appendix D

investments in other corporations

# Student Learning Objectives and Related Assignment Materials

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| **Student Learning Objectives** | **Mini-Exercises** | **Exercises** | **Coached Problems** | **Problems (Groups  A & B)** |
| Not applicable | 1, 2, 3, 4, 5, 6, 7 | 1, 2, 3, 4, 5, 6, 7 | 1, 2 | A1, A2 |

# Overview

# This appendix introduces the controversy surrounding the use of fair values in mark-to-market accounting for investments in other corporations.

# Synopsis of Appendix Revisions

* New focus company (Google, Inc.) to provide contemporary context for topics
* New discussion of Google’s acquisitions of YouTube, Nest, and DoubleClick
* Revised discussion of mergers and acquisitions

# PowerPoint Slides

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| **Student Learning Objective** | **PowerPoint® Slides** |
| Not applicable | D-2 through D-26 |

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| Appendix Outline | Teaching Notes |
| I. An Overview |  |
| 1. Reasons Companies Invest: |  |
| 1. The nature of their business requires it; investments are significant assets to these companies. |  |
| 2. Excess cash may be invested to earn a return on idle funds until they are needed for other purposes. |  |
| 3. To expand the company’s presence in a related industry or market with the purpose of influencing, but not controlling, the company’s policies and activities. |  |
| 4. To control another company, either by purchasing it directly or by becoming the majority shareholder. |  |
| B. Identifying Investment Types and Accounting Methods—Method is directly related to the purpose of the investment | Balance sheet presentation illustrated in Exhibit D.1 |
| 1. Passive Investments—Investments made to earn a high rate of return on funds that may be needed in the future for either short- or long-term purposes. |  |
| a. Investments in equity securities |  |
| i. Presumed to be passive if the investing company owns less than 20 percent of the other company’s outstanding voting shares or any amount of nonvoting shares. |  |
| ii. The fair value method is used to measure and report these investments. |  |
| b. Investments in debt securities |  |
| i. Always considered to be passive. |  |
| ii. If the company intends to sell before maturity, they are treated as equity securities and reported using the fair value method. |  |
| iii. If the company intends and has the ability to hold until maturity, they are measured and reported at amortized cost. |  |
| 2. Investments in Stock for Significant Influence |  |
| a. Active investments—Those in which a company owns enough stock in another business to influence or control that business. |  |
| b. An investor or company policies is said to have significant influence when it owns enough shares of voting stock of another company to have an important impact on its operating and financing policies. |  |
| i. Significant influence is presumed to exist if the investing company owns from 20 to 50 percent of the outstanding voting shares. |  |
| ii. Various other factors may also indicate significant influence. |  |
| iii. The equity method is used to measure and report this type of investment. |  |

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| Appendix Outline | Teaching Notes |
| 3. Investments in Stock for Control |  |
| a. Control—The ability to determine the operating and financial policies of another company through ownership of its voting stock. |  |
| b. Control is presumed when the investing company owns more than 50% of the outstanding voting stock. |  |
| c. These investments are accounted for by combining the two companies using the consolidated statement method. |  |
| III. Accounting for Passive Investments |  |
| A. Debt Instruments Held to Maturity: Amortized Cost Method |  |
| 1. When management has the intent and ability to hold a bond investment until the maturity date, it is reported the account, Investments Held to Maturity. |  |
| 2. Bonds are reported at amortized cost—that is, at cost adjusted for the amortization of any bond discount or premium. |  |
| a. Bond Purchases—Following the cost principle, the bond’s total cost is debited to the Investments Held to Maturity account. |  |
| b. Interest Earned |  |
| i. If the bonds were purchased at par value, there is no premium or discount to amortize and the book value remains constant over the life of the investment. |  |
| ii. In such situations, the revenue earned on the investment each period is measured as the amount of interest collected in cash or accrued at year-end. | *Comparable to interest on notes receivable (covered in Chapter 8).* |
| iii. Interest Revenue is reported in the Other Items section of the income statement. |  |
| c. Principal at Maturity—At maturity, the receipt of the face value is recorded. |  |
| 3. If the bond investment is sold before maturity, any difference between the fair value (the proceeds from the sale) and the net book value (the unamortized cost) is reported in the income statement as a gain or loss on the sale. |  |
| 4. If management intends to sell the bonds before (or is unable to hold them until) the maturity date, they should be treated in the same way as stock investments classified as available-for-sale securities. (See below.) |  |

