# File: Chapter 01 - The Equity Method of Accounting for Investments

# Multiple Choice:

[QUESTION]

1. Gaw Company owns 15% of the common stock of Trace Corporation and used the fair-value method to account for this investment. Trace reported net income of $110,000 for 2018 and paid dividends of $60,000 on October 1, 2018. How much income should Gaw recognize on this investment in 2018?

A) $16,500.

B) $ 9,000.

C) $25,500.

D) $ 7,500.

E) $50,000.

Answer: B

Learning Objective: 01-01

Topic: Investments―Fair-value method

Difficulty: 1 Easy

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $60,000 × .15 = $9,000

[QUESTION]

2. Yaro Company owns 30% of the common stock of Dew Co. and uses the equity method to account for the investment. During 2018, Dew reported income of $250,000 and paid dividends of $80,000. There is no amortization associated with the investment. During 2018, how much income should Yaro recognize related to this investment?

A) $24,000.

B) $75,000.

C) $99,000.

D) $51,000.

E) $80,000.

Answer: B

Learning Objective: 01-03

Topic: Equity method―Investment income

Difficulty: 1 Easy

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $250,000 × .30 = $75,000

[QUESTION]

3. On January 1, 2018, Pacer Company paid $1,920,000 for 60,000 shares of Lennon Co.’s voting common stock which represents a 45% investment. No allocation to goodwill or other specific account was necessary. Significant influence over Lennon was achieved by this acquisition. Lennon distributed a dividend of $2.50 per share during 2018 and reported net income of $670,000. What was the balance in the *Investment in Lennon Co.* account found in the financial records of Pacer as of December 31, 2018?

A) $2,040,500.

B) $2,212,500.

C) $2,260,500.

D) $2,171,500.

E) $2,071,500.

Answer: E

Learning Objective: 01-03

Topic: Equity method―Investment account balance

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $1,920,000 + ($670,000 × .45) – ($2.50 × 60,000) = $2,071,500

[QUESTION]

4. An investor should always use the equity method to account for an investment if:

A) It has the ability to exercise significant influence over the operating policies of the investee.

B) It owns 30% of an investee’s stock.

C) It has a controlling interest (more than 50%) of an investee’s stock.

D) The investment was made primarily to earn a return on excess cash.

E) It does not have the ability to exercise significant influence over the operating policies of the investee.

Answer: A

Learning Objective: 01-02

Topic: Equity method―Significant influence criterion

Difficulty: 1 Easy

Blooms: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

5. On January 1, 2016, Dermot Company purchased 15% of the voting common stock of Horne Corp. On January 1, 2018, Dermot purchased 28% of Horne’s voting common stock. If Dermot achieves significant influence with this new investment, how must Dermot account for the change to the equity method?

A) It must use the equity method for 2018 but should make no changes in its financial statements for 2017 and 2016.

B) It should prepare consolidated financial statements for 2018.

C) It must restate the financial statements for 2017 and 2016 as if the equity method had been used for those two years.

D) It should record a prior period adjustment at the beginning of 2018 but should not restate the financial statements for 2017 and 2016.

E) It must restate the financial statements for 2017 as if the equity method had been used then.

Answer: A

Learning Objective: 01-05a

Topic: Report change to equity method

Difficulty: 2 Medium

Blooms: Understand

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

6. During January 2017, Wells, Inc. acquired 30% of the outstanding common stock of Wilton Co. for $1,400,000. This investment gave Wells the ability to exercise significant influence over Wilton. Wilton’s assets on that date were recorded at $6,400,000 with liabilities of $3,000,000. Any excess of cost over book value of Wells’ investment was attributed to unrecorded patents having a remaining useful life of ten years.

In 2017, Wilton reported net income of $600,000. For 2018, Wilton reported net income of $750,000. Dividends of $200,000 were paid in each of these two years. What was the reported balance of Wells’ *Investment in Wilson Co.* at December 31, 2018?

A) $1,609,000.

B) $1,485,000.

C) $1,685,000.

D) $1,647,000.

E) $1,054,300.

Answer: A

Learning Objective: 01-04

Topic: Equity method―Investment account balance

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $6,400,000 - $3,000,000 = $3,400,000 × 30% = $1,020,000

$1,400,000 - $1,020,000 = $380,000 / 10yrs = $38,000 Unrecorded Patents Amortization

$1,400,000 + $180,000 + $225,000 - $60,000 - $60,000 - $38,000 - $38,000 = $1,609,000

[QUESTION]

7. On January 1, 2018, Bangle Company purchased 30% of the voting common stock of Sleat Corp. for $1,000,000. Any excess of cost over book value was assigned to goodwill. During 2018, Sleat paid dividends of $24,000 and reported a net loss of $140,000. What is the balance in the investment account on December 31, 2018?

A) $950,800.

B) $958,000.

C) $836,000.

D) $990,100.

E) $956,400.

Answer: A

Learning Objective: 01-03

Learning Objective: 01-05c

Topic: Equity method―Investment account balance

Topic: Report investee losses

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $1,000,000 - $42,000 - $7,200 = $950,800

[QUESTION]

8. On January 1, 2018, Jordan Inc. acquired 30% of Nico Corp. Jordan used the equity method to account for the investment. On January 1, 2019, Jordan sold two-thirds of its investment in Nico. It no longer had the ability to exercise significant influence over the operations of Nico. How should Jordan account for this change?

A) Jordan should continue to use the equity method to maintain consistency in its financial statements.

B) Jordan should restate the prior years’ financial statements and change the balance in the investment account as if the fair-value method had been used since 2018.

C) Jordan has the option of using either the equity method or the fair-value method for 2018 and future years.

D) Jordan should report the effect of the change from the equity to the fair-value method as a retrospective change in accounting principle.

E) Jordan should use the fair-value method for 2019 and future years, but should not make a retrospective adjustment to the investment account.

Answer: E

Learning Objective: 01-05d

Topic: Report sale of equity investment

Difficulty: 2 Medium

Blooms: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

9. Tower Inc. owns 30% of Yale Co. and applies the equity method. During the current year, Tower bought inventory costing $66,000 and then sold it to Yale for $120,000. At year-end, only $24,000 of merchandise was still being held by Yale. What amount of intra-entity gross profit must be deferred by Tower?

A) $ 6,480.

B) $ 3,240.

C) $10,800.

D) $16,200.

E) $ 6,610.

Answer: B

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $120,000 - $66,000 = $54,000

$24,000 / $120,000 = 20% × $54,000 = $10,800 × 30% = $3,240

[QUESTION]

10. On January 4, 2018, Watts Co. purchased 40,000 shares (40%) of the common stock of Adams Corp., paying $800,000. There was no goodwill or other cost allocation associated with the investment. Watts has significant influence over Adams. During 2018, Adams reported income of $200,000 and paid dividends of $80,000. On January 2, 2019, Watts sold 5,000 shares for $125,000. What was the balance in the investment account after the shares had been sold?

A) $848,000.

B) $742,000.

C) $723,000.

D) $761,000.

E) $925,000.

Answer: B

Learning Objective: 01-05d

Topic: Report sale of equity investment

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $800,000 + $80,000 - $32,000 = $848,000 – (5,000 / 40,000 × $848,000) = $742,000

REFERENCE: 01-01

On January 3, 2018, Austin Corp. purchased 25% of the voting common stock of Gainsville Co., paying $2,500,000. Austin decided to use the equity method to account for this investment. At the time of the investment, Gainsville’s total stockholders’ equity was $8,000,000. Austin gathered the following information about Gainsville’s assets and liabilities:

Book Value

Fair Value

Buildings (10

-

year life)

$ 400,000

 $ 500,000

Equipment (5

Franchises (8-

-

year life)

year life)

1,000,000

0

 1,300,000

 400,000

For all other assets and liabilities, book value and fair value were equal. Any excess of cost over fair value was attributed to goodwill, which has not been impaired.

[QUESTION]

REFER TO: 01-01

11. What is the amount of goodwill associated with the investment?

A) $500,000.

B) $200,000.

C) $0.

D) $300,000.

E) $400,000.

Answer: D

Learning Objective: 01-04

Topic: Equity method―Allocate cost of investment

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: Buildings $500,000 - $400,000 = $100,000 FV > BV

Equipment $1,300,000 - $1,000,000 = $300,000 FV > BV

Franchises $400,000 – 0 = $400,000 FV > BV

$100,000 + $300,000 + $400,000 = $800,000 × 25% = $200,000 Identifiable Excess Paid

$8,000,000 × 25% = $2,000,000 BV

($2,500,000 Paid) – ($2,000,000 BV) = ($500,000 FV > BV) – ($200,000 Identifiable Excess Paid) = $300,000 Unidentifiable Excess Paid (Goodwill)

[QUESTION]

REFER TO: 01-01

12. For 2018, what is the total amount of excess amortization for Austin’s 25% investment in Gainsville?

A) $ 27,500.

B) $ 20,000.

C) $ 30,000.

D) $120,000.

E) $ 70,000.

Answer: C

Learning Objective: 01-04

Topic: Equity method―Amortize allocations

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $500,000 - $400,000 = $100,000 / 10yrs = $10,000

$1,300,000 - $1,000,000 = $300,000 / 5yrs = $60,000

$400,000 – 0 = $400,000 / 8yrs = $50,000

$10,000 + $60,000 + $50,000 = $120,000 × 25% = $30,000

[QUESTION]

13. Club Co. appropriately uses the equity method to account for its investment in Chip Corp. As of the end of 2018, Chip’s common stock had suffered a significant decline in fair value, which is expected to recover over the next several months. How should Club account for the decline in value?

A) Club should switch to the fair-value method.

B) No accounting because the decline in fair value is temporary.

C) Club should decrease the balance in the investment account to the current value and recognize a loss on the income statement.

D) Club should not record its share of Chip’s 2018 earnings until the decline in the fair value of the stock has been recovered.

E) Club should decrease the balance in the investment account to the current value and recognize an unrealized loss on the balance sheet.

Answer: B

Learning Objective: 01-05c

Topic: Report investee losses

Difficulty: 1 Easy

Blooms: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

14. An *upstream* sale of inventory is a sale:

A) Between subsidiaries owned by a common parent.

B) With the transfer of goods scheduled by contract to occur on a specified future date.

C) In which the goods are physically transported by boat from a subsidiary to its parent.

D) Made by the investor to the investee.

E) Made by the investee to the investor.

Answer: E

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 1 Easy

Blooms: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

REFERENCE: 01-02

Atlarge Inc. owns 30% of the outstanding voting common stock of Ticker Co. and has the ability to significantly influence the investee’s operations and decision-making. On January 1, 2018, the balance in the *Investment in Ticker Co.* account was $402,000. Amortization associated with the purchase of this investment is $8,000 per year. During 2018, Ticker earned income of $108,000 and paid cash dividends of $36,000. Previously in 2017, Ticker had sold inventory costing $28,800 to Atlarge for $48,000. All but 25% of this merchandise was consumed by Atlarge during 2017. The remainder was used during the first few weeks of 2018. Additional sales were made to Atlarge in 2018; inventory costing $33,600 was transferred at a price of $60,000. Of this total, 40% was not consumed until 2019.

