1) Passive investments can be classified as fair value through profit or loss (FVTPL) or as fair value through other comprehensive income (FVTOCI). Which of the following statements is *true*?
A) Under both FVTPL and FVTOCI, changes in the fair value of the investment are reported as other comprehensive income on the statement of comprehensive income.
B) Under both FVTPL and FVTOCI, changes in the fair value of the investment are reported under the net income section on the statement of comprehensive income.
C) Under both FVTPL and FVTOCI, dividends received from the investee are reported under the net income section on the statement of comprehensive income.
D) Under both FVTPL and FVTOCI, dividends received from the investee are reported as other comprehensive income on the statement of comprehensive income.
Answer: C
Page Ref: 28
Learning Obj.: 2.2
Difficulty: Moderate

2) Rudd Ltd. has a passive investment in Burke Ltd. Rudd has elected to treat Burke as a fair value through other comprehensive income (FVTOCI) investment under IFRS 9 *Financial Instruments*. Which of the following statements is *true*?
A) Dividends from Burke are reported as other comprehensive income in Rudd's statement of comprehensive income (SCI).
B) Dividends from Burke are reported as a line item on Rudd's statement of financial position.
C) Year-to-year changes in the fair value of the investment in Burke are reported as net income in Rudd's SCI.
D) Accumulated gains and losses in the fair value of investment in Burke should be reported as a separate component in Rudd's shareholders' equity on the statement of financial position.
Answer: D
Page Ref: 28
Learning Obj.: 2.2
Difficulty: Moderate

3) Townsend Ltd. has the following shareholders:

Palermo Co.—60%
Nix Ltd.—30%
Riley Ltd.—10%

Nix does not conduct any business with Townsend; nor has it been able to secure a seat on the board of directors. Which of the following statements is *true*?
A) Nix has significant influence over Townsend.
B) Nix should consider Townsend to be a special purpose entity.
C) Nix should consider Townsend to be an associated company.
D) Nix should treat Townsend as a non-strategic investment.
Answer: D
Page Ref: 30-32, 35
Learning Obj.: 2.1
Difficulty: Moderate

4) O'Reilly Ltd. incorporated O'Reilly R&D Co. to conduct research and development activities. O'Reilly

R&D is a(n) ________.
A) associated company
B) joint venture
C) structured entity
D) passive investment
Answer: C
Page Ref: 32-33
Learning Obj.: 2.1
Difficulty: Easy

5) What is securitization?
A) It is the process of issuing long-term debt for financing.
B) It is the process of issuing preferred and common shares for financing.
C) It is the process of transferring long-term liabilities to a structured entity.
D) It is the process of transferring receivables to a structured entity and issuing securities to finance those receivables.
Answer: D
Page Ref: 33
Learning Obj.: 2.2
Difficulty: Easy

6) In Canada, what entities must be included in consolidated financial statements?
A) Subsidiaries only
B) All subsidiaries, except for ones in unrelated industries
C) All domestic subsidiaries
D) All subsidiaries and structured entities
Answer: D
Page Ref: 33-34
Learning Obj.: 2.2
Difficulty: Moderate

7) Bela Ltd. has invested in several domestic manufacturing corporations. Which of the following investments would most likely be accounted for under the equity method on Bela's financial statements?
A) A holding of 15,000 of the 50,000 outstanding common shares of Earthwise Co.
B) A holding of 3,000 of the 10,000 outstanding preferred shares of Earthbent Co.
C) A holding of 5,000 of the 60,000 outstanding common shares of Earth-Kind Co.
D) A holding of 20,000 of the 25,000 outstanding common shares of Earth-Clean Co.
Answer: A
Page Ref: 35-36
Learning Obj.: 2.1
Difficulty: Easy

8) On January 1, 20X1, Best Décor Ltd. started Chic Styles Ltd. by contributing $500,000 and received 100% of the common shares of Chic Styles. Chic Styles reported net income of $50,000 in 20X1 and $75,000 in 20X2 and paid out 40% of its net income as dividends in each year. Under the equity method, what amount should be reported as *Investment in Chic Styles* and *Investment Income* on Best Décor's separate-entity 20X2 financial statements?

A)

Investment in Chic Styles	Investment Income
$500,000	$30,000

B)

Investment in Chic Styles	Investment Income
$575,000	$75,000

C)

Investment in Chic Styles	Investment Income
$625,000	$30,000

D)

Investment in Chic Styles	Investment Income
$625,000	$75,000

Answer: B
Page Ref: 36
Learning Obj.: 2.2
Difficulty: Moderate

9) Townsend Ltd. has the following shareholders:

Palermo Co.—60%
Nix Ltd.—30%
Riley Ltd.—10%

Nix has two seats on Townsend's five-person board of directors. Which of the following statements is *true*?
A) Nix has significant influence over Townsend.
B) Nix has control over Townsend.
C) Townsend is a special purpose entity to Nix.
D) Nix should treat Townsend as a passive investment.
Answer: A
Page Ref: 35
Learning Obj.: 2.1
Difficulty: Moderate

10) Which of the following is *not* an indicator of significant influence?
A) The investor has representation on the investee's board of directors.
B) There are material transactions between the investor and the investee.
C) The investor and the investee share office space and use the same accounting firm.
D) The investor provides computing services to the investee.
Answer: C
Page Ref: 35
Learning Obj.: 2.1
Difficulty: Easy

11) How do joint ventures differ from private corporations?
A) The joint venturers must share the risks and profits of the joint venture equally.
B) There can only be two parties in a joint venture.
C) A joint venture does not have a board of directors.
D) Venturers cannot make unilateral decisions.
Answer: D
Page Ref: 37
Learning Obj.: 2.1
Difficulty: Moderate

12) On whose books are the consolidating adjusting entries recorded?
A) In the general journal of both the parent and subsidiary companies
B) In the general journal of the parent company and on the consolidated worksheet
C) In the general journal of both the parent and subsidiary companies and on the consolidated worksheet
D) Only on the consolidated worksheet
Answer: D
Page Ref: 38
Learning Obj.: 2.3
Difficulty: Easy

13) How are most significant influence investments in equity securities actually recorded on the investors' books?
A) Using the cost method
B) Using the equity method
C) Using proportionate consolidation
D) On a fully consolidated basis
Answer: A
Page Ref: 38
Learning Obj.: 2.2
Difficulty: Moderate

