

Test Bank for Advanced Financial Accounting 13th Christensen

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CORRECT ANSWERS ARE LOCATED IN THE 2ND HALF OF THIS DOC.

MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.

- 1) If Push Company owned 51 percent of the outstanding common stock of Shove Company, which method would be appropriate for financial reporting purposes?
 - A) Cost method
 - B) Full consolidation method
 - C) Equity method
 - D) Fair value method

- 2) Usually, an investment of 20 to 50 percent in another company's voting stock is reported under the:
 - A) cost method.
 - B) full consolidation method.
 - C) equity method.
 - D) fair value method.

- 3) In the case of an investment in equity securities where the investor does not have significant influence and the investment is carried at fair value, a dividend from the investee is:
 - A) a reduction of the carrying amount of the investment.
 - B) income to the investor in the period of declaration.
 - C) an expense to the investor in the period of declaration.
 - D) a direct increase to retained earnings of the investor to offset the direct decrease to retained earnings of the investee.

- 4) Which of the following observations is NOT consistent with the accounting for investments in equity securities where there is no significant influence?
 - A) Changes in the number of investment shares resulting from stock dividends, stock splits, or reverse splits must be formally recorded by the investor.
 - B) Investments are carried by the investor at fair value.
 - C) The investor recognizes income from the investment as dividends are declared by the investee.
 - D) When the securities are remeasured to fair value as of the end of each period, any resulting difference is an unrealized gain or loss to be recognized in income.

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- 5) On January 1, 20X2 Pathlon Company acquired 30 percent of the common stock of Sopteron Corporation, at underlying book value. For the same year, Sopteron reported net income of \$55,000, which includes a gain from discontinued operations of \$40,000. Sopteron did not pay any dividends during the year. By what amount would Pathlon's investment in Sopteron Corporation increase for the year, if Pathlon used the equity method?
- A) \$0
 - B) \$16,500
 - C) \$4,500
 - D) \$12,000
- 6) A change from carrying securities at fair value to the equity method of accounting for an investment in common stock resulting from an increase in the number of shares held by the investor requires:
- A) only a footnote disclosure.
 - B) that the cumulative amount of the change be shown as a line item on the income statement, net of tax.
 - C) retroactive restatement as if the investor always had used the equity method.
 - D) that the investor begins accruing income earned by the investee under the equity method at the date of acquisition of the new shares.
- 7) Under the equity method of accounting for a stock investment, the investment initially should be recorded at:
- A) cost.
 - B) cost minus any differential.
 - C) proportionate share of the fair value of the investee company's net assets.
 - D) proportionate share of the book value of the investee company's net assets.
- 8) On July 1, 20X4, Pillow Corporation obtained significant influence over Sleep Company through the purchase of 3,000 shares of Sleep's 10,000 outstanding shares of common stock for \$20 per share. On December 15, 20X4, Sleep paid \$40,000 in dividends to its common stockholders. Sleep's net income for the year ended December 31, 20X4, was \$120,000, earned evenly throughout the year. In its 20X4 income statement, what amount of income from this investment should Pillow report?
- A) \$12,000
 - B) \$36,000
 - C) \$18,000
 - D) \$6,000

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- 9) On January 2, 20X5, Park Company purchased 10 percent of Sky, Incorporated's outstanding common shares for \$400,000. Park is the largest single shareholder in Sky, and Park's officers are a majority on Sky's board of directors. As a result, Park is able to exercise significant influence over Sky. Sky reported net income of \$500,000 for 20X5, and paid dividends of \$150,000. In its December 31, 20X5, balance sheet, what amount should Park report as investment in Sky?
- A) \$385,000
 - B) \$450,000
 - C) \$400,000
 - D) \$435,000
- 10) The Salmon Corporation (Salmon) reported net income for the current year of \$200,000 and paid cash dividends of \$30,000. The Pond Company (Pond) holds 22 percent of the outstanding voting stock of Salmon. However, another corporation holds the other 78 percent ownership and does not take Pond's input into consideration when making financing and operating decisions for Salmon. What investment income should Pond recognize for the current year?
- A) \$6,600
 - B) \$0
 - C) \$44,000
 - D) \$50,600
- 11) Slide Corporation reported net income for the current year of \$370,000 and paid cash dividends of \$50,000. Power Company holds 40 percent of the outstanding voting stock of Slide. However, another corporation holds the other 60 percent ownership and does not take Power's input into consideration when making financing and operating decisions for Slide. What investment income should Power recognize for the current year?
- A) \$0
 - B) \$20,000
 - C) \$128,000
 - D) \$148,000
- 12) What account balances in the subsidiary stockholders' equity accounts should be eliminated in preparing a consolidated balance sheet?
- A) Common stock
 - B) Additional paid-in capital
 - C) Retained Earnings
 - D) All of these account balances are eliminated

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13) The consolidation process consists of all the following except:

- A) Combining the financial statements of two or more legally separate companies.
- B) Eliminating intercompany transactions and holdings.
- C) Closing the individual subsidiary's revenue and expense accounts into the parent's retained earnings.
- D) Combining the accounts of separate companies, creating a single set of financial statements.

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

14) Pocket Corporation acquired 100 percent of the voting shares of Sleeve Incorporated by issuing 10,000 new shares of \$5 par value common stock with a \$30 market value.

Required:

1. Which company is the parent, and which is the subsidiary?
2. Define a subsidiary corporation.
3. Define a parent corporation.
4. Which entity prepares the consolidated worksheet?
5. Why are consolidation entries used?

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- 15) On January 1, 20X5, Peery Company acquired 100 percent of Standard Company's common shares at underlying book value. Peery uses the equity method in accounting for its ownership of Standard. On December 31, 20X5, the trial balances of the two companies are as follows:

Item	Peery Company		Standard Company	
	Debit	Credit	Debit	Credit
Current Assets	\$ 238,000		\$ 95,000	
Depreciable Assets	300,000		170,000	
Investment in Standard Company	100,000			
Other Expenses	90,000		70,000	
Depreciation Expense	30,000		17,000	
Dividends Declared	32,000		10,000	
Accumulated Depreciation		\$ 120,000		\$ 85,000
Current Liabilities		50,000		30,000
Long-Term Debt		120,000		50,000
Common Stock		100,000		50,000
Retained Earnings		175,000		35,000
Sales		200,000		112,000
Income from Standard Company		25,000		
	\$ 790,000	\$ 790,000	\$ 362,000	\$ 362,000

Required:

1. Prepare the consolidation entries needed as of December 31, 20X5, to complete a consolidation worksheet.
2. Prepare a three-part consolidation worksheet as of December 31, 20X5.

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- 16) In the absence of other evidence, common stock ownership of between 20 and 50 percent is viewed as indicating that the investor is able to exercise significant influence over the investee. What are some of the other factors that could constitute evidence of the ability to exercise significant influence?

