.
        iv. An interchange of management personnel.
        v. Technological dependency.
2. Equity method is used to measure and report investments in stock for significant influence.

C. Investments in Stock for Control

1. Control is the ability to determine the operating and financing policies of another company through ownership of voting stock.

Exhibit A.2: Summary of Measuring and Reporting Methods for Investments

2. Presumed when the investing company owns more than 50% of the outstanding voting stock of the other company.
3. The acquisition method of accounting and consolidation are applied to combine the companies.

II. Passive Investment in Debt Securities

A. Purchasing Debt Securities

1. A debt security (bond or note) may be acquired at the maturity amount (par), for less than the maturity amount (at a discount), or for more (at a premium). The total cost, including transfer fees and broker commissions, is

debited to Investments.

2. On October 1, 2026, Disney paid the par value of $150,000 for 6% bonds that mature on 9/30/31. Interest at 6 percent per year is paid on 3/31 and 9/30.

Dr Investments (+A)	150,000	
Cr Cash (−A)		150,000

Assets = Liabilities + Stockholders' Equity
Investments (A) +150,000 + Cash (A) − 150,000 = No change

B. Earning Interest Revenue

1. No premium or discount needs to be amortized because bonds were purchased at par. Disney records the receipt of $4,500 in interest revenue every March 31 and September 30 that Disney holds the bonds ($150,000 × .06 × ½ year).

Dr Cash (+A)	4,500	
Cr Interest Revenue (+R, +SE)		4,500

Assets = Liabilities + Stockholders' Equity

Cash (A) + 4,500 = Interest Revenue (R) + 4,500

2. At the end of each fiscal year, measuring and reporting investments in debt securities depend on management's purpose. Will the debt instruments be:

   a. Held to their maturity dates (classified as either current or noncurrent depending on maturity date),

   b. Traded actively over a short period time (classified as current assets), or

   c. Neither held to maturity nor actively traded (classified as current or noncurrent investments based on management's intent).

C. If Held to Maturity

1. Debt securities are considered held-to-maturity investments when management has the intent and ability

Only purchases at par are covered here; purchases of bonds at to hold them until maturity.

a. These debt instrument investments are reported at cost minus any premium amortization or plus any discount amortization (amortized cost method), not at their fair value.

b. No fair value adjusting entry is necessary at end of period because debt securities are already measured at amortized cost.

2. When Disney's bonds investment matures on 9/30/31, the journal entry to record the receipt of principal would be:

dr Cash (+A)	150,000	
cr Investments (−A)		150,000

Assets = Liabilities + Stockholders' Equity
Cash (A) + 150,000 + Investments (A) − 150,000 = No change

D. If Actively Traded

1. Investments in debt instruments that are held primarily for the purpose of active trading in the near future are accounted for as trading securities.

a. Objective is to generate profits on short-term changes in the price of the securities.

b. Trading securities with readily determinable market values are recorded by applying the fair value method and are reported as current assets.

i. The trading securities portfolio is adjusted up or down to fair value at the end of each fiscal year.

ii. The offsetting effect is reported on the income statement as an unrealized gain or loss, which is then closed to Retained Earnings.

c. If the fair value of Disney's trading securities is $140,000 at fiscal year-end (September 30, 2027), and the book value is $150,000, Disney will record the following adjusting entry:

amounts at other than par are covered in the appendix supplement

See Exhibit A.3: Fair Value Adjustment Illustration – Trading Securities

dr Unrealized loss (+E, −SE)	10,000	
cr Investments (−A)		10,000

Assets = Liabilities + Stockholders' Equity
Investments (A) − 10,000 = Unrealized Loss (E*, SE) − 10,000

* A component of net income; closed to Retained Earnings

2. When the securities are sold on 9/30/28, there are two journal entries:

   a. The trading securities are first adjusted to their fair value of $165,000 on 9/30/28

dr Investments (+A)	25,000	
cr Unrealized gain (+R, +SE)		25,000

Assets = Liabilities + Stockholders' Equity
Investments (A) + 25,000 = Unrealized Gain (R, SE) + 25,000

   b. The sale is then recorded

dr Cash (+A)	165,000	
Cr Investments (−A)		165,000

Assets = Liabilities + Stockholders' Equity
Cash (A) +165,000 + Investments (A) − 165,000 = No change