[QUESTION]

REFER TO: 01-02

15. What amount of *equity income* would Atlarge have recognized in 2018 from its ownership interest in Ticker?

A) $19,792.

B) $27,640.

C) $22,672.

D) $24,400.

E) $21,748.

Answer: C

Learning Objective: 01-03

Learning Objective: 01-04

Learning Objective: 01-06

Topic: Equity method―Investment income

Topic: Equity method―Amortize allocations

Topic: Intra–entity sales of inventory

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: 2018 Income $108,000 × 30% = $32,400

2017 Inventory Profit Recognized $48,000 - $28,800 = $19,200 × 25% = $4,800 × 30% = $1,440

2018 Inventory Profit Deferred $60,000 - $33,600 = $26,400 × 40% = $10,560 × 30% = $3,168

2018 Purchase Amortization $8,000

$32,400 + $1,440 - $3,168 -$8,000 = $22,672 Equity Income 2018

[QUESTION]

REFER TO: 01-02

16. What was the balance in the *Investment in Ticker Co.* account at the end of 2018?

A) $401,136.

B) $413,872.

C) $418,840.

D) $412,432.

E) $410,148.

Answer: B

Learning Objective: 01-03

Learning Objective: 01-04

Learning Objective: 01-06

Topic: Equity method―Investment income

Topic: Equity method―Amortize allocations

Topic: Intra–entity sales of inventory

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: 2018 Beginning Balance = $402,000

2018 Income Recognized = $22,672 (see previous question)

2018 Dividend Received = ($36,000 × 30%) = $10,800

2018 Ending Balance = ($402,000 + $22,672 - $10,800) = $413,872

REFERENCE: 01-03

On January 1, 2018, Deuce Inc. acquired 15% of Wiz Co.’s outstanding common stock for $62,400 and did not exercise significant influence. Wiz earned net income of $96,000 in 2018 and paid dividends of $36,000. The fair value of Deuce’s investment was $80,000 at December 31, 2018. On January 3, 2019, Deuce bought an additional 10% of Wiz for $54,000. This second purchase gave Deuce the ability to significantly influence the decision making of Wiz. During 2019, Wiz earned $120,000 and paid $48,000 in dividends. As of December 31, 2019, Wiz reported a net book value of $468,000. At the date of the second purchase, Deuce concluded that Wiz Co.’s book values approximated fair values and attributed any excess cost to goodwill.

[QUESTION]

REFER TO: 01-03

17. On Deuce’s December 31, 2019 balance sheet, what balance was reported for the *Investment in Wiz Co.* account?

A) $117,000.

B) $143,400.

C) $152,000.

D) $134,400.

E) $141,200.

Answer: C

Learning Objective: 01-01

Learning Objective: 01-03

Learning Objective: 01-05a

Topic: Investments―Fair-value method

Topic: Equity method―Investment account balance

Topic: Report change to equity method

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: 2018 Purchase = $62,400. The investment was increased to fair value of $80,000 at 12/31/18.

2019 Income = ($120,000 × 25%) = $30,000

2019 Dividend = ($48,000 × 25%) = $12,000

Ending 2019 Balance = ($80,000 + $54,000 + $30,000 - $12,000) = $152,000

[QUESTION]

REFER TO: 01-03

18. What amount of *equity income* should Deuce have reported for 2019?

A) $30,000.

B) $16,420.

C) $38,340.

D) $18,000.

E) $32,840.

Answer: A

Learning Objective: 01-03

Learning Objective: 01-05a

Topic: Equity method―Investment income

Topic: Report change to equity method

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: 2019 Income = ($120,000 × 25%) = $30,000

[QUESTION]

19. In a situation where the investor exercises significant influence over the investee, which of the following entries is *not* actually posted to the books of the investor?

(I) Debit to the Investment account, and a Credit to the Equity in Investee Income account.

(II) Debit to Cash (for dividends received from the investee), and a Credit to Investment Income account .

(III) Debit to Cash (for dividends received from the investee), and a Credit to the Dividend Receivable.

A) Entries I and II.

B) Entries II and III.

C) Entry I only.

D) Entry II only.

E) Entry III only.

Answer: D

Learning Objective: 01-03

Topic: Equity method―Basic journal entries

Difficulty: 2 Medium

Blooms: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

20. All of the following would require use of the equity method for investments *except*:

A) Material intra-entity transactions.

B) Investor participation in the policy-making process of the investee.

C) Valuation at fair value.

D) Technological dependency.

E) Interchange of managerial personnel.

Answer: C

Learning Objective: 01-02

Topic: Equity method―Significant influence criterion

Difficulty: 1 Easy

Blooms: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

21. All of the following statements regarding the investment account using the equity method are true *except*:

A) The investment is recorded at cost.

B) Dividends received are reported as revenue.

C) Net income of investee increases the investment account.

D) Dividends received reduce the investment account.

E) Amortization of fair value over cost reduces the investment account.

Answer: B

Learning Objective: 01-02

Topic: Equity method―Investment account balance

Difficulty: 1 Easy

Blooms: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

22. A company has been using the fair-value method to account for its investment. The company now has the ability to significantly influence the investee and the equity method has been deemed appropriate. Which of the following statements is true?

A) A cumulative effect change in accounting principle must occur.

B) A prospective change in accounting principle must occur.

C) A retrospective change in accounting principle must occur.

D) The investor will not receive future dividends from the investee.

E) Future dividends will continue to be recorded as revenue.

Answer: B

Learning Objective: 01-05a

Topic: Report change to equity method

Difficulty: 2 Medium

Blooms: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

23. A company has been using the equity method to account for its investment. The company sells shares and does not continue to have significant influence. Which of the following statements is true?

A) A cumulative effect change in accounting principle must occur.

B) A prospective change in accounting principle must occur.

C) A retrospective change in accounting principle must occur.

D) The investor will not receive future dividends from the investee.

E) Future dividends will continue to reduce the investment account.

Answer: B

Learning Objective: 01-05d

Topic: Report sale of equity investment

Difficulty: 2 Medium

Blooms: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

24. When an investor appropriately applies the equity method, how should it account for any investee Other Comprehensive Income (OCI)?

A) Under the equity method, the investor only recognizes its share of investee’s income from continuing operations.

B) The OCI would reduce the investment.

C) The OCI would increase the investment.

D) The OCI would not appear on the investor’s income statement but would be a component of comprehensive income.

E) The OCI would be ignored but shown in the investor’s notes to the financial statements.

Answer: C

Learning Objective: 01-05b

Topic: Report investee OCI

Difficulty: 2 Medium

Blooms: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

25. How should a permanent loss in value of an investment using the equity method be treated?

A) The equity in investee income is reduced.

B) A loss is reported in the same manner as a loss in value of other long-term assets.

C) The investor’s stockholders’ equity is reduced.

D) No adjustment is necessary.

E) Record an offset to cash.

Answer: B

Learning Objective: 01-05c

Topic: Report investee losses

Difficulty: 3 Hard

Blooms: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

26. Under the equity method, when the company’s share of cumulative losses equals its investment and the company has no obligation or intention to fund such additional losses, which of the following statements is true?

A) The investor should change to the fair-value method to account for its investment.

B) The investor should suspend applying the equity method until the investee reports income.

C) The investor should suspend applying the equity method and not record any equity in income of investee until its share of future profits is sufficient to recover losses that have not previously been recorded.

D) The cumulative losses should be reported as a prior period adjustment.

E) The investor should report these as equity method losses in its income statement.

Answer: C

Learning Objective: 01-05c

Topic: Report investee losses

Difficulty: 3 Hard

Blooms: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

27. When an investor sells shares of its investee company, which of the following statements is true?

A) A recognized gain or loss is reported as the difference between selling price and original cost.

B) An recognized gain or loss is reported as the difference between selling price and original cost.

C) A recognized gain or loss is reported as the difference between selling price and carrying value.

D) An unrealized gain or loss is reported as the difference between selling price and carrying value.

E) Any gain or loss is reported as part of comprehensive income.

Answer: C

Learning Objective: 01-05d

Topic: Report sale of equity investment

Difficulty: 2 Medium

Blooms: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

28. When applying the equity method, how is the excess of cost over book value calculated and accounted for?

A) The excess is allocated to the difference between fair value and book value multiplied by the percent ownership of current assets.

B) The excess is allocated to the difference between fair value and book value multiplied by the percent ownership of total assets.

C) The excess is allocated to the difference between fair value and book value multiplied by the percent ownership of net assets.

D) The excess is allocated to goodwill.

E) The excess is ignored.

Answer: C

Learning Objective: 01-04

Topic: Equity method―Allocate cost of investment

Difficulty: 2 Medium

Blooms: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

29. After allocating cost in excess of book value, which asset or liability would *not* be amortized over a useful life?

A) Cost of goods sold.

B) Property, plant, & equipment.

C) Patents.

D) Goodwill.

E) Bonds payable.

Answer: D

Learning Objective: 01-04

Topic: Equity method―Allocate cost of investment

Difficulty: 1 Easy

Blooms: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

30. Which statement is true concerning unrecognized profits in intra-entity inventory sales when an investor uses the equity method?

A) The investee must defer upstream ending inventory profits.

B) The investee must defer upstream beginning inventory profits.

C) The investor must defer downstream ending inventory profits.

D) The investor must defer downstream beginning inventory profits.

E) The investor must defer upstream beginning inventory profits.

Answer: C

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 2 Medium

Blooms: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

31. Which statement is true concerning unrecognized profits in intra-entity inventory sales when an investor uses the equity method?

A) The investor and investee make reciprocal entries to defer and recognize inventory profits.

B) The same adjustments are made for upstream and downstream sales.

C) Different adjustments are made for upstream and downstream sales.

D) No adjustments are necessary.

E) Adjustments will be made only when profits are known upon sale to outsiders.

Answer: B

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 2 Medium

Blooms: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

REFERENCE: 01-04

On January 1, 2017, Dawson, Incorporated, paid $100,000 for a 30% interest in Sacco Corporation. This investee had assets with a book value of $550,000 and liabilities of $300,000. A patent held by Sacco having a book value of $10,000 was actually worth $40,000 with a six-year remaining life. Any goodwill associated with this acquisition is considered to have an indefinite life. During 2017, Sacco reported net income of $50,000 and paid dividends of $20,000 while in 2018 it reported net income of $75,000 and dividends of $30,000. Assume Dawson has the ability to significantly influence the operations of Sacco.

[QUESTION]

REFER TO: 01-04

32. The amount allocated to goodwill at January 1, 2017, is

A) $25,000.

B) $13,000

C) $ 9,000.

D) $16,000.

E) $10,000.

Answer: D

Learning Objective: 01-04

Topic: Equity method―Allocate cost of investment

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Book value purchased = ($550,000 - $300,000) = 250,000 × 30% = 75,000

Excess: $75,000 × 30% = $25,000

Allocated to patent: $30,000 × 30% = $9,000

Remainder to goodwill: $25,000 - $9,000 = $16,000.

[QUESTION]

REFER TO: 01-04

33. The equity in income of Sacco for 2017, is

A) $ 9,000.

