CHAPTER 16

Investments

ASSIGNMENT CLASSIFICATION TABLE

Learning Objectives	Questions	Brief Exercises	Do It!	Exercises	A Problems	B Problems
1. Discuss why corporations invest in debt and stock securities.	1			1		
2. Explain the accounting for debt investments.	2, 3, 4	1	1	2, 3	1A, 2A	1B, 2B
3. Explain the accounting for stock investments.	5, 6, 7, 8, 9, 10	2, 3	2	4, 5, 6, 7, 8	2A, 3A, 4A, 5A	2B, 3B, 4B, 5B
4. Describe the use of consolidated financial statements.	11, 20			9		
5. Indicate how debt and stock investments are reported in financial statements.	10, 12, 13, 14, 15, 16, 17, 18	4, 5, 6, 7, 8	3	8, 10, 11, 12	1A, 2A, 3A, 5A, 6A	1B, 2B, 3B, 5B, 6B
6. Distinguish between short-term and long-term investments.	19	5, 7, 8	4	10, 11, 12	1A, 2A, 3A, 5A, 6A	1B, 2B, 3B, 5B, 6B

ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Journalize debt investment transactions and show financial statement presentation.	Moderate	30–40
2A	Journalize investment transactions, prepare adjusting entry, and show statement presentation.	Moderate	30–40
3A	Journalize transactions and adjusting entry for stock investments.	Moderate	30–40
4A	Prepare entries under the cost and equity methods, and tabulate differences.	Simple	20–30
5A	Journalize stock investment transactions and show statement presentation.	Moderate	40–50
6A	Prepare a balance sheet.	Moderate	30–40
1B	Journalize debt investment transactions and show financial statement presentation.	Moderate	30–40
2B	Journalize investment transactions, prepare adjusting entry, and show statement presentation.	Moderate	30–40
3B	Journalize transactions and adjusting entry for stock investments.	Moderate	30–40
4B	Prepare entries under the cost and equity methods, and tabulate differences.	Simple	20–30
5B	Journalize stock investment transactions and show statement presentation.	Moderate	40–50
6B	Prepare a balance sheet.	Moderate	30–40

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CHAPTER 16
INVESTMENTS

Number	LO	BT	Difficulty	Time (min.)
BE1	2	AP	Simple	2–4
BE2	3	AP	Simple	3–5
BE3	3	AP	Simple	3–5
BE4	5	AP	Simple	2–3
BE5	5, 6	AN	Simple	2–4
BE6	5	AN	Simple	2–3
BE7	5, 6	AP	Simple	2–4
BE8	5, 6	AP	Simple	3–5
DI1	2	AP	Moderate	6–8
DI2	3	AP	Simple	6–8
DI3	5	AN	Simple	4–6
DI4	6	K	Simple	4–6
EX1	1	K	Simple	8–10
EX2	2	AP	Moderate	8–10
EX3	2	AP	Moderate	8–10
EX4	3	AP	Simple	8–10
EX5	3	AP	Simple	6–8
EX6	3	AP	Simple	8–10
EX7	3	AP	Simple	6–8
EX8	3, 5	AP	Simple	8–10
EX9	4	K	Simple	6–8
EX10	5, 6	AN	Simple	4–6
EX11	5, 6	AN	Simple	8–10
EX12	5, 6	AN	Simple	6–8
P1A	2, 5, 6	AN	Moderate	30–40
P2A	2, 3, 5, 6	AN	Moderate	30–40
P3A	3, 5, 6	AN	Moderate	30–40
P4A	3	AN	Simple	20–30
P5A	3, 5, 6	AN	Moderate	40–50
P6A	5, 6	AP	Moderate	30–40

INVESTMENTS (Continued)

Number	LO	BT	Difficulty	Time (min.)
P1B	2, 5, 6	AN	Moderate	30–40
P2B	2, 3, 5, 6	AN	Moderate	30–40
P3B	3, 5, 6	AN	Moderate	30–40
P4B	3	AN	Simple	20–30
P5B	3, 5, 6	AN	Moderate	40–50
P6B	5, 6	AP	Moderate	30–40
BYP1	4	C	Simple	10–15
BYP2	4	AN	Simple	10–15
BYP3	4	AN	Simple	5–10
BYP4	—	K	Simple	10–15
BYP5	3	C	Moderate	15–20
BYP6	5	C	Simple	5–10
BYP7	5	E	Simple	10–15
BYP8	—	C	Simple	10–15
BYP9	—	AP	Moderate	10–15

Correlation Chart between Bloom's Taxonomy, Learning Objectives and End-of-Chapter Exercises and Problems

Learning Objective	Knowledge	Comprehension	Application	Analysis	Synthesis	Evaluation
1. Discuss why corporations invest in debt and stock securities.	E16-1 Q16-1					
2. Explain the accounting for debt investments.	Q16-2	Q16-3 Q16-4	BE16-1 E16-2 DI16-1 E16-3	P16-1A P16-1B P16-2A P16-2B		
3. Explain the accounting for stock investments.	Q16-7	Q16-5 Q16-8 Q16-9 Q16-10	Q16-6 E16-5 BE16-2 E16-6 BE16-3 E16-7 DI16-2 E16-8 E16-4	P16-2A P16-2B P16-3A P16-3B P16-4A P16-4B P16-5A P16-5B		
4. Describe the use of consolidated financial statements.	E16-9 Q16-11 Q16-20					
5. Indicate how debt and stock investments are reported in financial statements.	Q16-12 Q16-17	Q16-10 Q16-13 Q16-18	Q16-14 Q16-16 BE16-4 BE16-7 BE16-8 E16-8 P16-6A P16-6B	Q16-15 P16-2A BE16-5 P16-3A BE16-6 P16-5A DI16-3 P16-1B E16-10 P16-2B E16-11 P16-3B E16-12 P16-5B P16-1A		
6. Distinguish between short-term and long-term investments.	DI16-4	Q16-19	BE16-7 BE16-8 P16-6A P16-6B	BE16-5 P16-3A E16-10 P16-5A E16-11 P16-1B E16-12 P16-2B P16-1A P16-3B P16-2A P16-5B		
Broadening Your Perspective	Real-World Focus	Financial Reporting Decision Making Across the Organization Communication All About You	FASB Codification	Comparative Analysis		Ethics Case

ANSWERS TO QUESTIONS

1. The reasons corporations invest in securities are: (1) excess cash not needed for operations that can be invested, (2) for additional earnings, and (3) strategic reasons.

2. (a) The cost of an investment in bonds consists of all expenditures necessary to acquire the bonds, such as the market price of the bonds plus any brokerage fees.
(b) Interest is recorded as it is earned; that is, over the life of the investment in bonds.

3. (a) Losses and gains on the sale of debt investments are computed by comparing the amortized cost of the securities to the net proceeds from the sale.
(b) Losses are reported in the income statement under other expenses and losses whereas gains are reported under other revenues and gains.

4. Seibel Company is incorrect. The gain is the difference between the net proceeds, exclusive of interest, and the cost of the bonds. The correct gain is $4,500, or [($45,000 – $500) – $40,000].