14) Which of the following statements about the direct approach to consolidation is true?
A) It can be used for both simple and complex consolidations.
B) It is a more methodical and less intuitive approach than the worksheet approach.
C) The starting point for preparing the consolidated financial statements is the financial statements for each of the parent and subsidiary companies.
D) The starting point for preparing the consolidated financial statements is the trial balance for each of the parent and subsidiary companies.
Answer: C
Page Ref: 39
Learning Obj.: 2.3
Difficulty: Moderate

15) Carr Co. owns 100% of the common shares of Ice Tops Ltd. Carr records its investment in Ice Tops using the cost method. Carr and Ice Tops have transactions with each other. In preparing Carr's consolidated financial statements, which of the following should be done?
A) Ice Tops's retained earnings should be deducted from Carr's retained earnings.
B) Ice Tops's share capital should be added to Carr's share capital.
C) Dividends received by Carr from Ice Tops should be deducted from Carr's dividend income.
D) Carr's receivable from Ice Tops should be netted with Carr's accounts receivable.
Answer: C
Page Ref: 43-45
Learning Obj.: 2.3, 2.4
Difficulty: Moderate

16) Forest Ltd. accounts for its investment in Leeds Co. using the cost method. During the year, Forest received $10,000 in dividends from Leeds. How should Forest report these dividends on its separate-entity financial statements?
A) As an increase to the "Investment in Leeds Co." account on its statement of financial position
B) As a decrease to the "Investment in Leeds Co." account on its statement of financial position
C) As dividend income on its statement of changes in equity-retained earnings section
D) As dividend income in its statement of comprehensive income
Answer: D
Page Ref: 43
Learning Obj.: 2.2
Difficulty: Moderate

17) At the beginning of 20X1, Anwar Ltd. acquired 15% of the voting shares of Cruz Co. for $150,000. Anwar does not have any significant influence over Cruz. Anwar reports the investment using the cost method. In 20X1, Cruz earned net income of $70,000 and paid dividends of $40,000. In 20X2, Cruz earned net income of $80,000 and paid dividends of $100,000. At the end of 20X2, what journal entry should Anwar make to record its share of Cruz's net income?

A)

DR Investment in Cruz	12,000
CR Investment income	12,000

B)

DR Investment in Cruz	18,000
CR Investment income	18,000

C)

DR Investment in Cruz	80,000
CR Investment income	80,000

D) No entry is required
Answer: D
Page Ref: 29, 43
Learning Obj.: 2.2
Difficulty: Moderate

18) At the beginning of 20X1, Anwar Ltd. acquired 15% of the voting shares of Cruz Co. for $150,000. Anwar does not have any significant influence over Cruz. Anwar reports the investment using the cost method. In 20X1, Cruz earned net income of $70,000 and paid dividends of $40,000. In 20X2, Cruz earned net income of $80,000 and paid dividends of $100,000. At the end of 20X2, what journal entry should Anwar make on its books to record the dividends from Cruz?

A)

DRCash	12,000
CR Investment in Cruz	12,000

B)

DRCash	15,000
CR Investment in Cruz	15,000

C)

DRCash	15,000
CR Investment income	15,000

D) No entry is required
Answer: C
Page Ref: 29, 43
Learning Obj.: 2.2
Difficulty: Moderate

19) At the beginning of 20X1, Anwar Ltd. acquired 15% of the voting shares of Cruz Co. for $150,000. Anwar does not have any significant influence over Cruz. Anwar reports the investment using the cost method. In 20X1, Cruz earned net income of $70,000 and paid dividends of $40,000. In 20X2, Cruz earned net income of $80,000 and paid dividends of $100,000. At the end of 20X2, what is the balance of Anwar's "Investment in Cruz" account?
A) $150,000
B) $150,150
C) $154,500
D) $172,500
Answer: A
Page Ref: 29, 43, 45
Learning Obj.: 2.2
Difficulty: Moderate

20) On January 1, 20X1, Belle Ltd. purchased 100% of the common shares of Dominique Corporation for $700,000. Dominique's net income was $30,000 for 20X1 and $50,000 for 20X2. Dominique paid dividends of $20,000 on its common shares during 20X1 and $100,000 during 20X2. As such, total dividends paid by Dominique exceeded income earned by Dominique since it was acquired by Belle. What is the balance in the investment in Dominique's account at the end of 20X2 under the cost and equity methods?

A)

Cost	Equity
$660,000	$700,000

B)

Cost	Equity
$660,000	$660,000

C)

Cost	Equity
$700,000	$660,000

D)

Cost	Equity
$700,000	$700,000

Answer: C
Page Ref: 43, 45, 48-50
Learning Obj.: 2.2
Difficulty: Moderate

21) Rally Ltd. owns 70% of Neily Ltd. and records it using the cost method. Neily did not have any transactions with Rally with the exception of the payment of dividends. On its separate-entity financial statements, Rally plans to *report* its investment in Neily using the equity method. To this end, Rally has prepared a worksheet with adjustments to eliminate the dividends and recognize its share of Neily's current income. To recognize Rally's share of Neily's unremitted income in prior years, the following adjustments should be made:
A) Debit the *Investment in Neily* account and credit the *Retained Earnings* account.
B) Debit the *Retained Earnings* account and credit the *Investment in Neily* account.
C) Debit the *Investment in Neily* account and credit the *Equity in Earnings of Neily* account.
D) No entry is required at this time.
Answer: A
Page Ref: 49
Learning Obj.: 2.2, 2.4
Difficulty: Difficult

22) At the beginning of 20X1, Rally Ltd. acquired 18% of Neily Co. for $90,000. Rally has significant influence over Neily. Rally records the investment in Neily using the cost method. Rally's share of Neily's income was $29,000 for 20X1 and $33,000 for 20X2. Rally received dividends from Neily of $25,000 in 20X1 and $35,000 in 20X2. For reporting purposes in 20X2, what adjustment must be made to recognize Rally's share of Neily's 20X2 income?
A)

DR Income receivable from Neily	33,000
CR Equity in earnings of Neily	33,000

B)

DR Income receivable from Neily	33,000
CR Investment in Neily	33,000

C)