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| Appendix Outline | Teaching Notes |
| B. Available-for-Sale Securities: Fair Value Method |  |
| 1. When the investing company owns less than 20 percent of the outstanding voting stock in another company or any level of nonvoting stock, its investment in equity securities is considered passive. |  |
| 2. Among the assets and liabilities shown on the balance sheet, only passive investments in marketable securities are reported using the fair value method. |  |
| 3. Classifying Passive Investments |  |
| a. **Trading Securities**—Securities purchased with the intent of selling them in the near future at a profit. |  |
| i. This approach is similar to the one taken by many mutual funds whose portfolio managers actively buy and sell securities. |  |
| ii. Trading securities are classified as current assets on the balance sheet. |  |
| b. **Available-for-Sale Securities**—Securities purchased with excess funds, with the intent of earning a return until the funds are needed by the company’s operating or financing activities. |  |
| i. Most companies do not actively trade the securities of other companies; instead, they invest to earn a return on funds they may need for future operating purposes. |  |
| ii. Available-for-sale securities are classified as either current or noncurrent assets on the balance sheet, depending on whether management intends to sell them within the next year. |  |
| 4. Recording and Reporting Available-for-Sale Securities | Illustrated in Exhibit D.2 |
| a. Applying the fair value method: |  |
| i. The cost of each passive investment is recorded as an asset called Available-for-Sale Securities. | * Supplemental Enrichment Activity (Activity) #1 |
| ii. At period-end, these investments are adjusted to their fair value. |  |
| * Adjustment involves increasing or decreasing the asset, Available-for-sale Securities, and recording this change in investment value as Net Unrealized Losses/Gains. |  |
| * The net amount of the unrealized losses/gains is included in Accumulated Other Comprehensive Income in the Stockholders’ Equity section of the balance sheet. |  |
| * Dividends received are reported as Dividend Revenue on the income statement. |  |

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| Appendix Outline | Teaching Notes |
| b. Related journal entries: |  |
| i. Purchase of Stock—The purchase of the investment is recorded with a debit to Available-for-Sale Securities and a credit to Cash. |  |
| ii. Dividends Earned—The receipt of dividends from the investee is recorded with a debit to Cash and a credit to Dividend Revenue. |  |
| iii. Year-End Valuation |  |
| * When the fair value of the securities increases, the increase is recorded with a debit to Available-for-Sale Securities and a credit to Net Unrealized Gains (Losses). |  |
| * When the fair value of the securities decreases, the decrease is recorded with a debit to Net Unrealized Gains (Losses) and a credit to Available-for-Sale Securities. |  |
| iv. Disposal of Securities |  |
| * When available-for-sale securities are sold, Cash is increased and two accounts on the balance sheet are eliminated: Available-for-Sale Securities and Net Unrealized Losses/Gains. |  |
| * If a gain is realized, it is recorded in the Gain on Sale of Investments account; if a loss is realized, it is recorded in the Loss on Sale of Investments account. |  |
| * Gain on Sale of Investments and Loss on Sale of Investments accounts are reported on the income statement with other nonoperating items. |  |
| 5. Comparison of Available-for-Sale and Trading Securities | Illustrated in Exhibit D.3 |
| a. Available-for-Sale Securities |  |
| i. The balance in the Net Unrealized Losses/Gains account is reported as a separate component of stockholders’ equity under Accumulated Other Comprehensive Income. |  |
| ii. The Net Unrealized Losses/Gains account is not reported on the income statement because it does not affect net income. |  |