E. If Not Held to Maturity or Actively Traded

1. Debt investments not held to maturity or traded actively are considered available-for-sale securities.

2. Available-for-sale securities with readily determinable market values are reported at fair value.

   a. Classified as current or noncurrent assets depending on whether management intends to sell the securities during the upcoming year.

b. Available-for-sale securities portfolio is adjusted up or down to fair value.

i. Adjusting entry for unrealized holding gain or loss will increase/decrease total assets.

ii. However, offsetting effect is not reported on the income statement, unlike the treatment for trading securities.

iii. Instead, any unrealized gain or loss is recorded as a component of Other Comprehensive Income on the Statement of Comprehensive Income.

3. When a sale takes place, the investment portfolio is first adjusted to fair value on the sale date. Then the accumulated net unrealized gain or loss is reclassified out of Other Comprehensive Income and reported on the current period's income statement as a realized gain or loss.

Exhibit A.4 Fair Value Adjustment Illustration – Available-for-Sale Debt Securities

a. Assume Disney purchases $150,000 in bonds at par and intends to hold the securities for two years. Fair value at fiscal year-end is $140,000.

i. Purchase and interest revenue journal entries are the same as held-to-maturity bonds.

ii. End of fiscal year end adjusting entry to record available-for-sale securities at fair value is:

dr Unrealized loss (−OCI, −SE)	10,000	
cr Investments (−A)		10,000

Assets = Liabilities + Stockholders' Equity
Investments (A) − 10,000 = Unrealized Loss (OCI, SE) − 10,000

b. Three entries need to be recorded when available-for-sale debt securities are sold:

i. Adjust the investment account to fair value ($165,000) as of the date of sale (9/30/27); book value is $140,000.

dr Investments (+A)	25,000	
cr Unrealized gain (+OCI, +SE)		25,000

Assets = Liabilities + Stockholders' Equity
Investments (A) + 25,000 = Unrealized Gain (OCI, SE) + 25,000

ii. Reclassify the Other Comprehensive Income balance as a realized gain (or loss) to be reported on the income statement. Realized gain = $15,000 ($165,000 current fair value − $150,000 original cost)

dr Unrealized gain (−OCI, −SE)	15,000	
cr Gain on sale of investments (+R, +SE)		15,000

Assets = Liabilities + Stockholders' Equity
No change = Unrealized gain (OCI, SE) − 15,000 + Gain on sale of investments (R, SE) + 15,000

iii. Record the sale of the available-for-sale securities by decreasing investment account by its book value and recording cash received of $165,000.

dr Cash (+A)	165,000	
cr Investments (−A)		165,000

Assets = Liabilities + Stockholders' Equity
Cash (A) +165,000 + Investments (A) − 165,000 = No change

Refer students to Pause for Feedback – Self-Study Quiz and ***Guided Help*** *A-1*

iv. Comparison of Financial Statement Effects of Using Fair Value

LO A-2 – Analyze and report passive investments in equity securities using the fair value method.

III. Passive Investments: The Fair Value Method

A. When a company purchases and owns less than 20% of the outstanding voting stock of another company, the investment is usually considered passive.

B. Passive investments in equity securities, whether current or noncurrent, are reported at fair value with any year-end adjustments for unrealized gains or losses included in net income.

C. Purchasing Equity Securities

1. Purchase of Securities

   a. Recorded initially at cost.

   b. Disney purchased 10,000 shares of Green Light's common stock for $15 per share; the purchase represents 10% of Green Light's 100,000 shares outstanding, which is treated as a passive investment.

dr Investments (+A)	150,000	
cr Cash (−A)		150,000

Assets = Liabilities + Stockholders' Equity
Investments (A) +150,000 + Cash (A) − 150,000 = No change

2. Earning Dividend Revenue

   a. Dividends earned are reported as investment income on the income statement and are included in the computation of net income for the period.

   b. Green Light declares and pays dividends at the end of September each year. A $0.50 per share cash dividend from Green Light is recorded totaling $5,000.