5. The cost of an investment in stock includes all expenditures necessary to acquire the investment. These expenditures include the actual purchase price plus any commissions or brokerage fees.

6. The entry is:

Stock Investments	62,000	
Cash		62,000

7. (a) Whenever the investor's influence on the operating and financial affairs of the investee is significant, the equity method should be used. The major factor in determining significant influence is the percentage of ownership interest held by the investor in the investee. The general guideline for use of the equity method is 20%–50% ownership interest. Companies are required to use judgment, however, rather than blindly follow the 20%–50% guideline.
(b) Revenue is recognized as it is earned by the investee.

8. Since Ling Corporation uses the equity method, the income reported by Gorman Packing ($80,000) should be multiplied by Ling's ownership interest (35%) and the result ($28,000) should be debited to Stock Investments and credited to Revenue from Stock Investments. Also, of the total dividend declared and paid by Gorman ($10,000) Ling will receive 35% or $3,500. This amount should be debited to Cash and credited to Stock Investments.

9. Significant influence over an investee may result from representation on the board of directors, participation in policy-making processes, material intercompany transactions. One must also consider whether the stock held by other stockholders is concentrated or dispersed. An investment (direct or indirect) of 20%–50% of the voting stock of an investee constitutes significant influence unless there exists evidence to the contrary.

10. Under the cost method, an investment is originally recorded and reported at cost. Dividends are recorded as revenue. In subsequent periods, it is adjusted to fair value and an unrealized holding gain or loss is recognized and included in income (trading security) or as a separate component of stockholders' equity (available-for-sale security). Under the equity method, the investment is originally recorded and reported at cost; subsequently, the investment account is adjusted during each period for the investor's share of the earnings or losses of the investee. The investor's share of the investee's earnings is recognized in the earnings of the investor. Dividends received from the investee are reductions in the carrying amount of the investment.

11. Consolidated financial statements present the details of the assets and liabilities controlled by the parent company and the total revenues and expenses of the affiliated companies.

Consolidated financial statements are especially useful to the stockholders, board of directors, and management of the parent company. Conversely, they are of limited use to minority stockholders and the creditors of the subsidiary company.

12. The valuation guidelines for investments is as follows:

Category	Valuation and Reporting
Trading	At fair value with changes reported in net income
Available-for-sale	At fair value with changes reported in stockholders' equity
Held-to-maturity	At amortized cost

Investments recorded under the equity method are reported at their carrying value. The carrying value is the cost adjusted for the investor's share of the investee's income and dividends received.

13. Jill should report as follows:

(1) Under current assets in the balance sheet:	
Short-term investments, at fair value	$72,000
(2) Under other expenses and losses in the income statement:	
Unrealized loss on trading securities	$ 2,000

14. Jill should report as follows:

(1) Under investments in the balance sheet:	
Investments in stock of less than 20% owned companies, at fair value	$72,000
(2) Under stockholders' equity in the balance sheet:	
Less: Unrealized loss on available-for-sale securities	$ (2,000)

15. The entry is:

	Debit	Credit
Fair Value Adjustment—Available-for-Sale	10,000	
Unrealized Gain or Loss—Equity		10,000

16. The entry is:

	Debit	Credit
Fair Value Adjustment—Trading	10,000	
Unrealized Gain—Income		10,000

17. Unrealized Loss—Equity is reported as a deduction from stockholders' equity. The unrealized loss is not included in the computation of net income.

18. Reporting Unrealized Gains (Losses)—Equity in the stockholders' equity section serves two important purposes: (1) it reduces the volatility of net income due to fluctuations in fair value, and (2) it still informs the financial statement user of the gain or loss that would occur if the securities were sold at fair value.

19. No. The investment in Orr Corporation stock is a long-term investment because there is no intent to convert the stock into cash within a year or the operating cycle, whichever is longer.

20. In Note 1**,** Apple stated the following regarding its accounting policy on consolidated financial statements:

The accompanying consolidated financial statements include the accounts of the Company. Intercompany accounts and transactions have been eliminated. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. Certain prior year amounts in the consolidated financial statements and notes there to have been reclassified to conform to the current year's presentation.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 16-1

Jan. 1	Debt Investments	52,000	
	Cash		52,000
July 1	Cash	2,340	
	Interest Revenue		2,340

BRIEF EXERCISE 16-2

Aug. 1	Stock Investments	37,000	
	Cash		37,000
Dec. 1	Cash	40,000	
	Stock Investments		37,000
	Gain on Sale of Stock Investments		3,000

BRIEF EXERCISE 16-3

Dec. 31	Stock Investments	45,000	
	Revenue from Stock Investments		45,000
31	Cash (25% X $50,000)	12,500	
	Stock Investments		12,500

BRIEF EXERCISE 16-4

Dec. 31	Unrealized Loss—Income	5,000	
	Fair Value Adjustment—Trading ($64,000 – $59,000)		5,000

BRIEF EXERCISE 16-5

Balance Sheet

Current assets	
Short-term investments, at fair value	$59,000

Income Statement

Other expenses and losses	
Unrealized Loss—Income	5,000

BRIEF EXERCISE 16-6

Dec. 31	Unrealized Gain or Loss—Equity	4,000	
	Fair Value Adjustment—Available-for-Sale		4,000

BRIEF EXERCISE 16-7

Balance Sheet

Investments	
Investments in stock of less than 20% owned companies, at fair value	$68,000
Stockholders' equity	
Less: Unrealized loss on available-for-sale securities	$ (4,000)

BRIEF EXERCISE 16-8

Investments	
Investments in stock of less than 20% owned companies, at fair value	$115,000
Investment in stock of 20–50% owned company, at equity	260,000
Total investments	$375,000

SOLUTIONS FOR DO IT! REVIEW EXERCISES

DO IT! 16-1

(a)	Jan. 1	Debt Investments	50,000	
		Cash		50,000
	July 1	Cash	2,500	
		Interest Revenue ($50,000 X 10% X 6/12)		2,500
	July 1	Cash	29,000	
		Loss on Sale of Debt Investments	1,000	
		Debt Investments ($50,000 X 30/50)		30,000
(b)	Dec. 31	Interest Receivable	1,000	
		Interest Revenue ($20,000 X 10% X 6/12)		1,000

DO IT! 16-2

(a)	June 17	Stock Investments	550,000	
		Cash		550,000
	Sept. 3	Cash	16,000	
		Dividend Revenue		16,000
(b)	Jan. 1	Stock Investments	540,000	
		Cash		540,000
	May 15	Cash	45,000	
		Stock Investments		45,000
	Dec. 31	Stock Investments	81,000	
		Revenue from Stock Investments		81,000

DO IT! 16-3

Trading securities:

Unrealized Loss—Income	14,600*	
Fair Value Adjustment—Trading		14,600

*$11,400 + $3,200

Available-for-sale securities:

Fair Value Adjustment—Available-for-Sale	9,950**	
Unrealized Gain or Loss—Equity		9,950

**$5,750 + $4,200

DO IT! 16-4

Item	Financial statement	Category
1. Loss on sale of investments in stock.	Income statement	Other expenses and losses
2. Unrealized gain on available-for-sale securities.	Balance sheet	Stockholders' equity
3. Fair value adjustment—trading.	Balance sheet	Current assets
4. Interest earned on investments in bonds.	Income statement	Other revenues and gains
5. Unrealized loss on trading securities.	Income statement	Other expenses and losses

SOLUTIONS TO EXERCISES

EXERCISE 16-1

1. Companies purchase investments in debt or stock securities because they have excess cash, to generate earnings from investment income, or for strategic reasons.

