CHAPTER 17

INVESTMENTS

IFRS questions are available at the end of this chapter.

TRUE-FALSE—Conceptual

Answer	No.	Description
F	1.	Examples of debt securities.
T	2.	Definition of trading securities.
F	3.	Available-for-sale unrealized gains/losses.
F	4.	Classifying held-to-maturity securities.
T	5.	Fair value changes in AFS securities.
F	6.	Fair Value Adjustment account.
T	7.	Accounting for trading securities.
F	8.	Definition of significant influence.
T	9.	Reporting Unrealized Holding Gain/Loss—Equity account.
T	10.	Examples of significant influence.
F	11.	Definition of controlling interest.
T	12.	Effect of dividends on investment under equity.
F	13.	Reporting revenue under fair value method.
T	14.	Definition of controlling interest.
F	15.	Using fair value option.
T	16.	Accounting for changes in fair value.
F	17.	Temporary declines and write downs.
T	18.	Necessary of reclassification adjustment.
F	19.	Transfer of held-to-maturity securities.
T	20.	Transfers from trading to available-for-sale.

MULTIPLE CHOICE—Conceptual

Answer	No.	Description
c	21.	Debt securities.
b	22.	Valuation of debt securities.
c	23.	Held-to-maturity securities.
c	24.	Unrealized gain/loss recognition for securities.
a	P25.	Accounting for accrued interest.
a	S26.	Identifying securities accounted for at amortized cost.
c	S27.	Accounting for available-for-sale securities.
b	S28.	Using effective-interest method of amortization.
a	S29.	Identifying available-for-sale securities.
d	30.	Classification as held-to-maturity.
b	31.	Reporting held-to-maturity securities.
c	32.	Acquisition of held-to-maturity securities.
d	33.	Accounting for trading securities.
c	34.	Accounting for trading debt securities.
c	35.	Recording investments in debt securities.
d	36.	Calculating the issue price of bonds.
c	37.	Valuation of investments in debt securities.
a	38.	Recording amortization of bond discount.
c	39.	Amortization of premium/discount on investment in a debt security.

MULTIPLE CHOICE—Conceptual (cont.)

Answer	No.	Description
d	40.	Effective-interest rate method.
c	41.	Debt securities purchased between interest dates.
c	42.	Sale of debt security prior to maturity.
b	S43.	Passive interest investment.
a	S44.	Fair value vs. equity method.
c	P45.	Fair value vs. equity method.
b	46.	Conditions for using the equity method.
d	47.	Ownership interest required for using the equity method.
a	48.	Recording of dividends received under the equity method.
d	49.	Recognition of earnings of investee using the equity method.
d	50.	Effect of using the fair value method in error.
d	51.	Determine value of investment.
a	52.	Fair value option.
d	53.	Accounting for impairments.
c	54.	Reclassification adjustment in comprehensive income.
b	55.	Reclassification of securities.
b	56.	Reclassification of securities.
d	P57.	Transfer of a debt security.
c	58.	Definition of “gains trading” or “cherry picking”.
b	59.	Accounting for transfers between Categories.
a	*60.	Accounting for derivatives.
c	*61.	Characteristics of a derivative instrument.
b	*62.	Identifying companies that are arbitrageurs.
d	*63.	Identifying equity securities.
c	*64.	Accounting for fair value hedges.
b	*65.	Gains/losses on cash flow hedges.
a	*66.	Identifying an embedded derivative.
c	*67.	Requirements for financial instrument disclosures.
a	*68.	Variable-interest entity.
d	*69.	Risk-and-reward model and voting-interest approach.

P These questions also appear in the Problem-Solving Survival Guide.
S These questions also appear in the Study Guide.
*This topic is dealt with in an Appendix to the chapter.

MULTIPLE CHOICE—Computational

Answer	No.	Description
c	70.	Recording the purchase of debt securities.
b	71.	Computing cost of bond investment.
d	72.	Calculation of discount amortization.
b	73.	Calculation of revenue from HTM securities.
a	74.	Computation of other comprehensive income.
c	75.	Computation of gain/loss on sale of bonds.
a	76.	Acquisition of held-to-maturity securities.
b	77.	Carrying value of held-to-maturity securities.
c	78.	Carrying value of available-for-sale debt securities.
a	79.	Calculation of income from available-for-sale debt securities.
b	80.	Calculation of income from HTM securities.

MULTIPLE CHOICE—Computational (cont.)

Answer	No.	Description
b	81.	Determine gain on sale of debt securities.
d	82.	Computation of revenue from HTM securities.
a	83.	Calculation of premium amortization.
d	84.	Calculation of other comprehensive income.
b	85.	Calculation of loss on sale of bonds.
d	86.	Calculation of loss on sale of trading security.
b	87.	Determination of unrealized loss on trading security.
c	88.	Determination of accumulated other comprehensive income.
b	89.	Entry to record unrealized gain on AFS securities.
c	90.	Fair value for trading securities.
a	91.	Unrealized gain on available-for-sale securities.
a	92.	Calculation of gain on sale of equity security.
b	93.	Determination of unrealized loss on AFS securities.
a	94.	Calculation of unrealized loss included in comprehensive income.
b	95.	Computation of purchase price of equity method investment.
c	96.	Computation of revenue from investment.
c	97.	Computation of investment account balance.
a	98.	Calculation of investment revenue.
c	99.	Accounting for stock investments/fair value method.
b	100.	Accounting for stock investments/equity method.
b	101.	Accounting for stock investments/fair value method.
b	102.	Equity method of accounting.
c	103.	Fair value method of accounting for stock investment.
c	104.	Equity method of accounting for stock investment.
c	105.	Balance of investment account using the equity method.
b	106.	Investment income recognized under the equity method.
c	107.	Balance of investment account using the equity method.
b	108.	Balance of investment account using the equity method.
d	109.	Investment income recognized under the equity method.
b	110.	Other comprehensive income.

MULTIPLE CHOICE—CPA Adapted

Answer	No.	Description
d	111.	Carrying value of AFS debt securities.
d	112.	Unrealized loss on trading and AFS securities.
c	113.	Unrealized loss on trading and AFS securities.
d	114.	Classification of an equity security.
c	115.	Investment income recognized under the equity method.
b	116.	Balance of investment account using the equity method.
c	117.	Sale of stock investment.
a	118.	Calculate the acquisition price of a stock investment.
b	119.	Transfer of securities from trading to AFS.

EXERCISES

Item	Description
E17-120	Investment in debt securities at a premium.
E17-121	Investment in debt securities at a discount.
E17-122	Investments in equity securities (essay).
E17-123	Investment in equity securities.
E17-124	Fair value and equity methods (essay).
E17-125	Fair value and equity methods.
E17-126	Comprehensive income calculation.
*E17-127	Fair value hedge.
*E17-128	Cash flow hedge.

PROBLEMS

Item	Description
P17-129	Trading equity securities.
P17-130	Trading securities.
P17-131	Available-for-sale securities.
*P17-132	Derivative financial instrument.
*P17-133	Free-standing derivative.

CHAPTER LEARNING OBJECTIVES

1. Identify the three categories of debt securities and describe the accounting and reporting treatment for each category.

2. Understand the procedures for discount and premium amortization on bond investments.

3. Identify the categories of equity securities and describe the accounting and reporting treatment for each category.

4. Explain the equity method of accounting and compare it to the fair value method for equity securities.

5. Describe the accounting for the fair value option.

6. Discuss the accounting for impairments of debt and equity investments.

7. Explain why companies report reclassification adjustments.

8. Describe the accounting for transfer of investment securities between categories.

*9. Explain who uses derivatives and why.

*10. Understand the basic guidelines for accounting for derivatives.

*11. Describe the accounting for derivative financial instruments.

*12. Explain how to account for a fair value hedge.

*13. Explain how to account for a cash flow hedge.

*14. Identify special reporting issues related to derivative financial instruments that cause unique accounting problems.

*15. Describe the accounting for variable-interest entities.

SUMMARY OF LEARNING OBJECTIVES BY QUESTIONS

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Learning Objective 1													
1.	TF	3.	TF	22.	MC	24.	MC	[S]26.	MC	70.	MC		
2.	TF	21.	MC	23.	MC	[P]25.	MC	[S]27.	MC	71.	MC		
Learning Objective 2													
4.	TF	30.	MC	36.	MC	42.	MC	77.	MC	83.	MC		
5.	TF	31.	MC	37.	MC	72.	MC	78.	MC	84.	MC		
6.	TF	32.	MC	38.	MC	73.	MC	79.	MC	85.	MC		
7.	TF	33.	MC	39.	MC	74.	MC	80.	MC	111.	MC		
[S]28.	MC	34.	MC	40.	MC	75.	MC	81.	MC	120.	E		
[S]29.	MC	35.	MC	41.	MC	76.	MC	82.	MC	121.	E		
Learning Objective 3													
8.	TF	11.	TF	87.	MC	90.	MC	93.	MC	113.	MC	129.	P
9.	TF	[S]43.	MC	88.	MC	91.	MC	94.	MC	114.	MC	130.	P
10.	TF	86.	MC	89.	MC	92.	MC	112.	MC	122.	E	131.	P
Learning Objective 4													
12.	TF	46.	MC	95.	MC	100.	MC	105.	MC	115.	MC	124.	E
13.	TF	47.	MC	96.	MC	101.	MC	106.	MC	116.	MC	125.	E
14.	TF	48.	MC	97.	MC	102.	MC	107.	MC	117.	MC	126.	E
[S]44.	MC	49.	MC	98.	MC	103.	MC	108.	MC	118.	MC		
[P]45.	MC	50.	MC	99.	MC	104.	MC	109.	MC	123.	E		
Learning Objective 5													
15.	TF	16.	TF	51.	MC	52.	MC	110.	MC				
Learning Objective 6													
17.	TF	53.	MC	122.	E	130.	P						
Learning Objective 7													
18.	TF	54.	MC										
Learning Objective 8													
19.	TF	55.	MC	[P]57.	MC	59.	MC	122.	E	130.	P		
20.	TF	56.	MC	58.	MC	119.	MC	129.	P				
Learning Objective 9*													
60.	MC												
Learning Objective 10*													
61.	MC												
Learning Objective 11*													
62.	MC	63.	MC	132.	P	133.	P						
Learning Objective 12*													
64.	MC	127.	E										

SUMMARY OF LEARNING OBJECTIVES BY QUESTIONS (cont.)