B) $13,500.

C) $15,000.

D) $ 7,500.

E) $50,000.

Answer: B

Learning Objective: 01-03

Learning Objective: 01-04

Topic: Equity method―Investment income

Topic: Equity method―Amortize allocations

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: 2017 Equity Income = ($50,000 × 30%) = $15,000

2017 Excess Patent Amortization = ($30,000 / 6 = $5,000) × 30%) = $1,500

$15,000 - $1,500 = $13,500

[QUESTION]

REFER TO: 01-04

34. The equity in income of Sacco for 2018, is

A) $22,500.

B) $21,000.

C) $12,000.

D) $13,500.

E) $75,000.

Answer: B

Learning Objective: 01-03

Learning Objective: 01-04

Topic: Equity method―Investment income

Topic: Equity method―Amortize allocations

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: 2018 Equity Income = ($75,000 × 30%) = $22,500

2018 Excess Patent Amortization = ($30,000 / 6 = $5,000) × 30%) = $1,500

$22,500 - $1,500 = $21,000

[QUESTION]

REFER TO: 01-04

35. The balance in the Investment in Sacco account at December 31, 2017, is

A) $100,000.

B) $112,000.

C) $106,000.

D) $107,500.

E) $140,000.

Answer: D

Learning Objective: 01-03

Learning Objective: 01-04

Topic: Equity method―Investment account balance

Topic: Equity method―Investment income

Topic: Equity method―Amortize allocations

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $100,000 + $13,500 – ($20,000 × 30%) = $107,500

[QUESTION]

REFER TO: 01-04

36. The balance in the Investment in Sacco account at December 31, 2018, is

A) $119,500.

B) $125,500.

C) $116,500.

D) $118,000.

E) $100,000.

Answer: A

Learning Objective: 01-03

Learning Objective: 01-04

Topic: Equity method―Investment account balance

Topic: Equity method―Amortize allocations

Topic: Equity method―Investment income

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $107,500 + $21,000 – ($30,000 × 30%) = $119,500

REFERENCE: 01-05

Dodge, Incorporated acquires 15% of Gates Corporation on January 1, 2017, for $105,000 when the book value of Gates was $600,000. During 2017 Gates reported net income of $150,000 and paid dividends of $50,000. On January 1, 2018, Dodge purchased an additional 25% of Gates for $200,000. Any excess cost over book value is attributable to goodwill with an indefinite life. The fair-value method was used during 2017 but Dodge has deemed it necessary to change to the equity method after the second purchase. During 2018 Gates reported net income of $200,000, and reported dividends of $75,000.

[QUESTION]

REFER TO: 01-05

37. The income reported by Dodge for 2017 with regard to the Gates investment is

A) $ 7,500.

B) $ 22,500.

C) $ 15,000.

D) $100,000.

E) $150,000.

Answer: A

Learning Objective: 01-01

Topic: Investments―Fair-value method

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: ($50,000 × 15% = $7,500) = Dividends received by Dodge in 2017

[QUESTION]

REFER TO: 01-05

38. The income reported by Dodge for 2018 with regard to the Gates investment is

A) $80,000.

B) $30,000.

C) $50,000.

D) $15,000.

E) $75,000.

Answer: A

Learning Objective: 01-02

Learning Objective: 01-05a

Topic: Equity method―Investment income

Topic: Report change to equity method

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $200,000 × 40% = $80,000

[QUESTION]

REFER TO: 01-05

39. Which of the following is true regarding the change from the fair-value method to the equity method?

A) Dodge must record a debit to additional paid-in capital in the amount of $200,000.

B) Dodge must record a debit to additional paid-in capital for $15,000.

C) Dodge must retrospectively apply the equity method to interests reported under the fair-value method.

D) Dodge must record a debit of $200,000 to the Gates Investment Account.

E) Dodge must record a credit of $15,000 to the Gates Investment Account.

Answer: D

Learning Objective: 01-05a

Topic: Report change to equity method

Difficulty: 3 Hard

Blooms: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: ASU No. 2016-07 eliminated retrospective application of equity method and requires prospective treatment such that the acquisition cost of the new shares of the investment is added to the current basis of the investment.

[QUESTION]

REFER TO: 01-05

40. The balance in the investment account at December 31, 2018, is

A) $335,000.

B) $355,000.

C) $400,000.

D) $412,500.

E) $480,000.

Answer: B

Learning Objective: 01-05a

Topic: Report change to equity method

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback:

Balance 2018 Year End

Book value purchased = $105,000 + $200,000 = $305,000

2018 Net Income and Dividends = $80,000 - $30,000 = $50,000

End of Year Balance = $305,000 + $55,000 = $355,000

REFERENCE: 01-06

Clancy Incorporated sold $210,000 of its inventory to Reid Company during 2018 for $350,000. Reid sold $224,000 of this merchandise in 2018 with the remainder to be disposed of during 2019. Assume Clancy owns 30% of Reid and accounts for its investment using the equity method.

[QUESTION]

REFER TO: 01-06

41. What journal entry will be recorded at the end of 2018 to defer the recognition of the investor’s share of the intra-entity gross profits?

|  |  |  |  |
| --- | --- | --- | --- |
| A) | Equity in income of Reid | $50,400 |  |
|  |  Investment in Reid |  | $50,400 |
| B) | Investment in Reid | $50,400 |  |
|  |  Equity in income of Reid |  | $50,400 |
| C) | Equity in income of Reid | $15,120 |  |
|  |  Investment in Reid |  | $15,120 |
| D) | Investment in Reid | $15,120 |  |
|  |  Equity in income of Reid |  | $15,120 |

A) Entry A.

B) Entry B.

C) Entry C.

D) Entry D.

E) No entry is necessary.

Answer: C

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $350,000 - $210,000 = $140,000 × (1 – ($224,000 / $350,000)) = $50,400 × 30% = $15,120 Recognition of its share of intra-entity gross profits by reduction <CR> in the *Investment in Reid* Account

[QUESTION]

REFER TO: 01-06

42. What journal entry will be recorded in 2019 to recognize its share of the intra-entity gross profit that was deferred in 2018?

|  |  |  |  |
| --- | --- | --- | --- |
| A) | Equity in income of Reid | $50,400 |  |
|  |  Investment in Reid |  | $50,400 |
| B) | Investment in Reid | $50,400 |  |
|  |  Equity in income of Reid |  | $50,400 |
| C) | Equity in income of Reid | $15,120 |  |
|  |  Investment in Reid |  | $15,120 |
| D) | Investment in Reid | $15,120 |  |
|  |  Equity in income of Reid |  | $15,120 |

A) Entry A.

B) Entry B.

C) Entry C.

D) Entry D.

E) No entry is necessary.

Answer: D

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: Reversal of the previous deferral entry in 2018, thus recognizing the profit in 2019 income

REFERENCE: 01-07

On January 1, 2017, Mehan, Incorporated purchased 15,000 shares of Cook Company for $150,000 giving Mehan a 15% ownership of Cook. The fair value of the 15% investment was the same as the carrying value of the investment when, on January 1, 2018, Mehan purchased an additional 25,000 shares (25%) of Cook for $300,000. This last purchase gave Mehan the ability to apply significant influence over Cook. The book value of Cook on January 1, 2017 was $1,000,000. The book value of Cook on January 1, 2018, was $1,100,000. Any excess of cost over book value for this second transaction is assigned to a database and amortized over four years.

Cook reports net income and dividends as follows. These amounts are assumed to have occurred evenly throughout the years:

|  |  |  |
| --- | --- | --- |
|  | Net Income | Dividends |
| 2017 | $200,000 | $50,000 |
| 2018 | 225,000 | 50,000 |
| 2019 | 250,000 | 60,000 |

On April 1, 2019, just after its first dividend receipt, Mehan sells 10,000 shares of its investment.

[QUESTION]

REFER TO: 01-07

43. What is the balance in the investment account for the 15% ownership interest, at January 1, 2018?

A) $150,000.

B) $172,500.

C) $180,000.

D) $157,500.

E) $170,000

Answer: A

Learning Objective: 01-01

Topic: Investments―Fair-value method

Difficulty: 1 Easy

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $150,000; The fair value is the same as the carrying value so there is no adjustment to the investment account. Thus, the account is carried at the original cost of the investment.

[QUESTION]

REFER TO: 01-07

44. How much income did Mehan report from Cook during 2017?

A) $30,000.

B) $22,500.

C) $ 7,500.

D) $ 0.

E) $50,000.

Answer: C

Learning Objective: 01-01

Topic: Investments―Fair-value method

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $7,500 Dividends Received = 15% × (Dividends Declared $50,000)

[QUESTION]

REFER TO: 01-07

45. How much income did Mehan report from Cook during 2018?

A) $90,000.

B) $110,000.

C) $67,500.

D) $87,500.

E) $78,750.

Answer: D

Learning Objective: 01-04

Learning Objective: 01-05a

Topic: Report change to equity method

Topic: Equity method―Allocate cost of investment

Topic: Equity method―Amortize allocations

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: Share of net income: $225,000 × 40% = $90,000

Fair value of 40% acquired: $150,000 + $300,000 = $450,000.

Book value of 40% acquired: $1,100,000 x 40% = $440,000

$450,000 - $440,000 = $10,000 attributable to database

$10,000 / 4 = $2,500

$90,000 - $2,500 = $87,500

[QUESTION]

REFER TO: 01-07

46. What was the balance in the investment account at December 31, 2018?

A) $517,500.

B) $537,500.

C) $520,000.

D) $540,000.

E) $211,250.

Answer: A

Learning Objective: 01-03

Learning Objective: 01-04

Learning Objective: 01-05a

Topic: Report change to equity method

Topic: Equity method―Amortize allocations

Topic: Equity method―Investment account balance

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $150,000 = $150,000 Balance at date of changing to equity method.

$150,000 + $300,000 + ($90,000 - $2,500) - $20,000 = $517,500 Balance 2018 Year End

[QUESTION]

REFER TO: 01-07

47. What was the balance in the investment account at April 1, 2019 just before the sale of shares?

A) $447,500.

B) $468,750.

C) $535,875.

D) $555,000.

E) $624,375.

Answer: C

Learning Objective: 01-05d

Topic: Report sale of equity investment

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $517,500 + ($25,000 - $625) - $6,000 = $535,875

2019 Beginning Investment Account Balance + (40% of 1st Quarter Income – 1st Quarter Amortization) – 1st Quarter Dividend

[QUESTION]

REFER TO: 01-07

48. How much of Cook’s net income did Mehan report for the year 2019?

A) $61,750.

B) $81,250.

C) $72,500.

D) $59,250.

E) $75,000.

Answer: B

Learning Objective: 01-05d

Topic: Report sale of equity investment

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: (First Quarter Income × 40%) + (2nd thru 4th Qtr Income × 30%) = ($250,000/4 × 40%) + [($250,000/4 × 30%) × 3] = $25,000 + ($18,750 × 3) = $25,000 + $56,250 = $81,250

REFERENCE: 01-08

On January 4, 2017, Harley, Inc. acquired 40% of the outstanding common stock of Bike Co. for $2,400,000. This investment gave Harley the ability to exercise significant influence over Bike. Bike’s assets on that date were recorded at $10,500,000 with liabilities of $4,500,000. There were no other differences between book and fair values.