DR Investment in Neily	33,000
CR Equity in earnings of Neily	33,000

D) No entry is required
Answer: C
Page Ref: 49
Learning Obj.: 2.2
Difficulty: Moderate

23) Forest Ltd. reports its investment in Leeds Co. on an equity basis. During the year, Forest received $10,000 in dividends from Leeds. How should Forest report these dividends?
A) As an increase to the "Investment in Leeds Co." account on its statement of financial position
B) As a decrease to the "Investment in Leeds Co." account on its statement of financial position
C) As dividend income on its statement of changes in equity-retained earnings section
D) As dividend income in its statement of comprehensive income
Answer: B
Page Ref: 49
Learning Obj.: 2.2
Difficulty: Moderate

24) Jarrett Corporation uses the equity method to account for its 25% investment in Polo Corporation and receives $15,000 in dividends. How should Jarrett account for these dividends?
A) An increase in assets
B) A decrease in the investment
C) An increase in income
D) A decrease in income
Answer: B
Page Ref: 49
Learning Obj.: 2.2
Difficulty: Easy

25) Which methods will result in the same income and shareholders' equity?
A) Equity and consolidation
B) Cost and consolidation
C) Cost and equity
D) Each method results in different income and shareholders' equity amounts.
Answer: A
Page Ref: 50-52
Learning Obj.: 2.5
Difficulty: Moderate

26) Gunnar Ltd. owns 100% of the common shares of Ivy Ltd. During the year, Gunnar reported net income of $108,000, including its income from its investment in Ivy accounted for under the cost method. Ivy reported net income of $20,000 and paid dividends of $8,000 during the year. What net income will be reported by Gunnar on its separate-entity financial statements under the equity method and on its consolidated financial statements?
A)

Equity Method	Consolidated Financial Statements
$112,000	$112,000

B)

Equity Method	Consolidated Financial Statements
$112,000	$120,000

C)

Equity Method	Consolidated Financial Statements
$120,000	$112,000

D)

Equity Method	Consolidated Financial Statements
$120,000	$120,000

Answer: D
Page Ref: 50-52
Learning Obj.: 2.2, 2.3, 2.4, 2.5
Difficulty: Moderate

27) In changing from the cost method to consolidation, which of the following is *not* required?
A) Replacement of the "Investment in Subsidiary" account with the assets and liabilities of the subsidiary
B) Elimination of intercompany transactions and balances
C) Elimination of the subsidiary's share capital account
D) Elimination of the subsidiary's retained earnings since acquisition
Answer: D
Page Ref: 55
Learning Obj.: 2.2, 2.3, 2.4, 2.5
Difficulty: Moderate

28) Under which method does the statement of comprehensive income show "Equity in earnings of Subsidiary"?
A) Cost method
B) Equity method
C) Modified equity
D) Consolidation
Answer: B
Page Ref: 49 and 51
Learning Obj.: 2.2, 2.3
Difficulty: Easy

29) Under the equity method, the purchase price discrepancy (PPD) is ________.
A) the difference between the carrying value of the investment in the books of the investee and the purchase price paid by the investor
B) the difference between the market value of the investment in the books of the investee and the purchase price paid by the investor
C) the difference between the implied cost of the investment in the books of the investee and the purchase price of the investor
D) the difference between the net present value of the investment in the books of the investee and the purchase price paid by the investor
Answer: A
Page Ref: 55
Learning Obj.: 2.3
Difficulty: Moderate

30) Diaz Ltd. acquired 35% of Saturn Ltd. many years ago. At first, Saturn was profitable, but recently, it has been posting losses. Diaz believes that Saturn will be profitable again and has no plans to dispose of it, even though Diaz's share of the losses has exceeded its investment interest. Diaz uses the equity method. Which of the following statements is true?
A) Diaz should continue to decrease its "Investment in Saturn" account.
B) Diaz should put its share of Saturn's losses in a contra-account to its "Investment in Saturn" account, to be reduced by Saturn's future profits.
C) Diaz should reduce its retained earnings directly by its share of Saturn's losses.
D) Diaz should stop recognizing its share of Saturn's losses and not recognize Saturn's future profits until they exceed the unrecognized losses.
Answer: D
Page Ref: 56
Learning Obj.: 2.3, 2.5

Difficulty: Difficult

31) Jonas Co. owned 60% of Kara Co.'s voting shares and 25% of Lynn Ltd.'s voting shares. Kara owns 30% of Lynn's voting shares. Which of the following statements is *true*?
A) Kara is the only subsidiary of Jonas.
B) Both Kara and Lynn are subsidiaries of Jonas.
C) Lynn is a subsidiary of both Kara and Jonas.
D) Lynn is the only subsidiary of Kara.
Answer: B
Page Ref: 57-58
Learning Obj.: 2.3
Difficulty: Moderate

32) Bud Ltd. owns 100% of Calla Co. Calla owns 55% of Daisy Ltd., and Daisy owns 90% of Fern Ltd. Which of the following statements is *true*?
A) Only Bud has to prepare consolidated financial statements.
B) Only Bud and Calla have to prepare consolidated financial statements.
C) Only Bud and Daisy have to prepare consolidated financial statements.
D) Bud, Calla, Daisy, and Fern have to prepare non-consolidated financial statements.
Answer: D
Page Ref: 58
Learning Obj.: 2.2, 2.3
Difficulty: Moderate

33) Ritva Co purchased a 38% interest in Saron Ltd on October 1, 20X9, for $795,000. Management at Ritva is now preparing the first set of financial statements since the acquisition and is unsure of how to report the investment.

A) If Ritva is a publicly traded company following IFRS, can the investment be reported on an equity basis? On a cost basis? At fair market value through profit or loss? Under what circumstances would each of these be appropriate for reporting purposes? What would be the impact on net earnings under each method? What is the impact on the investment account under each method?
B) If Ritva is a privately held corporation following ASPE, can the investment be reported on an equity basis? On a cost basis? At fair market value through profit or loss? Under what circumstances would each of these be appropriate for reporting purposes?