dr Cash (+A)	5,000	
cr Dividend Revenue (+R, +SE)		5,000

Assets = Liabilities + Stockholders' Equity
Cash (A) + 5,000 = Dividend Revenue (R) + 5,000

3. Applying the Fair Value Method

   a. At end of accounting period, passive investments are reported on the balance sheet at fair value (as current or noncurrent assets, depending on management's intent).

b. Reporting the investment at fair value requires adjusting the Investments account up or down to fair value at the end of the period.

c. The unrealized gain or loss is reported on the income statement.

   i. The unrealized gain or loss is subsequently closed to Retained Earnings.

   ii. Thus, the balance sheet remains in balance.

   iii. Only when the security is sold are any realized gains or losses included in net income.

d. Green Light had a $12 per share fair value at September 30, 2027 ($120,000); the investment originally cost $15 per share. Therefore, the lost value is ($15 − $12 = $3 per share × 10,000 shares) = $30,000 for the year.

Exhibit A.5 Fair Value Method – Passive Investment in Equity Securities Illustration

dr Unrealized Loss (+E, −SE)	30,000	
cr Investments (−A)		30,000

Assets = Liabilities + Stockholders' Equity
Investments (A) − 30,000 = Unrealized Loss (E, SE) − 30,000

e. Green Light had a $16.50 per share fair value at September 30, 2028; the investment had gained value ($16.50 − $12 = $4.50 per share) for the year.

dr Investments (+A)	45,000	
cr Unrealized Gain (+R, +SE)		45,000

Assets = Liabilities + Stockholders' Equity
Investments (A) + 45,000 = Unrealized Gain (R, SE) + 45,000

f. On its 2028 balance sheet, Disney would report an investment in equity securities of $165,000.

4. Sale of Securities

   a. The investment account is again adjusted to its fair value on the sale date.

b. The sale is then recorded with the investments account decreased by its book value (equal to fair value after the adjustment above) and the cash account increased by the amount received.

c. On March 31, 2029, Disney sold all of its investment in Green Light for $190,000 in cash ($19 × 10,000 shares).

i. The investment account is again adjusted to fair value on the sale date.

Use Supplemental Enrichment Activity #1

dr Investments (+A)	25,000	
Cr Unrealized gain (+R, +SE)		25,000

Assets = Liabilities + Stockholders' Equity

Investments (A) + 25,000 = Unrealized gain (R, SE) + 25,000

ii. The sale of equity securities is recorded.

dr Cash (+A)	190,000	
cr Investments (−A)		190,000

Assets = Liabilities + Stockholders' Equity
Cash (A) + 190,000 + Investments (A) − 190,000 = No change

Refer students to Pause for Feedback and Self-Study Quiz

d. Financial Statement Effects of Using Fair Value

LO A-3 – Analyze and report investments involving significant influence using the equity method.

IV. Investments for Significant Influence: Equity Method

A. Recording Investments Under the Equity Method

1. An investor may want to exert influence (presumed by owning 20% to 50% of the outstanding voting stock) without becoming the controlling shareholder (presumed when owning more than 50% of the voting stock) for the following reasons:

   a. A retailer may want to influence a manufacturer to be sure that it can obtain certain products designed to its specifications.

   b. A manufacturer may want to influence a computer consulting firm to ensure that it can incorporate the consulting firm's cutting-edge technology in its manufacturing processes.

   c. A manufacturer may recognize that a parts supplier lacks experienced management and could prosper with additional managerial support.

2. Equity method—used when an investor can exert significant influence over an affiliate; the method permits recording the investor's share of the affiliate's income.

3. Investments in affiliates or associated companies—investments in stock held for the purpose of influencing the operating and financing strategies of the entity for the long term.

