Advanced Financial Accounting 12th edition Christensen Solutions Manual

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CHAPTER 2

REPORTING INTERCORPORATE INVESTMENTS AND CONSOLIDATION OF WHOLLY OWNED SUBSIDIARIES WITH NO DIFFERENTIAL

ANSWERS TO QUESTIONS

Q2-1 (a) An investment in the voting common stock of another company is reported on an equity-method basis when the investor is able to significantly influence the operating and financial policies of the investee.

(b) An investment in the voting common stock of another company is carried at fair value when the investor is NOT able to significantly influence the operating and financial policies of the investee.

Q2-2 Under normal circumstances, the balance in the intercorporate investment account is expected to be different if the investment is carried at fair value, or if the equity method of accounting is used.

Q2-3 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

Q2-4 A dividend is treated as a reduction of the investment account under equity-method reporting. A dividend received on investments carried at fair value is recorded as dividend income.

Q2-5 For securities carried at fair value, the change in the fair value of the shares held by the investor is recorded as an unrealized gain or loss at the end of the period. Under the equity method the investor's share of the earnings of the investee are recorded as investment income (and recorded as an increase to the investment account). Under the equity method any dividends received from the investee are treated as a reduction of the investment account and these dividends are not considered income to the investor.

Q2-6 A one-line consolidation implies that under equity-method reporting the investor's net income and stockholders' equity will be the same as if the investee were consolidated. Income from the investee is included in a single line in the investor's income statement and the investment is reported as a single line in the investor's balance sheet.

Q2-7 An adjusting entry is recorded on the company's books and causes the balances reported by the parent or subsidiary company to change. Consolidation entries, on the other hand, are not recorded on the books of the companies. Instead, they are entered in the consolidation worksheet so that when the amounts included in the consolidation entries are applied, - the appropriate balances for the consolidated entity are reported.

Q2-8 Each of the stockholders' equity accounts of the subsidiary is eliminated in the consolidation process. Thus, none of the balances is included in the stockholders' equity accounts of the consolidated entity. That portion of the stockholders' equity claim assigned to the noncontrolling shareholders is reported indirectly in the balance assigned to the noncontrolling shareholders.

Q2-9 Additional entries are needed to eliminate all income statement and retained earnings statement effects of intercorporate ownership and any transfers of goods and services between related companies.

Q2-10 Separate parts of the consolidation worksheet are used to develop the consolidated income statement, retained earnings statement, and balance sheet. All consolidation entries needed to complete the entire worksheet normally are entered before any of the three statements are prepared. The income statement portion of the worksheet is completed first so that net income can be carried forward to the retained earnings statement portion of the worksheet. When the retained earnings portion is completed, the ending balances are carried forward and entered in the consolidated balance sheet portion of the worksheet.

Q2-11 None of the dividends declared by the subsidiary are included in the consolidated retained earnings statement. Those which are paid to the parent have not gone outside the consolidated entity and therefore must be eliminated in preparing the consolidated statements.

Q2-12 Consolidated net income includes 100 percent of the revenues and expenses of the individual consolidating companies arising from transactions with unaffiliated companies.

Q2-13 Consolidated retained earnings is that portion of the undistributed earnings of the consolidated entity accruing to the parent company shareholders.

Q2-14 Consolidated retained earnings at the end of the period is equal to the beginning consolidated retained earnings balance plus consolidated net income attributable to the controlling interest, less consolidated dividends. Under the fully adjusted equity method, consolidated retained earnings should equal the parent company's retained earnings.

Q2-15 The retained earnings statement shows the increase or decrease in retained earnings during the period. Thus, income for the period is added to the beginning balance and dividends are deducted in deriving the ending balance in retained earnings. Because the consolidation worksheet includes the retained earnings statement, the beginning retained earnings balance must be entered in the worksheet.

Q2-16A The general rule established in ASC 323 is that in the absence of other evidence, common stock ownership of 20 percent or more is viewed as indicating that the investor is able to exercise significant influence over the investee. However, ASC 323-10-15-6 also states a number of factors that could constitute other evidence of the ability to exercise significant influence:

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.

Q2-17A Equity-method reporting should not be used when (a) the investee has initiated litigation or complaints challenging the investor's ability to exercise significant influence, (b) the investor signs an agreement surrendering important shareholder rights, (c) majority ownership is concentrated in a small group that operates the company without regard to the investor's desires, (d) the investor is not able to acquire the information from the investee, or (e) the investor tries and fails to gain representation on the board of directors.

Q2-18A When the modified equity method is used, a proportionate share of subsidiary net income and dividends is recorded on the parent's books and an appropriate amount of any differential is amortized each period. In some situations, companies also choose not to make adjustments for intercompany profits and the amortization of the differential. Under the fully adjusted equity method, the parent's books also are adjusted for unrealized profits and any other items that are needed to bring the investor's net income into agreement with the income to the controlling interest that would be reported if consolidation were used.

Q2-19A The term modified equity method generally is used when the investor records its portion of the reported net income and dividends of the investee and amortizes an appropriate portion of any differential. Unlike the fully adjusted equity method, no adjustment for unrealized profit on intercompany transfers normally is made on the investor's books. (In some situations, companies also choose not to amortize the differential.) When an investee is consolidated for financial reporting purposes, the investor may not feel it is necessary to record fully adjusted equity method entries on its books since income from the investee and the balance in the investment account must be eliminated in preparing the consolidated statements.

SOLUTIONS TO CASES

C2-1 Choice of Accounting Method

a. The equity method is to be used when an investor has significant influence over an investee. Significant influence normally is assumed when more than 20 percent ownership is held. Factors to be considered in determining whether to apply equity-method reporting include the following:

1. Is the investee under the control of the courts or other parties as a result of filing for reorganization or entering into liquidation procedures?

2. Does the investor have representation on the board of directors, or has it attempted to gain representation and been unable to do so?

3. Has the investee initiated litigation or complaints challenging the investor's ability to exercise significant influence?

4. Has the investor signed an agreement surrendering its ability to exercise significant influence?

5. Is majority ownership concentrated in a small group that operates the company without regard of the wishes of the investor?

6. Is the investor able to acquire the information needed to use equity-method reporting?

b. The equity method will align the contribution to Slanted’s earnings with the earnings reported by Flat. If the investment is carried at fair value, the contribution to Slanted’s earnings will be aligned with the change in market value of Flat’s shares, thus market expectations play a key role in the contribution to earnings if the investment is carried at fair value.

c. The key reason that the equity method is more appropriate as the percentage of ownership increases is that GAAP requires the use of the equity method at the point when the investor gains significant influence over an investee. Therefore Slanted is likely to be required to use the equity method to account for its investment in Flat. Some of the reasons for this include that as the investor uses more of its resources to acquire ownership of the investee, and as the investor has a greater share of the investee's profits and losses, the success of the investee's operations may have more of an impact on the overall financial well-being of the investor. In many cases, the investor will want to participate in key decisions of the investee once the investor's ownership share reaches a certain level. Also, use of the equity method eliminates the possibility of the investor manipulating its own income by influencing investee dividend distributions, as might occur if the investor carries the investment at fair value.

C2-2 Intercorporate Ownership

MEMO

To: Chief Accountant
Most Company

From: ______ ______, CPA

Re: Equity Method Reporting for Investment in Adams Company

The equity method should be used in reporting investments in which the reporting company has a significant influence over the operating and financing decisions of another company. In this case, Most Company holds 15 percent of the voting common stock of Adams Company and Port Company holds an additional 10 percent. During the course of the year, both Most and Port are likely to carry their respective investments in Adams at fair value. However, when consolidated statements are prepared for Most, the combined ownership must be used in determining whether significant influence exists. Both direct and indirect ownership must be taken into consideration. [ASC 323]

A total of 15 percent of the voting common stock of Adams is held directly by Most Company and an additional 10 percent is controlled indirectly through Most's ownership of Port Company. Equity-method reporting for the investment in Adams Company therefore appears to be required in the consolidated financial statements.

If Most and Port have carried their investments in Adams at fair value during the year, then at the time consolidated statements are prepared, adjustments must be made to (a) increase the balance in the investment account for a proportionate share of the investee's reported net income (25 percent) and reduce the balance in the investment account for a proportionate share of the dividend paid by the investee, (b) include a proportionate share of the investee's net income in the consolidated income statement, (c) delete any dividend income recorded by Most and Port, and (d) reverse any impact of entries that Most and Port have made related to changes in fair value of Adams stock during the year.

Primary citation
ASC 323

C2-3 Application of the Equity Method

MEMO

To: Controller
Forth Company

From: ______ ______, CPA

Re: Equity Method Reporting for Investment in Brown Company

This memo is prepared in response to your request to evaluate whether Forth should use the equity method in accounting for its investment in Brown Company, or if the investment should be carried at fair value.

Forth Company held 85 percent of the common stock of Brown Company prior to January 1, 20X2, and was required to fully consolidate Brown Company in its financial statements prepared prior to that date [ASC 810]. Forth now holds only 15 percent of the common stock of Brown. Investments are normally carried at fair value when ownership is less than 20 percent of the stock that is directly or indirectly held by the investor.

Equity-method reporting should be used when the investor has “significant influence over operating and financing policies of the investee.” While 20 percent ownership is regarded as the level at which the investor is presumed to have significant influence, other factors must be considered as well. [ASC 323]

Although Forth currently holds only 15 percent of Brown’s common stock, the other factors associated with its ownership indicate that Forth does exercise significant influence over Brown. Forth has two members on Brown’s board of directors, it purchases a substantial portion of Brown’s output, and Forth appears to be the largest single shareholder by virtue of its sale of 10,000 shares to each of 7 other investors.

These factors provide strong evidence that Forth has significant influence over Brown and points to the need to use equity-method reporting for its investment in Brown. Your office should monitor the activities of the standard setting bodies with respect to consolidation standards [www.fasb.org]. Active consideration is being given to situations in which control may be exercised even though the investor does not hold majority ownership. It is conceivable that your situation might be one in which consolidation could be required.

Primary citations
APB 18, par. 17; ASC 323-10-15-6 through 15-8
ASC 810

C2-4 Need for Consolidation Process

After the financial statements of each of the individual companies are prepared in accordance with generally accepted accounting principles, consolidated financial statements must be prepared for the economic entity as a whole. The individual companies generally record transactions with other subsidiaries on the same basis as transactions with unrelated enterprises. In preparing consolidated financial statements, the effects of all transactions with related companies must be removed, just as all transactions within a single company must be removed in preparing financial statements for that individual company. It therefore is necessary to prepare a consolidation worksheet and to enter a number of special journal entries in the worksheet to remove the effects of the intercorporate transactions. The parent company also reports an investment in each of the subsidiary companies and investment income or loss in its financial statements. Each of these accounts must be eliminated as well as the stockholders' equity accounts of the subsidiaries. The latter must be eliminated so that only the parent’s equity remains. This is because only the parent's ownership is held by parties outside the consolidated entity.

C2-5 Account Presentation

MEMO

To: Chief Accountant
Prime Company

From: ______ ______, Accounting Staff

Re: Combining Broadly Diversified Balance Sheet Accounts

Many manufacturing and merchandising enterprises excluded finance, insurance, real estate, leasing, and perhaps other types of subsidiaries from consolidation prior to 1987 on the basis of "nonhomogeneous" operations. Companies generally argued that the accounts of these companies were dissimilar in nature and combining them in the consolidated financial statements would mislead investors. ASC 810 specifically eliminated the exception for nonhomogeneous operations. ASC 810 affirms the requirement for consolidating entities in which a controlling financial interest is held.

Prime Company controls companies in very different industries and combining the accounts of its subsidiaries may lead to confusion by some investors; however, it may be equally confusing to provide detailed listings of assets and liabilities by industry or other breakdowns in the consolidated balance sheet. The actual number of assets and liabilities presented in the consolidated balance sheet must be carefully considered, but is the decision of Prime's management.

It is important to recognize that the notes to the consolidated financial statements are regarded as an integral part of the financial statements and Prime Company is required to include in its notes to the financial statements certain information on its reportable segments [ASC 280]. Because of the diversity of its ownership, Prime may wish to provide more than the minimum disclosures specified in the guidance. Segment information appears to be used quite broadly by investors and permits the company to provide sufficient detail to assist the financial statement user in gaining a better understanding of the various operating divisions of the company.

You have requested information on those situations in which it may not be appropriate to combine similar appearing accounts of two or more subsidiaries. The following is a partial listing of such situations: (a) the accounts of a subsidiary should not be included along with other subsidiaries if control of the assets and liabilities does not rest with Prime Company, as when a subsidiary is in receivership; (b) while the assets and liability accounts of the subsidiary should be combined with the parent, the equity account balances should not; (c) negative account balances in cash or accounts receivable should be reclassified as liabilities rather than being added to the positive balances of other affiliates if there is no right of offset in the underlying bank accounts, and (d) assets pledged for a specific purpose and not available for other use by the consolidated entity generally should be separately reported.

Primary citations:
ASC 810
ASC 280-10
ASC 810-10-65-1
Secondary sources:
ASC 810

C2-6 Consolidating an Unprofitable Subsidiary

MEMO

TO: Chief Accountant
Amazing Chemical Corporation

FROM: ___________ ___________, Accounting Staff

Re: Consolidation of Unprofitable Boatyard

This memo is intended to provide recommendations on the presentation of the boatyard in Amazing Chemical's consolidated financial statements. Amazing Chemical Corporation currently has full ownership of the boatyard and should fully consolidate the boatyard in its financial statements. Consolidated statements should be prepared when a company directly or indirectly has a controlling financial interest in one or more other companies. [ASC 810]. Amazing Chemical appears to be following generally accepted accounting procedures in fully consolidating the boatyard in its financial statements and should continue to do so.

The operations of the boatyard appear to be distinct from the other operations of the parent company and its losses appear to be sufficient to establish it as a reportable segment [ASC 280]. While the operating losses of the boatyard may not be evident in analyzing the consolidated income statement, a review of the notes to the consolidated statements should provide adequate disclosure of its operations as a reportable segment. The financial statements for the current period should contain these disclosures and if prior period statements have not included the boatyard as a reportable segment it may be necessary to restate those statements.

Failure of the president of Amazing Chemical to receive approval by the board of directors for the purchase of the boatyard and his subsequent actions to keep information about its operations from the board members appears to be a serious breach of ethics. These actions by the president should immediately be brought to the attention of the board of directors for appropriate action by the board.

Primary citations:
ASC 810-10-10-1
ASC 810
ASC 280-10-50
ASC 810-10-65-1

SOLUTIONS TO EXERCISES

E2-1 Multiple-Choice Questions on Accounting for Equity Investments [AICPA Adapted]

1. **a** – Cash dividends received will never cause an *increase* in the investment account under either method.