During 2017, Bike reported net income of $500,000. For 2018, Bike reported net income of $800,000. Dividends of $300,000 were paid in each of these two years.

[QUESTION]

REFER TO: 01-08

49. How much income did Harley report from Bike for 2017?

A) $120,000.

B) $200,000.

C) $300,000.

D) $320,000.

E) $500,000.

Answer: B

Learning Objective: 01-02

Learning Objective: 01-03
Topic: Equity method―Investment income

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $500,000 × 40% = $200,000

[QUESTION]

REFER TO: 01-08

50. How much income did Harley report from Bike for 2018?

A) $120,000.

B) $200,000.

C) $300,000.

D) $320,000.

E) $500,000.

Answer: D

Learning Objective: 01-02

Learning Objective: 01-03

Topic: Equity method―Investment income

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $800,000 × 40% = $320,000

[QUESTION]

REFER TO: 01-08

51. What was the reported balance of Harley’s Investment in Bike Co. at December 31, 2017?

A) $880,000.

B) $2,400,000.

C) $2,480,000.

D) $2,600,000.

E) $2,900,000.

Answer: C

Learning Objective: 01-02

Topic: Equity method―Investment account balance

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $2,400,000 + $200,000 - $120,000 = $2,480,000

[QUESTION]

REFER TO: 01-08

52. What was the reported balance of Harley’s Investment in Bike Co. at December 31, 2018?

A) $2,400,000.

B) $2,480,000.

C) $2,500,000.

D) $2,600,000.

E) $2,680,000.

Answer: E

Learning Objective: 01-02

Topic: Equity method―Investment account balance

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $2,480,000 + $320,000 - $120,000 = $2,680,000

REFERENCE: 01-09

On January 1, 2018, Anderson Company purchased 40% of the voting common stock of Barney Company for $2,000,000, which approximated book value. During 2018, Barney paid dividends of $30,000 and reported a net loss of $70,000.

[QUESTION]

REFER TO: 01-09

53. What is the balance in the investment account on December 31, 2018?

A) $1,900,000.

B) $1,960,000.

C) $2,000,000.

D) $2,016,000.

E) $2,028,000.

Answer: B

Learning Objective: 01-02

Topic: Equity method―Investment account balance

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $2,000,000 - $28,000 - $12,000 = $1,960,000

[QUESTION]

REFER TO: 01-09

54. What amount of equity income would Anderson recognize in 2018 from its ownership interest in Barney?

A) $12,000 income.

B) $12,000 loss.

C) $16,000 loss.

D) $28,000 income.

E) $28,000 loss.

Answer: E

Learning Objective: 01-02

Topic: Equity method―Investment income

Difficulty: 2 Medium

Blooms: Apply

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $70,000 Loss × 40% = $28,000 Loss

[QUESTION]

55. Luffman Inc. owns 30% of Bruce Inc. and appropriately applies the equity method. During the current year, Bruce bought inventory costing $52,000 and then sold it to Luffman for $80,000. At year-end, all of the merchandise had been sold by Luffman to other customers. What amount of gross profit on intra-entity sales must be deferred by Luffman?

A) $ 0.

B) $ 8,400.

C) $28,000.

D) $52,000.

E) $80,000.

Answer: A

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 1 Easy

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $80,000 - $52,000 = $28,000 Income Recognized; None Deferred

REFERENCE: 01-10

On January 3, 2018, Roberts Company purchased 30% of the 100,000 shares of common stock of Thomas Corporation, paying $1,500,000. There was no goodwill or other cost allocation associated with the investment. Roberts has significant influence over Thomas. During 2018, Thomas reported net income of $300,000 and paid dividends of $100,000. On January 4, 2019, Roberts sold 15,000 shares for $800,000.

[QUESTION]

REFER TO: 01-10

56. What was the balance in the investment account before the shares were sold?

A) $1,560,000.

B) $1,600,000.

C) $1,700,000.

D) $1,800,000.

E) $1,860,000.

Answer: A

Learning Objective: 01-05d

Topic: Equity method―Investment income

Topic: Report sale of equity investment

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $1,500,000 + $90,000 - $30,000 = $1,560,000

[QUESTION]

REFER TO: 01-10

57. What is the gain/loss on the sale of the 15,000 shares?

A) $ 0

B) $10,000 gain.

C) $12,000 loss.

D) $15,000 loss.

E) $20,000 gain.

Answer: E

Learning Objective: 01-05d

Topic: Report sale of equity investment

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $1,560,000 × (15,000 / 30,000) = $780,000 Cost of Shares Sold

$800,000 Sales Price - $780,000 Cost of Shares Sold = $20,000 Gain on Sale of Shares

[QUESTION]

REFER TO: 01-10

58. What is the balance in the investment account after the sale of the 15,000 shares?

A) $750,000.

B) $760,000.

C) $780,000.

D) $790,000.

E) $800,000.

Answer: C

Learning Objective: 01-05d

Topic: Report sale of equity investment

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $1,560,000 × (15,000 / 30,000) = $780,000 Cost of shares Sold

$1,560,000 - $780,000 Cost of Shares Sold = $780,000 Balance in the Investment Account

[QUESTION]

REFER TO: 01-10

59. What is the appropriate journal entry to record the sale of the 15,000 shares?

|  |  |  |  |
| --- | --- | --- | --- |
| A)  | Cash | 800,000 |  |
|  |  Investment in Thomas |  | 800,000 |
| B) | Cash | 800,000 |  |
|  |  Investment in Thomas |  | 780,000 |
|  |  Gain on sale of investment |  |  20,000 |
| C) | Cash | 800,000 |  |
|  | Loss on investment | 12,000 |  |
|  |  Investment in Thomas |  | 812,000 |
| D)  | Cash | 800,000 |  |
|  |  Investment in Thomas |  | 790,000 |
|  |  Gain on sale of investment |  |  10,000 |
| E)  | Cash | 800,000 |  |
|  | Loss on sale of investment | 15,000 |  |
|  |  Investment in Thomas |  | 815,000 |

A) A Above.

B) B Above.

C) C Above.

D) D Above.

E) E Above.

Answer: B

Learning Objective: 01-05d

Topic: Report sale of equity investment

Difficulty: 3 Hard

Blooms: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $20,000 Gain is only shown in Option B

REFERENCE: 01-11

On January 4, 2018, Mason Co. purchased 40,000 shares (40%) of the common stock of Hefly Corp., paying $560,000. At that time, the book value and fair value of Hefly’s net assets was $1,400,000. The investment gave Mason the ability to exercise significant influence over the operations of Hefly. During 2018, Hefly reported income of $150,000 and paid dividends of $40,000. On January 2, 2019, Mason sold 10,000 shares for $150,000.

[QUESTION]

REFER TO: 01-11

60. What was the balance in the investment account before the shares were sold?

A) $520,000.

B) $544,000.

C) $560,000.

D) $604,000.

E) $620,000.

Answer: D

Learning Objective: 01-02

Topic: Equity method―Investment account balance

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $560,000 + ($150,000 × 40%) – ($40,000 × 40%) = $604,000

[QUESTION]

REFER TO: 01-11

61. What is the gain/loss on the sale of the 10,000 shares?

A) $20,000 gain.

B) $10,000 gain.

C) $1,000 gain.

D) $1,000 loss.

E) $10,000 loss.

Answer: D

Learning Objective: 01-05d

Topic: Report sale of equity investment

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $604,000 × (10,000 / 40,000) = $151,000 Cost of Shares Sold

$150,000 Sales Price - $151,000 Cost of Shares Sold = $1,000 Loss on Sale of Shares

[QUESTION]

REFER TO: 01-11

62. What is the balance in the investment account after the sale of the 10,000 shares?

A) $390,000.

B) $420,000.

C) $453,000.

D) $454,000.

E) $465,000.

Answer: C

Learning Objective: 01-05d

Topic: Report sale of equity investment

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $604,000 - $151,000 = $453,000

[QUESTION]

REFER TO: 01-11

63. What is the appropriate journal entry to record the sale of the 10,000 shares?

|  |  |  |  |
| --- | --- | --- | --- |
| A)  | Cash | 150,000 |  |
|  |  Investment in Hefly |  | 150,000 |
| B) | Cash |  150,000 |  |
|  |  Investment in Hefly |  | 130,000 |
|  |  Gain on sale of investment |  |  20,000 |
| C) | Cash | 150,000 |  |
|  | Loss on investment | 1,000 |  |
|  |  Investment in Hefly |  | 151,000 |
| D)  | Cash | 150,000 |  |
|  |  Investment in Hefly |  | 149,000 |
|  |  Gain on sale of investment |  |  1,000 |
| E)  | Cash | 150,000 |  |
|  | Loss on sale of investment | 10,000 |  |
|  |  Investment in Hefly |  | 160,000 |

A) A Above

B) B Above

C) C Above

D) D Above

E) E Above

Answer: C

Learning Objective: 01-05d

Topic: Report sale of equity investment

Difficulty: 3 Hard

Blooms: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $1,000 Loss only shown in Option C

REFERENCE: 01-12

On January 4, 2018, Bailey Corp. purchased 40% of the voting common stock of Emery Co., paying $3,000,000. Bailey properly accounts for this investment using the equity method. At the time of the investment, Emery’s total stockholders’ equity was $5,000,000. Bailey gathered the following information about Emery’s assets and liabilities whose book values and fair values differed:

|  |  |  |
| --- | --- | --- |
|  | Book Value | Fair Value |
| Buildings (20-year life) | $1,000,000 | $1,800,000 |
| Equipment (5-year life) |  1,500,000 |  2,000,000 |
| Franchises (10-year life) |  0 |  700,000 |

Any excess of cost over fair value was attributed to goodwill, which has not been impaired. Emery Co. reported net income of $400,000 for 2018, and paid dividends of $200,000 during that year.

[QUESTION]

REFER TO: 01-12

64. What is the amount of the excess of purchase price over book value?

A) $(2,000,000).

B) $ 800,000.

C) $1,000,000.

D) $2,000,000.

E) $3,000,000.

Answer: C

Learning Objective: 01-04

Topic: Equity method―Allocate cost of investment

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $5,000,000 × 40% = $2,000,000 BV for 40% of the Shares

$3,000,000 Price Paid - $2,000,000 BV = $1,000,000 Excess

[QUESTION]

REFER TO: 01-12

65. How much goodwill is associated with this investment?

A) $(500,000).

B) $ 0.

C) $ 100,000.

D) $ 200,000.

E) $2,000,000.

Answer: D

Learning Objective: 01-04

Topic: Equity method―Allocate cost of investment

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $800,000 Buildings + $500,000 Equipment + $700,000 Franchises = $2,000,000 FV > BV of Assets

$2,000,000 × 40% = $800,000 FV Identified to Purchaser

$1,000,000 Price Paid - $800,000 FV > BV = $200,000 Excess Unidentified (Goodwill)

[QUESTION]

REFER TO: 01-12

66. What is the amount of excess amortization expense for Bailey’s investment in Emery for the first year?

A) $ 0.

