**Chapter 16**

Investments and International  
Operations

Questions

1. The cost of the investment in Shopify shares would be $20,300 (200 × $101.50) and the brokerage commission of $75 would be expensed.

2. A short-term investment in shares must meet two qualifications. It is liquid, and the investor intends to make a profit due to short-term price changes, thus converting it to cash within one year. All other investments in shares are long-term investments. *Management intent* is the deciding factor about how it should be recorded.

3. Notes and bonds are examples of debt instruments.

4. Investments in shares are equity investments (because some of the ownership [equity] is purchased).

5. When equity investments that are traded on public stock exchanges are revalued to market value at year-end, investors are given the most current information possible on which to base their decisions. Predictions are easier for investors to make, since the cost of investments might be very different from their market values; market values approximate the liquidation values.

6. Receipt of a cash dividend is recorded by debiting Cash and crediting Dividend Revenue. Receipt of a stock dividend is recorded in a memorandum entry that states the number of dividend shares received and the new cost per share.

7. Sale proceeds $15,000

Cost of investment sold:

Shares sold 500

Cost per share ($30,000/1,100 shares) × $27.27

Cost of investment sold  13,635

Gain on sale $ 1,365

8. An investment of between 20 and 50 percent in the investee’s voting shares is normally accounted for by the equity method. The investment is recorded at cost when purchased. When the investee company reports net income (loss) the investor debits (credits) the Investment account and credits (debits) Equity Method Investment Revenue for the investor’s share of the ownership. Receipt of a cash dividend from the investee is recorded as a debit to Cash and a credit to the Investment account. Gain or loss on sale of the investment is measured by taking the difference between the sale proceeds and the investor’s carrying value of the investment.

9. Three transactions are: purchase of the investment; net income (loss) of the investee; and receipt of a cash dividend from the investee. A fourth transaction (not required) is the sale of the investment.

10. Eliminating intercompany items from consolidated financial statements avoids counting the same resources twice, such as a parent receivable from the subsidiary and the subsidiary’s payable to the parent, or vice versa. Two intercompany items eliminated are a receivable/payable and the parent’s investment in the subsidiary/subsidiary’s owner equity.

11. *Goodwill* is the excess of the cost of an investment over the market value of the subsidiary’s owner equity. Goodwill is an intangible asset, reported after property, plant, and equipment on the balance sheet.

12. *Non-controlling Interest* or *Minority Interest* is reported on the balance sheet between long-term liabilities and owner’s equity.

13. The parent’s net income is the sum of its own net income plus its proportion of the subsidiaries’ net income (100 percent of two subsidiaries’ income plus 60 percent of the third subsidiary’s income).

14. Weel Soo paid $303,900 ($300,000 × 1.013). The principal collected at maturity is $300,000.

15. $10,000.00 ($300,000 × 0.08 × 5/12).

16. Foreign-Currency Transaction Loss

17. Foreign-Currency Transaction Gain

18. Foreign-Currency Transaction Gain

19. Under IFRS, most short-term financial instruments must be measured at fair value. Under ASPE, actively traded equity investments are valued at fair value but when there is no active market, the cost method can be used.

Under ASPE gains and losses are reported under Net Income. Depending on the situation, businesses reporting under IFRS may report gains and losses under Net Income or Other Comprehensive Income.

20. Under IFRS, the parent must prepare consolidated financial statements that include the financial results of its subsidiaries. Under ASPE, the *CPA Canada Handbook* emphasizes consolidation but the parent is allowed to report its investment in subsidiaries using either the cost or equity method as well.

Under IFRS, minority interest must be presented within the equity section, but separate from the parent’s shareholders’ equity. Under ASPE, there is no guidance about where to report minority interest on the balance sheet.

Starters

(5-10 min.) **S16-1**

a. $9,075 (550 × $16.50)

The brokerage commission fees are expensed.

b. $44,400 (600 × $74.00)

The dividend is irrelevant. The brokerage fees are expensed.

c. $55,100 (1,000 × $55.10)

The brokerage commission fees are expensed.

d. $2,485 (70 × $35.50)   
 The brokerage commission fees are expensed.

(10-15 min.) **S16-2**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| **2019** | |  |  |  |  |
| Dec. | 6 | Short-Term Investments |  | 41,000 |  |
|  |  | Brokerage Commissions Expense |  | 350 |  |
|  |  | Cash |  |  | 41,350 |
|  |  | (1,000 × $41.00) |  |  |  |
|  |  |  |  |  |  |
|  | 23 | Cash |  | 1,100 |  |
|  |  | Dividend Revenue |  |  | 1,100 |
|  |  | (1,000 × $1.10) |  |  |  |
|  |  |  |  |  |  |
|  | 31 | Fair Value Valuation Allowance |  | 4,000 |  |
|  |  | Unrealized Gain on Fair Value Adjustment |  |  | 4,000 |
|  |  | [(1,000 × $45) – $41,000] |  |  |  |
|  |  |  |  |  |  |
| **2020** | |  |  |  |  |
| Jan. | 27 | Cash |  | 45,630 |  |
|  |  | Brokerage Commissions Expense |  | 370 |  |
|  |  | Gain on Sale of Short-Term Investments |  |  | 1,000 |
|  |  | Fair Value Valuation Allowance |  |  | 4,000 |
|  |  | Short-Term Investments |  |  | 41,000 |
|  |  | Cash paid was [(1,000 × $46) – $370] |  |  |  |

(10-15 min.) **S16-3**

1. Short-term investment

2.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| Date | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| 2019 | |  |  |  |  |
| Dec. | 12 | Short-Term Investments |  | 93,000 |  |
|  |  | Brokerage Commissions Expense |  | 510 |  |
|  |  | Cash |  |  | 93,510 |
|  |  | (1,500 × $62) |  |  |  |
|  |  |  |  |  |  |
|  | 21 | Cash |  | 720 |  |
|  |  | Dividend Revenue |  |  | 720 |
|  |  | (1,500 × $0.48) |  |  |  |
|  |  |  |  |  |  |
|  | 31 | Unrealized Loss on Fair Value Adjustment |  | 750 |  |
|  |  | Fair Value Valuation Allowance |  |  | 750 |
|  |  | [1,500 × ($62 − $61.50)] |  |  |  |
|  |  |  |  |  |  |
| **2020** | |  |  |  |  |
| Jan. | 16 | Cash |  | 88,010 |  |
|  |  | Brokerage Commissions Expense |  | 490 |  |
|  |  | Fair Value Valuation Allowance |  | 750 |  |
|  |  | Loss on Sale of Short-Term Investments |  | 3,750 |  |
|  |  | Short-Term Investments |  |  | 93,000 |
|  |  | Cash received was [(1,500 × $59.00) – $490] |  |  |  |

(5 min.) **S16-4**

a. Current asset

b. Current asset

c. Long-term asset

(5-10 min.) **S16-5**

|  |  |  |  |
| --- | --- | --- | --- |
| **Shares** | **Carrying Value** | **Fair Value** | **Differences** |
| All Seasons Hotels | $ 88,000 | $ 97,000 | $ 9,000 |
| Tent Manufacturing Corp. | 140,000 | 124,000 | (16,000) |
| East End Grocers Inc. | 74,000 | 76,000 | 2,000 |
| Totals | $302,000 | $297,000 | ($ 5,000) |

Report the investments at fair value, $297,000, and report an unrealized loss of $5,000 ($297,000 – $302,000) in the non-operating section of the income statement. The adjusting journal entry would be:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Dec. | 31 | Unrealized Loss on Fair Value Adjustment |  | 5,000 |  |
|  |  | Fair Value Valuation Allowance |  |  | 5,000 |
|  |  | Adjusted short-term investments to fair value. |  |  |  |

(5-10 min.) **S16-6**

1. Cost of the investment = 2,000 × $35 = $70,000

New number of shares held = 2,000 + 0.10 (2,000) = 2,200

New cost per share = $70,000 / 2,200 = $31.82

2. Cash received from sale = 2,200 × $29 = $ 63,800

Cost (70,000)

Loss on sale of long-term investment $ (6,200)

(15-20 min.) **S16-7**

1.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2020** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Jan. | 14 | Long-Term Investments |  | 41,000 |  |
|  |  | Cash |  |  | 41,000 |
|  |  | (1,000 × $41.00) |  |  |  |
|  |  |  |  |  |  |
| Aug. | 22 | Cash |  | 3,280 |  |
|  |  | Dividend Revenue |  |  | 3,280 |
|  |  | (1,000 × $3.28) |  |  |  |
|  |  |  |  |  |  |
| Dec. | 31 | Fair Value Valuation Allowance |  | 9,750 |  |
|  |  | Unrealized Gain on Fair Value Adjustment |  |  | 9,750 |
|  |  | ($50,750 – $41,000) |  |  |  |

2.

Long-term investments, fair value 50,750

(5-10 min.) **S16-8**

1.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2021** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Aug. | 4 | Cash |  | 54,000 |  |
|  |  | Fair Value Valuation Allowance |  |  | 9,750 |
|  |  | Long-Term Investments |  |  | 41,000 |
|  |  | Gain on Sale of Long-Term Investments |  |  | 3,250 |
|  |  | Cash received (1,000 × $54.00) |  |  |  |

2. This gain on sale of investment is a *realized* gain. The gain recorded at December 31, 2020 was *unrealized* because it resulted from a change in the investment’s fair value, not from the sale of the investment.

(10-15 min.) **S16-9**

1. *Equity method* is appropriate because Ling Corp holds a 40 percent investment in True World Inc. and, therefore, will have significant influence.

2.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **General Journal** | | | | |
| **Date**  **2020** | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Jan. 6 | Investment in True World Inc. Common Shares |  | 5,000,000 |  |
|  | Cash |  |  | 5,000,000 |
|  | Purchased 40 percent investment in True World Inc. common shares. |  |  |  |
|  |  |  |  |  |
| Dec. 31 | Investment in True World Inc. Common Shares |  | 720,000 |  |
|  | Equity Method Investment Revenue |  |  | 720,000 |
|  | Recorded investment revenue. ($1,800,000 × 0.40) |  |  |  |
|  |  |  |  |  |
| Dec. 31 | Cash |  | 320,000 |  |
|  | Investment in True World Inc. Common Shares |  |  | 320,000 |
|  | Received 40 percent of True World Inc. cash dividend. ($800,000 × 0.40) |  |  |  |

3.

|  |  |  |  |
| --- | --- | --- | --- |
| Investment in True World Inc. Common Shares | | | |
| Purchase | 5,000,000 |  |  |
| Net income | 720,000 | Dividends received | 320,000 |
| Balance | 5,400,000 |  |  |

(10-15 min.) **S16-10**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
|  | **2019** | |  |  |  |  |
|  | 1. Mar. | 1 | Investment in Mint Ltd. Common Shares |  | 1,000,000 |  |
|  |  |  | Cash |  |  | 1,000,000 |
|  |  |  | Purchased 35% investment in Mint Ltd. common shares. |  |  |  |
|  |  |  |  |  |  |  |
|  | **2020** | |  |  |  |  |
|  | 2. Feb. | 29 | Investment in Mint Ltd. Common Shares |  | 87,500 |  |
|  |  |  | Equity Method Investment Revenue |  |  | 87,500 |
|  |  |  | To record 35% of Mint Ltd. net income of $250,000. |  |  |  |
|  |  |  |  |  |  |  |
|  | 3. Mar. | 1 | Cash |  | 19,250 |  |
|  |  |  | Investment in Mint Ltd. Common Shares |  |  | 19,250 |
|  |  |  | To record receipt of 35% of Mint Ltd. cash dividend of $55,000. |  |  |  |

*(10 min.)* S16-11

1. A *parent company* is a corporation that owns controlling (more than 50 percent) interest in another company. A *subsidiary* is a company that is controlled by another corporation.