   (b) *Incorrect*. A cash dividend is recorded as dividend income and does not affect the investment account when the investment is carried at fair value. Under the equity method, dividends *reduce* the investment account.
   (c) *Incorrect.* A cash dividend is recorded as dividend income and does not affect the investment account when the investment is carried at fair value.
   (d) *Incorrect.* Under the equity method, dividends *reduce* the investment account.

2. **a** – Because the ownership in Amal Corporation is less than 20%, the investment should be carried at fair value. Accordingly, the $1,500 dividend received from Amal is recorded as dividend revenue.

   (b) *Incorrect*. Stock dividends are not recorded as income.
   (c) *Incorrect.* The cash dividend received from B&K is not recorded as dividend revenue because it is accounted for under the equity method.
   (d) *Incorrect.* The stock dividend and cash dividend from B&K are not recorded as dividend revenue.

3. **a** – Under the equity method, net income increases the investment account while dividends decrease it. Because net income was greater than the dividends declared, this results in a net increase in the investment account. The problem information indicated that fair value of the stock was unchanged during the year. Thus in this problem, the balance at year-end would be lower if the investment was carried at fair value than it would be under the equity method.

   (b) *Incorrect*. This would only be true if the dividends were less than the net income.
   (c) *Incorrect.* It doesn't matter when the dividends are paid; as soon as they are declared they act as a reduction to the investment under the equity method.
   (d) *Incorrect.* It doesn't matter when the dividends are paid; as soon as they are declared they act as a reduction to the investment under the equity method.

4. **b** – Under the equity method the company records a share of the affiliate net income as income for the company. This increases the net income of the company which increases earnings per share.

   (a) *Incorrect*. An increase in income affects long-term assets, not current assets or current liabilities, so it would have no effect on the current ratio.
   (c) *Incorrect.* The assets would be higher so asset turnover would decrease. No other turnover ratios would be affected.
   (d) *Incorrect.* The affiliate company's profitability would not decrease the book value per share of the company, it would increase it since retained earnings would increase with the recognition of income from the subsidiary.

E2-2 Multiple-Choice Questions on Intercorporate Investments

1. **b** – Equity method reporting is used when an investor gains significant influence over the operating and financing decisions of the investee. Typically, this is satisfied by maintaining 20% or more of the voting stock, but can also be obtained by other contractual obligations or circumstances.

   (a) *Incorrect.* Voting shares can be obtained without gaining significant influence (i.e. less than 20%) and thus the equity method is not typically used.
   (c) *Incorrect.* Purchasing goods and services would not constitute significant influence over the company, and thus does not result in the equity method being applied.
   (d) *Incorrect.* This would result in a write-down of the investment, and does not correlate to the use of the equity method.

2. **c** – Under the equity method, net income from the investee causes an increase to the investment, while dividends declared by the investee causes a reduction.

   (a) *Incorrect.* This simply represents the historical cost of the investment. It must be adjusted for the income and dividends declared by the investee.
   (b) *Incorrect.* Dividends declared by the investee cause a reduction to the investment, not an increase.
   (d) *Incorrect.* Net income reported by the investee causes an increase to the investment, not a decrease.

E2-3 Multiple-Choice Questions on Applying Equity Method [AICPA Adapted]

1. **d** – $250,000 + ($100,000 x 0.30) – ($10,000 x 0.30) = $277,000

2. **d** – If the investment had been accounted for using the equity method, Investor would have recorded its share of Alimand's income by increasing the investment account and increasing earnings by $40,000 ($100,000 x 40%). Investor would also have decreased the investment account by $4,000 for its share of the dividends ($10,000 x 40%). However, since Investor incorrectly accounted for the investment as if were carried at fair value, the only entry Investor recorded was to increase income by $4,000 for the dividends. As a result, the investment account will be understated, earnings will be understated, and retained earnings will be understated.

3. **d** – Under the equity method, dividends by the investee are recorded with a credit to the investment account, not to dividend revenue. By wrongly classifying this entry, the investment is overstated, and retained earnings are also overstated.

   (a) *Incorrect.* Because the dividend entry was recorded incorrectly, the financial position will not be correctly stated.
   (b) *Incorrect.* Because the dividends were recorded as dividend revenue, retained earnings would be overstated.
   (c) *Incorrect.* Currently, the investment is overstated because the dividends declared should have resulted in a reduction to the investment account.

E2-4 Carrying an Investment at Fair Value versus Equity Method Reporting

a. Winston Corporation net income – carried at fair value:

20X2	$100,000	+	.40($30,000)	+	$20,000	$132,000
20X3	$ 60,000	+	.40($60,000)	+	$20,000	104,000
20X4	$250,000	+	.40($50,000)	+	$20,000	290,000

b. Winston Corporation net income – equity method:

20X2	$100,000	+	.40($70,000)	$128,000
20X3	$ 60,000	+	.40($40,000)	76,000
20X4	$250,000	+	.40($25,000)	260,000

E2-5 Acquisition Price

Balance at date of acquisition:

a. Carried at fair value: $54,000 − $6,000 = $48,000

The investment account would be increased by $2,000 each year reflecting the increase in the market value of Phillips' investment in Jones' stock.

b. Equity method $54,000 - $2,000 = $52,000

Year	Net Income	Dividends	Phillips's share of Investment
20X1	$ 8,000	$15,000	$(2,800)
20X2	12,000	10,000	800
20X3	20,000	10,000	4,000
Change in account balance			$ 2,000

E2-6 Investment Income

a. (1) Ravine Corporation net income when investment is carried at fair value:

20X6	$140,000	+	0.30($20,000)	+ $10,000	=	$156,000
20X7	$ 80,000	+	0.30($40,000)	+ $10,000	=	$102,000
20X8	$220,000	+	0.30($30,000)	+ $10,000	=	$242,000
20X9	$160,000	+	0.30($20,000)	+ $10,000	=	$176,000

(2) Ravine Corporation net income under Equity Method:

20X6	$140,000	+	0.30($30,000)	=	$149,000
20X7	$ 80,000	+	0.30($50,000)	=	$ 95,000
20X8	$220,000	+	0.30($10,000)	=	$223,000
20X9	$160,000	+	0.30($40,000)	=	$172,000

b. Journal entries recorded by Ravine Corporation in 20X8:

(1) Carried at fair value:

Cash	12,000	
Dividend Income		12,000

Investment in Valley Stock	10,000	
Unrealized Gain on Valley Stock		10,000

(2) Equity method:

Cash	12,000	
Investment in Valley Stock		12,000

Investment in Valley Stock	3,000	
Income from Valley		3,000

E2-7 Investment Value

The following amounts would be reported as the carrying value of Port's investment in Sund:

20X2	$184,500	=	$180,000	+	($40,000 x 0.30)	-	($25,000 x 0.30)
20X3	$193,500	=	$184,500	+	($30,000 x 0.30)		
20X4	$195,000	=	$193,500	+	($5,000 x 0.30)		

E2-8 Carrying an Investment at Fair Value versus Equity Method Reporting

a. Fair value method:

Operating income reported by Mock	$90,000
Unrealized gain on increase in value of Small stock	16,000
Dividend income from Small ($15,000 x 0.20)	3,000
Net income reported by Mock	$ 109,000

b. Equity method:

Operating income reported by Mock	$90,000
Income from investee ($40,000 x 0.20)	8,000
Net income reported by Mock	$98,000

E2-9 Carrying an Investment at Fair Value versus Equity Method Reporting

a. Journal entries under the equity method:

(1)	Investment in Lomm Company Stock	140,000	
	Cash		140,000
	Record purchase of Lomm Company stock.		
(2)	Cash	7,000	
	Investment in Lomm Company Stock		7,000
	Record dividends from Lomm Company: $20,000 x 0.35		
(3)	Investment in Lomm Company Stock	28,000	
	Income from Lomm Company		28,000
	Record equity-method income: $80,000 x 0.35		

b. Journal entries for investment carried at fair value.

(1)	Investment in Lomm Company Stock	140,000	
	Cash		140,000
	Record purchase of Lomm Company stock.		
(2)	Cash	7,000	
	Dividend Income		7,000
	Record dividends from Lomm Company: $20,000 x 0.35		
(3)	Investment in Lomm Company Stock	34,000	
	Unrealized Gain on Increase in Value of Lomm Stock		34,000
	Record increase in value of Lomm stock: $174,000 - $140,000		

E2-10 Basic Consolidation Entry

Common Stock – Broadway Corporation	200,000	
Additional Paid-In Capital	300,000	
Retained Earnings	100,000	
Investment in Broadway Common Stock		600,000

E2-11 Balance Sheet Worksheet

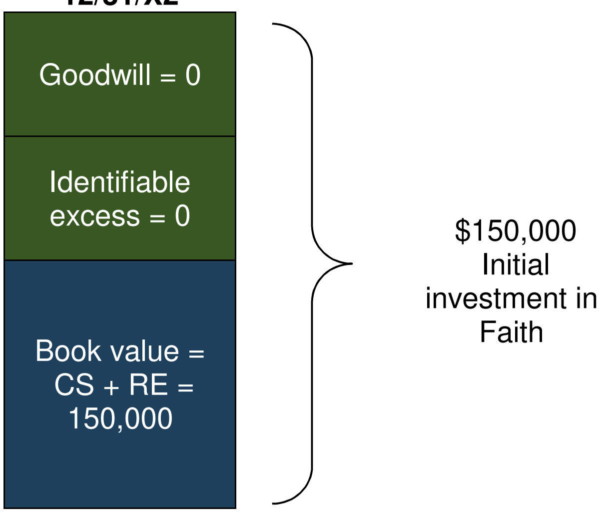
a.

Equity Method Entries on Blank's Books:

Investment in Faith	150,000	
Cash		150,000

Record the initial investment in Faith

12/31/X2



Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Ending book value	150,000		60,000		90,000

Basic Consolidation Entry

Common stock	60,000	
Retained earnings	90,000	
Investment in Faith		150,000

Accumulated Depreciation Consolidation Entry

Accumulated depreciation	30,000	
Buildings & equipment		30,000

E2-11 (continued)

(Since the buildings and equipment are reported net of accumulated depreciation on the balance sheet, this entry will not affect the worksheet. However, if sufficient information had been given, this entry would have made a difference in the worksheet balances for Buildings and Equipment and Accumulated Depreciation. Additionally, this entry would impact any footnote disclosure of the details of Buildings and Equipment.)

b.

			Consolidation Entries		
	Blank	**Faith**	**DR**	**CR**	**Consolidated**
Balance Sheet					
Cash	65,000	18,000			83,000
Accounts Receivable	87,000	37,000			124,000
Inventory	110,000	60,000			170,000
Buildings & Equipment (net)	220,000	150,000	**30,000**	**30,000**	370,000
Investment in Faith	150,000			**150,000**	0
Total Assets	**632,000**	**265,000**	**30,000**	**180,000**	**747,000**
Accounts Payable	92,000	35,000			127,000
Notes Payable	150,000	80,000			230,000
Common Stock	100,000	60,000	**60,000**		100,000
Retained Earnings	290,000	90,000	**90,000**		290,000
Total Liabilities & Equity	**632,000**	**265,000**	**150,000**	**0**	**747,000**

E2-12 Consolidation Entries for Wholly Owned Subsidiary

a.

Equity Method Entries on Trim Corp.'s Books:

Investment in Round Corp.	400,000	
Cash		400,000

Record the initial investment in Round Corp.

Investment in Round Corp.	80,000	
Income from Round Corp.		80,000

Record Trim Corp.'s 100% share of Round Corp.'s 20X2 income

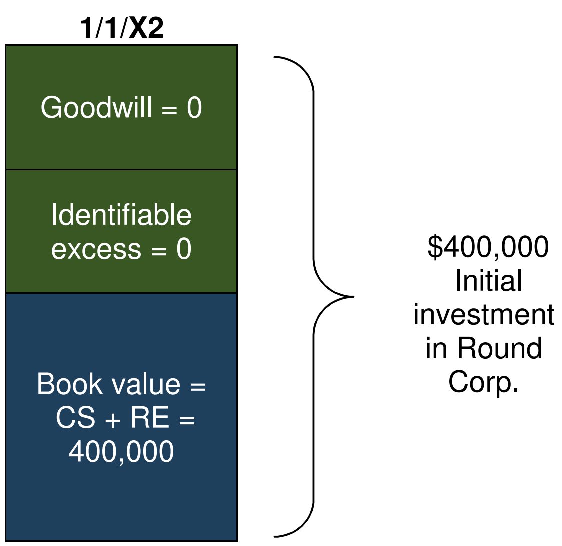
Cash	25,000	
Investment in Round Corp.		25,000

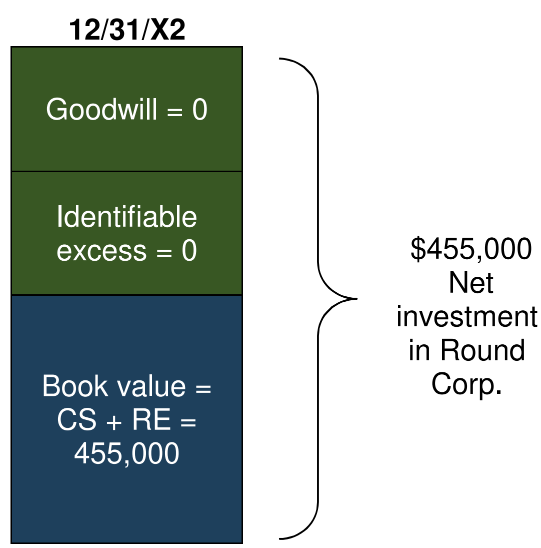
Record Trim Corp.'s 100% share of Round Corp.'s 20X2 dividend

b.

Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Beginning book value	**400,000**		**120,000**		**280,000**
+ Net Income	**80,000**				**80,000**
- Dividends	**(25,000)**				**(25,000)**
Ending book value	**455,000**		**120,000**		**335,000**





E2-12 (continued)

Basic Consolidation Entry

Common stock	120,000	
Retained earnings	280,000	
Income from Round Corp.	80,000	
Dividends declared		25,000
Investment in Round Corp.		455,000

E2-13 Basic Consolidation Entries for Fully Owned Subsidiary

a.

Equity Method Entries on Purple Co.'s Books:

Investment in Amber Corp.	500,000	
Cash		500,000

Record the initial investment in Amber Corp.