2. A corporation would have excess cash that it does not need for operations due to seasonal fluctuations in sales and as a result of economic cycles.

3. The typical investment when investing cash for short periods of time is low-risk, high liquidity, short-term securities such as government-issued securities.

4. The typical investments when investing cash to generate earnings are debt securities and stock securities.

5. A company would invest in securities that provide no current cash flows for speculative reasons. They are speculating that the investment will increase in value.

6. The typical investment when investing cash for strategic reasons is stock of companies in a related industry or in an unrelated industry that the company wishes to enter.

EXERCISE 16-2

(a)	Jan.	1	Debt Investments	50,000	
			Cash		50,000
	July	1	Cash ($50,000 X 9% X 1/2)	2,250	
			Interest Revenue		2,250
		1	Cash	33,000	
			Debt Investments ($50,000 X 3/5)		30,000
			Gain on Sale of Debt Investments ($33,000 – $30,000)		3,000

EXERCISE 16-2 (Continued)

(b)	Dec. 31	Interest Receivable	900	
		Interest Revenue ($20,000 X 9% X 1/2)		900

EXERCISE 16-3

January 1, 2014		
Debt Investments	70,000	
Cash		70,000
July 1, 2014		
Cash ($70,000 X 12% X 6/12)	4,200	
Interest Revenue		4,200
December 31, 2014		
Interest Receivable	4,200	
Interest Revenue		4,200
January 1, 2015		
Cash	4,200	
Interest Receivable		4,200
January 1, 2015		
Cash	38,500	
Loss On Sale of Debt Investments	1,500	
Debt Investments (40/70 X $70,000)		40,000

EXERCISE 16-4

(a)

Feb.	1	Stock Investments	7,200	
		Cash		7,200
July	1	Cash (600 X $1)	600	
		Dividend Revenue		600
Sept.	1	Cash	4,300	
		Stock Investments ($7,200 X 3/6)		3,600
		Gain on Sale of Stock Investments ($4,300 – $3,600)		700
Dec.	1	Cash (300 X $1)	300	
		Dividend Revenue		300

(b) Dividend revenue and the gain on sale of stock investments are reported under other revenues and gains in the income statement.

EXERCISE 16-5

Jan.	1	Stock Investments	152,000	
		Cash		152,000
July	1	Cash (2,500 X $3)	7,500	
		Dividend Revenue		7,500
Dec.	1	Cash	32,000	
		Stock Investments ($152,000 X 1/5)		30,400
		Gain on Sale of Stock Investments		1,600
Dec.	31	Cash (2,000 X $3)	6,000	
		Dividend Revenue		6,000

EXERCISE 16-6

February 1		
Stock Investments	16,000	
Cash (500 X $32)		16,000
March 20		
Cash	2,900	
Loss on Sale of Stock Investments	300	
Stock Investments ($16,000 X 100/500)		3,200
April 25		
Cash (400 X $1)	400	
Dividend Revenue		400
June 15		
Cash	7,600	
Stock Investments ($16,000 X 200/500)		6,400
Gain on Sale of Stock Investments		1,200
July 28		
Cash (200 X $1.25)	250	
Dividend Revenue		250

EXERCISE 16-7

(a)	Jan. 1	Stock Investments	180,000	
		Cash		180,000
	Dec. 31	Cash ($60,000 X 25%)	15,000	
		Stock Investments		15,000
	31	Stock Investments	50,000	
		Revenue from Stock Investments ($200,000 X 25%)		50,000

(b)	Investment in Helbert, January 1	$180,000
	Less: Dividend received	(15,000)
	Plus: Share of reported income	50,000
	Investment in Helbert, December 31	$215,000

EXERCISE 16-8

(a)	2014			
	Mar. 18	Stock Investments	260,000	
		Cash (200,000 X 10% X $13)		260,000
	June 30	Cash	6,000	
		Dividend Revenue ($60,000 X 10%)		6,000
	Dec. 31	Fair Value Adjustment—Available-for-Sale	40,000	
		Unrealized Gain or Loss—Equity ($300,000 – $260,000)		40,000
(b)	Jan. 1	Stock Investments	108,000	
		Cash (30,000 X 40% X $9)		108,000
	June 15	Cash	12,000	
		Stock Investments ($30,000 X 40%)		12,000
	Dec. 31	Stock Investments	32,000	
		Revenue from Stock Investments ($80,000 X 40%)		32,000

EXERCISE 16-9

(a) Since Agee owns more than 50% of the common stock of Himes Corporation, Agee is called the parent company. Himes is the subsidiary (affiliated) company. Because of its stock ownership, Agee has a controlling interest in Himes.

(b) When a company owns more than 50% of the common stock of another company, consolidated financial statements are usually prepared. Consolidated financial statements present the total assets and liabilities controlled by the parent company. They also present the total revenues and expenses of the affiliated companies.

(c) Consolidated financial statements are useful because they indicate the magnitude and scope of operations of the companies under common control.

EXERCISE 16-10

(a)

Dec. 31	Unrealized Loss—Income		2,000	
		Fair Value Adjustment—Trading		2,000

(b)

Balance Sheet

Current assets

Short-term investments, at fair value	$51,000

Income Statement

Other expenses and losses

Unrealized loss on trading securities	$ 2,000

EXERCISE 16-11

(a)

Dec. 31	Unrealized Gain or Loss—Equity		2,000	
		Fair Value Adjustment—Available-for-Sale		2,000

(b)

Balance Sheet

Investments

Investments in stock of less than 20% owned companies, at fair value	$51,000

Stockholders' equity

Less: Unrealized loss on available-for-sale securities	$ 2,000

EXERCISE 16-11 (Continued)

(c) Dear Ms. Kretsinger:

Investments which are classified as trading (held for sale in the near term) are reported at fair value in the balance sheet, with unrealized gains or losses reported in net income. Investments which are classified as available-for-sale (held longer than trading but not to maturity) are also reported at fair value, but unrealized gains or losses are reported in the stockholders' equity section.

Fair value is used as a reporting basis because it represents the cash realizable value of the securities. Unrealized gains or losses on trading investments are reported in the income statement because of the likelihood that the securities will be sold at fair value in the near term. Unrealized gains or losses on available-for-sale securities are reported in stockholders' equity rather than in income because there is a significant chance that future changes in fair value will reverse unrealized gains or losses. So as to not distort income with these fluctuations, they are reported directly in stockholders' equity.

I hope that the preceding discussion clears up any misunderstandings. Please contact me if you have any questions.

Sincerely,

Student

EXERCISE 16-12

(a)

Fair Value Adjustment—Trading		
($126,000 – $120,000)	6,000	
Unrealized Gain—Income		6,000
Unrealized Gain or Loss—Equity	4,000	
Fair Value Adjustment—Available-for-Sale		4,000

(b)

Balance Sheet

Current assets	
Short-term investments, at fair value	$126,000
Investments	
Investments in stock of less than 20% owned companies, at fair value	96,000
Stockholders' equity	
Less: Unrealized loss on available-for-sale securities	$ 4,000

Income Statement

Other revenues and gains	
Unrealized gain on trading securities	$ 6,000

SOLUTIONS TO PROBLEMS

PROBLEM 16-1A

(a)

2014			
Jan. 1	Debt Investments	2,000,000	
	Cash		2,000,000
July 1	Cash ($2,000,000 X .08 X 1/2)	80,000	
	Interest Revenue		80,000
Dec. 31	Interest Receivable	80,000	
	Interest Revenue		80,000
2017			
Jan. 1	Cash	80,000	
	Interest Receivable		80,000
1	Cash ($1,000,000 X 1.06)	1,060,000	
	Debt Investments		1,000,000
	Gain on Sale of Debt Investments		60,000
July 1	Cash ($1,000,000 X .08 X 1/2)	40,000	
	Interest Revenue		40,000
Dec. 31	Interest Receivable	40,000	
	Interest Revenue		40,000

(b)

2014			
Dec. 31	Fair Value Adjustment—Available-for-Sale	200,000	
	Unrealized Gain or Loss—Equity		200,000

PROBLEM 16-1A (Continued)

(c) **Balance Sheet**

Current assets	
Interest receivable	$ 80,000
Investments	
Debt investments, at fair value	$2,200,000

The unrealized gain of $200,000 would be reported in the stockholders' equity section of the balance sheet as an addition to total paid-in capital and retained earnings.

PROBLEM 16-2A

(a)

Feb.	1	Stock Investments	32,400	
		Cash		32,400
Mar.	1	Stock Investments	20,000	
		Cash		20,000
Apr.	1	Debt Investments	50,000	
		Cash		50,000
July	1	Cash ($.60 X 600)	360	
		Dividend Revenue		360
Aug.	1	Cash (200 X $58)	11,600	
		Stock Investments [($32,400 ÷ 600) X 200]		10,800
		Gain on Sale of Stock Investments		800
Sept.	1	Cash ($1 X 800)	800	
		Dividend Revenue		800
Oct.	1	Cash ($50,000 X 7% X 1/2)	1,750	
		Interest Revenue		1,750
	1	Cash	49,000	
		Loss on Sale of Debt Investments	1,000	
		Debt Investments		50,000

Stock Investments

Feb. 1	32,400	Aug. 1	10,800
Mar. 1	20,000		
Dec. 31 Bal.	41,600		

Debt Investments

Apr. 1	50,000	Oct. 1	50,000
Dec. 31 Bal.	0		

PROBLEM 16-2A (Continued)

(b) Dec. 31 Unrealized Loss—Income 400
Fair Value Adjustment—Trading
($41,600 – $41,200) 400

Security	Cost	Fair Value	
Muninger common	$21,600	$22,000	(400 X $55)
Tatman common	20,000	19,200	(800 X $24)
	$41,600	$41,200	

(c) Current assets
Short-term investments, at fair value............................... $41,200

(d)

Income Statement Account	Category
Dividend Revenue	Other revenues and gains
Gain on Sale of Stock Investments	Other revenues and gains
Interest Revenue	Other revenues and gains
Loss on Sale of Debt Investments	Other expenses and losses
Unrealized Loss—Income	Other expenses and losses

PROBLEM 16-3A

(a)

	2015		
July 1	Cash (5,000 X $1)	5,000	
	Dividend Revenue		5,000
Aug. 1	Cash (2,000 X $.50)	1,000	
	Dividend Revenue		1,000
Sept. 1	Cash (1,500 X $8)	12,000	
	Loss on Sale of Stock Investments ($13,500 – $12,000)	1,500	
	Stock Investments (1,500 X $9)		13,500
Oct. 1	Cash (800 X $33)	26,400	
	Stock Investments (800 X $30)		24,000
	Gain on Sale of Stock Investments ($26,400 – $24,000)		2,400
Nov. 1	Cash (1,500 X $1)	1,500	
	Dividend Revenue		1,500
Dec. 15	Cash (1,200 X $.50)	600	
	Dividend Revenue		600
31	Cash (3,500 X $1)	3,500	
	Dividend Revenue		3,500

Stock Investments

2015			2015	
Jan. 1	Balance	135,000	Sept. 1	13,500
			Oct. 1	24,000
2015				
Dec. 31	Balance	97,500		

PROBLEM 16-3A (Continued)

(b) Dec. 31	Unrealized Gain or Loss—Equity ($97,500 – $93,400)	4,100	
	Fair Value Adjustment—Available-for-Sale		4,100

Security	Cost	Fair Value	
Gehring Co. common	$36,000	$38,400	(1,200 X $32)
Wooderson Co. common	31,500	28,000	(3,500 X $ 8)
Kitselton Co. common	30,000	27,000	(1,500 X $18)
	$97,500	$93,400	

(c) **Investments**

Investments in stock of less than 20% owned companies, at fair value		$ 93,400

Stockholders' equity

Common stock	$1,500,000	
Retained earnings	1,000,000	
Total paid-in capital and retained earnings	2,500,000	
Less: Unrealized loss on available-for-sale securities	4,100	
Total stockholders' equity		$2,495,900

PROBLEM 16-4A

(a)	Jan.	1	Stock Investments	800,000	
			Cash		800,000
	Mar.	15	Cash	9,000	
			Dividend Revenue (30,000 X $.30)		9,000
	June	15	Cash	9,000	
			Dividend Revenue		9,000
	Sept.	15	Cash	9,000	
			Dividend Revenue		9,000
	Dec.	15	Cash	9,000	
			Dividend Revenue		9,000
		31	Fair Value Adjustment—Trading	220,000	
			Unrealized Gain—Income [$800,000 – ($34 X 30,000)]		220,000
(b)	Jan.	1	Stock Investments	800,000	
			Cash		800,000
	Mar.	15	Cash	9,000	
			Stock Investments		9,000
	June	15	Cash	9,000	
			Stock Investments		9,000
	Sept.	15	Cash	9,000	
			Stock Investments		9,000
	Dec.	15	Cash	9,000	
			Stock Investments		9,000

PROBLEM 16-4A (Continued)

Dec. 31	Stock Investments................................	64,000	
	Revenue from Stock Investments		
	($320,000 X 20%)......................		64,000

(c)

	Cost Method	Equity Method
Stock Investment	$1,020,000*	$828,000**
Dividend revenue	220,000	0
Revenue from stock investments	36,000	64,000
Revenue from stock investments	0	

*$34 X 30,000 shares
**$800,000 + $64,000 – $36,000

PROBLEM 16-5A

(a)	Jan. 20	Cash	55,000	
		Stock Investments		52,000
		Gain on Sale of Stock Investments		3,000
	28	Stock Investments	31,200	
		Cash		31,200
	30	Cash	1,610	
		Dividend Revenue ($1.15 X 1,400)		1,610
	Feb. 8	Cash	480	
		Dividend Revenue ($.40 X 1,200)		480
	18	Cash ($27 X 1,200)	32,400	
		Loss on Sale of Stock Investments	1,200	
		Stock Investments		33,600
	July 30	Cash	1,400	
		Dividend Revenue ($1 X 1,400)		1,400
	Sept. 6	Stock Investments	73,800	
		Cash ($82 X 900)		73,800
	Dec. 1	Cash	1,950	
		Dividend Revenue ($1.50 X 1,300)		1,950

(b) Stock Investments

1/1 Bal.	169,600	1/20	52,000
1/28	31,200	2/18	33,600
9/6	73,800		
12/31 Bal.	189,000		

PROBLEM 16-5A (Continued)

(c)	Dec. 31	Unrealized Gain or Loss—Equity	5,800	
		Fair Value Adjustment—Available-for-Sale ($189,000 – $183,200)..........		5,800

Security	Cost	Fair Value	
Hutcherson Corporation common	$ 84,000	$ 89,600	(1,400 X $64)
Liggett Corporation common	105,000	93,600	(1,300 X $72)
	$189,000	$183,200	

(d) Investments

Investments in stock of less than 20% owned companies, at fair value..	$183,200

Stockholders' equity

Total paid-in capital and retained earnings................	xxxxx
Less: Unrealized loss on available-for-sale securities..	5,800
Total stockholders' equity	$ xxxxx

PROBLEM 16-6A

NIETO CORPORATION
Balance Sheet
December 31, 2014

Assets			
Current assets			
Cash			$ 62,000
Short-term investments, at fair value			180,000
Accounts receivable		$140,000	
Less: Allowance for doubtful accounts		6,000	134,000
Inventory			170,000
Prepaid insurance			16,000
Total current assets			562,000
Investments			
Investments in stock of less than 20% of owned companies, at fair value		286,000*	
Investment in stock of 20%–50% owned company, at equity		380,000	
Total investments			666,000
Property, plant, and equipment			
Land		390,000	
Buildings	$950,000		
Less: Accumulated depreciation—buildings	180,000	770,000	
Equipment	275,000		
Less: Accumulated depreciation—equipment	52,000	223,000	
Total property, plant, and equipment			1,383,000
Intangible assets			
Goodwill			200,000
Total assets			$2,811,000

*$278,000 + $8,000

NIETO CORPORATION
Balance Sheet (Continued)
December 31, 2014

Liabilities and Stockholders' Equity

Current liabilities		
Notes payable		$ 70,000
Accounts payable		260,000
Income taxes payable		120,000
Dividends payable		80,000
Total current liabilities		530,000
Long-term liabilities		
Bonds payable, 10%, due 2022	$ 500,000	
Plus: Premium on bonds payable	40,000	
Total long-term liabilities		540,000
Total liabilities		1,070,000
Stockholders' equity		
Paid-in capital		
Common stock, $10 par value, 500,000 shares authorized, 150,000 shares issued and outstanding	1,500,000	
Paid-in capital in excess of par	130,000	
Total paid-in capital	1,630,000	
Retained earnings	103,000	
Total paid-in capital and retained earnings	1,733,000	
Add: Unrealized gain on available-for-sale securities	8,000	
Total stockholders' equity		1,741,000
Total liabilities and stockholders' equity		$2,811,000

PROBLEM 16-1B

(a)	2014			
	Jan. 1	Debt Investments	400,000	
		Cash		400,000
	July 1	Cash ($400,000 X .09 X 1/2)	18,000	
		Interest Revenue		18,000
	Dec. 31	Interest Receivable	18,000	
		Interest Revenue		18,000
	2017			
	Jan. 1	Cash	18,000	
		Interest Receivable		18,000
	1	Cash ($200,000 X 1.14)	228,000	
		Debt Investments		200,000
		Gain on Sale of Debt Investments		28,000
	July 1	Cash ($200,000 X .09 X 1/2)	9,000	
		Interest Revenue		9,000
	Dec. 31	Interest Receivable	9,000	
		Interest Revenue		9,000
(b)	2014			
	Dec. 31	Unrealized Gain or Loss—Equity	15,000	
		Fair Value Adjustment—Available-for-Sale		15,000

(c) Balance Sheet

Current assets	
Interest receivable	**$ 18,000**
Investments	
Debt investments, at fair value	**$385,000**

The unrealized loss of $15,000 would be reported in the stockholders' equity section of the balance sheet as a deduction from total paid-in capital and retained earnings.

PROBLEM 16-2B

(a)

Feb. 1	Stock Investments	30,800	
	Cash		30,800
Mar. 1	Stock Investments	20,300	
	Cash		20,300
Apr. 1	Debt Investments	40,000	
	Cash		40,000
July 1	Cash ($.60 X 500)	300	
	Dividend Revenue		300
Aug. 1	Cash (300 X $69)	20,700	
	Stock Investments [($30,800 ÷ 500) X 300]		18,480
	Gain on Sale of Stock Investments		2,220
Sept. 1	Cash ($1 X 600)	600	
	Dividend Revenue		600
Oct. 1	Cash ($40,000 X 9% X 1/2)	1,800	
	Interest Revenue		1,800
1	Cash	44,000	
	Debt Investments		40,000
	Gain on Sale of Debt Investments ($44,000 – $40,000)		4,000

Stock Investments

Feb. 1	30,800	Aug. 1	18,480
Mar. 1	20,300		
Dec. 31 Bal.	32,620		

Debt Investments

Apr. 1	40,000	Oct. 1	40,000
Dec. 31 Bal.	0		

PROBLEM 16-2B (Continued)

(b)	Dec. 31	Unrealized Loss—Income	2,020	
		Fair Value Adjustment—Trading.....		2,020

Security	Cost	Fair Value	
Day common	$12,320	$13,200	(200 X $66)
Eldridge common	20,300	17,400	(600 X $29)
	$32,620	$30,600	

(c) Current assets

Trading securities, at fair value....................................... $30,600

(d)

Income Statement Account	Category
Dividend Revenue	Other revenues and gains
Gain on Sale of Stock Investments	Other revenues and gains
Interest Revenue	Other revenues and gains
Gain on Sale of Debt Investments	Other revenues and gains
Unrealized Loss—Income	Other expenses and losses

PROBLEM 16-3B

(a)

Date	Account	Debit	Credit
	2015		
July 1	Cash (5,000 X $1)	5,000	
	Dividend Revenue		5,000
Aug. 1	Cash (4,000 X $.50)	2,000	
	Dividend Revenue		2,000
Sept. 1	Cash (1,500 X $7)	10,500	
	Stock Investments (1,500 X $6)		9,000
	Gain on Sale of Stock Investments		1,500
Oct. 1	Cash (600 X $30)	18,000	
	Stock Investments (600 X $25)		15,000
	Gain on Sale of Stock Investments		3,000
Nov. 1	Cash (3,000 X $1)	3,000	
	Dividend Revenue		3,000
Dec. 15	Cash (3,400 X $.50)	1,700	
	Dividend Revenue		1,700
31	Cash (3,500 X $1)	3,500	
	Dividend Revenue		3,500

Stock Investments

2015			2015	
Jan. 1	Balance	190,000	Sept. 1	9,000
			Oct. 1	15,000
2015				
Dec. 31	Balance	166,000		

PROBLEM 16-3B (Continued)

(b) Dec. 31 Unrealized Gain or Loss—Equity

Unrealized Gain or Loss—Equity ($166,000 – $159,700)	6,300	
Fair Value Adjustment—Available-for-Sale		6,300

Security	Cost	Fair Value	
Woolridge Co. common	$ 85,000	$ 78,200	(3,400 X $23)
Coria Co. common	21,000	24,500	(3,500 X $7)
Sterling Motors Co. common	60,000	57,000	(3,000 X $19)
	$166,000	$159,700	

(c) Investments

Investments in stock of less than 20% owned companies, at fair value		$ 159,700

Stockholders' equity

Common stock	$2,000,000	
Retained earnings	1,200,000	
Total paid-in capital and retained earnings	3,200,000	
Less: Unrealized loss on available-for-sale securities	6,300	
Total stockholders' equity		$3,193,700

PROBLEM 16-4B

(a)

Date	Account	Debit	Credit
2014			
Jan. 1	Stock Investments	1,100,000	
	Cash		1,100,000
June 30	Cash	20,000	
	Dividend Revenue (40,000 X $.50)		20,000
Dec. 31	Cash	20,000	
	Dividend Revenue (40,000 X $.50)		20,000
31	Fair Value Adjustment—Available-for-Sale	100,000	
	Unrealized Gain or Loss—Equity [$1,100,000 – ($30 X 40,000)]		100,000

(b)

Date	Account	Debit	Credit
2014			
Jan. 1	Stock Investments	1,100,000	
	Cash		1,100,000
June 30	Cash	20,000	
	Stock Investments		20,000
Dec. 31	Cash	20,000	
	Stock Investments		20,000
31	Stock Investments	120,000	
	Revenue from Stock Investments ($600,000 X 20%)		120,000

PROBLEM 16-4B (Continued)

(c)

	Cost Method	Equity Method
Stock Investments	$1,200,000*	$1,180,000**
Unrealized gain—equity	100,000	0
Dividend revenue	40,000	120,000
Revenue from stock investments	0	

*$30 X 40,000 shares
**$1,100,000 + $120,000 – $40,000

PROBLEM 16-5B

(a)

Jan.	7	Cash (700 X $55)	38,500	
		Stock Investments		35,000
		Gain on Sale of Stock Investments		3,500
	10	Stock Investments	23,400	
		Cash		23,400
	26	Cash	1,035	
		Dividend Revenue ($1.15 X 900)		1,035
Feb.	2	Cash	320	
		Dividend Revenue ($.40 X 800)		320
	10	Cash ($26 X 800)	20,800	
		Loss on Sale of Stock Investments	1,600	
		Stock Investments		22,400
July	1	Cash	900	
		Dividend Revenue ($1 X 900)		900
Sept.	1	Stock Investments	60,000	
		Cash ($75 X 800)		60,000
Dec.	15	Cash	1,650	
		Dividend Revenue ($1.50 X 1,100)		1,650

(b)

Stock Investments

1/1 Bal.	99,400	1/7	35,000
1/10	23,400	2/10	22,400
9/1	60,000		
12/31 Bal.	125,400		

PROBLEM 16-5B (Continued)

(c)	Dec. 31	Unrealized Gain or Loss—Equity	3,000	
		Fair Value Adjustment—Available-for-Sale ($125,400 – $122,400)............		3,000

Security	Cost	Fair Value	
Robison Corporation Common	$ 42,000	$ 43,200	(900 X $48)
Younker Corporation Common	83,400	79,200	(1,100 X $72)
	$125,400	$122,400	

(d) Investments

Investments in stock of less than 20% owned companies, at fair value...	$122,400

Stockholders' equity

Total paid-in capital and retained earnings.................	xxxxx
Less: Unrealized loss on available- for-sale securities..	3,000
Total stockholders' equity	$ xxxxx

PROBLEM 16-6B

MUSSATTO CORPORATION
Balance Sheet
December 31, 2014

Assets

Current assets			
Cash			$ 210,000
Short-term investments, at fair value			280,000
Accounts receivable		$ 135,000	
Less: Allowance for doubtful accounts		10,000	125,000
Inventory			255,000
Prepaid insurance			25,000
Total current assets			895,000
Investments			
Investment in stock of 20%–50% owned company, at equity			900,000
Property, plant, and equipment			
Land		780,000	
Buildings	$1,350,000		
Less: Accumulated depreciation—buildings	270,000	1,080,000	
Equipment	415,000		
Less: Accumulated depreciation—equipment	80,000	335,000	
Total property, plant, and equipment			2,195,000
Intangibles			
Goodwill			300,000
Total assets			$4,290,000

PROBLEM 16-6B (Continued)

MUSSATTO CORPORATION
Balance Sheet (Continued)
December 31, 2014

Liabilities and Stockholders' Equity

Current liabilities		
Notes payable		$ 110,000
Accounts payable		375,000
Income taxes payable		180,000
Dividends payable		75,000
Total current liabilities		740,000
Long-term liabilities		
Bonds payable, 10%, due 2024	$ 600,000	
Less: Discount on bonds payable	30,000	
Total long-term liabilities		570,000
Total liabilities		1,310,000
Stockholders' equity		
Paid-in capital		
Common stock, $5 par value, 500,000 shares authorized, 440,000 shares issued and outstanding	$2,200,000	
Paid-in capital in excess of par—common stock	300,000	
Total paid-in capital	2,500,000	
Retained earnings	480,000	
Total stockholders' equity		2,980,000
Total liabilities and stockholder's equity		$4,290,000

COMPREHENSIVE PROBLEM: CHAPTERS 12 TO 16

Part I

(a) To: Debby Kauffman, Jamie Hiatt, and Ella Rincon

From: Joe Student

Date: 5/26/2013

Re: Analysis of Partnership vs. Corporate Form of Business Organization

I have examined your situation regarding the establishment of your business. Before discussing my recommendations, I would like to briefly review the advantages and disadvantages of partnerships and corporations.

The primary advantages of a partnership over a corporation are:

1. Partnerships are more easily formed than corporations. Partnerships can be formed simply by the voluntary agreement of two or more individuals. Forming a corporation requires preparing and filing documents with governmental agencies, paying incorporation fees, etc.

2. Income from a partnership is subject to less tax than income from a corporation. Even though partnerships are required to file information tax returns (returns that show financial information, but do not require any payment of taxes), they are not considered taxable entities. A partner's share of partnership income is taxed only on the partner's personal income tax return. Corporations are taxable entities and pay taxes on corporate income. In addition, any dividends distributed by corporations to individuals are subject to personal income tax on the personal income tax return. This is known as double taxation.

3. Partnerships have more flexibility in decision making. The decision-making process used in a partnership is determined by the partners, whereas some decisions required in corporations must follow formal procedures described in the bylaws of the corporation.

The primary advantages of a corporation over a partnership are:

1. **Mutual agency does not exist in a corporation. This means that the owners of a corporation (stockholders) do not have the power to bind the corporation beyond their authority. For example, a stockholder who is not employed by the firm cannot enter into contracts or other agreements on behalf of the corporation. Owners of a partnership (partners) are bound by the actions of their partners, even when partners act beyond the scope of their authority. This is true as long as the actions seem appropriate for the business.**

2. **The owners of a corporation have limited liability. When the corporation's assets are not sufficient to pay creditors' claims, the personal assets of the stockholders are protected from the corporation's creditors. In a partnership, once the assets of the partnership have been used to pay creditors' claims, the personal assets of the partners can be taken to satisfy the creditors' demands. A special type of partnership, a limited partnership, protects the personal assets of limited partners, but at least one partner's assets are still at risk. This partner is called a general partner.**

3. **The life of a corporation is unlimited. When ownership changes occur (e.g., stockholders buy or sell stock), the corporation continues to exist as a legal entity. When ownership changes occur in a partnership (e.g., existing partner leaves, new partner is added), the old partnership no longer exists as a legal entity. A new partnership can be formed and the business can continue, but the original partnership must be dissolved.**

After examining your situation, I believe that you would be wise to choose the corporate form of business organization. There are two reasons for this recommendation. The first reason is that the venture you are about to undertake will require significant capital and, generally, capital is more easily raised via a corporation than a partnership. The other reason is that you will be protected from unlimited liability if you incorporate as opposed to forming a partnership. Given the potential risk of starting a venture of this kind, I believe it is in your best interest to protect your personal assets by using the corporate form of organization.

I wish you the best in your new endeavor and please call upon me when you are in need of further assistance.

COMPREHENSIVE PROBLEM (Continued)

Part II

(b) Equity financing option:

Positives	Negatives
No fixed interest payments required	Control of the corporation is lost
	Difficulty of finding an interested investor
	Earnings per share are lower

Debt financing option:

Positives	Negatives
Control stays with three incorporators	Interest payments quickly drain cash
No need for additional investor	
Earnings per share are higher	

Shares outstanding before financing 60,000 shares

	Equity Financing	Debt Financing
Income before interest and taxes	$300,000	$300,000
Interest expense	—	126,000
Income before taxes	300,000	174,000
Tax expense	96,000	55,680
Net income	$204,000	$118,320
Shares outstanding after financing	200,000	60,000
Earnings per share	$ 1.02	$ 1.97

Part III

(c)	(1)	6/12/13	Cash	100,000	
			Buildings	200,000	
			Common Stock		120,000
			Paid-in Capital in Excess of Par—Common Stock		180,000

COMPREHENSIVE PROBLEM (Continued)

7/21/13	Cash	900,000	
	Common Stock		180,000
	Paid-in Capital in Excess of Par—Common Stock		720,000
7/27/14	Stock Dividends (150,000 X .10 X $3)	45,000	
	Common Stock Dividends Distributable		30,000
	Paid-in Capital in Excess of Par—Common Stock		15,000
7/31/14	No entry		
8/15/14	Common Stock Dividends Distributable	30,000	
	Common Stock		30,000
12/4/14	Cash Dividends (165,000 X $.05)	8,250	
	Dividends Payable		8,250
12/14/14	No entry		
12/24/14	Dividends Payable	8,250	
	Cash		8,250

(2) Shares Issued and Outstanding

Date	Event	Number of Shares Issued	Total Shares Issued and Outstanding
6/12/13	Issuance to Incorporators	60,000	60,000
7/21/13	Issuance to Hansen	90,000	150,000
8/15/14	Stock dividend issuance	15,000	165,000

Part IV

(d) (1)

6/1/15	Cash	548,000	
	Discount on Bonds Payable	52,000	
	Bonds Payable		600,000

COMPREHENSIVE PROBLEM (Continued)

(2)	12/1/15	Interest Expense	20,600	
		Discount on Bonds		
		Payable ($52,000 ÷ 20)		2,600
		Cash ($600,000 X .03)		18,000
(3)	12/31/15	Interest Expense	3,433	
		Discount on Bonds Payable		
		[($52,000 ÷ 20) ÷ 6]		433
		Interest Payable		
		[($600,000 X .03) ÷ 6]		3,000
(4)	6/1/16	Interest Payable	3,000	
		Interest Expense ($20,600 – $3,433)	17,167	
		Cash		18,000
		Discount on Bonds		
		Payable ($2,600 – $433)		2,167

Part V

(e)	(1)	2013	Stock Investments	900,000	
			Cash		900,000
			Stock Investments	18,000	
			Revenue from Stock		
			Investments (.6 X $30,000)		18,000
			Cash	1,260	
			Stock Investments		
			(.6 X $2,100)		1,260
		2014	Stock Investments	42,000	
			Revenue from Stock		
			Investments (.6 X $70,000)		42,000
			Cash	12,000	
			Stock Investments		
			(.6 X $20,000)		12,000

COMPREHENSIVE PROBLEM (Continued)

2015	Stock Investments..........................	63,000	
	Revenue from Stock Investments (.6 X $105,000)		63,000
	Cash	30,000	
	Stock Investments (.6 X $50,000)		30,000

(2)

Stock Investments	
900,000	
18,000	1,260
42,000	12,000
63,000	30,000
979,740	

CCC16 CONTINUING COOKIE CHRONICLE

(a) 1. The amount of influence you would have in The Beanery would determine how you would account for the investment. Given that you would own 30% of the common shares of The Beanery, it would be assumed (unless there was evidence to the contrary) that you could exert significant influence over the day-to-day operations of the business. This is especially so given the small number of stockholders. Significant influence over an investee may also result from representation on the board of directors, participation in policy-making processes, material intercompany transactions, interchange of managerial personnel, or technological dependency.

Assuming significant influence existed, the investment would be accounted for using the equity method of accounting. However, in this case, the Thornton sisters will still exercise majority control and may not be willing to let an investor participate in the decision-making process. If this did occur, significant influence may not exist and the investment would be accounted for using the cost method.

2. One of the major advantages of going ahead with this investment would be the strategic advantage of the horizontal and vertical integration that would occur. Not only would you eliminate a competitor but you both could learn the business of roasting beans while taking advantage of the expertise the Thornton sisters have developed with respect to the operation of their coffee shop.

CCC16 (Continued)

(a) (Continued)

3. **There would be disadvantages associated with this investment as well. For example, there may be a significant time investment required by both of you especially since both of the Thornton sisters are very busy and would like the investor to take over some of the responsibilities of running the business. Also, the Thornton sisters will still exercise majority control and may not be willing to let an investor participate in the decision-making process. Finally, if the investment did not work out, it may be difficult to find another investor to purchase the shares held by Cookie & Coffee Creations.**

(b)

Stock Investments	**15,000**	
Cash		**15,000**

(c)

Cost Method

Cash	**7,500**	
Dividend Revenue ($25,000 X 30%)		**7,500**

<u>Equity Method</u>

Stock Investments	**15,000**	
Revenue from Stock Investments ($50,000 X 30%)		**15,000**
Cash ($25,000 X 30%)	**7,500**	
Stock Investments		**7,500**

CCC16 (Continued)

(d) Because the investment in The Beanery is a strategic investment, it would be classified as a long-term investment in the noncurrent assets section of Cookie & Coffee Creations' balance sheet. If the investment were accounted for using the cost method, it would be recorded at its original cost of $15,000. If the investment were accounted for using the equity method, it would be accounted for at its original cost plus a proportionate share of The Beanery's income, less a proportionate share of any dividends paid by The Beanery. For the current year the investment would be at $22,500 ($15,000 + $15,000 – $7,500).

BYP 16-1 FINANCIAL REPORTING PROBLEM

(a) Percentage increase from 2010 to 2011:

(1) Short-term marketable securities: ($16,137-$14,359) ÷ 14,359 = 12.4%

(2) Long-term marketable securities: ($55,618-25,391) ÷ 25,391 = 119.0%

(b)

(1) Purchases of marketable securities during the year: $102,317 million.

(2) Payments for business acquisitions, net of cash acquired: $244 million.

BYP 16-2 COMPARATIVE ANALYSIS PROBLEM

(a)

(in millions)	PepsiCo	Coca-Cola
1. Cash used for investing activities	$5,618	$2,524
2. Cash used for capital expenditures (spending)	3,339	2,920

(b) In its Note 1 to the consolidated financial statements, PepsiCo states that its financial statements include the consolidated accounts of *PepsiCo Inc. and the affiliates that it controls*. In addition, PepsiCo includes its share of the results of certain other affiliates based on its ownership interest.

As for specific corporations consolidated, PepsiCo lists the following companies as its principal divisions.

Frito-Lay North America
PepsiCo Beverages North America
Quaker Foods North America
PepsiCo International

BYP 16-3 COMPARATIVE ANALYSIS PROBLEM

(in millions)	Amazon	Wal-Mart
1. Cash used for investing activities	$1,930	$16,609
2. Cash used for capital expenditures	1,811	13,510

BYP 16-4 REAL-WORLD FOCUS

Answers will vary depending on company chosen. The following sample solution is provided for Medtronic, Inc.

(a) 29 analysts rated this company.
(b) 7/29 or 24% of the analysts rated it a strong buy.
(c) Average rating 2.2 on a scale of 1.0 (strong buy) to 5.0 (strong sell).
(d) Average rating: No change.
(e) Earnings surprise 1.390%.

BYP 16-5 DECISION MAKING ACROSS THE ORGANIZATION

(a) The dollar amount received upon the sale of the JMB Company stock was \$1,468,000. Since Neosho Corporation has a 30% interest in JMB, the equity method should be used to report dividends and net income. A reconstruction of the correct entries can be prepared for the acquisition, the equity method treatment of dividends and revenue, and the sale. A plug figure for cash will balance the entry for the sale. These entries are provided below.

(b) Both the stockholder and the president are correct. Since the equity method adjusts the investment account for the earnings of the investee, the "very profitable" JMB investment balance has increased during the period the stock was held. The stock was sold at less than its current investment balance and thus a loss was recognized. Stockholder Linton is correct in labeling this a very profitable company and in noting that a loss was recognized on its sale.
President Cedeno is correct in that the investment was sold at a higher figure than the \$1,300,000 purchase price. The key to the dilemma is to note that the selling price was less than the carrying amount of the investment. The carrying amount has increased due to the recognition of JMB income during the time the stock was held.

Entries for the investment in JMB Company:

Acquisition		
Stock Investments	1,300,000	
Cash		1,300,000
Previous Years—Equity Method		
Stock Investments	372,000	
Revenue from Stock Investments		
(\$1,240,000 X 30%)		372,000
Cash	132,000	
Stock Investments (\$440,000 X 30%)		132,000

BYP 16-5 (Continued)

This Year—Equity Method

Stock Investments	**156,000**	
Revenue from Stock Investments		
($520,000 X 30%)		**156,000**
Cash...	**48,000**	
Stock Investments ($160,000 X 30%).......		**48,000**

Sale of the JMB Company Stock

Cash (Cash is a plug.)	**1,468,000**	
Loss on Sale of Stock Investments.................	**180,000**	
Stock Investments		**1,648,000***

***$1,300,000 + ($372,000 + $156,000) – ($132,000 + $48,000)**

BYP 16-6 COMMUNICATION ACTIVITY

Dear Mr. Nichols:

I am writing this memo to make suggestions regarding the appropriate treatment for the two securities you are holding in your portfolio. Assuming that your investment in Plummer Corporation does not represent a significant interest in that firm, it should be accounted for as an available-for-sale security because it is a stock investment that you do not intend on selling in the near future. You will not report any gains or losses on this investment in your income statement until you sell it. On the other hand, your debt investment should be accounted for as a trading security since you purchased it with the intent to generate a short-term profit. Unrealized gains and losses at your balance sheet date should be reported directly in income.

BYP 16-7 ETHICS CASE

(a) **Classifying the securities as they propose will indeed have the effect on net income that they say it will. Classifying all the gains as trading securities will cause all the gains to flow through the income statement this year and classifying the losses as available-for-sale securities will defer the losses from this year's income statement. Classifying the gains and losses just the opposite will have the opposite effect.**

(b) **What each proposes is unethical since it is knowingly not in accordance with GAAP. The financial statements are fraudulently, not fairly, stated. The affected stakeholders are other members of the company's officers and directors, the independent auditors (who may detect these misstatements), the stockholders, and prospective investors.**

(c) **The act of selling certain securities (those with gains or those with losses) is management's choice and is not per se unethical. Generally accepted accounting principles allow the sale of selected securities so long as the method of assigning cost adopted by the company is consistently applied. If the officers act in the best interest of the company and its stakeholders, and in accordance with GAAP, and not in their self-interest, their behavior is probably ethical. Knowingly engaging in unsound and poor business and accounting practices that waste assets or that misstate financial statements is unethical behavior.**

BYP 16-8 ALL ABOUT YOU

(a)
- *Ask*—The lowest price at which a market maker will sell a specified number of shares of a stock at any given time.
- *Margin*—Paying for stock partly in cash and partly by borrowing from the brokerage firm.
- *Prospectus*—A document that contains important information about an investment company's fees and expenses, investment objectives, investment strategies, risks, performance, pricing, and more.
- *Index Fund*—A type of mutual fund or Unit Investment Trust whose investment objective typically is to achieve the same return as a particular market index, such as the S&P 500 Composite Stock Price Index.

(b) The SEC quiz is interactive, thus students are provided with feedback regarding their answers.

BYP 16-9 FASB CODIFICATION ACTIVITY

(a) Trading Securities; Securities that are bought and held principally for the purpose of selling them in the near term and therefore held for only a short period of time. Trading generally reflects active and frequent buying and selling, and trading securities are generally used with the objective of generating profits on short-term differences in price.

(b) Available-for-Sale-Securities; Those not classified as either trading securities or held-for-collection securities.

(c) Held-for-Collection Securities; Investment in debt securities shall be classified as held-for-collection only if the reporting entity has the positive intent and ability to hold these securities to maturity.