2. The *parent company’s* name appears on the consolidated financial statements. To consolidate, the parent company must own *more than* 50 percent of the subsidiary’s voting shares.

3. *Consolidated financial statements* combine the balance sheets, income  
 statements, and other statements of a parent company with those of its  
 majority-owned subsidiaries. The result is a single set of financial statements, as if the parent and its subsidiaries were all the same entity.

(5 min.) **S16-12**

1. The shareholders’ equity of the consolidated entity excludes the shareholders’ equity of a subsidiary because the shareholders’ equity of the consolidated entity is that of the parent only, and because the subsidiary’s equity and the parent company’s investment balance represent the same resources. Therefore, including them both would amount to double counting.

2. Non-controlling or minority interest—reported on A Ltd.’s (parent) consolidated balance sheet between the liabilities and shareholders’ equity sections.

3. Goodwill—reported on C Ltd.’s (parent) consolidated balance sheet as a long-term asset.

*(10-15 min.)* S16-13

1. Paid $970,000 ($1,000,000 × 0.97)

Will collect at maturity $1,000,000

2. Annual cash interest = $60,000 ($1,000,000 × 0.06)

3. Cash interest received each year $60,000

+ Amortization of discount:  
 $1,000,000 – $970,000 =

5 years 6,000

= Annual interest revenue $66,000

(10-15 min.) **S16-14**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | | |
| **Date** | | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| **2020** | | |  |  |  |  |
| 1. | Jan. | 2 | Investment in Bonds |  | 970,000 |  |
|  |  |  | Cash |  |  | 970,000 |
|  |  |  | Purchase bond investment. ($1,000,000 × 0.97) |  |  |  |
|  |  |  |  |  |  |  |
| 2. | Dec. | 31 | Cash |  | 60,000 |  |
|  |  |  | Interest Revenue |  |  | 60,000 |
|  |  |  | Received annual interest.($1,000,000 × 0.06) |  |  |  |
|  |  |  |  |  |  |  |
| 3. |  | 31 | Investment in Bonds |  | 6,000 |  |
|  |  |  | Interest Revenue |  |  | 6,000 |
|  |  |  | Amortized discount on bond investment. |  |  |  |
|  |  |  | [($1,000,000 – $970,000)/5] |  |  |  |
|  |  |  |  |  |  |  |
| **2024** | | |  |  |  |  |
| 4. | Dec. | 31 | Cash |  | 1,000,000 |  |
|  |  |  | Investment in Bonds |  |  | 1,000,000 |
|  |  |  | Received face value at maturity. |  |  |  |

*(10-15 min.)* S16-15

|  |  |  |  |
| --- | --- | --- | --- |
| **General Journal** | | | |
| **Date**  **2020** | **Account Titles and Explanations** | **Debit** | **Credit** |
| Apr. 30 | Investment in Bonds | 97,500 |  |
|  | Cash |  | 97,500 |
|  | Purchased long-term Starr Limited bond investment ($100,000 × 0.975). |  |  |
|  |  |  |  |
| Oct. 31 | Cash | 2,000 |  |
|  | Interest Revenue |  | 2,000 |
|  | Received semi-annual interest ($100,000 × 0.04 × 6/12). |  |  |
|  |  |  |  |
| Oct. 31 | Investment in Bonds | 227 |  |
|  | Interest Revenue |  | 227 |
|  | To amortize discount on bond investment for six months [($100,000 – $97,500) × 6/66]. |  |  |
|  |  |  |  |
| Dec. 31 | Interest Receivable | 667 |  |
|  | Interest Revenue |  | 667 |
|  | To accrue interest revenue for two months ($100,000 × 0.04 × 2/12). |  |  |
|  |  |  |  |
| Dec. 31 | Investment in Bonds | 76 |  |
|  | Interest Revenue |  | 76 |
|  | To amortize discount on bond investment for two months [($100,000 – $97,500) × 2/66]. |  |  |

*(10 min.)* **S16-16**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Jun. | 2 | Inventory |  | 13,504 |  |
|  |  | Accounts Payable |  |  | 13,504 |
|  |  | Purchase on account. (US$10,000 × 1.3504) |  |  |  |
|  |  |  |  |  |  |
| Jul. | 28 | Accounts Payable |  | 13,504 |  |
|  |  | Foreign-Currency Transaction Gain |  |  | 1,057 |
|  |  | Cash |  |  | 12,447 |
|  |  | Payment on account. (US$10,000 × 1.2447) |  |  |  |
|  |  |  |  |  |  |

a. (10 min.) **S16-17**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Mar. | 14 | Accounts Receivable |  | 3,120,000 |  |
|  |  | Sales Revenue |  |  | 3,120,000 |
|  |  | Sale on account. (2,000,000 euros × $1.56) |  |  |  |
|  |  |  |  |  |  |
| Apr. | 19 | Cash |  | 1,550,000 |  |
|  |  | Foreign-Currency Transaction Loss |  | 10,000 |  |
|  |  | Accounts Receivable |  |  | 1,560,000 |
|  |  | Collection on account.  Cash = 1,000,000 euros × $1.55  Receivable = $3,120,000 × 1/2 |  |  |  |
|  |  |  |  |  |  |
| May | 10 | Cash |  | 1,580,000 |  |
|  |  | Accounts Receivable |  |  | 1,560,000 |
|  |  | Foreign-Currency Transaction Gain |  |  | 20,000 |
|  |  | Collection on account.  Cash = 1,000,000 euros × $1.58  Receivable = $3,120,000 × 1/2 |  |  |  |

b. Overall, Fleetstar Ltd. had a net foreign-currency gain of $10,000  
(gain of $20,000 minus a loss of $10,000)

(10-15 min.) **S16-18**

a. Financial instruments are measured at fair value (market value).

b. Significant influence is a rebuttable assumption. It is presumed that if an investor holds (directly or indirectly) 20 percent or more of the votes.

c. Minority interest is shown on the balance sheet in the equity section but separate from the parent’s shareholders’ equity.

d. Short-term investments in bonds are measured and reported at fair value.

e. Long-term investments in bonds are amortized using the effective-interest-rate method.

Exercises

(10-15 min.) **E16-1**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| **2020** | |  |  |  |  |
| Nov. | 6 | Short-Term Investments |  | 93,600 |  |
|  |  | Brokerage Commissions Expense |  | 500 |  |
|  |  | Cash |  |  | 94,100 |
|  |  | Purchase of 1,200 Aveda Corporation common shares at $78 plus $500 brokerage commission. |  |  |  |
|  |  |  |  |  |  |
| Nov. | 30 | Cash |  | 4,620 |  |
|  |  | Dividend Revenue |  |  | 4,620 |
|  |  | Received dividend of $3.85 on 1,200 shares of Aveda Corporation. |  |  |  |
|  |  |  |  |  |  |
| Dec. | 31 | Unrealized Loss on Fair Value Adjustment |  | 2,100 |  |
|  |  | Fair Value Valuation Allowance |  |  | 2,100 |
|  |  | To reduce investment to fair value  (1,200 × $76.25 = $91,500);  ($93,600 − $91,500). |  |  |  |
|  |  |  |  |  |  |
| **2021** | |  |  |  |  |
| Jun. | 14 | Cash |  | 95,000 |  |
|  |  | Brokerage Commissions Expense |  | 400 |  |
|  |  | Fair Value Valuation Allowance |  | 2,100 |  |
|  |  | Gain on Sale of Short-Term Investments |  |  | 3,900 |
|  |  | Short-Term Investments |  |  | 93,600 |
|  |  | Sale of Aveda Corporation investment at $79.50 per share.  Cash received: [(1,200 × $79.50) – $400]. |  |  |  |

(10-15 min.) **E16-2**

Req. 1

|  |  |
| --- | --- |
| **SHOPIFY INC.** | |
| Balance Sheet (partial) | |
|  | (Thousands of US dollars) |
| Current assets |  |
| Cash and cash equivalents | $ 84,013 |
| Marketable securities (Note X) | 308,401 |

*Note X:* Short-term investments are reported at fair value. Cost is $303,901,000. Fair value is $308,401,000.

Req. 2

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| **2016** | |  |  | (Thousands of US dollars) | |
| Dec. | 31 | Fair Value Valuation Allowance\* |  | 4,500 |  |
|  |  | Unrealized Gain on Fair Value Adjustment |  |  | 4,500 |

\* $308,401 – $303,901

(15-20 min.) **E16-3**

Req. 1

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| **2020** | |  |  |  |  |
| Nov. | 6 | Short-Term Investments |  | 60,000 |  |
|  |  | Brokerage Commissions Expense |  | 800 |  |
|  |  | Cash |  |  | 60,800 |
|  |  |  |  |  |  |
|  | 30 | Cash |  | 3,000 |  |
|  |  | Dividend Revenue\* |  |  | 3,000 |
|  |  |  |  |  |  |
| Dec. | 31 | Fair Value Valuation Allowance |  | 2,000 |  |
|  |  | Unrealized Gain on Fair Value Adjustment |  |  | 2,000 |
|  |  |  |  |  |  |
| **2021** | |  |  |  |  |
| Jan. | 20 | Cash\*\* |  | 63,100 |  |
|  |  | Brokerage Commissions Expense |  | 900 |  |
|  |  | Short-Term Investments |  |  | 60,000 |
|  |  | Fair Value Valuation Allowance |  |  | 2,000 |
|  |  | Gain on Sale of Short-Term Investments |  |  | 2,000 |
|  |  |  |  |  |  |

\* Dividend Revenue: (2,000 × $1.50)

\*\* Cash received: ($64,000 – $900)

Req. 2

|  |  |  |
| --- | --- | --- |
| **RYERSON CORP.** | | |
| Balance Sheet (partial) | | |
| December 31, 2020 | | |
| Current assets |  |  |
| Short-term investments, at fair value |  | $62,000 |

(5-10 min.) **E16-4**

a. Provided this investment is readily convertible into cash, it would be classified as a short-term investment as the intention is to sell it within 12 months.

b. As this investment will be sold within 90 days, and provided it is readily convertible into cash, it would qualify as a short-term investment.

c. This investment should be treated as a long-term investment since it is intended to be held for more than one year.