B) $ 84,000.

C) $100,000.

D) $160,000.

E) $400,000.

Answer: B

Learning Objective: 01-04

Topic: Equity method―Amortize allocations

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $800,000 / 20 = $40,000 per year Buildings × 40% = $16,000

$500,000 / 5 = $100,000 per year Equipment × 40% = $40,000

$700,000 / 10 = $70,000 per year Franchises × 40% = $28,000

$16,000 + $40,000 + $28,000 = $84,000 Annual Excess Amortization

REFERENCE: 01-13

On January 1, 2018, Jackie Corp. purchased 30% of the voting common stock of Rob Co., paying $2,000,000. Jackie properly accounts for this investment using the equity method. At the time of the investment, Rob’s total stockholders’ equity was $3,000,000. Jackie gathered the following information about Rob’s assets and liabilities whose book values and fair values differed:

|  |  |  |
| --- | --- | --- |
|  | Book Value | Fair Value |
| Buildings (15-year life) | $1,000,000 | $1,500,000 |
| Equipment (5-year life) |  2,500,000 |  3,000,000 |
| Franchises (10-year life) |  0 |  500,000 |

Any excess of cost over fair value was attributed to goodwill, which has not been impaired. Rob Co. reported net income of $300,000 for 2018, and paid dividends of $100,000 during that year.

[QUESTION]

REFER TO: 01-13

67. What is the amount of the excess of purchase price over book value?

A) $(1,000,000.)

B) $ 400,000.

C) $ 800,000.

D) $ 1,000,000.

E) $ 1,100,000.

Answer: E

Learning Objective: 01-04

Topic: Equity method―Allocate cost of investment

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $2,000,000 – ($3,000,000 × 30%) = $1,100,000 Price Paid > BV

[QUESTION]

REFER TO: 01-13

68. How much goodwill is associated with this investment?

A) $(500,000.)

B) $ 0.

C) $ 650,000.

D) $1,000,000.

E) $2,000,000.

Answer: C

Learning Objective: 01-04

Topic: Equity method―Allocate cost of investment

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $500,000 Buildings + $500,000 Equipment + $500,000 Franchises = ($1,500,000 FV>BV) × 30% = $450,000

($1,100,000 Total > BV) – ($450,000 Identified) = $650,000 Unidentified (Goodwill)

[QUESTION]

REFER TO: 01-13

69. What is the amount of excess amortization expense for Jackie Corp’s investment in Rob Co. for year 2018?

A) $ 0.

B) $30,000.

C) $40,000.

D) $55,000.

E) $60,000.

Answer: D

Learning Objective: 01-04

Topic: Equity method―Amortize allocations

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $500,000 / 15 = $33,333 per year Buildings × 30% = $10,000

$500,000 / 5 = $100,000 per year Equipment × 30% = $30,000

$500,000 / 10 = $50,000 per year Franchises × 30% = $15,000

$10,000 + $30,000 + $15,000 = $55,000 Annual Excess Amortization

[QUESTION]

REFER TO: 01-13

70. What is the balance in Jackie Corp’s *Investment in Rob Co.* account at December 31, 2018?

A) $2,000,000.

B) $2,005,000.

C) $2,060,000.

D) $2,090,000.

E) $2,200,000.

Answer: B

Learning Objective: 01-04

Topic: Equity method―Investment account balance

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $2,000,000 + ($300,000 × 30%) – ($100,000 × 30%) – $55,000 = $2,005,000

REFERENCE: 01-14

Acker Inc. bought 40% of Howell Co. on January 1, 2017 for $576,000. The equity method of accounting was used. The book value and fair value of the net assets of Howell on that date were $1,440,000. Acker began supplying inventory to Howell as follows:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | Cost to |  | Transfer |  | Amount Held by  |
| Year |  | Acker |  | Price |  |  Howell at Year-End |
| 2017 |  |  $55,000  |  |  $ 75,000  |  |  $15,000  |
| 2018 |  |  $70,000  |  |  $110,000  |  |  $55,000  |

Howell reported net income of $100,000 in 2017 and $120,000 in 2018 while paying $40,000 in dividends each year.

[QUESTION]

REFER TO: 01-14

71. What is Acker’s share of the intra-entity inventory gross profit that should be deferred on December 31, 2017?

A) $ 1,600.

B) $ 4,000.

C) $ 8,000.

D) $15,000.

E) $20,000.

Answer: A

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $75,000 - $55,000 = $20,000 × ($15,000 / $75,000) = $4,000 × 40% = $1,600 Deferred itra-entity gross profit

[QUESTION]

REFER TO: 01-14

72. What is Acker’s share of the intra-entity inventory gross profit that should be deferred on December 31, 2018?

A) $ 1,600.

B) $ 8,000.

C) $15,000.

D) $20,000.

E) $40,000

Answer: B

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $110,000 - $70,000 = $40,000 × ($55,000 / $110,000) = $20,000 × 40% = $8,000 Deferred intra-entity gross profit

[QUESTION]

REFER TO: 01-14

73. What is the Equity in Howell Income that should be reported by Acker in 2017?

A) $10,000.

B) $24,000.

C) $36,000.

D) $38,400.

E) $40,000.

Answer: D

Learning Objective: 01-06

Topic: Deferral Intra–entity sales of inventory

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $100,000 × 40 % = $40,000 – ($1,600 Deferred intra-entity gross profit) = $38,400

[QUESTION]

REFER TO: 01-14

74. What is the balance in Acker’s Investment in Howell account at December 31, 2017?

A) $576,000.

B) $598,400.

C) $614,400.

D) $606,000.

E) $616,000.

Answer: B

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $576,000 + ($100,000 × 40%) – ($40,000 × 40%) – ($1,600 Deferred intra-entity gross profit) = $598,400

[QUESTION]

REFER TO: 01-14

75. What is the Equity in Howell Income that should be reported by Acker in 2018?

A) $32,000.

B) $41,600.

C) $48,000.

D) $49,600.

E) $50,600.

Answer: B

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $120,000 × 40 % = $48,000 + ($1,600 in 2017 Recognized intra-entity gross profit) – ($8,000 in 2018 Deferred intra-entity gross profit) = $41,600

[QUESTION]

REFER TO: 01-14

76. What is the balance in Acker’s Investment in Howell account at December 31, 2018?

A) $624,000.

B) $636,000.

C) $646,000.

D) $656,000.

E) $666,000.

Answer: A

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: ($598,400 Balance 2017) + ($41,600 Income from 2018) – ($16,000 Dividend from 2018) = $624,000

REFERENCE: 01-15

Cayman Inc. bought 30% of Maya Company on January 1, 2018 for $450,000. The equity method of accounting was used. The book value and fair value of the net assets of Maya on that date were $1,500,000. Maya began supplying inventory to Cayman as follows:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | Cost to |  | Transfer |  | Amount Held by |
| Year |  | Maya |  | Price |  | Cayman at Year-End |
| 2018 |  | $30,000 |  | $45,000 |  |  $ 9,000  |
| 2019 |  | $48,000 |  | $80,000 |  |  $20,000  |

Maya reported net income of $100,000 in 2018 and $120,000 in 2019 while paying $40,000 in dividends each year.

[QUESTION]

REFER TO: 01-15

77. What is the investor’s share of gross profit on intra-entity inventory sales that should be deferred on December 31, 2018?

A) $ 900.

B) $3,000.

C) $4,500.

D) $6,000.

E) $9,000.

Answer: A

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $45,000 - $30,000 = $15,000 × ($9,000 / $45,000) = $3,000 × 30% = $900 Deferred intra-entity gross profit

[QUESTION]

REFER TO: 01-15

78. What is the investor’s share of gross profit on intra-entity inventory sales that should be deferred on December 31, 2019?

A) $1,500.

B) $2,400.

C) $3,600.

D) $4,000.

E) $8,000.

Answer: B

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $80,000 - $48,000 = $32,000 × ($20,000 / $80,000) = $8,000 × 30% = $2,400 Deferred intra-entity gross profit

[QUESTION]

REFER TO: 01-15

79. What is the Equity in Maya Income that should be reported by Cayman in 2018?

A) $17,100.

B) $18,000.

C) $25,500.

D) $29,100.

E) $30,900.

Answer: D

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $100,000 × 30% = $30,000 - $900 Share of Deferred gross profit on intra-entity inventory sales = $29,100

[QUESTION]

REFER TO: 01-15

80. What is the balance in Cayman’s Investment in Mayaaccount at December 31, 2018?

A) $463,500.

B) $467,100.

C) $468,000.

D) $468,900.

E) $480,000.

Answer: B

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $450,000 + ($100,000 × 30% = $30,000 - $900 Deferred) – ($40,000 Dividends × 30%) = $467,100

[QUESTION]

REFER TO: 01-15

81. What is the Equity in Maya Income that should be reported by Cayman in 2019?

A) $34,200.

B) $34,800.

C) $34,500.

D) $36,000.

E) $37,800.

Answer: C

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $120,000 × 30% = $36,000 + ($900 from 2018) – ($2,400 from 2019 Deferral) = $34,500

[QUESTION]

REFER TO: 01-15

82. What is the balance in Cayman’s Investment in Maya account at December 31, 2019?

A) $488,700.

B) $489,600.

C) $492,000.

D) $494,400.

E) $514,500.

Answer: B

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $467,100 + $34,500 - $12,000 = $489,600

[QUESTION]

83. Which of the following results in a decrease in the investment account when applying the equity method?

A) Dividends paid by the investor.

B) Net income of the investee.

C) Net income of the investor.

D) Share of gross profit on intra-entity inventory sales for the current year.

E) Purchase of additional common stock by the investor during the current year.

Answer: D

Learning Objective: 01-06

Topic: Deferral of Intra-Entity Gross Profits in Inventory

Difficulty: 2 Medium

Blooms: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

84. Which of the following results in an increase in the investment account when applying the equity method?

A) Investor’s share of gross profit from intra-entity inventory sales for the prior year.

B) Investor’s share of gross profit from intra-entity inventory sales for the current year.

C) Dividends paid by the investor.

D) Dividends paid by the investee.

E) Sale of a portion of the investment during the current year.

Answer: A

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 1 Easy

Blooms: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

85. Which of the following results in a decrease in the Equity in Investee Income account when applying the equity method?

A) Dividends paid by the investor.

B) Net income of the investee.

C) Investor’s share of gross profit from intra-entity inventory sales for the current year.

D) Investor’s share of gross profit from intra-entity inventory sales for the prior year.

E) Other Comprehensive Income of the investee.

Answer: C

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 1 Easy

Blooms: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

86. Which of the following results in an increase in the Equity in InvesteeIncome account when applying the equity method?

A) Amortizations of purchase price over book value on date of purchase.

B) Amortizations, since date of purchase, of purchase price over book value on date of purchase.

C) Sale of a portion of the investment at a gain to the investor.

D) Investor’s share of gross profit from intra-entity inventory sales for the prior year.

E) Sale of a portion of the investment at a loss.