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| Appendix Outline | Teaching Notes |
| b. Trading Securities | * Activity #2 |
| i. The amount of the adjustment to record unrealized holding losses/gains is included in each period’s income statement (that is, it is treated as if it were realized). |  |
| ii. The amount recorded with Net Unrealized Losses/Gains on trading securities is closed to Retained Earnings at the end of the period. | The “Spotlight on Financial |
| iii. When selling a trading security, Cash and only one other balance sheet account are affected: Trading Securities. | Reporting” feature addresses the reporting the fair value of investments |
| III. Accounting for Influential Investments |  |
| A. Investments Involving Significant Influence: Equity Method | * Activity #3 |
| 1. Equity method—Used when an investor can exert significant influence over an investee, which is presumed if the investor owns between 20% and 50% of the investee’s outstanding voting stock. |  |
| 2. Recording Investments Under the Equity Method |  |
| a. Purchase of Stock—The purchase of the investment is recorded with a debit to Investments in Affiliates and a credit to Cash. |  |
| b. Affiliate Earnings |  |
| i. When the investee reports net income for the year, its percentage share of the investee’s net income is recorded with a debit to the Investments in Affiliates account. |  |
| ii. The Equity in Affiliate Earnings account, which is credited, is reported on the income statement with other nonoperating items. |  |
| c. Dividends Received—The receipt of dividends from the investee is recorded with a debit to Cash and a credit to Investments in Affiliates (for the investor’s share of the dividends). |  |
| d. Disposal of Stock |  |
| i. Companies record any sale of stock in affiliated companies in the same way as sales of other assets. |  |
| ii. The sale is recorded with a debit to Cash, a credit to Investment in Affiliates (for the cost of the percentage of stock sold), and a credit (debit) to Gain (or Loss) on Sale of Investments (for the difference). |  |

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| Appendix Outline | Teaching Notes |
| 3. Reporting Investments under the Equity Method |  |
| a. On the balance sheet, the Investments in Affiliates account is reported as a long-term asset. |  |
| b. However, as the year-end entries show, the investment account does not reflect either cost or fair value because of the following: |  |
| i. The investment account increased with the cost of the purchased shares and the proportional share of the investee’s income. |  |
| ii. The investment account decreased with the dividends received from the investee, the proportional share of any investee losses, and any sale of shares in the investee. |  |
| c. At the end of the accounting period, the investment account is not adjusted to reflect changes in the fair value of securities accounted for under the equity method. |  |
| d. When the securities are sold, accountants record the difference between the cash received and the book value of the investment as a Gain (Loss) on Sale of Investments and report the amount on the income statement in the Other Items section. | The “Spotlight on Ethics” feature addresses the impact of improper influence. |
| B. Investments with Controlling Interests: Consolidated Statements |  |
| 1. Why Control Other Companies? |  |
| a. Reasons for acquiring ownership of more than 50% of another company’s outstanding voting stock: |  |
| i. Vertical integration—One company acquires another company that operates on a different level in the distribution channel. . |  |
| ii. Horizontal growth—Such acquisitions involve companies that operate on the same level of the distribution channel. |  |
| iii. Synergy—Two companies operating together may be more profitable than two companies operating separately |  |

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| Appendix Outline | Teaching Notes |
| 2. What are Consolidated Statements? |  |
| a. Merger—Occurs when one company purchases all assets and liabilities of another company and the acquired company’s corporate status is terminated and its operations are merged with the acquiring corporation. |  |
| b. **Parent company**—The entity that controls another company. |  |
| c. **Subsidiary company**—The entity that is controlled by the parent. |  |
| d. **Consolidated financial statements**—Combine the operations of the parent and subsidiary companies into a single set of statements, usually identified by the word consolidated in the statement titles. |  |
| i. Consolidated statements may be thought of as adding together the financial statements for two or more companies so that they appear to be a single company. |  |
| ii. Combining all financial information into one set of consolidated statements gives users better information on the size and scope of operations in companies controlled by the parent corporation. |  |
| e. When consolidated statements are prepared, intercompany items such as loans from the parent company to the subsidiaries must be eliminated. | All four methods of accounting are summarized in Exhibit D.4. |

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# Supplemental Enrichment Activities

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

1. Handout D–1

Use Handout D–1 for an in-class activity to review the equity method. The solution follows the handout master.