(10-15 min.) **E16-5**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Aug. | 6 | Long-Term Investments |  | 81,000 |  |
|  |  | Brokerage Commissions Expense |  | 900 |  |
|  |  | Cash |  |  | 81,900 |
|  |  | To purchase 900 shares of Rhodes Corporation at $90 per share. |  |  |  |
|  |  |  |  |  |  |
| Sep. | 12 | Cash |  | 1,440 |  |
|  |  | Dividend Revenue |  |  | 1,440 |
|  |  | To receive cash dividend of $1.60 per share. |  |  |  |
|  |  |  |  |  |  |
| Nov. | 23 | Note: Received 90 shares of Rhodes Corporation common shares in 10% stock dividend.  New cost per share is $81.82 ($81,000/990 shares). |  |  |  |
|  |  |  |  |  |  |
| Dec. | 4 | Cash |  | 86,370 |  |
|  |  | Brokerage Commissions Expense |  | 750 |  |
|  |  | Gain on Sale of Long-Term Investments |  |  | 6,120 |
|  |  | Long-Term Investments |  |  | 81,000 |
|  |  | To sell investment (990 shares with a rounded cost of $81,000). Sold for $87,120 (990 × $88). |  |  |  |

(10-15 min.) **E16-6**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
|  | Jan. | 2 | Investment in Minecraft Ltd. Common Shares |  | 12,000,000 |  |
|  |  |  | Cash |  |  | 12,000,000 |
|  |  |  | Purchased 40% investment in Minecraft Ltd. common shares. |  |  |  |
|  |  |  |  |  |  |  |
|  | Dec. | 31 | Investment in Minecraft Ltd. Common Shares |  | 712,000 |  |
|  |  |  | Equity Method Investment Revenue |  |  | 712,000 |
|  |  |  | To record 40% of Minecraft Ltd. net income of $1,780,000. |  |  |  |
|  |  |  |  |  |  |  |
|  | Dec. | 31 | Cash |  | 260,000 |  |
|  |  |  | Investment in Minecraft Ltd. Common Shares |  |  | 260,000 |
|  |  |  | To record receipt of 40% of Minecraft Ltd. cash dividend of $650,000. |  |  |  |

(10-15 min.) **E16-7**

|  |  |  |  |
| --- | --- | --- | --- |
| Investment in Minecraft Ltd. Common Shares | | | |
| Jan.2 Purchase | 12,000,000 |  |  |
| Dec. 31 Net income | 712,000 | Dec. 31 Dividends | 260,000 |
| Balance | 12,452,000 |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Dec. | 31 | Cash |  | 13,200,000 |  |
|  |  | Investment in Minecraft Ltd. Common Shares |  |  | 12,452,000 |
|  |  | Gain on Sale of Equity Investment |  |  | 748,000 |
|  |  | Sold investment in Minecraft Ltd. common shares. |  |  |  |

(10-15 min.) **E16-8**

1. It would be appropriate for Markle Inc. to use the equity method of recording its investment in Harry Systems Inc. since it holds 35 percent of the common shares. With a holding of this size, it is probable that Markle Inc. can exercise significant influence on the operations of Harry Systems Inc. (Note: It is assumed that no other classes of shares carry significant voting rights and that there is no controlling shareholder.)

2. Cost of investment—Harry Systems Inc. $ 760,000

Add share of net income (35% × $360,000)     126,000

886,000

Less dividends received (35% × $105,000)     36,750

Carrying value of investment $ 849,250

The income statement will show:

Equity Method Investment Revenue $  126,000

3. There is no adjustment for fluctuations in fair value for this type of investment unless there is a permanent impairment in the value of the shares.

(20-30 min.) **E16-9**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **PENFOLD LTD.** | | | | | |
| Consolidation Worksheet | | | | | |
|  | **Penfold Ltd.** | **Simmons Ltd.** | **Eliminations** | |  |
| **Debit** | **Credit** | **Consolidated Amounts** |
| **Assets** |  |  |  |  |  |
| Cash | 225,000 | 55,000 |  |  | 280,000 |
| Accounts receivable, net | 360,000 | 264,000 |  |  | 624,000 |
| Note receivable from Simmons Ltd. | 76,000 |  |  | (a) 76,000 | 0 |
| Inventory | 258,000 | 159,000 |  |  | 417,000 |
| Investment in Simmons Ltd. | 2,350,000 |  |  | (b) 2,350,000 | 0 |
| Property, plant, and equipment, net | 3,590,000 | 2,900,000 |  |  | 6,490,000 |
| Goodwill |  |  | (b) 121,000 |  | 121,000 |
| Total assets | 6,859,000 | 3,378,000 |  |  | 7,932,000 |
|  |  |  |  |  |  |
| **Liabilities and Shareholders’ Equity** |  |  |  |  |  |
| Accounts payable | 357,000 | 180,000 |  |  | 537,000 |
| Notes payable | 462,000 | 759,000 | (a) 76,000 |  | 1,145,000 |
| Other liabilities | 78,000 | 210,000 |  |  | 288,000 |
| Common shares | 1,980,000 | 670,000 | (b) 670,000 |  | 1,980,000 |
| Retained earnings | 3,982,000 | 1,559,000 | (b) 1,559,000 |  | 3,982,000 |
| Total liabilities and shareholders’ equity | 6,859,000 | 3,378,000 | 2,426,000 | 2,426,000 | 7,932,000 |

(20-30 min.) **E16-10**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **PEANUT HOLDINGS LTD.** | | | | | |
| Consolidation Worksheet | | | | | |
|  | **Peanut Holdings Ltd.** | **Snoop Inc.** | **Eliminations** | |  |
| **Debit** | **Credit** | **Consolidated Amounts** |
| **Assets** |  |  |  |  |  |
| Cash | 96,000 | 36,000 |  |  | 132,000 |
| Accounts receivable, net | 210,000 | 144,000 |  |  | 354,000 |
| Note receivable from Snoop Inc. | 60,000 |  |  | (b) 60,000 | 0 |
| Inventory | 246,000 | 216,000 |  |  | 462,000 |
| Investment in Snoop Inc. | 228,000 | — |  | (a) 228,000 | 0 |
| Property, plant, and equipment, net | 720,000 | 312,000 |  |  | 1,032,000 |
| Other assets | 48,000 | 42,000 |  |  | 90,000 |
| Goodwill |  |  | (a) 16,800\* |  | 16,800 |
| Total assets | 1,608,000 | 750,000 |  |  | 2,086,800 |
|  |  |  |  |  |  |
| **Liabilities and Shareholders’ Equity** |  |  |  |  |  |
| Accounts payable | 108,000 | 66,000 |  |  | 174,000 |
| Notes payable | 120,000 | 96,000 | (b) 60,000 |  | 156,000 |
| Other liabilities | 204,000 | 324,000 |  |  | 528,000 |
| Non-controlling interest | — | — |  | (a) 52,800\*\* | 52,800 |
| Common shares | 780,000 | 204,000 | (a) 204,000 |  | 780,000 |
| Retained earnings | 396,000 | 60,000 | (a)   60,000 |  | 396,000 |
| Total liabilities and shareholders’ equity | 1,608,000 | 750,000 | 340,800 | 340,800 | 2,086,800 |

\* Goodwill: $228,000 − ($264,000 × 0.80) = $16,800

\*\* Non-controlling interest = $204,000 + $60,000 + $16,800 – $228,000 = $52,800

(10-15 min.) **E16-11**

Req. 1

Paid $5,880,000 ($6,000,000 × 0.98)

Will collect at maturity $6,000,000

Req. 2

Annual cash interest = $150,000 ($6,000,000 × 0.025)

Req. 3

Annual interest revenue will be more than the amount of cash interest received each year because the investor bought the bonds at a discount.

Req. 4

Cash interest received each year ($6,000,000 × 0.025) $150,000

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| + | Amortization of discount | $6,000,000 – $5,880,000 | = | 12,000 |
| 10 years |

= Annual interest revenue $162,000

(10-15 min.) **E16-12**

Req. 1

The bonds should be reported on the financial statements as a long-term investment. Therefore, the discount will be amortized over the life of the bond and any temporary fluctuation in market price will be ignored.

Req. 2

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2020** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Mar. | 31 | Investment in Bonds |  | 98,250 |  |
|  |  | Cash |  |  | 98,250 |
|  |  | To purchase $100,000, 4% bonds in Claim Limited due 30/9/2024at 98.25. |  |  |  |
|  |  |  |  |  |  |
| Sep. | 30 | Cash |  | 2,000 |  |
|  |  | Interest Revenue |  |  | 2,000 |
|  |  | To receive semi-annual interest.  ($100,000 × 0.04 × 6/12) |  |  |  |
|  |  |  |  |  |  |
|  | 30 | Investment in Bonds |  | 194 |  |
|  |  | Interest Revenue |  |  | 194 |
|  |  | To record amortization of bond discount ($1,750 × 6/54). |  |  |  |
|  |  |  |  |  |  |
| Dec. | 31 | Interest Receivable |  | 1,000 |  |
|  |  | Interest Revenue |  |  | 1,000 |
|  |  | To accrue interest revenue for three months ($100,000 × 0.04 × 3/12). |  |  |  |
|  |  |  |  |  |  |
|  | 31 | Investment in Bonds |  | 97 |  |
|  |  | Interest Revenue |  |  | 97 |
|  |  | To record amortization of bond discount ($1,750 × 3/54). |  |  |  |

Req. 3

Long-Term Investment—Bonds (Note X) $98,541\*

*Note X:* The long-term bonds are reported at cost plus amortization of discount. At December 31, 2020, the market value was $99,250.

\* $98,541 = $98,250 + $194 + $97

(10-15 min.) **E16-13**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| **2020** | |  |  |  |  |
| May | 1 | Investment in Bonds |  | 969,900 |  |
|  |  | Cash |  |  | 969,900 |
|  |  | Purchased $1,000,000 in bonds at a discount |  |  |  |
|  |  |  |  |  |  |
| **2021** | |  |  |  |  |
| Apr. | 30 | Cash |  | 45,000 |  |
|  |  | Interest Revenue |  |  | 45,000 |
|  |  | To receive annual interest at 4.5% |  |  |  |
|  |  |  |  |  |  |
|  | 30 | Investment in Bonds |  | 5,435 |  |
|  |  | Interest Revenue |  |  | 5,435 |
|  |  | To reflect discount on bond for the period. (per effective-interest rate table) |  |  |  |

Req. 1 (10-20 min.) **E16-14**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| May | 16 | Accounts Receivable |  | 142,648 |  |
|  |  | Sales Revenue |  |  | 142,648 |
|  |  | To record a sale on account for 80,000 pounds sterling. Exchange rate is $1.7831 per pound |  |  |  |
|  |  |  |  |  |  |
| Jun. | 19 | Cash |  | 70,456 |  |
|  |  | Foreign-Currency Transaction Loss |  | 868 |  |
|  |  | Accounts Receivable |  |  | 71,324 |
|  |  | To record receipt of half the amount receivable (40,000 × $1.7614). |  |  |  |
|  |  |  |  |  |  |
| Jul. | 16 | Cash |  | 71,168 |  |
|  |  | Foreign-Currency Transaction Loss |  | 156 |  |
|  |  | Accounts Receivable |  |  | 71,324 |
|  |  | To record receipt of the remaining amount receivable (40,000 × $1.7792). |  |  |  |

Req. 2

Overall, Zed had a net foreign-currency loss of $1,024 ($868 + $156).