Learning Objective 13*						
65. MC	128. E					
Learning Objective 14*						
66. MC						
Learning Objective 15*						
67. MC	68. MC	69. MC				

Note: TF = True-False E = Exercise
MC = Multiple Choice P = Problem

TRUE-FALSE—Conceptual

1. Debt securities include corporate bonds and convertible debt, but not U.S. government securities.

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

3. Unrealized holding gains and losses are recognized in net income for available-for-sale debt securities.

4. A company can classify a debt security as held-to-maturity if it has the positive intent to hold the securities to maturity.

5. Companies do not report changes in the fair value of available-for-sale debt securities as income until the security is sold.

6. The Fair Value Adjustment account has a normal credit balance.

7. Companies report trading securities at fair value, with unrealized holding gains and losses reported in net income.

8. Equity security holdings between 20 and 50 percent indicates that the investor has a controlling interest over the investee.

9. The Unrealized Holding Gain/Loss—Equity account is reported as a part of other comprehensive income.

10. Significant influence over an investee may be indicated by material intercompany transactions and interchange of managerial personnel.

11. The accounting profession has concluded that an investment of more than 50 percent of the voting stock of an investee should lead to a presumption of significant influence over an investee.

12. All dividends received by an investor from the investee decrease the investment's carrying value under the equity method.

13. Under the fair value method, the investor reports as revenue its share of the net income reported by the investee.

14. A controlling interest occurs when one corporation acquires a voting interest of more than 50 percent in another corporation.

15. Companies may not use the fair value option for investments that follow the equity method of accounting.

16. Changes in the fair value of a company's debt instruments are included as part of earnings in any given period.

17. If a decline in a security's value is judged to be temporary, a company needs to write down the cost basis of the individual security to a new cost basis.

18. A reclassification adjustment is necessary when a company reports realized gains/losses as part of net income but also shows unrealized gains/losses as part of other comprehensive income.

19. If a company transfers held-to-maturity securities to available-for-sale securities, the unrealized gain or loss is recognized in income.

20. The transfer of securities from trading to available-for-sale and from available-for-sale to trading has the same impact on stockholders' equity and net income.

True-False Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	F	6.	F	11.	F	16.	T
2.	T	7.	T	12.	T	17.	F
3.	F	8.	F	13.	F	18.	T
4.	F	9.	T	14.	T	19.	F
5.	T	10.	T	15.	F	20.	T

MULTIPLE CHOICE—Conceptual

21. Which of the following is *not* a debt security?
    a. Convertible bonds
    b. Commercial paper
    c. Loans receivable
    d. All of these are debt securities.

22. A correct valuation is
    a. available-for-sale at amortized cost.
    b. held-to-maturity at amortized cost.
    c. held-to-maturity at fair value.
    d. none of these.

23. Securities which could be classified as held-to-maturity are
    a. redeemable preferred stock.
    b. warrants.
    c. municipal bonds.
    d. treasury stock.

24. Unrealized holding gains or losses which are recognized in income are from securities classified as
    a. held-to-maturity.
    b. available-for-sale.
    c. trading.
    d. none of these.

P25. When an investor's accounting period ends on a date that does not coincide with an interest receipt date for bonds held as an investment, the investor must
    a. make an adjusting entry to debit Interest Receivable and to credit Interest Revenue for the amount of interest accrued since the last interest receipt date.
    b. notify the issuer and request that a special payment be made for the appropriate portion of the interest period.
    c. make an adjusting entry to debit Interest Receivable and to credit Interest Revenue for the total amount of interest to be received at the next interest receipt date.
    d. do nothing special and ignore the fact that the accounting period does not coincide with the bond's interest period.

S26. Debt securities that are accounted for at amortized cost, not fair value, are
    a. held-to-maturity debt securities.
    b. trading debt securities.
    c. available-for-sale debt securities.
    d. never-sell debt securities.

S27. Debt securities acquired by a corporation which are accounted for by recognizing unrealized holding gains or losses and are included as other comprehensive income and as a separate component of stockholders' equity are
    a. held-to-maturity debt securities.
    b. trading debt securities.
    c. available-for-sale debt securities.
    d. never-sell debt securities.

S28. Use of the effective-interest method in amortizing bond premiums and discounts results in
    a. a greater amount of interest income over the life of the bond issue than would result from use of the straight-line method.
    b. a varying amount being recorded as interest income from period to period.
    c. a variable rate of return on the book value of the investment.
    d. a smaller amount of interest income over the life of the bond issue than would result from use of the straight-line method.

S29. Equity securities acquired by a corporation which are accounted for by recognizing unrealized holding gains or losses as other comprehensive income and as a separate component of stockholders' equity are
    a. available-for-sale securities where a company has holdings of less than 20%.
    b. trading securities where a company has holdings of less than 20%.
    c securities where a company has holdings of between 20% and 50%.
    d. securities where a company has holdings of more than 50%.

30. A requirement for a security to be classified as held-to-maturity is
    a. ability to hold the security to maturity.
    b. positive intent.
    c. the security must be a debt security.
    d. All of these are required.

31. Held-to-maturity securities are reported at
    a. acquisition cost.
    b. acquisition cost plus amortization of a discount.
    c. acquisition cost plus amortization of a premium.
    d. fair value.

32. Watt Co. purchased $300,000 of bonds for $315,000. If Watt intends to hold the securities to maturity, the entry to record the investment includes
    a. a debit to Held-to-Maturity Securities at $300,000.
    b. a credit to Premium on Investments of $15,000.
    c. a debit to Held-to-Maturity Securities at $315,000.
    d. none of these.

33. Which of the following is *not* correct in regard to trading securities?
    a. They are held with the intention of selling them in a short period of time.
    b. Unrealized holding gains and losses are reported as part of net income.
    c. Any discount or premium is not amortized.
    d. All of these are correct.

34. In accounting for investments in debt securities that are classified as trading securities,
    a. a discount is reported separately.
    b. a premium is reported separately.
    c. any discount or premium is not amortized.
    d. none of these.

35. Investments in debt securities are generally recorded at
    a. cost including accrued interest.
    b. maturity value.
    c. cost including brokerage and other fees.
    d. maturity value with a separate discount or premium account.

36. Jordan Co. purchased ten-year, 10% bonds that pay interest semiannually. The bonds are sold to yield 8%. One step in calculating the issue price of the bonds is to multiply the principal by the table value for
    a. 10 periods and 10% from the present value of 1 table.
    b. 10 periods and 8% from the present value of 1 table.
    c. 20 periods and 5% from the present value of 1 table.
    d. 20 periods and 4% from the present value of 1 table.

37. Investments in debt securities should be recorded on the date of acquisition at
    a. lower of cost or market.
    b. market value.
    c. market value plus brokerage fees and other costs incident to the purchase.
    d. face value plus brokerage fees and other costs incident to the purchase.

38. An available-for-sale debt security is purchased at a discount. The entry to record the amortization of the discount includes a
    a. debit to Available-for-Sale Securities.
    b. debit to the discount account.
    c. debit to Interest Revenue.
    d. none of these.

39. *APB Opinion No. 21* specifies that, regarding the amortization of a premium or discount on a debt security, the
    a. effective-interest method of allocation must be used.
    b. straight-line method of allocation must be used.
    c. effective-interest method of allocation should be used but other methods can be applied if there is no material difference in the results obtained.
    d. par value method must be used and therefore no allocation is necessary.

40. Which of the following is correct about the effective-interest method of amortization?
    a. The effective interest method applied to investments in debt securities is different from that applied to bonds payable.
    b. Amortization of a discount decreases from period to period.
    c. Amortization of a premium decreases from period to period.
    d. The effective-interest method produces a constant rate of return on the book value of the investment from period to period.

41. When investments in debt securities are purchased between interest payment dates, preferably the
    a. securities account should include accrued interest.
    b. accrued interest is debited to Interest Expense.
    c. accrued interest is debited to Interest Revenue.
    d. accrued interest is debited to Interest Receivable.

42. Which of the following is not generally correct about recording a sale of a debt security before maturity date?
    a. Accrued interest will be received by the seller even though it is not an interest payment date.
    b. An entry must be made to amortize a discount to the date of sale.
    c. The entry to amortize a premium to the date of sale includes a credit to the Premium on Investments in Debt Securities.
    d. A gain or loss on the sale is not extraordinary.

[S]43. When a company has acquired a "passive interest" in another corporation, the acquiring company should account for the investment
    a. by using the equity method.
    b. by using the fair value method.
    c. by using the effective interest method.
    d. by consolidation.

S44. Santo Corporation declares and distributes a cash dividend that is a result of current earnings. How will the receipt of those dividends affect the investment account of the investor under each of the following accounting methods?

	Fair Value Method	Equity Method
a.	No Effect	Decrease
b.	Increase	Decrease
c.	No Effect	No Effect
d.	Decrease	No Effect

P45. An investor has a long-term investment in stocks. Regular cash dividends received by the investor are recorded as

	Fair Value Method	Equity Method
a.	Income	Income
b.	A reduction of the investment	A reduction of the investment
c.	Income	A reduction of the investment
d.	A reduction of the investment	Income

46. When a company holds between 20% and 50% of the outstanding stock of an investee, which of the following statements applies?
    a. The investor should always use the equity method to account for its investment.
    b. The investor should use the equity method to account for its investment unless circumstances indicate that it is unable to exercise "significant influence" over the investee.
    c. The investor must use the fair value method unless it can clearly demonstrate the ability to exercise "significant influence" over the investee.
    d. The investor should always use the fair value method to account for its investment.