1. Handout D–2

Use Handout D–2 for an in-class activity to review the accounting for available-for-sale securities. The solution follows the handout master.

1. Handout D–3

Use Handout D–3 for an in-class activity to review the accounting for trading securities. The solution follows the handout master.

# Handout D–1

# BELLOWS CORP.

1. Bellows Corp. had $100,000 in its Cash account on January 1, 2016. On June 15, 2016, Bellows Corp. acquired 100 shares of Sonny, Inc. for $75 per share. Assume that Bellows considers the stock as a security available for sale. 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 |  |  |  | |  |  |  |  | | |
|  |  |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | | |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |

1. On September 15, 2016, 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:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Sep. 15 |  |  |  | |  |  |  |  | | |
|  |  |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | | |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |

1. At December 31, 2016, 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 D–1, continued

1. At February 17, 2017, Bellows sold the stock for $115 per share. Prepare the journal entry required to record this transaction and update the appropriate T-accounts:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Feb. 17 |  |  |  | | 2017 |  |  |  | |  |  |  |  | |  |  |  |  | |

Note: Start with the beginning balances as of January 1, 2017 in the T-accounts below.

|  |  |
| --- | --- |
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| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | | |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | | |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |

# Handout D–1 Solution

# BELLOWS CORP.

1. Bellows Corp. had $100,000 in its Cash account on January 1, 2016. On June 15, 2016, Bellows Corp. acquired 100 shares of Sonny, Inc. for $75 per share. Assuming that Bellows considers the stock as a security available for sale, prepare the journal entry required to record this transaction and post it to the appropriate T-accounts:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | June 15 | Available-for-Sale Securities (+A) | 7,500 |  | |  | Cash (–A) |  | 7,500 | | |
|  |  |
| + Available-for-Sale Securities (A) –   |  |  |  |  | | --- | --- | --- | --- | | June 15 | 7,500 |  |  | |  |  |  |  | |  | 7,500 |  |  | | + Cash (A) –   |  |  |  |  | | --- | --- | --- | --- | | Jan. 1 | 100,000 |  |  | |  |  | 7,500 | June 15 | |  | 92,500 |  |  | |

1. On September 15, 2016, 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:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Sep. 15 | Cash (+A) (100 shares @ $2) | 200 |  | |  | Dividend Revenue (+R, +SE) |  | 200 | | |
|  |  |
| – Dividend Revenue +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 200 | Sep. 15 | |  |  |  |  | |  |  | 200 |  | | + Cash (A) –   |  |  |  |  | | --- | --- | --- | --- | | Jan. 1 | 100,000 |  |  | | Sep. 15 | 200 | 7,500 | June 15 | |  | 92,700 |  |  | |

1. At December 31, 2016, the value of the stock was $120 per share. Prepare the journal entry required to record this transaction and update the appropriate T-accounts:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Year | Fair Value | - | Balance in  Available-for-Sale Securities Account | = | Amount for Adjusting Entry |
| 2016 | $12,000 ($120 × 100) | - | 7,500 | = | 4,500 |

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Available-for-Sale Securities (+A) | 4,500 |  | |  | Net Unrealized Losses/Gains (+SE) |  | 4,500 | | |
|  |  |
| + Available-for-Sale Securities (A) –   |  |  |  |  | | --- | --- | --- | --- | | June 15 | 7,500 |  |  | | Dec. 31 | 4,500 |  |  | |  | 12,000 |  |  | | – Net Unrealized Losses/Gains (SE) +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 4,500 | Dec. 31 | |  |  |  |  | |  |  | 4,500 |  | |