(10-20 min.) **E16-15**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| **2020** | |  |  |  |  |
| Nov. | 17 | Inventory |  | 5,850 |  |
|  |  | Accounts Payable |  |  | 5,850 |
|  |  | Purchase of goods for 500,000¥ at $0.0117. |  |  |  |
|  |  |  |  |  |  |
| Dec. | 16 | Accounts Payable |  | 5,850 |  |
|  |  | Foreign Currency Transaction Loss |  | 150 |  |
|  |  | Cash |  |  | 6,000 |
|  |  | Paid account for 500,000¥ at $0.0120. |  |  |  |
|  |  |  |  |  |  |
|  | 19 | Accounts Receivable |  | 125,600 |  |
|  |  | Sales Revenue |  |  | 125,600 |
|  |  | Sale to French company for €80,000 at $1.57. |  |  |  |
|  |  |  |  |  |  |
|  | 31 | Foreign Currency Transaction Loss |  | 2,400 |  |
|  |  | Accounts Receivable |  |  | 2,400 |
|  |  | Adjust receivable for decrease in euro exchange from $1.57 to $1.54. (€80,000 × ($1.57 − $1.54)) |  |  |  |
|  |  |  |  |  |  |
| **2021** | |  |  |  |  |
| Jan. | 14 | Cash |  | 126,400 |  |
|  |  | Accounts Receivable |  |  | 123,200 |
|  |  | Foreign Currency Transaction Gain |  |  | 3,200 |
|  |  | Received payment for receivable—€80,000 at $1.58. |  |  |  |

*(10-20 min.)* **E16-16**

a. Gains and losses are recorded under “other comprehensive income” under IFRS.

b. Equity investments with no significant influence can only be recorded at cost under ASPE.

c. Equity investments with over 20 percent ownership must be treated as having significant influence unless proven otherwise under IFRS.

d. When there is significant influence, impairment loss reversals are permitted under IFRS, and it is possible to increase the asset value above its cost.

e. For long-term investments in bonds, the straight-line amortization method is not allowed under IFRS.

Serial Exercise

*(40-50 min.)* E16-17

*Req. 1*

|  |  |  |  |
| --- | --- | --- | --- |
| **General Journal** | | | |
| **Date**  **2024** | **Accounts and Explanation** | **Debit** | **Credit** |
| Jul. 1 | Long-Term Investments | 24,000 |  |
|  | Cash |  | 24,000 |
|  | Purchased long-term investment in shares of Adobe Outdoor Adventure Company. |  |  |
|  |  |  |  |
| 7 | Investment in Bison Backpacks Inc. Common Shares | 218,750 |  |
|  | Cash |  | 218,750 |
|  | Purchased 35% investment in Bison’s shares (equity method). |  |  |
|  |  |  |  |
| 10 | Investment in Bonds | 80,000 |  |
|  | Cash |  | 80,000 |
|  | Purchased investment in bonds (ignoring interim interest). |  |  |
|  |  |  |  |
| Sep. 30 | Cash | 1,200 |  |
|  | Dividend Revenue |  | 1,200 |
|  | Received cash dividends (8,000 shares x $0.15/share). |  |  |
|  |  |  |  |
| Nov. 1 | Cash | 13,125 |  |
|  | Investment in Bison Backpacks Inc. Common Shares |  | 13,125 |
|  | Received cash dividends (equity method). (43,750 x $0.30) |  |  |
|  |  |  |  |
| Dec. 31 | Cash | 3,200 |  |
|  | Interest Revenue |  | 3,200 |
|  | Received cash interest. |  |  |
|  |  |  |  |
| 31 | Investment in Bison Backpacks Inc. Common Shares | 5,250 |  |
|  | Equity Method Investment Revenue |  | 5,250 |
|  | Recorded revenue earned from investment. |  |  |
|  |  |  |  |
| 31 | Unrealized Loss on Fair Value Adjustment | 160 |  |
|  | Fair Value Valuation Allowance |  | 160 |
|  | Adjusted long-term investment to fair value ($24,000 - $23,840). |  |  |

*Req. 1 (continued)*

Calculations:

Cost of investments:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Total cost | = | Number of shares | × | Price per share |  |  |
| Adobe | = | 8,000 shares | × | $3 per share | = | $ 24,000 |
| Bison | = | 43,750 shares | × | $5 per share | = | 218,750 |

Cash dividends:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Total dividends | = | Number of shares | × | Dividend per share |  |  |
| Adobe | = | 8,000 shares | × | $0.15 per share | = | $ 1,200 |
| Bison | = | 43,750 shares | × | $0.30 per share | = | 13,125 |

Share of net income:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Equity Method Investment Revenue | = | Reported  net income | × | Percent ownership × Number of Months Held  12 |
| Bison | = | $30,000 | × | 35% × 6/12 |
|  | = | $5,250 |  |  |

Unrealized Loss on Fair Value Adjustment:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Unrealized Loss on Fair Value Adjustment | = | Total fair value | − | Total cost |
| Adobe | = | (8,000 shares × $2.98 per share) | − | $24,000 |
|  | = | $23,840 | − | $24,000 |
|  | = | $160 |  |  |

*Req. 2*

|  |  |  |  |
| --- | --- | --- | --- |
| Investment | Account | Effect on Income | |
| Adobe | Dividend Revenue | $ 1,200 |  |
|  | Unrealized Loss on Fair Value Adjustment | (160) |  |
|  |  | $ 1,040 | Increase |
|  |  |  |  |
| Bison | Revenue from Investments | $ 5,250 | Increase |
|  |  |  |  |
| Camelot | Interest Revenue | $ 3,200 | Increase |
|  |  |  |  |

**Challenge Exercise**

(10-20 min.) **E16-18**

|  |  |  |  |
| --- | --- | --- | --- |
| (Thousands of Dollars) Equity Method Investments | | | |
| Beginning balance | 6,800 |  |  |
| Investments | 350 |  |  |
| Equity method investment income | 640 | Dividends received | 840 |
| Ending balance 2020 | 6,950 |  |  |

Dividends received = $6,800 + $350 + $640 – X = $6,950

X = $840

Beyond the Numbers

(30-45 min.) **BN16-1**

1 *Consolidated* financial statements report the combined accounts of a parent company and its subsidiaries, which are companies in which the parent company owns more than 50 percent of the voting shares. The parent company can control the subsidiary, so the parent’s consolidated financial statements include those of the subsidiary.

2. A parent company eliminates intercompany transactions and accounts in preparing its consolidated financial statements to avoid reporting an item that is entirely within the consolidated entity. For example, a subsidiary may owe an amount to the parent company on a note payable. The subsidiary’s balance sheet reports the note payable, and the parent’s separate balance sheet reports the same amount as a note receivable. The combined balance sheets of the two companies include both the receivable and the payable. To avoid including this receivable/payable in the consolidated statements, the receivable and the payable are eliminated from the consolidated balance sheet. All intercompany items should be eliminated because they were created solely within the consolidated entity. The subsidiary owes real money to the parent, but this debt goes no further than the parent and so stays within the consolidated entity. In reporting the parent’s consolidated statements, it is necessary to eliminate all intercompany items. As each company will report its pre-consolidated financial statements to Canada Revenue Agency, there is no juggling of the books.

3. *Goodwill* is the excess of the price paid by a parent company to acquire a subsidiary over the fair value of the net assets of the subsidiary. The existence of goodwill does not necessarily mean that the company’s shares have increased in value, although this might occur. The two events, however, have no effect on each other.

Ethical Issue

(15-20 min.) **EI16-1**

Req. 1

Susan Shearer is acting within her authority to influence Lo Foods Ltd. to pay large cash dividends. The board of directors has the authority to declare and pay dividends.

The ethics of Shearer’s action are questionable. As the president of Woods Inc., Shearer is responsible for stewardship of company resources. As a member of Lo Foods Ltd.’s board of directors, Shearer is also responsible for stewardship of Lo Foods Ltd.’s resources. It appears that she is using her position to increase her own bonus, even if it hurts Lo Foods Ltd. and Woods Inc. Her actions could also hurt creditors if either of the two companies fails to pay its debts.

Req. 2

Under the fair value method, receipts of dividends increase investor income. In this case, Shearer is manipulating Woods Inc. income—and her bonus—by having Lo Foods Ltd. pay high dividends to Woods Inc.

Under the equity method, investor (Woods Inc.) income is increased when the investee company (Lo Foods Ltd.) earns income. Receipts of dividends have no effect on investor income.

Investment income under the equity method depends on many factors beyond the investor’s control. Therefore, it is more difficult for the investor company to manipulate its income—and for Shearer to manipulate her bonus—under the equity method.

Problems

Group A

(25-35 min.) **P16-1A**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2020** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Jan. | 1 | Investment in Canadian Parts Corp. Common Shares |  | 950,000 |  |
|  |  | Brokerage Commissions Expense |  | 20,000 |  |
|  |  | Cash |  |  | 970,000 |
|  |  | Purchased 12,000 common shares of Canadian Parts Corp. (24 percent of common shares). |  |  |  |
|  |  |  |  |  |  |
| Jan. | 2 | Investment in Canadian Parts Corp. Common Shares |  | 162,000 |  |
|  |  | Brokerage Commissions Expense |  | 1,500 |  |
|  |  | Cash |  |  | 163,500 |
|  |  | Purchased an additional 2,000 common shares of Canadian Parts Corp., now owning 28 percent of common shares. |  |  |  |
|  |  |  |  |  |  |
| Sep. | 15 | Cash |  | 44,800 |  |
|  |  | Investment in Canadian Parts Corp. Common Shares |  |  | 44,800 |
|  |  | Received $3.20 per share cash dividend on 14,000 Canadian Parts Corp. common shares. |  |  |  |
|  |  |  |  |  |  |
| Oct. | 12 | Short-Term Investments |  | 33,000 |  |
|  |  | Brokerage Commissions Expense |  | 1,000 |  |
|  |  | Cash |  |  | 34,000 |
|  |  | Purchased 1,000 common shares of Sharma Ltd. at $33.00 plus commission of $1,000. |  |  |  |
|  |  |  |  |  |  |
| Dec. | 14 | Cash |  | 1,500 |  |
|  |  | Dividend Revenue |  |  | 1,500 |
|  |  | Received $1.50 per share cash dividend on 1,000 Sharma Ltd. common shares. |  |  |  |

(continued) **P16-1A**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| **2020** | |  |  |  |  |
| Dec. | 31 | Investment in Canadian Parts Corp. Common Shares |  | 224,000 |  |
|  |  | Equity Method Investment Revenue |  |  | 224,000 |
|  |  | To record 28% of Canadian Parts Corp. net income of $800,000. |  |  |  |
|  |  |  |  |  |  |
|  | 31 | Unrealized Loss on Fair Value Adjustment |  | 2,000 |  |
|  |  | Fair Value Valuation Allowance |  |  | 2,000 |
|  |  | Adjust short-term investment in Sharma to fair value ($33,000 – $31,000). |  |  |  |
|  |  |  |  |  |  |
| **2021** | |  |  |  |  |
| Feb. | 6 | Cash |  | 166,950 |  |
|  |  | Brokerage Commissions Expense |  | 1,550 |  |
|  |  | Loss on Sale of Investment |  | 15,957 |  |
|  |  | Investment in Canadian Parts Corp. Common Shares |  |  | 184,457 |
|  |  | Sold 2,000 common shares of Canadian Parts Corp. |  |  |  |

\* Carrying amount was $950,000 + $162,000 – $44,800 + $224,000 = $1,291,200

$1,291,200 × 2,000/14,000 = $184,457

Req. 1 (45-60 min.) **P16-2A**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2020** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Mar. | 3 | Short-Term Investments |  | 200,000 |  |
|  |  | Brokerage Commissions Expense |  | 500 |  |
|  |  | Cash |  |  | 200,500 |
|  |  | Purchased 8,000 shares at $25.00 plus commission of $500. |  |  |  |
|  |  |  |  |  |  |
|  | 4 | Investments in Significantly Influenced Companies |  | 600,000 |  |
|  |  | Brokerage Commissions Expense |  | 4,500 |  |
|  |  | Cash |  |  | 604,500 |
|  |  | Purchased investment in common shares of significantly influenced company. |  |  |  |
|  |  |  |  |  |  |
| May | 14 | Cash |  | 13,600 |  |
|  |  | Dividend Revenue |  |  | 13,600 |
|  |  | Received $1.70 per share cash dividend on 8,000 shares of short-term investment. |  |  |  |
|  |  |  |  |  |  |
| Jun. | 15 | Cash |  | 55,000 |  |
|  |  | Investment in Significantly Influenced Companies |  |  | 55,000 |
|  |  | Received cash dividend from significantly influenced company. |  |  |  |
|  |  |  |  |  |  |
| Aug. | 28 | Cash |  | 191,500 |  |
|  |  | Brokerage Commissions Expense |  | 500 |  |
|  |  | Loss on Sale of Short-Term Investment |  | 8,000 |  |
|  |  | Short-Term Investments |  |  | 200,000 |
|  |  | Sold the short-term investment purchased on March 3 at $24.00 per share less $500 commission. |  |  |  |
|  |  |  |  |  |  |
| Oct. | 24 | Short-Term Investments |  | 275,000 |  |
|  |  | Brokerage Commissions Expense |  | 400 |  |
|  |  | Cash |  |  | 275,400 |
|  |  | Purchased short-term investment. |  |  |  |

Req. 1, cont. (continued) **P16-2A**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2020** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Dec. | 15 | Cash |  | 30,000 |  |
|  |  | Investments in Significantly Influenced Companies |  |  | 30,000 |
|  |  | Received cash dividend from significantly influenced company. |  |  |  |
|  |  |  |  |  |  |
|  | 31 | Investments in Significantly Influenced Companies |  | 390,000 |  |
|  |  | Equity Method Investment Revenue |  |  | 390,000 |
|  |  | To record 30% of significantly influenced companies’ net income of $1,300,000. |  |  |  |

Req. 2

|  |  |  |  |
| --- | --- | --- | --- |
| Investments in Significantly Influenced and Other Companies | | | |
| Jan. 1 Balance | 2,500,000 |  |  |
| Mar. 4 Purchase | 600,000 | Jun. 15 Dividends | 55,000 |
| Dec. 31 Net income | 390,000 | Dec. 15 Dividends | 30,000 |
| Dec. 31 Balance | 3,405,000 |  |  |

Req. 3

|  |  |  |  |
| --- | --- | --- | --- |
| Short-Term Investments | | | |
| Jan. 1 Balance | 250,000 |  |  |
| Mar. 3 Purchase | 200,000 | Aug. 28 Sale | 200,000 |
| Oct. 24 Purchase | 275,000 |  |  |
| Dec. 31 Balance | 525,000 |  |  |

Req. 4

|  |  |
| --- | --- |
| **NORTHERN DEVELOPMENTS CORP.** | |
| Balance Sheet (partial) | |
| December 31, 2020 | |
| Current assets |  |
| Cash | $        XXX |
| Short-term investments, at fair value | 510,000 |
| Accounts receivable (net) | XXX |
| Total current assets | XXX |
| Investments in significantly influenced and other companies | 3,405,000 |

|  |  |  |
| --- | --- | --- |
|  | Option 1: 3,600 Shares | Option 2: 11,400 Shares |
| 1. Accounting method to use for common shares | Fair value method | Equity method |
| 1. Journal entry to record purchase of shares at $27 each. No commissions. | Long-term Investment 97,200 | Investment in BF Ltd Common Shares 307,800 |
| Cash 97,200 | Cash 307,800 |
| (3,600 × $27) | (11,400 × $27) |
| 1. Journal entry to recognize share of $25,000 in dividends declared and paid. | Cash 3,000 | Cash 9,500 |
| Dividend Revenue 3,000 | Investment in BF Ltd Common Shares 9,500 |
| ($25,000 × 3,600/30,000) | ($25,000 × 11,400/30,000) |
| 1. Journal entry to recognize $50,000 in net income declared by BF Ltd. | n/a | Investment in BF Ltd. Common Shares 19,000 |
| Equity Method Investment Revenue 19,000 |
| ($50,000 × 11,400/30,000) |
| 1. Journal entry to recognize the year-end market value of $30 per share. | Fair Value Valuation Allowance 10,800 | n/a |
| Unrealized Gain on Fair Value Adjustment 10,800 |
| [($30 – $27) × 3,600] |
| 1. What is the balance in the Investments account at year-end? | $108,000  ($30 × 3,600 shares) | $317,300  (purchase + income – dividends = balance)  ($307,800 + 19,000 – 9,500 = 317,300) |

(20-25 min.) **P16-3A**

(35-45 min.) **P16-4A**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **PLUTO CORP.** | | | | | |
| Consolidation Worksheet | | | | | |
| May 31, 2020 | | | | | |
|  | **Pluto  Corp.** | **Saturn Inc.** | **Eliminations** | |  |
| **Debit** | **Credit** | **Consolidated Amounts** |
| **Assets** |  |  |  |  |  |
| Cash | 60,000 | 100,000 |  |  | 160,000 |
| Accounts receivable, net | 210,000 | 150,000 |  |  | 360,000 |
| Note receivable from Saturn Inc. | 170,000 | — |  | (a) 170,000 | — |
| Inventory | 300,000 | 440,000 |  |  | 740,000 |
| Investment in Saturn Inc. | 750,000 | — |  | (b) 750,000 | — |
| Property, plant, and equipment, net | 600,000 | 500,000 |  |  | 1,100,000 |
| Goodwill | — | — | (b) 60,000 |  | 60,000 |
| Total assets | 2,090,000 | 1,190,000 |  |  | 2,420,000 |
|  |  |  |  |  |  |
| **Liabilities and Shareholders’ Equity** |  |  |  |  |  |
| Accounts payable | 250,000 | 40,000 |  |  | 290,000 |
| Notes payable | 400,000 | 210,000 |  |  | 610,000 |
| Note payable to Pluto Corp. | — | 170,000 | (a) 170,000 |  | — |
| Other liabilities | 156,000 | 80,000 |  |  | 236,000 |
| Common shares | 800,000 | 500,000 | (b) 500,000 |  | 800,000 |
| Retained earnings | 484,000 | 190,000 | (b) 190,000 | — | 484,000 |
| Total liabilities and shareholders’ equity | 2,090,000 | 1,190,000 | 920,000 | 920,000 | 2,420,000 |

*(35-45 min.)* **P16-5A**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **PATRONE HOLDINGS LTD.** | | | | | |
| Consolidation Worksheet | | | | | |
| July 18, 2020 | | | | | |
|  | **Patrone Holdings  Ltd.** | **Smirnoff Inc.** | **Eliminations** | |  |
| **Debit** | **Credit** | **Consolidated Amounts** |
| **Assets** |  |  |  |  |  |
| Cash | 200,000 | 340,000 |  |  | 540,000 |
| Accounts receivable, net | 720,000 | 480,000 |  |  | 1,200,000 |
| Note receivable from Smirnoff Inc. | 240,000 | — |  | (a) 240,000 | — |
| Inventory | 1,480,000 | 920,000 |  |  | 2,400,000 |
| Investment in Smirnoff Inc. | 1,920,000 | — |  | (b) 1,920,000 | — |
| Property, plant, and equipment, net | 2,190,000 | 1,540,000 |  |  | 3,730,000 |
| Goodwill | — | — | (b) 429,600\* |  | 429,600 |
| Total assets | 6,750,000 | 3,280,000 |  |  | 8,299,600 |
|  |  |  |  |  |  |
| **Liabilities and Shareholders’ Equity** |  |  |  |  |  |
| Accounts payable | 1,060,000 | 680,000 |  |  | 1,740,000 |
| Notes payable | 1,680,000 | 320,000 |  |  | 2,000,000 |
| Note payable to Patrone Holdings Ltd. | — | 240,000 | (a) 240,000 |  | — |
| Other liabilities | 260,000 | 384,000 |  |  | 644,000 |
| Non-controlling interest | — | — |  | (b) 165,600\*\* | 165,600 |
| Common shares | 1,540,000 | 1,060,000 | (b) 1,060,000 |  | 1,540,000 |
| Retained earnings | 2,210,000 | 596,000 | (b) 596,000 |  | 2,210,000 |
| Total liabilities and shareholders’ equity | 6,750,000 | 3,280,000 | 2,325,600 | 2,325,600 | 8,299,600 |

\* Goodwill = $1,920,000 – 0.90 ($1,060,000 + $596,000) = $429,600

\*\* Non-controlling interest = ($1,060,000 + $596,000) × 0.10 = $165,600

(45-60 min.) **P16-6A**

*Reqs. 1 & 2*

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2020** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Jul. | 1 | Investment in Bonds |  | 1,020,000 |  |
|  |  | Cash |  |  | 1,020,000 |
|  |  | To purchase $1,000,000 Hydro-Québec 3.00% bonds at 102. |  |  |  |
|  |  |  |  |  |  |
| Dec. | 31 | Interest Receivable |  | 15,000 |  |
|  |  | Interest Revenue |  |  | 15,000 |
|  |  | To accrue interest revenue on $1,000,000 at 3.00% for 6 months. |  |  |  |
|  |  |  |  |  |  |
|  | 31 | Interest Revenue |  | 500 |  |
|  |  | Investment in Bonds |  |  | 500 |
|  |  | To amortize premium on bond investment ($1,020,000 – $1,000,000) / 240\* × 6 months |  |  |  |

\* Amortization period: 240 months, from July 1, 2020, to July 1, 2040.

Req. 3

Cost of bonds $1,020,000

Deduct amortization of premium 500

Carrying value $1,019,500

(25-35 min.) **P16-7A**

Req. 1

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Semi-annual Interest Period** | **Interest Received (2.5%)** | **Period**  **Interest Revenue  (3% of Preceding Investment Carrying Amount)** | **Discount Amortization** | **Unamortized Discount Balance** | **Investment Carrying Value ($700,000 – Unamortized Discount)** |
| Dec. 31, 2020 |  |  |  | $52,071 | $647,929 |
| Jun. 30, 2021 | $17,500 | $19,438 | $1,938 | 50,133 | 649,867 |
| Dec. 31, 2021 | 17,500 | 19,496 | 1,996 | 48,137 | 651,863 |

Req. 2

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| **2020** | |  |  |  |  |
| Dec. | 31 | Investment in Bonds |  | 647,929 |  |
|  |  | Cash |  |  | 647,929 |
|  |  | To purchase Solar Ltd. 10-year, 5 percent bond investment. |  |  |  |
|  |  |  |  |  |  |
| **2021** | |  |  |  |  |
| Jun. | 30 | Cash |  | 17,500 |  |
|  |  | Investment in Bonds |  | 1,938 |  |
|  |  | Interest Revenue |  |  | 19,438 |
|  |  | To receive semi-annual interest revenue and amortize discount on investment. |  |  |  |
|  |  |  |  |  |  |
| Dec. | 31 | Cash |  | 17,500 |  |
|  |  | Investment in Bonds |  | 1,996 |  |
|  |  | Interest Revenue |  |  | 19,496 |
|  |  | To receive semi-annual interest revenue and amortize discount on investment. |  |  |  |

*(continued)* **P16-7A**

*Note:* At June 30 and December 31, 2021, the investor can make separate entries for the accrual of cash interest and for the amortization of discount on the investment, as shown below.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2021** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Jun. | 30 | Cash |  | 17,500 |  |
|  |  | Interest Revenue |  |  | 17,500 |
|  |  | To receive semi-annual interest revenue. |  |  |  |
|  |  |  |  |  |  |
|  | 30 | Investment in Bonds |  | 1,938 |  |
|  |  | Interest Revenue |  |  | 1,938 |
|  |  | To amortize discount on investment. |  |  |  |
|  |  |  |  |  |  |
| Dec. | 31 | Cash |  | 17,500 |  |
|  |  | Interest Revenue |  |  | 17,500 |
|  |  | To receive semi-annual interest revenue. |  |  |  |
|  |  |  |  |  |  |
|  | 31 | Investment in Bonds |  | 1,996 |  |
|  |  | Interest Revenue |  |  | 1,996 |
|  |  | To amortize discount on investment. |  |  |  |

(30-50 min.) **P16-8A**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2020** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Jan. | 5 | Short-Term Investments |  | 255,000 |  |
|  |  | Brokerage Commissions Expense |  | 500 |  |
|  |  | Cash |  |  | 255,500 |
|  |  | Purchase of 5,000 HHN Ltd. shares at $51.00 plus commission of $500. |  |  |  |
|  |  |  |  |  |  |
|  | 31 | No entry required. |  |  |  |
|  |  |  |  |  |  |
| Feb. | 15 | Cash |  | 42,000 |  |
|  |  | Dividend Revenue |  |  | 42,000 |
|  |  | Received dividend from HHN Ltd. |  |  |  |
|  |  |  |  |  |  |
| Apr. | 1 | Investment in Bonds |  | 396,000 |  |
|  |  | Cash |  |  | 396,000 |
|  |  | Purchased $400,000, 5% bonds at 99. |  |  |  |
|  |  |  |  |  |  |
| Aug. | 31 | Received 500 common shares of HHN Ltd. in a 10% stock dividend. New cost per share is $46.36 ($255,000/5,500). |  |  |  |
|  |  |  |  |  |  |
| Oct. | 1 | Cash |  | 10,000 |  |
|  |  | Investment in Bonds |  | 1,000 |  |
|  |  | Interest Revenue |  |  | 11,000 |
|  |  | To record semi-annual interest on bonds and amortize discount ($4,000/4). |  |  |  |
|  |  |  |  |  |  |
| Nov. | 1 | Received 5,500 additional common shares of HHN Ltd. in a 2 for 1 stock split. New cost per share is $23.18 ($255,000/11,000). |  |  |  |

(continued) **P16-8A**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2020** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Dec. | 15 | Cash |  | 110,500 |  |
|  |  | Brokerage Commission Expense |  | 1,500 |  |
|  |  | Gain on Sale of Investment |  |  | 19,273 |
|  |  | Short-Term Investments |  |  | 92,727 |
|  |  | Sale of 4,000 shares of HHN Ltd. at $28.00 less commission $1,500 ($255,000 × 4,000/11,000). |  |  |  |
|  |  |  |  |  |  |
|  | 31 | Bond Interest Receivable |  | 5,000 |  |
|  |  | Investment in Bonds |  | 500 |  |
|  |  | Interest Revenue |  |  | 5,500 |
|  |  | Accrue interest on bonds ($10,000 × 3/6) and amortize premium ($1,000 × 3/6). |  |  |  |
|  |  |  |  |  |  |
|  | 31 | Fair Value Valuation Allowance |  | 107,727 |  |
|  |  | Unrealized Gain on Fair Value Adjustment |  |  | 107,727 |
|  |  | Adjusted short-term investments to fair value ($1,045,000 – $937,273). |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
|  | Carrying  Value | Market Value  Dec. 31, 2020 | Differences |
| Alberta Energy Co. | $310,000 | $ 280,000 | ($30,000) |
| Finning Ltd. | 180,000 | 187,000 | 7,000 |
| Canadian National Railway | 285,000 | 290,000 | 5,000 |
| HHN Ltd. | 162,273\* | 288,000 | 125,727 |
| Total short-term investments | $937,273 | $1,045,000 | 107,727 |

\* $255,000 – $92,727 = $162,273

Req. 1 (30-40 min.) **P16-9A**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| **2020** | |  |  |  |  |
| Dec. | 1 | Accounts Receivable |  | 45,000 |  |
|  |  | Sales Revenue |  |  | 45,000 |
|  |  | Sale of machinery to a Japanese company. |  |  |  |
|  |  |  |  |  |  |
|  | 10 | Supplies |  | 132,500 |  |
|  |  | Accounts Payable |  |  | 132,500 |
|  |  | Purchase of supplies for US$125,000. US exchange rate is US$1 = $1.06 Cdn. |  |  |  |
|  |  |  |  |  |  |
|  | 17 | Accounts Receivable |  | 354,200 |  |
|  |  | Sales Revenue |  |  | 354,200 |
|  |  | Sale of machinery for £220,000. Exchange rate is £1 = $1.61 Cdn. |  |  |  |
|  |  |  |  |  |  |
|  | 22 | Cash |  | 45,000 |  |
|  |  | Accounts Receivable |  |  | 45,000 |
|  |  | Collection of receivable from Dec. 1, 2020. |  |  |  |
|  |  |  |  |  |  |
|  | 31 | Foreign Currency Transaction Loss |  | 9,400 |  |
|  |  | Accounts Payable |  |  | 5,000 |
|  |  | Accounts Receivable |  |  | 4,400 |
|  |  | Payable = [US$125,000 × ($1.10 – $1.06)]  Receivable = [£220,000 × ($1.61 – $1.59)] |  |  |  |
|  |  |  |  |  |  |
| **2021** | |  |  |  |  |
| Jan. | 18 | Accounts Payable |  | 137,500 |  |
|  |  | Cash |  |  | 135,000 |
|  |  | Foreign Currency Transaction Gain |  |  | 2,500 |
|  |  | Paid $125,000 × $1.08 = $135,000  Owed $132,500 + $5,000 = $137,000,  Gain is $137,500 – 135,000 |  |  |  |
|  |  |  |  |  |  |
|  | 24 | Cash |  | 358,600 |  |
|  |  | Foreign Currency Transaction Gain |  |  | 8,800 |
|  |  | Accounts Receivable |  |  | 349,800 |
|  |  | Received £220,000 × $1.63 = 358,600  Owed $354,200 – $4,400 = $349,800  Gain is $358,600 - $349,800 = $8,800 |  |  |  |

(continued) **P16-9A**

*Req. 1, cont.*

|  |  |
| --- | --- |
| **FREEDOM ELECTRONICS INC.** | |
| Income Statement (partial) | |
| For the Year Ended December 31, 2020 | |
| Other revenue and expense |  |
| Foreign currency transaction loss | $9,400 |

Req. 2

This problem demonstrates that the final amount of a cash receipt or cash payment on an international transaction may differ from the agreed-upon amount of the transaction. Students can thus learn the need to hedge their receivable and payable positions denominated in foreign currencies. This will help them minimize the negative impacts of foreign-currency fluctuations. The alternative would be to always request payment in Canadian funds.

*Note to instructor: An additional learning point might be that small changes in exchange rates can result in large differences in amounts paid/received.*

Problems

Group B

(25-35 min.) **P16-1B**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2020** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Jan. | 1 | Investment in Earl Mfg. Ltd. Common Shares |  | 2,550,000 |  |
|  |  | Brokerage Commissions Expense |  | 15,000 |  |
|  |  | Cash |  |  | 2,565,000 |
|  |  | Purchased 30,000 common shares of Earl Mfg. Ltd., a 25 percent investment. |  |  |  |
|  |  |  |  |  |  |
| Jan. | 2 | Investment in Earl Mfg. Ltd. Common Shares |  | 528,000 |  |
|  |  | Brokerage Commissions Expense |  | 400 |  |
|  |  | Cash |  |  | 528,400 |
|  |  | Purchased 6,000 common shares of Earl Mfg. Ltd. |  |  |  |
|  |  |  |  |  |  |
| Aug. | 9 | Cash |  | 72,000 |  |
|  |  | Investment in Earl Mfg. Ltd. Common Shares |  |  | 72,000 |
|  |  | Received $2.00 per share cash dividend on 36,000 Earl Mfg. Ltd. common shares. |  |  |  |
|  |  |  |  |  |  |
| Oct. | 16 | Short-Term Investments |  | 126,000 |  |
|  |  | Brokerage Commissions Expense |  | 500 |  |
|  |  | Cash |  |  | 126,500 |
|  |  | Purchased 2,000 common shares of Excellence Ltd. At $63 plus commission of $500. |  |  |  |
|  |  |  |  |  |  |
| Nov. | 30 | Cash |  | 5,000 |  |
|  |  | Dividend Revenue |  |  | 5,000 |
|  |  | Received $2.50 per share cash dividend on 2,000 Excellence Ltd. common shares. |  |  |  |

(continued) **P16-1B**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| **2020** | |  |  |  |  |
| Dec. | 31 | Investment in Earl Mfg. Ltd. Common Shares |  | 348,000 |  |
|  |  | Equity Method Investment Revenue |  |  | 348,000 |
|  |  | To record 30% of Earl Mfg. Ltd. net income of $1,160,000. |  |  |  |
|  |  |  |  |  |  |
|  | 31 | Fair Value Valuation Allowance |  | 14,000 |  |
|  |  | Unrealized Gain on Fair Value Adjustment |  |  | 14,000 |
|  |  | Adjust short-term investment to fair value. ($140,000 – $126,000) |  |  |  |
|  |  |  |  |  |  |
| **2021** | |  |  |  |  |
| Jan. | 14 | Cash |  | 459,200 |  |
|  |  | Brokerage Commissions Expense |  | 800 |  |
|  |  | Loss on Sale of Investment |  | 5,833 |  |
|  |  | Investment in Earl Mfg. Ltd. Common Shares |  |  | 465,833\* |
|  |  | Sold 5,000 Earl Mfg. Ltd. common shares at a loss. |  |  |  |

\* Carrying amount was $465,833 [($2,550,000 + $528,000 – $72,000 + $348,000)/(30,000 shares + 6,000 shares)] × 5,000 shares.

Req. 1 (45-60 min.) **P16-2B**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2020** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Mar. | 2 | Short-Term Investments |  | 76,000 |  |
|  |  | Brokerage Commissions Expense |  | 900 |  |
|  |  | Cash |  |  | 76,900 |
|  |  | Purchased 2,000 shares at $38.00 plus commission of $900. |  |  |  |
|  |  |  |  |  |  |
|  | 5 | Equity Investments |  | 1,600,000 |  |
|  |  | Brokerage Commissions Expense |  | 30,000 |  |
|  |  | Cash |  |  | 1,630,000 |
|  |  | Purchased additional investment in common shares of associated company. |  |  |  |
|  |  |  |  |  |  |
| Jul. | 21 | Cash |  | 3,000 |  |
|  |  | Dividend Revenue |  |  | 3,000 |
|  |  | Received $1.50 per share cash dividend on short-term investment (2,000 × $1.50). |  |  |  |
|  |  |  |  |  |  |
| Aug. | 17 | Cash |  | 160,000 |  |
|  |  | Equity Investments |  |  | 160,000 |
|  |  | Received cash dividends from associated company. |  |  |  |
|  |  |  |  |  |  |
| Oct. | 16 | Cash |  | 39,000 |  |
|  |  | Brokerage Commissions Expense |  | 600 |  |
|  |  | Loss on Sale of Short-Term Investment |  | 2,200 |  |
|  |  | Short-Term Investment |  |  | 41,800 |
|  |  | Sold 1,100 shares of a short-term investment. ($76,000 × 1,100/2,000 shares) |  |  |  |
|  |  |  |  |  |  |
| Nov. | 8 | Short-Term Investments |  | 310,000 |  |
|  |  | Brokerage Commissions Expense |  | 5,000 |  |
|  |  | Cash |  |  | 315,000 |
|  |  | Purchased short-term investment plus commission of $5,000. |  |  |  |

Req. 1, cont. (continued) **P16-2B**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2020** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Nov. | 17 | Cash |  | 280,000 |  |
|  |  | Equity Investments |  |  | 280,000 |
|  |  | Received cash dividends from associated company. |  |  |  |
|  |  |  |  |  |  |
| Dec. | 31 | Equity Investments |  | 1,656,000 |  |
|  |  | Equity Method Investment Revenue |  |  | 1,656,000 |
|  |  | To record proportion of associated companies' net income ($6,900,000 × 0.24). |  |  |  |

Req. 2

|  |  |  |  |
| --- | --- | --- | --- |
| Equity Investments | | | |
| Jan. 1 Balance | 15,000,000 | Aug. 17 Dividends | 160,000 |
| Mar. 5 Purchase | 1,600,000 | Nov. 17 Dividends | 280,000 |
| Dec. 31 Net income | 1,656,000 |  |  |
| Dec. 31 Balance | 17,816,000 |  |  |

Req. 3

|  |  |  |  |
| --- | --- | --- | --- |
| Short-Term Investments | | | |
| Jan. 1 Balance | 104,000 | Oct. 16 Sale | 41,800 |
| Mar. 2 Purchase | 76,000 |  |  |
| Nov. 8 Purchase | 310,000 |  |  |
| Dec. 31 Balance | 448,200 |  |  |

Req. 4

|  |  |
| --- | --- |
| **FT CORPORATION** | |
| Balance Sheet (partial) | |
| December 31, 2020 | |
| Current assets |  |
| Cash | $           XXX |
| Short-term investments, at fair value | 425,000 |
| Accounts receivable | XXX |
| Total current assets | XXX |
| Investments—Associated companies at equity | $17,816,000 |

(20-25 min.) **P16-3B**

|  |  |  |
| --- | --- | --- |
|  | Option 1: 3,800 Shares | Option 2: 11,900 Shares |
| 1. Accounting method to use for common shares | Fair value method | Equity method |
| 1. Journal entry to record purchase of shares at $35 each. Ignore brokerage commissions. | Long-term Investment 133,000 | Investment in Hughes Ltd Common Shares 416,500 |
| Cash 133,000 | Cash 416,500 |
|  |  |
| 1. Journal entry to recognize share of $40,000 in dividends declared and paid. | Cash 4,343 | Cash 13,600 |
| Dividend Revenue 4,343 | Investment in BF Ltd Common Shares 13,600 |
| ($40,000 × 3,800/35,000) | ($40,000 × 11,900/35,000) |
| 1. Journal entry to recognize $75,000 in net income declared by Hughes Ltd. | n/a | Investment in Hughes Ltd. Common Shares 25,500 |
| Equity Method Investment Revenue 25,500 |
| ($75,000 × 11,900/35,000) |
| 1. Journal entry to recognize the year-end market value of $34 per share. | Unrealized Loss on Fair Value Valuation Adjustment 3,800 | n/a |
| Fair Value Valuation Allowance 3,800 |
| [($34 – $35) × 3,800] |
| 1. What is the balance in the investments account at year-end? | $129,200  ($34 × 3,800 shares) | $428,400  (purchase + income – dividends = balance)  ($416,500 + 25,500 – 13,600 = 428,400) |

(35-45 min.) **P16-4B**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **PISA INC.** | | | | | |
| Consolidation Worksheet | | | | | |
| June 30, 2020 | | | | | |
|  | **Pisa Inc.** | **Sienna Ltd.** | **Eliminations** | |  |
| **Debit** | **Credit** | **Consolidated Amounts** |
| **Assets** |  |  |  |  |  |
| Cash | 80,000 | 72,000 |  |  | 152,000 |
| Accounts receivable | 288,000 | 144,000 |  |  | 432,000 |
| Note receivable from Sienna Ltd. | 120,000 | — |  | (a) 120,000 | — |
| Inventory | 480,000 | 388,000 |  |  | 868,000 |
| Investment in Sienna Ltd. | 1,040,000 | — |  | (b) 1,040,000 | — |
| Property, plant and equipment, net | 608,000 | 720,000 |  |  | 1,328,000 |
| Goodwill |  |  | (b) 200,000 |  | 200,000 |
| Total assets | 2,616,000 | 1,324,000 |  |  | 2,980,000 |
|  |  |  |  |  |  |
| **Liabilities and Shareholders’ Equity** |  |  |  |  |  |
| Accounts payable | 192,000 | 128,000 |  |  | 320,000 |
| Notes payable | 588,000 | 224,000 |  |  | 812,000 |
| Note payable to Pisa Inc. | — | 120,000 | (a) 120,000 |  | — |
| Other liabilities | 204,000 | 12,000 |  |  | 216,000 |
| Common shares | 880,000 | 440,000 | (b) 440,000 |  | 880,000 |
| Retained earnings | 752,000 | 400,000 | (b) 400,000 |  | 752,000 |
| Total liabilities and shareholders’ equity | 2,616,000 | 1,324,000 | 1,160,000 | 1,160,000 | 2,980,000 |

(35-45 min.) **P16-5B**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **PINK CORP.** | | | | | |
| Consolidation Worksheet | | | | | |
| March 22, 2020 | | | | | |
|  | **Pink Corp.** | **Salmon Inc.** | **Eliminations** | |  |
| **Debit** | **Credit** | **Consolidated Amounts** |
| **Assets** |  |  |  |  |  |
| Cash | 570,000 | 150,000 |  |  | 720,000 |
| Accounts receivable | 540,000 | 440,000 |  |  | 980,000 |
| Note receivable from Pink Corp. | — | 400,000 | (a) 400,000 | — | — |
| Inventory | 750,000 | 540,000 |  |  | 1,290,000 |
| Investment in Salmon Inc. | 1,575,000 | — |  | (b) 1,575,000 | — |
| Property, plant, and equipment, net | 1,797,000 | 1,520,000 |  |  | 3,317,000 |
| Goodwill |  |  | (b) 84,000\* |  | 84,000 |
| Total assets | 5,232,000 | 3,050,000 |  |  | 6,391,000 |
| **Liabilities and Shareholders’ Equity** |  |  |  |  |  |
| Accounts payable | 480,000 | 420,000 |  |  | 900,000 |
| Notes payable | 1,077,000 | 270,000 | — |  | 1,347,000 |
| Note payable to Salmon Inc. | 400,000 | — |  | (a) 400,000 | — |
| Other liabilities | 155,000 | 230,000 |  |  | 385,000 |
| Non-controlling interest | — | — |  | (b) 639,000\*\* | 639,000 |
| Common shares | 1,170,000 | 540,000 | (b) 540,000 |  | 1,170,000 |
| Retained earnings | 1,950,000 | 1,590,000 | (b) 1,590,000 |  | 1,950,000 |
| Total liabilities and shareholders’ equity | 5,232,000 | 3,050,000 | 2,614,000 | 2,614,000 | 6,391,000 |

\* Goodwill = $1,575,000 – [($540,000 + $1,590,000) × 0.70] = $84,000

\*\* Non-controlling interest = ($540,000 + $1,590,000) × 30% = $639,000

(45-60 min.) **P16-6B**

*Reqs. 1–3*

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2020** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Jan. | 1 | Investment in Bonds |  | 2,100,000 |  |
|  |  | Cash |  |  | 2,100,000 |
|  |  | To purchase $2,000,000, 3% Province of Manitoba Bonds at 105. |  |  |  |
|  |  |  |  |  |  |
| Jul. | 1 | Cash |  | 30,000 |  |
|  |  | Interest Revenue |  |  | 30,000 |
|  |  | To receive semi-annual interest  ($2,000,000 × 0.03 × 6/12). |  |  |  |
|  |  |  |  |  |  |
|  | 1 | Interest Revenue |  | 5,000 |  |
|  |  | Investment in Bonds |  |  | 5,000 |
|  |  | To amortize premium on bond investment for six months.  [($2,100,000 – $2,000,000)/120\* × 6] |  |  |  |
|  |  |  |  |  |  |
| Oct. | 31 | Interest Receivable |  | 20,000 |  |
|  |  | Interest Revenue |  |  | 20,000 |
|  |  | To accrue interest revenue for four months ($2,000,000 × 0.03 × 4/12) |  |  |  |
|  |  |  |  |  |  |
|  | 31 | Interest Revenue |  | 3,333 |  |
|  |  | Investment in Bonds |  |  | 3,333 |
|  |  | To amortize premium on bond investment for four months.  [($2,100,000 – $2,000,000)/120\* × 4] |  |  |  |

\* Amortization period: 120 months, from January 1, 2020, to January 1, 2030.