Investment in Amber Corp.	50,000	
Income from Amber Corp.		50,000

Record Purple Co.'s 100% share of Amber Corp.'s 20X7 income

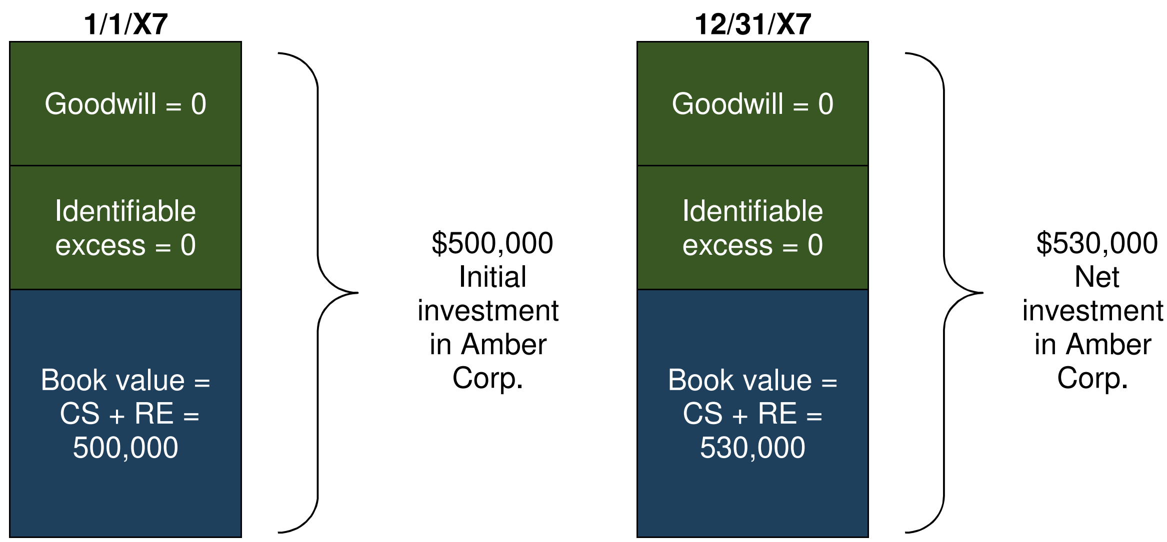
Cash	20,000	
Investment in Amber Corp.		20,000

Record Purple Co.'s 100% share of Amber Corp.'s 20X7 dividend

b.

Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Original book value	500,000		300,000		200,000
+ Net Income	50,000				50,000
- Dividends	(20,000)				(20,000)
Ending book value	530,000		300,000		230,000


1/1/X7
Goodwill = 0
Identifiable excess = 0
Book value = CS + RE = 500,000
$500,000 Initial investment in Amber Corp.
12/31/X7
Goodwill = 0
Identifiable excess = 0
Book value = CS + RE = 530,000
$530,000 Net investment in Amber Corp.

E2-13 (continued)

Basic Consolidation Entry

Common stock	**300,000**	
Retained earnings	**200,000**	
Income from Amber Corp.	**50,000**	
Dividends declared		**20,000**
Investment in Amber Corp.		**530,000**

	Investment in Amber Corp.			**Income from Amber Corp.**		
Acquisition Price	**500,000**					
Net Income	**50,000**				**50,000**	**Net Income**
		20,000	**Dividends**			
Ending Balance	**530,000**				**50,000**	**Ending Balance**
		530,000	**Basic**	**50,000**		
	0				**0**	

E2-14A Income Reporting

Journal entry recorded by Grandview Company:

Investment in Spinet Corporation Stock	36,000	
Income from Spinet Corporation		24,000
Discontinued Operations (from Spinet Corporation)		12,000

E2-15A Investee with Preferred Stock Outstanding

Journal entries recorded by Reden Corporation:

(1)	Investment in Montgomery Co. Stock	288,000	
	Cash		288,000

Record purchase of Montgomery Co. stock.

(2)	Cash	6,750	
	Investment in Montgomery Co. Stock		6,750

Record dividend from Montgomery Co.: [$40,000 - ($250,000 x .10)] x 0.45

(3)	Investment in Montgomery Co. Stock	31,500	
	Income from Montgomery Co.		31,500

Record equity-method income: [$95,000 - ($250,000 x .10)] x 0.45

E2-16A Other Comprehensive Income Reported by Investee

Journal entries recorded by Callas Corp. during 20X9:

(1)	Investment in Thinbill Co. Stock	380,000	
	Cash		380,000
	Record purchase of Thinbill Company		
(2)	Cash	3,600	
	Investment in Thinbill Co. Stock		3,600
	Record dividend from Thinbill: $9,000 x 0.40		
(3)	Investment in Thinbill Co. Stock	18,000	
	Income from Thinbill Co.		18,000
	Record equity-method income: $18,000 = $45,000 x 0.40		
(4)	Investment in Thinbill Co. Stock	8,000	
	Unrealized Gain on Investments of Investee (OCI)		8,000
	Record share of OCI reported by Thinbill: $8,000 = $20,000 x 0.40		

Closing entries recorded at December 31, 20X9:

(5)	Income from Thinbill Co.	18,000	
	Retained Earnings		18,000
(6)	Unrealized Gain on Investments of Investee (OCI)	8,000	
	Accumulated Other Comprehensive Income from Investee-Unrealized Gain on Investments		8,000

E2-17A Other Comprehensive Income Reported by Investee

Investment account balance reported by Baldwin Corp.		$67,000
Add decrease in account recorded in 20X8:		
Equity-method loss ($20,000 x .25)	$ (5,000)	
Dividend received ($10,000 x .25)	(2,500)	7,500
Deduct increase in account recorded in 20X9:		
Equity-method income ($68,000 x .25)	$17,000	
Dividend received ($16,000 x .25)	(4,000)	
Other comprehensive income reported by Gwin Company ($12,000 x .25)	3,000	(16,000)
Purchase price		$58,500

SOLUTIONS TO PROBLEMS
P2-18 Changes in the Number of Shares Held

Journal entries recorded by Idle Corporation:

(1)	Investment in Fast Track Enterprises Stock		34,000	
	Cash			34,000
	Record purchase of Fast Track stock.			
(2)	Investment in Fast Track Enterprises Stock		11,000	
	Retained Earnings			11,000
	Record pick-up of difference between cost and equity income:			
	20X2 .10($40,000 - $20,000)		$ 2,000	
	20X3 .10($60,000 / 2)	$3,000		
	.15[($60,000 / 2) - $20,000]	1,500	4,500	
	20X4 .15($40,000 - $10,000)		4,500	
	Amount of increase		$11,000	
(3)	Cash		5,000	
	Investment in Fast Track Enterprises Stock			5,000
	Record dividend from Fast Track Enterprises: $20,000 x .25			
(4)	Investment in Fast Track Enterprises Stock		12,500	
	Income from Fast Track Enterprises			12,500
	Record equity-method income: $50,000 x .25			

P2-19 Investments Carried at Fair Value and Equity Method

a. Fair value method:

	20X6	20X7	20X8
Investment income:			
Dividends received	$ 3,000	$ 6,000	$ 4,000
Gain (loss) on fair value	19,000	(3,000)	11,000
Total income reported	$22,000	$ 3,000	$15,000
Balance in investment account	$89,000	$86,000	$97,000

b. Equity method:

	20X6	20X7	20X8
Investment income:			
$40,000 x .20	$ 8,000		
$35,000 x .20		$ 7,000	
$60,000 x .20			$12,000
Balance in investment account:			
Balance at January 1	$70,000	$75,000	$76,000
Investment income	8,000	7,000	12,000
Dividends received	(3,000)	(6,000)	(4,000)
Balance at December 31	$75,000	$76,000	$84,000

P2-20 Carried at Fair Value Journal Entries

Journal entries investment carried at fair value for 20X8:

(1)	Investment in Brown Company Stock	85,000	
	Cash		85,000
	Record purchase of Brown Company stock.		
(2)	Cash	4,000	
	Dividend Income		4,000
	Record dividends from Brown Company: $10,000 x .40		
(3)	Investment in Brown Company Stock	12,000	
	Unrealized Gain on Increase in Value of Brown Company Stock		12,000
	Record increase in value of Brown stock: $97,000 - $85,000		

Journal entries investment carried at fair value for 20X9:

(1)	Cash	6,000	
	Dividend Income		6,000
	Record dividends from Brown Company: $15,000 x .40		
(2)	Unrealized Loss on Decrease in Value of Brown Company Stock	5,000	
	Investment in Brown Company Stock		5,000
	Record decrease in value of Brown stock: $97,000 - $92,000		

P2-21 Consolidated Worksheet at End of the First Year of Ownership (Equity Method)

a.

Equity Method Entries on Peanut Co.'s Books:

Investment in Snoopy Co.	300,000	
Cash		300,000

Record the initial investment in Snoopy Co.

Investment in Snoopy Co.	75,000	
Income from Snoopy Co.		75,000

Record Peanut Co.'s 100% share of Snoopy Co.'s 20X8 income

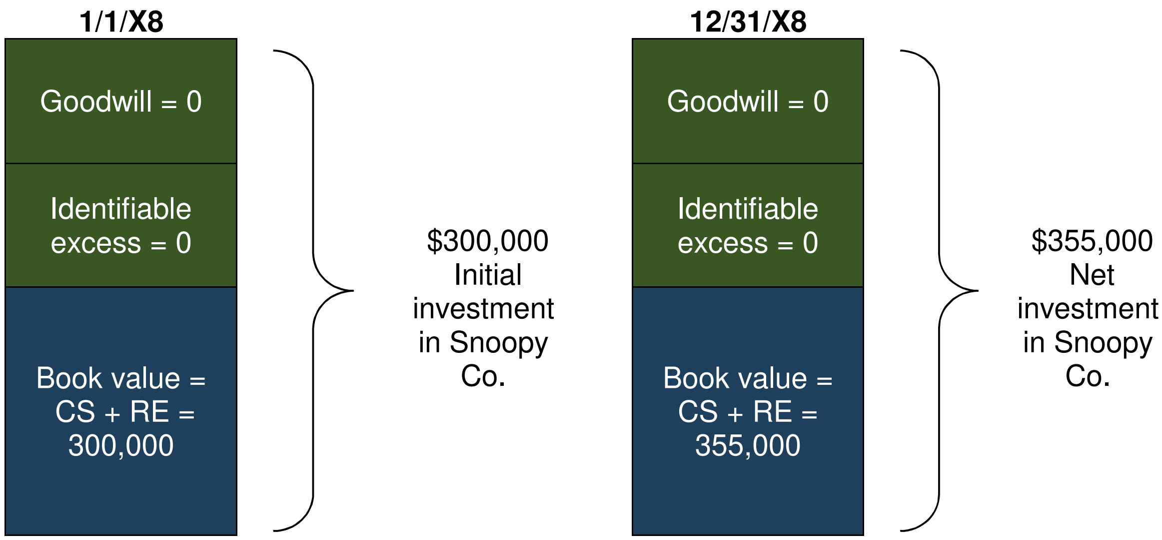
Cash	20,000	
Investment in Snoopy Co.		20,000

Record Peanut Co.'s 100% share of Snoopy Co.'s 20X8 dividend

b.

Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Beginning book value	**300,000**		**200,000**		**100,000**
+ Net Income	**75,000**				**75,000**
- Dividends	**(20,000)**				**(20,000)**
Ending book value	**355,000**		**200,000**		**155,000**



P2-21 (continued)

Basic Consolidation Entry

Common stock	200,000	
Retained earnings	100,000	
Income from Snoopy Co.	75,000	
Dividends declared		20,000
Investment in Snoopy Co.		355,000

Accumulated Depreciation Consolidation Entry

Accumulated depreciation	10,000	
Buildings & equipment		10,000

The amount of this entry is found by looking at the depreciation expense ($10,000) for the year and the accumulated depreciation at the end of the year ($20,000). The difference must be what was in accumulated depreciation at the date of the acquisition. Note that this assumes there were no sales or other disposals of Buildings and equipment during the year.

	Investment in Snoopy Co.			Income from Snoopy Co.		
Acquisition Price	300,000					
Net Income	75,000				75,000	Net Income
		20,000	Dividends			
Ending Balance	355,000				75,000	Ending Balance
		355,000	Basic	75,000		
	0				0	

P2-21 (continued)

	Peanut Co.	Snoopy Co.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	800,000	250,000			1,050,000
Less: COGS	(200,000)	(125,000)			(325,000)
Less: Depreciation Expense	(50,000)	(10,000)			(60,000)
Less: Other Expenses	(225,000)	(40,000)			(265,000)
Income from Snoopy Co.	75,000		75,000		0
Net Income	**400,000**	**75,000**	**75,000**	**0**	**400,000**
Statement of Retained Earnings					
Beginning Balance	225,000	100,000	100,000		225,000
Net Income	**400,000**	**75,000**	**75,000**	**0**	400,000
Less: Dividends Declared	(100,000)	(20,000)		20,000	(100,000)
Ending Balance	**525,000**	**155,000**	**175,000**	**20,000**	**525,000**
Balance Sheet					
Cash	130,000	80,000			210,000
Accounts Receivable	165,000	65,000			230,000
Inventory	200,000	75,000			275,000
Investment in Snoopy Co.	355,000			355,000	0
Land	200,000	100,000			300,000
Buildings & Equipment	700,000	200,000		10,000	890,000
Less: Accumulated Depreciation	(450,000)	(20,000)	10,000		(460,000)
Total Assets	**1,300,000**	**500,000**	**10,000**	**365,000**	**1,445,000**
Accounts Payable	75,000	60,000			135,000
Bonds Payable	200,000	85,000			285,000
Common Stock	500,000	200,000	200,000		500,000
Retained Earnings	**525,000**	**155,000**	**175,000**	**20,000**	525,000
Total Liabilities & Equity	**1,300,000**	**500,000**	**375,000**	**20,000**	**1,445,000**

P2-22 Consolidated Worksheet at End of the Second Year of Ownership (Equity Method)

a.

Equity Method Entries on Peanut Co.'s Books:

Investment in Snoopy Co.	80,000	
Income from Snoopy Co.		80,000

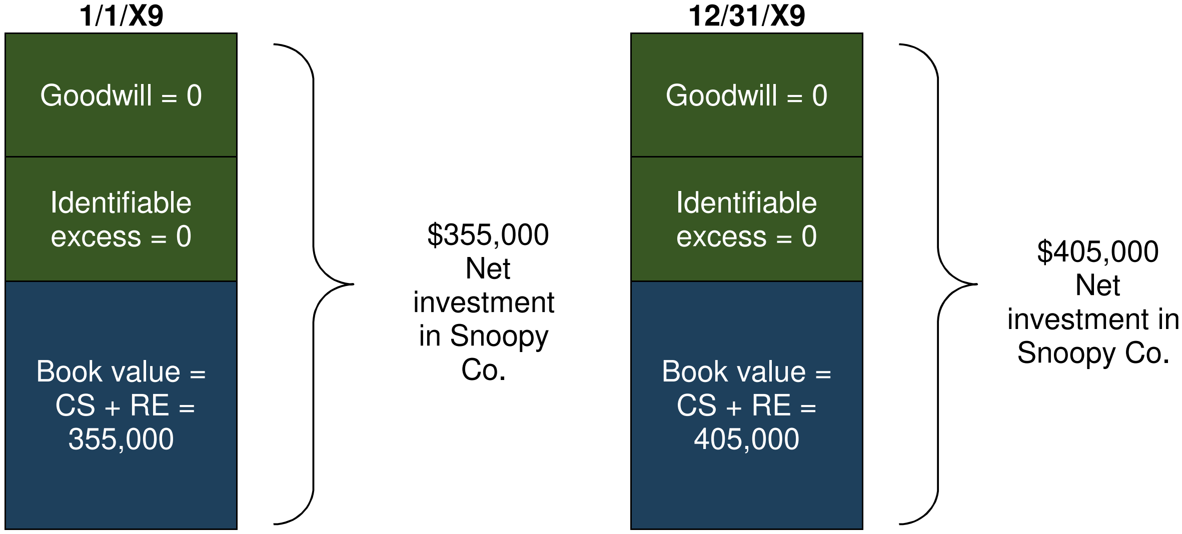
Record Peanut Co.'s 100% share of Snoopy Co.'s 20X9 income

Cash	30,000	
Investment in Snoopy Co.		30,000

Record Peanut Co.'s 100% share of Snoopy Co.'s 20X9 dividend

b.

1/1/X9 **12/31/X9**



Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Beg. book value	**355,000**		**200,000**		**155,000**
+ Net Income	**80,000**				**80,000**
- Dividends	**(30,000)**				**(30,000)**
Ending book value	**405,000**		**200,000**		**205,000**

P2-22 (continued)

Basic Consolidation Entry

Common stock	200,000	
Retained earnings	155,000	
Income from Snoopy Co.	80,000	
Dividends declared		30,000
Investment in Snoopy Co.		405,000

Accumulated Depreciation Consolidation Entry

Accumulated depreciation	10,000	
Buildings & equipment		10,000

Note that this entry is carried forward from the previous year (see solution to P2-21) again assuming that no sales or other disposals of Buildings and equipment took place during the year.

	Investment in Snoopy Co. (Dr)	Investment in Snoopy Co. (Cr)		Income from Snoopy Co. (Dr)	Income from Snoopy Co. (Cr)	
Beginning Balance	355,000					
Net Income	80,000				80,000	Net Income
		30,000	Dividends			
Ending Balance	405,000				80,000	Ending Balance
		405,000	Basic	80,000		
	0				0	

P2-22 (continued)

	Peanut Co.	Snoopy Co.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	850,000	300,000			1,150,000
Less: COGS	(270,000)	(150,000)			(420,000)
Less: Depreciation Expense	(50,000)	(10,000)			(60,000)
Less: Other Expenses	(230,000)	(60,000)			(290,000)
Income from Snoopy Co.	80,000		80,000		0
Net Income	**380,000**	**80,000**	**80,000**	**0**	**380,000**
Statement of Retained Earnings					
Beginning Balance	525,000	155,000	155,000		525,000
Net Income	**380,000**	**80,000**	**80,000**	**0**	380,000
Less: Dividends Declared	(225,000)	(30,000)		30,000	(225,000)
Ending Balance	**680,000**	**205,000**	**235,000**	**30,000**	**680,000**
Balance Sheet					
Cash	230,000	75,000			305,000
Accounts Receivable	190,000	80,000			270,000
Inventory	180,000	100,000			280,000
Investment in Snoopy Co.	405,000			405,000	0
Land	200,000	100,000			300,000
Buildings & Equipment	700,000	200,000		**10,000**	890,000
Less: Accumulated Depreciation	(500,000)	(30,000)	**10,000**		(520,000)
Total Assets	**1,405,000**	**525,000**	**10,000**	**415,000**	**1,525,000**
Accounts Payable	75,000	35,000			110,000
Bonds Payable	150,000	85,000			235,000
Common Stock	500,000	200,000	200,000		500,000
Retained Earnings	**680,000**	**205,000**	**235,000**	**30,000**	680,000
Total Liabilities & Equity	**1,405,000**	**525,000**	**435,000**	**30,000**	**1,525,000**

P2-23 Consolidated Worksheet at End of the First Year of Ownership (Equity Method)

a.

Equity Method Entries on Paper Co.'s Books:

Investment in Scissor Co.	370,000	
Cash		370,000

Record the initial investment in Scissor Co.

Investment in Scissor Co.	93,000	
Income from Scissor Co.		93,000

Record Paper Co.'s 100% share of Scissor Co.'s 20X8 income

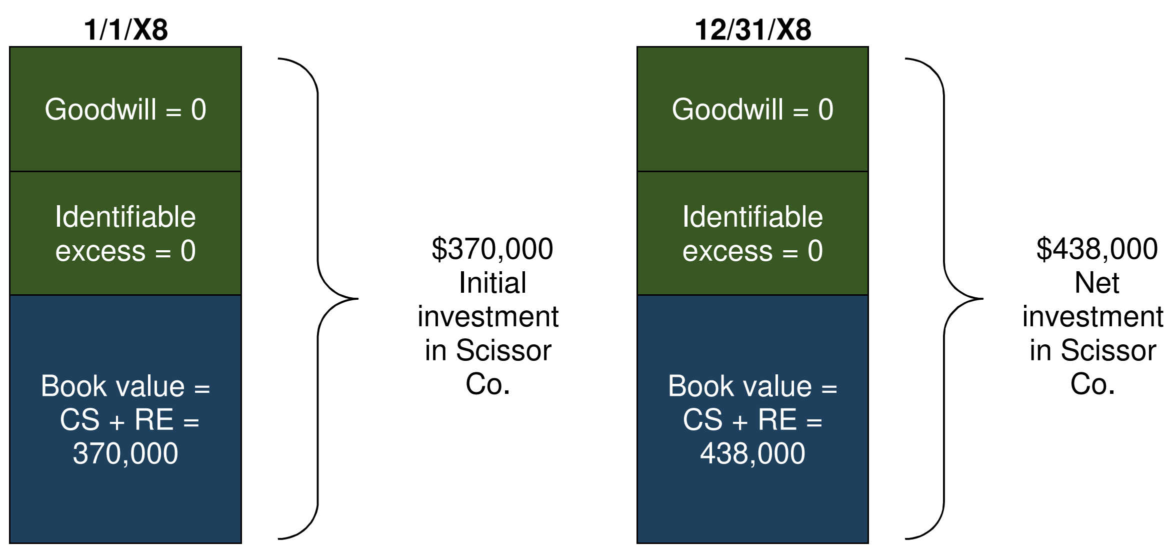
Cash	25,000	
Investment in Scissor Co.		25,000

Record Paper Co.'s 100% share of Scissor Co.'s 20X8 dividend

b.

Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Beginning book value	**370,000**		**250,000**		**120,000**
+ Net Income	**93,000**				**93,000**
- Dividends	**(25,000)**				**(25,000)**
Ending book value	**438,000**		**250,000**		**188,000**



P2-23 (continued)

Basic Consolidation Entry

Common stock	250,000	
Retained earnings	120,000	
Income from Scissor Co.	93,000	
Dividends declared		25,000
Investment in Scissor Co.		438,000

Accumulated Depreciation Consolidation Entry

Accumulated depreciation	24,000	
Buildings & equipment		24,000

The amount of this entry is found by looking at the depreciation expense ($12,000) for the year and the accumulated depreciation at the end of the year ($36,000). The difference must be what was in accumulated depreciation at the date of the acquisition. Note that this assumes there were no sales or other disposals of Buildings and equipment during the year.

	Investment in Scissor Co.			Income from Scissor Co.		
Acquisition Price	370,000					
Net Income	93,000				93,000	Net Income
		25,000	Dividends			
Ending Balance	438,000				93,000	Ending Balance
		438,000	Basic	93,000		
	0				0	

P2-23 (continued)

	Paper Co.	Scissor Co.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	800,000	310,000			1,110,000
Less: COGS	(250,000)	(155,000)			(405,000)
Less: Depreciation Expense	(65,000)	(12,000)			(77,000)
Less: Other Expenses	(280,000)	(50,000)			(330,000)
Income from Scissor Co.	93,000		93,000		0
Net Income	**298,000**	**93,000**	**93,000**	**0**	**298,000**
Statement of Retained Earnings					
Beginning Balance	280,000	120,000	120,000		280,000
Net Income	**298,000**	**93,000**	**93,000**	**0**	298,000
Less: Dividends Declared	(80,000)	(25,000)		25,000	(80,000)
Ending Balance	**498,000**	**188,000**	**213,000**	**25,000**	**498,000**
Balance Sheet					
Cash	122,000	46,000			168,000
Accounts Receivable	140,000	60,000			200,000
Inventory	190,000	120,000			310,000
Investment in Scissor Co.	438,000			438,000	0
Land	250,000	125,000			375,000
Buildings & Equipment	875,000	250,000		24,000	1,101,000
Less: Accumulated Depreciation	(565,000)	(36,000)	24,000		(577,000)
Total Assets	**1,450,000**	**565,000**	**24,000**	**462,000**	**1,577,000**
Accounts Payable	77,000	27,000			104,000
Bonds Payable	250,000	100,000			350,000
Common Stock	625,000	250,000	250,000		625,000
Retained Earnings	**498,000**	**188,000**	**213,000**	**25,000**	498,000
Total Liabilities & Equity	**1,450,000**	**565,000**	**463,000**	**25,000**	**1,577,000**

P2-24 Consolidated Worksheet at End of the Second Year of Ownership (Equity Method)

a.

Equity Method Entries on Paper Co.'s Books:

Investment in Scissor Co.	107,000	
Income from Scissor Co.		107,000

Record Paper Co.'s 100% share of Scissor Co.'s 20X9 income

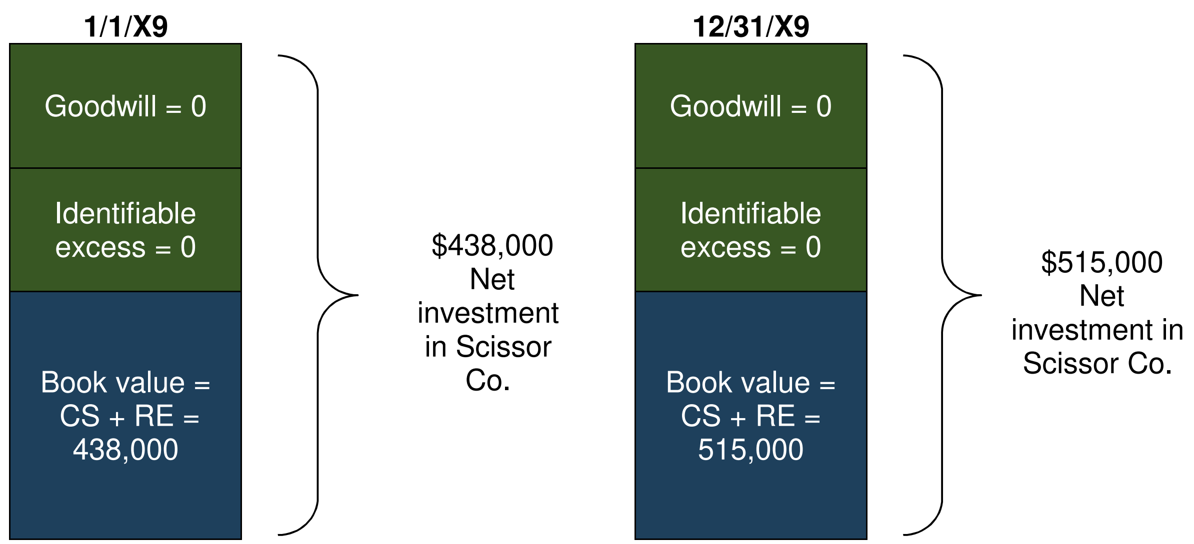
Cash	30,000	
Investment in Scissor Co.		30,000

Record Paper Co.'s 100% share of Scissor Co.'s 20X9 dividend

b.

Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Beg. book value	**438,000**		**250,000**		**188,000**
+ Net Income	**107,000**				**107,000**
- Dividends	**(30,000)**				**(30,000)**
Ending book value	**515,000**		**250,000**		**265,000**



P2-24 (continued)

Basic Consolidation Entry

Common stock	250,000	
Retained earnings	188,000	
Income from Scissor Co.	107,000	
Dividends declared		30,000
Investment in Scissor Co.		515,000

Accumulated Depreciation Consolidation Entry

Accumulated depreciation	24,000	
Buildings & equipment		24,000

Note that this entry is carried forward from the previous year (see solution to P2-23) again assuming that no sales or other disposals of Buildings and equipment took place during the year.

Investment in Scissor Co.

Beginning Balance	438,000		
Net Income	107,000		
		30,000	Dividends
Ending Balance	515,000		
		515,000	Basic
	0		

Income from Scissor Co.

		107,000	Net Income
		107,000	Ending Balance
Basic	107,000		
		0	

P2-24 (continued)

	Paper Co.	Scissor Co.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	880,000	355,000			1,235,000
Less: COGS	(278,000)	(178,000)			(456,000)
Less: Depreciation Expense	(65,000)	(12,000)			(77,000)
Less: Other Expenses	(312,000)	(58,000)			(370,000)
Income from Scissor Co.	107,000		107,000		0
Net Income	**332,000**	**107,000**	**107,000**	**0**	**332,000**
Statement of Retained Earnings					
Beginning Balance	498,000	188,000	188,000		498,000
Net Income	**332,000**	**107,000**	**107,000**	**0**	332,000
Less: Dividends Declared	(90,000)	(30,000)		30,000	(90,000)
Ending Balance	**740,000**	**265,000**	**295,000**	**30,000**	**740,000**
Balance Sheet					
Cash	232,000	116,000			348,000
Accounts Receivable	165,000	97,000			262,000
Inventory	193,000	115,000			308,000
Investment in Scissor Co.	515,000			515,000	0
Land	250,000	125,000			375,000
Buildings & Equipment	875,000	250,000		**24,000**	1,101,000
Less: Accumulated Depreciation	(630,000)	(48,000)	**24,000**		(654,000)
Total Assets	**1,600,000**	**655,000**	**24,000**	**539,000**	**1,740,000**
Accounts Payable	85,000	40,000			125,000
Bonds Payable	150,000	100,000			250,000
Common Stock	625,000	250,000	250,000		625,000
Retained Earnings	**740,000**	**265,000**	**295,000**	**30,000**	740,000
Total Liabilities & Equity	**1,600,000**	**655,000**	**545,000**	**30,000**	**1,740,000**

P2-25A Other Comprehensive Income Reported by Investee

a. Equity-method income reported by Dewey Corporation in 20X5:

Amounts reported by Jimm Co. for 20X5:	
Operating income	$70,000
Dividend income	7,000
Gain on investment in trading securities	18,000
Net income	$95,000
Ownership held by Dewey	x .30
Investment income reported by Dewey	$28,500

b. Computation of other comprehensive income reported by Jimm Co.:

Amount added to investment account in 20X5	$ 37,800
Investment income reported by Dewey in 20X5	(28,500)
Increase due to other comprehensive income reported by Jimm Co.	$ 9,300
Proportion of ownership held by Dewey	÷ 0.30
Other comprehensive income reported by Jimm Co.	$ 31,000

P2-26A Equity-Method Income Statement

a.

Diversified Products Corporation
Income Statement
Year Ended December 31, 20X8

Net Sales		$400,000
Cost of Goods Sold		(320,000)
Gross Profit		$ 80,000
Other Expenses	$(25,000)	
Gain on Sale of Truck	10,000	(15,000)
Income from Continuing Operations		$ 65,000
Discontinued Operations:		
Operating Loss from Discontinued Division	$(15,000)	
Gain on Sale of Division	44,000	29,000
Net Income		$ 94,000

P2-26A (continued)

Diversified Products Corporation
Retained Earnings Statement
Year Ended December 31, 20X8

Retained Earnings, January 1, 20X8	$260,000
20X8 Net Income	94,000
	$354,000
Dividends Declared, 20X8	(10,000)
Retained Earnings, December 31, 20X8	$344,000

b.

Wealthy Manufacturing Company
Income Statement
Year Ended December 31, 20X8

Net Sales		$850,000
Cost of Goods Sold		(670,000)
Gross Profit		$180,000
Other Expenses	$(90,000)	
Income from Continuing Operations of Diversified Products Corporation	26,000	(64,000)
Income from Continuing Operations		$116,000
Discontinued Operations:		
Share of Operating Loss Reported by Diversified Products on Discontinued Division	$ (6,000)	
Share of Gain on Sale of Division Reported by Diversified Products	17,600	11,600
Net Income		$127,600

Wealthy Manufacturing Company
Retained Earnings Statement
Year Ended December 31, 20X8

Retained Earnings, January 1, 20X8	$420,000
20X8 Net Income	127,600
	$547,600
Dividends Declared, 20X8	(30,000)
Retained Earnings, December 31, 20X8	$517,600

P2-27B Consolidated Worksheet at End of the First Year of Ownership (Investment Carried at Cost)

a.

Investment Carried at Cost Entries on Peanut Co.'s Books:

Investment in Snoopy Co.	300,000	
Cash		300,000

Record the initial investment in Snoopy Co.

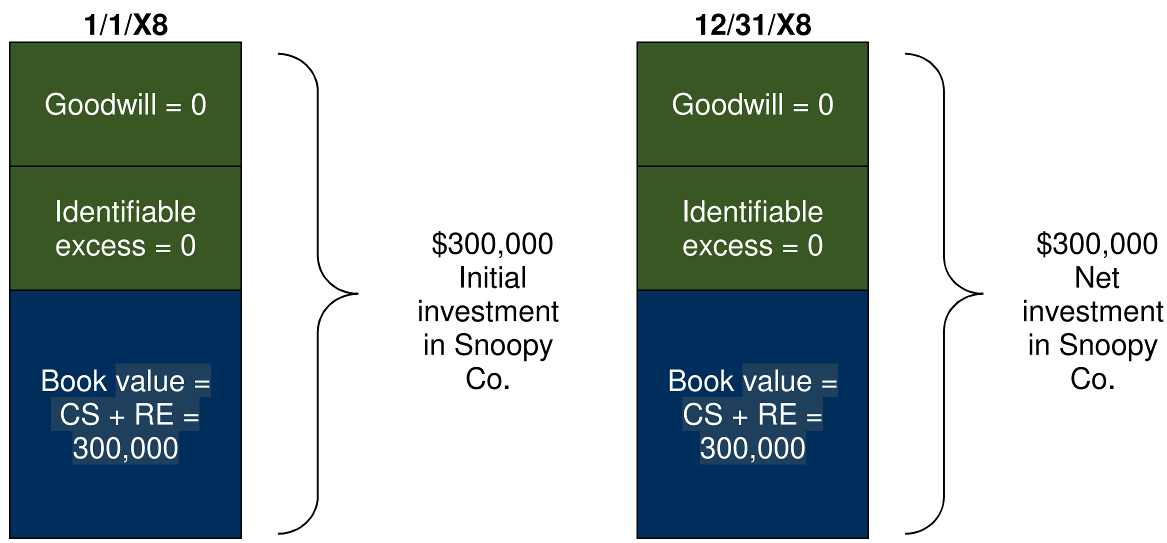
Cash	20,000	
Dividend Income		20,000

Record Peanut Co.'s 100% share of Snoopy Co.'s 20X8 dividend

b.

Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Original book value	300,000		200,000		100,000



P2-27B (continued)

Investment consolidation entry

Common stock	200,000	
Retained earnings	100,000	
Investment in Snoopy Co.		300,000

Dividend consolidation entry

Dividend income	20,000	
Dividends declared		20,000

Accumulated Depreciation Consolidation Entry

Accumulated depreciation	10,000	
Buildings & equipment		10,000

The amount of this entry is found by looking at the depreciation expense ($10,000) for the year and the accumulated depreciation at the end of the year ($20,000). The difference must be what was in accumulated depreciation at the date of the acquisition. Note that this assumes there were no sales or other disposals of Buildings and equipment during the year.

	Investment in Snoopy Co. (Dr.)	Investment in Snoopy Co. (Cr.)		Dividend Income (Dr.)	Dividend Income (Cr.)	
Acquisition Price	300,000					
					20,000	Dividends
Ending Balance	300,000				20,000	Ending Balance
		300,000	Basic	20,000		
	0				0	

P2-27B (continued)

	Peanut Co.	Snoopy Co.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	800,000	250,000			1,050,000
Less: COGS	(200,000)	(125,000)			(325,000)
Less: Depreciation Expense	(50,000)	(10,000)			(60,000)
Less: Other Expenses	(225,000)	(40,000)			(265,000)
Dividend Income	20,000		20,000		0
Net Income	**345,000**	**75,000**	**20,000**	**0**	**400,000**
Statement of Retained Earnings					
Beginning Balance	225,000	100,000	100,000		225,000
Net Income	**345,000**	**75,000**	**20,000**	**0**	400,000
Less: Dividends Declared	(100,000)	(20,000)		20,000	(100,000)
Ending Balance	**470,000**	**155,000**	**120,000**	**20,000**	**525,000**
Balance Sheet					
Cash	130,000	80,000			210,000
Accounts Receivable	165,000	65,000			230,000
Inventory	200,000	75,000			275,000
Investment in Snoopy Co.	300,000			300,000	0
Land	200,000	100,000			300,000
Buildings & Equipment	700,000	200,000		10,000	890,000
Less: Accumulated Depreciation	(450,000)	(20,000)	10,000		(460,000)
Total Assets	**1,245,000**	**500,000**	**10,000**	**310,000**	**1,445,000**
Accounts Payable	75,000	60,000			135,000
Bonds Payable	200,000	85,000			285,000
Common Stock	500,000	200,000	200,000		500,000
Retained Earnings	**470,000**	**155,000**	**120,000**	**20,000**	525,000
Total Liabilities & Equity	**1,245,000**	**500,000**	**320,000**	**20,000**	**1,445,000**

P2-28B Consolidated Worksheet at End of the Second Year of Ownership (Investment Carried at Cost)

a.

Investment Carried at Cost Entries on Peanut Co.'s Books:

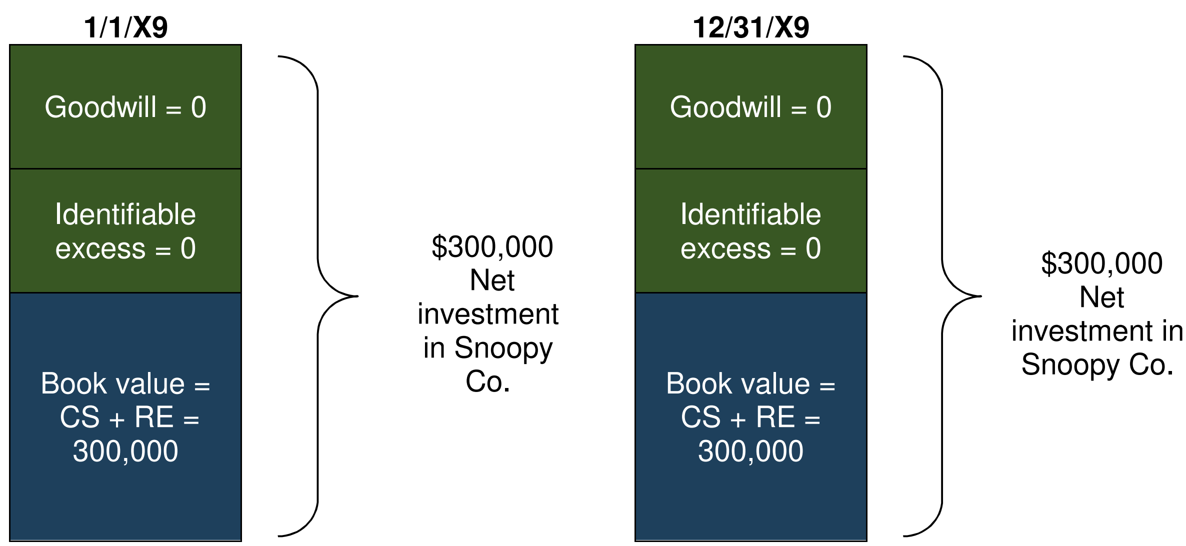
Cash	30,000	
Dividend Income		30,000

Record Peanut Co.'s 100% share of Snoopy Co.'s 20X9 dividend

b.

Book Value Calculations:

	Total Book Value	=	Common Stock	+	Retained Earnings
Original book value	300,000		200,000		100,000



P2-28 (continued)

Investment consolidation entry

Common stock	**200,000**	
Retained earnings	**100,000**	
Investment in Snoopy Co.		**300,000**

Dividend consolidation entry

Dividend income	**30,000**	
Dividends declared		**30,000**

Accumulated Depreciation Consolidation Entry

Accumulated depreciation	**10,000**	
Buildings & equipment		**10,000**

Note that this entry is carried forward from the previous year (see solution to P2-27B) again assuming that no sales or other disposals of Buildings and equipment took place during the year.

	Investment in Snoopy Co.			Dividend Income		
Acquisition Price	**300,000**					
					20,000	**Dividends**
Ending Balance	**300,000**				**20,000**	**Ending Balance**
		300,000	**Basic**	**20,000**		
	0				**0**	

P2-28 (continued)

	Peanut Co.	Snoopy Co.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	850,000	300,000			1,150,000
Less: COGS	(270,000)	(150,000)			(420,000)
Less: Depreciation Expense	(50,000)	(10,000)			(60,000)
Less: Other Expenses	(230,000)	(60,000)			(290,000)
Dividend Income	30,000		30,000		0
Net Income	**330,000**	**80,000**	**30,000**	**0**	**380,000**
Statement of Retained Earnings					
Beginning Balance	470,000	155,000	100,000		525,000
Net Income	**330,000**	**80,000**	**30,000**	**0**	380,000
Less: Dividends Declared	(225,000)	(30,000)		30,000	(225,000)
Ending Balance	**575,000**	**205,000**	**130,000**	**30,000**	**680,000**
Balance Sheet					
Cash	230,000	75,000			305,000
Accounts Receivable	190,000	80,000			270,000
Inventory	180,000	100,000			280,000
Investment in Snoopy Co.	300,000			300,000	0
Land	200,000	100,000			300,000
Buildings & Equipment	700,000	200,000		**10,000**	890,000
Less: Accumulated Depreciation	(500,000)	(30,000)	**10,000**		(520,000)
Total Assets	**1,300,000**	**525,000**	**10,000**	**310,000**	**1,525,000**
Accounts Payable	75,000	35,000			110,000
Bonds Payable	150,000	85,000			235,000
Common Stock	500,000	200,000	200,000		500,000
Retained Earnings	**575,000**	**205,000**	**130,000**	**30,000**	680,000
Total Liabilities & Equity	**1,300,000**	**525,000**	**330,000**	**30,000**	**1,525,000**

CHAPTER 2

REPORTING INTERCORPORATE INTERESTS AND CONSOLIDATION OF WHOLLY OWNED SUBSIDIARIES WITH NO DIFFERENTIAL

IMPORTANT NOTE TO INSTRUCTORS

The 12th edition uses a building block approach to our coverage of consolidation in chapters 2 through 5. Chapter 2 introduces our coverage of consolidation in the most basic setting when the subsidiary is either created or purchased at an amount equal to the book value of the subsidiary's underlying net assets.

	Wholly Owned Subsidiary	**Partially Owned Subsidiary**	
Investment = Book Value	**Chapter 2**	**Chapter 3**	**No Differential**
Investment > Book Value	**Chapter 4**	**Chapter 5**	**Differential**
	No NCI Shareholders	**NCI Shareholders**	

- ***Chapter 3*** explains how the basic consolidation process changes when the parent company owns less than 100 percent of the subsidiary.
- ***Chapter 4*** shows how the consolidation process differs when the parent company acquires the subsidiary for an amount greater (or less) than the book value of the subsidiary's net assets.
- Finally, ***Chapter 5*** presents the most complex consolidation scenario (where the parent owns less than 100 percent of the subsidiary's outstanding voting stock and the acquisition price is not equal to the book value of the subsidiary's net assets). In order to facilitate this new approach, we emphasize that this edition includes consolidation entries used in consolidation to facilitate the elimination of the investment in a subsidiary in two steps: (1) first the book value portion of the investment and income from the subsidiary are eliminated and (2) then the differential portion of the investment and income from the subsidiary are

eliminated with separate entries. We believe that this approach is more intuitive for students.

OVERVIEW OF CHAPTER 2

Chapter 2 provides detailed coverage of the accounting and reporting requirements for investments in the common stock of another company. It presents the criteria used in determining when equity method reporting must be applied, and it fully illustrates and compares both the equity method and fair value. While coverage of this topic may seem to replicate materials presented in the typical intermediate accounting sequence, many students do not have an adequate understanding of the entries recorded on the parent company's books and experience problems with the consolidation entries needed in the consolidation process as a result.

The discussion of securities carried at fair value includes purchases and sales of additional shares subsequent to the initial investment. The discussion of the equity method includes changes in the number of shares held and application of the equity method when sufficient additional shares of the investee are acquired to attain significant influence.

We introduce the most basic setting for learning consolidation—when the subsidiary is created or 100% is purchased at book value. In this most simple scenario, there is no differential and there is no need to account for a noncontrolling interest. It allows students to become familiar with the consolidation process in the easiest possible scenario.

Appendix 2A covers many topics that may be more tangential, including how to determine significant influence, unrealized intercompany profits, additional requirements under ASC 323-10, investors' share of other comprehensive income, and alternative versions of accounting for investments in consolidated subsidiaries.

Appendix 2B repeats the consolidation example from the chapter but illustrates a consolidation when the parent company uses the cost method instead of the equity method.

LEARNING OBJECTIVES

When students finish studying this chapter, they should be able to:

LO 2-1	Understand and explain how ownership and control can influence the accounting for investments in common stock.
LO 2-2	Prepare journal entries for investments carried at fair value.
LO 2-3	Prepare journal entries for investments using the equity method.
LO 2-4	Understand and explain differences in accounting for investments carried at fair value and investments accounted for using the equity method.
LO 2-5	Make calculations and prepare basic consolidation entries for a simple consolidation.
LO 2-6	Prepare a consolidation worksheet.

SYNOPSIS OF CHAPTER 2

Reporting Intercorporate Investments and
Consolidation of Wholly Owned Subsidiaries with No Differential

Berkshire Hathaway's Many Investments

LO 2-1 Understand and explain how ownership and control can influence the accounting for investments in common stock.

Accounting for Investments in Common Stock

LO 2-2 Prepare journal entries for investments carried at fair value.

Securities Carried at Fair Value
- Accounting Procedures for Securities Carried at Fair Value
- Changes in the Number of Shares Held

LO 2-3 Prepare journal entries for investments using the equity method.

The Equity Method
- Use of the Equity Method
- Investor's Equity in the Investee
- Recognition of Income
- Recognition of Dividends
- Carrying Amount of the Investment and Investment Income under the Equity Method
- Changing to the Equity Method at an Interim Date
- Acquisition at Interim Date
- Changes in the Number of Shares Held

LO 2-4 Understand and explain differences in accounting for investments carried at fair value and investments accounted for using the equity method.

Investments Carried at Fair Value and Investments Accounted for Using the Equity Method

LO 2-5 Make calculations and prepare basic consolidation entries for a simple consolidation.

Overview of the Consolidation Process
Consolidation Procedures for Wholly-Owned Subsidiaries that are Created or Purchased at Book Value

LO 2-6 Prepare a consolidation worksheet.

Consolidation Worksheets
- Worksheet Format
- Nature of Consolidation Entries

Consolidated Balance Sheet with Wholly-Owned Subsidiary
- 100 Percent Ownership Acquired at Book Value

Consolidation Subsequent to Acquisition
- Consolidated Net Income
- Consolidated Retained Earnings

Consolidated Financial Statements—100 Percent Ownership, Created or Acquired at Book Value
- Initial Year of Ownership
- Second and Subsequent Years of Ownership
- Consolidated Net Income and Retained Earnings

Appendix 2A: Additional Considerations Relating to the Equity Method
- Determination of Significant Influence
- Unrealized Intercompany Profits
- Adjusting for Unrealized Intercompany Profits
- Unrealized Profit Adjustments Illustrated
- Additional Requirements of ASC 323-10
- Investor's Share of Other Comprehensive Income
- Alternative Versions of the Equity Method of Accounting for Investments in Consolidated Subsidiaries

Appendix 2B: Consolidation when Parent Companies Choose to Carry at Cost Investments that are to Be Consolidated
- Consolidation—Year of Combination
- Consolidation—Second Year of Ownership

NOTES ON POWERPOINT SLIDES

We have attempted to provide PowerPoint slides that will be useful to a broad set of users. Since instructors often have different styles and preferences, we have attempted to include slides that will accommodate different approaches and that can be adapted to classes with different levels of preparation. For example, some instructors prefer to introduce the material before students have read the chapter. We have tried to facilitate these types of introductory discussions by including slides that replicate key points from the chapter. Other instructors expect students to have read the chapter and attempted homework problems before coming to class. As a result, they may not find it useful to review all of the topics in the chapter or to include slides that simply review many of the details they expect students to study before class. However, instructors following this approach often like to use sample exercises and problems built into the slides that allow them to have extended discussions or to facilitate group interaction in class.

If instructors elect to spend two class periods on the same subject, they might find a combination of both styles to be useful by first introducing foundational material before students have read the chapter and studied the topic, followed by an extended discussion the next class period after students have read the chapter and attempted homework problems.

We have tried to develop slides that can facilitate a flexible approach to allow instructors to select the slides that best match their objectives and style for class discussions. This is the reason we are including over 100 slides for some chapters in the text. We do not expect all instructors to use all slides, but the slide files should help support different teaching approaches and allow instructors to select the subset of slides that best matches their specific discussion objectives.

The slides are organized by learning objective. We have included a slide at the beginning of each learning objective to show where the new material begins. Instructors may or may not want to use these learning objective slides in class. We provide them primarily as a way of organizing the material. We also include short multiple choice questions at the end of most learning objectives. Some instructors find it useful to pause periodically during class to assess students' level of understanding. For this reason, we include several "practice quiz questions" that can be used throughout class discussions to engage students, help them focus on key points, or to facilitate group interaction. Finally, we provide longer exercises and problems that many instructors find useful in assessing understanding and encouraging group learning.

LO 2-1 Understand and explain how ownership and control can influence the accounting for investments in common stock.

- Slides 3-7 summarize basic concepts related to LO 2-1. While slide 4 repeats the diagram from the chapter, slide 5 provides a more interactive view of the same concept.
- Instructors should choose slides from this LO that they deem most important to emphasize to their students.

LO 2-2 Prepare journal entries for investments carried at fair value.

- Slides 11-14 summarize basic concepts related to LO 2-2 related to investments carried at fair value. The simple example in slide 13 allows students to practice fair value journal entries.
- Instructors should choose slides from this LO that they deem most important to emphasize to their students.

LO 2-3 Prepare journal entries for investments using the equity method.

- Slides 18-28 summarize basic concepts related to LO 2-3 related to the equity method. The simple example in slides 24-25 allows students to practice equity method journal entries.
- Instructors should choose slides from this LO that they deem most important to emphasize to their students.

LO 2-4 Understand and explain differences in accounting for investments carried at fair value and investments accounted for using the equity method.

- Slides 34-40 summarize basic concepts related to LO 2-4 comparing the fair value and equity methods. The example in slides 37-40 allows students to practice making journal entries under both methods and to easily compare them.
- Instructors should choose slides from this LO that they deem most important to emphasize to their students.

LO 2-5 Make calculations and prepare basic consolidation entries for a simple consolidation.

- Slides 44-45 provide a summary of the consolidation process.

LO 2-6 Prepare a consolidation worksheet.

- Slides 47-102 show students how to set up the worksheet.
- Slide 48 allows the instructor to explain how the worksheet is used to calculate the numbers used in consolidated financial statements.
- Slides 49-51 introduce the concept of consolidation entries.
- Slide 52 introduces a comprehensive example to be used to illustrate the consolidation process under the equity method.
- Slides 53-63 show how to make basic book value calculations used in the basic consolidation entry. This series of slides provides the foundation for helping students begin to learn how to prepare consolidated financial statements. Instructors should spend enough time here to ensure that students understand these basic concepts.
- Slides 64-66 show students how to set up the worksheet. In slide 64 instructors should explain that the first step in preparing a consolidation worksheet is to enter the numbers from trail balances of the parent and subsidiary into the first two columns of the worksheet. In slide 65, we emphasize that the same line items that are subtotaled in the actual financial statements of the companies need to subtotaled in the consolidation entry columns. This is a critical point. In slide 66 we ask students to introduce the numbers from the basic consolidation entry for the Pea Soup example from the previous section into the worksheet. We emphasize that debits and credits in each subsection need to be subtotaled. However, it is critical to help students understand that the articulation in the financial statements also applies to the

adjustment columns. Since net income carries down to the statement of retained earnings, the subtotals in the consolidation entry adjustment columns must be carried down with the net income number. Likewise, since the ending balance in retained earnings carries down from the statement of retained earnings to the balance sheet, the subtotals in the consolidation entry columns must be carried down with the retained earnings ending balances. We spend a few minutes emphasizing the "mechanics" of the worksheet because students who try to work too quickly and skip these important details will inevitably make mistakes in their consolidation column. Emphasize that taking time to pay attention to these details will save students a significant amount of time (and headaches) in the long run.

- Slides 67-72 walk students through the consolidation worksheet one line item at a time. We only do this once in chapter 2. Once students have practiced adding across each row, we assume they can do it on future worksheets. While this may seem like a tedious exercise (and even though this is an advanced financial accounting text), we have found from our experience that students often forget the normal balance in different types of accounts and have trouble remembering whether a debit or credit entry increases or decreases different types of accounts. We find that walking through this exercise one time helps students to remember these basic concepts.
- Slide 73 emphasizes that when the parent uses the fully adjusted equity method, the parent's net income and retained earnings ending balance will always be equal to the corresponding consolidated numbers.
- Slide 74 provides a detailed comprehensive consolidation example. We have students work this exercise in small groups in class. Advanced preparation includes either providing students a spreadsheet file or a hard copy similar to slide 65 so that they can work this exercise in class. In slide 75, we ask students to work together to perform the book value calculations. In slide 76, we review the book value calculations and explain which numbers are used in the basic consolidation entry. We then ask students to attempt the basic consolidation entry in their groups. In slide 77, we show them the answer.
- Slides 78-79 allow the instructor to explain the optional accumulated depreciation consolidation entry. The idea is that if the company had purchased property, plant, and equipment assets "used" from another company, the acquiring company would have recorded the assets at their purchase price with zero accumulated depreciation. The acquiring company would not have been concerned with the former owner's cost basis or accumulated depreciation. In purchasing another company, it is also useful to ensure that the fixed assets of the acquired company appear in the consolidated financial statements as if the acquiring company had acquired those assets on the date of acquisition. This consolidation entry nets the accumulated depreciation on the date of acquisition against the cost basis, so that they appear as if they were newly acquired (at their net book values) on the acquisition date. This entry essentially allows these assets to start with a "clean slate" on the date of acquisition with no accumulated depreciation.
- Slide 80 allows the instructor to ask students to enter the basic consolidation entry into the adjustment columns, calculate their subtotals, and carry down the net income and retained earnings ending balance adjustments to ensure proper "mechanics" for their consolidation. After having students go through this process with their groups,

we show them slide 80 BEFORE having them complete the worksheet. Slide 81 provides the solution.

- Slides 82-93 walk through the consolidation process in the first year of ownership.
- Slides 94-102 walk through the consolidation process in the second and following years of ownership.

Appendix 2B Consolidation and the Cost Method

- Slide 105 summarizes the difference between the cost and equity method.
- Slides 106-108 repeat the same consolidation example using the cost method. Some instructors like to show students how to perform a consolidation under the cost method.
- Slides 109-110 compare the equity method and cost method results of the example.
- Slides 112-113 can be used to give students practice with the cost method (solution is Slide 114).
- Slides 115-117 present some final thoughts on the equity method and cost method comparisons.

TEACHING IDEAS

1. Students could be asked to write a brief memo discussing why companies would be encouraged to invest in the stock of other companies. A question could be raised as to the trade-off of investing in stock of another company or increasing the capital expenditures of the company for additional fixed assets. What are the economic benefits of investing in another company?

2. Students could be assigned a recent article on investments on the Internet and asked to prepare an executive summary of the article, highlighting its major points for a business executive (e.g., a corporate controller or a partner in a CPA firm) who has not read the article.

3. Students could be asked to review the financial statements of a large public company and write a report on their investments. Students should list the different type of investments, percentage ownership, and method of accounting for the investments.

DESCRIPTIONS OF CASES, EXERCISES, AND PROBLEMS

C2-1 20 min. LO 2-2, LO 2-3 E	**Choice of Accounting Method** The criteria used in determining significant influence are reviewed. Students also must specify when investment income will be greater under the cost method and when it will be greater under the equity method. They should also explain why the use of the equity method becomes more appropriate as the percentage of ownership increases.
C2-2 30 min. LO 2-2, LO 2-3 M	**Intercorporate Ownership** Students are required to research current authoritative pronouncements and develop a memorandum to management supporting the use of either the cost or equity method in accounting for the company's investment. They should support their findings with citations and quotations from the appropriate literature.
C2-3 30 min. LO 2-2, LO 2-3 M	**Application of the Equity Method** Students must review authoritative pronouncements to determine whether the company should utilize the cost or equity method subsequent to the sale of part of its investment. Students must prepare a memorandum to the controller and outline and support their opinion.
C2-4 25 min. LO 2-5, LO 2-6 M	**Need for Consolidation Process** An effective answer to this case requires an understanding of which balances must be eliminated in order to avoid misstating the consolidated balance sheet totals.
C2-5 25 min. LO 2-1 M	**Account Presentation** Students must research authoritative literature to determine the proper way of combining account balances from different subsidiaries. A memorandum that reports findings and provides the necessary supporting references is required.
C2-6 25 min. LO 2-5, LO 2-6 M	**Consolidating an Unprofitable Subsidiary** An unprofitable venture is currently consolidated with a profitable entity without separately disclosing the loss. Students must research the issue to determine if disclosure is necessary, and describe what type of disclosures will be necessary in the financial statement notes or the management discussion. Reference to authoritative literature must be included in a memorandum to the treasurer.
E2-1 15 min. LO 2-2, LO 2-3 E	**Multiple-Choice Questions on Use of Cost and Equity Investments [AICPA Adapted]** Four multiple-choice questions deal with basic applications of the cost and equity methods and when each should be used.

E2-2 5 min. LO 2-4 M	**Multiple Choice Questions on Intercorporate Investments** Two multiple-choice questions deal with conceptual issues related to the cost and equity methods.
E2-3 15 min. LO 2-3 M	**Multiple-Choice Questions on Applying Equity Method [AICPA Adapted]** Three multiple-choice questions focus primarily on the computation of equity method income.
E2-4 20 min. LO 2-4 E	**Carrying an Investment at Fair Value versus Equity Method Reporting** Students must compute the income to be reported for three years under the (a) cost method and (b) the equity method. Liquidating dividends exist for the cost method.
E2-5 10 min. LO 2-2, LO 2-3 E	**Acquisition Price** Given the net income and dividend payments of an investee for a three-year period and the ending balance in the investment account on the investor's books, the acquisition price paid by the investor is computed under cost and equity method reporting.
E2-6 20 min. LO 2-2, LO 2-3 M	**Investment Income** The investor's income is computed for a four-year period using both the cost and equity methods. Journal entries for the final year are recorded under both methods. Dividends in excess of earnings are paid in the third year.
E2-7 15 min. LO 2-3 E	**Investment Value** Calculation of the investment account balance is required for three consecutive years.
E2-8 15 min. LO 2-2, LO 2-4 M	**Carrying an Investment at Fair Value versus Equity Method Reporting** Net income has to be calculated under three methods—cost, equity, and fair value methods.
E2-9 15 min. LO 2-2, LO 2-3 M	**Carrying an Investment at Fair Value versus Equity Method Reporting** Journal entries are required for all transactions occurring during the year of purchase assuming that the investor utilizes (1) the equity method and (2) the fair value method.

E2-10 20 min. LO 2-6 M	**Basic Consolidation Entry** Consolidation entry is required assuming acquisition of 100% of an investee's stock.
E2-11 25 min. LO 2-5, LO 2-6 E	**Balance Sheet Worksheet** A simple balance sheet worksheet following the business consolidation is required. An entry for elimination of the investment account and the stockholders' equity balances of the subsidiary is needed.
E2-12 40 min. LO 2-3, LO 2-6 M	**Consolidation Entries for Wholly Owned Subsidiary** Students must prepare journal entries for an acquisition using the equity method. Consolidation entries to prepare consolidated financial statements are required.
E2-13 15 min. LO 2-3, LO 2-6 E	**Basic Consolidation Entries for Fully Owned Subsidiary** Journal entries recorded by the parent company and the consolidation entries needed to prepare consolidated statements at the end of the first year of ownership are required for a fully-owned subsidiary.
E2-14A 5 min. LO 2-2, LO 2-3 E	**Income Reporting** Separate recognition of an extraordinary gain reported by the investee is required on an investor's books.
E2-15A 15 min. LO 2-2, LO 2-3 M	**Investee with Preferred Stock Outstanding** Journal entries must be given for the investor under the equity method. Preferred stock information is provided.
E2-16A 15 min. LO 2-2, LO 2-3 M	**Other Comprehensive Income Reported by Investee** Journal entries must be given for the investor. Operating income and other comprehensive income reported by the investee is provided.
E2-17A 10 min. LO 2-2, LO 2-3 E	**Other Comprehensive Income Reported by Investee** The investee records an operating loss in the first year and a gain in the second year. Dividends are paid in both years. It also reports other comprehensive income in the second year. The balance in the investor's equity-method investment account is given at the end of the second year. The purchase price must be calculated.
P2-18 20 min. LO 2-2, LO 2-3 H	**Changes in the Number of Shares Held** Students must show the journal entries to be recorded on an investor's books assuming that an increase in the percentage ownership over the past three years requires application of the equity method.

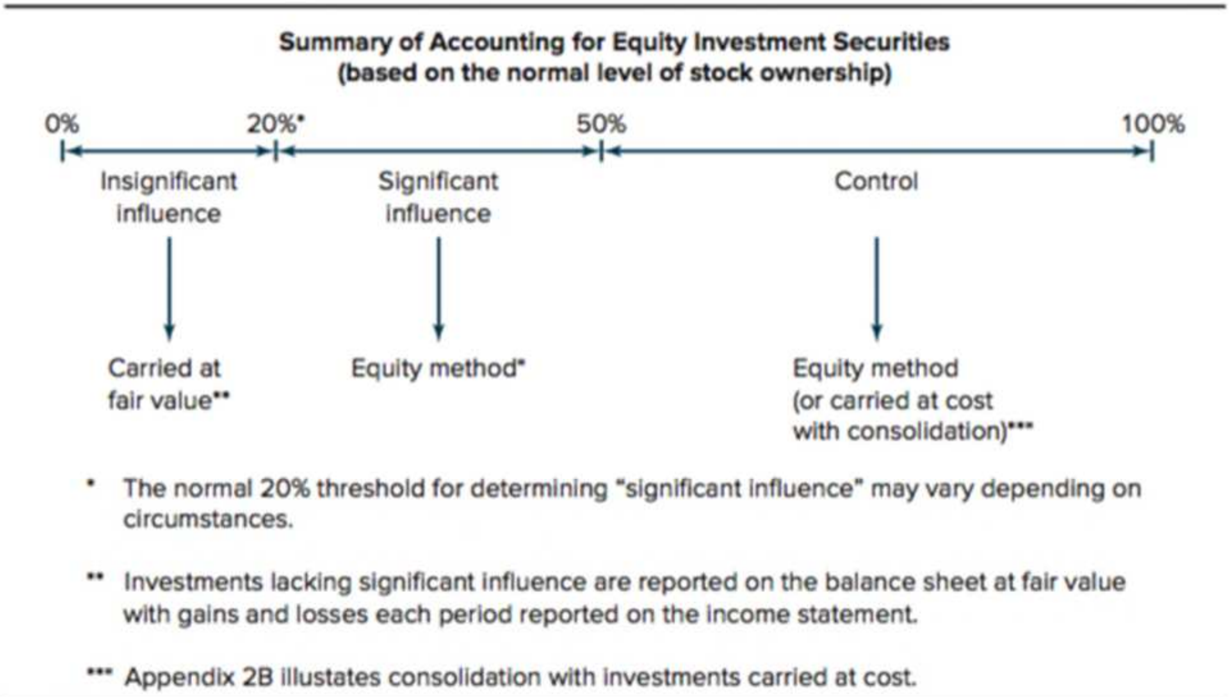
P2-19 20 min. LO 2-2, LO 2-4 M	**Investments Carried at Fair Value and Equity Method** Investment income and the balances in the investment account are to be calculated for three years, assuming the equity method, and the fair value method.

P2-20 15 min. LO 2-2 M	**Carried at Fair Value Journal Entries** All journal entries made by the investor are required for two years, assuming the usage of the fair value method.
P2-21 30 min. LO 2-3, LO 2-5, LO 2-6 M	**Consolidated Worksheet at End of the First Year of Ownership (Equity Method)** Students are asked to prepare journal entries on a parent company's books at the time of an acquisition and then to prepare a consolidation worksheet at the end of the first year.
P2-22 30 min. LO 2-3, LO 2-5, LO 2-6 M	**Consolidated Worksheet at End of the Second Year of Ownership (Equity Method)** As a continuation of P2-21, students are asked to prepare equity method journal entries on a parent company's books related to the subsidiary and then to prepare a consolidation worksheet at the end of the second year.
P2-23 35 min. LO 2-3, LO 2-5, LO 2-6 M	**Consolidated Worksheet at End of the First Year of Ownership (Equity Method)** Students are asked to prepare journal entries on a parent company's books at the time of an acquisition and then to prepare a consolidation worksheet at the end of the first year.
P2-24 35 min. LO 2-3, LO 2-5, LO 2-6 M	**Consolidated Worksheet at End of the Second Year of Ownership (Equity Method)** As a continuation of P2-23, students are asked to prepare equity method journal entries on a parent company's books related to the subsidiary and then to prepare a consolidation worksheet at the end of the second year.
P2-25A 25 min. LO 2-2 H	**Other Comprehensive Income Reported by Investee** An investee reports other comprehensive income during the period. Students must compute the equity-method income reported for the year, the increase in the balance in the investment account for the year, the amount of other comprehensive income reported by the investee, and the market value of the securities reported as available-for-sale by the investee at the end of the year.

P2-26A 45 min. LO 2-3, LO 2-6 H	**Equity-Method Income Statement** An income statement and a retained earnings statement for both the investee and investor must be prepared. The investee has discontinued operations, an extraordinary item, and a cumulative adjustment from a change of accounting principle. This problem presents a good review of income statement disclosures for the investee and the resulting disclosures needed in the financial statements of the investor.
P2-27B 30 min. LO 2-2, LO 2-5, LO 2-6 M	**Consolidated Worksheet at End of the First Year of Ownership (Investment Carried at Cost)** This problem uses the same data as provided in P2-23 except that it assumes the parent uses the cost method for subsidiary investments. Students are asked to prepare journal entries on a parent company's books at the time of an acquisition and then to prepare a consolidation worksheet at the end of the first year.
P2-28B 30 min. LO 2-2, LO 2-5, LO 2-6 M	**Consolidated Worksheet at End of the Second Year of Ownership (Investment Carried at Cost)** This problem uses the same data as provided in P2-24 except that it assumes the parent uses the cost method for subsidiary investments. As a continuation of P2-27, students are asked to prepare any cost method journal entries on a parent company's books related to the subsidiary and then to prepare a consolidation worksheet at the end of the second year.

OTHER RESOURCES

Chapter 2
Level of Ownership and Accounting and Reporting



Chapter 2
Investment Example

On July 1, 20X8, A Company purchases a 20 percent ownership interest in B Company for $500. At this date, the book value of B's assets is $2,000 and the fair value of B's depreciable assets is $300 greater than book value. Depreciable assets have a remaining economic life of 10 years. Goodwill is not amortized.
B Company reports net income of $400 for the year, earned evenly throughout the year. Dividends of $300 are declared and paid on December 31. The fair value of the investment in Company B at December 31, 20X8 is $480.

A. Assume that A Company is able to exert significant influence over B Company.
B. Assume that A Company is unable to exert significant influence over B Company.

7/1/X8	
B's BOOK VALUE ON 7/1/X8	$2,000
Investment cost	$500
Book value ($2,000 x .20)	(400)
Excess of Cost over B.V.	$100
Revalue asset (300 x 0.20)	60
(Depreciated over 10 years)	
Goodwill	$40

A. EQUITY METHOD

Changes in Investment Account and Calculation of End of Period Balance:

Original Cost	$500
Plus: Income from Investment	40
($400 x 0.20 x 0.5 years)	
Less: Amortization	(3)
[($60/10years) x 0.5 years]	
Less: Dividends	(60)
	$477

Income from Equity Investment:

Income from Investment		$40
Less:	Amortization	(3)
		$37

B. CARRIED AT FAIR VALUE

	Total	20%
Dividend on December 31	300	60

Changes in Investment Account and Calculation of End of Period Balance:

Original Cost:	$500
Less: Decrease in FV	(20)
Ending Balance	$480

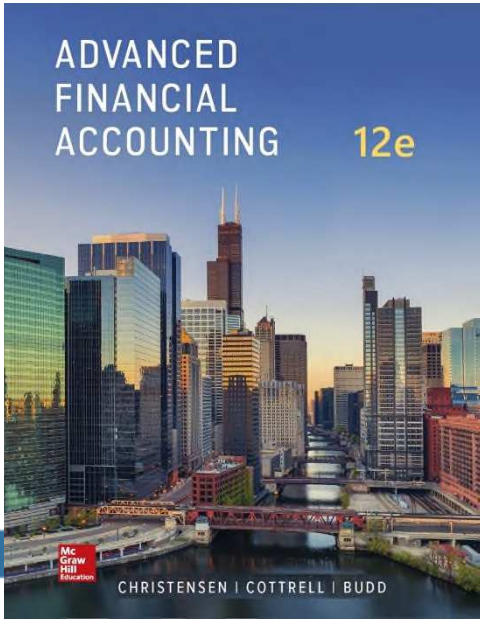
Income from Equity Investment:

Dividend Income	$60

COMPARISON OF FAIR VALUE AND EQUITY METHODS

Transaction	FAIR VALUE	EQUITY METHOD
1.) Acquired stock	Investment 500 Cash 500	Investment 500 Cash 500
2.) Investee reports income	--- no entry ---	Investment 40 Income-Invest. 40
3.) Investee declares cash dividends	Cash 60 Div. Income 60	Cash 60 Investment 60
4.) Amortization of differential	--- no entry ---	Income-Invest. 3 Investment 3
5.) Decline in FV	UnrealizedLoss 20 Investment 20	--- no entry -

Chapter 2



Reporting Intercorporate Investments and Consolidation of Wholly Owned Subsidiaries with No Differential

Learning Objective 2-1

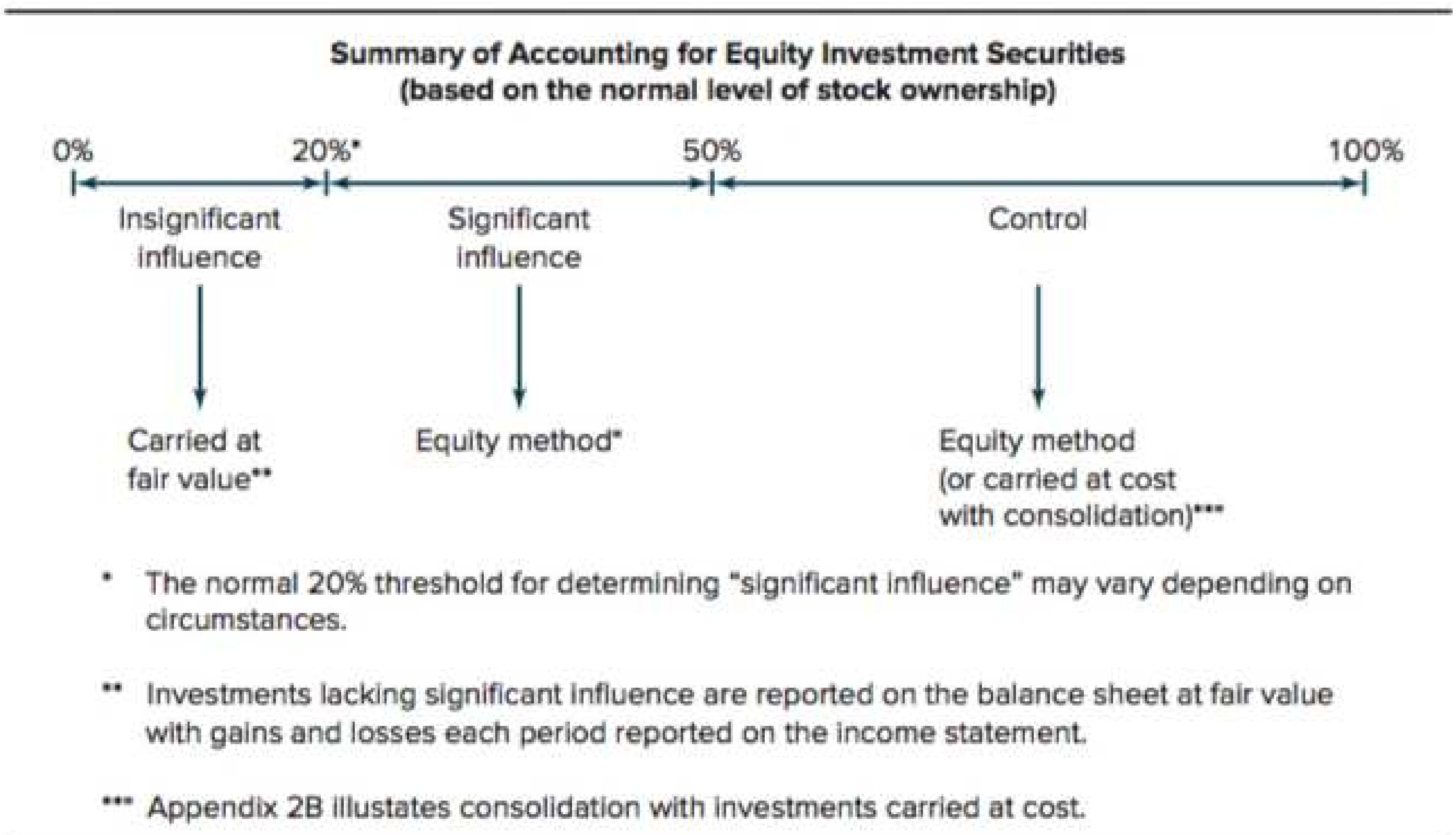
Understand and explain how ownership and control can influence the accounting for investments in common stock.