Answer:
Part A)
Equity: Under IFRS, the equity basis is used when an investment has been purchased for strategic reasons and the investor has significant influence. Significant influence is the ability to participate in the operating and financing policy decisions of the investee. In this case, Ritva owns 38% of Saron, which may indicate that Ritva has the ability to participate in decisions since this is greater than the 20% normally indicated. If there was evidence available to indicate that this was not the case, then the investment would have to be recorded as a passive investment. Provided Ritva plans to hold this investment and influence the decisions, the equity basis must be used. Under this method, Ritva would report in earnings (and OCI) its proportionate share of earnings (and OCI) from Saron each year. The investment account will represent the initial investment cost plus Ritva's proportionate share of Saron's earnings since the acquisition date, less any dividends received from Saron since the acquisition date.

Cost: The cost basis is not allowed for equity investments for reporting purposes under IFRS. It may be used for *recording* purposes only, and then adjustments would be required at the end of the year to adjust the investment account to an equity basis (or consolidated, if this was appropriate). Under the cost basis, dividends received from Saron during the year would be reported in Ritva's net income. Under this method, the investment account would remain unchanged at $795,000.

FVTPL: If Ritva purchased the investment in Saron to actively trade for short-term profits or to strictly earn dividends, then the investment is a passive investment. In addition, if there was evidence to indicate that Ritva could not significantly influence the decisions of Saron, even though it owned more than 20% of the voting shares, then the investment would also be reported as a passive investment. Passive equity investments under IFRS must be reported as a financial instrument and at fair value at each reporting period. Under this method, dividend income and the changes in fair value are reported in Ritva's net earnings. The investment account would be the fair value of the shares owned in Saron at each reporting period.

Part B)
Under ASPE, Ritva has a choice to using either the equity or the cost method when it has significant influence in the investment. However, once the choice is made, all equity investments that the company has significant influence in must be reported in the same manner. Significant influence is the ability to exercise influence over the strategic operating, investing, and financing policy decisions of the investee. In this case, Ritva owns 38% of Saron, which may indicate that Ritva has this ability to influence decisions since this is greater than the 20% normally indicated. If there was evidence available to indicate that this

was not the case, then the investment would have to be recorded as a passive investment.

Assuming that this is Rita’s only equity investment with significant influence, it will have a choice of using either the equity or the cost basis.

Equity: Under ASPE, the equity basis may be used when an investment has been purchased for strategic reasons and the investor has significant influence. Under this method, Ritva would report in earnings its proportionate share of earnings from Saron each year. The investment account will represent the initial investment cost plus Ritva's proportionate share of Saron's earnings since the acquisition date, less any dividends received from Saron since the acquisition date.

Cost: The cost basis is also allowed for equity investments with significant influence. If the shares of Saron are not publicly traded, and there is evidence of no significant influence, Ritva could still use the cost basis under ASPE for these shares. Under the cost basis, dividends received from Saron during the year would be reported in Ritva's net income. Under this method, the investment account would remain unchanged at $795,000. This method is not allowed if Saron’s shares are publicly traded.

FVTPL: Under ASPE, a company has the choice of using fair value for equity investments that are passive investments. In addition, if there was evidence to indicate that Ritva could not significantly influence the decisions of Saron, even though it owned more than 20% of voting shares, then the investment would also be reported as a passive investment. Under ASPE, if the shares of Sharon are not publicly traded, then Ritva has a choice of using either the cost method (above) or the fair value method. If the shares of Saron are publicly traded, then ASPE requires these shares be reported at fair value at each reporting period. Under this method, dividend income and the changes in fair value are reported in Ritva's net earnings. The investment account would be the fair value of the shares owned in Saron at each reporting period.
Page Ref: 28-31 and 35-36
Learning Obj.: 2.1, 2.2
Difficulty: Difficult

34) On February 1, 20X5, Peter Co. purchased 20% of the outstanding shares of Mary Inc. at a cost of $275,000. During the next two fiscal years, Mary Inc. reported the following:

	Net income	Dividends
January 31, 20X6	$42,000	$20,000
January 31, 20X7	$35,000	$15,000

The fair value of the investment in Mary shares was $310,000 and $260,000, on January 31, 20X6 and 20X7, respectively.

Required:
A) If Peter uses the FVTOCI for recording its investment in Mary, what would the balance in the investment account be at January 31, 20X7? What would be reported on the statement of comprehensive income with respect to this investment for 20X6 and 20X7?
B) If Peter uses the equity method for recording its investment in Mary, what would the balance in the investment account be at January 31, 20X7? What would be reported on the statement of comprehensive income with respect to this investment for 20X6 and 20X7?

Answer:
A) The FVTOCI method will result in the investment in the Mary account being measured at fair value at each reporting period. The balance will be $310,000 on January 31, 20X6, and $260,000 on January 31, 20X7.
For the year ended January 31, 20X6: Dividend income of $4,000 ($20,000 × 20%) will be reported in the net income and a holding gain of $35,000 ($310,000 - $275,000) will be reported in other comprehensive income.
For the year ended January 31, 20X7: Dividend income of $3,000 ($15,000 × 20%) will be reported in the profit or loss and a holding loss of $50,000 ($260,000-$310,000) will be reported in other comprehensive income.
B) The equity method will result in the investment in the Mary account as follows:

	$
Opening balance Feb 1, 20X5	275,000
Jan 20X6: Equity in earnings of Mary 20% × $42,000	8,400
Dividends received during 20X6 20% × $20,000	(4,000)
Balance Jan 31, 20X6	279,400
Jan 20X7: Equity in earnings of Mary 20% × $35,000	7,000
Dividends received during 20X7 20% × $15,000	(3,000)
Balance Jan 31, 20X7	283,400

The amount showing on the statement of comprehensive income for each year is:
For the year ended January 31, 20X6: Equity in earnings of Mary $8,400
For the year ended January 31, 20X7: Equity in earnings of Mary $7,000
Page Ref: 28-30 and 36
Learning Obj.: 2.1, 2.2
Difficulty: Moderate

35) On January 1, 20X8, XZ Co. purchased 3,000 shares, representing 30% of AR Limited, for $390,000. XZ is a publicly traded company. AR's total net income was $86,000 for the year ended December 31, 20X8. AR also paid dividends in total of $25,000 during 20X8. At year end, each share of AR was trading at $150 per share.

Required:
A) Based on the information above, show the journal entries that XZ would have used to report its original purchase and any related investment income from AR for 20X8 assuming that XZ reports its investment in AR using FVTPL. What is the investment account balance at the end of December 31, 20X8?
B) Based on the information above, show the journal entries that XZ would have used to report its original purchase and any related investment income for AR for 20X8 assuming that XZ reports its investment in AR as a significantly influenced investment. What is the investment account balance at the end of December 31, 20X8?

Answer:
Part A–FVTPL method
Journal entries during 20X8 would be for the investment recorded at FVTPL
January 1, 20X8–To record initial investment in AR

Dr. Investment in AR (SFP)	390,000	
Cr. Cash		390,000

To record receipt of dividends during the year from AR

Dr. Cash (30% × $25,000)	7,500	
Cr. Dividend income (SCI)		7,500

December 31, 20X8–To adjust the investment to fair value at year-end report date

Dr. Investment in AR ($150 × 3,000) - $390,000 (SFP)	60,000	
Cr. Holding gain on investment in AR (SCI)		60,000

The balance in the investment in AR account is $450,000 at December 31, 20X8.

Part B–Equity method
Journal entries during 20X8 would be for the investment recorded at FVTPL.
January 1, 20X8–To record initial investment in AR

Dr. Investment in AR (SFP)	390,000	
Cr. Cash		390,000

To record receipt of dividends during the year from AR

Dr. Cash (30% × $25,000)	7,500	
Cr. Investment in AR (SFP)		7,500

December 31, 20X8–To record portion of earnings from AR for the year

Dr. Investment in AR (30% × $86,000) (SFP)	25,800	
Cr. Share of earnings of AR (SCI)		25,800

The balance in the investment in AR account is $408,300 (390,000 + 25,800 - 7,500) at December 31, 20X8.
Page Ref: 29 and 36
Learning Obj.: 2.1, 2.2
Difficulty: Moderate

36) On January 1, 20X2, Soho Co. purchased 4,000 shares, representing 12%, of Rico Inc., for $78,000. Soho is a publicly traded company. During the next two years, the following information was available for Rico.

	Net income (loss)	Dividends declared	Share price December 31
20X2	$65,000	$55,000	$22.20
20X3	$35,000	$10,000	$15.70

Soho sold all of its 4,000 shares in Rico on December 31, 20X3.

Required:
A) Assuming Soho classifies this investment as FVTPL, prepare the journal entries for the next two years related to this investment, and the carrying value of the investment at the end of 20X2 and 20X3.
B) Assuming Soho classifies this investment as FVTOCI, prepare the journal entries for the next two years related to this investment, and the carrying value of the investment at the end of 20X2 and 20X3.

Answer:
Part A)
Assuming the FVTPL classification, journal entries are as follows:

January 1, 20X2–To record initial investment

Dr. Investment in Rico	78,000	
Cr. Cash		78,000

December 31, 20X2–To record the dividend income received during 20X2

Dr. Cash (12% × $55,000)	6,600	
Dividend Income (SCI)		6,600

December 31, 20X2–To adjust to the fair value of the investment at year end 20X2.

Dr. Investment in Rico ((4,000 × $22.20) - 78,000)	10,800	
Cr. Holding gain on investment in Rico (SCI)		10,800

Investment account balance at December 31, 20X2 is:
$78,000 + $10,800 = $88,800. This is equal to 4,000 shares × $22.20 per share.

December 31, 20X3–To record the dividend income received during 20X3

Dr. Cash (12% × $10,000)	1,200	
Dividend Income (SCI)		1,200

December 31, 20X3–To record sale of 4,000 shares

Dr. Cash		62,800
Dr. Loss on sale of investment in Rico (SCI)		26,000

Cr. Investment in Rico		88,800

Loss on sale is calculated as: (4,000 × $15.70) - 88,800

Part B)

Assuming the FVOCI classification, journal entries are as follows:

January 1, 20X2–To record initial investment

Dr. Investment in Rico	78,000	
Cr. Cash		78,000

December 31, 20X2–To record the dividend income received during 20X2

Dr. Cash (12% × $55,000)	6,600	
Dividend Income (SCI)		6,600

December 31, 20X2–To adjust to the fair value of the investment at year end 20X2

Dr. Investment in Rico ((4,000 × $22.20) - 78,000))	10,800	
Cr. OCI - Holding gain on investment of Rico		10,800

Investment account balance at December 31, 20X2 is:
78,000 + 10,800 = 88,800. This is equal to 4,000 shares × $22.20 per share.

December 31, 20X3–To record the dividend income received during 20X3

Dr. Cash (12% × $10,000)	1,200	
Dividend Income (SCI)		1,200

December 31, 20X3–To record sale of 4,000 shares for $62,800 (4,000 × $15.70)

Dr. Cash	62,800	
Dr. OCI–Loss on sale of investment in Rico	26,000	
Cr. Investment in Rico		88,800

Investment account balance at December 31, 20X3 is:
Loss on sale is: 88,800 - 62,800= 26,000
Page Ref: 29-30
Learning Obj.: 2.1, 2.2
Difficulty: Moderate

37) Hattrick Corp. is a wholly owned, parent-founded subsidiary of Bobby Inc. Both Bobby and Hattrick report under IFRS. The unconsolidated statements of comprehensive income and part of the statement of changes in equity—retained earnings for the two companies for the year ended December 31, 20X6, are as follows (in 000s):

Statements of Comprehensive Income
Year Ended December 31, 20X6

	Bobby	**Hattrick**
Revenues:		
Sales	$265,000	$121,000
Interest, dividend, & lease income	13,000	600
	278,000	121,600
Expenses:		
Cost of goods sold	133,000	63,000
Amortization expense	26,000	11,600
Administrative expense	39,000	13,000
Income tax expense	17,800	11,700
Other expenses	12,900	400
	228,700	99,700
Net income	49,300	21,900

Statement of Changes in Equity—Retained Earnings Section
Year Ended December 31, 20X6

Retained earnings, January 1, 20X6	19,200	15,200
Net income	49,300	21,900
Dividends declared	(13,300)	(10,000)
Retained earnings, December 31, 20X6	$55,200	$27,100

Additional information:

- Bobby sells some of its output to Hattrick. During 20X6, intercompany sales amounted to $25,000,000, all of which had been sold by Hattrick to outside customers by year-end. Hattrick has accounts payable owing to Bobby of $200,000 at December 31, 20X6.
- Bobby owns the land on which Hattrick's building is located. Bobby leases the land to Hattrick for $30,000 per month.
- Bobby accounts for its investment in Hattrick under the cost method.