Req. 4

The book value of the bonds at October 31, 2020, is:

Cost $2,100,000

Less amortization of premium (5,000 + 3,333)        8,333

Book value $2,091,667

(25-35 min.) **P16-7B**

Req. 1

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Semi-annual Interest Period** | **Interest Received (2.75%)** | **Period Interest Revenue  (3%)** | **Discount Amortization** | **Unamortized Discount Balance** | **Investment Carrying Value ($5,000,000 – Unamortized Discount)** |
| Dec. 31, 2020 |  |  |  | $124,425 | $4,875,575 |
| Jun. 30, 2021 | $137,500 | $146,267 | $8,767 | 115,658 | 4,884,342 |
| Dec. 31, 2021 | 137,500 | 146,530 | 9,030 | 106,628 | 4,893,372 |

Req. 2

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| **2020** | |  |  |  |  |
| Dec. | 31 | Investment in Bonds |  | 4,875,575 |  |
|  |  | Cash |  |  | 4,875,575 |
|  |  | To purchase bond investment. |  |  |  |
|  |  |  |  |  |  |
| **2021** | |  |  |  |  |
| Jun. | 30 | Cash |  | 137,500 |  |
|  |  | Investment in Bonds |  | 8,767 |  |
|  |  | Interest Revenue |  |  | 146,267 |
|  |  | To receive semi-annual interest revenue and amortize discount on investment. |  |  |  |
|  |  |  |  |  |  |
| Dec. | 31 | Cash |  | 137,500 |  |
|  |  | Investment in Bonds |  | 9,030 |  |
|  |  | Interest Revenue |  |  | 146,530 |
|  |  | To receive semi-annual interest revenue and amortize discount on investment. |  |  |  |

*Note:* At June 30 and December 31, 2021, the investor can make separate entries for the accrual of cash interest and for the amortization of the discount on the investment.

(30-50 min.) **P16-8B**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2020** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Jan. | 5 | Short-term Investments |  | 250,000 |  |
|  |  | Brokerage Commission Expense |  | 300 |  |
|  |  | Cash |  |  | 250,300 |
|  |  | Bought 5,000 shares in Salmon Ltd. at $50.00 + $300 commission per share. |  |  |  |
|  |  |  |  |  |  |
|  | 31 | No entry required. |  |  |  |
|  |  |  |  |  |  |
| Feb. | 15 | Cash |  | 18,000 |  |
|  |  | Dividend Revenue |  |  | 18,000 |
|  |  |  |  |  |  |
| Apr. | 1 | Investment in Bonds |  | 300,000 |  |
|  |  | Cash |  |  | 300,000 |
|  |  | $300,000 bonds at 100. |  |  |  |
|  |  |  |  |  |  |
| Aug. | 31 | Received 500 Salmon Ltd. common shares in a 10% stock dividend. New cost per share is $45.45 ($250,000/5,500). |  |  |  |
|  |  |  |  |  |  |
| Oct. | 1 | Cash |  | 9,000 |  |
|  |  | Interest Revenue |  |  | 9,000 |
|  |  | $300,000 × 0.03 = $9,000 |  |  |  |
|  |  |  |  |  |  |
| Nov. | 1 | Received 5,500 Salmon Ltd. common shares in a 2 for 1 stock split. New cost per share is $22.73 ($250,000/11,000). |  |  |  |

(continued) **P16-8B**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date**  **2020** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| Dec. | 15 | Cash |  | 158,200 |  |
|  |  | Brokerage Commission Expense |  | 200 |  |
|  |  | Gain on Sale of Investment |  |  | 83,400 |
|  |  | Short-Term Investments |  |  | 75,000 |
|  |  | Sold 3,300 of 11,000 shares (30%) of Salmon Ltd. at 48.00. (Investment = $250,000 × 0.30) |  |  |  |
|  |  |  |  |  |  |
|  | 31 | Bond Interest Receivable |  | 4,500 |  |
|  |  | Interest Revenue |  |  | 4,500 |
|  |  | To accrue interest on bonds ($9,000 × 3/6) |  |  |  |
|  |  |  |  |  |  |
|  | 31 | Fair Value Valuation Allowance |  | 85,009 |  |
|  |  | Unrealized Gain on Fair Value Adjustment |  |  | 85,009 |
|  |  | Adjusted short-term investments to fair value ($1,155,000 – $1,069,991). |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Carrying**  **Value** | **Market Value**  **Dec. 31, 2020** | **Differences** |
| Canadian Utilities Limited | $ 310,000 | $ 290,000 | ($20,000) |
| TELUS Corporation. | 425,000 | 420,000 | (5,000) |
| Salmon Ltd. (at Cost) | 174,991 | 270,000 | 95,009 |
| Talisman Energy Ltd. | 160,000 | 175,000 | 15,000 |
| Total short-term investments | $1,069,991 | $1,155,000 | 85,009 |

\* $250,000 – $75,009 = $174,991

Req. 1 (30-40 min.) **P16-9B**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **General Journal** | | | | | |
| **Date** | | **Account Titles and Explanations** | **Post. Ref.** | **Debit** | **Credit** |
| **2020** | |  |  |  |  |
| Dec. | 4 | Accounts Receivable |  | 110,000 |  |
|  |  | Sales Revenue |  |  | 110,000 |
|  |  |  |  |  |  |
|  | 13 | Inventory |  | 252,000 |  |
|  |  | Accounts Payable |  |  | 252,000 |
|  |  | (US$240,000 × $1.05) |  |  |  |
|  |  |  |  |  |  |
|  | 20 | Accounts Receivable |  | 298,800 |  |
|  |  | Sales Revenue |  |  | 298,800 |
|  |  | (£180,000 × $1.66) |  |  |  |
|  |  |  |  |  |  |
|  | 27 | Cash |  | 110,000 |  |
|  |  | Accounts Receivable |  |  | 110,000 |
|  |  |  |  |  |  |
|  | 31 | Foreign Currency Transaction Loss |  | 6,600 |  |
|  |  | Accounts Payable |  |  | 4,800 |
|  |  | Accounts Receivable |  |  | 1,800 |
|  |  | Payable = [US$240,000 × ($1.07 – $1.05)]  Receivable = [£180,000 × ($1.66 – $1.65)] |  |  |  |
|  |  |  |  |  |  |
| **2021** | |  |  |  |  |
| Jan. | 21 | Accounts Payable |  | 256,800 |  |
|  |  | Foreign Currency Transaction Gain |  |  | 2,400 |
|  |  | Cash |  |  | 254,400 |
|  |  | Payable = ($252,000 + $4,800)  Cash = ($240,000 × $1.06) |  |  |  |
|  |  |  |  |  |  |
| Feb. | 17 | Cash |  | 304,200 |  |
|  |  | Foreign Currency Transaction Gain |  |  | 7,200 |
|  |  | Accounts Receivable |  |  | 297,000 |
|  |  | Cash = (£180,000 × $1.69)  Receivable = ($298,800 – $1,800) |  |  |  |

(continued) **P16-9B**

|  |  |
| --- | --- |
| **CUSTOM ICE CREAM CORPORATION** | |
| Income Statement (partial) | |
| For the Year Ended December 31, 2020 | |
| Other revenue and expense |  |
| Foreign-currency transaction loss | $6,600 |

Req. 2

This problem demonstrates that the final amount of a cash receipt or cash payment on an international transaction may differ from the agreed-upon amount of the transaction. Students can thus learn the need to hedge their receivable and payable positions denominated in foreign currencies. This will help them minimize the negative impacts of foreign-currency fluctuations.

**Challenge Problems**

**P16-1C**

This question requires the student to understand the philosophy underlying the three methods.

1. A company that owns less than 20 percent but nevertheless exerts “significant influence” may believe that the equity method is appropriate especially if the investee company is earning large profits but paying small dividends. If the investor had the right to appoint one or more directors, then the influence could be significant and the equity method may be appropriate.

2. A company that owns between 20 and 50 percent may believe that it does not exercise significant influence over the investee company and thus think that the fair value method is the most appropriate. This would especially be true if the investee were controlled by another shareholder who owned more than 50 percent of the voting shares. An alternative response might consider a situation when the investor intends to sell the investment in the near future.

3. The investor company may own more than 50 percent but may not believe that consolidation is appropriate because the investor (parent) does not exercise significant influence over the subsidiary.

One example would be if the subsidiary were in a foreign country and the foreign government controlled the operations of the subsidiary even though the investor company owned more than 50 percent of the shares. Another example would be where the subsidiary was in financial difficulties and the investor did not exercise significant influence.

**P16-2C**

Exporters are generally happy when the Canadian dollar weakens because it means Canadian exports are cheaper in international markets and thus more competitive. Where the sales are priced in the foreign currency, the Canadian company will receive more dollars for their sales.

Finance ministers are likely to be unhappy if they have borrowed in international markets because a weaker dollar makes foreign borrowings more expensive in Canadian dollars in terms of both interest cost and repayment. It also increases the cost of foreign goods imported, which tends to increase the cost of living and may generate wage increases.

Decision Problems

Req. 1 (15-20 min.) **DP16-1**

The *fair value method* is normally used to account for investments of less than 20 percent of the investee company’s voting shares. Under the fair value method, the investment is recorded initially at cost. Dividends received are accounted for as revenue, and gains and losses on sales of investments are measured as the difference between sale price and the carrying value. The investments are reported on the balance sheet at their fair value.

The *equity method* is used to account for investments between 20 percent and 50 percent of the investee company’s voting shares. An investment of this magnitude is virtually always long term. Under the equity method, the investment is recorded initially at cost. Dividends received are accounted for as a partial repayment of the profits or original investment in the investee company. The investor’s percentage of the investee company’s net income is accounted for as an increase in the Investment account and an increase in Equity Method Investment Revenue. Gains and losses on sales of the investments are measured as the difference between sale price and the Investment account carrying value (cost + net income – dividends). The investment is shown on the balance sheet at carrying value unless the decline in market value is believed to be permanent.

Req. 2

The equity method should be used for the investment in Old Times Ltd. The fair value method should be used for Mountain Music Inc.

Financial Statement Cases

**FSC16-1**

*Req. 1*

The balance sheet lists an asset called “Equity Investment.” Further information is found in Note 22. In addition, Note 4 Significant Accounting Policies describes the *basis of consolidation*. This note mentions that “The consolidated financial statements comprise the financial statements of the company and entities controlled by the company.”

*Req. 2*

Note 22 states that there is 50 percent equity ownership in Calendar Club—a business that sells calendars, games, and other gifts.

*Req. 3*

Indigo Books & Music Inc. does have foreign-currency transactions.

The Consolidated Statements of Cash Flows shows a line item called “Effect of foreign currency exchange rates on changes in cash and cash equivalents.”

Note 4 Significant Accounting Policies includes a section on Foreign Currency Translation (page 43)

Note 21 Financial Risk Management has a section about “foreign exchange risk section,” which tells the reader that there are purchases from US suppliers and a New York office that require payment in US rather than Canadian dollars.

*Req. 4*

In 2017 there was a $200,000 gain on foreign-currency transactions*.*

**FSC16-2**

*Req. 1*

Significant accounting policies are reported in Note 1. There is information about “translation of foreign currencies” in Note 1 (j.), which reads:

Trade transactions completed in foreign currencies are translated into Canadian dollars at the rates of exchange prevailing at the time of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the rate of exchange in effect at the statement of financial position date, with any resulting gain or loss recorded in the Consolidated statements of income and other comprehensive income as a component of Financing costs, as set out in Note 8.

*Req. 2*

Note 1 (a) addresses consolidation. TELUS Corporation has 100 percent equity interest in TELUS Communications Inc. In 2016, the issuance of shares in TELUS International (Cda) Inc. to Baring Private Equity Asia resulted in a non-controlling interest being reported in the balance sheet in 2016. TELUS Corporation still maintains control and consolidates this subsidiary.