CHAPTER 16

INVESTMENTS

SUMMARY OF QUESTIONS BY LEARNING OBJECTIVES AND BLOOM'S TAXONOMY

Item	LO	BT	Item	LO	BT	Item	LO	BT	Item	LO	BT	Item	LO	BT
True-False Statements														
1.	1	K	8.	3	C	15.	4	C	22.	5	C	[sg]29.	4	C
2.	1	C	9.	3	C	16.	4	K	23.	6	K	[sg]30.	5	K
3.	2	K	10.	3	K	17.	5	C	24.	6	K	[sg]31.	6	C
4.	2	C	11.	3	C	18.	5	K	25.	6	C			
5.	2	C	12.	3	K	19.	5	K	[sg]26.	1	K			
6.	2	C	13.	3	K	20.	5	C	[sg]27.	2	K			
7.	2	K	14.	4	K	21.	5	K	[sg]28.	3	K			
Multiple Choice Questions														
32.	1	K	54.	3	AP	76.	3	C	98.	4	K	120.	6	C
33.	1	K	55.	3	AP	77.	3	C	99.	4	K	121.	6	K
34.	1	K	56.	3	AP	78.	3	K	100.	5	K	122.	6	C
35.	1	K	57.	3	K	79.	3	K	101.	5	K	123.	6	K
36.	1	K	58.	3	AP	80.	3	K	102.	5	K	124.	6	C
37.	2	K	59.	3	AP	81.	3	K	103.	5	C	[sg]125.	1	C
38.	2	C	60.	3	AP	82.	3	K	104.	5	K	[st]126.	2	K
39.	2	AP	61.	3	AP	83.	3	K	105.	5	K	[st]127.	2	K
40.	2	AN	62.	3	AP	84.	3	C	106.	5	K	[st]128.	3	K
41.	2	AP	63.	3	K	85.	3	C	107.	5	AP	[sg]129.	3	K
42.	2	AP	64.	3	K	86.	3	C	108.	5	AP	[sg]130.	3	K
43.	2	AN	65.	3	AP	87.	3	AP	109.	5	C	[sg]131.	3	AP
44.	2	K	66.	3	AP	88.	3	AP	110.	5	K	[st]132.	5	K
45.	2	C	67.	3	K	89.	3	AN	111.	5	C	[sg]133.	5	K
46.	2	K	68.	3	K	90.	3	AN	112.	5	C	[sg]134.	6	K
47.	2	AP	69.	3	C	91.	3	AN	113.	5	K	[st]135.	6	K
48.	2	AP	70.	3	C	92.	3	AN	114.	5	AP	136.	7	K
49.	2	AP	71.	3	K	93.	4	K	115.	5	K	137.	7	K
50.	2	K	72.	3	K	94.	4	C	116.	5	AP	138.	7	K
51.	2	K	73.	3	K	95.	4	K	117.	5	AP	139.	7	K
52.	2	AP	74.	3	AP	96.	4	K	118.	5	AP	140.	7	K
53.	2	AP	75.	3	K	97.	4	K	119.	5	AP			
Brief Exercises														
141.	2	AP	143.	3	AP	145.	3	AP	147.	5	AP	149.	5	AP
142.	2	AP	144.	3	AP	146.	3	AP	148.	5	AP	150.	5	AP
Exercises														
151.	2	AP	155.	3	AP	159.	3	AP	163.	3	AP	167.	5	AN
152.	2	AN	156.	3	AP	160.	3	AP	164.	3	AP	168.	5	AP
153.	2	AP	157.	3,5	AN	161.	3	AP	165.	5,6	AN	169.	5	AN
154.	2,3	AP	158.	3,5	AN	162.	3	AP	166.	5	AP	170.	5,6	AP

[sg] This question also appears in the Study Guide.
[st] This question also appears in a self-test at the student companion website.

SUMMARY OF QUESTIONS BY LEARNING OBJECTIVES AND BLOOM'S TAXONOMY

Completion Statements														
171.	2	K	174.	3	K	177.	5	K	180.	5	K			
172.	2	K	175.	3	AP	178.	5	K	181.	5	K			
173.	3	K	176.	4	K	179.	5	K	182.	6	K			
Matching Statements														
183.	2	K												
Short-Answer Essay														
184.	3,5	K	186.	5	K	188.	5	K	190.	3	K			
185.	4	K	187.	5	K	189.	5	K						

SUMMARY OF LEARNING OBJECTIVES BY QUESTION TYPE

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Learning Objective 1													
1.	TF	26.	TF	33.	MC	35.	MC	125.	MC				
2.	TF	32.	MC	34.	MC	36.	MC						
Learning Objective 2													
3.	TF	27.	TF	41.	MC	46.	MC	51.	MC	141.	BE	154.	Ex
4.	TF	37.	MC	42.	MC	47.	MC	52.	MC	142.	BE	171.	C
5.	TF	38.	MC	43.	MC	48.	MC	53.	MC	151.	Ex	172.	C
6.	TF	39.	MC	44.	MC	49.	MC	126.	MC	152.	Ex	183.	Ma
7.	TF	40.	MC	45.	MC	50.	MC	127.	MC	153.	Ex		
Learning Objective 3													
8.	TF	58.	MC	69.	MC	80.	MC	91.	MC	155.	Ex	174.	C
9.	TF	59.	MC	70.	MC	81.	MC	92.	MC	156.	Ex	175.	C
10.	TF	60.	MC	71.	MC	82.	MC	128.	MC	157.	Ex	184.	SA
11.	TF	61.	MC	72.	MC	83.	MC	129.	MC	158.	Ex	190.	SA
12.	TF	62.	MC	73.	MC	84.	MC	130.	MC	159.	Ex		
13.	TF	63.	MC	74.	MC	85.	MC	131.	MC	160.	Ex		
28.	TF	64.	MC	75.	MC	86.	MC	143.	BE	161.	Ex		
54.	MC	65.	MC	76.	MC	87.	MC	144.	BE	162.	Ex		
55.	MC	66.	MC	77.	MC	88.	MC	145.	BE	163.	Ex		
56.	MC	67.	MC	78.	MC	89.	MC	146.	BE	164.	Ex		
57.	MC	68.	MC	79.	MC	90.	MC	154.	Ex	173.	C		
Learning Objective 4													
14.	TF	16.	TF	93.	MC	95.	MC	97.	MC	99.	MC	185.	SA
15.	TF	29.	TF	94.	MC	96.	MC	98.	MC	176.	C		
Learning Objective 5													
17.	TF	100.	MC	107.	MC	114.	MC	133.	MC	165.	Ex	178.	C
18.	TF	101.	MC	108.	MC	115.	MC	147.	BE	166.	Ex	179.	C
19.	TF	102.	MC	109.	MC	116.	MC	148.	BE	167.	Ex	180.	C
20.	TF	103.	MC	110.	MC	117.	MC	149.	BE	168.	Ex	181.	C
21.	TF	104.	MC	111.	MC	118.	MC	150.	BE	169.	Ex	186.	SA
22.	TF	105.	MC	112.	MC	119.	MC	157.	Ex	170.	Ex	187.	SA
30.	TF	106.	MC	113.	MC	132.	MC	158.	Ex	177.	C	188/189.	SA

Note: TF = True-False; MC = Multiple Choice; BE = Brief Exercise; Ex = Exercise; C = Completion

SUMMARY OF LEARNING OBJECTIVES BY QUESTION TYPE

Learning Objective 6													
23.	TF	31.	TF	122.	MC	134.	MC	165.	Ex	184.	SA		
24.	TF	120.	MC	123.	MC	135.	MC	170.	Ex	188.	SA		
25.	TF	121.	MC	124.	MC	164.	Ex	182.	C				
Learning Objective 7													
136.	MC	137.	MC	138.	MC	139.	MC	140.	MC				

Note: TF = True-False BE = Brief Exercise C = Completion
MC = Multiple Choice Ex = Exercise

The chapter also contains one set of ten Matching questions and Seven Short-Answer Essay questions.

CHAPTER LEARNING OBJECTIVES

1. ***Discuss why corporations invest in debt and stock securities.*** Corporations invest for three primary reasons: (a) They have excess cash; (b) They view investments as a significant revenue source; or (c) They have strategic goals such as gaining control of a competitor or moving into a new line of business.

2. ***Explain the accounting for debt investments.*** Companies record investments in debt securities when they purchase bonds, receive or accrue interest, and sell the bonds. They report gains or losses on the sale of bonds in the “Other revenues and gains” or “Other expenses and losses” sections of the income statement.

3. ***Explain the accounting for stock investments.*** Companies record investments in common stock when they purchase the stock, receive dividends, and sell the stock. When ownership is less than 20%, the cost method is used. When ownership is between 20% and 50%, the equity method should be used. When ownership is more than 50%, companies prepare consolidated financial statements.

4. ***Describe the use of consolidated financial statements.*** When a company owns more than 50% of the common stock of another company, it usually prepares consolidated financial statements. These statements indicate the magnitude and scope of operations of the companies under common control.

5. ***Indicate how debt and stock investments are reported in financial statements.*** Investments in debt and stock securities are classified as trading, available-for-sale, or held-to-maturity securities for valuation and reporting purposes. Trading securities are reported in current assets at fair value, with changes from cost reported in net income. Available-for-sale securities are also reported at fair value, with the changes from cost reported in stockholders’ equity. Available-for-sale securities are classified as short-term or long-term depending on their expected realization.

6. ***Distinguish between short-term and long-term investments.*** Short-term investments are securities that are (a) readily marketable and (b) intended to be converted to cash within the next year or operating cycle, whichever is longer. Investments that do not meet both criteria are classified as long-term investments.

TRUE-FALSE STATEMENTS

1. Corporations purchase investments in debt or stock securities generally for one of two reasons.

Ans: F, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Resource Management, AICPA FN: Decision Modeling, AICPA PC: Problem Solving, IMA: Business Economics

2. A reason some companies purchase investments is because they generate a significant portion of their earnings from investment income.

Ans: T, LO: 1, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Resource Management, AICPA FN: Decision Modeling, AICPA PC: Problem Solving, IMA: Business Economics

3. The accounting for short-term debt investments and for long-term debt investments is similar.

Ans: T, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: None, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

4. When debt investments, are sold, the gain or loss is the difference between the net proceeds from the sale and the fair value of the bonds.

Ans: F, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Resource Management, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

5. Debt investments are investments in government and corporation bonds.

Ans: T, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Risk Analysis, AICPA PC: Problem Solving, IMA: Business Economics

6. In accordance with the historical cost principle, brokerage fees should be added to the cost of an investment.

Ans: T, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

7. In accordance with the historical cost principle, the cost of debt investments includes brokerage fees and accrued interest.

Ans: F, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

8. In accounting for stock investments of less than 20%, the equity method is used.

Ans: F, LO: 3, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Resource Management, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Business Economics

9. Dividends received on stock investments of less than 20% should be credited to the Stock Investments account.

Ans: F, LO: 3, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Resource Management, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Business Economics

10. If an investor owns between 20% and 50% of an investee's common stock, it is presumed that the investor has significant influence on the investee.

Ans: T, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Resource Management, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Business Economics

11. The Stock Investments account is debited at acquisition under both the equity method and cost method of accounting for investments in common stock.

Ans: T, LO: 3, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

12. Under the equity method, the investment in common stock is initially recorded at cost, and the Stock Investments account is adjusted annually.

Ans: T, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

13. Under the equity method, the receipt of dividends from the investee company results in an increase in the Stock Investments account.

Ans: F, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

14. Consolidated financial statements are appropriate when an investor controls an investee by ownership of more than 50% of the investee's common stock.

Ans: T, LO: 4, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communications, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting

15. Consolidated financial statements are prepared in place of the financial statements for the parent and subsidiary companies.

Ans: F, LO: 4, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Communications, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting

16. Consolidated financial statements should be prepared only when a subsidiary company has a controlling interest in the parent company.

Ans: F, LO: 4, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communications, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting

17. The valuation of available-for-sale securities is similar to the procedures followed for trading securities, except that changes in fair value are not recognized in current income.

Ans: T, LO: 5, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Communications, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting

18. An unrealized gain or loss on trading securities is reported as a separate component of stockholders' equity.

Ans: F, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communications, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting

19. For available-for-sale securities, the unrealized gain or loss account is carried forward to future periods.

Ans: T, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communications, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting

20. A decline in the fair value of a trading security is recorded by debiting an unrealized loss account and crediting the Fair Value Adjustment account.

Ans: T, LO: 5, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Communications, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting

21. If the fair value of an available-for-sale security exceeds its cost, the security should be written up to fair value and a realized gain should be recognized.

Ans: F, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Communications, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting

22. The Fair Value Adjustment account can only have a credit balance or a zero balance.

Ans: F, LO: 5, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Communications, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting

23. To be classified as a short-term investment, the investment must be readily marketable and intended to be converted into cash within the next year or operating cycle.

Ans: T, SO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

24. An investment is readily marketable if it is management's intent to sell the investment.

Ans: F, SO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting

25. Stocks traded on the New York Stock Exchange are considered readily marketable.

Ans: T, SO: 6, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

26. One of the reasons a corporation may purchase investments is that it has excess cash.

Ans: T, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Resource Management, AICPA FN: Risk Analysis, AICPA PC: Problem Solving, IMA: Business Economics

27. When recording bond interest, Interest Receivable is reported as a fixed asset in the balance sheet.

Ans: F, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

28. Under the cost method, the investment is recorded at cost and revenue is recognized only when cash dividends are received.

Ans: T, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

29. Consolidated financial statements present a condensed version of the financial statements so investors will not experience information overload.

Ans: F, LO: 4, Bloom: C, Difficulty: Easy, Min: 1, AACSB: Communications, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting

30. Available-for-sale securities are securities bought and held primarily for sale in the near term to generate income on short-term price differences.

Ans: F, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Risk Analysis, AICPA PC: None, IMA: Business Economics

31. "Intent to convert" does not include an investment used as a resource that will be used whenever the need for cash arises.

Ans: F, SO: 6, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Business Economics

Answers to True-False Statements

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	F	6.	T	11.	T	16.	F	21.	F	26.	T	31.	F
2.	T	7.	F	12.	T	17.	T	22.	F	27.	F		
3.	T	8.	F	13.	F	18.	F	23.	T	28.	T		
4.	F	9.	F	14.	T	19.	T	24.	F	29.	F		
5.	T	10.	T	15.	F	20.	T	25.	T	30.	F		

MULTIPLE CHOICE QUESTIONS

32. Corporations invest excess cash for short periods of time in each of the following **except**
    a. equity securities.
    b. highly liquid securities.
    c. low-risk securities.
    d. government securities.

Ans: a, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Resource Management, AICPA FN: Reporting, AICPA PC: None, IMA: Business Economics

33. Corporations invest in other companies for all of the following reasons **except** to
    a. house excess cash until needed.
    b. generate earnings.
    c. meet strategic goals.
    d. increase trading of the other companies' stock.

Ans: d, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Resource Management, AICPA FN: Reporting, AICPA PC: None, IMA: Business Economics

34. A typical investment to house excess cash until needed is
    a. stocks of companies in a related industry.
    b. debt securities.
    c. low-risk, highly liquid securities.
    d. stock securities.

Ans: c, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Resource Management, AICPA FN: Risk Analysis, AICPA PC: None, IMA: Business Economics

35. A company may purchase a noncontrolling interest in another firm in a related industry
    a. to house excess cash until needed.
    b. to generate earnings.
    c. for strategic reasons.
    d. for speculative reasons.

Ans: c, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Resource Management, AICPA FN: Risk Analysis, AICPA PC: None, IMA: Business Economics

36. Pension funds and mutual funds regularly invest in debt and stock securities to
    a. generate earnings.
    b. house excess cash until needed.
    c. meet strategic goals.
    d. control the company in which they invest.

Ans: a, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Resource Management, AICPA FN: Risk Analysis, AICPA PC: None, IMA: Business Economics

37. At the time of acquisition of a debt investment,
    a. no journal entry is required.
    b. the historical cost principle applies.
    c. the Stock Investments account is debited when bonds are purchased.
    d. the Investment account is credited for its cost plus brokerage fees.

Ans: b, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: Business Economics

38. Which of the following is **not** a true statement regarding short-term debt investments?
    a. The securities usually pay interest.
    b. Investments are frequently government or corporate bonds.
    c. This type of investment must be currently traded in the securities market.
    d. Debt investments are recorded at the price paid less brokerage fees.

Ans: d, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Resource Management, AICPA FN: Risk Analysis, AICPA PC: None, IMA: Business Economics

39. On January 1, 2014, Brenner Company purchased at face value, a $1,000, 6% bond that pays interest on January 1 and July 1. Brenner Company has a calendar year end. The entry for the receipt of interest on July 1, 2014, is

a.	Cash	30	
	Interest Revenue		30
b.	Cash	60	
	Interest Revenue		60
c.	Interest Receivable	30	
	Interest Revenue		30
d.	Interest Receivable	60	
	Interest Revenue		60

Ans: a, LO: 2, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: 1,000 × .06 × 1/2 = $30

40. On January 1, 2014, Brenner Company purchased at face value, a $1,000, 8% bond that pays interest on January 1 and July 1. Brenner Company has a calendar year end. The adjusting entry on December 31, 2014, is
    a. not required.

b.	Cash	40	
	Interest Revenue		40
c.	Interest Receivable	40	
	Interest Revenue		40
d.	Interest Receivable	40	
	Debt Investments		40

Ans: c, LO: 2, Bloom: AN, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $1,000 × .08 × 1/2 = $40

41. On January 1, 2014, Brenner Company purchased at face value, a $1,000, 10% bond that pays interest on January 1 and July 1. Brenner Company has a calendar year end. The entry for the receipt of interest on January 1, 2015 is

a.	Cash	50	
	Interest Revenue		50
b.	Cash	50	
	Interest Receivable		50
c.	Cash	50	
	Interest Revenue		50
d.	Cash	50	
	Interest Receivable		50

Ans: d, LO: 2, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $1,000 × .1 × 1/2 = $50

42. On January 1, Skills Company purchased as a short-term investment a $1,000, 6% bond for $1,000. The bond pays interest on January 1 and July 1. The bond is sold on October 1 for $1,200 plus accrued interest. Interest has not been accrued since the last interest payment date. What is the entry to record the cash proceeds at the time the bond is sold?

a.	Cash	1,200	
	Debt Investments		1,200
b.	Cash	1,215	
	Debt Investments		1,000
	Gain on Sale of Debt Investments		200
	Interest Revenue		15
c.	Cash	1,215	
	Debt Investments		1,200
	Interest Revenue		15
d.	Cash	1,200	
	Debt Investments		1,000
	Gain on Sale of Debt Investments		200

Ans: b, LO: 2, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $\$1,200 - \$1,000 = 200$ gain; $\$1,000 \times .6 \times 3/12 = \$15$

43. Which of the following is ***not*** a true statement about the accounting for debt investments?
   a. At acquisition, the historical cost principle applies.
   b. The cost includes any brokerage fees.
   c. Debt investments include investments in government and corporation bonds.
   d. The cost includes any accrued interest.

Ans: d, LO: 2, Bloom: AN, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

44. The cost of debt investments includes each of the following **except**
   a. brokerage fees.
   b. commissions.
   c. accrued interest.
   d. the price paid.

Ans: c, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: FSA

45. If a short-term debt investment is sold, the Investment account is
   a. credited for the book value of the bonds at the sale date.
   b. credited for the cost of the bonds at the sale date.
   c. credited for the fair value of the bonds at the sale date.
   d. debited for the cost of the bonds at the sale date.

Ans: b, LO: 2, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: FSA

46. In accounting for debt investments, entries are made for each of the following **except** the
   a. acquisition.
   b. interest revenue.
   c. amortization of any discount or premium.
   d. sale.

Ans: c, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: FSA

47. Bay Company acquires 60, 8%, 5 year, $1,000 Community bonds on January 1, 2014 for $60,000.
The journal entry to record this investment includes a debit to
a. Debt Investments for $64,800.
b. Debt Investments for $60,000.
c. Cash for $60,000.
d. Stock Investments for $60,000.

Ans: b, LO: 2, Bloom: AP, Difficulty: Hard, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

48. Bay Company acquires 60, 8%, 5 year, $1,000 Community bonds on January 1, 2014 for $60,000.
Assume Community pays interest on January 1 and July 1, and the July 1 entry was done correctly. The journal entry at December 31, 2014 would include a credit to
a. Interest Receivable for $2,400.
b. Interest Revenue for $4,800.
c. Accrued Expense for $4,800.
d. Interest Revenue for $2,400.

Ans: d, LO: 2, Bloom: AP, Difficulty: Hard, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $60,000 × .08 × 1/2 = $2,400 Interest Revenue

49. Bay Company acquires 60, 8%, 5 year, $1,000 Community bonds on January 1, 2014 for $60,000.
If Bay sells all of its Community bonds for $64,500, what gain or loss is recognized?
a. Loss of $9,300
b. Loss of $4,500
c. Gain of $9,300
d. Gain of $4,500

Ans: d, LO: 2, Bloom: AP, Difficulty: Hard, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: ($64,500 – $60,000) = $4,500

50. Ban Co. purchased 50, 5% Waylan Company bonds for $50,000 cash plus brokerage fees of $500. Interest is payable semiannually on July 1 and January 1. The entry to record the July 1 semiannual interest payment would include a
a. debit to Interest Receivable for $1,250.
b. credit to Interest Revenue for $1,250.
c. credit to Interest Revenue for $1,262.50.
d. credit to Debt Investments for $1,262.50.

Ans: b, LO: 2, Bloom: K, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $50,000 × .05 × 1/2 = $1,250 Interest.

51. Ban Co. purchased 50, 5% Waylan Company bonds for $50,000 cash plus brokerage fees of $500. Interest is payable semiannually on July 1 and January 1. The entry to record the December 31 interest accrual would include a
    a. debit to Interest Receivable for $1,250.
    b. debit to Interest Revenue for $1,250.
    c. credit to Interest Revenue for $1,262.50.
    d. debit to Debt Investments for $1,262.50.

Ans: a, LO: 2, Bloom: K, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $\$50{,}000 \times .05 \times 1/2 = \$1{,}250$

52. Tempest Co. purchased 60, 6% Urich Company bonds for $60,000 cash. Interest is payable semiannually on July 1 and January 1. If 30 of the securities are sold on July 1 for $32,000, the entry would include a credit to Gain on Sale of Debt Investments for
    a. $1,600.
    b. $1,750.
    c. $1,800.
    d. $2,000.

Ans: d, LO: 2, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $(\$32{,}000) - (60{,}000 \times 1/2) = \$2{,}000$ Gain

53. On January 1, Hamm Company purchased as an investment a $1,000, 6% bond for $1,020. The bond pays interest on January 1 and July 1. What is the entry to record the interest accrual on December 31?

a. Interest Receivable	30	
Interest Revenue		30
b. Debt Investments	30	
Interest Revenue		30
c. Interest Receivable	60	
Interest Revenue		60
d. Debt Investments	60	
Interest Revenue		60

Ans: a, LO: 2, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $\$1{,}000 \times .06 \times 1/2 = \$30$ Interest

54. Beak Corporation sells 200 shares of common stock being held as an investment. The shares were acquired six months ago at a cost of $25 a share. Beak sold the shares for $40 a share. The entry to record the sale is

a. Cash	5,000	
Loss on Sale of Stock Investments	3,000	
Stock Investments		8,000
b. Stock Investments	8,000	
Cash		8,000
c. Cash	8,000	
Gain on Sale of Stock Investments		3,000
Stock Investments		5,000
d. Cash	8,000	
Stock Investments		8,000

Ans: c, LO: 3, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $(200 \times \$40) - (200 \times 25) = \$3{,}000$ Gain

55. Yeloe Corporation sells 400 shares of common stock being held as an investment. The shares were acquired six months ago at a cost of $60 a share. Yeloe sold the shares for $40 a share. The entry to record the sale is

a.	Cash	16,000	
	Loss on Sale of Stock Investments	8,000	
	Stock Investments		24,000
b.	Cash	24,000	
	Gain on Sale of Stock Investments		8,000
	Stock Investments		16,000
c.	Cash	16,000	
	Stock Investments		6,000
d.	Stock Investments	16,000	
	Loss on Sale of Stock Investments	8,000	
	Cash		24,000

Ans: a, LO: 3, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: (400 × $60) − (400 × $40) = $8,000 Loss

56. Blaine Company had these transactions pertaining to stock investments:
Feb. 1 Purchased 2,000 shares of Horton Company (10%) for $51,000 cash.
June 1 Received cash dividends of $2 per share on Horton stock.
Oct. 1 Sold 1,200 shares of Horton stock for $32,400.
The entry to record the purchase of the Horton stock would include a

a. debit to Stock Investments for $45,900.
b. credit to Cash for $45,900.
c. debit to Stock Investments for $51,000.
d. debit to Investment Expense for $5,100.

Ans: c, LO: 3, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

57. Blaine Company had these transactions pertaining to stock investments:
Feb. 1 Purchased 2,000 shares of Horton Company (10%) for $51,000 cash.
June 1 Received cash dividends of $3 per share on Horton stock.
Oct. 1 Sold 1,200 shares of Horton stock for $32,400.
The entry to record the receipt of the dividends on June 1 would include a

a. debit to Stock Investments for $6,000.
b. credit to Dividend Revenue for $6,000.
c. debit to Dividend Revenue for $6,000.
d. credit to Stock Investments for $6,000.

Ans: b, LO: 3, Bloom: K, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: 2,000 × $3 = $6,000 Dividend Revenue.

58. Blaine Company had these transactions pertaining to stock investments:
Feb. 1 Purchased 2,000 shares of Norton Company (10%) for $51,000.
June 1 Received cash dividends of $2 per share on Horton stock.
Oct. 1 Sold 1,200 shares of Horton stock for $33,000 less brokerage fees of $600.
The entry to record the sale of the stock would include a
a. debit to Cash for $32,400.
b. credit to Gain on Sale of Stock Investments for $1,200.
c. debit to Stock Investments for $30,600.
d. credit to Gain on Sale of Stock Investments for $1,800.

Ans: d, LO: 3, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $32,400 − ($51,000 × 1,200 / 2,000) = $1,800 Gain

59. Mize Company owns 30% interest in the stock of Lyte Corporation. During the year, Lyte pays $20,000 in dividends to Mize, and reports $300,000 in net income. Mize Company's investment in Lyte will increase Mize′s net income by
a. $6,000.
b. $90,000.
c. $96,000.
d. $10,000.

Ans: b, LO: 3, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

Solution: $300,000 × 30% = $90,000

60. Penny Company owns 20% interest in the stock of Lynn Corporation. During the year, Lynn pays $25,000 in dividends, and reports $200,000 in net income. Penny Company's investment in Lynn will increase by
a. $25,000.
b. $40,000.
c. $45,000.
d. $35,000.

Ans: d, LO: 3, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: ($200,000 × 20%) − ($25,000 × 20%) = $35,000

61. On January 1, 2014, Grgante Corporation purchased 25% of the common stock outstanding of Sheat Corporation for $270,000. During 2014, Long Corporation reported net income of $80,000 and paid cash dividends of $40,000. The balance of the Stock Investments—Long account on the books of Grgante Corporation at December 31, 2014 is
a. $270,000.
b. $310,000.
c. $350,000.
d. $280,000.

Ans: d, LO: 3, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

Solution: $270,000 + 25% ($80,000 − $40,000) = $280,000

62. Gayton Corporation purchased 1,000 shares of Smart common stock ($50 par) at $80 per share as a short-term investment. The shares were subsequently sold at $78 per share. The cost of the securities purchased and gain or loss on the sale were

	Cost	Gain or Loss
a.	$50,000	$2,000 gain
b.	$50,000	$2,000 loss
c.	$80,000	$2,000 gain
d.	$80,000	$2,000 loss

Ans: d, LO: 3, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

Solution: (($78 × 1,000) - (80, × 1,000) = $2,000 Loss

63. In accounting for stock investments between 20% and 50%, the _______ method is used.
a. consolidated statements
b. controlling interest
c. cost
d. equity

Ans: d, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: FSA

64. When a company holds stock of several different corporations, the group of securities is identified as a(n)
a. affiliated investment.
b. consolidated portfolio.
c. investment portfolio.
d. controlling interest.

Ans: c, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

65. Roxy Corporation makes a short-term investment in 180 shares of Sager Company's common stock. The stock is purchased for $53 a share. The entry for the purchase is

a.	Debt Investments	9,540	
	Cash		9,540
b.	Stock Investments	9,540	
	Cash		9,540
c.	Stock Investments	9,000	
	Cash		9,000
d.	Stock Investments	9,000	
	Cash		9,000

Ans: b, LO: 3, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: (180 × $53) = $9,540

66. Alistair Corporation sells 500 shares of common stock being held as a short-term investment. The shares were acquired six months ago at a cost of $55 a share. Alistair sold the shares for $40 a share. The entry to record the sale is

a.	Cash	20,000	
	Loss on Sale of Stock Investments	7,500	
	Stock Investments		27,500
b.	Cash	27,500	
	Gain on Sale of Stock Investments		7,500
	Stock Investments		20,000
c.	Cash	20,000	
	Stock Investments		20,000

d.	Stock Investments	20,000	
	Loss on Sale of Stock Investments	7,500	
	Cash		27,000

Ans: a, LO: 3, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: (500 × \$55) – (500 × \$40) = \$7,500 Loss

67. For accounting purposes, the method used to account for long-term investments in common stock is determined by
   a. the amount paid for the stock by the investor.
   b. the extent of an investor's influence on the operating and financial affairs of the investee.
   c. whether the stock has paid dividends in past years.
   d. whether the acquisition of the stock by the investor was "friendly" or "hostile."

Ans: b, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: FSA

68. If an investor owns less than 20% of the common stock of another corporation as a long-term investment,
   a. the equity method of accounting for the investment should be employed.
   b. no dividends can be expected.
   c. it is presumed that the investor has relatively little influence on the investee.
   d. it is presumed that the investor has significant influence on the investee.

Ans: c, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

69. If the cost method is used to account for a long-term investment in common stock, dividends received should be
   a. credited to the Stock Investments account.
   b. credited to the Dividend Revenue account.
   c. debited to the Stock Investments account.
   d. recorded only when 20% or more of the stock is owned.

Ans: b, LO: 3, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: FSA

70. If 10% of the common stock of an investee company is purchased as a long-term investment, the appropriate method of accounting for the investment is
   a. the cost method.
   b. the equity method.
   c. the preparation of consolidated financial statements.
   d. determined by agreement with whomever owns the remaining 90% of the stock.

Ans: a, LO: 3, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

71. The cost method of accounting for long-term investments in stock should be employed when the
   a. investor owns more than 50% of the investee's stock.
   b. investor has significant influence on the investee and the stock held by the investor are marketable equity securities.
   c. market value of the shares held is greater than their historical cost.
   d. investor's influence on the investee is insignificant.

Ans: d, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

72. When an investor owns between 20% and 50% of the common stock of a corporation, it is generally presumed that the investor
   a. has insignificant influence on the investee and that the cost method should be used to account for the investment.

b. should apply the cost method in accounting for the investment.
c. will prepare consolidated financial statements.
d. has significant influence on the investee and that the equity method should be used to account for the investment.

Ans: d, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

73. Under the equity method of accounting for long-term investments in common stock, when a dividend is received from the investee company,
a. the Dividend Revenue account is credited.
b. the Stock Investments account is increased.
c. the Stock Investments account is decreased.
d. no entry is necessary.

Ans: c, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: FSA

74. On January 1, 2014, Lark Corporation purchased 35% of the common stock outstanding of Dinc Corporation for $700,000. During 2014, Dinc Corporation reported net income of $200,000 and paid cash dividends of $100,000. The balance of the Stock Investments—Run account on the books of Lark Corporation at December 31, 2014 is
a. $700,000.
b. $735,000.
c. $770,000.
d. $665,000.

Ans: b, LO: 3, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

Solution: $700,000 + 35% ($200,000 − $100,000) = $735,000

75. Under the equity method, the Stock Investments account is increased when the
a. investee company reports net income.
b. investee company pays a dividend.
c. investee company reports a loss.
d. stock investment is sold at a gain.

Ans: a, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

76. The account, Stock Investments, is
a. a subsidiary ledger account.
b. a long-term liability account.
c. a general ledger control account.
d. another name for Debt Investments.

Ans: c, LO: 3, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

77. Which of the following would ***not*** be considered a motive for making a stock investment in another corporation?
a. Appreciation in the market value of the stock investment
b. Use of the investment for expanding its own operations
c. Use of the investment to diversify its own operations
d. An increase in the amount of interest revenue from the stock investment

Ans: d, LO: 3, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Resource Management, AICPA FN: Risk Analysis, AICPA PC: None, IMA: Business Economics

78. Revenue is recognized when cash dividends are received under
a. the controlling interest method.
b. the cost method.
c. the equity method.

d. both the cost and equity methods.

Ans: b, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

79. Which of the following is the correct matching concerning an investor's influence on the operations and financial affairs of an investee?

	% of Investor Ownership	Presumed Influence
a.	Less than 20%	Short-term
b.	Between 20%-50%	Significant
c.	More than 50%	Long-term
d.	Between 20%-50%	Controlling

Ans: b, LO: 3, Bloom: K, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

80. Which of the following is the correct matching concerning the appropriate accounting for long-term stock investments?

	% of Investor Ownership	Accounting Guidelines
a.	Less than 20%	Cost method
b.	Between 20%–50%	Cost method
c.	More than 50%	Cost or equity method
d.	Between 20%–50%	Consolidated financial statements

Ans: a, LO: 3, Bloom: K, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

81. If the cost method is used to account for a long-term investment in common stock,
   a. it is presumed that the investor has significant influence on the investee.
   b. the earning of net income by the investee is considered a proper basis for recognition of income by the investor.
   c. net income of the investee is not considered earned by the investor until dividends are declared by the investee.
   d. the Investment account may be, at times, greater than the acquisition cost.

Ans: c, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

82. If a company acquires a 40% common stock interest in another company,
   a. the equity method is usually applicable.
   b. all influence is classified as controlling.
   c. the cost method is usually applicable.
   d. the ability to exert significant influence over the activities of the investee does not exist.

Ans: a, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

83. If a common stock investment is sold at a gain, the gain
   a. is reported as operating revenue.
   b. is reported under a special section, "Discontinued investments," on the income statement.
   c. is reported in the Other revenues and gains section of the income statement.
   d. contributes to gross profit on the income statement.

Ans: c, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

84. If the equity method is being used, cash dividends received
    a. are credited to Dividend Revenue.
    b. require no entry because investee net income has already been recorded at the proper proportion on the investor's books.
    c. are credited to the Stock Investments account.
    d. are credited to the Revenue from Stock Investments account.

Ans: c, LO: 3, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: FSA

85. If the equity method is being used, the Revenue from Stock Investments account is
    a. just another name for a Dividend Revenue account.
    b. credited when dividends are declared by the investee.
    c. credited when net income is reported by the investee.
    d. debited when dividends are declared by the investee.

Ans: c, LO: 3, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: FSA

86. Under the equity method, the Stock Investments account is credited when the
    a. investee reports net income.
    b. investee reports a net loss.
    c. investment is originally acquired.
    d. investee reports net income and when the investment is originally acquired.

Ans: b, LO: 3, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: FSA

87. On August 1, Masters Company buys 2,000 shares of ABD common stock for $72,500 cash. On December 1, the stock investments are sold for $75,000 in cash. Which of the following are the correct journal entries to record for the purchase and sale of the common stock?

a.	Aug. 1	Cash	72,500	
		Stock Investments		72,500
	Dec. 1	Cash	75,000	
		Stock Investments		72,500
		Gain on Sale of Stock Investments		2,500
b.	Aug. 1	Stock Investments	72,500	
		Cash		72,500
	Dec. 1	Cash	75,000	
		Stock Investments		72,500
		Gain on Sale of Stock Investments		2,500
c.	Aug. 1	Stock Investments	72,500	
		Cash		72,500
	Dec. 1	Stock Investments	75,000	
		Cash		72,500
		Gain on Sale of Stock Investments		2,500
d.	Aug. 1	Cash	72,500	
		Stock Investments		72,500
	Dec. 1	Stock Investments	75,000	
		Cash		72,500
		Gain on Sale of Stock Investments		2,500

Ans: b, LO: 3, Bloom: AP, Difficulty: Medium, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $75,000 - $72,500 = $2,500 Gain

88. Cody Industries owns 35% of Macarthy Company. For the current year, Macarthy reports net income of $250,000 and declares and pays a $60,000 cash dividend. Which of the following correctly presents the journal entries to record Cody's equity in Macarthy's net income and the receipt of dividends from Macarthy?

a.	Dec. 31	Stock Investments................................	87,500	
		Revenue from Stock Investments ….		87,500
	Dec. 31	Cash..	21,000	
		Stock Investments		21,000
b.	Dec. 31	Stock Investments.................................	87,500	
		Revenue from Stock Investments ….		87,500
	Dec. 31	Cash..	60,000	
		Stock Investments		60,000
c.	Dec. 31	Stock Investments..............................	66,500	
		Revenue from Stock Investments …		66,500
d.	Dec. 31	Revenue from Stock Investments ……….	87,500	
		Stock Investments		87,500
	Dec. 31	Stock Investments...............................	21,000	
		Cash		21,000

Ans: a, LO: 3, Bloom: AP, Difficulty: Hard, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $250,000 × 35% = $87,500 Revenue; $60,000 × 35% = $21,000 Decrease in Stock Investment

89. On January 1, 2014, Gene Corp. paid $800,000 for 100,000 shares of Onofine Company's common stock, which represents 30% of Onofine′s outstanding common stock. Onofine reported net income of $200,000 and paid cash dividends of $60,000 during 2014. Gene should report the investment in Onofine Company on its December 31, 2014, balance sheet at:
    a. $800,000
    b. $758,000
    c. $818,000
    d. $842,000

Ans: d, LO: 3, Bloom: AN, Difficulty: Medium, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

Solution: $800,000 + 30% ($200,000 − $60,0000) = 842,000

90. Viejo Inc. earns $60,000 and pays cash dividends of $150,000 during 2014. Cruz Corporation owns 73,500 of the 210,000 outstanding shares of Viejo.
    What amount should Cruz show in the investment account at December 31, 2014 if the beginning of the year balance in the account was $40,000?
    a. $197,500
    b. $210,000
    c. $157,500
    d. $250,000

Ans: a, LO: 3, Bloom: AN, Difficulty: Medium, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

Solution: $40,000 + 35% ($600,000 − $150,000) = $197,500

91. Viejo Inc. earns $450,000 and pays cash dividends of $150,000 during 2014. Cruz Corporation owns 73,500 of the 210,000 outstanding shares of Viejo.
How much revenue from investment should Viejo report in 2014?
    a. $52,500
    b. $105,000
    c. $157,500
    d. $210,000

Ans: c, LO: 3, Bloom: AN, Difficulty: Medium, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

Solution: 35% × $450,000 = $157,500

92. On January 1, 2014, Dumas Industries acquired a 18% interest in Arlongton Corporation through the purchase of 12,000 shares of Arlongton Corporation common stock for $250,000. During 2014, Arlongton Corp. paid $60,000 in dividends and reported a net loss of $90,000. Dumas is able to exert significant influence on Arlongton. However, Dumas mistakenly records these transactions using the cost method rather than the equity method of accounting. Which of the following would show the correct presentation for Dumas's investment using the equity method?

	Investment Account	*Net Earnings (loss)*
a.	$90,000	($30,000)
b.	$223,000	($16,200)
c.	$233,800	($16,200)
d.	$233,800	($5,400)

Ans: b, LO: 3, Bloom: AN, Difficulty: Medium, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

Solution: $90,000 × 18% = ($16,200); $250,000 − $16,200 − ($60,000 × 18%) = $223,000

93. Consolidated financial statements are prepared when a company owns _________ of the common stock of another company.
    a. less than 20%
    b. between 20% and 50%
    c. less than 50%
    d. more than 50%

Ans: d, LO: 4, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

94. Consolidated financial statements present all of the following **except** the
    a. individual assets and liabilities of the parent company
    b. individual assets and liabilities of the subsidiary.
    c. total revenues and expenses of the subsidiary.
    d. All of these are presented in consolidated financial statements.

Ans: d, LO: 4, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

95. The company whose stock is owned by the parent company is called the
    a. controlled company.
    b. subsidiary company.
    c. investee company.
    d. sibling company.

Ans: b, LO: 4, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

96. A company that owns more than 50% of the common stock of another company is known as the
   a. charge company.
   b. subsidiary company.
   c. parent company.
   d. management company.

Ans: c, LO: 4, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

97. If one company owns more than 50% of the common stock of another company,
   a. the cost method should be used to account for the investment.
   b. a partnership exists.
   c. a parent-subsidiary relationship exists.
   d. the company whose stock is owned must be liquidated.

Ans: c, LO: 4, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

98. If a parent company has two wholly owned subsidiaries, how many legal and economic entities are there from the viewpoint of the shareholders of the parent company?

	Legal	Economic
a.	3	3
b.	1	2
c.	3	1
d.	2	1

Ans: c, LO: 4, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

99. When a company owns more than 50% of the common stock of another company,
   a. affiliated financial statements are prepared.
   b. consolidated financial statements are prepared.
   c. controlling financial statements are prepared.
   d. significant financial statements are prepared.

Ans: b, LO: 4, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

100. Changes from cost are reported as part of net income for
   a. available-for-sale securities.
   b. held-to-maturity securities.
   c. debt securities.
   d. trading securities.

Ans: d, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

101. Short-term investments are listed on the balance sheet immediately below
   a. cash.
   b. inventory.
   c. accounts receivable.
   d. prepaid expenses.

Ans: a, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

102. Short-term stock investments should be valued on the balance sheet at
   a. the lower of cost or fair value.
   b. the higher of cost or fair value.
   c. cost.
   d. fair value.

Ans: d, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

103. In recognizing a decline in the fair value of short-term stock investments, an unrealized loss account is debited because
   a. management intends to realize this loss in the near future.
   b. the securities have not been sold.
   c. the stock market is volatile.
   d. management cannot determine the exact amount of the loss in value.

Ans: b, LO: 5, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

104. The Fair Value Adjustment account
   a. is set up for each security in the company's portfolio.
   b. relates to the entire portfolio of securities held by the company.
   c. is closed at the end of each accounting period.
   d. appears on the income statement as Other Expenses and Losses.

Ans: b, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

105. The contra-account, Fair Value Adjustment, is also called a(n)
   a. offset account.
   b. adjustment account.
   c. valuation account.
   d. opposite account.

Ans: c, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

106. Reporting investments at fair value is
   a. applicable to stock securities only.
   b. applicable to debt securities only.
   c. applicable to both debt and stock securities.
   d. a conservative approach because only losses are recognized.

Ans: c, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

107. Brandy Corporation's trading portfolio at the end of the year is as follows:

Security	Cost	Fair Value
Common Stock C	$10,000	$12,000
Common Stock D	9,000	5,000
	$19,000	$17,000

At the end of the year, Brandy Corporation should
   a. set up a Fair Value Adjustment account for Stock D.
   b. set up a Fair Value Adjustment account for the portfolio.
   c. recognize an Unrealized Gain or Loss—Income for $4,000.
   d. report a loss on the income statement for $4,000 under "Other expenses and losses."

Ans: b, LO: 5, Bloom: AP, Difficulty: Medium, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

108. Brandy Corporation's trading portfolio at the end of the year is as follows:

Security	Cost	Fair Value
Common Stock C	$10,000	$12,000
Common Stock D	8,000	5,000
	$18,000	$17,000

Brandy subsequently sells Stock D for $10,000. What entry is made to record the sale?

a. Cash	10,000	
Stock Investments		10,000

MC 108. (cont.)

b. Cash	10,000	
Fair Value Adjustment Trading		2,000
Stock Investments		8,000
c. Cash	10,000	
Stock Investments		8,000
Gain on Sale of Stock Investments		2,000
d. Cash	10,000	
Stock Investments		5,000
Gain on Sale of Stock Investments		5,000

Ans: c, LO: 5, Bloom: AP, Difficulty: Medium, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

Solution: \$10,000 – \$8,000 = \$2,000 Gain

109. Which of the following would **not** be reported under "Other Revenues and Gains" on the income statement?
   a. Unrealized gain on available-for-sale securities
   b. Dividend revenue
   c. Interest revenue
   d. Gain on sale of short-term debt investments

Ans: a, LO: 5, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

110. The balance in the Unrealized Gain or Loss—Equity account will
   a. appear on the balance sheet as a contra asset.
   b. appear on the income statement under Other Expenses and Losses.
   c. appear as a deduction in the stockholders' equity section.
   d. not be shown on the financial statements until the securities are sold.

Ans: c, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

111. If the cost of an available-for-sale security exceeds its fair value by \$40,000, the entry to recognize the loss
   a. is not required since the share prices will likely rebound in the long run.
   b. will show a debit to an expense account.
   c. will show a credit to a contra-asset account that appears in the stockholders' equity section of the balance sheet.
   d. will show a debit to an unrealized loss account that is deducted in the stockholders' equity section of the balance sheet.

Ans: d, LO: 5, Bloom: C, Difficulty: Medium, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

112. The balance sheet presentation of an unrealized loss on an available-for-sale security is similar to the statement presentation of
   a. treasury stock.
   b. discount on bonds payable.
   c. allowance for doubtful accounts.
   d. prepaid expenses.

Ans: a, LO: 5, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

113. At the end of its first year, the trading securities portfolio consisted of the following common stocks.

	Cost	Fair Value
Atrium Corporation	$ 46,500	$ 50,000
Barnes Inc.	60,000	58,000
Cantor Corporation	80,000	76,400
	$186,500	$184,400

The unrealized loss to be recognized under the fair value method is
a. $2,000.
b. $5,600.
c. $2,100.
d. $3,600.

Ans: c, LO: 5, Bloom: K, Difficulty: Hard, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $186,500 – $184,400 = $2,100 Loss

114. At the end of its first year, the trading securities portfolio consisted of the following common stocks.

	Cost	Fair Value
Atrium Corporation	$ 46,500	$ 50,000
Barnes Inc.	60,000	58,000
Cantor Corporation	80,000	76,400
	$186,500	$184,400

In the following year, the Barnes common stock is sold for cash proceeds of $57,000. The gain or loss to be recognized on the sale is a
a. gain of $1,200.
b. loss of $3,000.
c. Loss of $1,000.
d. loss of $2,000.

Ans: b, LO: 5, Bloom: AP, Difficulty: Hard, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $60,000 – $57,000 = $3,000 Loss

115. At the end of the first year of operations, the total cost of the trading securities portfolio is $245,000. Total fair value is $250,000. The financial statements should show
a. an addition to an asset of $5,000 and a realized gain of $5,000.
b. an addition to an asset of $5,000 and an unrealized gain of $5,000 in the stockholders' equity section.
c. an addition to an asset of $5,000 in the current assets section and an unrealized gain of $5,000 in "Other revenues and gains."
d. an addition to an asset of $5,000 in the current assets section and a realized gain of $5,000 in "Other revenues and gains."

Ans: c, LO: 5, Bloom: K, Difficulty: Hard, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

116. Comanic Corp. has common stock of $5,400,000, retained earnings of $2,000,000, unrealized gains on trading securities of $100,000 and unrealized losses on available-for-sale securities of $200,000. What is the total amount of its stockholders' equity?
   a. $7,200,000
   b. $7,400,000
   c. $7,300,000
   d. $7,500,000

Ans: a, LO: 5, Bloom: AP, Difficulty: Hard, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

Solution: $5,400,000 + $2,000,000 − $200,000 = $7,200,000

117. Cost and fair value data for the trading securities of McMahon Company at December 31, 2014, are $110,000 and $85,000, respectively. Which of the following correctly presents the adjusting journal entry to record the securities at fair value?

a.	Dec. 31	Unrealized Loss—Income	25,000	
		Trading Securities........................		25,000
b.	Dec. 31	Unrealized Gain—Income	25,000	
		Trading Securities..........................		25,000
c.	Dec. 31	Unrealized Loss—Income	25,000	
		Fair Value Adjustment—Trading....		25,000
d.	Dec. 31	Fair Value Adjustment -Trading...........	25,000	
		Unrealized Gain-Income................		25,000

Ans: c, LO: 5, Bloom: AP, Difficulty: Medium, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $110,000 − $85,000 = $25,000 Unrealized Loss Income

118. At December 31, 2014, the trading securities for Saddle, Inc. are as follows:

Security	Cost	Fair Value 12/31/14
A	$90,000	$94,000
B	150,000	141,000
C	32,000	30,000

Saddle should report the following amount related to the securities in its 2014 income statement:

   a. $4,000 gain
   b. $7,000 realized loss.
   c. $7,000 unrealized loss.
   d. $11,000 unrealized loss.

Ans: c, LO: 5, Bloom: AP, Difficulty: Hard, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

Solution: ($90,000 + $150,000 + $32,000) − ($94,000 + $141,000 + $30,000) = $7,000 Unrealized Loss

119. At December 31, 2014, Delta Inc. has these data on its security investments:

Security	Cost	Fair Value 12/31/14
Trading	$ 140,000	$190,000
Available-for-sale	137,000	122,000

If the available-for-sale securities are held as long-term investments, which of the following will be recorded to adjust the securities to fair value?

a.

Securities	35,000	
Unrealized Gain—Income		35,000

b.

Unrealized Loss—Income	15,000	
Securities	35,000	
Unrealized Gain—Income		50,000

c.

Fair Value Adjustment—Trading	50,000	
Unrealized Gain—Income		50,000
Unrealized Gain or Loss—Equity	15,000	
Fair Value Adjustment—Available-for-Sale		15,000

d.

Unrealized Gain—Income	50,000	
Fair Value Adjustment—Trading		50,000
Fair Value Adjustment—Available-for-Sale	15,000	
Unrealized Gain or Loss—Equity		15,000

Ans: c, LO: 5, Bloom: AP, Difficulty: Hard, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution: $190,000 − $140,000 = $50,000 Unrealized Gain-Income; $137,000 − $122,000 = $15,000 Unrealized Loss-Equity

120. All of the following statements about short-term investments are true **except**:
a. Short-term investments are also called marketable securities
b. Trading securities are always classified as short-term investments.
c. Short-term investments are listed below accounts receivable in the current asset section of the balance sheet.
d. Short-term assets must be readily marketable.

Ans: c, SO: 6, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

121. Available-for-sale securities are classified as
a. short-term investments only.
b. long-term investments only.
c. either short-term or long-term investments.
d. current assets only.

Ans: c, SO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

122. Which one of the following would **not** be classified as a short-term investment?
a. Marketable stock securities
b. Equity method investments
c. Marketable debt securities
d. Short-term paper

Ans: b, SO: 6, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

123. Short-term investments are securities that are readily marketable and intended to be converted into cash within the next
   a. year.
   b. two years.
   c. year or operating cycle, whichever is shorter.
   d. year or operating cycle, whichever is longer.

Ans: d, SO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Resource Management, AICPA FN: Measurement, AICPA PC: None, IMA: Business Economics

124. Which of the following would **not** be classified as a short-term investment?
   a. Short-term commercial paper
   b. Idle cash in a bank checking account
   c. Marketable stock securities
   d. Marketable debt securities

Ans: b, SO: 6, Bloom: C, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

125. Which of the following reasons best explains why a company that experiences seasonal fluctuations in sales may purchase investments in debt or stock securities?
   a. The company may have excess cash.
   b. The company may generate a significant portion of its earnings from investment income.
   c. The company may invest for the strategic reason of establishing a presence in a related industry.
   d. The company may invest for speculative reasons to increase the value in pension funds.

Ans: a, LO: 1, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Risk Analysis, AICPA PC: Problem Solving, IMA: Business Economics

126. When bonds are sold, the gain or loss on sale is the difference between the
   a. sales price and the cost of the bonds.
   b. net proceeds and the cost of the bonds.
   c. sales price and the market value of the bonds.
   d. net proceeds and the market value of the bonds.

Ans: b, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: FSA

127. Debt investments are recorded at the
   a. face value of the bonds purchased.
   b. face value of the bonds purchased plus interest.
   c. price paid for the bonds plus interest.
   d. price paid for the bonds plus brokerage fees.

Ans: d, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: FSA

128. Under the equity method, the investor records dividends received by crediting
   a. Dividend Revenue.
   b. Investment Income.
   c. Revenue from Investment.
   d. Stock Investments.

Ans: d, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: FSA

129. A company that acquires less than 20% ownership interest in another company should account for the stock investment in that company using
   a. the cost method.
   b. the equity method.
   c. the significant method.
   d. consolidated financial statements.

Ans: a, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

130. The equity method of accounting for an investment in the common stock of another company should be used by the investor when the investment
   a. is composed of common stock and it is the investor's intent to vote the common stock.
   b. ensures a source of supply of raw materials for the investor.
   c. enables the investor to exercise significant influence over the investee.
   d. is obtained by an exchange of stock for stock.

Ans: c, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

131. On January 2, Angle Corporation acquired 40% of the outstanding common stock of Bobbe Company for $550,000. For the year ended December 31, Bobbe reported net income of $90,000 and paid cash dividends of $30,000 on its common stock. At December 31, the carrying value of Angle's investment in Bobbe under the equity method is
   a. $538,000.
   b. $550,000.
   c. $586,000.
   d. $574,000.

Ans: d, LO: 3, Bloom: AP, Difficulty: Medium, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

Solution: $550,000 + 40% ($90,000 – $30,000) = $574,000

132. An unrealized loss on available-for-sale securities is
   a. reported under Other Expenses and Losses in the income statement.
   b. closed-out at the end of the accounting period.
   c. reported as a separate component of stockholders' equity.
   d. deducted from the cost of the investment.

Ans: c, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

133. Securities bought and held primarily for sale in the near term to generate income on short-term price differences are
   a. trading securities.
   b. available-for-sale securities.
   c. never-sell securities.
   d. held-to-maturity securities.

Ans: a, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

134. Short-term investments are
   a. (1) readily marketable and (2) intended to be converted into cash after the current year or operating cycle, whichever is shorter.
   b. (1) readily marketable and (2) intended to be converted into cash within the current year or operating cycle, whichever is longer.
   c. (1) readily marketable and (2) intended to be converted into cash after the current year or operating cycle, whichever is longer.

MC 134. (cont.)

d. (1) readily marketable and (2) intended to be converted into cash within the current year or operating cycle, whichever is shorter.

Ans: b, LO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Risk Analysis, AICPA PC: None, IMA: Business Economics

135. Short-term investments are securities held by a company that are
 a. readily marketable.
 b. intended to be converted into cash within the next year.
 c. readily marketable and intended to be converted into cash within the next year or operating cycle, whichever is longer.
 d. readily marketable and intended to be held until maturity.

Ans: c, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Risk Analysis, AICPA PC: None, IMA: Business Economics

136. Debt investments that are held to maturity are recorded at
 a. amortized cost.
 b. fair value.
 c. original cost.
 d. maturity value.

IFRS: Ans: a, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Risk Analysis, AICPA PC: None, IMA: Business Economics

137. Equity investments are generally recorded and reported at
 a. amortized cost.
 b. fair value.
 c. original cost.
 d. maturity value.

IFRS: Ans: b, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Risk Analysis, AICPA PC: None, IMA: Business Economics

138. Which of the following investment classifications are the same for GAAP and IFRS?
 a. Available-for-sale
 b. Held-to-maturity
 c. Non-trading
 d. Trading.

IFRS Ans: d, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Risk Analysis, AICPA PC: None, IMA: Business Economics

139. Which of the following are accounted for at amortized cost?
 a. Held-for-collection investments
 b. Held-to-maturity investments
 c. Non-trading equity investments
 d. Both Held-for-collection and Held-to-maturity investments

IFRS: Ans: d, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Risk Analysis, AICPA PC: None, IMA: Business Economics

140. Unrealized gains and losses related to available-for-sale/non-trading equity investments are reported in other comprehensive income under
 a. GAAP only.
 b. IFRS only.
 c. Both GAAP and IFRS.
 d. Neither GAAP or IFRS.

IFRS Ans: c, LO: 7, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Risk Analysis, AICPA PC: None, IMA: Business Economics

Answers to Multiple Choice Questions

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
32.	a	49.	d	66.	a	83.	c	100.	d	117.	c	134.	b
33.	d	50.	b	67.	b	84.	c	101.	a	118.	c	135.	c
34.	c	51.	a	68.	c	85.	c	102.	d	119.	c	136.	a
35.	c	52.	d	69.	b	86.	b	103.	b	120.	c	137.	b
36.	a	53.	a	70.	a	87.	b	104.	b	121.	c	138.	d
37.	b	54.	c	71.	d	88.	a	105.	c	122.	b	139.	d
38.	d	55.	a	72.	d	89.	d	106.	c	123.	d	140.	c
39.	a	56.	c	73.	c	90.	a	107.	b	124.	b		
40.	c	57.	b	74.	b	91.	c	108.	c	125.	a		
41.	d	58.	d	75.	a	92.	b	109.	a	126.	b		
42.	b	59.	b	76.	c	93.	d	110.	c	127.	d		
43.	d	60.	d	77.	d	94.	d	111.	d	128.	d		
44.	c	61.	d	78.	b	95.	b	112.	a	129.	a		
45.	b	62.	d	79.	b	96.	c	113.	c	130.	c		
46.	c	63.	d	80.	a	97.	c	114.	b	131.	d		
47.	b	64.	c	81.	c	98.	c	115.	c	132.	c		
48.	d	65.	b	82.	a	99.	b	116.	a	133.	a		

BRIEF EXERCISES

BE 141

On January 14, Balcom Corporation purchased 20, 11%, $1,000 Eiger Company bonds for $20,000, plus brokerage fees of $400. On November 30, the company sold 10 of the Eiger Company bonds for $11,600. Prepare journal entries for the purchase and sale of the Eiger Company bonds.

Ans: N/A, LO: 2, Bloom: AP, Difficulty: Medium, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 141 (5 min.)

Jan. 14	Debt Investments	20,000	
	Cash		20,000
Nov. 30	Cash	11,600	
	Debt Investments ($20,000 × 1/2)		10,000
	Gain on Sale of Debt Investments		1,600

BE 142

On January 2, Penny Company purchased 45, 10%, $1,000 Mikel Company bonds for $45,000 cash. Interest is payable semiannually on July 1 and January 1. On July 1, the company received a semiannual interest payment on the Mikel Company bonds. Journalize the entries to record the purchase of the bonds and the receipt of the interest payment.

Ans: N/A, LO: 2, Bloom: AP, Difficulty: Medium, Min: 4, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 142 (4 min.)

Jan. 2	Debt Investments	45,000	
	Cash		45,000
July 1	Cash ($45,000 × 10% × 1/2)	2,250	
	Interest Revenue		2,250

BE 143

On April 25, Davis Company buys 4,200 shares of Carter common stock for $94,500. On October 31, Davis sells 600 shares of Carter stock for $16,500,. Prepare journal entries for the purchase and sale of the Carter common stock.

Ans: N/A, LO: 3, Bloom: AP, Difficulty: Medium, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 143 (5 min.)

April 25	Stock Investments	94,500	
	Cash		94,500
Oct. 31	Cash	16,500	
	Stock Investments ($94,500 × 600/4,200)		13,500
	Gain on Sale of Stock Investments		3,000

BE 144

On January 1, Sanchez Corporation purchased a 35% equity in Lawton Company for $380,000. At December 31, Lawton declared and paid a $40,000 cash dividend and reported net income of $98,000. Prepare the necessary journal entries for Sanchez Corporation.

Ans: N/A, LO: 3, Bloom: AP, Difficulty: Medium, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 144 (5 min.)

Jan. 1	Stock Investments	380,000	
	Cash		380,000
Dec. 31	Cash ($40,000 × .35)	14,000	
	Stock Investments		14,000
	Stock Investments ($98,000 × .35)	34,300	
	Revenue from Stock Investments		34,300

BE 145

Jenner Company had the following transactions pertaining to its short-term stock investments.

Jan. 1 Purchased 600 shares of Pork Company stock for $8,420.

June 1 Received cash dividends of $0.60 per share on the Pork Company stock.

Sept. 15 Sold 300 shares of the Pork Company stock for $3,400 Cash.

Instructions

Journalize the transactions.

Ans: N/A, LO: 3, Bloom: AP, Difficulty: Medium, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 145 (5 min.)

Jan. 1	Stock Investments	8,420	
	Cash		8,420
June 1	Cash (600 × $0.60)	360	
	Dividend Revenue		360
Sept. 15	Cash	3,400	
	Loss on Sale of Stock Investments	810	
	Stock Investments		4,210
	[300 × ($8,420 ÷ 600)]		

BE 146

On January 1, 2014, Mink Company purchased 5,000 shares of Kusher Company stock for $360,000. Mink's investment represents 30 percent of the total outstanding shares of Kusher. During 2014, Kusher paid total dividends of $100,000 and reported net income of $300,000. What revenue does Mink report related to this investment and what is the amount to be reported as an investment in Kusher stock at December 31?

Ans: N/A, LO: 3, Bloom: AP, Difficulty: Medium, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

Solution 146 (5 min.)

Revenue for 2014 ($300,000 x .30)	$90,000
Balance in Investment account	
Purchase price	$360,000
Less dividend receipt ($100,000 × .30)	– 30,000
Plus investment revenue ($300,000 × .30)	+90,000
Ending balance Investment in Kusher	$420,000

BE 147

At January 1, 2014, the trading securities portfolio held by the Darren Corporation consisted of the following investments:

1. 2,000 shares of Temper common stock purchased for $42 per share.
2. 1,500 shares of Logan common stock purchased for $50 per share.

At December 31, 2014, the fair values per share were Temper $38 and Logan $54.

Instructions

(a) Prepare a schedule showing the cost and fair value of the portfolio at December 31, 2014.

(b) Prepare the adjusting entry to report the portfolio at fair value at December 31, 2014.

Ans: N/A, LO: 5, Bloom: AP, Difficulty: Medium, Min: 6, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

Solution 147 (6 min.)

(a)

Security	Cost	Fair Value	
Temper	$ 84,000	$ 76,000	(2,000 × $38)
Logan	75,000	81,000	(1,500 × $54)
Totals	$159,000	$157,000	

(b)

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

BE 148

At December 31, 2014, the trading securities for Eddy Company are as follows:

Security	Cost	Fair Value
A	$16,000	$20,000
B	34,000	32,000
	$50,000	$52,000

Prepare the adjusting entry at December 31, 2014, to report the securities at fair value.

Ans: N/A, LO: 5, Bloom: AP, Difficulty: Medium, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 148 (3 min.)

Fair Value Adjustment—Trading ($52,000 – $50,000)..........................	2,000	
Unrealized Gain—Income		2,000

BE 149

At January 1, 2014, Grand Corporation held one available-for-sale security: 1,500 shares of Nettle common stock purchased for $40 per share. At December 31, 2014, the fair value per share for Nettle was $42. Prepare the adjusting entry to report the portfolio at fair value at December 31, 2014.

Ans: N/A, LO: 5, Bloom: AP, Difficulty: Medium, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 149 (3 min.)

Dec. 31	Fair Value Adjustment—Available-for-Sale	3,000	
	[1,500 × ($42 – $40)] = $3,000		
	Unrealized Gain or Loss—Equity		3,000

BE 150

Terra Cotta Company has the following data at December 31, 2014 for its securities:

Securities	Cost	Fair Value
Available-for-sale	$34,000	$39,000
Trading	46,000	42,000

Instructions
Journalize the December 31 adjusting entries.

Ans: N/A, LO: 5, Bloom: AP, Difficulty: Medium, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 150 (5 min.)

Dec. 31	Fair Value Adjustment—Available-for-Sale	5,000	
	Unrealized Gain or Loss—Equity		5,000
	Unrealized Loss—Income	4,000	
	Fair Value Adjustment—Trading		4,000

EXERCISES

Ex. 151

Maxim Corporation had the following transactions pertaining to debt investments.

Jan. 1 Purchased 80, 8%, $1,000 Woodrow Company bonds for $80,000.

July 1 Sold 20 Woodrow Company bonds for $21,500.

Instructions

Prepare journal entries for the purchase and sale of the Woodrow Company bonds.

Ans: N/A, LO: 2, Bloom: AP, Difficulty: Medium, Min: 7, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 151 (7 min.)

Jan. 1	Debt Investments	80,000	
	Cash		80,000
July 1	Cash	21,500	
	Debt Investments ($80,000 × 1/4)		20,000
	Gain on Sale of Debt Investments		1,500

Ex. 152

Quagle Company had the following transactions pertaining to debt securities held as a short-term investment.

Jan. 1 Purchased 40, 8%, $1,000 Steve Company bonds for $40,000 cash. Interest is payable semiannually on July 1 and January 1.

July 1 Received semiannual interest on Steve Company bonds.

Oct. 1 Sold 24 Steve Company bonds for $26,000 plus accrued interest.

Instructions

(a) Journalize the transactions.
(b) Prepare the adjusting entry for the accrual of interest on December 31.

Ans: N/A, LO: 2, Bloom: AN, Difficulty: Medium, Min: 10, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 152 (10–15 min.)

(a) Jan. 1	Debt Investments	40,000	
	Cash		40,000
July 1	Cash ($40,000 × 8% × 1/2)	1,600	
	Interest Revenue		1,600
Oct. 1	Cash ($26,000 + $480)	26,480	
	Debt Investments		24,000
	Interest Revenue ($24,000 × 8% × 3/12)		480
	Gain on Sale of Debt Investments ($26,000 – $24,000 = $2,000)		2,000
(b)	Interest Receivable	640	
	Interest Revenue ($16,000 × 8% × ½)		640

Ex. 153

Pincher Company purchased 50 Issac Company 12%, 10-year, $1,000 bonds on January 1, 2014, for $50,000. The bonds pay interest semiannually. On January 1, 2015, after receipt of interest, Pincher Company sold 30 of the bonds for $28,300.

Instructions

Prepare the journal entries to record the transactions described above.

Ans: N/A, LO: 2, Bloom: AP, Difficulty: Medium, Min: 10, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 153 (10-14 min.)

Jan. 1, 2014	Debt Investments	50,000	
	Cash		50,000
July 1, 2014	Cash ($50,000 × 12% × 6/12)	3,000	
	Interest Revenue		3,000
Dec. 31, 2014	Interest Receivable	3,000	
	Interest Revenue		3,000
Jan. 1, 2015	Cash	3,000	
	Interest Receivable		3,000
Jan. 1, 2015	Cash	28,300	
	Loss On Sale of Debt Investments	1,700	
	Debt Investments (30/50 × 50,000)		30,000

Ex. 154

The following transactions were made by Allen Company. Assume all investments are short-term and are readily marketable.

June	2	Purchased 400 shares of Snoop Corporation common stock for $45 per share.
July	1	Purchased 200 Barr Corporation bonds for $228,000.
	30	Received a cash dividend of $1.50 per share from Snoop Corporation.
Sept.	15	Sold 120 shares of Snoop Corporation stock for $50 per share.
Dec.	31	Received semiannual interest check for $13,000 from Barr Corporation.
	31	Received a cash dividend of $2 per share from Snoop Corporation.

Instructions
Journalize the transactions.

Ans: N/A, LO: 2, 3, Bloom: AP, Difficulty: Medium, Min: 12, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 154 (12–17 min.)

June	2	Stock Investments	18,000	
		Cash		18,000
		(To record purchase of 400 shares of Snoop Corporation common stock)		
July	1	Debt Investments	228,000	
		Cash		228,000
		(To record purchase of 200 Barr Corporation bonds)		
	30	Cash	600	
		Dividend Revenue		600
		(To record receipt of cash dividend)		
Sept.	15	Cash	6,000	
		Stock Investments		5,400
		Gain on Sale of Stock Investments		600
		(To record sale of Snoop Corporation stock)		
Dec.	31	Cash	13,000	
		Interest Revenue		13,000
		(To record receipt of interest on Barrr Corporation bonds)		
	31	Cash	560	
		Dividend Revenue		560
		(To record receipt of cash dividend)		

Ex. 155

On April 1, Sign Company buys 4,000 shares of Polk common stock for $61,500. On October 1, Sign sells 1,000 shares of Polk stock for $20,500..

Instructions
Prepare journal entries for the purchase and sale of the Polk common stock.

Ans: N/A, LO: 3, Bloom: AP, Difficulty: Medium, Min: 7, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 155 (7 min.)

Apr. 1	Stock Investments	61,500	
	Cash		61,500
Oct. 1	Cash	20,500	
	Stock Investments ($61,500 × 1/4)...............................		15,375
	Gain on Sale of Stock Investments		5,125

Ex. 156

Hungh Company had the following transactions pertaining to short-term investments in equity securities.

Jan.	1	Purchased 1,500 shares of Antuni Company stock for $9,500 cash.
June	1	Received cash dividends of $.40 per share on Antuni Company stock.
Sept.	15	Sold 375 shares of Antuni Company stock for $2,300 less brokerage fees of $100.
Dec.	1	Received cash dividends of $.80 per share on Antuni Company stock.

Instructions
(a) Journalize the transactions.
(b) Indicate the income statement effects of the transactions.

Ans: N/A, LO: 3, Bloom: AP, Difficulty: Medium, Min: 10, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 156 (10–15 min.)

(a)	Jan. 1	Stock Investments	9,500	
		Cash		9,500
	June 1	Cash (1,500 × $.40)...	600	
		Dividend Revenue		600
	Sept. 15	Cash ($2,300 – $100)...	2,200	
		Loss on Sale of Stock Investments.............................	175	
		Stock Investments		2,375
		[(375 ÷ 1,500) × $9,500]		
	Dec. 1	Cash (1,125 × $.80)...	900	
		Dividend Revenue		900

(b) Dividend Revenue is reported under Other Revenues and Gains on the income statement. Loss on Sale of Stock Investments is reported under Other Expenses and Losses on the income statement.

Ex. 157

Stewart Corporation's balance sheet at December 31, 2013, showed the following:

Short-term investments, at fair value	$46,500

Stewart Corporation's trading portfolio of stock investments consisted of the following at December 31, 2013:

Stock	Number of Shares	Cost
Conn Common Stock	200	$28,000
Ares Preferred Stock	400	6,000
Hall Common Stock	300	9,000
		$43,000

During 2014, the following transactions took place:

Feb.	5	Sold 100 shares of Conn common stock for $18,000.
Mar.	30	Purchased 25 shares of Hall common stock for $1,000.
Sept.	9	Purchased 50 shares of Hall common stock for $3,000.

At year end on December 31, 2014, the fair values per share were:

	Fair Value Per Share
Conn Common Stock	$158.00
Ares Preferred Stock	$14.00
Hall Common Stock	$24.00

Instructions

(a) Prepare the journal entries to record the 2014 stock transactions.

(b) On December 31, 2014, prepare any adjusting entry that might be necessary relative to the trading portfolio.

(c) Show how the stock investments will appear on Stewart Corporation's balance sheet at December 31, 2014.

Ans: N/A, LO: 3, 5, Bloom: AN, Difficulty: Hard, Min: 15, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 157 (15–20 min.)

(a)	Feb.	5	Cash	18,000	
			Stock Investments (100 ÷ 200 × $28,000)		14,000
			Gain on Sale of Stock Investments		4,000
			(To record sale of 100 shares of Conn common stock)		
	Mar.	30	Stock Investments	1,000	
			Cash		1,000
			(To record purchase of 25 shares of Hall common stock)		
	Sept.	9	Stock Investments	3,000	
			Cash		3,000
			(To record purchase of 50 shares of Hall common stock)		

(b)

Stock	Number of Shares	Cost	Fair Value
Conn Common Stock	100	$14,000	$15,800
Ares Preferred Stock	400	6,000	5,600
Hall Common Stock	375	13,000	9,000
		$33,000	$30,400

Unrealized Loss—Income [($33,000 – $30,400) + $3,500*].........	6,100	
Fair Value Adjustment—Trading		6,100

*($46,500 fair value – $43,000 cost)

(c) Short-term investments, at fair value $30,400

Ex. 158

On January 5, 2014, Grouse Company purchased the following stock securities as a long-term investment:

300 shares Bonter Corporation common stock for $4,500.
500 shares Wane Corporation common stock for $10,000.
800 shares Strauss Corporation common stock for $22,800.

Assume that Grouse Company cannot exercise significant influence over the activities of the investee companies and that the cost method is used to account for the investments.

On June 30, 2014, Grouse Company received the following cash dividends:

Bonter Corporation	$2.00 per share
Wane Corporation	$1.00 per share
Strauss Corporation....................................	$1.50 per share

On November 15, 2014, Grouse Company sold 160 shares of Strauss Corporation common stock for $7,200.

On December 31, 2014, the fair value of the securities held by Grouse Company is as follows:

	Per Share
Bonter Corporation common stock	$10
Wane Corporation common stock	16
Strauss Corporation common stock	28

Instructions
Prepare the appropriate journal entries that Grouse Company should make on the following dates:

January 5, 2014
June 30, 2014
November 15, 2014
December 31, 2014

Ans: N/A, LO: 3, 5, Bloom: AN, Difficulty: Hard, Min: 20, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 158 (20–25 min.)

January 5, 2014

Stock Investments	37,300	
Cash		37,300
(To record purchase of stock securities as a long-term investment)		

June 30, 2014

Cash	2,425*	
Dividend Revenue		2,425
(To record cash dividends received)		

*300 × $2 = $600; 500 × $1.25 = $625; and 800 × $1.50 = $1,200.

November 15, 2014

Cash	7,200	
Stock Investments		4,560
Gain on Sale of Stock Investments		2,640
(To record sale of 160 shares of Strauss Corporation common stock)		

December 31, 2014

Unrealized Loss—Equity	3,820	
Fair Value Adjustment—Available-for-Sale		3,820
(To value long-term investments at fair value)		

Investment Portfolio

Security	Shares	Cost	Fair Value
Bonter Corporation	300	$ 4,500	$ 3,000
Wane Corporation	500	10,000	8,000
Strauss Corporation	640	18,240	17,920
Total		$32,740	$28,920

Ex. 159

Rosco Company purchased 35,000 shares of common stock of Paxton Corporation as a long-term investment for $900,000. During the year, Paxton Corporation reported net income of $300,000 and paid dividends of $100,000.

Instructions

(a) Assuming that the 35,000 shares represent a 10% interest in Paxton Corporation:
1. Prepare the journal entry to record the investment in Paxton stock.
2. Prepare any entries that Rosco Company should make in accounting for its investment in Paxton stock during the year.
3. What is the balance of the Stock Investments account on Rosco Company's books at the end of the year?

(b) Repeat requirement (a) above except assume that the 35,000 shares represent a 20% interest in Paxton Corporation.

Ans: N/A, LO: 3, Bloom: AP, Difficulty: Medium, Min: 16, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 159 (16–21 min.)

(a) Cost Method

1.	Stock Investments	900,000	
	Cash		900,000
	(To record purchase of 35,000 shares of Paxton Corporation stock)		
2.	Cash	10,000	
	Dividend Revenue		10,000
	[(To record dividends received); $100,000 × 10% = $10,000]		

3. The Stock Investments account balance at the end of the year is $900,000.

(b) Equity Method

1.	Stock Investments	900,000	
	Cash		900,000
	(To record purchase of 35,000 shares of Paxton's Corporation stock)		
2.	Stock Investments	60,000	
	Revenue from Stock Investments		60,000
	(To record 20% equity in Paxton's net income) $300,000 × 20% = $60,000		
	Cash	20,000	
	Stock Investments		20,000
	[(To record dividends received); $100,000 × 20% = $20,000]		

3. The Stock Investments account balance at the end of the year is $940,000 ($900,000 + $60,000 – $20,000).

Ex. 160

On January 1, Oetry Corporation purchased a 35% equity in Selig Company for $190,000. At December 31, Selig declared and paid a $50,000 cash dividend and reported net income of $80,000.

Instructions

Prepare the necessary journal entries for Oetry Corporation.

Ans: N/A, LO: 3, Bloom: AP, Difficulty: Medium, Min: 7, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 160 (7–9 min.)

Jan. 1	Stock Investments	190,000	
	Cash		190,000
Dec. 31	Cash ($50,000 × .35)	17,500	
	Stock Investments		17,500
	Stock Investments ($80,000 × .35)	28,000	
	Revenue from Stock Investments		28,000

Ex. 161

Information pertaining to long-term stock investments in 2014 by Bell Corporation follows:

Acquired 18% of the 250,000 shares of common stock of Kansas Company at a total cost of $8 per share on January 1, 2014. On July 1, Kansas Company declared and paid a cash dividend of $2 per share. On December 31, Kansas's reported net income was $654,000 for the year.

Obtained significant influence over Toto Company by buying 30% of Toto's 100,000 outstanding shares of common stock at a total cost of $22 per share on January 1, 2014. On June 15, Toto Company declared and paid a cash dividend of $1.50 per share. On December 31, Toto's reported net income was $280,000.

Instructions
Prepare all necessary journal entries for 2014 for Bell Corporation.

Ans: N/A, LO: 3, Bloom: AP, Difficulty: Medium, Min: 15, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 161 (15–20 min.)

Jan. 1	Stock Investments	360,000	
	Cash		360,000
	(250,000 × 18% × $8 = $360,000)		
Jan. 1	Stock Investments	660,000	
	Cash		660,000
	(30% × 100,000 × $22 = $660,000)		
June 15	Cash (30,000 × $1.50)	45,000	
	Stock Investments		45,000
July 1	Cash (45,000 × $2)	90,000	
	Dividend Revenue		90,000
Dec. 31	Stock Investments	84,000	
	Revenue from Stock Investments		84,000
	($280,000 × 30% = $84,000)		

Ex. 162

On February 1, Brutus Company purchased 1,000 shares (2% ownership) of Wynne Company common stock for $25 per share. On March 20, Brutus Company sold 200 shares of Wynne stock for $4,700. Brutus received a dividend of $1.20 per share on April 25. On June 15, Marcus sold 300 shares of Wynne stock for $8,500.

Instructions
Prepare the journal entries to record the transactions described above.

Ans: N/A, LO: 3, Bloom: AP, Difficulty: Medium, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 162 (10–13 min)

February 1		
Stock Investments	25,000	
Cash (1,000 × $25)		25,000
March 20		
Cash	4,700	
Loss on Sale of Stock Investments..............................	300	
Stock Investments ($25,000 × 200/1,000)..............		5,000
April 25		
Cash (800 × $1.20)...	960	
Dividend Revenue		960
June 15		
Cash	8,500	
Stock Investments ($25,000 × 300/1,000)..............		7,500
Gain on Sale of Stock Investments......................		1,000

Ex. 163

On January 1 Jarret Corporation purchased a 35% equity in Dorman Corporation for $220,000. At December 31 Dorman declared and paid a $60,000 cash dividend and reported net income of $200,000.

Instructions

(a) Journalize the transactions.
(b) Determine the amount to be reported as an investment in Dorman stock at December 31.

Ans: N/A, LO: 3, Bloom: AP, Difficulty: Medium, Min: 8, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 163 (8–10 min.)

(a)	Jan. 1	Stock Investments..............................	220,000	
		Cash..		220,000
	Dec. 31	Cash ($60,000 × 35%).........................	21,000	
		Stock Investments		21,000
	31	Stock Investments..............................	70,000	
		Revenue from Stock Investments ($200,000 × 35%)..........................		70,000

(b)	Investment in Dorman, January 1	$220,000
	Less: Dividend received	(21,000)
	Plus: Share of reported income	70,000
	Investment in Dorman, December 31	$269,000

Ex. 164

Presented below are two independent situations.

1. Guo Cosmetics acquired 10% of the 200,000 shares of common stock of Chy Fashion at a total cost of $12 per share on March 18, 2014. On June 30, Chy declared and paid a $50,000 dividend. On December 31, Chy reported net income of $110,000 for the year. At December 31, the market price of Chy Fashion was $15 per share. The stock is classified as available-for-sale.
2. Liptin, Inc., obtained significant influence over Blurr Corporation by buying 25% of Blurr 50,000 outstanding shares of common stock at a total cost of $7 per share on January 1, 2014. On June 15, Blurr declared and paid a cash dividend of $40,000. On December 31, Blurr reported a net income of $90,000 for the year.

Instructions

Prepare all the necessary journal entries for 2014 for (a) Guo Cosmetics and (b) Liptin, Inc.

Ans: N/A, LO: 3,5 Bloom: AP, Difficulty: Medium, Min: 10, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 164 (10–14 min.)

1.	2014			
	Mar. 18	Stock Investments	240,000	
		Cash (200,000 × 10% × $12)		240,000
	June 30	Cash	5,000	
		Dividend Revenue ($50,000 × 10%)..		5,000
	Dec. 31	Fair Value Adjustment—Available-for-Sale	60,000	
		Unrealized Gain on Loss—Equity.		
		($300,000 – $240,000).......................		60,000
2.	Jan. 1	Stock Investments	87,500	
		Cash (50,000 × 25% × $7)		87,500
	June 15	Cash	10,000	
		Stock Investments ($40,000 × 25%)..		10,000
	Dec. 31	Stock Investments	22,500	
		Revenue from Stock Investments		
		($90,000 × 25%)............................		22,500

Ex. 165

At December 31, 2014, the available-for-sale securities for Allison, Inc. are as follows.

Security	Cost	Fair Value
X	$27,500	$24,000
Y	12,500	13,000
Z	23,000	18,000
	$63,000	$55,000

Ex. 165 (Cont.)

Instructions

(a) Prepare the adjusting entry at December 31, 2014, to report the securities at fair value.
(b) Show the balance sheet and income statement presentation at December 31, 2014, after adjustment to fair value. The securities are considered to be a long-term investment.

Ans: N/A, LO: 5, 6, Bloom: AN, Difficulty: Medium, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 165 (5-8 min)

(a)	Dec. 31	Unrealized Gain or Loss—Equity......................	8,000	
		Fair Value Adjustment—Available-for-Sale		8,000

(b) Balance Sheet

Investments	
Investments in stock of less than 20% owned companies, at fair value	$55,000
Stockholders' equity	
Less: Unrealized loss on available-for-sale securities	$ (8,000)

Ex. 166

At December 31, 2014, the trading securities for Wolfe Company are as follows:

Security	Cost	Fair Value
X	$25,000	$27,000
Y	45,000	38,000
	$70,000	$65,000

Instructions

Prepare the adjusting entry at December 31, 2014, to report the securities at fair value.

Ans: N/A, LO: 5, Bloom: AP, Difficulty: Medium, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 166 (3 min.)

Unrealized Loss—Income	5,000	
Fair Value Adjustment—Trading ($70,000 – $65,000)................		5,000

Ex. 167

Plotner Corporation has the following trading portfolio of stock investments as of December 31, 2014.

Security	Cost	Fair Value
A	$19,000	$15,000
B	22,000	27,000
C	34,000	29,000
	$75,000	$71,000

On January 22, 2015, Plotner Corporation sold security C for $32,000.

Ex. 167 (Cont.)

Instructions

(a) Prepare the adjusting entry for Plotner Corporation on December 31, 2014, to report the portfolio at fair value.

(b) Indicate the balance sheet and income statement presentation of the fair value data for Plotner Corporation at December 31, 2014.

(c) Prepare the journal entry for the 2015 sale.

Ans: N/A, LO: 5, Bloom: AN, Difficulty: Medium, Min: 12, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 167 (12–17 min.)

(a)

	2014		
Dec. 31	Unrealized Loss—Income	4,000	
	Fair Value Adjustment—Trading		4,000

(b) On the balance sheet, the short-term investments are reported in the current assets section as follows:

Current Assets	
Short-term Investments, at fair value	$71,000

The unrealized loss account is reported under Other Expenses and Losses in the income statement.

(c)

	2015		
Jan. 22	Cash	32,000	
	Loss on Sale of Stock Investments	2,000	
	Stock Investments		34,000

Ex. 168

The following information is available for Lewis Corporation's available-for-sale securities at December 31, 2014.

Security	Cost	Fair Value
X	$34,000	$30,000
Y	24,000	32,000
	$58,000	$62,000

Instructions

Prepare the adjusting entry to record the securities at fair value at December 31, 2014.

Ans: N/A, LO: 5, Bloom: AP, Difficulty: Medium, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 168 (3 min.)

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

Ex. 169

At January 1, 2014, the available-for-sale securities portfolio held by Hyde Corporation consisted of the following investments:

1. 2,500 shares of Park common stock purchased for $42 per share.
2. 1,500 shares of Grace common stock purchased for $60 per share.

At December 31, 2014, the market values per share were Park $36 and Grace $68.

Instructions

(a) Prepare a schedule showing the cost and fair value of the portfolio at December 31, 2014.

(b) Prepare the adjusting entry to report the portfolio at fair value at December 31, 2014.

Ans: N/A, LO: 5, Bloom: AN, Difficulty: Medium, Min: 8, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 169 (8–10 min.)

(a)

Security	Cost	Fair Value	
Park	$105,000	$ 90,000	(2,500 × $36)
Grace	90,000	102,000	(1,500 × $68)
Totals	$195,000	$192,000	

(b)

Dec. 31	Unrealized Gain on Loss—Equity..............................	3,000	
	Fair Value Adjustment—Available-for-Sale		3,000

Ex. 170

Shallot Company has the following data at December 31, 2014 for its securities.

Securities	Cost	Fair Value
Trading	$90,000	$93,000
Available-for-sale	74,000	68,000

Instructions

(a) Prepare the adjusting entries to report the securities at fair value.

(b) Indicate the statement presentation of the related unrealized gain (loss) accounts for each class of securities.

Ans: N/A, LO: 5, 6, Bloom: AP, Difficulty: Medium, Min: 7, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Problem Solving, IMA: FSA

Solution 170 (7–9 min.)

a)

Fair Value Adjustment—Trading..	3,000	
Unrealized Gain—Income...		3,000
Unrealized Gain or Loss—Equity...	6,000	
Fair Value Adjustment—Available-for-Sale		6,000

(b) Unrealized Gain—Income: Income Statement under other revenues and gains
Unrealized Gain or Loss—Equity: Balance Sheet as part of stockholders' equity

COMPLETION STATEMENTS

171. Debt investments are investments in government and _____________ bonds.

Ans: N/A, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

172. Cost of debt investments includes the price paid plus ______________

Ans: N/A, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: FSA

173. When an investor owns between 20% and 50% of the common stock of a corporation, it is generally presumed that the investor has _______________ influence over the investee and therefore, the appropriate method of accounting for this type of investment is the _______________ method.

Ans: N/A, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

174. Under the cost method, dividends received from an investee company are credited to the _______________ account, whereas under the equity method, dividends received from an investee company are credited to the _______________ account.

Ans: N/A, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: None, IMA: FSA

175. At the beginning of the year, Price Corporation acquired 15% of Cooper Company common stock for $400,000. Cooper Company reported net income for the year of $85,000 and paid $25,000 cash dividends during the year. The balance of the Stock Investments account on the books of Price Corporation at the end of the year should be $___________.

Ans: N/A, LO: 3, Bloom: AP, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Problem Solving, IMA: Reporting

176. A company that owns more than 50% of the common stock of another company is known as the ______________ company and _____________ financial statements are usually prepared.

Ans: N/A, LO: 4, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

177. _______________ securities are bought and held primarily for sale in the near future.

Ans: N/A, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

178. Fair Value Adjustment is a valuation _______________ account which is _______________ to (from) the cost of the investments.

Ans: N/A, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

179. At the end of an accounting period, if the fair value of the trading portfolio is less than its cost, then the company should recognize an ______________ which is reported on the _________________.

Ans: N/A, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

180. An unrealized loss on trading securities is reported under Other ____________________ on the income statement.

Ans: N/A, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

181. An unrealized gain or loss on available-for-sale securities is reported as a separate component of _________________.

Ans: N/A, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

182. Short-term investments are securities that are _____________ and ______________ to be converted into cash within the next year.

Ans: N/A, SO: 6, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

Answers to Completion Statements

171. corporate
172. brokerage fees
173. significant, equity
174. Dividend Revenue, Stock Investments
175. 409,000
176. parent, consolidated
177. Trading
178. allowance, added (subtracted)
179. unrealized loss, income statement
180. Expenses and Losses
181. stockholders' equity
182. readily marketable, intended

MATCHING

183. Match the items below by entering the appropriate code letter in the space provided.

A. Available-for-sale securities	F. Consolidated financial statements
B. Subsidiary company	G. Controlling interest
C. Equity method	H. Fair Value Adjustment
D. Unrealized Gain or Loss—Equity	I. Parent company
E. Fair value	J. Long-term investments

____ 1. Valuation allowance account.

____ 2. Amount for which a security could be sold.

____ 3. Ownership of more than 50% of another company's common stock.

____ 4. Securities that may be sold in the future.

____ 5. Investments that are not readily marketable and not intended to be converted into cash within the next year.

____ 6. Financial statements that present the total assets and liabilities controlled by the parent and the total revenues and expenses of the subsidiary companies.

____ 7. The Stock Investments account is adjusted for net income and dividends received.

____ 8. A company that owns more than 50% of the common stock of another entity.

____ 9. Entity whose stock is owned by the parent company.

____ 10. An account that is reported in the stockholders' equity section.

Ans: N/A, LO: 2, Bloom: K, Difficulty: Easy, Min: 3, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: None, IMA: Reporting

Answers to Matching

1.	H	6.	F
2.	E	7.	C
3.	G	8.	I
4.	A	9.	B
5.	J	10.	D

SHORT-ANSWER ESSAY QUESTIONS

S-A E 184

Distinguish between the cost and equity methods of accounting for investments in stocks.

Ans: N/A, LO: 2, Bloom: K, Difficulty: Medium, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Communication, IMA: Reporting

Solution 184

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.

S-A E 185

A consolidated balance sheet reports the financial position of two or more legal entities just as if they were one reporting unit. Explain why all the individual items appearing on the separate balance sheets of each of the affiliated companies cannot be added together to arrive at a consolidated total for each item.

Ans: N/A, LO: 4, Bloom: K, Difficulty: Medium, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting

Solution 185

A consolidated balance sheet does not include transactions that occurred between the affiliated companies (intercompany transactions). The inclusion of intercompany transactions would cause the assets, liabilities, and stockholders' equity accounts to all be overstated in the consolidated balance sheet. Thus, the individual items appearing on the separate balance sheets cannot simply be added together.

S-A E 186

What purposes are served by reporting Unrealized Gains (Losses)—Equity in the stockholders' equity section?

Ans: N/A, LO: 5, Bloom: K, Difficulty: Medium, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting

Solution 186

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.

S-A E 187

The Fair Value Adjustment account is a balance sheet account. Identify the asset account it is related to. Explain how this account is increased and describe the procedure followed when its related asset account is disposed of.

Ans: N/A, LO: 5, Bloom: K, Difficulty: Medium, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting

Solution 187

The Fair Value Adjustment account is a valuation allowance account for short-term and long-term investments. The Fair Value Adjustment account is increased when the difference between the investments' fair value and cost increases. When specific securities are sold, the Fair Value Adjustment account is ignored because the account relates to the entire portfolio and not the specific securities.

S-A E 188

When a year-end adjustment is made to reduce the trading securities portfolio to market, what effect, if any, will the adjustment have on the balance sheet and the income statement?

Ans: N/A, LO: 4, Bloom: K, Difficulty: Medium, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting

Solution 188

The unrealized loss would be reported in the Other Expenses and Losses section of the Income Statement and the assets would be decreased by a credit balance in the Fair Value Adjustment—Trading valuation account.

S-A E 189 (Ethics)

Greyhound Stables, Inc. operates several dog racing tracks throughout the United States. Since most facilities are outdoor tracks only, most of the cash receipts for Greyhound are received from April through October. These funds are usually invested in short-term, very liquid investments, such as stocks and bonds. Among the stocks purchased last year, was Servitronics, a company specializing in automatic vending equipment.

The company decided not to sell its Servitronics stock at the end of last year, and has purchased more of the stock this year. The company intends to continue to purchase stock until it holds enough to make a takeover bid for the company. The accountants have been instructed to continue to classify the investment as short-term until the takeover is accomplished, so that less attention will be directed to it. (Presently, Greyhound has no long-term investment in stock at all.)

Required:
1. Is it ethical for Greyhound to attempt to take over another company? Explain.
2. Is it ethical for Greyhound to leave its investment in the short-term investment category? Explain.

Ans: N/A, LO: 5, Bloom: K, Difficulty: Medium, Min: 5, AACSB: Ethics, AICPA BB: Industry/Sector, AICPA FN: Decision Modeling, AICPA PC: Problem Solving, IMA: Business Economics

Solution 189

1. Yes, Greyhound may attempt to "take over" or purchase another company. The means that it uses to accomplish its goal must be ethical, and certainly building up a portfolio of the stock in question is ethical. Unethical takeovers are those in which a company is purchased for its assets and "harvested," leaving employees without jobs, and possibly irreparably damaging a community.

2. It is not ethical for the company to leave the stock in the short-term category if it no longer meets the criterion for a short-term investment. It would depend upon whether the company was serious in its intention to purchase a controlling interest in Servitronics. Since there is no evidence to the contrary, it appears that Greyhound's investment should be classified as long-term.

S-A E 190 (Communication)
Sue Garner is the daughter of Fred Garner, the founder and president of Big Sky Enterprises. She has been working in various departments during school vacations throughout high school. She burst into the accounting department excitedly one morning. She said that the stock prices of several of the firm's available-for-sale securities are up, and that her father said that the company had made over $10,000 because of this jump in stock prices. She asks to see how the increase is recorded. It is a very busy time in the accounting department, and so her question is deferred.

Required:
Prepare a brief note to answer Sue's question.

Ans: N/A, LO: 3, Bloom: K, Difficulty: Medium, Min: 5, AACSB: None, AICPA BB: Legal/Regulatory, AICPA FN: Measurement, AICPA PC: Communication, IMA: FSA

Solution 190

This communication can be informal, but it should contain the key elements of the answer.

Dear Sue,

Yesterday, you asked to see how we recorded the $10,000 that the company had "earned" because of the jump in the price of some of the stock we hold. Since we were finishing month-end closing, we couldn't answer your question right away.

The basic answer to your question is that we don't record those earnings. The change in stock price is kind of like having the value of your house or car change. You don't get any money unless you sell the house or the car. It's the same with those investments. We record changes in the value only when we sell the stock. We would record the difference between the amount we paid originally and the amount we received on the sale as a gain or a loss.

Again, I'm sorry we couldn't ask you to stay yesterday. Stop by again sometime (any time except month end!)

(signed)