Required:
Prepare a consolidated statement of comprehensive income and consolidated statement of changes in equity—retained earnings section for Bobby Inc. for the year ended December 31, 20X6.

Answer:

Bobby Inc.
Consolidated Statement of Comprehensive Income
Year Ended December 31, 20X6
(in 000s)

Revenues:	
Sales (265 + 121 - 25)	$361,000
Interest (13 + 0.6 - 10 - 0.36)	3,240
	364,240
Expenses:	
Cost of goods sold (133 + 63-25)	171,000
Amortization expense (26 + 11.6)	37,600
Administrative expense (39 + 13-0.36)	51,640
Income tax expense (17.8 + 11.7)	29,500
Other expenses (12.9 + 0.4)	13,300
	303,040
Net income	61,200

Bobby Inc.
Consolidated Statement of Changes in Equity–
Retained Earnings Section
Year Ended December 31, 20X6
(in 000s)

Retained earnings, January 1, 20X6 (19.2 + 15.2)	34,400
Net income	61,200
Dividends declared (13.3 + 10-10)	(13,300)
Retained earnings, December 31, 20X6	$82,300

Eliminations required:
1. $25,000,000 intercompany sales (sales and cost of goods sold)
2. $360,000 intercompany lease revenue (lease income and other expenses)
3. $10,000,000 intercompany dividends (dividend income and dividends declared)

Page Ref: 42-48
Learning Obj.: 2.3, 2.4
Difficulty: Moderate

38) Hattrick Corp. is a wholly owned, parent-founded subsidiary of Bobby Inc. The unconsolidated statements of income and the statement of changes of retained earnings for the two companies for the year ended December 31, 20X6, are as follows (in 000s):

Statements of Income and Retained Earnings
Year Ended December 31, 20X6

	Bobby	**Hattrick**
Revenues:		
Sales	$265,000	$121,000
Interest, dividend, & lease income	13,000	600
	278,000	121,600
Expenses:		
Cost of goods sold	133,000	63,000
Amortization expense	26,000	11,600
Administrative expense	39,000	13,000
Income tax expense	17,800	11,700
Other expenses	12,900	400
	228,700	99,700
Net income	49,300	21,900
Retained earnings, January 1, 20X6	19,200	15,200
Dividends declared	(13,300)	(10,000)
Retained earnings, December 31, 20X6	$55,200	$27,100

Additional information:

- Bobby sells some of its output to Hattrick. During 20X6, intercompany sales amounted to $25,000,000, all of which had been sold by Hattrick to outside customers by year-end. Hattrick has accounts payable owing to Bobby for $200,000 at December 31, 20X6.
- Bobby owns the land on which Hattrick's building is located. Bobby leases the land to Hattrick for $30,000 per month.
- Bobby accounts for its investment in Hattrick under the cost method

Assume that Bobby is a private corporation that reports under ASPE. Prepare the statement of income and retained earnings for Bobby for the year 20X6 using the equity method.

Answer:

Bobby Inc.
Statement of Income and Retained Earnings
Year Ended December 31, 20X6
(in 000s)

Revenues:	
Sales	$265,000
Interest and lease income–Note 1	3,000
	268,000
Expenses:	
Cost of goods sold	133,000
Amortization expense	26,000
Administrative expense	39,000
Income tax expense	17,800
Other expenses	12,900
	228,700
Net income from operations	39,300
Equity in earnings of Hattrick–Note 2	21,900
Net income	61,200
Retained earnings, January 1, 20X6	34,400
Dividends declared	(13,300)
Retained earnings, December 31, 20X6	$82,300

Note 1: Dividend income is reported against the investment account under the equity method, and therefore $10,000 has been removed.
Note 2: 100% × $21,900 = 21,900. There are no adjustments to net income required.
Page Ref: 48-50
Learning Obj.: 2.3
Difficulty: Difficult

39) Ying Corporation formed a new subsidiary, Zang Limited, in 20X2. Ying is mainly involved in the manufacturing, distribution, and retailing of dog food and Zang manufacturers and distributes cat food. At that time, Ying provided all of the start-up capital to Zang in the form of equity, purchasing all of Zang's shares for $1.5 million. The unconsolidated statements for the two companies at December 31, 20X7, are shown below.

Separate-Entity Financial Statements
Statements of Financial Position for Ying and Zang
December 31, 20X7
(In 000s)

(In $000s)	Ying $	Zang $
Assets		
Cash	160	320
Accounts receivable	2,300	620
Inventory	3,500	650
	5,960	1,590
Property, Plant, and Equipment—net	10,900	5,980
Investment in Zang	1,500	
Loan receivable—from sub	1,000	
Total assets	19,360	7,570
Liabilities		
Accounts payable	5,600	1,250
Long term debt	8,500	1,880
Loan payable—to parent		1,000
Total liabilities	14,100	4,130
Shareholders' equity		
Common shares	1,000	1,500
Retained earnings	4,260	1,940
Total shareholders' equity	5,260	3,440
Total liabilities and shareholders' equity	19,360	7,570

Statements of Comprehensive Income for Ying and Zang
Year Ended December 31, 20X7
(In 000s)

(in $000s)	Ying $	Zang $
Sales	27,600	7,440
Cost of goods sold	19,320	4,840
Gross profit	8,280	2,600
Expenses		
Selling, general, and administration	3,670	1,530
Interest	750	260
Total expenses	4,420	1,790
Operating profit	3,860	810
Other income	1,330	0
Earnings before taxes	5,190	810
Income taxes	2,070	320
Net earnings	3,120	490

Statements of Changes in Equity—Retained Earnings Section for Ying and Zang
Year Ended December 31, 20X7
(In 000s)

(in $000s)	Ying $	Zang $
Retained Earnings—January 1, 20X7	2,740	1,800
Net earnings	3,120	490
Dividends paid	(1,600)	(350)
Retained Earnings—December 31, 20X6	4,260	1,940

During 20X7, the following transactions took place (all dollars are in thousands):

- Ying provided a loan to Zang and charged interest totalling $80.
- Zang sold merchandise to Ying totalling $3,270, which was all subsequently sold to outside third parties by the end of the year.
- Included in Zang's receivables is $270 still owed by Ying for these sales.
- Ying charged management fees of $900 to Zang during the year.