Answer: D

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 2 Medium

Blooms: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

REFERENCE: 01-16

Renfroe, Inc. acquired 10% of Stanley Corporation on January 1, 2017, for $90,000 when the book value of Stanley was $1,000,000. During 2017, Stanley reported net income of $215,000 and paid dividends of $50,000. The book value of the 10% investment was the same as the fair value of that investment when, on January 1, 2018, Renfroe purchased an additional 30% of Stanley for $325,000. Any excess of cost over book value is attributable to goodwill with an indefinite life. During 2018, Renfroe reported net income of $320,000 and paid dividends of $50,000.

[QUESTION]

REFER TO: 01-16

87. How much is the adjustment to the Investmentin Stanley Corporation for the change from the fair-value method to the equity method on January 1, 2018?

A) A debit of $16,500.

B) A debit of $21,500.

C) A debit of $90,000.

D) A debit of $165,000.

E) There is no adjustment.

Answer: E

Learning Objective: 01-03

Topic: Report change to equity method

Difficulty: 1 Easy

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: The change is prospective only.

[QUESTION]

REFER TO: 01-16

88. What is the balance in the Investment in Stanley Corporation on December 31, 2018?

A) $415,000.

B) $512,500.

C) $523,000.

D) $539,500.

E) $544,500.

Answer: C

Learning Objective: 01-03

Learning Objective: 01-05a

Topic: Report change to equity method

Topic: Equity method―Investment account balance

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $90,000 2017 Cost + $325,000 2018 Cost + ($320,000 Income × 40%) – ($50,000 Dividends × 40%) = $523,000

REFERENCE: 01-17

On January 4, 2017, Trycker, Inc. acquired 40% of the outstanding common stock of Inkblot Co. for $2,400,000. This investment gave Trycker the ability to exercise significant influence over Inkblot. Inkblot’s assets on that date were recorded at $8,000,000 with liabilities of $2,000,000. There were no other differences between book and fair values.

During 2017, Inkblot reported net income of $500,000 and paid dividends of $300,000. The fair value of Inkblot at December 31, 2017 is $7,000,000. Trycker elects the fair value option for its investment in Inkblot.

[QUESTION]

REFER TO: 01-17

89. How are dividends received from Inkblot reflected in Trycker’s accounting records for 2017?

A) Reduce investment in Inkblot by $280,000.

B) Increase Investment in Inkblot by $280,000.

C) Reduce Investment in Inkblot by $120,000.

D) Increase Investment in Inkblot by $120,000.

E) Increase Dividend Income by $120,000.

Answer: E

Learning Objective: 01-07

Topic: Report using fair-value accounting option

Difficulty: 2 Medium

Blooms: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $300,000 × 40% = $120,000 Credit to the Dividend Income Account

[QUESTION]

REFER TO: 01-17

90. At what amount will Inkblot be reflected in Trycker’s December 31, 2017 balance sheet?

A) $2,400,000.

B) $2,280,000.

C) $2,480,000.

D) $2,800,000.

E) $7,000,000.

Answer: D

Learning Objective: 01-07

Topic: Report using fair-value accounting option

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Feedback: $7,000,000 FV × 40 % = $2,800,000 at December 31, 2017

**Essay:**

[QUESTION]

91. For each of the following numbered situations below, select the best letter answer concerning accounting for investments:

(A) Increase the investment account.

(B) Decrease the investment account.

(C) Increase dividend revenue.

(D) No adjustment necessary.

(1.) Income reported by 40% owned investee.

(2.) Income reported by 10% owned investee.

(3.) Loss reported by 40% owned investee.

(4.) Loss reported by 10% investee.

(5.) Change from fair-value method to equity method. Prior income exceeded dividends.

(6.) Change from fair-value method to equity method. Prior income was less than dividends.

(7.) Change from equity method to fair-value method. Prior income exceeded dividends.

(8.) Change from equity method to fair-value method. Prior income was less than dividends.

(9.) Dividends received from 40% investee.

(10.) Dividends received from 10% investee.

(11.) Purchase of additional shares of investee.

(12.) Investor’s share of gross profit from intra-entity inventory sales when using the equity method.

Answer: (1) A; (2) D; (3) B; (4) D; (5) D; (6) D; (7) D; (8) D; (9) B; (10) C; (11) A; (12) B

Learning Objective: 01-01

Learning Objective: 01-02

Learning Objective: 01-03

Learning Objective: 01-05a

Learning Objective: 01-05d

Learning Objective: 01-06

Topic: Investments―Fair-value method

Topic: Equity method―Significant influence criterion

Topic: Equity method―Investment income

Topic: Report change to equity method

Topic: Report sale of equity investment

Topic: Intra–entity sales of inventory

Difficulty: 2 Medium

Blooms: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

92. Jarmon Company owns twenty-three percent (23%) of the voting common stock of Kaleski Corp. Jarmon does not have the ability to exercise significant influence over the operations of Kaleski. What method should Jarmon use to account for its investment in Kaleski?

Answer:

The fair-value method should be used. Generally, ownership of more than twenty percent (20%) of the voting common stock would be presumed to carry significant influence and would require use of the equitymethod. The equity method is not appropriate in this case because of the lack of the ability to exercise significant influence.

Learning Objective: 01-01

Topic: Investments―Fair-value method

Difficulty: 1 Easy

Blooms: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

93. Idler Co. has an investment in Cowl Corp. for which it uses the equity method. Cowl has suffered large losses for several years, and the balance in the investment account has been reduced to zero. How should Idler account for this investment?

Answer:

Idler should discontinue the use of the *equity method*. The investment would have a *zero balance* until investee profits eliminate unrecognized losses.

Learning Objective: 01-05c

Topic: Report investee losses

Difficulty: 2 Medium

Blooms: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

94. Which types of transactions, exchanges, or events would indicate that an investor has the ability to exercise significant influence over the operations of an investee?

Answer:

When an investor has the ability to exercise significant influence over the operations of an investee, the investor should use the equity method to account for the investment. GAAP suggests several events or conditions which would indicate such influence: (1) investor representation on the investee’s board of directors; (2) material transactions between investor and investee; (3) interchange of managerial personnel; (4) technological dependency between investor and investee; and (5) the extent of investor ownership and the concentration of other ownership interests in the investee; (6) investor participation in the policy-making process of the investee. All of these conditions should be examined to determine whether the investor has the ability to exercise significant influence over the investee.

Learning Objective: 01-02

Topic: Equity method―Significant influence criterion

Difficulty: 2 Medium

Blooms: Remember

AACSB: Reflective Thinking

AACSB: Communication

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

95. You are auditing a company that owns twenty percent of the voting common stock of another corporation and uses the equity method to account for the investment. How would you verify that the equity method is appropriate in this case?

Answer:

In order to verify that the equity method is appropriate, the auditor should determine whether the investor is able to exercise significant influence over the operations of the investee. The ability to influence the investee’s operations is the most important criterion for adopting the equity method. The auditor should look for such evidence of significant influence such as: (1) frequent or material intercompany transactions; (2) exchange of managerial personnel; (3) technological interdependency; and (4) investor participation in the decision-making process of the investee.

Learning Objective: 01-02

Topic: Equity method―Significant influence criterion

Difficulty: 2 Medium

Blooms: Understand

AACSB: Reflective Thinking

AACSB: Communication

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

96. How does the use of the equity method affect the investor’s financial statements?

Answer:

The use of the equity method influences the investor’s income statement and balance sheet. On the income statement, the investor’s total revenues will be increased by its share of the investee’s earnings reduced by any amortization of cost in excess of fair value of depreciable net assets. On the balance sheet, the investor’s total assets will include the investment account. The balance of the investment account is increased by the investor’s share of the investee’s income and decreased by investee losses and dividends paid and amortization of depreciable allocations. The investor’s retained earnings are influenced by the investee’s income or loss reported on the investor’s income statement.

Learning Objective: 01-02

Topic: Equity method―Investment income

Topic: Equity method―Investment account balance

Difficulty: 2 Medium

Blooms: Understand

AACSB: Reflective Thinking

AACSB: Communication

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

97. What is the primary objective of the equity method of accounting for an investment?

Answer:

The objective of the equity method is to reflect the special relationship between investor and investee. The equity method is used when the investor holds a relatively large share of the investee, but not a controlling interest. The large ownership percentage indicates that the investor has the ability to influence the decision-making processes of the investee. Use of the fair-valuemethod would not reflect the relationship between the two parties.

Learning Objective: 01-01

Topic: Equity method―Significant influence criterion

Difficulty: 2 Medium

Blooms: Remember

AACSB: Reflective Thinking

AACSB: Communication

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

98. What is the justification for the timing of recognition of income under the equity method?

Answer:

According to the equity method, the investor should recognize its share of the investee’s income in the same period in which it is earned by the investee. The equity method applies accrual accounting when the investor could exercise significant influence over the investee.

Learning Objective: 01-02

Topic: Equity method―Significant influence criterion

Difficulty: 2 Medium

Blooms: Understand

AACSB: Reflective Thinking

AACSB: Communication

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

99. What argument could be made against the equity method?

Answer:

An argument could be made against the recognition of income under the equity method. The investor is required to recognize its share of the investee’s income even when it is unlikely that the investor will ever receive the entire amount in cash dividends.

Learning Objective: 01-02

Topic: Equity method―Significant influence criterion

Difficulty: 2 Medium

Blooms: Understand

AACSB: Reflective Thinking

AACSB: Communication

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

100. How would a change be made from the equity method to the fair value method of accounting for investments?

Answer:

A change to the fair value method is appropriate when the investor can no longer exercise significant influence over the operations of the investee. No retrospective adjustment of previous years’ financial statements or the balance in the investment account is required. The balance in the investment account at the time of the change would be treated prospectively as the cost of the investment.

Learning Objective: 01-03

Topic: Equity method―Investment income

Difficulty: 3 Hard

Blooms: Remember

AACSB: Reflective Thinking

AACSB: Communication

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

101. How should an investor account for, and report, an investee’s other comprehensive income (or loss)?

Answer:

The investor should account for other comprehensive income or loss by including it in an income statement account that is separate from the Equity in Investee Income account. The investor should record its share of investee OCI, which should be included in its balance sheet as Accumulated Other Comprehensive Income (AOCI).

Learning Objective: 01-05b

Topic: Report investee OCI

Difficulty: 2 Medium

Blooms: Remember

AACSB: Reflective Thinking

AACSB: Communication

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

102. When should an investor not use the equity method for an investment of 21% in another corporation?

Answer:

When the investor does not have significant influence with regard to the investee.

Learning Objective: 01-02

Topic: Equity method―Significant influence criterion

Difficulty: 1 Easy

Blooms: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

103. What is the primary objective of the fair value method of accounting for an investment?

Answer: The investor possesses only a small percentage of an investee and cannot expect to have a significant impact on the operations or decision-making of the investee. Since the shares are bought in anticipation of cash dividends or appreciation of stock market values, dividends received are accounted for as income and the investment is reflected at each balance sheet date at its fair value which is generally the market value at that date.

Learning Objective: 01-01

Topic: Investments―Fair-value method

Difficulty: 2 Medium

Blooms: Remember

AACSB: Reflective Thinking

AACSB: Communication

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

104. How would a change be made from the fair value method to the equity method of accounting for investments?

Answer: According to GAAP, when there is a change from the fair value method to the equity method for investments, the change should be incorporated prospectively.