47. If the parent company owns 90% of the subsidiary company's outstanding common stock, the company should generally account for the income of the subsidiary under the
    a. cost method.
    b. fair value method.
    c. divesture method.
    d. equity method.

48. Koehn Corporation accounts for its investment in the common stock of Sells Company under the equity method. Koehn Corporation should ordinarily record a cash dividend received from Sells as
    a. a reduction of the carrying value of the investment.
    b. additional paid-in capital.
    c. an addition to the carrying value of the investment.
    d. dividend income.

49. Under the equity method of accounting for investments, an investor recognizes its share of the earnings in the period in which the
    a. investor sells the investment.
    b. investee declares a dividend.
    c. investee pays a dividend.
    d. earnings are reported by the investee in its financial statements.

50. Judd, Inc., owns 35% of Cosby Corporation. During the calendar year 2012, Cosby had net earnings of $300,000 and paid dividends of $30,000. Judd mistakenly recorded these transactions using the fair value method rather than the equity method of accounting. What effect would this have on the investment account, net income, and retained earnings, respectively?
    a. Understate, overstate, overstate
    b. Overstate, understate, understate
    c. Overstate, overstate, overstate
    d. Understate, understate, understate

51. Dublin Co. holds a 30% stake in Club Co. which was purchased in 2013 at a cost of $3,000,000. After applying the equity method, the Investment in Club Co. account has a balance of $3,040,000. At December 31, 2013 the fair value of the investment is $3,120,000. Which of the following values is acceptable for Dublin to use in its balance sheet at December 31, 2013?
    I. $3,000,000
    II. $3,040,000
    III. $3,120,000
    a. I, II, or III.
    b. I or II only.
    c. II only.
    d. II or III only.

52. The fair value option allows a company to
    a. value its own liabilities at fair value.
    b. record income when the fair value of its bonds increases.
    c. report most financial instruments at fair value by recording gains and losses as a separate component of stockholders' equity.
    d. All of the above are true of the fair value option.

53. Impairments are
    a. based on discounted cash flows for securities.
    b. recognized as a realized loss if the impairment is judged to be temporary.
    c. based on fair value for available-for-sale investments and on negotiated values for held-to-maturity investments.
    d. evaluated at each reporting date for every investment.

54. A reclassification adjustment is reported in the
    a. income statement as an Other revenue or expense.
    b. stockholders' equity section of the balance sheet.
    c. statement of comprehensive income as other comprehensive income.
    d. statement of stockholders' equity.

55. When an investment in a held-to-maturity security is transferred to an available-for-sale security, the carrying value assigned to the available-for-sale security should be
    a. its original cost.
    b. its fair value at the date of the transfer.
    c. the lower of its original cost or its fair value at the date of the transfer.
    d. the higher of its original cost or its fair value at the date of the transfer.

56. When an investment in an available-for-sale security is transferred to trading because the company anticipates selling the stock in the near future, the carrying value assigned to the investment upon entering it in the trading portfolio should be
    a. its original cost.
    b. its fair value at the date of the transfer.
    c. the higher of its original cost or its fair value at the date of the transfer.
    d. the lower of its original cost or its fair value at the date of the transfer.

P57. A debt security is transferred from one category to another. Generally acceptable accounting principles require that for this particular reclassification (1) the security be transferred at fair value at the date of transfer, and (2) the unrealized gain or loss at the date of transfer currently carried as a separate component of stockholders' equity be amortized over the remaining life of the security. What type of transfer is being described?
    a. Transfer from trading to available-for-sale
    b. Transfer from available-for-sale to trading
    c. Transfer from held-to-maturity to available-for-sale
    d. Transfer from available-for-sale to held-to-maturity

58. “Gains trading” or “cherry picking” involves
    a. moving securities whose value has decreased since acquisition from available-for-sale to held-to-maturity in order to avoid reporting losses.
    b. reporting investment securities at fair value but liabilities at amortized cost.
    c. selling securities whose value has increased since acquisition while holding those whose value has decreased since acquisition.
    d. All of the above are considered methods of “gains trading” or “cherry picking.”

59. Transfers between categories
    a. result in companies omitting recognition of fair value in the year of the transfer.
    b. are accounted for at fair value for all transfers.
    c. are considered unrealized and unrecognized if transferred out of held-to-maturity into trading.
    d. will always result in an impact on net income.

*60. Companies that attempt to exploit inefficiencies in various derivative markets by attempting to lock in profits by simultaneously entering into transactions in two or more markets are called
    a. arbitrageurs.
    b. gamblers.
    c. hedgers.
    d. speculators.

*61. All of the following statements regarding accounting for derivatives are correct *except* that
    a. they should be recognized in the financial statements as assets and liabilities.
    b. they should be reported at fair value.
    c. gains and losses resulting from speculation should be deferred.
    d. gains and losses resulting from hedge transactions are reported in different ways, depending upon the type of hedge.

*62. All of the following are characteristics of a derivative financial instrument *except* the instrument
a. has one or more underlyings and an identified payment provision.
b. requires a large investment at the inception of the contract.
c. requires or permits net settlement.
d. All of these are characteristics.

*63. Which of the following are considered equity securities?
I. Convertible debt.
II. Redeemable preferred stock.
III. Call or put options.
a. I and II only.
b. I and III only.
c. II only.
d. III only.

*64. The accounting for fair value hedges records the derivative at its
a. amortized cost.
b. carrying value.
c. fair value.
d. historical cost.

*65. Gains or losses on cash flow hedges are
a. ignored completely.
b. recorded in equity, as part of other comprehensive income.
c. reported directly in net income.
d. reported directly in retained earnings.

*66. An option to convert a convertible bond into shares of common stock is a(n)
a. embedded derivative.
b. host security.
c. hybrid security.
d. fair value hedge.

*67. All of the following are requirements for disclosures related to financial instruments *except*
a. disclosing the fair value and related carrying value of the instruments.
b. distinguishing between financial instruments held or issued for purposes other than trading.
c. combining or netting the fair value of separate financial instruments.
d. displaying as a separate classification of other comprehensive income the net gain/loss on derivative instruments designated in cash flow hedges.

*68. A variable-interest entity has
a. insufficient equity investment at risk.
b. stockholders who have decision-making rights.
c. stockholders who absorb the losses or receive the benefits of a normal stockholder.
d. All of the above are characteristics of a variable-interest entity.

*69. Under U.S. GAAP, which of the following models may be used to determine if an investment is consolidated?

	Risk-and-reward model	Voting-interest approach
a.	Yes	No
b.	No	Yes
c.	No	No
d.	Yes	Yes

Multiple Choice Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
21.	c	28.	b	35.	c	42.	c	49.	d	56.	b	*63.	d
22.	b	29.	a	36.	d	43.	b	50.	d	57.	d	*64.	c
23.	c	30.	d	37.	c	44.	a	51.	d	58.	c	*65.	b
24.	c	31.	b	38.	a	45.	c	52.	a	59.	b	*66.	a
25.	a	32.	c	39.	c	46.	b	53.	d	*60.	a	*67.	c
26.	a	33.	d	40.	d	47.	d	54.	c	*61.	c	*68.	a
27.	c	34.	c	41.	c	48.	a	55.	b	*62.	b	*69.	d

MULTIPLE CHOICE—Computational

70. On August 1, 2012, Dambro Co. acquired 400, $1,000, 9% bonds at 97 plus accrued interest. The bonds were dated May 1, 2012, and mature on April 30, 2018, with interest paid each October 31 and April 30. The bonds will be added to Dambro's available-for-sale portfolio. The preferred entry to record the purchase of the bonds on August 1, 2012 is

		Dr.	Cr.
a.	Debt Investments	397,000	
	Cash		397,000
b.	Debt Investments	388,000	
	Interest Receivable	9,000	
	Cash		397,000
c.	Debt Investments	388,000	
	Interest Revenue	9,000	
	Cash		397,000
d.	Debt Investments	400,000	
	Interest Revenue	9,000	
	Discount on Debt Investments		12,000
	Cash		397,000

71. Kern Company purchased bonds with a face amount of $600,000 between interest payment dates. Kern purchased the bonds at 102, paid brokerage costs of $9,000, and paid accrued interest for three months of $15,000. The amount to record as the cost of this long-term debt investment is
a. $636,000.
b. $621,000.
c. $612,000.
d. $600,000.

Use the following information for questions 72 and 73.

Patton Company purchased $600,000 of 10% bonds of Scott Co. on January 1, 2013, paying $564,150. The bonds mature January 1, 2023; interest is payable each July 1 and January 1. The discount of $35,850 provides an effective yield of 11%. Patton Company uses the effective-interest method and plans to hold these bonds to maturity.

72. On July 1, 2013, Patton Company should increase its Debt Investments account for the Scott Co. bonds by
    a. $3,588.
    b. $2,056.
    c. $1,794.
    d. $1,028.

73. For the year ended December 31, 2013, Patton Company should report interest revenue from the Scott Co. bonds of:
    a. $63,588.
    b. $62,113.
    c. $62,052.
    d. $60,000.

Use the following information for questions 74 and 75.

Landis Co. purchased $1,000,000 of 8%, 5-year bonds from Ritter, Inc. on January 1, 2012, with interest payable on July 1 and January 1. The bonds sold for $1,041,580 at an effective interest rate of 7%. Using the effective-interest method, Landis Co. decreased the available-for-sale Debt Investments account for the Ritter, Inc. bonds on July 1, 2012 and December 31, 2012 by the amortized premiums of $3,540 and $3,660, respectively.

