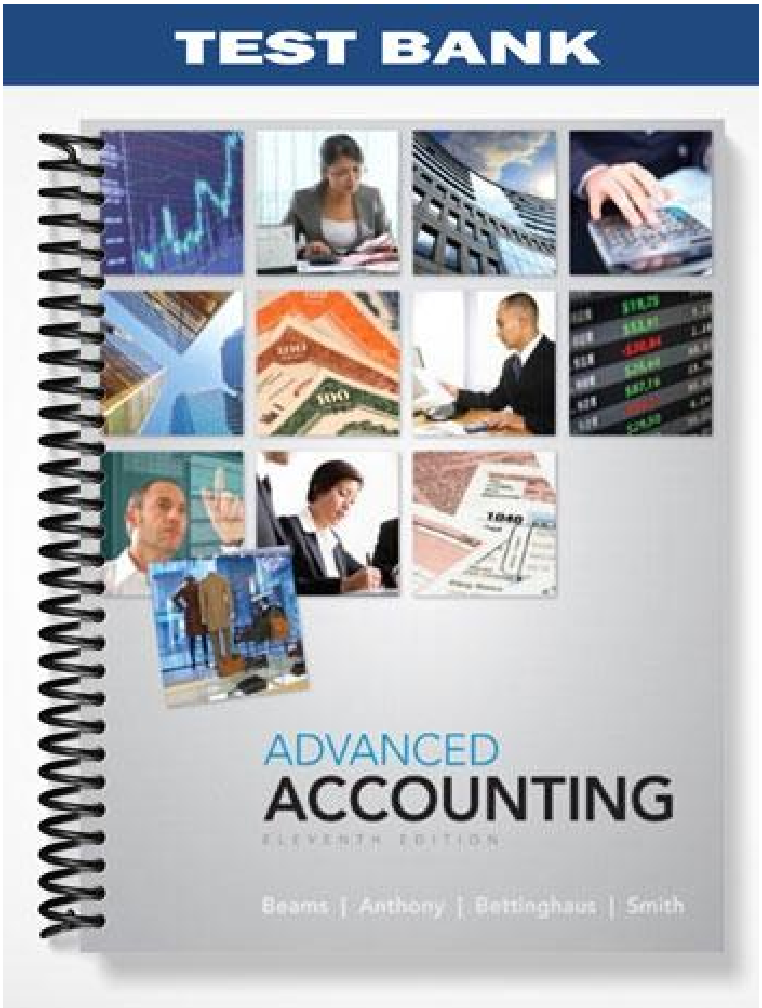
TEST BANK
ADVANCED
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Advanced Accounting, 11e **(Beams/Anthony/Bettinghaus/Smith)**
Chapter 2 Stock Investments — Investor Accounting and Reporting

Multiple Choice Questions

1) What method of accounting will generally be used when one company purchases less than 20% of the outstanding stock of another company?
A) Only the fair value method may be used.
B) Only the equity method may be used.
C) Either the fair value method or the equity method may be used, depending upon the relationship between the companies.
D) Neither the fair value method nor the equity method may be used, regardless of the level of ownership.
Answer: C
Objective: LO1
Difficulty: Easy

2) What method of accounting will generally be used when one company purchases between 20% to 50% of the outstanding stock of another company?
A) Only the fair value method may be used.
B) Only the equity method may be used.
C) Either the fair value method or the equity method may be used, depending upon the relationship between the companies.
D) Neither the fair value method nor the equity method may be used, regardless of the level of ownership.
Answer: C
Objective: LO1
Difficulty: Easy

3) Which one of the following items, originally recorded in the Investment in Falcon Co. account under the equity method, would not be systematically used to reduce investment income on a periodic basis?
A) Amortization expense of goodwill
B) Depreciation expense on the excess fair value attributed to machinery
C) Amortization expense on the excess fair value attributed to lease agreements
D) Interest expense on the excess fair value attributed to long-term bonds payable
Answer: A
Objective: LO5
Difficulty: Moderate

4) Which one of the following statements is correct for an investor company?
A) The balance in the Investment in Osprey Co. account can be reduced to represent a decline in the fair market value of the investment, but will not be adjusted if the fair market value increases.
B) Under the equity method, the balance in the Investment in Osprey Co. account can be negative if the investee corporation operates at a loss.
C) Once the balance in the Investment in Osprey Co. is reduced to zero, it will not be reduced any further.
D) Under the equity method, the balance in the Investment in Osprey Co. account will increase when cash dividends are received.
Answer: C
Objective: LO2
Difficulty: Moderate

5) Pinkerton Inc. owns 10% of Sable Company. In the most recent year, Sable had net earnings of $40,000 and paid dividends of $6,000. Pinkerton's accountant mistakenly assumed Pinkerton had considerable influence over Sable and used the equity method instead of the cost method. What is the impact on the investment account and net earnings, respectively?
A) By using the equity method, the accountant has understated the investment account and overstated the net earnings.
B) By using the equity method, the accountant has overstated the investment account and understated the net earnings.
C) By using the equity method, the accountant has understated the investment account and understated the net earnings.
D) By using the equity method, the accountant has overstated the investment account and overstated the net earnings.
Answer: D
Objective: LO3
Difficulty: Moderate

6) Griffon Incorporated holds a 30% ownership in Duck Corporation. Griffon should use the equity method under which of the following circumstances?
A) Griffon has surrendered significant stockholder rights by agreement between Griffon and Duck.
B) Griffon has been unable to secure a position on the Duck Corporation's Board of Directors.
C) Griffon has inadequate or untimely information to apply the equity method.
D) The ownership of Duck Corporation is diverse.
Answer: D
Objective: LO1
Difficulty: Easy

7) Pond Corporation uses the fair value method of accounting for its investment in Swan Company. Which one of the following events would affect the Investment in Swan Co. account?
A) Investee losses
B) Investee dividend payments
C) An increase in the investee's share price from last period
D) All of the above would affect the Investment in Swan Co. account.
Answer: C
Objective: LO2
Difficulty: Easy

8) Sadie Corporation's stockholders' equity at December 31, 2010 included the following:

6% Preferred stock, $10 par value	$1,000,000
Common stock, $1 par value	10,000,000
Other paid-in capital—common	4,000,000
Retained earnings	4,000,000
	$19,000,000

Pilga Corporation purchased a 30% interest in Sadie's common stock from other shareholders on January 1, 2011 for $5,800,000. What was the book value of Pilga's investment in Sadie on January 1, 2011?