# Handout D–1 Solution, continued

1. On February 17, 2017, Bellows sold the stock for $115 per share. Prepare the journal entry required to record this transaction and update the appropriate T-accounts:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Feb. 17 | Cash (+A) ($115 × 100) | 11,500 |  | | 2017 | Available-for-Sale Securities (–A) |  | 12,000 | |  | Gain on Sale of Investments (+R, +SE) |  | 4,000 | |  | Net Unrealized Losses/Gains (–SE) | 4,500 |  | |

Note: Start with the beginning balances as of January 1, 2017 in the T-accounts below.

|  |  |
| --- | --- |
|  |  |
| + Cash (A) –   |  |  |  |  | | --- | --- | --- | --- | | Jan. 1 | 92,700 |  |  | | Feb. 17 | 11,500 |  |  | |  | 104,200 |  |  | | + Available-for-Sale Securities (A) –   |  |  |  |  | | --- | --- | --- | --- | | Jan. 1 | 12,000 |  |  | |  |  | 12,000 | Feb. 17 | |  | 0 |  |  | |
| – Gain on Sale of Investments (SE, R) +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 4,000 | Feb. 17 | |  |  |  |  | |  |  | 4,000 |  | | – Net Unrealized Losses/Gains (SE) +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 4,500 | Jan. 1 | | Feb. 17 | 4,500 |  |  | |  |  | 0 |  | |

# Handout D–2

# BAWL CORP.

1. Bellows Corp. had $100,000 in its Cash account on January 1, 2016. On June 15, 2016, Bellows Corp. acquired 100 shares of Sonny, Inc. for $75 per share. Assuming that Bellows considers the stock as a trading security, prepare the journal entry required to record this transaction and post it to the appropriate T-accounts:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | June 15 |  |  |  | |  |  |  |  | | |
|  |  |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | | |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |

1. On September 15, 2016, Bawl Corp. received dividends from Darkness of $2 per share. Prepare the journal entry required to record this transaction and update the appropriate T-accounts:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Sept. 15 |  |  |  | |  |  |  |  | | |
|  |  |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | | |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |

1. At December 31, 2016, 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 D–2, continued

1. At February 17, 2017, Bawl sold the stock for $115 per share. Prepare the journal entry required to record this transaction and update the appropriate T-accounts:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Feb. 17 |  |  |  | | 2017 |  |  |  | |  |  |  |  | |  |  |  |  | |

Note: Start with the beginning balances as of January 1, 2017 in the T-accounts below.

|  |  |
| --- | --- |
|  |  |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | | |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |

# Handout D–2 Solution

# BAWL CORP.

1. Bellows Corp. had $100,000 in its Cash account on January 1, 2016. On June 15, 2016, Bellows Corp. acquired 100 shares of Sonny, Inc. for $75 per share. Assuming that Bellows considers the stock as a trading security, prepare the journal entry required to record this transaction and post it to the appropriate T-accounts:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | June 15 | Trading Securities (+A) | 7,500 |  | |  | Cash (–A) |  | 7,500 | | |
|  |  |
| + Trading Securities (A) –   |  |  |  |  | | --- | --- | --- | --- | | June 15 | 7,500 |  |  | |  |  |  |  | |  | 7,500 |  |  | | + Cash (A) –   |  |  |  |  | | --- | --- | --- | --- | | Jan. 1 | 100,000 |  |  | |  |  | 7,500 | June 15 | |  | 92,500 |  |  | |