74. At December 31, 2012, the fair value of the Ritter, Inc. bonds was $1,060,000. What should Landis Co. report as other comprehensive income and as a separate component of stockholders' equity?
    a. $25,620.
    b. $18,420.
    c. $7,200.
    d. No entry should be made.

75. At April 1, 2013, Landis Co. sold the Ritter bonds for $1,030,000. After accruing for interest, the carrying value of the Ritter bonds on April 1, 2013 was $1,033,750. Assuming Landis Co. has a portfolio of available-for-sale Debt Investments, what should Landis Co. report as a gain or loss on the bonds?
    a. ($29,370).
    b. ($21,870).
    c. ($3,750).
    d. $ 0.

76. On August 1, 2012, Fowler Company acquired $600,000 face value 10% bonds of Kasnic Corporation at 104 plus accrued interest. The bonds were dated May 1, 2012, and mature on April 30, 2017, with interest payable each October 31 and April 30. The bonds will be held to maturity. What entry should Fowler make to record the purchase of the bonds on August 1, 2012?

a.	Debt Investments	624,000	
	Interest Revenue	15,000	
	Cash		639,000
b.	Debt Investments	639,000	
	Cash		639,000
c.	Debt Investments	639,000	
	Interest Revenue		15,000
	Cash		624,000
d.	Debt Investments	600,000	
	Premium on Bonds	39,000	
	Cash		639,000

77. On October 1, 2012, Renfro Co. purchased to hold to maturity, 2,000, $1,000, 9% bonds for $1,980,000 which includes $30,000 accrued interest. The bonds, which mature on February 1, 2021, pay interest semiannually on February 1 and August 1. Renfro uses the straight-line method of amortization. The bonds should be reported in the December 31, 2012 balance sheet at a carrying value of
a. $1,950,000.
b. $1,951,500.
c. $1,980,000.
d. $1,980,500.

78. On November 1, 2012, Howell Company purchased 900 of the $1,000 face value, 9% bonds of Ramsey, Incorporated, for $948,000, which includes accrued interest of $13,500. The bonds, which mature on January 1, 2017, pay interest semiannually on March 1 and September 1. Assuming that Howell uses the straight-line method of amortization and that the bonds are appropriately classified as available-for-sale, the net carrying value of the bonds should be shown on Howell's December 31, 2012, balance sheet at
a. $900,000.
b. $934,500.
c. $933,120.
d. $948,000.

79. On November 1, 2012, Horton Co. purchased Lopez, Inc., 10-year, 9%, bonds with a face value of $500,000, for $450,000. An additional $15,000 was paid for the accrued interest. Interest is payable semiannually on January 1 and July 1. The bonds mature on July 1, 2019. Horton uses the straight-line method of amortization. Ignoring income taxes, the amount reported in Horton's 2012 income statement as a result of Horton's available-for-sale investment in Lopez was
a. $8,750.
b. $8,333.
c. $7,500.
d. $6,666.

80. On October 1, 2012, Menke Co. purchased to hold to maturity, 500, $1,000, 9% bonds for $520,000. An additional $15,000 was paid for accrued interest. Interest is paid semiannually on December 1 and June 1 and the bonds mature on December 1, 2016. Menke uses straight-line amortization. Ignoring income taxes, the amount reported in Menke's 2012 income statement from this investment should be
    a. $11,250.
    b. $10,050.
    c. $12,450.
    d. $13,650.

81. During 2010, Hauke Co. purchased 3,000, $1,000, 9% bonds. The carrying value of the bonds at December 31, 2012 was $2,940,000. The bonds mature on March 1, 2017, and pay interest on March 1 and September 1. Hauke sells 1,500 bonds on September 1, 2014, for $1,482,000, after the interest has been received. Hauke uses straight-line amortization. The gain on the sale is
    a. $0.
    b. $7,200.
    c. $12,000.
    d. $16,800.

<u>Use the following information for 82 and 83.</u>

On January 3, 2012, Moss Co. acquires $400,000 of Adam Company's 10-year, 10% bonds at a price of $425,672 to yield 9%. Interest is payable each December 31. The bonds are classified as held-to-maturity.

82. Assuming that Moss Co. uses the effective-interest method, what is the amount of interest revenue that would be recognized in 2013 related to these bonds?
    a. $40,000
    b. $42,568
    c. $38,312
    d. $38,160

83. Assuming that Moss Co. uses the straight-line method, what is the amount of premium amortization that would be recognized in 2014 related to these bonds?
    a. $2,568
    b. $1,688
    c. $1,840
    d. $2,008

Questions 84 and 85 are based on the following information:

Richman Co. purchased $600,000 of 8%, 5-year bonds from Carlin, Inc. on January 1, 2012, with interest payable on July 1 and January 1. The bonds sold for $624,948 at an effective interest rate of 7%. Using the effective interest method, Richman Co. decreased the available-for-sale Debt Investments account for the Carlin, Inc. bonds on July 1, 2012 and December 31, 2012 by the amortized premiums of $2,124 and $2,196, respectively.

84. At December 31, 2012, the fair value of the Carlin, Inc. bonds was $636,000. What should Richman Co. report as other comprehensive income and as a separate component of stockholders' equity?
    a. $0
    b. $4,320
    c. $11,052
    d. $15,372

85. At February 1, 2013, Richman Co. sold the Carlin bonds for $618,000. After accruing for interest, the carrying value of the Carlin bonds on February 1, 2013 was $620,250. Assuming Richman Co. has a portfolio of available-for-sale debt investments, what should Richman Co. report as a gain (or loss) on the bonds?
    a. $0.
    b. ($2,250).
    c. ($13,122).
    d. ($17,622).

86. During 2012 Logic Company purchased 6,000 shares of Midi, Inc. for $30 per share. The investment was classified as a trading security. During the year Logic Company sold 1,500 shares of Midi, Inc. for $35 per share. At December 31, 2012 the market price of Midi, Inc.'s stock was $28 per share. What is the total amount of gain/(loss) that Logic Company will report in its income statement for the year ended December 31, 2012 related to its investment in Midi, Inc. stock?
    a. ($12,000)
    b. $7,500
    c. ($4,500)
    d. ($1,500)

Use the following information for questions 87 and 88.

Instrument Corp. has the following investments which were held throughout 2012–2013:

		Fair Value	
	Cost	12/31/12	12/31/13
Trading	$450,000	$600,000	$570,000
Available-for-sale	450,000	480,000	540,000

87. What amount of gain or loss would Instrument Corp. report in its income statement for the year ended December 31, 2013 related to its investments?
    a. $30,000 gain.
    b. $30,000 loss.
    c. $210,000 gain.
    d. $120,000 gain.

88. What amount would be reported as accumulated other comprehensive income related to investments in Instrument Corp.'s balance sheet at December 31, 2012?
    a. $60,000 gain.
    b. $90,000 gain.
    c. $30,000 gain.
    d. $180,000 gain.

89. At December 31, 2013, Atlanta Co. has a stock portfolio valued at $120,000. Its cost was $99,000. If the Securities Fair Value Adjustment (Available-for-Sale) has a debit balance of $6,000, which of the following journal entries is required at December 31, 2013?

a. Fair Value Adjustment (available-for-sale)	21,000	
Unrealized Holding Gain or Loss - Equity		21,000
b. Fair Value Adjustment (available-for-sale)	15,000	
Unrealized Holding Gain or Loss - Equity		15,000
c. Unrealized Holding Gain or Loss - Equity	21,000	
Fair Value Adjustment (available-for-sale)		21,000
d. Unrealized Holding Gain or Loss - Equity	15,000	
Fair Value Adjustment (available-for-sale)		15,000

90. Kramer Company's trading securities portfolio which is appropriately included in current assets is as follows:

	December 31, 2012		
	Cost	Fair Value	Unrealized Gain (Loss)
Catlett Corp.	$250,000	$205,000	$(45,000)
Lyman, Inc.	245,000	265,000	20,000
	$495,000	$470,000	$(25,000)

Ignoring income taxes, what amount should be reported as a charge against income in Kramer's 2012 income statement if 2012 is Kramer's first year of operation?
a. $0.
b. $20,000.
c. $25,000.
d. $45,000.

91. On its December 31, 2012, balance sheet, Trump Co. reported its investment in available-for-sale securities, which had cost $600,000, at fair value of $550,000. At December 31, 2013, the fair value of the securities was $585,000. What should Trump report on its 2013 income statement as a result of the increase in fair value of the investments in 2013?
a. $0.
b. Unrealized loss of $15,000.
c. Realized gain of $35,000.
d. Unrealized gain of $35,000.

92. During 2012, Woods Company purchased 40,000 shares of Holmes Corp. common stock for $630,000 as an available-for-sale investment. The fair value of these shares was $600,000 at December 31, 2012. Woods sold all of the Holmes stock for $17 per share on December 3, 2013, incurring $28,000 in brokerage commissions. Woods Company should report a realized gain on the sale of stock in 2013 of
a. $22,000.
b. $50,000.
c. $52,000.
d. $80,000.

Use the following information for questions 93 and 94.

On its December 31, 2012 balance sheet, Calhoun Company appropriately reported a $10,000 debit balance in its Fair Value Adjustment (available-for-sale) account. There was no change during 2013 in the composition of Calhoun's portfolio of equity investments held as available-for-sale securities. The following information pertains to that portfolio:

Security	Cost	Fair value at 12/31/13
X	$125,000	$160,000
Y	100,000	85,000
Z	175,000	125,000
	$400,000	$370,000

93. What amount of unrealized loss on these securities should be included in Calhoun's stockholders' equity section of the balance sheet at December 31, 2013?
    a. $40,000.
    b. $30,000.
    c. $10,000.
    d. $0.

94. The amount of unrealized loss to appear as a component of comprehensive income for the year ending December 31, 2013 is
    a. $40,000.
    b. $30,000.
    c. $10,000.
    d. $0.

95. On January 2, 2013 Pod Company purchased 25% of the outstanding common stock of Jobs, Inc. and subsequently used the equity method to account for the investment. During 2013 Jobs, Inc. reported net income of $630,000 and distributed dividends of $270,000. The ending balance in the Equity Investments account at December 31, 2013 was $480,000 after applying the equity method during 2013. What was the purchase price Pod Company paid for its investment in Jobs, Inc?
    a. $255,000
    b. $390,000
    c. $570,000
    d. $705,000

96. Ziegler Corporation purchased 25,000 shares of common stock of the Sherman Corporation for $40 per share on January 2, 2010. Sherman Corporation had 100,000 shares of common stock outstanding during 2013, paid cash dividends of $120,000 during 2013, and reported net income of $400,000 for 2013. Ziegler Corporation should report revenue from investment for 2013 in the amount of
    a. $30,000.
    b. $70,000.
    c. $100,000.
    d. $110,000.

Use the following information for questions 97 and 98.

Harrison Co. owns 20,000 of the 50,000 outstanding shares of Taylor, Inc. common stock. During 2013, Taylor earns $1,200,000 and pays cash dividends of $960,000.

97. If the beginning balance in the investment account was $750,000, the balance at December 31, 2013 should be
    a. $1,230,000.
    b. $990,000.
    c. $846,000.
    d. $750,000.

98. Harrison should report investment revenue for 2013 of
    a. $480,000.
    b. $384,000.
    c. $96,000.
    d. $0.

Use the following information for questions 99 through 102.

The summarized balance sheets of Goebel Company and Dobbs Company as of December 31, 2012 are as follows:

Goebel Company
Balance Sheet
December 31, 2012

Assets	$1,200,000
Liabilities	$ 150,000
Capital stock	600,000
Retained earnings	450,000
Total equities	$1,200,000

Dobbs Company
Balance Sheet
December 31, 2012

Assets	$900,000
Liabilities	$225,000
Capital stock	555,000
Retained earnings	120,000
Total equities	$900,000

99. If Goebel Company acquired a 20% interest in Dobbs Company on December 31, 2012 for $195,000 and the fair value method of accounting for the investment were used, the amount of the debit to Equity Investments (Dobbs) would have been
    a. $135,000.
    b. $111,000.
    c. $195,000.
    d. $180,000.

100. If Goebel Company acquired a 30% interest in Dobbs Company on December 31, 2012 for $225,000 and the equity method of accounting for the investment were used, the amount of the debit to Equity Investments (Dobbs) would have been
    a. $285,000.
    b. $225,000.
    c. $180,000.
    d. $202,500.

101. If Goebel Company acquired a 20% interest in Dobbs Company on December 31, 2011 for $135,000 and during 2013 Dobbs Company had net income of $75,000 and paid a cash dividend of $30,000, applying the fair value method would give a debit balance in the Equity Investments (Dobbs) account at the end of 2013 of
    a. $111,000.
    b. $135,000.
    c. $150,000.
    d. $144,000.

102. If Goebel Company acquired a 30% interest in Dobbs Company on December 31, 2012 for $210,000 and during 2013 Dobbs Company had net income of $75,000 and paid a cash dividend of $30,000, applying the equity method would give a debit balance in the Equity Investments (Dobbs) account at the end of 2013 of
    a. $210,000.
    b. $223,500.
    c. $232,500.
    d. $201,000.

Use the following information for questions 103 and 104.

Blanco Company purchased 200 of the 1,000 outstanding shares of Darby Company's common stock for $600,000 on January 2, 2013. During 2013, Darby Company declared dividends of $100,000 and reported earnings for the year of $400,000.

103. If Blanco Company used the fair value method of accounting for its investment in Darby Company, its Equity Investments (Darby) account on December 31, 2013 should be
    a. $580,000.
    b. $660,000.
    c. $600,000.
    d. $680,000.

104. If Blanco Company uses the equity method of accounting for its investment in Darby Company, its Equity Investments (Darby) account at December 31, 2013 should be
    a. $580,000.
    b. $600,000.
    c. $660,000.
    d. $680,000.

Use the following information for questions 105 and 106.

Brown Corporation earns $600,000 and pays cash dividends of $200,000 during 2012. Dexter Corporation owns 3,000 of the 10,000 outstanding shares of Brown.

105. What amount should Dexter show in the investment account at December 31, 2012 if the beginning of the year balance in the account was $800,000?
    a. $980,000.
    b. $800,000.
    c. $920,000.
    d. $1,200,000.

106. How much investment revenue should Dexter report in 2012?
   a. $200,000.
   b. $180,000.
   c. $120,000.
   d. $600,000.

107. Myers Co. acquired a 60% interest in Gannon Corp. on December 31, 2012 for $1,260,000. During 2013, Gannon had net income of $800,000 and paid cash dividends of $200,000. At December 31, 2013, the balance in the investment account should be
   a. $1,260,000.
   b. $1,740,000.
   c. $1,620,000.
   d. $1,860,000.

Use the following information for questions 108 and 109.

Tracy Co. owns 4,000 of the 10,000 outstanding shares of Penn Corp. common stock. During 2013, Penn earns $360,000 and pays cash dividends of $120,000.

108. If the beginning balance in the investment account was $720,000, the balance at December 31, 2013 should be
   a. $720,000.
   b. $816,000.
   c. $864,000.
   d. $960,000.

109. Tracy should report investment revenue for 2013 of
   a. $48,000.
   b. $96,000.
   c. $120,000.
   d. $144,000.

110. The following information relates to Windom Company for 2013:

Realized gain on sale of available-for-sale securities	$30,000
Unrealized holding gains arising during the period on available-for-sale securities	70,000
Reclassification adjustment for gains included in net income	20,000

   Windom's 2013 other comprehensive income is
   a. $50,000.
   b. $80,000.
   c. $100,000.
   d. $120,000.

Multiple Choice Answers—Computational

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
70.	c	76.	a	82.	d	88.	c	94.	a	100.	b	106.	b
71.	b	77.	b	83.	a	89.	b	95.	b	101.	b	107.	c
72.	d	78.	c	84.	d	90.	c	96.	c	102.	b	108.	b
73.	b	79.	a	85.	b	91.	a	97.	c	103.	c	109.	d
74.	a	80.	b	86.	d	92.	a	98.	a	104.	c	110.	b
75.	c	81.	b	87.	b	93.	b	99.	c	105.	c		

MULTIPLE CHOICE—CPA Adapted

111. On October 1, 2012, Wenn Co. purchased 800 of the $1,000 face value, 8% bonds of Loy, Inc., for $936,000, including accrued interest of $16,000. The bonds, which mature on January 1, 2019, pay interest semiannually on January 1 and July 1. Wenn used the straight-line method of amortization and appropriately recorded the bonds as available-for-sale. On Wenn's December 31, 2013 balance sheet, the carrying value of the bonds is
a. $920,000.
b. $912,000.
c. $908,800.
d. $896,000.

112. Valet Corp. began operations in 2013. An analysis of Valet's equity securities portfolio acquired in 2013 shows the following totals at December 31, 2013 for trading and available-for-sale securities:

	Trading Securities	Available-for-Sale Securities
Aggregate cost	$90,000	$110,000
Aggregate fair value	70,000	95,000

What amount should Valet report in its 2013 income statement for unrealized holding loss?
a. $35,000.
b. $5,000.
c. $15,000.
d. $20,000.

113. At December 31, 2013, Jeter Corp. had the following equity securities that were purchased during 2013, its first year of operation:

	Cost	Fair Value	Unrealized Gain (Loss)
Trading Securities:			
Security A	$ 95,000	$ 60,000	$(35,000)
B	15,000	20,000	5,000
Totals	$110,000	$ 80,000	$(30,000)
Available-for-Sale Securities:			
Security Y	$ 70,000	$ 80,000	$ 10,000
Z	85,000	55,000	(30,000)
Totals	$155,000	$135,000	$(20,000)

All market declines are considered temporary. Fair value adjustments at December 31, 2013 should be established with a corresponding charge against

	Income	Stockholders' Equity
a.	$50,000	$ 0
b.	$35,000	$30,000
c.	$30,000	$20,000
d.	$30,000	$ 0

114. On December 29, 2013, James Co. sold an equity security that had been purchased on January 4, 2012. James owned no other equity securities. An unrealized holding loss was reported in the 2012 income statement. A realized gain was reported in the 2013 income statement. Was the equity security classified as available-for-sale and did its 2012 market price decline exceed its 2013 market price recovery?

	Available-for-Sale	2012 Market Price Decline Exceeded 2013 Market Price Recovery
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

Use the following information for questions 115 through 117.

Rich, Inc. acquired 30% of Doane Corp.'s voting stock on January 1, 2012 for $600,000. During 2012, Doane earned $240,000 and paid dividends of $150,000. Rich's 30% interest in Doane gives Rich the ability to exercise significant influence over Doane's operating and financial policies. During 2013, Doane earned $300,000 and paid dividends of $90,000 on April 1 and $90,000 on October 1. On July 1, 2013, Rich sold half of its stock in Doane for $396,000 cash.

115. Before income taxes, what amount should Rich include in its 2012 income statement as a result of the investment?
a. $240,000.
b. $150,000.
c. $72,000.
d. $45,000.

116. The carrying amount of this investment in Rich's December 31, 2012 balance sheet should be
a. $600,000.
b. $627,000.
c. $672,000.
d. $690,000.

117. What should be the gain on sale of this investment in Rich's 2013 income statement?
a. $96,000.
b. $82,500.
c. $73,500.
d. $60,000.

118. On January 1, 2013, Reston Co. purchased 25% of Ace Corp.'s common stock; no goodwill resulted from the purchase. Reston appropriately carries this investment at equity and the balance in Reston's investment account was $960,000 at December 31, 2013. Ace reported net income of $600,000 for the year ended December 31, 2013, and paid common stock dividends totaling $240,000 during 2013. How much did Reston pay for its 25% interest in Ace?
   a. $870,000.
   b. $1,020,000.
   c. $1,050,000.
   d. $1,170,000.

119. On December 31, 2012, Patel Co. purchased equity investments as trading securities. Pertinent data are as follows:

Investment	Cost	Fair Value At 12/31/13
A	$132,000	$117,000
B	168,000	186,000
C	288,000	268,000

On December 31, 2013, Patel transferred its investment in security C from trading to available-for-sale because Patel intends to retain security C as a long-term investment. What total amount of gain or loss on its securities should be included in Patel's income statement for the year ended December 31, 2013?
   a. $3,000 gain.
   b. $17,000 loss.
   c. $20,000 loss.
   d. $35,000 loss.

Multiple Choice Answers—CPA Adapted

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
111.	d	113.	c	115.	c	117.	c	119.	b
112.	d	114.	d	116.	b	118.	a		

DERIVATIONS — Computational

No.	Answer	Derivation
70.	c	Dr. Debt Investments: 400 × $1,000 × .97 = $388,000 Dr. Interest Revenue: $400,000 × .045 × 3/6 = $9,000 Cr. Cash: $388,000 + $9,000 = $397,000.
71.	b	($600,000 × 1.02) + $9,000 = $621,000.
72.	d	($564,150 × .055) – ($600,000 × .05) = $1,028.
73.	b	$564,150 × .055 = $31,028 ($564,150 + $1,028) × .055 = $31,085; $31,028 + $31,085 = $62,113.
74.	a	$1,060,000 – ($1,041,580 – $3,540 – $3,660) = $25,620.
75.	c	$1,033,750 – $1,030,000 = $3,750.

DERIVATIONS — Computational (cont.)

No.	Answer	Derivation
76.	a	Dr. Debt Investments: $600,000 × 1.04 = $624,000 Dr. Interest Revenue: $600,000 × .05 × 3/6 = $15,000 Cr. Cash: $624,000 + $15,000 = $639,000.
77.	b	$1,950,000 + ($50,000 × 3/100) = $1,951,500.
78.	c	$948,000 – $13,500 = $934,500 $934,500 – ($34,500 × 2/50) = $933,120.
79.	a	($500,000 × .045) + ($50,000 × 2/80) – $15,000 = $8,750.
80.	b	($500,000 × .09 × 3/12) – ($20,000 × 3/50) = $10,050.
81.	b	Discount amortization: $60,000 × 8/50 = $9,600 ($2,940,000 + $9,600) ÷ 2 = $1,474,800; $1,482,000 – $1,474,800 = $7,200 gain.
82.	d	($425,672 × .09) – ($400,000 × .10) = ($1,688) ($425,672 – $1,688) × .09 = $38,160.
83.	a	($425,672 – $400,000) ÷ 10 = $2,568.
84.	d	$636,000 – ($624,948 – $2,124 – $2,196) = $15,372.
85.	b	$620,250 – $618,000 = $2,250.
86.	d	[($35 – $30) × 1,500] – [($30 – $28) × 4,500] = ($1,500).
87.	b	$600,000 – $570,000 = $30,000 loss.
88.	c	$480,000 – $450,000 = $30,000 gain.
89.	b	($120,000 – $99,000) – $6,000 = $15,000 unrealized gain.
90.	c	$25,000 (unrealized loss).
91.	a	$0 (available-for-sale securities).
92.	a	[(40,000 × $17) – $28,000] – $630,000 = $22,000.
93.	b	($400,000 – $370,000) = $30,000.
94.	a	$10,000 + $30,000 = $40,000.
95.	b	X + [($630,000 – $270,000) × .25] = $480,000 X + $90,000 = $480,000 X = $390,000.
96.	c	$400,000 × (25,000 ÷ 100,000) = $100,000.

DERIVATIONS — Computational (cont.)

No.	Answer	Derivation
97.	c	$750,000 + [($1,200,000 – $960,000) × (20,000 ÷ 50,000)] = $846,000.
98.	a	$1,200,000 × (20,000 ÷ 50,000) = $480,000.
99.	c	$195,000, acquisition cost.
100.	b	$225,000, acquisition cost.
101.	b	$135,000, acquisition cost.
102.	b	$210,000 + ($75,000 × .3) – ($30,000 × .3) = $223,500.
103.	c	$600,000, acquisition cost.
104.	c	$600,000 + ($400,000 × .2) – ($100,000 × .2) = $660,000.
105.	c	$800,000 + ($600,000 × .3) – ($200,000 × .3) = $920,000.
106.	b	$600,000 × .3 = $180,000.
107.	c	$1,260,000 + ($800,000 × .6) – ($200,000 × .6) = $1,620,000.
108.	b	$720,000 + ($360,000 × .4) – ($120,000 × .4) = $816,000.
109.	d	$360,000 × .4 = $144,000.
110.	b	$30,000 + $70,000 – $20,000 = $80,000.

DERIVATIONS — CPA Adapted

No.	Answer	Derivation
111.	d	$936,000 – $16,000 = $920,000 $\$920{,}000 - \left(\$120{,}000 \times \frac{15}{75}\right) = \$896{,}000.$
112.	d	$90,000 – $70,000 = $20,000.
113.	c	
114.	d	Conceptual.
115.	c	$240,000 × 30% = $72,000.
116.	b	$600,000 + $72,000 – ($150,000 × 30%) = $627,000.

DERIVATIONS — CPA Adapted (cont.)

No.	Answer	Derivation
117.	c	$627,000 – ($90,000 × 30%) + ($300,000 × 50% × 30%) = $645,000. $396,000 – ($645,000 ÷ 2) = $73,500.
118.	a	$960,000 – ($600,000 × 25%) + ($240,000 × 25%) = $870,000.
119.	b	$18,000 – $15,000 – $20,000 = $17,000 loss.

EXERCISES

Ex. 17-120—Investment in debt securities at premium.

On April 1, 2012, West Co. purchased $320,000 of 6% bonds for $332,600 plus accrued interest as an available-for-sale security. Interest is paid on July 1 and January 1 and the bonds mature on July 1, 2017.

Instructions

(a) Prepare the journal entry on April 1, 2012.

(b) The bonds are sold on November 1, 2013 at 103 plus accrued interest. Amortization was recorded when interest was received by the straight-line method (by months and round to the nearest dollar). Prepare all entries required to properly record the sale.

Solution 17-120

		Debit	Credit
(a)	Debt Investments	332,600	
	Interest Revenue ($320,000 × .06 × 1/4)	4,800	
	Cash		337,400
(b)	Interest Revenue ($12,600 × 4 ÷ 63)	800	
	Debt Investments		800
	Cash ($320,000 × .06 × 1/3)	6,400	
	Interest Revenue		6,400
	Cash	329,600	
	Gain on Sale of Investments		800
	Debt Investments		328,800
	$332,600 – [($12,600 ÷ 63) × 19]		

Ex. 17-121—Investment in debt securities at a discount.

On May 1, 2012, Kirmer Corp. purchased $600,000 of 12% bonds, interest payable on January 1 and July 1, for $562,600 plus accrued interest. The bonds mature on January 1, 2018. Amortization is recorded when interest is received by the straight-line method (by months and round to the nearest dollar). (Assume bonds are available for sale.)

Instructions

(a) Prepare the entry for May 1, 2012.

(b) The bonds are sold on August 1, 2013 for $565,000 plus accrued interest. Prepare all entries required to properly record the sale.

Solution 17-121

(a)	Debt Investments	562,600	
	Interest Revenue ($600,000 × .12 × 4/12)	24,000	
	Cash		586,600
(b)	Debt Investments ($37,400 ÷ 68 × 1)	550	
	Interest Revenue		550
	Cash ($600,000 × .12 × 1/12)	6,000	
	Interest Revenue		6,000
	Cash	565,000	
	Loss on Sale of Investments	5,850	
	Debt Investments		570,850
	$562,600 + [($37,400 ÷ 68) × 15]		

Ex. 17-122—Investments in equity securities.

Presented below are unrelated cases involving investments in equity securities.

<u>Case I.</u> The fair value of the trading securities at the end of last year was 30% below original cost, and this was properly reflected in the accounts. At the end of the current year, the fair value has increased to 20% above cost.

<u>Case II.</u> The fair value of an available-for-sale security has declined to less than forty percent of the original cost. The decline in value is considered to be other than temporary.

<u>Case III.</u> An equity security, whose fair value is now less than cost, is classified as trading but is reclassified as available-for-sale.

Instructions

Indicate the accounting required for each case separately.

Solution 17-122

Case I. At the end of last year, the company would have recognized an unrealized holding loss and recorded a Fair Value Adjustment (trading). At the end of the current year, the company would record an unrealized holding gain that would be reported in the other revenue and gains section. The adjustment account would now have a debit balance.

Solution 17-122 (cont.)

Case II. When the decline in value is considered to be other than temporary, the loss should be recognized as if it were realized and earnings will be reduced. The fair value becomes a new cost basis.

Case III. The security is transferred at fair value, which is the new cost basis of the security. The Equity Investments (available-for-sale) account is recorded at fair value, and the Unrealized Holding Loss—Income account is debited for the unrealized loss. The Equity Investments (trading) account is credited for cost.

Ex. 17-123—Investment in equity securities.

Agee Corp. acquired a 30% interest in Trent Co. on January 1, 2013, for $500,000. At that time, Trent had 1,000,000 shares of its $1 par common stock issued and outstanding. During 2013, Trent paid cash dividends of $160,000 and thereafter declared and issued a 5% common stock dividend when the fair value was $2 per share. Trent's net income for 2013 was $360,000. What is the balance in Agee’s equity investments account at the end of 2013?

Solution 17-123

Cost	$500,000
Share of net income (.30 × $360,000)	108,000
Share of dividends (.30 × $160,000)	(48,000)
Balance in equity investments account	$560,000

Ex. 17-124—Fair value and equity methods. (Essay)

Compare the fair value and equity methods of accounting for investments in stocks subsequent to acquisition.

Solution 17-124

Under the fair value method, investments are originally recorded at cost and are reported at fair value. Dividends are reported as other revenues and gains. Under the equity method, investments are originally recorded at cost. Subsequently, the investment account is adjusted for the investor's share of the investee's net income or loss and this amount is recognized in the income of the investor. Dividends received from the investee are reductions in the investment account.

Ex. 17-125—Fair value and equity methods.

Fill in the dollar changes caused in the Investment account and Dividend Revenue or Investment Revenue account by each of the following transactions, assuming Crane Company uses (a) the fair value method and (b) the equity method for accounting for its investments in Hudson Company.

	(a) Fair Value Method		(b) Equity Method	
Transaction	Investment Account	Dividend Revenue	Investment Account	Investment Revenue
1. At the beginning of Year 1, Crane bought 40% of Hudson's common stock at its book value. Total book value of all Hudson's common stock was $800,000 on this date.				
2. During Year 1, Hudson reported $60,000 of net income and paid $30,000 of dividends.				
3. During Year 2, Hudson reported $30,000 of net income and paid $40,000 of dividends.				
4. During Year 3, Hudson reported a net loss of $10,000 and paid $5,000 of dividends.				
5. Indicate the Year 3 ending balance in the Investment account, and cumulative totals for Years 1, 2, and 3 for dividend revenue and investment revenue.				

Solution 17-125

	(a) Fair Value Method		(b) Equity Method	
Transaction	Investment Account	Dividend Revenue	Investment Account	Investment Revenue
1.	320,000		320,000	
2.			24,000	24,000
		12,000	(12,000)	
3.			12,000	12,000
		16,000	(16,000)	
4.			(4,000)	(4,000)
		2,000	(2,000)	
5.	320,000	30,000	322,000	32,000

Ex. 17-126—Comprehensive income calculation.
The following information is available for Irwin Company for 2013:

Net Income	$120,000
Realized gain on sale of available-for-sale securities	10,000
Unrealized holding gain arising during the period on available-for-sale securities	29,000
Reclassification adjustment for gains included in net income	8,000

Instructions
(1) Determine other comprehensive income for 2013.
(2) Compute comprehensive income for 2013.

Solution 17-126

(1) 2013 other comprehensive income = $31,000 ($10,000 realized gain + $29,000 unrealized holding gain – $8,000 reclassification adjustment).

(2) 2013 comprehensive income = $151,000 ($120,000 + $31,000).

***Ex. 17-127**—Fair value hedge.

On January 2, 2013, Tylor Co. issued a 4-year, $750,000 note at 6% fixed interest, interest payable semiannually. Tylor now wants to change the note to a variable rate note. As a result, on January 2, 2013, Tylor Co. enters into an interest rate swap where it agrees to receive 6% fixed and pay LIBOR of 5.6% for the first 6 months on $750,000. At each 6-month period, the variable interest rate will be reset. The variable rate is reset to 6.6% on June 30, 2013.

Instructions
(a) Compute the net interest expense to be reported for this note and related swap transaction as of June 30, 2013.
(b) Compute the net interest expense to be reported for this note and related swap transaction as of December 31, 2013.

***Solution 17-127**

(a) and (b)

	6/30/13	12/31/13
Fixed-rate debt	$750,000	$750,000
Fixed rate (6% ÷ 2)	3%	3%
Semiannual debt payment	$ 22,500	$ 22,500
Swap fixed receipt	22,500	22,500
Net income effect	$ 0	$ 0
Swap variable rate		
5.6% × ½ × $750,000	$ 21,000	
6.6% × ½ × $750,000	0	$ 24,750
Net interest expense	$ 21,000	$ 24,750

***Ex. 17-128**—Cash flow hedge.

On January 2, 2012, Sloan Company issued a 5-year, $6,000,000 note at LIBOR with interest paid annually. The variable rate is reset at the end of each year. The LIBOR rate for the first year is 6.8%

Sloan Company decides it prefers fixed-rate financing and wants to lock in a rate of 6%. As a result, Sloan enters into an interest rate swap to pay 7% fixed and receive LIBOR based on $8 million. The variable rate is reset to 7.4% on January 2, 2013.

Instructions

(a) Compute the net interest expense to be reported for this note and related swap transactions as of December 31, 2012.

(b) Compute the net interest expense to be reported for this note and related swap transactions as of December 31, 2013.

***Solution 17-128**

(a) and (b)

	12/31/12	12/31/13
Variable-rate debt	$6,000,000	$6,000,000
Variable rate	6.8%	7.4%
Debt payment	$ 408,000	$ 444,000
Debt payment	$ 408,000	$ 444,000
Swap receive variable	(408,000)	(444,000)
Net income effect	$ 0	$ 0
Swap payable—fixed	420,000	420,000
Net interest expense	$ 420,000	$ 420,000

PROBLEMS

Pr. 17-129—Trading equity securities.

Korman Company has the following securities in its portfolio of trading securities on December 31, 2012:

	Cost	Fair Value
5,000 shares of Thomas Corp., Common	$159,000	$139,000
10,000 shares of Gant, Common	182,000	190,000
	$341,000	$329,000

All of the securities had been purchased in 2012. In 2013, Korman completed the following securities transactions:

March 1 Sold 5,000 shares of Thomas Corp., Common @ $31 less fees of $1,500.
April 1 Bought 600 shares of Werth Stores, Common @ $45 plus fees of $550.

Pr. 17-129 (cont.)

The Korman Company portfolio of trading securities appeared as follows on December 31, 2013:

	Cost	Fair Value
10,000 shares of Gant, Common	$182,000	$195,500
600 shares of Werth Stores, Common	27,550	25,500
	$209,550	$221,000

Instructions

Prepare the general journal entries for Korman Company for:

(a) the 2012 adjusting entry.
(b) the sale of the Thomas Corp. stock.
(c) the purchase of the Werth Stores' stock.
(d) the 2013 adjusting entry.

Solution 17-129

		Debit	Credit
(a)	12-31-12		
	Unrealized Holding Gain or Loss—Income	12,000	
	Fair Value Adjustment (trading)		12,000
	($341,000 – $329,000)		
(b)	3-1-13		
	Cash [(5,000 × $31) – $1,500]	153,500	
	Loss on Sale of Investments	5,500	
	Equity Investments		159,000
(c)	4-1-13		
	Equity Investments	27,550	
	Cash [(600 × $45) + $550]		27,550
(d)	12-31-13		
	Fair Value Adjustment (trading)	23,450	
	Unrealized Holding Gain or Loss—Income		23,450

Pr. 17-130—Trading equity securities.

Perez Company began operations in 2011. Since then, it has reported the following gains and losses for its investments in trading securities on the income statement:

	2011	2012	2013
Gains (losses) from sale of trading securities	$ 15,000	$(20,000)	$ 14,000
Unrealized holding losses on valuation of trading securities	(25,000)	—	(20,000)
Unrealized holding gain on valuation of trading securities	—	10,000	—

At January 1, 2014, Perez owned the following trading securities:

	Cost
BKD Common (15,000 shares)	$450,000
LRF Preferred (2,000 shares)	210,000
Drake Convertible bonds (100 bonds)	115,000

Pr. 17-130 (cont.)

During 2014, the following events occurred:
1. Sold 5,000 shares of BKD for $170,000.
2. Acquired 1,000 shares of Horton Common for $40 per share. Brokerage commissions totaled $1,000.

At 12/31/14, the fair values for Perez's trading securities were:
BKD Common, $28 per share
LRF Preferred, $110 per share
Drake Bonds, $1,020 per bond
Horton Common, $45 per share

Instructions
(a) Prepare a schedule which shows the balance in the Fair Value Adjustment (trading) account at December 31, 2013 (after the adjusting entry for 2013 is made).
(b) Prepare a schedule which shows the aggregate cost and fair values for Perez's trading securities portfolio at 12/31/14.
(c) Prepare the necessary adjusting entry based upon your analysis in (b) above.

Solution 17-130

(a)

Balance 12/31/11 (result of that year's adjusting entry)	$(25,000)
Deduct unrealized gain for 2012	10,000
Add: Unrealized loss for 2013	(20,000)
Balance at 12/31/13	$(35,000)

(b) Aggregate cost and fair value for trading securities at 12/31/14

	Cost	Fair Value
BKD Common 10,000 shares	$300,000	$280,000
LRF Preferred 2,000 shares	210,000	220,000
Horton Common, 1,000 shares	41,000	45,000
Drake Bonds, 100 bonds	115,000	102,000
Total	$666,000	$647,000

(c) Adjusting entry at 12/31/14:

Fair Value Adjustment (trading)	16,000	
Unrealized Holding Gain or Loss—Income		16,000

(Balance at 1/1/14	$35,000
Balance needed at 12/31/14	19,000
Recovery	$16,000)

Pr. 17-131—Available-for-sale equity securities.

During the course of your examination of the financial statements of Doppler Corporation for the year ended December 31, 2013, you found a new account, "Investments." Your examination revealed that during 2013, Doppler began a program of investments, and all investment-related transactions were entered in this account. Your analysis of this account for 2013 follows:

Doppler Corporation
Analysis of Investments
For the Year Ended December 31, 2013

Date—2013			Debit	Credit
		(a)		
		Harmon Company Common Stock		
Feb.	14	Purchased 4,000 shares @ $55 per share.	$220,000	
July	26	Received 400 shares of Harmon Company common stock as a stock dividend. (Memorandum entry in general ledger.)		
Sept.	28	Sold the 400 shares of Harmon Company common stock received July 26 @ $65 per share.		$26,000
		(b)	Debit	Credit
		Taber Inc., Common Stock		
Apr.	30	Purchased 20,000 shares @ $40 per share.	$800,000	
Oct.	28	Received dividend of $1.20 per share.		$24,000

Additional information:

1. The fair value for each security as of the 2013 date of each transaction follow:

Security	Feb. 14	Apr. 30	July 26	Sept. 28	Dec. 31
Harmon Co.	$55		$62	$70	$74
Taber Inc.		$40			33
Doppler Corp.	25	28	30	33	35

2. All of the investments of Doppler are nominal in respect to percentage of ownership (5% or less).

3. Each investment is considered by Doppler's management to be available-for-sale.

Instructions

(1) Prepare any necessary correcting journal entries related to investments (a) and (b).

(2) Prepare the entry, if necessary, to record the proper valuation of the available-for-sale equity security portfolio as of December 31, 2013.

Solution 17-131

(1) (a) Harmon —	original purchase	4,000 shares	
	stock dividend	400 shares	
	total holding	4,400 shares	

Total cost of $220,000 ÷ Total shares of 4,400 = $50 cost per share

Solution 17-131 (cont.)

Sold 100 shares

Correct entry:		
Cash (400 × $65)	26,000	
Equity Investments		20,000
Gain on Sale of Investments		6,000
Entry made:		
Cash	26,000	
Equity Investments		26,000
Correction:		
Equity Investments	6,000	
Gain on Sale of Investments		6,000

(b) Taber—should record cash dividend as dividend income.

Correct entry:		
Cash	24,000	
Dividend Revenue		24,000
Entry made:		
Cash	24,000	
Equity Investments		24,000
Correction:		
Equity Investments	24,000	
Dividend Revenue		24,000
(To properly record dividends under fair value method)		

(2) Valuation at End of Year:

	Quantity	Cost	Fair Value	Increase (Decrease)
Harmon	4,000 shares	$ 200,000	$296,000	$ 96,000
Taber	20,000 shares	800,000	660,000	(140,000)
		$1,000,000	$956,000	$(44,000)

Year-end Adjustment:		
Unrealized Holding Gain or Loss—Equity	44,000	
Fair Value Adjustment (available-for-sale)		44,000

***Pr. 17-132**—Derivative financial instrument.

Hummel Co. purchased a put option on Olney common shares on July 7, 2012, for $100. The put option is for 200 shares, and the strike price is $30. The option expires on January 31, 2013. The following data are available with respect to the put option:

Date	Market Price of Olney Shares	Time Value of Put Option
September 30, 2012	$32 per share	$55
December 31, 2012	$31 per share	21
January 31, 2013	$33 per share	0

Instructions
Prepare the journal entries for Hummel Co. for the following dates:

(a) July 7, 2012—Investment in put option on Olney shares.

(b) September 30, 2012— Hummel prepares financial statements.

(c) December 31, 2012— Hummel prepares financial statements.

(d) January 31, 2013—Put option expires.

***Solution 17-132**

		Dr.	Cr.
	July 7, 2012		
(a)	Put Option	100	
	Cash		100
	September 30, 2012		
(b)	Unrealized Holding Gain or Loss—Income	45	
	Put Option ($100 – $55)		45
	December 31, 2012		
(c)	Unrealized Holding Gain or Loss—Income	34	
	Put Option ($55 – $21)		34
	January 31, 2013		
(d)	Loss on Settlement of Put Option	21	
	Put Option ($21 – $0)		21

***Pr. 17-133**—Free-standing derivative.

Welch Co. purchased a put option on Reese common shares on January 7, 2013, for $215. The put option is for 300 shares, and the strike price is $51. The option expires on July 31, 2013. The following data are available with respect to the put option:

Date	Market Price of Reese Shares	Time Value of Put Option
March 31, 2013	$47 per share	$120
June 30, 2013	$50 per share	56
July 6, 2013	$46 per share	16

***Pr. 17-133** (cont.)

Instructions

Prepare the journal entries for Welch Co. for the following dates:

(a) January 7, 2013—Investment in put option on Reese shares.

(c) March 31, 2013— Welch prepares financial statements.

(d) June 30, 2013— Welch prepares financial statements.

(e) July 6, 2013— Welch settles the call option on the Reese shares.

***Solution 17-133**

	January 7, 2013		
(a)	Put Option	215	
	Cash		215
	March 31, 2013		
(b)	Put Option	1,200	
	Unrealized Holding Gain or Loss—Income ($4 × 300)		1,200
	Unrealized Holding Gain or Loss—Income	95	
	Put Option ($215 – $120)		95
	June 30, 2013		
(c)	Unrealized Holding Gain or Loss—Income	900	
	Put Option ($3 × 300)		900
	Unrealized Holding Gain or Loss—Income	64	
	Put Option ($120 – $56)		64
	July 6, 2013		
(d)	Unrealized Holding Gain or Loss—Income	40	
	Put Option ($56 – $16)		40
	Cash (300 × $5)	1,500	
	Gain on Settlement of Put Option		1,184
	Put Option*		316

*Value of Put Option settlement:

Put Option

215	
1,200	95
	900
	64
	40
316	

IFRS QUESTIONS

True/False

1. IFRS requires that gains and losses on non-trading investments be reported directly in equity.

2. Under IFRS, impairment charges related to debt investments may be reversed, but impairment charges related to equity investments may *not* be reversed.

3. Reclassification in and out of trading securities is permitted under IFRS, although this type of reclassification should be rare.

4. IFRS requires that Company A consolidate Company B when it controls and owns at least 50% of Company B.

5. Under IFRS, both the investor and the associate company should follow the same accounting practices, requiring adjustments be made to the investor's books in order to prepare financial information.

Answers to True/False

1. True
2. True
3. False
4. True
5. False

Multiple Choice

1. Match the approach and location where gains and losses from non-trading investments are reported:

	Approach	Location where gains/ losses reported
a.	GAAP	Equity
b.	IFRS	Equity
c.	GAAP	Income
d.	IFRS	Comprehensive income

Use the following information for questions 2 and 3

Rushia Company has a non-trading investment in the 10%, 10-year bonds of Pear Co. The investment's carrying value is $3,200,000 at December 31, 2012. On January 9, 2013, Rushia learns that Pear Co. has lost its primary manufacturing facility in an uninsured fire. As a result, Rushia determines that the investment is impaired and now has a fair value of $2,300,000. In June, 2014, Pear Co. has succeeded in rebuilding its manufacturing facility, and its prospects have improved as a result.

2. If Rushia Company determines that the fair value of the investment is now $3,900,000 and is using U.S. GAAP for its external financial reporting, which of the following is true?
   a. Rushia is prohibited from recording the recovery in value of the impaired investment.
   b. Rushia may record a recovery of $900,000.
   c. Rushia may record a recovery of $700,000.
   d. Rushia may record a recovery of $1,600,000.

3. If Rushia Company determines that the fair value of the investment is now $2,900,000 and is using IFRS for its external financial reporting, which of the following is true?
   a. Rushia is prohibited from recording the recovery in value of the impaired investment.
   b. Rushia may record a recovery of $600,000.
   c. Rushia may record a recovery of $900,000.
   d. Rushia may record a recovery, but is limited to 80% of the value of the recovery.

Answers to multiple choice

1. b
2. a
3. b

Short Answer:

1. Briefly describe some of the similarities and differences between U.S. GAAP and IFRS with respect to the accounting for investments.

   1. The accounting and reporting under IFRS and U.S. GAAP are for the most part very similar, although the criteria used to determine the accounting is often different. For example, among the notable similarities are: (1) the accounting for trading, available-for-sale, and held-to-maturity securities is essentially the same between IFRS and U.S. GAAP; (2) both IFRS and U.S. GAAP use the same test to determine whether the equity method of accounting should be used – that is, significant influence with a general guide of over 20% ownership. IFRS uses the term associate investment rather than equity investment to describe its investment under the equity method; (3) reclassifications of securities from one category to another generally follow the same accounting under the two GAAP systems. Reclassification in and out of trading securities is prohibited under IFRS. It is not prohibited under U.S. GAAP, but this type of reclassification should be rare.

Differences include: (1) Gains and losses related to available-for-sale securities are reported in other comprehensive income under U.S. GAAP. Under IFRS, these gains and losses are reported directly in equity; (2) under IFRS, both the investor and an associate company should follow the same accounting policies. As a result, in order to prepare financial information, adjustments are made to the associate's policies to conform to the investor's books; (3) the basis for consolidation under IFRS is control. Under U.S. GAAP, a bipolar approach is used which is a risk-and-reward model (often referred to as a variable-entity approach) and a voting-interest approach. However, under both systems, for consolidation to occur, the investor company must generally own 50% of another company; (4) U.S. GAAP does not permit the reversal of an impairment charge related to available-for-sale debt and equity investments. IFRS follows the same approach for non-trading equity investments but permits reversal for non-trading debt investments and held-for-collection securities.

2. Ramirez Company has an available-for-sale (non-trading) investment in the 6%, 20-year bonds of Soto Company. The investment was originally purchased for $1,200,000 in 2009. Early in 2012, Ramirez recorded an impairment of $200,000 on the Soto investment, due to Soto's financial distress. In 2013, Soto returned to profitability and the Soto investment was no longer impaired. What entry does Ramirez make in 2013 under (a) U.S. GAAP and (b) IFRS?

    2. Under U.S. GAAP, Ramirez makes no entry, because impaired investments may not be written up if they recover in value. Under IFRS, Ramirez makes the following entry:

Debt Investments……………………………………	200,000	
Recovery of Impairment Loss ………………………..		200,000