A) $5,400,000
B) $5,700,000
C) $7,120,000
D) $7,440,000
Answer: A

Explanation: A) Total stockholders' equity	$19,000,000
Less: preferred equity	(1,000,000)
Equals: common equity	18,000,000
x Pilga's percentage	× 30%
Book value of Pilga investment	$5,400,000

Objective: LO5
Difficulty: Moderate

9) Jabiru Corporation purchased a 20% interest in Fish Company common stock on January 1, 2008 for $300,000. This investment was accounted for using the complete equity method and the correct balance in the Investment in Fish account on December 31, 2010 was $440,000. The original excess purchase transaction included $60,000 for a patent amortized at a rate of $6,000 per year. In 2011, Fish Corporation had net income of $4,000 per month earned uniformly throughout the year and paid $20,000 of dividends in May. If Jabiru sold one-half of its investment in Fish on August 1, 2011 for $500,000, how much gain was recognized on this transaction?

A) $278,950
B) $280,000
C) $280,950
D) $282,000
Answer: C
Explanation: C)

Dec 31, 2010 investment balance	$440,000
Jabiru's interest in Fish's income from Jan 1-July 31:	
($4,000 × 7 months × 20%) =	5,600
Less: Dividends ($20,000 × 20%) =	(4,000)
Less: Seven months of patent amortization:	
$500 × 7 =	(3,500)
Investment account balance at July 31, 2011	$438,100

Amount received from sale:	$500,000
Book value of one-half interest	(219,050)
Gain on sale	$280,950

Objective: LO5
Difficulty: Moderate

10) An investor uses the cost method of accounting for its investment in common stock. During the current year, the investor received $25,000 in dividends, an amount that exceeded the investor's share of the investee company's undistributed income since the investment was acquired. The investor should report dividend income of what amount?
A) $25,000
B) $25,000 less the amount in excess of its share of undistributed income since the investment was acquired
C) $25,000 less the amount that is not in excess of its share of undistributed income since the investment was acquired
D) None of the above is correct.
Answer: A
Objective: LO3
Difficulty: Easy

Use the following information to answer the question(s) below.

On January 1, 2011, Pansy Company acquired a 10% interest in Sunflower Corporation for $80,000 when Sunflower's stockholders' equity consisted of $400,000 capital stock and $100,000 retained earnings. Book values of Sunflower's net assets equaled their fair values on this date. Sunflower's net income and dividends for 2011 through 2013 were as follows:

	2011	2012	2013
Net income	$ 8,000	$ 10,000	$15,000
Dividends paid	5,000	5,000	5,000

11) Assume that Pansy Incorporated used the cost method of accounting for its investment in Sunflower. The balance in the Investment in Sunflower account at December 31, 2013 was
A) $76,700.
B) $80,000.
C) $83,300.
D) $95,000.
Answer: B
Explanation: B) Income and dividends are not added or deducted from the investment account under the cost method unless liquidating dividends are received
Objective: LO3
Difficulty: Moderate

12) Assume that Pansy has significant influence and uses the equity method of accounting for its investment in Sunflower. The balance in the Investment in Sunflower account at December 31, 2013 was
A) $78,200.
B) $80,000.
C) $81,800.
D) $83,300.
Answer: C
Explanation: C)

Initial Investment in Sunflower	$80,000
adjustments:	
2011: 10% × ($8,000-$5,000)=	300
2012: 10% × ($10,000-$5,000)=	500
2013: 10% × ($15,000-$5,000)=	1,000
Investment balance at 12/31/2013:	$81,800

Objective: LO3
Difficulty: Moderate

13) Pyming Corporation accounts for its 40% investment in Sillabog Company using the equity method. On the date of the original investment, fair values were equal to the book values except for a patent, which cost Pyming an additional $40,000. The patent had an estimated life of 10 years. Sillabog has a steady net income of $20,000 per year and consistently pays out 40% of its net income as dividends to its shareholders. Which one of the following statements is correct?
A) The net change in the investment account for each full year will be a debit of $8,000.
B) The net change in the investment account for each full year will be a debit of $4,800.
C) The net change in the investment account for each full year will be a debit of $800.
D) The net change in the investment account for each full year will be a credit of $800.
Answer: C
Objective: LO3
Difficulty: Moderate

14) Jacana Corporation paid $200,000 for a 25% interest in Lilypad Corporation's common stock on January 1, 2010, but was not able to exercise significant influence over Lilypad. During 2011, Jacana reported income of $120,000, excluding its income from Lilypad, and paid dividends of $50,000. Lilypad reported net income of $40,000 during 2011 and paid dividends of $20,000. Jacana should report net income for 2011 in the amount of
A) $115,000.
B) $120,000.
C) $125,000.
D) $130,000.
Answer: C
Explanation: C)

Jacana's separate income	$ 120,000
Dividend income from Lilypad	
equals $20,000 × 25% =	5,000
Jacana's net income =	$ 125,000

Objective: LO4
Difficulty: Moderate

15) Panda Corporation purchased 100,000 previously unissued shares of Skunk Company's $10 par value common stock directly from Skunk for $2,200,000. Skunk's stockholders' equity immediately before the investment by Panda consisted of $3,000,000 of common stock and $4,800,000 in retained earnings. What is Panda's book value of equity in the net assets of Skunk?
A) $2,200,000
B) $2,500,000
C) $3,000,000
D) $3,333,000
Answer: B
Explanation: B)

Shares outstanding before issue of new shares	300,000
Shares issued to Panda	100,000
Total shares outstanding	400,000
Percentage owned by Panda(100,000/400,000)	25.00%
Stockholders' equity before issue of new shares	$7,800,000
+Investment by Panda	2,200,000
=Stockholders' equity after Panda investment	10,000,000
× Panda's percentage ownership	25.00%
= Book value of Panda's interest	$2,500,000

Objective: LO5
Difficulty: Difficult

16) The income from an equity method investee is reported on one line of the investor company's income statement except when
A) the cost method is used.
B) the investee has extraordinary items.
C) the investor company is amortizing cost-book value differentials.
D) the investor company changes from the cost to the equity method.
Answer: B
Objective: LO5
Difficulty: Easy

17) Bart Company purchased a 30% interest in Simpson Corporation on January 1, 2008, and Bart accounted for its investment in Simpson under the equity method for the next 3 years. On January 1, 2011, Bart sold one-half of its interest in Simpson after which it could no longer exercise significant influence over Simpson. Bart should
A) continue to account for its remaining investment in Simpson under the equity method for the sake of consistency.
B) adjust the investment in Simpson account to one-half of its original amount and account for the remaining 15% interest using the equity method.
C) account for the remaining investment under the cost method, using the investment in Simpson account balance immediately after the sale as the new cost basis.
D) adjust the investment account to one-half of its original amount (one-half of the purchase price in 2008), and account for the remaining 15% investment under the cost method.
Answer: C
Objective: LO5
Difficulty: Easy

18) Pelican Corporation acquired a 25% interest in Seafare Incorporated at book value several years ago. Seafare declared $100,000 dividends in 2010 and reported its income for the year as follows:

Income from continuing operations	$600,000
Loss on discontinued division	(100,000)
Net income	$500,000

Pelican's Investment in Seafare account for 2010 should increase by
A) $ 100,000.
B) $ 125,000.
C) $ 150,000.
D) $ 180,000.
Answer: A
Explanation: A)

Pelican's share of income ($500,000 × 25%) =	$125,000
Pelican's share of dividends = $100,000 × 25%	(25,000)
Increase in investment account	$100,000

Objective: LO5
Difficulty: Moderate

19) In reference to intercompany transactions between an investor and an investee, when the investor can significantly influence the investee, which of the following statements is correct, assuming that the investor is using the equity method?
A) There is the presumption of arms-length bargaining between the related parties.
B) As long as the investor recognizes the effects of the transaction in its financial statements, it is not required to provide any additional disclosures.
C) In reporting its share of earnings and losses of an investee, the investor must eliminate the effect of profits and losses on the intercompany transactions until they are realized.
D) None of the above is correct.
Answer: C
Objective: LO5
Difficulty: Easy

20) In reference to the determination of goodwill impairment, which of the following statements is correct?
A) The goodwill impairment test under FASB 142 is a three-step process.
B) If the reporting unit's fair value exceeds its carrying value, goodwill is unimpaired.
C) Under FASB 142, firms must first compare carrying values (book values) at the firm level.
D) All of the above are correct.
Answer: B
Objective: LO6
Difficulty: Easy

21) Firms must conduct impairment tests more frequently than annually when
A) other shareholders hold more than 50% interest.
B) a more-likely-than-not expectation exists that a reporting unit will be sold or disposed of.
C) a specific unit does not have publicly traded stock.
D) using the equity method.
Answer: B
Objective: LO6
Difficulty: Easy

Exercises

1) Plum Corporation paid $700,000 for a 40% interest in Satin Company on January 1, 2011 when Plum's stockholders' equity was as follows:

10% cumulative preferred stock, $100 par	$ 500,000
Common stock, $10 par value	300,000
Other paid-in capital	400,000
Retained earnings	800,000
Total stockholders' equity	$2,000,000

On this date, the book values of Plum's assets and liabilities equaled their fair values and there were no dividends in arrears.

Required: Calculate the amount recorded in the Investment in Satin Company and the amount of implied Goodwill in this transaction.
Answer:

Cost of Satin investment (amount recorded in the Investment account):		$700,000
Less: book value acquired:		
Total equity	$2,000,000	
Less: Preferred equity	(500,000)	
Net common equity	1,500,000	
× percent acquired	× 40%	
= Plum book value acquired		(600,000)
Goodwill		$100,000

Objective: LO5
Difficulty: Moderate

2) Pike Corporation paid $100,000 for a 10% interest in Salmon Corp. on January 1, 2010, when Salmon's stockholders' equity consisted of $800,000 of $10 par value common stock and $200,000 retained earnings. On December 31, 2011, after receipt of the year's dividends from Salmon, Pike paid $192,000 for an additional 20% interest in Salmon Corp. Both of Pike's investments were made when Salmon's book values equaled their fair values. Salmon's net income and dividends for 2010 and 2011 were as follows:

	2010	2011
Net income	$60,000	$140,000
Dividends	$20,000	$40,000

Required:
1. Prepare journal entries for Pike Corporation to account for its investment in Salmon Corporation for 2010 and 2011.

2. Calculate the balance of Pike's investment in Salmon at December 31, 2011

Answer:
Requirement 1

Date	Accounts	Debit	Credit
01/01/10	Investment in Salmon	100,000	
	Cash		100,000
12/31/10	Cash	2,000	
	Dividend Income		2,000
12/31/11	Cash	4,000	
	Dividend Income		4,000
12/31/11	Investment in Salmon	192,000	
	Cash		192,000
12/31/11	Investment in Salmon	14,000	
	Retained Earnings		14,000

Requirement 2

Calculation of investment balance	
Cost of initial purchase of a 10% interest	$100,000
Cost of second purchase of a 20% interest	192,000
Adjustment for cost to equity basis	14,000
Investment balance, December 31, 2011	$306,000

Objective: LO5
Difficulty: Moderate

3) Pancake Corporation saw the potential for vertical integration and purchases a 15% interest in Syrup Corp. on January 1, 2010, for $150,000. At that date, Syrup's stockholders' equity included $200,000 of $10 par value common stock, $300,000 of additional paid in capital, and $500,000 retained earnings. The companies began to work together and realized improved sales by both parties. On December 31, 2011, Pancake paid $250,000 for an additional 20% interest in Syrup Corp. Both of Pancake's investments were made when Syrup's book values equaled their fair values. Syrup's net income and dividends for 2010 and 2011 were as follows:

	2010	2011
Net income	$220,000	$330,000
Dividends	$20,000	$30,000

Required:
1. Prepare journal entries for Pancake Corporation to account for its investment in Syrup Corporation for 2010 and 2011.

2. Calculate the balance of Pancake's investment in Syrup at December 31, 2011

Answer:
Requirement 1

Date	Accounts	Debit	Credit
01/01/10	Investment in Syrup	150,000	
	Cash		150,000
12/31/10	Cash		3,000
	Dividend Income		3,000
12/31/11	Cash		4,500
	Dividend Income		4,500
12/31/11	Investment in Syrup	250,000	
	Cash		250,000
12/31/11	Investment in Syrup	75,000	
	Retained Earnings		75,000

Requirement 2

Calculation of investment balance	
Cost of initial purchase of a 15% interest	$150,000
Cost of second purchase of a 20% interest	250,000
Adjustment for cost to equity basis	75,000
Investment balance, December 31, 2011	$475,000

Objective: LO5
Difficulty: Moderate

4) Wader's Corporation paid $120,000 for a 25% interest in Shell Company on July 1, 2010. No information is available on the fair value of Shell's assets and liabilities. Assume the equity method. Shell's trial balances at July 1, 2010 and December 31, 2010 were as follows:

Debits	December 31	July 1
Current assets	$100,000	$50,000
Noncurrent assets	300,000	310,000
Expenses	160,000	120,000
Dividends (paid in June)	40,000	40,000
Total	$ 600,000	$ 520,000

Credits		
Current Liabilities	$60,000	$40,000
Capital stock (no change)	200,000	200,000
Retained earnings Jan. 1	100,000	100,000
Sales	240,000	180,000
Total	$600,000	$520,000

Required:

1. What is Wader's investment income from Shell for the year ending December 31, 2010?

2. Calculate Wader's investment in Shell at year end December 31, 2010.

Answer:

Requirement 1

Sales (increase in trial balance)	$60,000
Less: Expense (increase in trial balance)	(40,000)
Net Income =	$20,000

Wader's ownership of 25% yields $5,000 investment income

Requirement 2

	Debit	Credit
Initial Investment	120,000	
Investment Income	5,000	
Total	125,000	

Objective: LO3
Difficulty: Moderate

5) On January 1, 2010, Platt Corporation purchased a 30% interest in Sandig Company for $450,000. On this date, the fair values of Sandig's assets and liabilities are assumed to be the same as their book values. Platt will account for Sandig using the equity method. Sandig's adjusted trial balance at the date of acquisition and year end were as follows:

Debits	December 31	January 1
Current assets	$160,000	$120,000
Noncurrent assets	420,000	460,000
Expenses	390,000	
Dividends (paid June 30)	40,000	
Total	$1,010,000	

Credits		
Current Liabilities	$90,000	$120,000
Capital stock	250,000	250,000
Beginning Retained earnings	140,000	140,000
Sales	530,000	
Total	$1,010,000	

Required:

1. What is Platt's investment income from Sandig for the year ending December 31, 2010?

2. Calculate Platt's investment in Sandig at year end December 31, 2010.

Answer:

Requirement 1

Sales for the year ending December 31, 2010	$530,000
Less: Expenses for the year ending December 31, 2010	(390,000)
Net income	140,000
Ownership percentage	30%
Investment income for 2010	$42,000

Requirement 2

	Investment in Sandig Company	
	Debit	Credit
Initial Investment	450,000	
Investment Income 2010	42,000	
Dividends, 2010		12,000
Ending Balance, 12/31/2010	480,000	

Objective: LO3

Difficulty: Moderate

6) Dotterel Corporation paid $200,000 cash for 40% of the voting common stock of Swamp Land Inc. on January 1, 2011. Book value and fair value information for Swamp on this date is as follows:

Assets	Book Values	Fair Values
Cash	$60,000	$60,000
Accounts receivable	120,000	120,000
Inventories	80,000	100,000
Equipment	340,000	400,000
	$ 600,000	$ 680,000
Liabilities & Equities		
Accounts payable	$200,000	$200,000
Note payable	120,000	100,000
Capital stock	200,000	
Retained earnings	80,000	
	$600,000	$300,000

Required:
Prepare an allocation schedule for Dotterel's investment in Swamp Land.
Answer:

Investment cost	$200,000
Book value acquired: $280,000 × 40% =	112,000
Excess cost over book value acquired =	$ 88,000

Schedule to Allocate Cost-Book Value Differentials

	Fair value - Book value	Interest	Amount Assigned
Inventories	$20,000	40%	$8,000
Equipment	60,000	40%	24,000
Notes payable	20,000	40%	8,000
Allocated to specific assets			$40,000
Remainder allocated to goodwill			48,000
Excess of cost over book value acquired			$88,000

Objective: LO5
Difficulty: Moderate

7) On January 1, 2011, Pendal Corporation purchased 25% of the outstanding common stock of Sedda Corporation for $100,000 cash. Book value and fair value of Sedda's assets and liabilities at the time of acquisition are shown below.

Assets	Book Values	Fair Values
Cash	$40,000	$40,000
Accounts receivable	100,000	90,000
Inventories	40,000	50,000
Equipment	180,000	210,000
	$360,000	$390,000
Liabilities & Equities		
Accounts payable	$110,000	$110,000
Note payable	50,000	40,000
Capital stock	100,000	
Retained earnings	100,000	
	$360,000	$150,000

Required:
Prepare an allocation schedule for Pendal's investment in Sedda.
Answer:

Investment cost	$100,000
Less: Book value acquired: $200,000 × 25% =	(50,000)
Excess cost over book value acquired =	$ 50,000

Schedule to Allocate Cost-Book Value Differentials

	Fair value-Book value	Interest	Amount Assigned
Accounts receivable	10,000	25%	$(2,500)
Inventories	10,000	25%	2,500
Equipment	30,000	25%	7,500
Notes payable	10,000	25%	2,500
Allocated to specific assets			$10,000
Remainder allocated to goodwill			40,000
Excess of cost over book value acquired			$50,000

Objective: LO5
Difficulty: Moderate

8) Sandpiper Inc. acquired a 30% interest in Shore Corporation for $27,000 cash on January 1, 2011, when Shore's stockholders' equity consisted of $30,000 of capital stock and $20,000 of retained earnings. Shore Corporation reported net income of $18,000 for 2011. The allocation of the $12,000 excess of cost over book value acquired on January 1 is shown below, along with information relating to the useful lives of the items:

Overvalued receivables (collected in 2011)	$(600)
Undervalued inventories (sold in 2011)	2,400
Undervalued building (6 years' useful life remaining at January 1, 2011)	3,600
Undervalued land	900
Unrecorded patent (8 years' economic life remaining at January 1, 2011)	3,200
Undervalued accounts payable (paid in 2011)	(300)
Total of excess allocated to identifiable assets and liabilities	9,200
Goodwill	2,800
Excess cost over book value acquired	$12,000

Required:

Determine Sandpiper's investment income from Shore for 2011.

Answer:

Sandpiper's share of Shore net income ($18,000 x 30%)	$5,400
Add: Overvalued accounts receivable collected in 2011	600
Add: Undervalued accounts payable paid in 2011	300
Less: Undervalued inventories sold in 2011	(2,400)
Less: Depreciation on building undervaluation $3,600/6	(600)
Less: Amortization on patent $3,200/8 years	(400)
Income from Shore	$2,900

Objective: LO5
Difficulty: Moderate

9) On January 1, 2011, Pailor Inc. purchased 40% of the outstanding stock of Saska Company for $300,000. At that time, Saska's stockholders' equity consisted of $270,000 common stock and $330,000 of retained earnings. Saska Corporation reported net income of $360,000 for 2011. The allocation of the $60,000 excess of cost over book value acquired is shown below, along with information relating to the useful lives of the items:

Overvalued receivables (collected in 2011)	$(5,000)
Undervalued inventories (sold in 2011)	16,000
Undervalued building (4 years' useful life remaining at January 1, 2011)	24,000
Undervalued land	8,000
Unrecorded patent (6 years' economic life remaining at January 1, 2011)	18,000
Undervalued accounts payable (paid in 2011)	(4,000)
Total of excess allocated to identifiable assets and liabilities	57,000
Goodwill	3,000
Excess cost over book value acquired	$60,000

Required:
Determine Pailor's investment income from Saska for 2011.
Answer:

Pailors's share of Saska net income ($360,000 × 40%)	$144,000
Add: Overvalued accounts receivable collected in 2011	5,000
Add: Undervalued accounts payable paid in 2011	4,000
Less: Undervalued inventories sold in 2011	(16,000)
Less: Depreciation on building undervaluation $24,000/4	(6,000)
Less: Amortization on patent $18,000/6 years	(3,000)
Income from Saska	$128,000

Objective: LO5
Difficulty: Moderate

10) Stilt Corporation purchased a 40% interest in the common stock of Shallow Company for $2,660,000 on January 1, 2011, when the book value of Shallow's net equity was $6,000,000. Shallow's book values equaled their fair values except for the following items:

	Book Value	Fair Value	Difference
Inventories	$450,000	$500,000	$ 50,000
Land	100,000	450,000	350,000
Building-net	400,000	200,000	(200,000)
Equipment-net	350,000	400,000	50,000

Required:
Prepare a schedule to allocate any excess purchase cost to identifiable assets and goodwill.
Answer:

Cost of Stilt's 40% investment in Shallow	$2,660,000
Less: Book value of net assets acquired:	
40% × $6,000,000 of net equity =	2,400,000
Excess cost over book value acquired =	$ 260,000

Schedule to Allocate Cost-Book Value Differentials

	Fair value-Book value		Interest	Amount Assigned
Inventories	$50,000	×	40%	$20,000
Land	350,000	×	40%	140,000
Building-net	(200,000)	×	40%	(80,000)
Equipment-net	50,000	×	40%	20,000
Excess allocated to specific assets and liabilities				$100,000
Excess allocated to goodwill				$160,000
Calculated excess of cost over book value				$260,000

Objective: LO5
Difficulty: Moderate

11) Paster Corporation was seeking to expand its customer base, and wanted to acquire a company in a market area it had not yet served. Paster determined that the Semma Company was already in the market they were pursuing, and on January 1, 2011, purchased a 25% interest in Semma to assure access to Semma's customer base. Paster paid $800,000, at a time when the book value of Semma's net equity was $3,000,000. Semma's book values equaled their fair values except for the following items:

	Book Value	Fair Value	Difference
Inventories	$150,000	$200,000	$ 50,000
Land	80,000	100,000	20,000
Building-net	220,000	180,000	(40,000)
Equipment-net	260,000	310,000	50,000

Required:
Prepare a schedule to allocate any excess purchase cost to identifiable assets and goodwill.
Answer:

Cost of Paster's 25% investment in Semma	$800,000
Less: Book Value of net assets acquired:	
25% × $3,000,000 of net equity =	750,000
Excess cost over book value acquired =	$50,000

Schedule to Allocate Cost-Book Value Differentials

	Fair value-Book value		Interest	Amount Assigned
Inventories	$50,000	×	25%	$12,500
Land	20,000	×	25%	5,000
Building-net	(40,000)	×	25%	(10,000)
Equipment-net	50,000	×	25%	12,500
Excess allocated to specific assets and liabilities				$20,000
Excess allocated to goodwill				$30,000
Calculated excess of cost over book value				$50,000

Objective: LO5
Difficulty: Moderate

12) Pearl Corporation paid $150,000 on January 1, 2010 for a 25% interest in Sandlin Inc. On January 1, 2010, the book value of Sandlin's stockholders' equity consisted of $200,000 of common stock and $200,000 of retained earnings. All the excess purchase cost over book value acquired was attributable to a patent with an estimated life of 5 years. During 2010 and 2011, Sandlin paid $3,000 of dividends each quarter and reported net income of $60,000 for 2010 and $80,000 for 2011. Pearl used the equity method.

Required:
1. Calculate Pearl's income from Sandlin for 2010.
2. Calculate Pearl's income from Sandlin for 2011.
3. Determine the balance of Pearl's Investment in Sandlin account on December 31, 2011.

Answer:

Cost of Pearl's 25% investment in Sandlin	$150,000
Less: Book value of net assets acquired:	
25% × $400,000 of net assets =	100,000
Excess cost over book value acquired =	$50,000

Requirement 1:

Pearl's 2010 income from Sandlin equals:	
(25% × $60,000) - $10,000 of	
patent amortization	$5,000

Requirement 2:

Pearl's 2011 income from Sandlin equals:	
(25% × $80,000) - patent amortization of $10,000 =	$10,000

Requirement 3:

Initial investment in Sandlin	$150,000
Plus: Net change for 2010: (Income of $5,000 - Dividends of $3,000)	2,000
Plus: Net change for 2011: (Income of $10,000 - Dividends of $3,000)	7,000
Investment balance at December 31, 2011:	$159,000

Objective: LO5
Difficulty: Moderate

13) On January 2, 2010, Slurg Corporation paid $600,000 to acquire 20% interest in Padwaddy Inc. At that time, the book value of Padwaddy's stockholders' equity included $700,000 of common stock and $1,800,000 of retained earnings. All the excess purchase cost over the book value acquired was attributable to a patent with an estimated life of 10 years. Padwaddy paid $6,250 of dividends each quarter for the next two years, and reported net income of $180,000 for 2010 and $220,000 for 2011. Slurg recorded all activities related to their investment using the equity method.

Required:
1. Calculate Slurg's income from Padwaddy for 2010.
2. Calculate Slurg's income from Padwaddy for 2011.
3. Determine the balance of Slurg's Investment in Padwaddy account on December 31, 2011.

Answer:

Cost of Slurg's 20% investment in Padwaddy	$600,000
Less: Book value of net assets acquired:	
20% × $2,500,000 of net assets =	500,000
Excess cost over book value acquired =	$100,000

Requirement 1:

Slurg's 2010 income from Padwaddy equals:	
(20% × $180,000) - $10,000 of patent amortization	$26,000

Requirement 2:

Slurg's 2011 income from Padwaddy equals:	
(20% × $220,000) - patent amortization of $10,000 =	$34,000

Requirement 3:

Initial investment in Padwaddy	$600,000
Plus: Net change for 2010: (Income of $26,000 - Dividends of $5,000)	21,000
Plus: Net change for 2011: (Income of $34,000 - Dividends of $5,000)	29,000
Investment balance at December 31, 2011:	$650,000

Objective: LO5
Difficulty: Moderate

14) Shebing Corporation had $80,000 of $10 par value common stock outstanding on January 1, 2010, and retained earnings of $120,000 on the same date. During 2010 and 2011, Shebing earned net incomes of $30,000 and $45,000, respectively, and paid dividends of $8,000 and $10,000, respectively.

On January 1, 2010, Pentz Company purchased 25% of Shebing's outstanding common stock for $60,000. On January 1, 2011, Pentz purchased an additional 10% of Shebing's outstanding stock for $30,200. The payments made by Pentz in excess of the book value of net assets acquired were attributed to equipment, with each excess value amount depreciable over 8 years under the straight-line method.

Required:
1. What is the adjustment to Investment Income for depreciation expense relating to Pentz's Investment in Shebing in 2010 and 2011?

2. What will be the December 31, 2011 balance in the Investment in Shebing account after all adjustments have been made?

Answer:

Calculation of Shebing's net assets at the end of each year:	
Shebing's net assets on January 1, 2010	$200,000
Plus: 2010 net income minus dividends ($30,000—$8,000)	22,000
Shebing's net assets at December 31, 2010	$222,000
Plus: 2011 net income minus dividends ($45,000-$10,000)	35,000
Shebing's net assets at December 31, 2011	$257,000

Pentz's adjusted fair value payments for equipment	
Pentz's January 1, 2010 initial investment cost	$60,000
Less: Pentz's share of Shebing's net assets on this date = (25% × $200,000) =	50,000
Equals: fair value adjustment for equipment	$10,000
Pentz's January 1, 2011 investment cost	$30,200
Less: Pentz's share of Shebing's net assets on this date = (10% × $222,000) =	22,200
Equals: fair value adjustment for equipment	$ 8,000

Requirement 1	
2010 equipment depreciation ($10,000/8 years)=	$1,250
2011 equipment depreciation ($10,000/8 years) + ($8,000/8 years)=	$2,250

Requirement 2:	
Direct investment costs ($60,000+$30,200)=	$90,200
Plus: 2010 adjustments (25%)×($30,000-$8,000)-$1,250 =	4,250
Plus: 2011 adjustments (35%)×($45,000-$10,000)-$2,250=	10,000
Equals: December 31, 2011 investment account balance	$104,450

Objective: LO5
Difficulty: Moderate

15) Shoreline Corporation had $3,000,000 of $10 par value common stock outstanding on January 1, 2009, and retained earnings of $1,000,000 on the same date. During 2009, 2010, and 2011, Shoreline earned net incomes of $400,000, $700,000, and $300,000, respectively, and paid dividends of $300,000, $550,000, and $100,000, respectively.

On January 1, 2009, Pebble purchased 21% of Shoreline's outstanding common stock for $1,240,000. On January 1, 2010, Pebble purchased 9% of Shoreline's outstanding stock for $510,000, and on January 1, 2011, Pebble purchased another 5% of Shoreline's outstanding stock for $320,000. All payments made by Pebble that are in excess of the appropriate book values were attributed to equipment, with each block depreciable over 20 years under the straight-line method.

Required:
1. What is the adjustment to Investment Income for depreciation expense for Pebble's investment in Shoreline in 2009, 2010, and 2011?

2. What will be the December 31, 2011 balance in the Investment in Shoreline account after all adjustments have been made?

Answer:

Calculation of Shoreline's net assets at the end of each year:

Shoreline's net assets on January 1, 2009	$4,000,000
Plus: 2009 net income minus dividends ($400,000 - $300,000)	100,000
Shoreline's net assets at December 31, 2009	$4,100,000
Plus: 2010 net income minus dividends ($700,000 - $550,000)	150,000
Shoreline's net assets at December 31, 2010	4,250,000
Plus: 2011 net income minus dividends ($300,000 - $100,000)	$200,000
Shoreline's net assets at December 31, 2011	$4,450,000

Pebble's adjusted fair value payments for equipment

Pebble's January 1, 2009 initial investment cost	$1,240,000
Less: Pebble's share of Shoreline's net assets on this date = (21% × $4,000,000) =	840,000
Equals: fair value adjustment for equipment	$400,000
Pebble's January 1, 2010 investment cost	$510,000
Less: Pebble's share of Shoreline's net assets on this date = (9% × $4,100,000) =	369,000
Equals: fair value adjustment for equipment	$141,000
Pebble's January 1, 2011 investment cost	$320,000
Less: Pebble's share of Shoreline's net assets on this date = (5% × $4,250,000) =	212,500
Equals: fair value adjustment for equipment	$107,500

Requirement 1

2009 equipment depreciation ($400,000/20 years)=	$20,000
2010 equipment depreciation ($400,000/20 years) + ($141,000/20 years)=	$ 27,050
2011 equipment depreciation ($400,000/20 years) + ($141,000/20 years) + ($107,500/20 years)=	$32,425

Requirement 2:

Direct investment costs ($1,240,000 + $510,000 + $320,000)=	$2,070,000
Plus: 2009 adjustments (21%) × ($400,000 - $300,000) - $20,000 =	1,000
Plus: 2010 adjustments (30%) × ($700,000 - $550,000) - $27,050 =	17,950
Plus: 2011 adjustments (35%) × ($300,000 - $100,000) - $32,425 =	37,575
Equals: December 31, 2011 investment account balance	$2,126,525

Objective: LO5
Difficulty: Difficult

16) For 2010 and 2011, Sabil Corporation earned net income of $480,000 and $640,000 and paid dividends of $18,000 and $20,000, respectively. At January 1, 2010, Sabil had $200,000 of $10 par value common stock outstanding and $1,500,000 of retained earnings.
On January 1 of each of these years, Phyit Corporation bought 10% of the outstanding common stock of Sabil paying $200,000 per 10% block on January 1, 2010 and 2011. All payments made by Phyit in excess of book value were attributable to equipment, which is depreciated over ten years on a straight-line basis.

Required:
1. If Phyit uses the cost method of accounting for its investment in Sabil, how much dividend income will Phyit recognize in 2010 and 2011, and what will be the balance in the investment account at the end of each year?
2. If Phyit has significant influence and can justify using the equity method of accounting, how much net investee income will Phyit recognize for 2010 and 2011?
Answer:
Requirement 1

2010 dividend income = 10% × $18,000 of dividends =	$1,800
2011 dividend income = 20% × $20,000 of dividends =	$4,000

Investment account

Jan 1, 2010 purchase =	$200,000
Dec 31, 2010 balance =	$200,000
Jan 1, 2011 purchase =	$200,000
Dec 31, 2011 balance =	$400,000

Calculation of Sabil's net assets at end of year:

Sabil net assets on January 1, 2010	$1,700,000
Plus: 2010 net income minus dividends ($480,000 - $18,000)0	462,000
Sabil net assets at December 31, 2010	$2,162,000
Plus: 2011 net income minus dividends ($640,000 - $20,000)	620,000
Sabil net assets at December 31, 2011	$2,782,000

Phyit's adjusted fair value payments for equipment

Phyit's January 1, 2010 initial investment cost	$200,000
Less: Phyit's share of Sabil net assets on this date = (10% × $1,700,000) =	170,000
Equals: fair value adjustment for equipment	$30,000

Phyit's January 1, 2011 investment cost	$ 200,000
Less: Phyit's share of Sabil net assets on this date = (10% × $2,162,000) =	(216,200)
Equals: fair value adjustment for equipment	$ (16,200)

2010 net income from Sabil = (10% × 480,000) - Depreciation of $3,000 ($30,000/10 years) =	$45,000
2011 net income from Sabil = (20% × 640,000) - depreciation of $3,000 from the 2010 purchase and + depreciation of $1,620 from the 2011 purchase ($16,200/10 years) for a total depreciation of $1,380.	$126,620

Objective: LO5
Difficulty: Moderate

17) For 2010, 2011, and 2012, Squid Corporation earned net incomes of $40,000, $70,000, and $100,000, respectively, and paid dividends of $24,000, $32,000, and $44,000, respectively. On January 1, 2010, Squid had $500,000 of $10 par value common stock outstanding and $100,000 of retained earnings.

On January 1 of each of these years, Albatross Corporation bought 5% of the outstanding common stock of Squid paying $37,000 per 5% block on January 1, 2010, 2011, and 2012. All payments made by Albatross in excess of book value were attributable to equipment, which is depreciated over five years on a straight-line basis.

Required:

1. Assuming that Albatross uses the cost method of accounting for its investment in Squid, how much dividend income will Albatross recognize for each of the three years and what will be the balance in the investment account at the end of each year?
2. Assuming that Albatross has significant influence and uses the equity method of accounting (even though its ownership percentage is less than 20%), how much net investee income will Albatross recognize for each of the three years?

Answer:

Requirement 1

2010 dividend income = 5% × $24,000 of dividends =	$1,200
2011 dividend income = 10% × $32,000 of dividends =	$3,200
2012 dividend income = 15% × $44,000 of dividends =	$6,600

Investment account

Jan 1, 2010 purchase =	$37,000
Dec 31, 2010 balance =	$37,000
Jan 1, 2011 purchase =	$37,000
Dec 31, 2011 balance =	$74,000
Jan 1, 2012 purchase =	$37,000
Dec 31, 2012 balance =	$111,000

Requirement 2:
Calculation of Squid's net assets at end of year:

Squid net assets on January 1, 2010	$600,000
Plus: 2010 net income minus dividends ($40,000 - $24,000)	16,000
Squid net assets at December 31, 2010	$616,000
Plus: 2011 net income minus dividends ($70,000 - $32,000)	38,000
Squid net assets at December 31, 2011	$654,000
Plus: 2012 net income minus dividends ($100,000 - $44,000)	56,000
Squid net assets at December 31, 2012	$710,000

Albatross' adjusted fair value payments for equipment

Albatross' January 1, 2010 initial investment cost	$37,000
Less: Albatross' share of Squid net assets on this date = (5% × $600,000) =	30,000
Equals: fair value adjustment for equipment	$7,000

Albatross' January 1, 2011 investment cost	$37,000
Less: Albatross' 5% share of Squid net assets on this date = (5% × $616,000) =	30,800
Equals: fair value adjustment for equipment	$6,200

Albatross' January 1, 2012 investment cost	$37,000
Less: Albatross' share of Squid net assets on this date = (5% × $654,000) =	32,700
Equals: fair value adjustment for equipment	$4,300

2010 net income from Squid (investee) = (5% × 40,000) - Depreciation of $1,400 ($7,000/5 years) =	$600
2011 net income from Squid (investee) = (10% × 70,000) - depreciation of $1,400 from the 2010 purchase and — depreciation of $1,240 from the 2011 purchase ($6,200/5 years) for a total depreciation of $2,640.	$4,360
2012 net income from Squid (investee) = (15% × 100,000) — depreciation of $1,400 from the 2010 purchase and - depreciation of $1,240 from the 2011 purchase and - depreciation of $860 from the 2012 purchase ($4,300/5 years)for a total depreciation of $3,500.	$11,500

Objective: LO5
Difficulty: Difficult

18) On January 1, 2010, Petrel, Inc. purchased 70% of the outstanding voting common stock of Ocean, Inc., for $2,600,000. The book value of Ocean's net equity on that date was $3,100,000. Book values were equal to fair values except as follows:

Assets & Liabilities	Book Values	Fair Values
Equipment	$ 250,000	$ 190,000
Building	600,000	700,000
Note payable	270,000	240,000

Required:
Prepare a schedule to allocate any excess purchase cost to specific assets and liabilities.
Answer:

Cost of Petrel's 70% investment in Ocean	$2,600,000
Less:Book value of net assets acquired:	
70% × 3,100,000 of net assets =	2,170,000
Excess cost over book value acquired =	$ 430,000

Schedule to Allocate Cost-Book Value Differentials

	Fair value-Book value		Interest	Amount Assigned
Equipment	$(60,000)	×	70%	$(42,000)
Building	100,000	×	70%	70,000
Note payable	30,000	×	70%	21,000
Excess allocated to specific assets and liabilities				$49,000
Excess allocated to goodwill				381,000
Calculated excess of cost over book value				$430,000

Objective: LO5
Difficulty: Moderate

19) On January 1, 2010, Palgan, Co. purchased 75% of the outstanding voting common stock of Somil, Inc., for $1,500,000. The book value of Somil's net equity on that date was $2,000,000. Book values were equal to fair values except as follows:

Assets & Liabilities	Book Values	Fair Values
Inventory	$ 225,000	$ 253,000
Building	850,000	750,000
Note payable	320,000	304,000

Required:
Prepare a schedule to allocate any excess purchase cost to specific assets and liabilities.
Answer:

Cost of Palgan's 75% investment in Somil	$1,500,000
Less: Book value of net assets acquired:	
75% × 2,000,000 of net assets =	1,500,000
Excess cost over book value acquired =	$ 0

Schedule to Allocate Cost-Book Value Differentials

	Fair value-Book value		Interest	Amount Assigned
Inventory	$ 28,000	×	75%	$ 21,000
Building	(100,000)	×	75%	(75,000)
Note payable	16,000	×	75%	12,000
Excess allocated to specific assets and liabilities				$ (42,000
Excess allocated to goodwill				42,000
Calculated excess of cost over book value				$ 0

Objective: LO5
Difficulty: Moderate

20) Keynse Company owns 70% of Subdia Incorporated. The Investment in Subdia qualifies as a business reporting unit under FASB 142, and Keynse has reported goodwill in the amount of $200,000 with respect to its acquisition of Subdia. Subdia's $10 par common stock is currently trading for $92 per share, Subdia's account book balances and related fair values at December 31, 2011 are shown below.

	Book Values	Fair Values
Cash	$2,000,000	$2,000,000
Accounts Receivable	8,000,000	7,500,000
Plant assets — net	18,000,000	23,000,000
Patents	1,000,000	1,500,000
Accounts Payable	(9,000,000)	(9,000,000)
Notes Payable	(16,000,000)	(16,000,000)
Common Stock	(1,000,000)	
Retained Earnings	(3,000,000)	

Required: Determine if Goodwill has been impaired, and if so, the amount of adjustment that would be required.

Answer:
Step 1: Determine if goodwill is impaired. Compare book value of reporting unit to fair value of reporting unit. (Book value of reporting unit includes goodwill.)

Fair value of reporting unit	$9,000,000 (net assets)
Book value of reporting unit	$4,200,000

Book value of reporting unit:

Common stock	$1,000,000
Goodwill	200,000
Retained earnings	3,000,000
Total	$ 4,200,000

Fair value of reporting unit:

Cash	$2,000,000
Accounts receivable	7,500,000
Plant assets	23,000,000
Patents	1,500,000
Accounts payable	(9,000,000)
Notes payable	(16,000,000)
Tota	$ 9,000,000

If the reporting unit's fair value exceeds its book value(with goodwill), goodwill is not impaired. In this case, the reporting unit's fair value exceeds its book value, so goodwill is not impaired. No adjustment is required. No further work is needed.
Objective: LO6
Difficulty: Moderate