Learning Objective: 01-05a

Topic: Report change to equity method

Difficulty: 2 Medium

Blooms: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

105. When the fair value option is elected for application to an investment in which the investor has significant influence over the investee, how would the investor reflect the use of the fair value option in its balance sheet and in its income statement?

Answer: In the balance sheet, the Investment in Investee account will be at fair value at the balance sheet date. In the income statement, any change in fair value from period to period would be reflected as investment Income (increase in fair value) or loss (decrease in fair value). Also in the income statement, the dividends received would be reflected as dividend income.

Learning Objective: 01-07

Topic: Report using fair-value accounting option

Difficulty: 2 Medium

Blooms: Understand

AACSB: Reflective Thinking

AACSB: Communication

AICPA: BB Critical Thinking

AICPA: FN Measurement

**Problems:**

[QUESTION]

106. Charlie Co. owns 30% of the voting common stock of Turf Services Inc. Charlie uses the equity method to account for its investment. On January 1, 2018, the balance in the investment account was $624,000. During 2018, Turf Services reported net income of $120,000 and paid dividends of $30,000. Any excess of fair value over book value is attributable to goodwill with an indefinite life.

What is the balance in the investment account as of December 31, 2018?

Answer:

Investment in Turf Services Inc.:

 Balance at January 1, 2018

$ 624,000

 2018 equity income accrual ($120,000 × 30%)

 36,000

 2018 dividends ($30,000 × 30%)

 ( 9,000)

 Balance at December 31, 2018

$ 651,000

Learning Objective: 01-02

Topic: Equity method―Investment account balance

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

107. Tinker Co. owns 25% of the common stock of Harbor Co. and uses the equity method to account for the investment. During 2018, Harbor reported income of $120,000 and paid dividends of $40,000. Harbor owns a building with a useful life of twenty years, which was undervalued by $80,000 at the time that Tinker bought its shares of Harbor’s common stock.

*Required:*

Prepare a schedule to show the equity income Tinker should recognize for 2018 related to this investment.

Answer:

2016 equity income accrual ($120,000 × 25%)

$ 30,000

2016 amortization on purchase ($80,000 ÷ 20 × 25%)

 ( 1,000)

2016 equity income

$ 29,000

Learning Objective: 01-04

Topic: Equity method―Investment income

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

108. Aqua Corp. purchased 30% of the common stock of Marcus Co. by paying $500,000. Of this amount, $50,000 is associated with goodwill.

*Required:*

Prepare the journal entry to record Aqua’s investment.

Answer:

The journal entry is:

Investment in Marcus Co

500,000

Cash

500,000

The amount of goodwill does not affect the journal entry used to record the

investment.

Learning Objective: 01-04

Topic: Equity method―Basic journal entries

Topic: Equity method―Allocate cost of investment

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

109. On January 2, 2018, Heinreich Co. paid $500,000 for 25% of the voting common stock of Jones Corp. At the time of the investment, Jones had net assets with a book value and fair value of $1,800,000. During 2018, Jones incurred a net loss of $60,000 and paid dividends of $100,000. Any excess cost over book value is attributable to goodwill with an indefinite life.

*Required:*

1) Prepare a schedule to show the amount of goodwill from Heinrich’s investment in Jones.

2) Prepare a schedule to show the balance in Heinreich’s investment account at December 31, 2018.

Answer:

1) Purchase price

$ 500,000

 Net book value ($1,800,000 × 25%)

 (450,000)

 Goodwill

$ 50,000

2) Investment in Jones Corp.:

 Acquisition price

$ 500,000

 2018 equity loss accrual ($60,000 × 25%)

 ( 15,000)

 2018 dividends ($100,000 × 25%)

 ( 25,000)

 Balance at December 31, 2018

$ 460,000

Learning Objective: 01-02

Learning Objective: 01-04

Topic: Equity method―Allocate cost of investment

Topic: Equity method―Investment account balance

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

110. On January 3, 2018, Jenkins Corp. acquired 40% of the outstanding common stock of Bolivar Co. for $1,200,000. This acquisition gave Jenkins the ability to exercise significant influence over the investee. The book value of the acquired shares was $950,000. Any excess cost over the underlying bookvalue was assigned to a patent that was undervalued on Bolivar’s balance sheet. This patent has a remaining useful life of ten years. For the year ended December 31, 2018, Bolivar reported net income of $312,000 and paid cash dividends of $96,000.

*Required:*

Prepare a schedule to show the balance Jenkins should report as its Investment in Bolivar Co. at December 31, 2018.

Answer:

Investment in Bolivar Co.:

 Acquisition price

$ 1,200,000

 E

quity income ($312,000 × 40%)

 124,800

 Dividends ($96,000 × 40%)

 ( 38,400)

 Excess patent amortization ($1,200,000

–

 $950,000 ÷ 10)

 ( 25,000)

 Balance at December 31, 2018

$ 1,261,400

Learning Objective: 01-04

Topic: Equity method―Investment account balance

Topic: Equity method―Amortize allocations

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

111. On January 1, 2018, Spark Corp. acquired a 40% interest in Cranston Inc. for $250,000. On that date, Cranston’s balance sheet disclosed net assets of $430,000. During 2018, Cranston reported net income of $100,000 and paid cash dividends of $30,000. Spark sold inventory costing $40,000 to Cranston during 2018 for $50,000. Cranston used all of this merchandise in its operations during 2018. Any excess cost over fair value is attributable to an unamortized trademark with a 20-year remaining life.

*Required:*

Prepare all of Spark’s journal entries for 2018 to apply the equity method to this investment.

Answer:



|  |  |  |
| --- | --- | --- |
| Investment in Cranston Inc.  | 250,000 |  |
|  Cash (or liability) |  | 250,000 |
|  To record acquisition of a forty percent interest in  Cranston Inc. |  |  |
|  |  |  |
| Investment in Cranston Inc.  |  40,000 |  |
|  Equity in Investee Income |  |  40,000 |
|  To recognize forty percent of income earned during  the period by Cranston Inc., an investment recorded  using the equity method. |  |  |
|  |  |  |
| Cash |  12,000 |  |
|  Investment in Cranston Inc. |  |  12,000 |
|  To record collection of dividend from investee  using the equity method |  |  |
|  |  |  |
| Equity in Investee Income |  3,900 |  |
|  Investment in Cranston Inc. |  |  3,900 |
|  To reflect amortization of trademark excess over book value acquired. |  |  |

\*\*Note: All merchandise was used, so no deferral entry is needed.

Learning Objective: 01-02

Learning Objective: 01-03

Learning Objective: 01-04

Learning Objective: 01-06

Topic: Equity method―Basic journal entries

Topic: Equity method―Investment income

Topic: Equity method―Amortize allocations

Topic: Intra–entity sales of inventory

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

112. Wathan Inc. sold $180,000 in inventory to Miller Co. during 2017, for $270,000. Miller resold $108,000 of this merchandise in 2017 with the remainder to be disposed of during 2018.

*Required:*

Assuming Wathan owns 25% of Miller and applies the equity method, prepare the journal entry Wathan should have recorded at the end of 2017 to defer gross profit on intra-entity inventory sales.

Answer:

|  |  |  |
| --- | --- | --- |
| Ending inventory ($270,000 - $108,000) |  | $162,000 |
| Gross profit markup ($90,000 ÷ $270,000) |  | x 1/3 |
| Gross profit on intra-entity inventory sales |  | $ 54,000 |
| Ownership percentage |  | x 25% |
| Wathan’s share intra-entity inventory gross profit to defer to subsequent year |  | $ 13,500 |
|  |  |  |
| Equity Income – Investment in Miller Co. | 13,500 |  |
|  Investment in Miller Co. |  | 13,500 |

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

113. Jager Inc. holds 30% of the outstanding voting shares of Kinson Co. and appropriately applies the equity method of accounting. Amortization associated with this investment equals $11,000 per year. For 2018, Kinson reported earnings of $100,000 and paid cash dividends of $40,000. During 2018, Kinson acquired inventory for $62,400, which was then sold to Jager for $96,000. At the end of 2018, Jager still held some of this inventory at its intra-entity selling price of $50,000.

*Required:*

Determine the amount of Equity in InvesteeIncome that Jager should have reported for 2018.

Answer:

Equity in investee income:

 Equity income accrual ($100,000 × 30%)

$ 30,000

 Deferral of share of intra-entity gross profit (below)

 ( 5,250)

 Amortization (given)

 ( 11,000)

 Equity in investee income

$ 13,750

Deferral of its share of intra-entity gross profit:

 Remaining inventory

—

 end of year

$ 50,000

 Gross profit percentage ($33,600 ÷ $96,000)

 × 35%

 Profit within remaining inventory

$ 17,500

 Ownership percentage

 × 30%

 Share of intra-entity gross profit

$ 5,250

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

114. On January 2, 2017, Hull Corp. paid $516,000 for 24% (48,000 shares) of the outstanding common stock of Oliver Co. Hull used the equity method to account for the investment. At the end of 2017, the balance in the investment account was $620,000. On January 2, 2018, Hull sold 12,000 shares of Oliver stock for $12 per share. For 2018, Oliver reported net income of $118,000 and paid dividends of $30,000.

*Required:*

(A) Prepare the journal entry to record the sale of the 12,000 shares.

(B) After the sale has been recorded, what is the balance in the investment account?

(C) What percentage of Oliver Co. stock does Hull own after selling the 12,000 shares?

(D) Because of the sale of stock, Hull can no longer exercise significant influence over the operations of Oliver. What effect will this have on Hull’s accounting for the investment?

(E) Prepare Hull’s journal entries related to the investment for the rest of 2018.

Answer:

|  |  |  |  |
| --- | --- | --- | --- |
| A) | Cash | 144,000 |  |
|  | Loss on Sale of Investment | 11,000 |  |
|  |  Investment in Oliver Co. |  | 155,000 |
|  |  |  |  |
|  | Calculation of loss: |  |  |
|  |  (12,000 × $12) – [($620,000 48,000) × 12,000] |  | $ 11,000 |
|  |  |  |  |
| B) | Balance in investment: |  |  |
|  |  $620,000 - $155,000 |  | $465,000 |
|  |  |  |  |
| C) | -Before sale, Hull owns 48,000 shares = 24% Oliver (given). |  |  |
|  | -Oliver has 200,000 shares outstanding (48,000/.24).-After sale, Hull owns 36,000 shares (48,000 – 12,000). |  |  |
|  | -After sale, Hull owns 18% of Oliver (36,000/200,000). |  |  |
|  | Alternate calculation:-48,000 shares = 24 % |  |  |
|  |  Sell 1/4 of investment ( 6)% |  |  |
|  |  Remaining ownership of Oliver 18% |  |  |
|  |  |  |  |
| D) | To account for the investments, the *fair-value method* should be used. |  |  |
|  |  |  |  |
| E) | Cash | 5,400 |  |
|  |  Dividend Revenue |  | 5,400 |
|  |  |  |  |
|  | Calculation of dividend revenue: |  |  |
|  | $30,000 × 18% (from part C above) |  | $ 5,400 |
|  |  |  |  |

Learning Objective: 01-01

Learning Objective: 01-05d

Topic: Investments―Fair-value method

Topic: Report sale of equity investment

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

115. On January 1, 2018, Jolley Corp. paid $250,000 for 25% of the voting common stock of Tige Co. On that date, the book value of Tige was $850,000. A building with a carrying value of $160,000 was actually worth $220,000. The building had a remaining life of twenty years. Tige owned a trademark valued at $90,000 over cost that was to be amortized over 20 years.