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- 17) On January 1, 20X3, Plimsol Company acquired 100 percent of Shipping Corporation's voting shares, at underlying book value. Plimsol uses the cost method in accounting for its investment in Shipping. Shipping's reported retained earnings of \$75,000 on the date of acquisition. The trial balances for Plimsol Company and Shipping Corporation as of December 31, 20X4, follow:

Item	Plimsol Company		Shipping Corporation	
	Debit	Credit	Debit	Credit
Current Assets	\$ 160,000		\$ 115,000	
Depreciable Assets (net)	180,000		135,000	
Investment in Shipping Corporation	125,000			
Other Expenses	85,000		60,000	
Depreciation Expense	20,000		15,000	
Dividends Declared	30,000		15,000	
Current Liabilities		\$ 25,000		\$ 20,000
Long-Term Debt		75,000		50,000
Common Stock		100,000		50,000
Retained Earnings		210,000		100,000
Sales		175,000		120,000
Dividend Income		15,000		
	\$ 600,000	\$ 600,000	\$ 340,000	\$ 340,000

Required:

1. Provide all consolidating entries required to prepare a full set of consolidated statements for 20X4.
2. Prepare a three-part consolidation worksheet in good form as of December 31, 20X4.

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SECTION BREAK. Answer all the part questions.

18) On January 1, 20X2, Pullman Company acquired 30 percent of Skate Company's common stock, at underlying book value of \$100,000. Skate has 100,000 shares of \$2 par value, 5 percent cumulative preferred stock outstanding. No dividends are in arrears. Skate reported net income of \$150,000 for 20X2 and paid total dividends of \$72,000. Pullman uses the equity method to account for this investment.

18.1) Based on the preceding information, what amount would Pullman Company receive as dividends from Skate for the year?

- A) \$62,000
- B) \$21,600
- C) \$18,600
- D) \$54,000

18.2) Based on the preceding information, what amount of investment income will Pullman Company report from its investment in Skate for the year?

- A) \$45,000
- B) \$42,000
- C) \$62,000
- D) \$35,000

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18.3) Based on the preceding information, what amount would be reported by Pullman Company as the balance in its investment account on December 31, 20X2?

- A) \$100,000
- B) \$123,400
- C) \$120,400
- D) \$142,000

19) On January 1, 20X4, Pony Company acquired 25 percent of Stallion Company's common stock at underlying book value of \$200,000. Stallion has 80,000 shares of \$10 par value, 6 percent cumulative preferred stock outstanding. No dividends are in arrears. Stallion reported net income of \$270,000 for 20X4 and paid total dividends of \$140,000. Pony uses the equity method to account for this investment.

19.1) Based on the preceding information, what amount would Pony Company receive as dividends from Stallion for the year?

- A) \$23,000
- B) \$35,000
- C) \$37,500
- D) \$92,000

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19.2) Based on the preceding information, what amount of investment income will Pony Company report from its investment in Stallion for the year?

- A) \$140,000
- B) \$67,500
- C) \$55,500
- D) \$35,000

19.3) Based on the preceding information, what amount would be reported by Pony Company as the balance in its investment account on December 31, 20X4?

- A) \$200,000
- B) \$220,500
- C) \$232,500
- D) \$255,500

20) On January 1, 20X3, Poke Corporation acquired 25 percent of the outstanding shares of Shove Corporation for \$100,000 cash. Shove Company reported net income of \$75,000 and paid dividends of \$30,000 for both 20X3 and 20X4. The fair value of shares held by Poke was \$110,000 and \$105,000 on December 31, 20X3 and 20X4 respectively.

20.1) Based on the preceding information, what amount will be reported by Poke as income from its investment in Shove for 20X4, if it used the equity method of accounting?

- A) \$7,500
- B) \$11,250
- C) \$18,750
- D) \$26,250

20.2) Based on the preceding information, what amount will be reported by Poke as balance in investment in Shove on December 31, 20X4, if it used the equity method of accounting?

- A) \$108,250
- B) \$118,750
- C) \$100,000
- D) \$122,500

20.3) If instead, Poke could not exercise significant influence over the investee, by what amount will Poke's 20X3 income increase due to its investment in Shove?

- A) \$17,500
- B) \$12,500
- C) \$11,250
- D) \$7,500

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- 20.4) If instead, Poke could not exercise significant influence over the investee, by what amount will Poke's 20X4 income increase due to its investment in Shove?
- A) \$11,250
 - B) \$2,500
 - C) \$6,250
 - D) \$7,500
- 20.5) If instead, Poke could not exercise significant influence over the investee, what amount will be reported by Poke as balance in investment in Shove on December 31, 20X4?
- A) \$105,000
 - B) \$118,750
 - C) \$100,000
 - D) \$122,500
- 21) Prime Company acquired 100 percent of the voting common shares of Standard Video Corporation, its bitter rival, by issuing bonds with a par value and fair value of \$150,000. Immediately prior to the acquisition, Prime reported total assets of \$500,000, liabilities of \$280,000, and stockholders' equity of \$220,000. At that date, Standard Video reported total assets of \$400,000, liabilities of \$250,000, and stockholders' equity of \$150,000. Included in Standard's liabilities was an account payable to Prime in the amount of \$20,000, which Prime included in its accounts receivable. TBEXAM.COM
- 21.1) Based on the preceding information, what amount of total assets did Prime report in its separate balance sheet immediately after the acquisition before any consolidation with Standard Video?
- A) \$500,000
 - B) \$650,000
 - C) \$750,000
 - D) \$900,000
- 21.2) Based on the preceding information, what amount of total assets was reported in the consolidated balance sheet immediately after acquisition?
- A) \$650,000
 - B) \$880,000
 - C) \$920,000
 - D) \$750,000

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- 21.3) Based on the preceding information, what amount of total liabilities was reported in the consolidated balance sheet immediately after acquisition?
- A) \$500,000
 - B) \$530,000
 - C) \$280,000
 - D) \$660,000
- 21.4) Based on the preceding information, what amount of stockholders' equity was reported in the consolidated balance sheet immediately after acquisition?
- A) \$220,000
 - B) \$150,000
 - C) \$370,000
 - D) \$350,000
- 22) Pickup Company acquired 100 percent of the voting common shares of Sedan Corporation by issuing bonds with a par value and fair value of \$200,000. Immediately prior to the acquisition, Pickup reported total assets of \$600,000, liabilities of \$370,000, and stockholders' equity of \$230,000. At that date, Sedan reported total assets of \$500,000, liabilities of \$300,000, and stockholders' equity of \$200,000. Included in Sedan's liabilities was an account payable to Pickup in the amount of \$50,000, which Pickup included in its accounts receivable.
- 22.1) Based on the preceding information, what amount of total assets did Pickup report in its balance sheet immediately after the acquisition?
- A) \$1,100,000
 - B) \$1,000,000
 - C) \$800,000
 - D) \$1,600,000
- 22.2) Based on the preceding information, what amount of total assets was reported in the consolidated balance sheet immediately after acquisition?
- A) \$600,000
 - B) \$800,000
 - C) \$1,050,000
 - D) \$1,150,000

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- 22.3) Based on the preceding information, what amount of total liabilities was reported in the consolidated balance sheet immediately after the acquisition?
- A) \$370,000
 - B) \$670,000
 - C) \$820,000
 - D) \$870,000
- 22.4) Based on the preceding information, what amount of stockholders' equity was reported in the consolidated balance sheet immediately after acquisition?
- A) \$200,000
 - B) \$230,000
 - C) \$380,000
 - D) \$430,000
- 23) Parent Company purchases 100 percent of Son Company on January 1, 20X1, when Parent's retained earnings balance is \$520,000 and Son's is \$150,000. During 20X1, Son reports \$15,000 of net income and declares \$6,000 of dividends. Parent reports \$105,000 of separate operating earnings plus \$15,000 of equity-method income from its 100 percent interest in Son; Parent declares dividends of \$40,000.
- 23.1) Based on the preceding information, what is Parent's post-closing retained earnings balance on December 31, 20X1?
- A) \$640,000
 - B) \$480,000
 - C) \$529,000
 - D) \$600,000
- 23.2) Based on the preceding information, what is Son's post-closing retained earnings balance on December 31, 20X1?
- A) \$141,000
 - B) \$150,000
 - C) \$159,000
 - D) \$165,000
- 23.3) Based on the preceding information, what is the consolidated retained earnings balance on December 31, 20X1?
- A) \$470,000
 - B) \$585,000
 - C) \$600,000
 - D) \$759,000

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24) Phips Company purchases 100 percent of Sips Company on January 1, 20X2, when Phips' retained earnings balance is \$320,000 and Sips' is \$120,000. During 20X2, Sips reports \$20,000 of net income and declares \$8,000 of dividends. Phips reports \$125,000 of separate operating earnings plus \$20,000 of equity-method income from its 100 percent interest in Sips; Phips declares dividends of \$35,000.

24.1) Based on the preceding information, what is Phips' post-closing retained earnings balance on December 31, 20X2?

- A) \$305,000
- B) \$410,000
- C) \$430,000
- D) \$465,000

24.2) Based on the preceding information, what is Sips' post-closing retained earnings balance on December 31, 20X2?

- A) \$108,000
- B) \$120,000
- C) \$132,000
- D) \$140,000

24.3) Based on the preceding information, what is the consolidated retained earnings balance on December 31, 20X2?

- A) \$402,000
- B) \$410,000
- C) \$430,000
- D) \$562,000

24.4) The main guidance on equity-method reporting, found in ASC 323 and 325 requires all of the following except:

- A) The investor's share of the investee's discontinued operations should be reported.
- B) The investor's share of the investee's prior-period adjustments should be reported.
- C) Continued use of the equity-method even if continued losses result in a zero or negative balance in the investment account.
- D) Preferred dividends of the investee should be deducted from net income before the investor computes its share of investee earnings.

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25) On January 1, 20X4, Plimsol Company acquired 100 percent of Shipping Corporation's voting shares, at underlying book value. Plimsol accounts for its investment in Shipping at cost. Shipping's retained earnings was \$75,000 on the date of acquisition. On December 31, 20X4, the trial balance data for the two companies are as follows:

Item	Plimsol Company		Shipping Corporation	
	Debit	Credit	Debit	Credit
Current Assets	\$ 100,000		\$ 75,000	
Depreciable Assets (net)	200,000		150,000	
Investment in Shipping Corporation	125,000			
Other Expenses	60,000		45,000	
Depreciation Expense	20,000		15,000	
Dividends Declared	25,000		15,000	
Current Liabilities		\$ 40,000		\$ 25,000
Long-Term Debt		75,000		50,000
Common Stock		100,000		50,000
Retained Earnings		150,000		75,000
Sales		150,000		100,000
Dividend Income, Shipping Corporation		15,000		
	\$ 530,000	\$ 530,000	\$ 300,000	\$ 300,000

25.1) Based on the information provided, what amount of net income will be reported in the consolidated financial statements prepared on December 31, 20X4?

- A) \$100,000
- B) \$85,000
- C) \$110,000
- D) \$125,000

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- 25.2) Based on the information provided, what amount of total assets will be reported in the consolidated balance sheet prepared on December 31, 20X4?
- A) \$425,000
 - B) \$525,000
 - C) \$650,000
 - D) \$675,000
- 25.3) Based on the information provided, what amount of retained earnings will be reported in the consolidated balance sheet prepared on December 31, 20X4?
- A) \$235,000
 - B) \$210,000
 - C) \$310,000
 - D) \$225,000
- 25.4) Based on the information provided, what amount of total liabilities will be reported in the consolidated balance sheet prepared on December 31, 20X4?
- A) \$525,000
 - B) \$115,000
 - C) \$125,000
 - D) \$190,000
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- 25.5) Based on the information provided, what amount of total stockholders' equity will be reported in the consolidated balance sheet prepared on December 31, 20X4?
- A) \$190,000
 - B) \$335,000
 - C) \$460,000
 - D) \$310,000
- 26) Parent Company purchased 100 percent of Son Inc. on January 1, 20X2 for \$420,000. Son reported earnings of \$82,000 and declared dividends of \$4,000 during 20X2.
- 26.1) Based on the preceding information and assuming Parent carries its investment in Son at cost, what is the balance in Parent's Investment in Son account on December 31, 20X2, prior to consolidation?
- A) \$416,000
 - B) \$420,000
 - C) \$424,000
 - D) \$498,000

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- 26.2) Based on the preceding information and assuming Parent uses the equity method to account for its investment in Son, what is the balance in Parent's Investment in Son account on December 31, 20X2, prior to consolidation?
- A) \$416,000
 - B) \$420,000
 - C) \$424,000
 - D) \$498,000
- 27) Pone Company purchased 100 percent of Sone Incorporated on January 1, 20X5 for \$625,000. Sone reported earnings of \$76,000 and declared dividends of \$8,000 during 20X5.
- 27.1) Based on the preceding information and assuming Pone carries its investment in Sone at cost, what is the balance in Pone's Investment in Sone account on December 31, 20X5, prior to consolidation?
- A) \$617,000
 - B) \$625,000
 - C) \$633,000
 - D) \$693,000
- 27.2) Based on the preceding information and assuming Pone uses the equity method to account for its investment in Sone, what is the balance in Pone's Investment in Sone account on December 31, 20X5, prior to consolidation?
- A) \$617,000
 - B) \$625,000
 - C) \$633,000
 - D) \$693,000

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Answer Key

Test name: Chapter 02

1) B

The full consolidation method is correct. If the investor company acquires more than 50 percent of the investee's voting shares, it is required to consolidate the investee company.

The cost method is incorrect. While the cost method is an appropriate way to account for equity investment securities, the question asks for the method appropriate for financial reporting purposes. Thus, the full consolidation method is the correct answer.

The equity method is incorrect. The equity method is used when ownership is between 20 percent to 50 percent and when the investor has the ability to exercise significant influence over the operating and financial policies of the investee.

The fair value method is incorrect. The fair value method is used when the investor does not have significant influence and when ownership is between 0 percent to 20 percent.

2) C

The equity method is correct. The equity method is used when ownership is between 20 percent to 50 percent and when the investor has the ability to exercise significant influence over the operating and financial policies of the investee.

The cost method is appropriate when the investor company acquires more than 50 percent of the investee's voting shares.

The full consolidation method is appropriate when the investor company acquires more than 50 percent of the investee's voting shares.

The fair value method is used when the investor does not have significant influence and when ownership is between 0 percent to 20 percent.

3) B

Income to the investor in the period of declaration is correct. Investments in equity securities where the investor does not have significant influence are carried at fair value, and income is recognized from the investment when dividends are declared by the investee.

Under the equity method where the investor has significant influence, a dividend from the investee is a reduction of the carrying amount of the investment.

Neither the equity method *nor* when equity securities are carried at fair value is a dividend from the investee and an expense to the investor in the period of declaration.

There is no direct increase to retained earnings of the investor to offset the direct decrease to retained earnings of the investee. The dividend is reported as income to the investor and flows through the income statement.

4) A

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Changes in the number of investment shares resulting from stock dividends, stock splits, or reverse splits must be formally recorded by the investor is correct. Changes in the number of investment shares resulting from stock dividends, stock splits, or reverse splits receive *no* formal recognition in the accounts of the investor.

Investments are carried by the investor at fair value is incorrect. This is consistent with the accounting for investments in equity securities where there is *no significant influence*.

The investor recognizes income from the investment as dividends are declared by the investee is incorrect. This is consistent with the accounting for investments in equity securities where there is *no significant influence*.

When the securities are remeasured to fair value as of the end of each period, any resulting difference is an unrealized gain or loss to be recognized in income is incorrect. This is consistent with the accounting for investments in equity securities where there is *no significant influence*.

5) B

\$16,500 is correct. $\$55,000 \times 30 \text{ percent} = \$16,500$. Under the equity method, income from Sopteron increases Pathlon's investment account and income from Sopteron account by \$16,500 ($\$55,000 \times 30 \text{ percent}$).

\$12,000 is incorrect. This answer choice incorrectly multiplies \$40,000 by 30 percent instead of \$55,000.

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6) D

"That the investor begins accruing income earned by the investee under the equity method at the date of acquisition of the new shares" is correct. At the time the investment qualifies for use of the equity method, the investor shall add the cost of acquiring the additional interest in the investee (if any) to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting.

A footnote disclosure is not required when hanging to the equity method of accounting for an investment in common stock.

The cumulative amount of the change is not required to be shown as a line item on the income statement, net of tax when changing to the equity method of accounting for an investment in common stock does not require that the cumulative amount of the change be shown as a line item on the income. This is not a rule within the FASB Codification.

A retroactive restatement when implementing the equity method of accounting is not required. On the date of acquisition, the investor can begin accruing income earned by the investee under the equity method.

7) A

Cost is correct. Under the equity method, the investor records its investment at the original cost.

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8) C

\$18,000 is correct. The question asks for the amount of income earned by Pillow Corporation through its investment in Sleep Company. Pillow Corporation owns 30 percent of Sleep Company (3,000 shares / 10,000 outstanding shares). Under the equity method of accounting, Pillow Corporation would multiply Sleep Company's net income by its ownership percentage from the date of acquisition: $\$120,000 \times 30 \text{ percent} \times 6/12 \text{ months} = \$18,000$.

\$12,000 is incorrect. Because Pillow Corporation has obtained significant influence over Sleep Company, the equity method of accounting is used to determine the amount of income from Pillow's investment in Sleep Company. Therefore, dividends do not affect the amount of income Pillow would recognize. Rather, dividends are recognized as a return of capital reducing the investment in Sleep Company account.

\$36,000 is incorrect. Pillow Corporation must recognize income from Sleep Company starting at the date of acquisition, July 1, 20X4. \$36,000 is the amount Pillow Corporation would recognize if Pillow Corporation obtained significant influence over Sleep Company on January 1, 20X4.

\$6,000 is incorrect. This answer choice uses the \$40,000 of dividends instead of the \$120,000 of net income in its calculation. Dividends are not appropriate because the question asks for the amount of income from Pillow's investment in Sleep Company. The equity method of accounting recognizes dividends as a reduction in the investment account and does not affect the income from Sleep Company account.

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9) D

\$435,000 is correct. Park Company will use the equity method of accounting to report its investment in Sky Incorporated because Park Company exercises significant influence over Sky. Park Company's portion of Sky's net income will increase its investment account, and Park Company's portion of Sky's dividends will decrease its investment account per the rules of the equity method. Park Company's portion of Sky's net income is \$50,000 ($\$500,000 \times 10 \text{ percent}$), and Park Company's portion of Sky's dividends is \$15,000 ($\$150,000 \times 10 \text{ percent}$). Therefore, Park Company's investment in Sky account on December 31, 20X5 will be \$435,000 ($\$400,000 + \$50,000 - \$15,000 = \$435,000$).

\$385,000 is incorrect. Park Company's portion of Sky's net income must be added to Park Company's investment account ($\$385,000 + \$50,000 = \$435,000$).

\$450,000 is incorrect. Park Company's portion of Sky's dividends must be subtracted from Park Company's investment account ($\$450,000 - \$15,000 = \$435,000$).

\$400,000 represents the original cost of Park Company's investment in Sky Incorporated. However, the question asks for Park Company's investment in Sky Incorporated at December 31, 20X5.

10) A

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\$6,600 is correct. The Pond Company will not apply the equity method to its investment in Salmon despite owning more than 20 percent of Salmon. This is because Pond does not have significant influence over Salmon. Pond's investment in Salmon is valued at fair value with dividends received reported as dividend income on the income statement. Pond will recognize its 22 percent share of dividends as investment income ($\$30,000 \times 22$ percent).

\$0 is incorrect. Pond should recognize investment income equaling the amount of Pond's share of dividends. This is consistent with accounting for equity securities at fair value.

\$44,000 is incorrect. Pond will not recognize any of Salmon's net income because Pond's investment lacks the ability either to control or to exercise significant influence over the investee. As a result, Pond's investment is valued at fair value, not under the equity method.

\$50,600 is incorrect. Pond will only recognize its share of Salmon's dividends ($\$30,000 \times 22$ percent) and will not recognize any of Salmon's net income because Pond's investment lacks the ability either to control or to exercise significant influence over the investee.

11) B

\$20,000 is correct. Power Company will not apply the equity method to its investment in Slide despite owning more than 20 percent of Slide. This is because Power does not have significant influence over Slide. Power's investment in Slide is valued at fair value with dividends received reported as dividend income on the income statement. Power will recognize its 40 percent share of dividends as investment income ($\$50,000 \times 40$ percent).

\$0 is incorrect. Power should recognize investment income equaling the amount of Power's share of dividends. This is consistent with accounting for equity securities at fair value.

\$128,000 is incorrect. Power will not recognize any of Slide's net income because Power's investment lacks the ability either to control or to exercise significant influence over the investee. As a result, Power's investment is valued at fair value, not under the equity method. Power should recognize investment income equaling the amount of Power's share of dividends.

\$148,000 is incorrect. Power will not recognize any of Slide's net income because Power's investment lacks the ability either to control or to exercise significant influence over the investee. As a result, Power's investment is valued at fair value, not under the equity method. Power should recognize investment income equaling the amount of Power's share of dividends.

12) D

"All of these account balances are eliminated" is correct. The subsidiary's stockholders' equity accounts must be eliminated because the subsidiary's stock is held entirely within the consolidated entity and none represents claims by outsiders, if wholly owned.

13) C

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“Closing the individual subsidiary's revenue and expense accounts into the parent's retained earnings” is correct. The consolidation process does not consist of closing the individual subsidiary's revenue and expense accounts into the parent's retained earnings. Rather, consolidation entries “close” the subsidiary into the parent's books.

Combining the financial statements of two or more legally separate companies, creating a single set of financial statements is a part of the consolidation process.

Combining for financial reporting the individual assets, liabilities, revenues, and expenses of two or more related companies as if they were part of a single company is a part of the consolidation process.

Eliminating intracompany transactions and holdings is a part of the consolidation process.

14) Essay

2. Pocket is the parent and Sleeve is the subsidiary.
3. A subsidiary is an entity in which another entity, the parent company, holds a controlling financial interest.
4. A parent company holds a controlling financial interest in another company.
5. The parent, Pocket, prepares the consolidated worksheet.
6. Consolidation entries are used to adjust the amounts reported by the parent and all of the subsidiaries to reflect the amounts that would be reported if the separate legal entities were a single company.

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15) Essay

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Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Beginning Book Value	85,000		50,000		35,000
Net Income	25,000				25,000
Dividends	(10,000)				(10,000)
Ending Book Value	<u>100,000</u>		<u>50,000</u>		<u>50,000</u>

**Basic
consolidation
entry:**

Common Stock 50,000

Retained 35,000

Earnings

Income from 25,000

Standard

Company

Dividends 10,000

Declared

Investment 100,000

in Standard

Company

**Accumulated
depreciation
consolidation
entry:**

Accumulated 68,000

Depreciation

Depreciable 68,000

Assets

	Peery Company	Standard Company	Consolidation Entries	Consolidated
			Debit	Credit

Income

Statement

Sales 200,000 112,000 312,000

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Less: Other Expenses	(90,000)	(70,000)			(160,000)
Less: Depreciation Expense	(30,000)	(17,000)			(47,000)
Income from Standard Company	25,000	0	25,000		0
Net Income	105,000	25,000	25,000	0	105,000
Statement of Retained Earnings					
Beginning Balance	175,000	35,000	35,000		175,000
Net Income	105,000	25,000	25,000	0	105,000
Less: Dividends Declared	(32,000)	(10,000)		10,000	(32,000)
Ending Balance	248,000	50,000	60,000	10,000	248,000
Balance Sheet					
Current Assets	238,000	95,000			333,000
Depreciable Assets	300,000	170,000		68,000	402,000
Less: Accumulated Depreciation	(120,000)	(85,000)	68,000		(137,000)
Investment in Standard Company	100,000			100,000	0
Total Assets	518,000	180,000	68,000	168,000	598,000
Current Liabilities	50,000	30,000			80,000
Long-Term Debt	120,000	50,000			170,000
Common Stock	100,000	50,000	50,000		100,000
Retained Earnings	248,000	50,000	60,000	10,000	248,000

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Total	518,000	180,000	110,000	10,000	598,000
Liabilities & Equity					

16) Essay

APB stated that these include:

- 1) Representation on board of directors
- 2) Participation in policy making
- 3) Material intercompany transactions
- 4) Interchange of managerial personnel
- 5) Technological dependency
- 6) Size of investment in relation to concentration of other shareholdings

17) Essay

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Basic

consolidation

entry:

Common Stock 50,000

Retained 75,000

Earnings

Investment in 125,000

Standard

Company

Dividend

consolidation

entry:

Dividend Income 15,000

Dividends 15,000

Declared

Plimsol
Company

Shipping
Corporation

Consolidation
Entries

Debit

Credit

Consolidated

Income

Statement

Sales

175,000

120,000

295,000

Less: Other

(85,000)

(60,000)

(145,000)

Expenses

Less:

(20,000)

(15,000)

(35,000)

Depreciation

Expense

Dividend Income

15,000

15,000

0

Net Income

85,000

45,000

15,000

0

115,000

Statement of

Retained

Earnings

Beginning

210,000

100,000

75,000

235,000

Balance

Net Income

85,000

45,000

15,000

0

115,000

Less: Dividends

(30,000)

(15,000)

15,000

(30,000)

Declared

Ending Balance

265,000

130,000

90,000

15,000

320,000

Balance Sheet

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Current Assets	160,000	115,000			275,000
Depreciable Assets (net)	180,000	135,000			315,000
Investment in Shipping Corporation	125,000			125,000	0
Total Assets	465,000	250,000	0	125,000	590,000
Current Liabilities	25,000	20,000			45,000
Long-Term Debt	75,000	50,000			125,000
Common Stock	100,000	50,000	50,000		100,000
Retained Earnings	265,000	130,000	90,000	15,000	320,000
Total Liabilities & Equity	465,000	250,000	140,000	15,000	590,000

18) Section Break

18.1) C

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\$18,600 is correct. Before calculating Pullman Company's share of dividends from Skate for the year, preferred dividends must be backed out first. Out of the \$72,000 of total dividends paid, \$10,000 is allocated to the preferred stock outstanding – (100,000 shares × \$2 par value × 5 percent = \$10,000.) With \$62,000 of dividends remaining, Pullman Company's 30 percent share is \$18,600 of dividends from Skate for the year.

\$62,000 represents the total amount of dividends from Skate after preferred dividends have been distributed. This answer choice is incorrect because Pullman Company acquired 30 percent of Skate Company's common stock, not 100 percent.

\$21,600 is incorrect. This answer choice does not take into account the cumulative preferred stock outstanding that has first priority to the dividends from Skate.

18.2) B

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\$42,000 is correct. Preferred dividends of the investee should be deducted from the investee's net income if declared or, whether declared or not, if the preferred stock is cumulative, before the investor computes its share of investee earnings. Thus, $\$150,000 - \$10,000 = \$140,000 \times 30$ percent = \$42,000. The \$10,000 of preferred dividends is calculated as follows: $100,000 \text{ shares} \times \$2 \text{ par value} \times 5 \text{ percent} = \$10,000$.

\$45,000 is incorrect. This answer choice does not deduct the preferred dividends of the investee from the investee's net income.

\$62,000 is incorrect. \$62,000 represents the total amount of dividends from Skate after preferred dividends have been distributed. This answer choice is incorrect because the question asks about the income from Skate account. Dividends from the investee do not affect the income from Skate account; they affect the investment in Skate account.

18.3) B

\$123,400 is correct. The investment in Skate account uses the equity method to calculate its ending balance on December 31, 20X2 as follows: initial investment \$100,000 + share of net income \$42,000 – share of dividends \$18,600 = \$123,400.

\$100,000 is incorrect. \$100,000 is Pullman Company's initial investment. The question asks for the balance in Pullman Company's investment account at year-end.

\$120,400 is incorrect. This answer choice incorrectly uses \$21,600 as the amount of Pullman Company's share of dividends instead of \$18,600.

\$142,000 is incorrect. This answer choice does not subtract Pullman Company's \$18,600 share of dividends.

19) Section Break

19.1) A

\$23,000 is correct. Before calculating Pony Company's share of dividends from Stallion for the year, preferred dividends must be backed out first. Out of the \$140,000 of total dividends paid, \$48,000 is allocated to the preferred stock outstanding – $(80,000 \text{ shares} \times \$10 \text{ par value} \times 6 \text{ percent} = \$48,000)$. With \$92,000 of dividends remaining, Pony Company's 25 percent share is \$23,000 of dividends from Stallion for the year.

\$35,000 is incorrect. This answer choice does not take into account the cumulative preferred stock outstanding that has first priority to the dividends from Stallion.

\$92,000 is incorrect. \$92,000 represents the total amount of dividends from Stallion after preferred dividends have been distributed. This answer choice is incorrect because Pony Company acquired 25 percent of Stallion Company's common stock, not 100 percent.

19.2) C

Advanced Financial Accounting Edition 13 Christensen

\$55,500 is correct. Preferred dividends of the investee should be deducted from the investee's net income if declared or, whether declared or not, if the preferred stock is cumulative, before the investor computes its share of investee earnings. Thus, $\$270,000 - \$48,000 = \$222,000 \times 25$ percent = \$55,500. The \$48,000 of preferred dividends is calculated as follows: $80,000 \text{ shares} \times \$10 \text{ par value} \times 6 \text{ percent} = \$48,000$.

\$140,000 is incorrect. \$140,000 represents the total amount of dividends from Stallion. This answer choice is incorrect because the question asks about the income from Stallion account. Dividends from the investee do not affect the income from Stallion account; they affect the investment in Stallion account.

\$67,500 is incorrect. This answer choice does not deduct the preferred dividends of the investee from the investee's net income.

\$35,000 is incorrect. This answer choice multiplies the total dividends from Stallion by Pony's ownership percentage. However, the question asks for the amount of investment income, and dividends received affect the investment account, not the income account.

19.3) C

\$232,500 is correct. The investment in Stallion account uses the equity method to calculate its ending balance on December 31, 20X4 as follows: initial investment \$200,000 + share of net income \$55,500 – share of dividends \$23,000 = \$232,500.

\$200,000 is incorrect. \$200,000 is Pony Company's initial investment. The question asks for the balance in Pony Company's investment account at year-end.

\$220,500 is incorrect. This answer choice incorrectly uses \$35,000 as the amount of Pony Company's share of dividends instead of \$23,000.

\$255,500 is incorrect. This answer choice does not subtract Pony Company's \$23,000 share of dividends.

20) Section Break

20.1) C

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\$17,500 is correct. If Poke could not exercise significant influence over the investee, then the fair value method is used. Income from Shove will not affect Poke's income. Instead, Poke will remeasure its investment at year-end, and dividends received from Shove will be reported as dividend income on the income statement. See the calculation below.

	20X3	20X4
Investment Income	\$ -	\$ -
Dividends Received	7,500	7,500
Gain (Loss) on Fair Value	10,000	(5,000)
Change in Income	<u>\$ 17,500</u>	<u>\$ 2,500</u>

Dividends Received: $\$30,000 \times 25 \text{ percent} = \$7,500$

20X3 Gain $\$10,000 = \$110,000 - \$100,000$

20X4 Loss $(\$5,000) = \$105,000 - \$110,000$

\$7,500 is incorrect. This answer choice does not include the fair value remeasurement at year end 20X3.

20.4) B

\$2,500 is correct. If Poke could not exercise significant influence over the investee, then the fair value method is used. Income from Shove will not affect Poke's income. Instead, Poke will remeasure its investment at year-end, and dividends received from Shove will be reported as dividend income on the income statement. See the calculation below.

	20X3	20X4
Investment Income	\$ -	\$ -
Dividends Received	7,500	7,500
Gain (Loss) on Fair Value	10,000	(5,000)
Change in Income	<u>\$ 17,500</u>	<u>\$ 2,500</u>

Dividends Received: $\$30,000 \times 25 \text{ percent} = \$7,500$

20X3 Gain $\$10,000 = \$110,000 - \$100,000$

20X4 Loss $(\$5,000) = \$105,000 - \$110,000$

\$7,500 is incorrect. This answer choice does not include the fair value remeasurement at year end 20X4.

20.5) A

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\$105,000 is correct. Under the fair value method, equity securities must be remeasured to fair value as of the end of each period. At the end of 20X4, the fact pattern says that the fair value of shares held by Poke was \$105,000.

\$122,500 is incorrect. This is the value that would be reported at year end under the equity method when Poke could exercise significant influence over the investee, not the fair value.

21) Section Break

21.1) B

\$650,000 is correct. Prime reported total assets of \$650,000. Assets before the acquisition totaled \$500,000. The acquisition is reported as an investment in Standard Video Corporation for \$150,000. The total is \$650,000.

21.2) B

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\$880,000 is correct. The total consolidated amount of assets is \$880,000. This amount is derived as follows: Prime's assets \$650,000 + Standard's assets \$400,000 – investment in Standard \$150,000 – intercompany accounts receivable \$20,000.

	Prime Company	Standard Company	Consolidation Entries		Consolidated
			Debit	Credit	
Investment in Standard Company	150,000			150,000	0
Assets	500,000	400,000			900,000
Accounts Receivable				20,000	(20,000)
Total Assets	650,000	400,000			880,000
Liabilities	280,000	250,000	20,000		510,000
Bonds Payable	150,000				150,000
Total Liabilities	430,000	250,000			660,000
Equity	220,000	150,000	150,000		220,000
Total Liabilities & Equity	650,000	400,000			880,000

\$650,000 is incorrect. This amount represents the total assets on Prime Company's unconsolidated balance sheet. The intercompany accounts receivable should be subtracted from the consolidated amount of total assets, not added.

21.3) D

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\$660,000 is correct. The total consolidated amount of liabilities is calculated as follows: Prime's liabilities \$280,000 + Prime's bond payable \$150,000 + Standard's liabilities \$250,000 – intercompany accounts payable \$20,000. The bonds issued to acquire Standard must be included in the consolidated balance sheet along with the elimination of the intercompany accounts payable. \$280,000 is incorrect. This amount represents the total liabilities on Prime Company's unconsolidated balance sheet.

	Prime Company	Standard Company	Consolidation Entries		Consolidated
			Debit	Credit	
Investment in Standard Company	150,000			150,000	0
Assets	500,000	400,000			900,000
Accounts Receivable				20,000	(20,000)
Total Assets	650,000	400,000			880,000
Liabilities	280,000	250,000	20,000		510,000
Bonds Payable	150,000				150,000
Total Liabilities	430,000	250,000			660,000
Equity	220,000	150,000	150,000		220,000
Total Liabilities & Equity	650,000	400,000			880,000

21.4) A

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\$220,000 is correct. The total amount of stockholder's equity reported in the consolidated balance sheet is calculated as follows: Prime's equity \$220,000 + Standard's equity \$150,000 – Standard's equity \$150,000.

\$150,000 is incorrect. This amount represents Standard's equity which should be eliminated in the consolidation entries.

\$370,000 is incorrect. Standard's equity should be eliminated in the consolidation entries, not added to Prime's equity balance.

	Prime Company	Standard Company	Consolidation Entries	Consolidated
			Debit Credit	
Investment in Standard Company	150,000			0
Assets	500,000	400,000		900,000
Accounts Receivable				20,000 (20,000)
Total Assets	650,000	400,000		880,000
Liabilities	280,000	250,000	20,000	510,000
Bonds Payable	150,000			150,000
Total Liabilities	430,000	250,000		660,000
Equity	220,000	150,000	150,000	220,000
Total Liabilities & Equity	650,000	400,000		880,000

22) Section Break

22.1) C

\$800,000 is correct. Pickup reported total assets of \$800,000. Assets before the acquisition totaled \$600,000. The acquisition is reported as an investment in Sedan Corporation for \$200,000. The total is \$800,000.

22.2) C

Advanced Financial Accounting Edition 13 Christensen

\$1,050,000 is correct. The total consolidated amount of assets is \$1,050,000. This amount is derived as follows: Pickup's assets \$800,000 + Sedan's assets \$500,000 – investment in Sedan \$200,000 – intercompany accounts receivable \$50,000.

\$600,000 is incorrect. This amount represents the total assets on Pickup Company's balance sheet before acquisition of Sedan Company.

\$800,000 is incorrect. This amount represents the total assets on Pickup Company's unconsolidated balance sheet after the acquisition of Sedan Company.

\$1,150,000 is incorrect. The intercompany accounts receivable should be subtracted from the consolidated amount of total assets, not added.

	Pickup Company	Sedan Company	Consolidation Entries		Consolidated
			Debit	Credit	
Investment in Sedan Company	200,000			200,000	0
Assets	600,000	500,000			1,100,000
Accounts Receivable				50,000	(50,000)
Total Assets	800,000	500,000			1,050,000
Liabilities	370,000	300,000	50,000		620,000
Bonds Payable	200,000				200,000
Total Liabilities	570,000	300,000			820,000
Equity	230,000	200,000	200,000		230,000
Total Liabilities & Equity	800,000	500,000			1,050,000

22.3) C

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\$820,000 is correct. The total consolidated amount of liabilities is calculated as follows: Pickup's liabilities \$370,000 + Pickup's bond payable \$200,000 + Sedan's liabilities \$300,000 – intercompany accounts payable \$50,000.

\$370,000 is incorrect. This amount represents the total liabilities on Pickup Company's balance sheet before acquisition of Sedan Company.

\$670,000 is incorrect. The bonds issued to acquire Sedan must be included in the consolidated balance sheet along with the elimination of the intercompany accounts payable.

\$870,000 is incorrect. This amount does not eliminate the intercompany accounts payable balance of \$50,000.

	Pickup Company	Sedan Company	Consolidation Entries		Consolidated
			Debit	Credit	
Investment in Sedan Company	200,000			200,000	0
Assets	600,000	500,000			1,100,000
Accounts Receivable				50,000	(50,000)
Total Assets	800,000	500,000			1,050,000
Liabilities	370,000	300,000	50,000		620,000
Bonds Payable	200,000				200,000
Total Liabilities	570,000	300,000			820,000
Equity	230,000	200,000	200,000		230,000
Total Liabilities & Equity	800,000	500,000			1,050,000

22.4) B

Advanced Financial Accounting Edition 13 Christensen

\$230,000 is correct. The total amount of stockholder's equity reported in the consolidated balance sheet is calculated as follows: Pickup's equity \$230,000 + Sedan's equity \$200,000 – Sedan's equity \$200,000.

\$200,000 is incorrect. This amount represents Sedan's equity which should be eliminated in the consolidation entries.

\$430,000 is incorrect. Sedan's equity should be eliminated in the consolidation entries, not added to Pickup's equity balance.

	Pickup Company	Sedan Company	Consolidation Entries		Consolidated
			Debit	Credit	
Investment in Sedan Company	200,000			200,000	0
Assets	600,000	500,000			1,100,000
Accounts Receivable				50,000	(50,000)
Total Assets	800,000	500,000			1,050,000
Liabilities	370,000	300,000	50,000		620,000
Bonds Payable	200,000				200,000
Total Liabilities	570,000	300,000			820,000
Equity	230,000	200,000	200,000		230,000
Total Liabilities & Equity	800,000	500,000			1,050,000

23) Section Break

23.1) D

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\$600,000 is correct. Parent's post-closing retained earnings balance on December 31, 20X1 includes the beginning retained earnings balance of \$520,000 plus net income of \$120,000 minus dividends declared of \$40,000 for a total of \$600,000.

	Parent Company	Son Company	Consolidation Entries		Consolidated
			Debit	Credit	
Income Statement					
Operating Earnings	105,000	15,000			120,000
Income from Son Company	15,000		15,000		0
Net Income	<u>120,000</u>	<u>15,000</u>			<u>120,000</u>
Statement of Retained Earnings					
Beginning Balance	520,000	150,000	150,000		520,000
Net Income	120,000	15,000	15,000		120,000
Less: Dividends Declared	(40,000)	(6,000)		6,000	(40,000)
Ending Balance	<u>600,000</u>	<u>159,000</u>			<u>600,000</u>

23.2) C

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\$159,000 is correct. Son's post-closing retained earnings balance on December 31, 20X1 is calculated as follows: beginning retained earnings \$150,000 + net income \$15,000 – dividends declared \$6,000 = \$159,000. Net income reported by Son is added to retained earnings, and dividends declared by Son are subtracted from retained earnings.

\$150,000 is incorrect. This amount reflects beginning retained earnings at January 1, 20X1. The question asks for post-closing retained earnings on December 31, 20X1.

\$165,000 is incorrect. Dividends declared must be subtracted from retained earnings to arrive at the correct post-closing retained earnings balance on December 31, 20X1.

	Parent Company	Son Company	Consolidation Entries	Consolidated
			Debit Credit	
Income Statement				
Operating Earnings	105,000	15,000		120,000
Income from Son Company	15,000		15,000	0
Net Income	120,000	15,000		120,000
Statement of Retained Earnings				
Beginning Balance	520,000	150,000	150,000	520,000
Net Income	120,000	15,000	15,000	120,000
Less: Dividends Declared	(40,000)	(6,000)		(40,000)
Ending Balance	600,000	159,000		600,000

23.3) C

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\$430,000 is correct. Phips' post-closing retained earnings balance on December 31, 20X2 includes the beginning retained earnings balance of \$320,000 plus net income of \$145,000 minus dividends declared of \$35,000 for a total of \$430,000. Phips' post-closing retained earnings balance must correctly include \$20,000 of income from Sips Company but not include Sips Company's dividend declaration of \$8,000.

	Phips Company	Sips Company	Consolidation Entries		Consolidated
			Debit	Credit	
Income Statement					
Operating Earnings	125,000	20,000			145,000
Income from Sips Company	20,000		20,000		0
Net Income	145,000	20,000			145,000
Statement of Retained Earnings					
Beginning Balance	320,000	120,000	120,000		320,000
Net Income	145,000	20,000	20,000		145,000
Less: Dividends Declared	(35,000)	(8,000)		8,000	(35,000)
Ending Balance	430,000	132,000			430,000

24.2) C

Advanced Financial Accounting Edition 13 Christensen

\$132,000 is correct. Sips' post-closing retained earnings balance on December 31, 20X2 is calculated as follows: beginning retained earnings \$120,000 + net income \$20,000 – dividends declared \$8,000 = \$132,000.

Net income reported by Sips is added to retained earnings, and dividends declared by Sips are subtracted from retained earnings.

\$120,000 is incorrect. This amount reflects beginning retained earnings at January 1, 20X2. The question asks for post-closing retained earnings on December 31, 20X2.

\$140,000 is incorrect. Dividends declared must be subtracted from retained earnings to arrive at the correct post-closing retained earnings balance on December 31, 20X2.

	Phips Company	Sips Company	Consolidation Entries	Consolidated
			Debit	Credit
Income Statement				
Operating Earnings	125,000	20,000		145,000
Income from Sips Company	20,000		20,000	0
Net Income	145,000	20,000		145,000
Statement of Retained Earnings				
Beginning Balance	320,000	120,000	120,000	320,000
Net Income	145,000	20,000	20,000	145,000
Less: Dividends Declared	(35,000)	(8,000)		8,000
Ending Balance	430,000	132,000		430,000

24.3) C

Advanced Financial Accounting Edition 13 Christensen

\$430,000 is correct. Phips' consolidated retained earnings balance on December 31, 20X2 includes the beginning retained earnings balance of \$320,000 plus net income of \$145,000 minus dividends declared of \$35,000 for a total of \$430,000. Sips Company's beginning retained earnings, net income during the year, and dividends declared are all eliminated in the consolidation entries.

Phips' equity-method income of \$20,000 is included in the consolidated retained earnings balance through its inclusion in net income. The table below highlights how the equity-method income flows through the financial statements.

Sips Company's ending retained earnings balance cannot simply be added to Phips Company's ending retained earnings balance to arrive at the consolidated retained earnings balance.

Consolidation entries eliminate Sips Company's beginning retained earnings, net income, and dividends declared to arrive at the consolidated amount.

	Phips Company	Sips Company	Consolidation Entries		Consolidated
			Debit	Credit	
Income Statement					
Operating Earnings	125,000	20,000			145,000
Income from Sips Company	20,000		20,000		0
Net Income	145,000	20,000			145,000
Statement of Retained Earnings					
Beginning Balance	320,000	120,000	120,000		320,000
Net Income	145,000	20,000	20,000		145,000
Less: Dividends Declared	(35,000)	(8,000)		8,000	(35,000)
Ending Balance	430,000	132,000			430,000

24.4) C

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“Continued use of the equity-method even if continued losses result in a zero or negative balance in the investment account” is correct. ASC 323 and 325 does not require the continued use of the equity-method even if continued losses result in a zero or negative balance in the investment account.

ASC 323-10 does require that the investor’s share of the investee’s income from discontinued operations and prior-period adjustments should be reported as such by the investor, if material. ASC 323-10 does require that preferred dividends of the investee should be deducted from the investee’s net income if declared or, whether declared or not, if the preferred stock is cumulative, before the investor computes its share of investee earnings.

25) Section Break

25.1) C

\$110,000 is correct. The consolidated financial statements will report \$110,000 of net income. The calculation is as follows: sales \$250,000 – other expenses \$105,000 – depreciation expense \$35,000 = \$110,000. Income from Shipping Company is eliminated in the consolidation entries. \$100,000 is the amount of Shipping Company’s sales for the year, not the amount of consolidated net income.

Dividend income from Shipping Company is treated as a reduction in capital of Plimsol and will not affect the consolidated net income.

	Plimsol Company	Shipping Corporation	Consolidation Entries		Consolidated
			Debit	Credit	
Income Statement					
Sales	150,000	100,000			250,000
Other Expenses	(60,000)	(45,000)			(105,000)
Depreciation Expense	(20,000)	(15,000)			(35,000)
Income from Shipping Corporation	40,000		40,000		0
Net Income	110,000	40,000	40,000	0	110,000

25.2) B

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\$525,000 is correct. The amount of total assets reported in the consolidated balance sheet is calculated as follows: current assets \$175,000 + depreciable assets (net) \$350,000 = \$525,000. The investment in Shipping Company is eliminated in the consolidation entries. The investment in Shipping Company account is eliminated in the consolidation entries. \$150,000 is originally calculated by taking the acquisition cost of \$125,000, adding the income from Shipping Company of \$40,000, and subtracting Shipping Company’s dividends declared of \$15,000. This is consistent with the equity-method of accounting.

	Plimsol Company	Shipping Corporation	Consolidation Entries		Consolidated
			Debit	Credit	
Balance Sheet					
Current Assets	100,000	75,000			175,000
Depreciable Assets (net)	200,000	150,000			350,000
Investment in Shipping Corporation	150,000			150,000	0
Total Assets	450,000	225,000	0	150,000	525,000

25.3) A

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\$235,000 is correct. Consolidated retained earnings as of December 31, 20X4 is calculated as follows: beginning retained earnings \$150,000 + net income \$110,000 – dividends declared \$25,000 = \$235,000. Shipping Company's beginning retained earnings, net income, and dividends declared are all eliminated in consolidation entries.

	Plimsol Company	Shipping Corporation	Consolidation Entries		Consolidated
			Debit	Credit	
Income Statement					
Sales	150,000	100,000			250,000
Other Expenses	(60,000)	(45,000)			(105,000)
Depreciation Expense	(20,000)	(15,000)			(35,000)
Income from Shipping Corporation	40,000		40,000		0
Net Income	110,000	40,000	40,000	0	110,000
Statement of Retained Earnings					
Beginning Balance	150,000	75,000	75,000		150,000
Net Income	110,000	40,000	40,000		110,000
Less: Dividends Declared	(25,000)	(15,000)		15,000	(25,000)
Ending Balance	235,000	100,000	115,000	15,000	235,000

25.4) D

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\$335,000 is correct. The amount of total stockholders' equity is calculated by adding common stock of \$100,000 to retained earnings of \$235,000.

\$190,000 is incorrect. This amount represents total liabilities on the consolidated balance sheet, not the amount of total stockholders' equity.

Total stockholders' equity reported on the consolidated balance sheet eliminates Shipping Company's common stock and retained earnings as shown below.

	Plimsol Company	Shipping Corporation	Consolidation Entries		Consolidated
			Debit	Credit	
Balance Sheet					
Current Assets	100,000	75,000			175,000
Depreciable Assets (net)	200,000	150,000			350,000
Investment in Shipping Corporation	150,000			150,000	0
Total Assets	450,000	225,000	0	150,000	525,000
Current Liabilities	40,000	25,000			65,000
Long-Term Debt	75,000	50,000			125,000
Total Liabilities	115,000	75,000	0	0	190,000
Common Stock	100,000	50,000	50,000		100,000
Retained Earnings	235,000	100,000	115,000	15,000	235,000
Total Stockholders' Equity	335,000	150,000	165,000	15,000	335,000
Total Liabilities & Equity	450,000	225,000	165,000	15,000	525,000

26) Section Break

26.1) B

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\$420,000 is correct. Under the cost method, Parent Company will not adjust its investment in Son Incorporated when Son reports earnings or declares dividends. Neither events will affect the investment account when carried at cost.

No entries are made on Parent Company's books with respect to Son Incorporated's income in 20X2, as would be done under the equity method.

26.2) D

\$498,000 is correct. The balance in Parent's investment in Son account would increase by \$82,000 from Son's earnings during 20X2 and would decrease by Son's declared dividends of \$4,000 during 20X2. ($\$420,000 + \$82,000 - \$4,000 = \$498,000$.)

\$416,000 is incorrect. This answer choice does not include Son's earnings in Parent Company's investment account. \$498,000 is the correct amount.

\$424,000 is incorrect. \$498,000 is the correct amount. The balance in Parent's investment in Son account would increase by \$82,000 from Son's earnings during 20X2 and would decrease by Son's declared dividends of \$4,000 during 20X2. ($\$420,000 + \$82,000 - \$4,000 = \$498,000$.)

\$420,000 is incorrect. This amount represents the balance in Parent's investment in Son account under the cost method.

27) Section Break

27.1) B

\$625,000 is correct. Under the cost method, Pone Company will not adjust its investment in Sone Incorporated when Sone reports earnings or declares dividends. Neither events will affect the investment account when carried at cost.

27.2) D

\$693,000 is correct. The balance in Pone's investment in Sone account would increase by \$76,000 from Sone's earnings during 20X5 and would decrease by Sone's declared dividends of \$8,000 during 20X5. ($\$625,000 + \$76,000 - \$8,000 = \$693,000$.)

\$617,000 is incorrect. This answer choice does not include Sone's earnings in Pone Company's investment account.

\$633,000 is incorrect. This answer choice does not include Sone's earnings in Pone Company's investment account. Additionally, dividends should be subtracted, not added.

\$625,000 is incorrect. This amount represents the balance in Pone's investment in Sone account under the cost method.