4. Under the equity method, the investor's 20% to 50% ownership of a company presumes significant influence over the affiliate's process of earning income.

   a. As a consequence, the investor reports its portion of the affiliate's net income as its income and increases the investment account by the same amount.

      i. If affiliates report positive results of operations for the year, the investor then records investment income equal to its percentage share of the affiliates' net income and increases its Investments account.

      ii. If the affiliates report net losses, the investor records the opposite effect as Equity in Investee Losses.

   b. The receipt of dividends by the investor is treated as a reduction of the investment account (not revenue).

      i. If affiliates declare and pay dividends during the year (a financing decision), the investor reduces its investment account and increases Dividends

Receivable for its share of the dividends.

5. Summary:

Investments in Affiliates (A)

Debit	Credit
Beginning balance	
Purchases	Sales
Company's % share of affiliates' net income (credit Equity in Investee Earnings) [increase income]	Company's % share of affiliates' net losses (debit Equity in Investee Losses) [decrease income]
	Company's % share of affiliates' dividends declared for the period (debit Dividends Receivable)
	[No effect on income]
Ending balance	

6. Purchase of Stock

On September 30, 2026, the end of its fiscal year, Disney had no long-term investments in companies over which it exerted significant influence. In early 2027, Disney purchased 40,000 shares of the outstanding voting common stock of Green Light for $400,000; Disney acquired 40% and was presumed to have significant influence.

dr Investments (+A)	400,000	
cr Cash (−A)		400,000

Assets = Liabilities + Stockholders' Equity
Investments (A) + 400,000 + Cash (A)
− 400,000 = No change

7. Earnings of Affiliates

   During fiscal year 2027, Green Light Pictures reported a net income of $500,000 for the year; Disney's percentage share of Green Light's income was $200,000 (40% × $500,000).

   dr Investments (+A) 200,000

   cr Equity in Investee Earnings (+R, +SE) 200,000

   Assets = Liabilities + Stockholders' Equity
   Investments (A) + 200,000 = Equity in Investee Earnings (R) + 200,000

   a. If the affiliates report a net loss for the period, the investor records its percentage share of the loss by decreasing the investment account and recording Equity in Investee Losses.

   b. The Equity in Investee Earnings (or Loss) is reported in the Other Items section of the income statement, with interest revenue, dividend revenue, and interest expense.

8. Dividends Declared

   During fiscal year 2027, Green Light declared and paid a cash dividend of $0.50 per share to stockholders; Disney will receive $20,000 ($0.50 × 40,000 shares)

   dr Dividends receivable (+A) 20,000

   cr Investments (−A) 20,000

   Use Supplemental Enrichment Activity #2

   Assets = Liabilities + Stockholders' Equity
   Dividends Receivable (A) +20,000 + Investments (A) − 20,000 = No change

B. Reporting Investments Under the Equity Method

1. The Investments account is reported on the balance sheet as a long-term asset.

   a. The investment account does not reflect either cost or fair value; instead, the following occurs:

i. The investment account is increased by the cost of shares that were purchased and the proportional share of the affiliates' net income.

ii. The account is reduced by the proportional amount of dividends declared from the affiliate companies and the proportional share of any affiliates' net losses and the cost of shares that were sold.

b. At the end of the accounting period, accountants do not adjust the investment account to reflect changes in the fair value of the securities that are held.

Refer students to Pause for Feedback – Self-Study Quiz

c. When sold, the difference between the cash received and the book value of the investment is:

i. Recorded as a gain or loss on the sale of the investment.

ii. Reported on the income statement in the Other Items section.

See Financial Analysis feature "Transaction Structuring: Selecting Accounting Methods for Minority Investments"

C. Focus on Cash Flows: Investments

1. The cash resulting from the sale or purchase is reflected in the Investing Activities section.

2. In the Operating Activities section, there are a number of adjustments to net income:

a. Any gain (loss) on the sale is subtracted from (added to) net income.

b. Any unrealized holding gain (loss) on trading securities (debt) and equity securities (from applying the fair value method) is subtracted from (added to) net income.

c. Equity in income (losses) of investees (from applying the equity method) is subtracted from (added to) net income because no cash was involved in the recording of the revenue under the equity method.

d. Any dividends received from an affiliate are added to net income because, when cash was received, no revenue was recorded under the equity method.

LO A-4 – Analyze and report investments in controlling interests.

V. Controlling Interests: Mergers and Acquisitions

A. Reasons for Acquiring Control of Another Corporation

1. Vertical integration: In this type of acquisition, a company acquires another at a different level in the channels of distribution.

2. Horizontal growth: These acquisitions involve companies at the same level in the channels of distribution.

3. Synergy: The operations of two companies together may be more profitable than the combined profitability of the companies as separate entities.

B. Recording a Merger

1. Merger—occurs when one company purchases all of the assets and liabilities of another and the acquired company goes out of existence.

2. Acquisition method—records assets and liabilities acquired in a merger or acquisition at their fair value on the transaction date.

a. Only method allowed by U.S. GAAP and IFRS for recording a merger or acquisition.

b. Requires that the assets and liabilities of the company acquired be recorded by the acquiring company on its books at their fair value on the date of the merger.

c. Acquiring company must go through a two-step process, often called the purchase price allocation, to determine how to record the acquisition:

i. Step 1: Estimate the fair value of the acquired company's tangible assets, identifiable intangible assets, and liabilities.

ii. Step 2: Compute goodwill (cost in excess of net assets acquired)—for accounting purposes, the excess of the purchase price of a business over the fair value of the acquired company's assets and liabilities.	*Illustrated in this section of the text*
d. Assume that Green Light owned two assets (equipment and a patent) and had one liability (a note payable). Disney followed the two steps and produced the following:	
i. Step 1: The fair values were as follows: equipment \$350,000; patents \$600,000; and notes payable \$100,000	
ii. Step 2: Purchase price for Green Light \$1,000,000 − Fair value of assets of \$950,000 (= \$350,000 + \$600,000) − Fair value of liabilities (\$100,000) = Goodwill of \$150,000	
dr Equipment (+A) 350,000	
dr Patents (+A) 600,000	
dr Goodwill (+A) 150,000	
cr Notes Payable (+L) 100,000	
cr Cash (−A) 1,000,000	
Assets = Liabilities + Stockholders' Equity Cash (A) − 1,000,000 + Equipment (A) + 350,000 + Patents (A) + 600,000 + Goodwill (A) 150,000 = Notes Payable (L) + 100,000	*See Financial Analysis: "Disney Buys Fox"*
e. In summary, when performing a purchase price allocation, it is important to remember two points:	
i. The book values on the acquired company's balance sheet are irrelevant unless they represent fair value.	*See Walt Disney Company: Real World Excerpt: Fiscal Year 2023 Annual Report*
ii. Goodwill is reported only if it is acquired in a merger or acquisition transaction.	
C. Reporting for the Combined Companies	

1. After the merger, the acquiring company will treat the acquired assets and liabilities in the same manner as if they were acquired individually.

    a. For example, the company will depreciate amounts added to equipment over its remaining useful life.

    b. Goodwill is considered to have an indefinite life.

    See Chapter 8

        i. As a consequence, it is not amortized, but, like all long-lived assets, goodwill is reviewed for possible impairment of value.

        ii. Recording an impairment loss would increase expenses for the period and reduce the amount of goodwill on the balance sheet.

    See Walt Disney Company: Real World Notes to the Financial Statement Excerpt: Fiscal Year 2023 Annual Report

2. When a company acquires another, and both companies continue their separate legal existence, consolidated financial statements must be presented.

    a. The parent company is the company that gains control over the other company.

    b. The subsidiary company is the company that the parent acquires.

    c. When the parent buys 100% of the subsidiary, the resulting consolidated financial statements look the same as they would if the companies were combined into one in a simple merger (as discussed above).

    Refer students to Pause for Feedback – Self-Study Quiz

    And Demonstration Cases A through C.

IV. Appendix Supplement: Held-to-Maturity Bonds Purchased at Other Than Par Value: Amortized Cost Method

A. Bond Purchases

1. On the date of purchase, a bond may be acquired at the maturity amount (at par), for less than the maturity amount (at a discount), or for more than the maturity amount (at a premium).

2. The total cost of the bond, including all incidental acquisition costs such as transfer fees and broker

commissions, is debited to the Held-to-Maturity Investments account.

3. On October 1, Year 1, Disney paid $92,278 cash for an 8%, 5-year $100,000 bond that paid interest semiannually (on 3/31 and 9/30); bond's yield was 10%.
   Present value of the bond investment = Present value of the face + Present value of the interest annuity
   $92,278 = ($100,000 × 0.61391) + ($4,000 × 7.72173)
   [n = 10 periods; interest rate = 5%]

dr Investments (+A)	92,278	
cr Cash (−A)		92,278

   Assets = Liabilities + Stockholders' Equity
   Investments (A) + 92,278 + Cash (A)
   − 92,278 = No change

B. Interest Earned

1. The discount that needs to be amortized over the life of the investment; using the effective interest amortization method:

   a. Cash received is based on the face amount of the bond multiplied by the stated rate of interest for half of a year (4%).

   b. Revenue earned is computed by multiplying the current book value of the bond times the market rate for half of a year (5%).

2. Receipt of interest on March 31, Year 2

dr Cash (+A)	4,000	
dr Investments (+A)	614	
cr Interest Revenue (+R, +SE)		4,614

   Assets = Liabilities + Stockholders' Equity
   Cash (A) + 4,000 + Investments (A) + 614 = Interest Revenue (R) + 4,614

3. The amount reported on the balance sheet at March 31, Year 2 is $92,892 ($92,278 + $614), which will be the

book value of the bond used in determining interest revenue on the next payment date of September 30, Year 2.

4. If the bond investment must be sold before maturity, any difference between market value on the date of sale and net book value would be reported as a gain or loss on sale.

Supplemental Enrichment Activities

Note: These activities would be suitable for individual or group activities.

1. Handout A-1

   Use Handout A-1 for an in-class activity to review the accounting for a passive investment in equity securities. The solution follows the handout master.

2. Handout A-2

   Use Handout A-2 for an in-class activity to review the accounting for trading securities. The solution follows the handout master.

3. Handout A-3

   Use Handout A-3 for an in-class activity to review the equity method. The solution follows the handout master.

HANDOUT A – 1

BELLOWS CORP.

1. Bellows Corp. had $100,000 in its Cash account on January 1, Year 1. On June 15, Year 1, Bellows Corp. acquired 100 shares of Sonny, Inc. for $75 per share. Assume that Bellows considers the stock a passive investment. Prepare the journal entry required to record this transaction and, after entering the beginning Cash account balance, post it to the appropriate T-accounts:

June 15			

2. On September 15, Year 1, Bellows Corp. received dividends from Sonny of $2 per share. Prepare the journal entry required to record this transaction and update the appropriate T-accounts:

Sept. 15			

3. At December 31, Year 1, the value of the stock was $120 per share. Prepare the journal entry required to record this transaction and update the appropriate T-accounts:

Computation of amount:

Dec. 31			

HANDOUT A – 1, continued

4. On February 17, Year 2, Bellows sold the stock for $115 per share. Prepare the journal entries required to record this transaction and update the appropriate T-accounts:

Feb. 17			

Feb. 17			

HANDOUT A – 1 Solution

BELLOWS CORP.

1. Bellows Corp. had $100,000 in its Cash account on January 1, Year 1. On June 15, Year 1, Bellows Corp. acquired 100 shares of Sonny, Inc. for $75 per share. Assuming that Bellows considers the stock a passive investment, prepare the journal entry required to record this transaction and post it to the appropriate T-accounts:

June 15	Investments (+A)	7,500	
	Cash (−A)		7,500

+ Investments (A) −

June 15	7,500	
	7,500	

+ Cash (A) −

Jan. 1	100,000		
		7,500	June 15
	92,500		

2. On September 15, Year 1, Bellows Corp. received dividends from Sonny of $2 per share. Prepare the journal entry required to record this transaction and update the appropriate T-accounts:

Sept. 15	Cash (+A) (100 shares × $2 per share)	200	
	Dividend Revenue (+R, +SE)		200

− Dividend Revenue (R, SE) +

	200	Sep. 15
	200	

+ Cash (A) −

Jan. 1	100,000		
Sept. 15	200	7,500	June 15
	92,700		

3. At December 31, Year 1, the value of the stock was $120 per share. Prepare the journal entry required to record this transaction and update the appropriate T-accounts:

Yea r	Fair Value	−	Book Value before Adjustment	=	Amount for Adjusting Entry
1	$12,000 ($120 × 100)	−	7,500	=	4,500

Dec. 31	Investments (+A)	4,500	
	Unrealized Gain (+R, +SE)		4,500

+ Investments (A) −

June 15	7,500	
Dec. 31	4,500	
	12,000	

− Unrealized Gain (R, SE) +

	4,500	Dec. 31
	4.500	

HANDOUT A – 1 Solution, continued

4. On February 17, Year 2, Bellows sold the stock for $115 per share. Prepare the journal entries required to record this transaction and update the appropriate T-accounts:

Feb. 17	Unrealized Loss (+E, −SE)	500	
	Investments (−A)		500

+ Investments (A) −

Jan. 1	12,000	500	Feb. 17
	11,500		

+ Unrealized Loss (E, SE) −

Feb. 17	500	
	500	

Feb. 17	Cash (+A) ($115 × 100)	11,500	
	Investments (−A)		11,500

+ Cash (A) −

Jan. 1	92,700	
Feb. 17	11,500	
	104,200	

+ Investments (A) −

Jan 1	12,000	500	Feb. 17
		11,500	Feb. 17
	0		

HANDOUT A – 2

PARADE CORP.

1. Parade Corp. had $10,000,000 in its Cash account on January 1, Year 1. On January 2, Year 1, Parade Corp. paid $5,000,000 cash to acquire 400,000 shares of stock in Band Corp. These shares represent 40% of Band Corp.'s total outstanding stock. Parade accounted for this acquisition using the equity method. Prepare the journal entry required to record this transaction and, after entering the beginning Cash account balance, post it to the appropriate T-accounts:

Jan. 2			

2. For the year ended December 31, Year 1, Band Corp. earned $800,000 in net income. Prepare the journal entry required to record this transaction and update the appropriate T-accounts:

Dec. 31			

3. On December 31, Year 1, Band Corp. declared and paid $500,000 in dividends. Prepare the journal entry required to record this transaction and update the appropriate T-accounts:

Dec. 31			

HANDOUT A – 2 Solution

PARADE CORP.

1. Parade Corp. had $10,000,000 in its Cash account on January 1, Year 1. On January 2, Year 1, Parade Corp. paid $5,000,000 cash to acquire 400,000 shares of stock in Band Corp. These shares represent 40% of Band Corp.'s total outstanding stock. Parade accounted for this acquisition using the equity method. Prepare the journal entry required to record this transaction and, after entering the beginning Cash account balance, post it to the appropriate T-accounts:

Jan. 2	Investments (+A)	5,000,000	
	Cash (−A)		5,000,000

+ Investments (A) −

Jan. 1	0	
Jan. 2	5,000,000	
	5,000,000	

+ Cash (A) −

Jan. 1	10,000,000		
		5,000,000	Jan. 2
	5,000,000		

2. For the year ended December 31, Year 1, Band Corp. earned $800,000 in net income. Prepare the journal entry required to record this transaction and update the appropriate T-accounts:

Dec. 31	Investments (+A)	320,000	
	Equity in Investee Earnings (+R, +SE)		320,000

$800,000 × 40% = $320,000

+ Investments (A) −

Jan. 1	0	
Jan. 2	5,000,000	

− Equity in Investee Earnings (R, SE) +

Dec. 31	320,000		
	5,320,000		

		320,000	Dec. 31
		320,000	

3. On December 31, Year 1, Band Corp. declared and paid $500,000 in dividends. Prepare the journal entry required to record this transaction and update the appropriate T-accounts:

Dec. 31	Cash (+A)	200,000	
	Investments (−A)		200,000

$500,000 × 40% = $200,000

+ Investments (A) −

Jan. 1	0		
Jan. 2	5,000,000		
Dec. 31	320,000	200,000	Dec. 31
End Bal	5,120,000		

+ Cash (A) −

Jan. 1	10,000,000		
Dec. 31	200,000	5,000,000	Jan. 2
End Bal	5,200,000		