During 2018, Tige sold to Jolley inventory costing $60,000, at a markup of 50% on cost. At the end of the year, Jolley still owned some of these goods with an intra-entity selling price of $33,000. Jolly uses a perpetual inventory system.

Tige reported net income of $200,000 during 2018. This amount included a gain of $35,000. Tige paid dividends totaling $40,000.

*Required:*

Prepare all of Jolley’s journal entries for 2018 in relation to Tige Co. Assume the equity method is appropriate for use.

Answer:

Required journal entries:

|  |  |  |
| --- | --- | --- |
| Investment in Tige Co. | 250,000 |  |
|  Cash |  | 250,000 |
|  To record the initial investment in Tige Co. |  |  |
|  |  |  |
| Investor Cost of Intra-Entity Inventory  |  90,000 |  |
|  Cash |  |  90,000 |
|  To record the purchase of inventory from Tige Co. |  |  |
|  |  |  |
| Investment in Tige Co.  |  50,000 |  |
|  Equity in Tige Co. Income |  |  41,250 |
|  Gain of Tige Co. |  |  8,750 |
|  To record share of Tige Co.’s income. |  |  |
|  |  |  |
| Cash |  10,000 |  |
|  Investment in Tige Co. |  |  10,000 |
|  To record the receipt of dividend. |  |  |
|  |  |  |
| Equity in Tige Co. Income |  1,875 |  |
|  Investment in Tige Co. |  |  1,875 |
|  To record amortizations. |  |  |
|  |  |  |
| Equity in Tige Co. Income |  2,750 |  |
|  Investment in Tige Co. |  |  2,750 |
|  To defer its share of gross profit on Intra-Entity. |  |  |
|  |  |  |
| Calculation of equity in Tige Co. income: |  | $ 41,250 |
|  ($200,000 - $35,000) × 25% |  |  |
|  |  |  |
| Calculation of unusual gain of Tige Co.: |  | $ 8,750 |
|  $35,000 × 25% |  |  |
|  |  |  |
| Calculation of amortizations: |  |  |
|  Building [($220,000 - $160,000) 20] x 25%) |  | $ 750 |
|  Trademark [($90,000 × 25%) 20] |  1,125 |
|  Total  |  | $ 1,875 |

|  |  |  |
| --- | --- | --- |
|  |  |  |
| Calculation of deferred gross profit on intra-entity inventory sales:  |  |  |
|  Cost + 50% cost = $60,000 + $30,000 |  | $90,000 |
|  Cost |  | ( 60,000) |
|  Gross profit  |  | $30,000 |
|  GP % = 30,000/90,000 =  |  | 1/3 |
|  Remaining inventory | ﾗ | $33,000 |
|  = Intra-entity gross profit remaining in ending inventory |  | $11,000 |
|  Jolley’s ownership % |  | x 25% |
| Deferred gross profit on intra-entity inventory sales |  | $ 2,750 |

Learning Objective: 01-02

Learning Objective: 01-03

Learning Objective: 01-04

Learning Objective: 01-06

Topic: Equity method―Basic journal entries

Topic: Equity method―Amortize allocations

Topic: Equity method―Investment income

Topic: Intra–entity sales of inventory

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

116. On January 1, 2017, Pond Co. acquired 40% of the outstanding voting common shares of Ramp Co. for $700,000. On that date, Ramp reported assets and liabilities with book values of $2.2 million and $700,000, respectively. A building owned by Ramp had an appraised value of $300,000, although it had a book value of only $120,000. This building had a 12-year remaining life and no salvage value. It was being depreciated on the straight-line basis.

Ramp generated net income of $300,000 in 2017 and a loss of $120,000 in 2018. In each of these two years, Ramp paid a cash dividend of $70,000 to its stockholders.

During 2017, Ramp sold inventory to Pond that had an original cost of $60,000. The merchandise was sold to Pond for $96,000. Of this balance, $72,000 was resold to outsiders during 2017 and the remainder was sold during 2018. In 2018, Ramp sold inventory to Pond for $180,000. This inventory had cost only $108,000. Pond resold $120,000 of the inventory during 2018 and the rest during 2019.

*Required:*

For 2017 and then for 2018, calculate the equity income to be reported by Pond for external reporting purposes.

Answer:

|  |  |  |  |
| --- | --- | --- | --- |
| Equity Income-2017: |  |  |  |
|  |  |  |  |
|  Basic equity accrual ($300,000 × 40%) |  |  | $120,000 |
|  Amortization (Schedule 1) |  |  |  (6,000) |
|  Deferred intra-entity gross profit (Schedule 2) |  |  |  (3,600) |
|  Equity income – 2017 |  |  | $110,400 |
|  |  |  |  |
| Equity Income (Loss) – 2018: |  |  |  |
|  |  |  |  |
|  Basic equity accrual [($120,000) × 40%] |  |  | ($48,000) |
|  Amortization (Schedule 1) |  |  | ( 6,000) |
|  Recognition of 2017 deferred intra-entity gross profit (Schedule 2) |  |  |  3,600 |
|  Deferral of 2018 gross profit on intra- entity inventory sales (Schedule 3) |  |  | ( 9,600) |
| Equity income (loss) – 2018 |  |  | ($ 60,000) |
|  |  |  |  |
| Schedule 1 |  |  |  |
|  |  |  | Annual |
|  |  | Life | Amortization |
|  |  |  |  |
|  Acquisition price | $700,000 |  |  |
|  Book value equivalence |  |  |  |
|  ($1,500,000 × 40%) | (600,000) |  |  |
|  Payment in excess of book value | $100,000 |  |  |
|  Excess payment identified with |  |  |  |
|  specific assets |  |  |  |
|  Building ($180,000 × 40%) |  72,000 | 12 yrs | $ 6,000 |
|  Excess payment not identified with  |  |  |  |
|  specific accounts | $ 28,000 |  | \_\_\_\_\_\_\_\_ |
|  |  |  | $ 6,000 |
| Schedule 2 |  |  |  |
|  |  |  |  |
|  Inventory remaining at December 31, 2017 ($96,000 - $72,000) |  |  | $ 24,000 |
|  Gross profit percentage ($36,000 $96,000) |  |  |  × 37.5% |
|  Total gross profit on intra-entity sales |  |  | $ 9,000 |
|  Investor ownership percentage |  |  |  × 40.0% |
|  Deferred intra-entity gross profit  |  |  |  |
|  12/31/17 (to be deferred until recognized in 2018) |  |  | $ 3,600 |
|  |  |  |  |
| Schedule 3 |  |  |  |
|  |  |  |  |
|  Inventory remaining at December 31, 2018 ($180,000 - $120,000) |  |  | $ 60,000 |
|  Gross profit percentage ($72,000 $180,000) |  |  |  × 40.0% |
|  Gross profit on intra-entity inventory sales |  |  | $ 24,000 |
|  Investor ownership percentage |  |  |  × 40.0% |
|  Deferred intra-entity gross profit -12/31/18  |  |  |  |
|  (to be deferred until recognized in 2019) |  |  | $ 9,600 |

Learning Objective: 01-03

Learning Objective: 01-04

Learning Objective: 01-06

Topic: Equity method―Allocate cost of investment

Topic: Equity method―Amortize allocations

Topic: Equity method―Investment income

Topic: Intra–entity sales of inventory

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

117. Pursley, Inc. acquires 10% of Ritz Corporation on January 3, 2017, for $80,000 when the book value of Ritz was $800,000. Pursley adjusted the investment to its fair value of $162,500 at December 31, 2017. During 2017 Ritz reported net income of $125,000 and paid dividends of $30,000. On January 10, 2018, Pursley purchased an additional 20% of Ritz for $325,000, giving Pursley the ability to significantly influence the operating policies of Ritz. Any excess of cost over book value is attributable to goodwill with an indefinite life. What journal entry(ies) is(are) required on January 1, 2018?

Answer:

|  |  |  |
| --- | --- | --- |
|  |  |  |
| Investment in Ritz | 325,000 |  |
|  Cash |  | 325,000 |
| To record the purchase of an additional 20% share in Ritz Corporation |  |

Additionally, if the fair value of the original 10% shares differed on January 10, 2018, than it did on December 31, 2017, Pursley would record the adjustment to the investment account so that the proper allocation of excess payment to goodwill could be prepared when the ownership percentage required use of the equity method of accounting on January 10, 2018.

Learning Objective: 01-5a

Topic: Report change to equity method

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AACSB: Communication

AICPA: BB Critical Thinking

AICPA: FN Measurement

REFERENCE: 01-18

Steven Company owns 40% of the outstanding voting common stock of Nicole Corp. and has the ability to significantly influence the investee’s operations. On January 3, 2018, the balance in the *Investment in Nicole* *Corp.* account was $503,000. Amortization associated with this acquisition is $12,000 per year. During 2018, Nicole earned net income of $120,000 and paid cash dividends of $40,000. Previously in 2017, Nicole had sold inventory costing $35,000 to Steven for $50,000. All but 25% of that inventory had been sold to outsiders by Steven during 2017; the remainder was sold in 2018. Additional sales were made to Steven in 2018 at an intra-entity selling price of $75,000. The goods in the intra-entity sales cost Nicole $54,000. Only 10% of the 2018 intra-entity purchases from Nicole had not been sold to outsiders by the end of 2018.

[QUESTION]

REFER TO: 01-18

118. What amount of gross profit on 2017 intra-entity sales should Steven defer at December 31, 2017?

Answer:

[($50,000 - $35,000) × .25 × .40] = $1,500

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

REFER TO: 01-18

119. What amount of gross profit on 2018 intra-entity sales should Steven defer at December 31, 2018?

Answer:

[($75,000 - $54,000) × .10 × .40] = $840

Learning Objective: 01-06

Topic: Intra–entity sales of inventory

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

REFER TO: 01-18

120. What amount of equity income would Steven have recognized in 2018 from its ownership interest in Nicole?

Answer:

[($120,000 × .4) - $12,000 - $840 + $1,500] = $36,660

Learning Objective: 01-04

Learning Objective: 01-06

Topic: Equity method―Investment income

Topic: Intra–entity sales of inventory

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

[QUESTION]

REFER TO: 01-18

121. What was the balance in the *Investment in Nicole Corp*. account at December 31, 2018?

Answer:

[$503,000 + $36,660 – ($40,000 × .4)] = $523,660

Learning Objective: 01-03

Learning Objective: 01-04

Learning Objective: 01-06

Topic: Equity method―Amortize allocations

Topic: Equity method―Investment account balance

Topic: Intra–entity sales of inventory

Difficulty: 3 Hard

Blooms: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement