PART 1: MULTIPLE CHOICE

1. Which of the following statement(s) pertaining to Joint Ventures is **TRUE**?

    a. A joint venture must have a contractual arrangement establishing joint control over the venture.
    b. It must be accounted for using the Cost Method.
    c. It must be accounted for using the Equity Method.
    d. One of the parties of the joint venture must have unilateral control over the venture.

Ans: A
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 2

2. Which of the following does NOT constitute a Business Combination under IFRS 3?

    a. A Corp purchases the net assets of B Corp.
    b. A Corp enters into a Joint Venture with B Corp.
    c. A Corp acquires 51% of B Corp's voting shares for $1,000,000 in Cash.
    d. A Corp acquires 51% of B Corp's voting shares for future considerations.

Ans: B
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 2

3. Which of the following statements is TRUE under IAS 39?

    a. All unrealized gains and losses on equity investments are flow through Other Comprehensive Income.
    b. Unrealized gains and losses on held-for-trading securities are included in Other Comprehensive Income.
    c. Unrealized gains and losses on available-for-sale investments are included in Other Comprehensive Income.
    d. Other Comprehensive Income is included in Retained Earnings.

Ans: C
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 4

4. Which of the following statements is CORRECT?

a. A Comprehensive Revaluation of Assets and Liabilities is mandatory when there has been a change in control.
b. A Comprehensive Revaluation of Assets and Liabilities is optional when there has been a change in control.
c. A Comprehensive Revaluation of Assets and Liabilities is optional when the company was subject to a Financial Reorganization.
d. A Comprehensive Revaluation of Assets and Liabilities is mandatory when there has been a change in control and/or the company has been subject to a Financial Reorganization.

Ans: B
Difficulty: Moderate
Level of Learning: Knowledge
Topic: LO 2

5. Under which of the following scenarios would Foreign Currency translation of an Associate NOT be required?

a. The Associate is located in a different country.
b. The Associate prepares its financial statements in a foreign currency.
c. The investing Company has borrowings denominated in a Foreign Currency.
d. The Associate prepares its financial statements using the same currency as the Investing Company.

Ans: D
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 4

6. Since its inception Company X has had earnings of $800,000 and paid out dividends of $900,000. Which of the following statements is correct with respect to Company X?

a. The Company has been subject to a hostile takeover.
b. The Company's share price will likely increase when investors become aware of this.
c. A liquidating dividend has occurred.
d. Company X's total Shareholder Equity has increased since its inception.

Ans: C
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 4

7. Private enterprise gap is permitted in certain instances for:

   a. all privately held companies.
   b. all publicly held companies.
   c. all Canadian companies.
   d. Canadian companies consolidating its foreign subsidiaries.

Ans: A
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 2

8. Which of the following types of share investment does not qualify as a strategic investment?

   a. Significant influence investments.
   b. Joint Control investments.
   c. Held for Trading.
   d. Control investments.

Ans: C
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 2

9. What percentage of ownership is used as a guideline to determine that significant influence exists under IAS 28?

   a. 20% or less.
   b. Less than 20%.
   c. Between 20% and 50%.
   d. 25% or more.

Ans: C
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 3

10. Gains and losses on fair-value-through-profit-or-loss securities:

   a. are included in net income, regardless of whether they are realized or not.
   b. are included in net income only when the investment has become permanently impaired.

c. are included in net income only when realized.
d. are never recorded until the securities are sold.

Ans: A
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 4

11. Which of the following statements is correct?

a. Under the Cost Method, Consolidated Net Income is equal to the sum of the income of the parent and it's pro rata share of the net incomes of each of its subsidiaries.
b. Under the Cost Method, Consolidated Net Income is equal to the sum of the income of the parent and the total of the net incomes of each of its subsidiaries.
c. Under the Equity Method, Consolidated Net Income is equal to the sum of the income of the parent and it's pro rata share of the net incomes of each of its subsidiaries.
d. Consolidated Net Income should be equal to the Investor's total income when the Equity method is used.

Ans: D
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 4

12. A significant influence investment is one that:

a. allows the investor to exercise significant influence over the strategic, operating and financing policies of the Associate.
b. allows the investor to exercise significant influence over the operating and financing policies of the Associate.
c. allows the investor to exercise significant influence over the strategic and financing policies of the Associate.
d. allows the investor to exercise significant influence over the strategic and operating policies of the Associate.

Ans: A
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 3

13. Which of the following is NOT a possible indicator of significant influence?

a. The investor has the ability to elect members to the Board of Directors.

b. The investor has the right to participate in the policymaking process.
c. The investor has engaged in numerous intercompany transactions with the Associate.
d. The Associate's new CEO was previously CEO of the investor company.

Ans: D
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 3

14.What is the dominant factor used to distinguish portfolio from significant influence investments?

a. Use of the Cost Method.
b. Use of the Equity Method.
c. The investor intends to establish or maintain a long term relationship.
d. Ownership guidelines are the dominant factor.

Ans: C
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 3

15. Which of the following statements is CORRECT?

a. Control is still possible if the Investor owns less than 50% of the voting shares of the Associate.
b. An ownership interest between 20% and 50% always implies significant influence.
c. An ownership interest between 0 and 10% can never imply significant influence.
d. Significant influence is still possible if the Investor owns less than 20% of the voting shares of the Associate.

Ans: D
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 3

16. The difference between the Investor's cost and the Investor's percentage of the net identifiable assets of the Associate is known as:

a. goodwill.
b. the Acquisition Differential.
c. the Fair Value Increment.
d. the Excess Book Value.

Ans: B
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 4

17. Any unallocated positive Acquisition Differential is normally:

    a. pro-rated across the Associate's identifiable net assets.
    b. charged to Retained Earnings.
    c. recorded as Goodwill.
    d. expensed during the year following the acquisition.

Ans: C
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 3

18. The reporting method used when the Investor has control over its the corporation that it has invested in is:
    a. the fair value method.
    b. the cost method.
    c. proportionate consolidation.
    d. consolidation.

Ans: C
Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 2

19. Which of the following statements is correct with respect to the Goodwill implied from an Investment accounted for using the Equity Method?

    a. The Goodwill is tested annually for impairment.
    b. The Goodwill is amortized over 40 years.
    c. Impairment is deemed to have occurred if the market value of the Investment has permanently declined below the investor's carrying value.
    d. An adjustment is made to the Investment account only if the market value of the Investment drops significantly below the investor's carrying value, regardless of whether such a drop is permanent in nature.

Ans: C
Difficulty: Easy

Level of Learning: Knowledge
Topic: LO 3

The following information pertains to questions 20 through 25 inclusively.

On January 1, 2000, X Inc. purchased 12% of the voting shares of Y Inc for $100,000. The investment is reported at cost. X does not have significant influence over Y. Y's net income and paid dividends for the following three years are as follows:

	Net Income	**Dividends**
2000	$50,000	$20,000
2001	$70,000	$80,000
2002	$30,000	$60,000

20. Which of the following journal entries would have to be made to record X's purchase of Y's shares?

	Debit	**Credit**
a. Investment in Y	$100,000	
Cash		$100,000
b. Investment in Y	$12,000	
Cash		$12,000
c. Investment in Y	$100,000	
Goodwill		$100,000
d. No entry required.		

Ans: A
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

21. Which of the following journal entries would have to be made to record X's share of Y's net income for 2000?

	Debit	**Credit**
a. Investment in Y	$6,000	
Investment Income		$6,000
b. Investment in Y	$50,000	
Investment Income		$50,000
c. Investment in Y	$12,000	
Investment Income		$12,000
d. No entry required.		

Ans: D

Difficulty: Moderate
Level of Learning: Knowledge
Topic: LO 4

22. Which of the following journal entries would have to be made to record X's share of Y's dividends paid for 2000?

		Debit	Credit
a.	Cash	$2,400	
	Dividend Revenue		$2,400
b.	Cash	$2,400	
	Investment in Y		$2,400
c.	Investment in Y	$2,400	
	Dividend Revenue		$2,400
d.	No entry required.		

Ans: A
Difficulty: Moderate
Level of Learning: Knowledge
Topic: LO 4

23. Which of the following journal entries would have to be made to record X's share of Y's dividends paid for 2001?

		Debit	Credit
a.	Cash	$9,600	
	Dividend Revenue		$9,600
b.	Cash	$9,600	
	Investment in Y		$9,600
c.	Cash	$9,600	
	Dividend Revenue		$8,400
	Investment in Y		$1,200
d.	No entry required.		

Ans: A
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

24. Which of the following journal entries would have to be made to record X's share of Y's dividends paid for 2002?

		Debit	Credit
a.	Cash	$7,200	
	Dividend Revenue		$7,200
b.	Cash	$7,200	

		Debit	Credit
	Investment in Y		$7,200
c.	Cash	$7,200	
	Dividend Revenue		$7,200
d.	No entry required.		

Ans: C
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

25. What would be the carrying value of X's Investment in Y at the end of 2002?

a. $100,000
b. $98,800
c. $90,000
d. $91,200

Ans: A
Difficulty: Moderate
Level of Learning: Knowledge
Topic: LO 4

For questions 26 through 31, assume the same data that was used to answer question 20 through 25 with the following exceptions:

- **X owns 25% of Y's voting shares.**
- **X has significant influence over Y**

26. Which of the following journal entries would have to be made to record X's purchase of Y's shares?

		Debit	**Credit**
a.	Investment in Y	$100,000	
	Cash		$100,000
b.	Investment in Y	$12,000	
	Cash		$12,000
c.	Investment in Y	$100,000	
	Goodwill		$100,000
d.	No entry required.		

Ans: A
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

27. Which of the following journal entries would have to be made to record X's share of Y's net income for 2000?

		Debit	Credit
a.	Investment in Y	$12,500	
	Investment Income		$12,500
b.	Investment in Y	$7,500	
	Investment Income		$7,500
c.	Investment in Y	$12,000	
	Investment Income		$12,000
d.	No entry required.		

Ans: A
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

28. Which of the following journal entries would have to be made to record X's share of Y's dividends paid for 2000?

		Debit	Credit
a.	Cash	$5,000	
	Dividend Revenue		$5,000
b.	Cash	$5,000	
	Investment in Y		$5,000
c.	Investment in Y	$5,000	
	Dividend Revenue		$5,000
d.	No entry required.		

Ans: B
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

29. Which of the following journal entries would have to be made to record X's share of Y's dividends paid for 2001?

		Debit	Credit
a.	Cash	$20,000	
	Dividend Revenue		$20,000
b.	Cash	$20,000	
	Investment in Y		$20,000
c.	Cash	$20,000	
	Dividend Revenue		$17,500
	Investment in Y		$ 2,500
d.	No entry required.		

Ans: B
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

30. Which of the following journal entries would have to be made to record X's share of Y's dividends paid for 2002?

		Debit	Credit
a.	Cash	$15,000	
	Dividend Revenue		$15,000
b.	Cash	$15,000	
	Investment in Y		$15,000
c.	Cash	$15,000	
	Dividend Revenue		$12,500
	Investment in Y		$ 2,500
d.	No entry required.		

Ans: B
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

31. What would be the carrying value of X's Investment in Y at the end of 2002?

a. $100,000
b. $ 97,500
c. $ 98,800
d. $ 91,200

Ans: B
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

The following information pertains to questions 32 through 36 inclusively.

ABC Inc. acquired 40% of the voting shares of DEF Inc. for $200,000 on January 1, 2001. On that date, DEF's Common Shares and Retained Earnings were worth $240,000 and $60,000 respectively. On that date, DEF's Book Values approximated their Fair Values except for DEF's Inventory, which had a market value $50,000 higher than book value, and DEF's Plant & Equipment, which was said to have a market value that was $80,000 higher than its book value. The inventory was subsequently sold to outsiders during the year. The Plant and Equipment had a remaining useful life of ten years from the acquisition date.

During the year, DEF earned net income and paid Dividends in the amount of $100,000 and $10,000, respectively.

32. What is the amount of the Acquisition Differential?

a. ($100,000)
b. $ 28,000
c. $ 80,000
d. $100,000

Ans: C
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

33. What is the amount of Goodwill arising from ABC's acquisition of DEF?

a. ($100,000)
b. $ 28,000
c. $ 80,000
d. $100,000

Ans: B
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

34. What would be the amount of the Acquisition Differential amortization for 2001?

a. $28,000
b. $26,000
c. $130,000
d. $23,200

Ans: D
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

35. What would be the amount of the Acquisition Differential amortization for 2002?

a. $3,200
b. $32,000

c. $28,000
d. $2,800

Ans: A
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

36. What would be the carrying value of ABC's Investment in DEF on January 31, 2001?

a. $200,000
b. $300,000
c. $290,000
d. $212,800

Ans: D
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

The following information pertains to questions 37 through 43 inclusively.

Jones Corp owns 30% of Klein Inc for $250,000. During 2002, there were numerous intercompany inventory sales. During the year, Jones sold Inventory for $50,000 to Klein. At year-end, half of this Inventory was still in Klein's possession. Also during 2002, Klein sold Inventory for $60,000 to Jones. At year-end, 20% of this Inventory was still in Jones' possession. During the year, Klein declared a net income and paid dividends in the amount of $20,000 and $5,000 respectively. Klein's fair values approximated its book values on the date of acquisition. Both companies price all sales at a 25% mark-up above cost. In addition, both companies are subject to an effective tax rate of 40%.

37. What is the amount of after-tax profit realized from downstream sales during 2002?

a. $8,000
b. $5,000
c. $3,000
d. $4,000

Ans: C
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

38. What is the amount of unrealized after-tax profit from downstream sales during 2002?

a. $8,000
b. $3,000
c. $5,000
d. $4,000

Ans: B
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

39. What is the amount of after-tax profit realized from upstream sales during 2002?

a. $7,200
b. $5,760
c. $1,440
d. $1,920

Ans: B
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

40. What is the amount of unrealized after-tax profit from upstream sales during 2002?

a. $1,440
b. $1,920
c. $5,760
d. $7,200

Ans: A
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

41. What is the amount of unrealized after-tax profit from upstream deducted from the Investment in Klein account during 2002?

a. $1,440
b. $1,920
c. $5,760
d. $432

Ans: D
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

42. What is the amount of unrealized after-tax profit from downstream sales deducted from the Investment in Klein account during 2002?

a. $8,000
b. $5,000
c. $3,000
d. Nil

Ans: C
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

43. What would be the carrying value of Jones' Investment in Klein on January 31, 2002?

a. $250,000
b. $265,000
c. $251,068
d. $259,240

Ans: C
Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

44. Assuming that a company's ownership interest in the Associate increases or decreases, how are changes from the Cost to the Equity Method (or vice-versa) to be handled?

a. Changes from the Cost Method to the Equity Method are to be handled prospectively, while changes from the Equity Method to the Cost Method are to be handled retroactively.
b. Changes from the Cost Method to the Equity Method are to be handled retroactively, while changes from the Equity Method to the Cost Method are to be handled prospectively.
c. Any change is to be handled retroactively.
d. Any change is to be handled prospectively.

Ans: D
Difficulty: Moderate
Level of Learning: Knowledge
Topic: LO 3

45. How is an Associate's Income from non-operating sources such as extraordinary gains and losses to be accounted for?

    a. Any such gains or losses are to be charged directly to Retained Earnings net of tax.
    b. Any such gains or losses are combined with revenue and expenses from operations. The investor's pro rata share of these after-tax gains and losses are added to or deducted from the Investment account.
    c. Any such gains or losses are shown separately, net of tax below income from operations on the Associate's Income statement. The investor's pro rata share of these after-tax gains and losses are added to or deducted from the Investment account.
    d. No specific accounting treatment is required. These extraordinary items simply have to be disclosed in a note to the financial statements.

Ans: C
Difficulty: Moderate
Level of Learning: Knowledge
Topic: LO 4

46. If the Investor sells part of its stake in the Associate, the gain or loss on the sale of these shares is calculated using which of the following?

    a. The average carrying value of the Investment.
    b. FIFO.
    c. LIFO.
    d. Specific Identification.

Ans: A

Difficulty: Moderate
Level of Learning: Knowledge
Topic: LO 4

PART 2: SHORT-ANSWER QUESTIONS/PROBLEMS

47. On January 1, 2001, Joyce Inc. paid $600,000 to purchase 25% of Mark Inc's outstanding voting shares. Joyce has significant influence over Mark. On the date of acquisition, Mark's net assets were valued at $2,000,000. Any Acquisition Differential was allocated to Plant & Equipment, with a remaining useful life of 5 years. Mark's earnings for 2001 and 2002 were $100,000 and $200,000 respectively. Mark paid dividends in the amount of $20,000 and $10,000 during 2001 and 2002, respectively.

Required:

Calculate the balance in Joyce's Investment account as at December 31, 2002.

Solution: Joyce Inc.
Investment in Mark Account
As at December 31, 2002

Cost:	$600,000
Pro-rata share of Mark's 2002 Net Income	$50,000
Pro-rata share of Mark's 2002 Dividends	($5,000)
Amortization of Acquisition Differential	($20,000)
Pro-rata share of Mark's 2001 Net Income	$25,000
Pro-rata share of Mark's 2001 Dividends	($2,500)
Amortization of Acquisition Differential	($20,000)
Investment in Mark Inc. as at December 31, 2002	**$627,500**

Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

48. On January 1, 2002, Jonson Inc. paid $400,000 to purchase 20% of Mike Inc's outstanding voting shares. Jonson has significant influence over Mike. On the date of acquisition, Mike's net assets were valued at $1,200,000. Any Acquisition Differential was allocated to a Patent a remaining useful life of 10 years. Mike's earnings for 2002 and 2003 were $50,000 and $80,000 respectively. Mike paid dividends in the amount of $10,000 and $15,000 during 2002 and 2003, respectively.

Required:

Calculate the balance in Jonson's Investment account as at December 31, 2003.

Solution: Jonson Inc.
Investment in Mike Account
As at December 31, 2003

Cost:	$400,000
Pro-rata share of Mike's 2002 Net Income	$10,000
Pro-rata share of Mike's 2002 Dividends	($2,000)
Amortization of Acquisition Differential	($16,000)
Pro-rata share of Mike's 2003 Net Income	$16,000
Pro-rata share of Mike's 2003 Dividends	($3,000)

Amortization of Acquisition Differential	($16,000)
Investment in Mike Inc. as at December 31, 2003	**$389,000**

Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

49. On January 1, 2002, James Inc. paid $500,000 to purchase 40% of Joyce Inc's outstanding voting shares. James has significant influence over Joyce. On the date of acquisition, Joyce's net assets were valued at $1,000,000. Any Acquisition Differential was allocated to a Trademark a remaining useful life of 20 years. Joyce's earnings for 2002 and 2003 were $60,000 and $100,000 respectively. Joyce paid dividends in the amount of $15,000 and $20,000 during 2002 and 2003, respectively.

Required:

Calculate the balance in James' Investment account as at December 31, 2003.

Solution:

James Inc.
Investment in Joyce Account
As at December 31, 2003

Cost:	$500,000
Pro-rata share of Joyce's 2002 Net Income	$24,000
Pro-rata share of Joyce's 2002 Dividends	($6,000)
Amortization of Acquisition Differential	($5,000)
Pro-rata share of Joyce's 2003 Net Income	$40,000
Pro-rata share of Joyce's 2003 Dividends	($8,000)
Amortization of Acquisition Differential	($5,000)
Investment in Joyce Inc. as at December 31, 2003	**$540,000**

Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

The following information pertains to questions 54 and 55.

X owns 20% of Y. During the last fiscal year, Y sold Inventory to X for $100,000. X is still in possession of this inventory. Y marks up all its sales at 100% above cost. Assume a 20% tax rate.

50. Assuming that X’s Investment in Y qualifies as a portfolio investment, what journal entry should be made at the end of the year?

Solution:

No journal entry is required

Difficulty: Easy
Level of Learning: Application
Topic: LO 4

51. Assuming that X’s Investment in Y qualifies as a significant influence investment, what journal entry should be made at the end of the year?

Solution:

	Debit	**Credit**
Investment Income	$8,000	
Investment in Y		$8,000

Difficulty: Easy
Level of Learning: Knowledge
Topic: LO 4

The following information pertains to questions 56 and 57.

X purchased 30% of Y of Y on January 1, 2002 for $300,000. On the date, Y’s net assets of Y had a book value of $500,000. Any Acquisition Differential on the acquisition date is to be allocated to Y’s Equipment, which had a remaining useful life of 5 years from the date of acquisition. Y paid dividends of $20,000 in each year.

Y’s income statements for 2002 and 2003 showed the following:

	2002	2003
Net Income (Loss) before extraordinary items:	$150,000	($30,000)
Extraordinary Gain (net of tax)	$ 50,000	-
Net Income (Loss)	$200,000	($30,000)

52. Prepare X’s journal entries for 2002 and 2003, assuming that this is a significant influence investment.

Solution:

2002:	**Debit**	**Credit**
Investment in Y	$300,000	
Cash		$300,000
To record X's purchase of Y.		
Investment in Y	$60,000	
Investment Gain, Extraordinary Item		$15,000
Investment Income		$45,000
To record 2002 Net Income and Extraordinary Gain		
Cash	$6,000	
Investment in Y		$6,000
To record receipt of Dividends from Y – 2002		
Investment Income	$30,000	
Investment in Y		$30,000
To record amortization of Acquisition Differential for 2002		

2003:	**Debit**	**Credit**
Investment Income	$9,000	
Investment in Y		$9,000
To record 2002 Net Loss		
Cash	$6,000	
Investment in Y		$6,000
To record receipt of Dividends from Y – 2003		
Investment Income	$30,000	
Investment in Y		$30,000
To record amortization of Acquisition Differential for 2003		

Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

53. Prepare X's journal entries for 2002 and 2003, assuming that this is a Portfolio Investment.

Solution:

2002:	**Debit**	**Credit**
Investment in Y	$300,000	
Cash		$300,000

To record X's purchase of Y

Cash	$6,000	
Dividend Revenue		$6,000

To record receipt of Dividends from Y – 2002

2003:	**Debit**	**Credit**
Cash	$6,000	
Dividend Revenue		$6,000

To record receipt of Dividends from Y – 2003

Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

The following information pertains to questions 54 and 55.

On January 1, 2000 XYZ purchased 40% of the outstanding voting shares of SOS Inc. for $280,000. SOS's Balance Sheet on that date is shown below:

Cash		$300,000
Accounts Receivable		$100,000
Patent		$200,000
Assets		$600,000
Accounts Payable	$200,000	
Common Stock	$200,000	
Retained Earnings	$200,000	
Total Liabilities and Equity		$600,000

SOS's book values equalled their fair market values on the acquisition date, with the exception of the Patent, which was said to have a fair market value of $300,000. The patent had a remaining useful life of ten years from the acquisition date. The patent is being amortized on a straight line basis with no residual value at the end of its useful life. SOS reported Net Incomes of $40,000 and $50,000 for 2000 and 2001 respectively. SOS also paid dividends of $10,000 in each of the two years.

54. Calculate the Goodwill on the date of acquisition.

Solution:

Purchase Price	$280,000
Less:	
Book Value of SOS:	$400,000
*40%	($160,000)
Acquisition Differential	$120,000
Allocation:	
Patent ($300,000*40%)	($120,000)
Goodwill	$ 0

Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

55. Calculate the balance in XYZ's Investment account as at December 31, 2001.

Solution: XYZ Inc.
Investment in SOS Account
As at December 31, 2001

Cost:	$280,000
Pro-rata share of SOS's 2000 Net Income	$16,000
Pro-rata share of SOS's 2000 Dividends	($4,000)
Amortization of Acquisition Differential	($12,000)
Pro-rata share of SOS's 2001 Net Income	$20,000
Pro-rata share of SOS's 2001 Dividends	($4,000)
Amortization of Acquisition Differential	($12,000)
Investment in SOS Inc. as at December 31, 2001	$300,000

Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

56. UNI Inc. owns 30% of the outstanding voting shares of IOU Inc. UNI has significant influence over IOU. UNI's Investment in IOU Account had a balance of $500,000 on January 1, 2003. Amortization of the Acquisition Differential amounted to $20,000 per year. On December 31, 2003 UNI reported a Net Income of $150,000 and paid dividends

in the amount of $15,000. In 2002 IOU had sold Inventory to UNI for $30,000, which was a 50% mark-up above IOU's cost. This inventory was sold to outsiders during 2003. During 2003, UNI sold inventory to IOU and recorded a profit of $30,000 on the sale. Half of this inventory was still on hand at the end of 2003. Both companies are subject to a tax rate of 30%. UNI's Income statement for 2003 showed Sales and Operating Expenses (including Income Taxes) of $800,000 and $600,000 respectively before the equity method journal entries were prepared with respect to the Investment in UNI.

Required:

Prepare an abbreviated income statement for UNI Inc. one the Investment in IOU has been correctly accounted for in accordance with GAAP.

Solution:

Note: Prior to the preparation of the Income statement, we must compute the realized and unrealized profits for 2003.

Unrealized Profit:	**Before Tax**	**After Tax**
Beginning Inventory (upstream)	$10,000	$7,000
Ending Inventory (downstream)	$15,000	$10,500

Investment Income:

IOU's Income	$150,000	
Add: Upstream Profit Realized	$ 7,000	
UNI's ownership	30%	$47,100
Deduct: Unrealized Downstream Profit:		($10,500)
Deduct: Acquisition Differential Amortization		($20,000)
Investment Income		$16,500

UNI Inc.
Summarized Income Statement for the Year
Ended December 31, 2003

Sales	$800,000
Investment Income	$ 16,500
Less:	
Operating Expenses	$600,000

Net Income	$216,500

Difficulty: Hard
Level of Learning: Application
Topic: LO 4

57. On January 1, 2004, Black Corporation purchased 15 per cent of the outstanding shares of White Corporation for $498,000. From Black's perspective, White was a FVTPL investment. The fair value of Black's investment was $520,000 at December 31, 2004.

On January 1, 2005, Black purchased an additional 30 per cent of White's shares for $750,000. The second share purchase allows Black to exert significant influence over White There was an acquisition differential of 30 per cent on the date of acquisition.

During the two years White reported the following results:

	Profits	Dividends
2004	400,000	240,000
2005	540,000	250,000

Required:

With respect to this investment, prepare Black's journal entries for both 2004 and 2005.

Solution:

The 15 per cent purchase should be recorded under the fair value method. Black's journal entries during 2004 are as follows:

Investment in White	498,000	
Cash		498,000
Purchase 15% of White's shares		
Cash	36,000	
Dividend Income		36,000
15% of $240,000		
Investment in White	22,000	
Unrealized gain on FVTPL		22,000
520,000-498,000		

The shareholder will now record its share of White's income on the equity method as it now has significant influence.

Investment in White	750,000	
Investment in White		750,000
Purchase 30 per cent of the shares of White		
Investment in White	243,000	
Investment Income		243,000
45% of $540,000 profit		
Cash	87,500	
Investment in White		87,500
45% x $250,000 dividends		

Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

58. Dragon Corporation acquired a 7% interest in the outstanding shares of Slayer Inc. on January 1, 2007 at a cost of $200,000. Slayer reported net income and made dividend payments to its shareholders at noted below. On December 31, 2009 Slayer declared bankruptcy as a result of a series of losses as noted.

	Income	Dividends
2007	50,000	20,000
2008	(10,000)	20,000
2009	(40,000)	20,000

Required:

(a) Prepare the journal entries that Dragon would make in each year.
(b) Prepare the general ledger account for Dragon's investment in Slayer.

Solution:
(a)

1.1.2007	Investment in Slayer	200,000	
	Cash		200,000
	To record Dragon's investment in Slayer		
31.12.2007	Cash	1,400	
	Dividend Income		1,400
	To record dividend income		
31.12.2008	Cash	1,400	
	Dividend Income		1,400

To record dividend income

31.12.2009	Cash	1,400	
	Dividend Income		1,400
	To record dividend income		
31.12.2009	Loss on Investment	200,000	
	Investment in Slayer		200,000
	To write off investment after impairment		

(b) General Ledger

Investment in Slayer

	Dr	Cr	Balance
January 1, 2007-investment	200,0000		200,000
December 31, 2009-impairment		200,000	0

Difficulty: Moderate
Level of Learning: Application
Topic: LO 4

59. Telnor Corporation (whose year end is December 31 of each year) has made a series of investments in Pineapple Corp., one of their major customers. The management of Telnor has been impressed by the products produced and sold by Pineapple and their market success. These investments have been classified as available-for-sale and are only going to be held for a short period of time. The market price of Pineapple stock on December 31, 2008 and 2009 was $200 and $250 respectively per share. Dividends of $1.00 per share were declared and paid on December 31 of each year. The following are the purchases and sales that Telnor entered into in 2008 and 2009:

Date	No. Of Shares	Total	Cost (Per share)
March 31, 2008	1,000	1,000	$75
June 30, 2008	1,000	2,000	$125
September 30, 2008	1,000	3,000	$175
September 30, 2009	(5,000)	0	$240

Required:

(a) Prepare the journal entries to record the transactions in 2008 and 2009 with respect to Telnor's investment in Pineapple.
(b) How would Telnor disclose the investment in Pineapple on its balance sheet?

Solution:
(a)

Date	No. Of Shares	Total	Cost (Per share)	Total Cost
March 31, 2008	1,000	1,000	$75	$ 75,000

June 30, 2008	1,000	2,000	$125	$ 200,000
September 30, 2008	1,000	3,000	$175	$ 375,000
September 30, 2009	(5,000)	0	$240	$0

Unrealized gain at December 31, 2008 $600,000-$375,000=$225,000

(b)

12.31.2008	Investment in Pineapple	375,000	
	Cash		375,000
	To record investment		
12.31.2008	Investment in Pineapple	225,000	
	Other comprehensive income		225,000
	To record unrealized gain		
12.31.2008	Cash	3,000	
	Dividend Income		3,000
	To record dividend income		
12.31.2009	Cash	1,200,000	
	Cumulative Other comprehensive income	225,000	
	Gain on sale		825,000
	Investment in Pineapple		600,000
	To record disposal of Pineapple shares		

(c) The investment would be included in current assets given management's intention to hold them for a short period of time.

Difficulty: Hard
Level of Learning: Application
Topic: LO 4

60. Ronen Corporation owns 35% of the outstanding voting shares of Western Communications Inc. Over which it exerts significant influence. The carrying value of its investment as at October 31, 2009 was $3,750,000. Ronen has now designated its investment in Western as FVTPL as a result of the open market purchase of a 51% interest in Western by Overhaul Corp. Western is in financial distress. The market value of Ronen's 35% interest is now $2,000,000.

Required:

(a) What is the accounting result of a change from the equity method of accounting to FVTPL;

(b) Do any journal entries need to be recorded by Ronen as a result of this change? If so, what is the entry?

Solution:

(a) When an investment changes from significant influence to FVTPL the equity method ceases to be appropriate and the fair value method takes its place on a prospective basis. On this date, the investor shall measure at fair value any investment the investor retains in the former associate.

The investor shall recognize in profit or loss any difference between:

1. The fair value of any retained investment and any proceeds from disposing of the part interest in the associate; and
2. The carrying amount of the investment at the date when significant influence was lost.

(b)

Loss on investment	1,750,000	
Investment in Western Communications		1,750,000

Recording loss on change from significant influence to FVTPL

Difficulty: Moderate
Level of Learning: Synthesis
Topic: LO 4