Required:
Using the direct approach, prepare the consolidated statements of comprehensive income; statement of changes in equity—retained earnings section; and statement of financial position at December 31, 20X7. Show details of all of your work to arrive at the consolidated balances. Provide the consolidating journal entries required.

Answer:

Consolidated Statement of Financial Position for Ying at December 31, 20X7
(In 000s)

(in $000s)	$
Assets	
Cash (160 + 320)	480
Accounts receivable (2,300 + 620 – 270 (e))	2,650
Inventory (3,500 + 650)	4,150
	7,280
Property, plant, and equipment—net (10,900 + 5,980)	16,880
Investment in Zang (1,500 – 1,500 (a))	0
Loan receivable—from sub (1,000 – 1,000 (b))	0
Total assets	24,160
Liabilities	
Accounts payable (5,600 + 1,250 – 270(e))	6,580
Long-term debt (8,500 + 1,880)	10,380
Loan payable—to parent (1,000 – 1,000 (b))	0
Total liabilities	16,960
Shareholders' equity	
Common shares 1,000 + 1,500 – 1,500 (a)	1,000
Retained earnings (4,260 + 1,940)	6,200
Total shareholders' equity	7,200
Total liabilities and shareholders' equity	24,160

Consolidated Statement of Comprehensive Income for Ying
Year Ended December 31, 20X7
(In 000s)

(in $000s)	$
Sales (27,600 + 7,440 – 3,270 (d))	31,770
Cost of goods sold (19,320 + 4,840 – 3,270(d))	20,890
Gross profit	10,880
Expenses	
Selling, general, and administration (3,670 + 1,530 – 900(f))	4,300
Interest (750 + 260 – 80(c))	930
Total expenses	5,230
Operating profit	5,650
Other income (1,330 – 80(c)–900(f) – 350(g))	0
Earnings before taxes	5,650
Income taxes (2,070 + 320)	2,390
Net earnings	3,260

Consolidated Statement of Changes in Equity—Retained Earnings section for Ying
Year Ended December 31, 20X7
(In 000s)

(In $000s)	
Retained Earnings—January 1, 20X7 2,740 + 1,800	4,540
Net earnings (as above)	3,260
Dividends paid (1,600 + 350 – 350 (g))	(1,600)
Retained Earnings—December 31, 20X6	6,200

Consolidating journal entries required:

(a) To eliminate the investment account

Dr. Common shares (Zang)	1,500	
Cr. Investment in Zang (Ying)		1,500

(b) To eliminate the intercompany loan receivable and loan payable:

Dr. Loan payable—to parent (Zang)	1,000	
Cr. Loan receivable—from Sub (Ying)		1,000

(c) To eliminate the intercompany interest paid on the loan:

Dr. Other income (Ying)	80	
Cr. Interest expense (Zang)		80

(d) To eliminate the intercompany sales of merchandise:

Dr. Sales (Zang)	3,270	
Cr. Cost of goods sold (Ying)		3,270

(e) To eliminate the intercompany receivable and payable at year end:

Dr. Accounts payable (Ying)	270	
Cr. Accounts receivable (Zang)		270

(f) To eliminate the intercompany management fees paid during the year:

Dr. Other income (Ying)	900	
Cr. Selling, general, and admin (Zang)		900

(g) To eliminate the intercompany dividends paid during the year:

Dr. Other income (Ying)	350	
Cr. Retained earnings (Zang)		350

Page Ref: 42-48
Learning Obj.: 2.3, 2.4
Difficulty: Difficult

40) In 20X5, Bing created a wholly owned subsidiary called Bango Limited. Bing is a private company and reports under ASPE. Bing is currently using the cost method to record its investment in Bango, but is trying to decide if it should report using the equity method or the consolidation method. This is the only subsidiary that Bing has.

Separate Statements of Earnings and Retained Earnings for Bing and Bango
Year Ended December 31, 20X5.

	Bing	Bango
Sales of merchandise	$6,000,000	$1,000,000
Other revenues	200,000	20,000
Total revenues	$6,200,000	$1,020,000
Cost of goods sold	$2,500,000	$400,000
Depreciation expense	500,000	80,000
Interest expense	400,000	20,000
Other expenses (including income tax)	1,300,000	190,000
Total expenses	$4,700,000	$690,000
Net income	$1,500,000	$330,000
Retained earnings, January 1, 20X5	4,200,000	0
Dividends declared	(200,000)	(50,000)
Retained earnings, December 31, 20X5	$5,500,000	$280,000

Other Information

During the year, the following transactions occurred between the two companies:

1. Bing sold merchandise to Bango for $560,000. At the end of the year, Bango still owed Bing $25,000 for this merchandise, although Bango had sold this entire inventory to outside customers.
2. Bango charged rent of $20,000 to Bing for office space.
3. Licensing fees were paid by Bango to Bing in the amount of $150,000.

Required:

(a) Prepare the statement of earnings and retained earnings for Bing using the equity method of reporting its investment in Bango.
(b) Prepare the consolidated statement of earnings and retained earnings for Bing.
(c) Compare the equity method and the consolidation method and discuss any similarities and differences.
(d) If Bing had other subsidiary investments, what other factors would be considered in trying to decide if the consolidation or equity method should be used?

Answer:
Part A—Equity method

Under the equity method, Bing will include in its net earnings its proportionate share of the earnings from Bango. Any dividends received from Bango during the year would be reported as a reduction of the investment account and not as income.
The proportionate share of earnings will be:
100% × $330,000 = $330,000.
Dividends of $50,000 must be eliminated from Other Revenue.

Statement of Earnings and Retained Earnings for Bing
Year Ended December 31, 20X5

	Bing
	$6,000,000
	150,000
Total revenues	$6,150,000
Cost of goods sold	$2,500,000
Depreciation expense	500,000
Interest expense	400,000
Other expenses (including income tax)	1,300,000
Total expenses	$4,700,000
	$1,450,000
	330,000
Net earnings	$1,780,000
Retained earnings, January 1, 20X5	4,200,000
Dividends	(200,000)
Retained earnings, December 31, 20X5	$5,780,000

Part B—Consolidation method

Consolidated Statement of Earnings and Retained Earnings for Bing
Year Ended December 31, 20X5

Sales of merchandise (6,000 + 1,000 – 560)	6,440,000
Other revenues (200 + 20 – 20 – 50 – 150)	0
Total revenues	6,440,000
Cost of goods sold (2,500 + 400 – 560)	2,340,000
Depreciation expense (500 + 80)	580,000
Interest expense (400 + 20)	420,000
Other expenses (including income tax)(1,300 + 190 – 20 – 150)	1,320,000
Total expenses	4,660,000
Net income	1,780,000
Retained earnings, January 1, 20X5	4,200,000
Dividends 200 + 50 – 50	(200,000)
Retained earnings, December 31, 20X5	5,780,000

Part C

The consolidation and equity methods will result in the same net earnings and retained earnings of the parent as can be seen above. That is why the equity method is often called the single line consolidation: All of the earnings of the subsidiary are reported as a single line item on the statement of earnings for the parent. The consolidation method will combine the revenues and expenses of the parent and its subsidiaries on a line-by-line basis.

Part D

Under ASPE, although there is choice in reporting subsidiaries of using the cost, equity, or consolidation methods, the same method must be used for all similar types of investments. Consequently, if Bing already had some subsidiaries, then the same accounting policy that was currently being used by the company for its other subsidiaries would have to be used for its Bango investment. Alternatively, Bing could make an accounting policy change and apply a different method, but this method would have to be applied for all subsidiaries. As a result, the prior year's statements would have to be restated to show this change in accounting policy.

Page Ref: 35-36 and 40-52
Learning Obj.: 2.2, 2.3, 2.4, 2.5
Difficulty: Moderate

41) Rasor Inc. reports under IFRS and recently invested $50,750 to obtain 40% ownership in Ivan. Tenor owns 60% of Ivan. However, all major strategic decisions require the unanimous consent of both Rasor and Tenor. The agreement stipulates that both Rasor and Tenor have rights over the net assets of Ivan.

The balance of the Rasor's investment in Ivan was $50,750 at January 1, 20X3. During the next three years, Ivan reported the following net earnings (losses) and dividends paid.

	Net earnings (loss) $	Dividends paid $
20X3	135,600	120,000
20X4	15,700	120,000
20X5	(103,400)	0

Required:
A) Explain the two types of joint arrangements discussed in IFRS. How is each of these types of investments recognized in the accounts under IFRS? What type is Rasor's investment in Ivan and why? What accounting method is used by Rasor to recognize this investment?

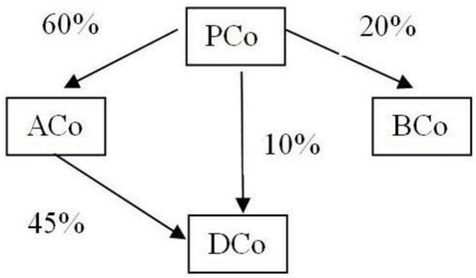
B) Calculate the balance of the Investment in Ivan account at December, 31 20X5.

Answer:
A) IFRS discusses two types of joint arrangements: joint operations and joint ventures. In a joint operation the parties have joint control and rights over individual assets and are obligated for the individual liabilities of the joint operation. Joint operators will include their share of the assets and liabilities, revenues, and expenses of the joint operation in their respective financial statements.
A joint venture: The parties have joint control but only rights to the net assets of the joint venture. This investment is reported using the equity method on the joint venturers' respective financial statements. Ivan is a joint venture, since the Rasor and Tenor only have rights to the net assets of Ivan and there is joint control. Consequently, Rasor should use the equity method to reports its investment in Ivan.

B) The table below shows the calculation of the Investment in Ivan account for each year.

	Balance $
Balance Jan 1, 20X3	50,750
Proportionate share of earnings for 20X3 - 135,600 × 40%	54,240
Dividends received during 20X3 120,000 × 40%	(48,000)
Balance Dec 31, 20X3	56,990
Proportionate share of earnings for 20X4 - 15,700 × 40%	6,280
Dividends received during 20X4 120,000 × 40%	(48,000)
Balance Dec 31, 20X4	15,270
Proportionate share of losses for 20X5 - 103,400 × 40% = 41,360, but there is only $15,270 in account (see note below)	(15,270)
Balance Dec 31, 20X5	0

Note: In 20X5, Rasor's share of losses in Ivan exceeded the balance in the investment account. Therefore, Rasor must stop recognizing further losses since the account would go into a credit position, representing a liability, which is not the case here. Once the JV resumes making profits, then Rasor will record its portion of the profits once they exceed the losses not recognized previously. In this case, to date, there are $26,090 (41,360-15,270) in losses that have not been recognized. Rasor would not commence reporting its proportionate share of profits until profits of more than $26,090 had been earned.
Page Ref: 36-37; 56
Learning Obj.: 2.2, 2.5
Difficulty: Moderate

42) PCo owns 60% of ACo, 20% of BCo, and 10% of DCo. ACo owns 45% of DCo. Identify the basis that each company is required to use when reporting its equity investments (if any).
Answer:


From the diagram, PCo owns directly control of ACo. PCo also owns 55% control of DCo by owning 10% directly and 45% through ACo. So PCo would be required to prepare consolidated statements consolidating both DCo and ACo. PCo's investment in BCo is significant influence and would therefore record its investment in BCo using the equity method.

ACo owns only 45% of DCo, so ACo would report its investment in DCo on the equity basis.

DCo and BCo do not have any equity investments.
Page Ref: 57-58
Learning Obj.: 2.3
Difficulty: Moderate

43) What is a structured entity? How is control determined in a structured entity? Give one example of how an entity might use a structured entity. How are SEs recognized?
Answer: A structured entity (SE) (or variable interest entity) is a type of entity set up for a specific purpose by a sponsoring corporation. The reporting enterprise has no control, since the SE is not controlled through voting shares. SEs are often used to securitize (sell) receivables in return for funds that have been raised by the SE from public and or private investors. Control is exercised by contractual means or management. Questions used to assess control include, "Who has the rights that provide power over the activities of the SE?" SEs are consolidated when the activities of the SE impact the sponsoring corporation's finances, operations, and financial reports.
Page Ref: 32-33
Learning Obj.: 2.1, 2.2
Difficulty: Moderate