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

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Sep. 15 | Cash (+A) (100 shares × $2) | 200 |  | |  | Dividend Revenue (+R, +SE) |  | 200 | | |
|  |  |
| – Dividend Revenue +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 200 | Sep. 15 | |  |  |  |  | |  |  | 200 |  | | + Cash (A) –   |  |  |  |  | | --- | --- | --- | --- | | Jan. 1 | 100,000 |  |  | | Sep. 15 | 200 | 7,500 | June 15 | |  | 92,700 |  |  | |

1. At December 31, 2016, the value of the stock was $120 per share. Prepare the journal entry required to record this transaction and update the appropriate T-accounts:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Year | Fair Value | - | Balance in Trading Securities Account | = | Amount for Adjusting Entry |
| 2016 | $12,000 ($120 × 100) | - | 7,500 | = | 4,500 |

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Trading Securities (+A) | 4,500 |  | |  | Net Unrealized Losses/Gains (+R,+SE) |  | 4,500 | | |
|  |  |
| + Trading Securities (A) –   |  |  |  |  | | --- | --- | --- | --- | | June 15 | 7,500 |  |  | | Dec. 31 | 4,500 |  |  | |  | 12,000 |  |  | | – Net Unrealized Losses/Gains (R, SE) +   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  | 4,500 | Dec. 31 | |  |  | 4,500 |  | |

# Handout D–2 Solution, continued

1. At February 17, 2017, Bawl sold the stock for $115 per share. Prepare the journal entry required to record this transaction and update the appropriate T-accounts:

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Feb. 17 | Cash (+A) ($115 × 100) | 11,500 |  | | 2017 | Loss on Sale of Investments (+R, +SE)  (11,500 – 7,500 – 4,500) | 500 |  | |  | Trading Securities (–A) |  | 12,000 | |

Note: Start with the beginning balances as of January 1, 2017 in the T-accounts below.

|  |  |
| --- | --- |
|  |  |
| + Cash (A) –   |  |  |  |  | | --- | --- | --- | --- | | Jan. 1 | 92,700 |  |  | | Feb. 17 | 11,500 |  |  | |  | 104,200 |  |  | | + Trading Securities (A) –   |  |  |  |  | | --- | --- | --- | --- | | Jan. 1 | 12,000 |  |  | |  |  | 12,000 | Feb. 17 | |  | 0 |  |  | |
| + Loss on Sale of Investments (+R, +SE) –   |  |  |  |  | | --- | --- | --- | --- | | Feb. 17 | 500 |  |  | |  |  |  |  | |  | 500 |  |  | |

# Handout D–3

# PARADE CORP.

1. Parade Corp. had $10,000,000 in its Cash account on January 1, 2016. On January 2, 2016, 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 |  |  |  | |  |  |  |  | | |
|  |  |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | | |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |

1. For the year ended December 31, 2016, 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 |  |  |  | |  |  |  |  | | |
|  |  |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | | |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |

1. On December 31, 2016, 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 D–3 Solution

# PARADE CORP.

1. Parade Corp. had $10,000,000 in its Cash account on January 1, 2016. On January 2, 2016, 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 in Affiliates (+A) | 5,000,000 |  | |  | Cash (-A) |  | 5,000,000 | | |
|  |  |
| + Investments in Affiliates (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 |  |  | |

1. For the year ended December 31, 2016, 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 in Affiliates (+A) | 320,000 |  | |  | Equity in Affiliate Earnings (+R, +SE) |  | 320,000 | | |
| $800,000 × 40% = $320,000 |  |
| + Investments in Affiliates (A) –   |  |  |  |  | | --- | --- | --- | --- | | Jan. 1 | 0 |  |  | | Jan. 2 | 5,000,000 |  |  | | Dec. 31 | 320,000 |  |  | |  | 5,320,000 |  |  | | * Equity in Affiliate Earnings (R, SE) +  |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  | 320,000 | Dec. 31 | |  |  | 320,000 |  | |

1. On December 31, 2016, 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 in Affiliates (-A) |  | 200,000 | | |
| $500,000 × 40% = $200,000 |  |
| + Investments in Affiliates (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 |  |  | |