Accounting for Investments in Common Stock

- The method used to account for investments in common stock depends on the level of influence or control that the investor is able to exercise over the investee.

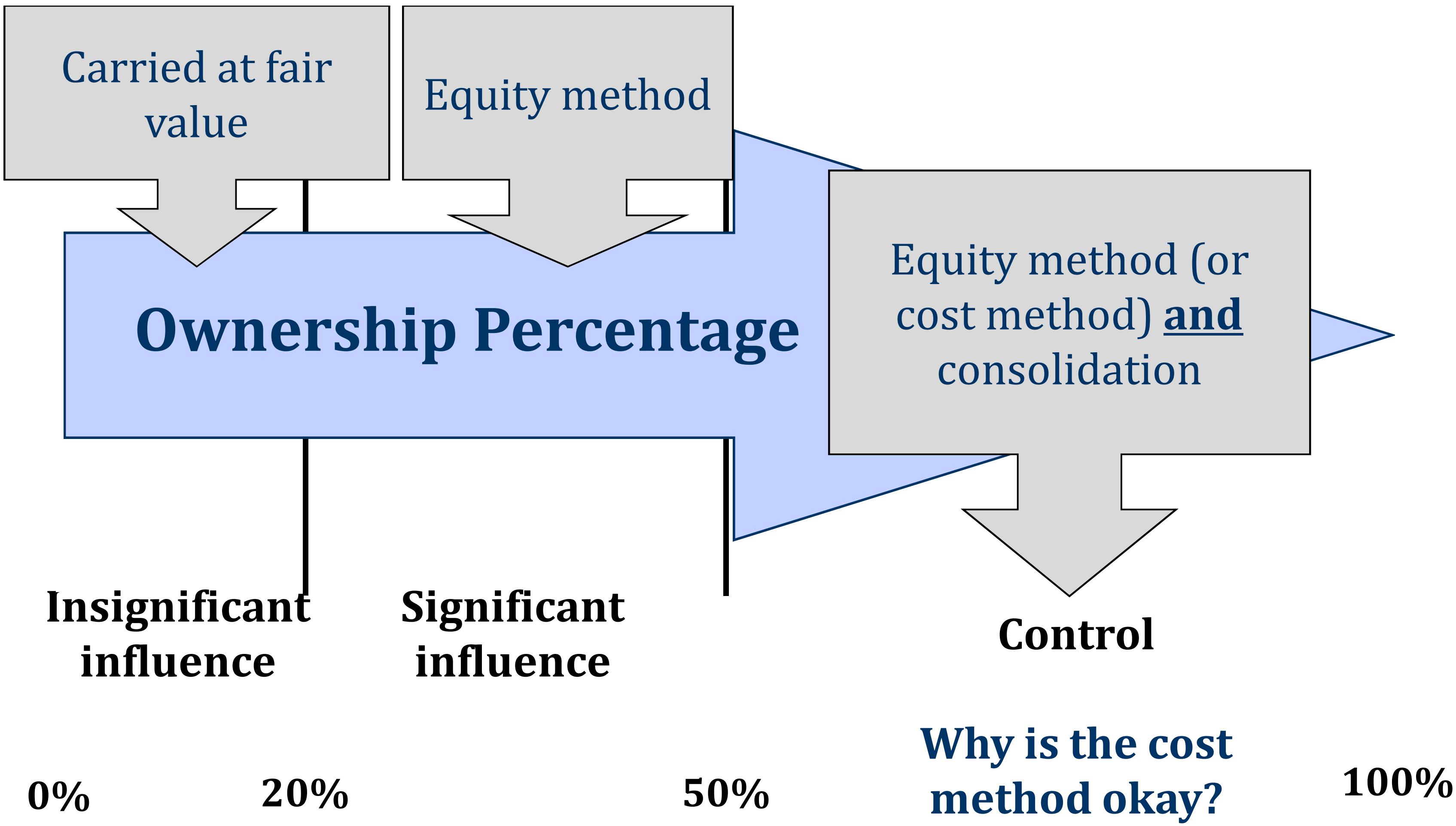
Financial Reporting Basis by Level of Common Stock Ownership

Figure 2-1



Investment versus Ownership

- Consolidation eliminates the investment account and replaces it with "the detail" on the subsidiary's balance sheet



Accounting for Investments in Common Stock: The Equity Method

- **Securities Carried at Fair Value**
  - Used for reporting investments in equity securities when both consolidation and equity-method reporting are inappropriate.
- **The Equity Method**
  - Used when the investor exercises ***significant influence*** over the operating and financial policies of the investee and consolidation is not appropriate.
  - Used most often when one company holds 20 percent or more of another company’s common stock.
  - The investment is reported as one line in the investor’s balance sheet, and the income recognized from the investee is reported as one line in the investor’s income statement.

Accounting for Investments in Common Stock: Consolidation

- **Consolidation**
  - Involves 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.
  - Normally is appropriate when one company, referred to as the ***parent***, controls another company, referred to as a ***subsidiary***.
  - A subsidiary that is not consolidated with the parent is referred to as an ***unconsolidated subsidiary*** and is shown as an investment on the parent's balance sheet.

Practice Quiz Question #1

If Company A purchases 45% of the outstanding common stock of Company B, the investment in Company B should be accounted for

a. at fair value.

b. at cost.

c. as a consolidated subsidiary.

d. as an equity method investment.

e. None of the above.

Practice Quiz Question #1 *Solution*

If Company A purchases 45% of the outstanding common stock of Company B, the investment in Company B should be accounted for

a. at fair value.

b. at cost.

c. as a consolidated subsidiary.

d. as an equity method investment.

e. None of the above.

Learning Objective 2-2

Prepare journal entries for investments carried at fair value.

Securities Carried at Fair Value

- Appropriate when the investor lacks the ability either to control or to exercise significant influence over the investee.
- May result from the size of the investment, usually at common stock ownership levels of less than 20 percent.
- Other factors, such as the existence of a majority shareholder, prevent the investor from exercising control or significant influence regardless of size of the investment.

Accounting Procedures for Securities Carried at Fair Value (1 of 3)

- The investor records its investment in common stock at the total cost incurred in making the purchase.
- The investment is adjusted to fair value at each balance sheet date until it is sold.
- Changes in fair value are recorded in income.
- Income from the investment is recognized by the investor as dividends are declared by the investee

Accounting Procedures for Securities Carried at Fair Value (2 of 3)

ABC Company acquires 20 percent of XYZ Company's common stock for $100,000 at the beginning of the year but does not gain significant influence over XYZ. During the year, XYZ has net income of $60,000 and declares dividends of $20,000. The fair value of ABC's investment in XYZ stock is $98,000 at the end of the year. ABC Company records the following entries:

Investment in XYZ Company Stock	100,000	
Cash		100,000

Record purchase of XYZ Company stock.

Dividends Receivable	4,000	
Dividend Income		4,000

Record dividend declared by XYZ Company ($20,000 x 0.20).

Unrealized Loss on XYZ Co. Stock (Income Statement)	2,000	
Investment in XYZ Company Stock		2,000

Record decline in value of XYZ Company stock ($100,000 - $98,000).

Accounting Procedures for Securities Carried at Fair Value (3 of 3)

- **Changes in the number of shares held**
  - Changes resulting from stock dividends, stock splits, or reverse splits receive no formal recognition in the accounts of the investor.
- **Purchases of additional shares**
  - Recorded at cost similar to initial purchase.
  - New percentage ownership of investee is calculated to determine whether switch to the equity method is required.
- **Sales of shares**
  - Accounted for in the same manner as the sale of any other asset.

Practice Quiz Question #2

For securities carried at fair value, an investee's dividends declared would

a. be eliminated in consolidation.

b. be the investor's income from investment.

c. decrease the investor's investment account.

d. increase the investor's investment account.

e. None of the above.

Practice Quiz Question #2 *Solution*

For securities carried at fair value, an investee's dividends declared would

a. be eliminated in consolidation.

b. be the investor's income from investment.

c. decrease the investor's investment account.

d. increase the investor's investment account.

e. None of the above.

Learning Objective 2-3

Prepare journal entries for investments using the equity method.

The Equity Method (1 of 6)

- The equity method is intended to reflect the investor's changing equity or interest in the investee.
- The investment is recorded at the initial purchase price and adjusted each period for the investor's share of the investee's profits or losses and the dividends declared by the investee.

The Equity Method (2 of 6)

- ASC 323-10-30 requires that the equity method be used for
  1. Corporate joint ventures
  2. Companies in which the investor's voting stock interest gives the investor the "ability to exercise significant influence over operating and financial policies" of that company
- ASC 323-10-15 establishes a "significant influence" criterion: 20 percent rule
  - In the absence of evidence to the contrary, an investor holding 20 percent or more of an investee's voting stock is presumed to have the ability to exercise significant influence over the investee.

The Equity Method (3 of 6)

- **Investor’s equity in the investee**
  - The investor records its investment at the original cost.
  - This amount is adjusted periodically for changes in the investee’s stockholders’ equity occasioned by the investee’s profits, losses, and dividend declarations.

Reported by Investee	Effect on Investor's Accounts
Net income	Record income from investment
	Increase investment account
Net loss	Record loss from investment
	Decrease investment account
Dividend declaration	Record asset (cash or receivable)
	Decrease investment account

The Equity Method (4 of 6)

- **The equity method reflects underlying economics**
  - Record income at the parent level based on investee's earnings and losses—a built-in valuation technique.
    - It isn't the same as fair value accounting.
    - Nevertheless, the investment generally goes up and down based on the operations of the investee company.
  - Investee's dividends reduce the investor's investment (the investor has less invested).

Investment in Investee

Cost	
Income	Losses
	Dividends
Adj. Bal.	

Income from Investee

Losses	Income

The Equity Method (5 of 6)

- **Pros**
  - Based on economic activity—not an investor-controlled dividend policy.
  - Simple "one-line" consolidation
- **Cons**
  - Requires continual bookkeeping.
  - Unnecessary work if statements are not used internally or issued to outsiders.

The Equity Method (6 of 6)

- **The equity method is a two-way street!**
- The investment can be
    1. Written up based on the investee's income, AND
    2. Written down based on investee's losses and dividends.

Recognition of Income

ABC Company acquires significant influence over XYZ Company by purchasing 20 percent of the common stock of the XYZ Company for $100,000. XYZ earns income of $60,000.

Investment in XYZ Company Stock	100,000	
Cash		100,000

Record purchase of XYZ Company stock.

- **Recognition of income**

Investment in XYZ Company Stock	12,000	
Income from XYZ Company		12,000

Record income from XYZ Company ($60,000 × 0.20).

  - This entry (***equity accrual***) is normally made as an adjusting entry at the end of the period.
  - If the investee reports a loss, the investor recognizes its share of the loss and reduces the carrying amount of the investment by that amount.

Recognition of Dividends

- **Recognition of dividends**

Dividends Receivable	4,000	
Investment in XYZ Company Stock		4,000

Record dividend from XYZ Company ($20,000 × 0.20).

- **Carrying amount of the investment**

	Investment in XYZ Company (Debit)	Investment in XYZ Company (Credit)	
Purchase	100,000		
20% of NI	12,000		
		4,000	20% of Dividend
Ending Balance	108,000		

Income from XYZ Company (Debit)	Income from XYZ Company (Credit)	
	12,000	20% of NI
	12,000	Ending Balance

Acquisition at Interim Date

- The investor begins accruing income from the investee under the equity method at the date of acquisition.
- The investor may not accrue income earned by the investee before the date of acquisition of the investment.
- When the purchase occurs between balance sheet dates:
  - The amount of income earned by the investee from the date of acquisition to the end of the fiscal period may need to be estimated by the investor in recording the equity accrual.

Changes in the Number of Shares Held (1 of 2)

- **Purchases of additional shares**
  - If the equity method is appropriate after the additional shares are purchased, the investor simply adds the cost of the new shares to the investment account and applies the equity method from the date of acquisition forward.
  - New and old investments in the same stock are combined for financial reporting purposes.

Changes in the Number of Shares Held (2 of 2)

- **Sale of shares**
  - Treated the same as the sale of any noncurrent asset.
  - First, the investment account is adjusted to the date of sale for the investor's share of the investee's current earnings.
  - Then, a gain or loss is recognized for the difference between the proceeds received and the carrying amount of the shares sold.
  - If only part of the investment is sold, the investor must decide whether to continue using the equity method or to change to fair value.

Practice Quiz Question #3

Under the equity method, an investee's dividends declared would

a. be eliminated in consolidation.

b. be the investor's income from investment.

c. decrease the investor's investment account.

d. increase the investor's investment account.

e. None of the above.

Practice Quiz Question #3 *Solution*

Under the equity method, an investee's dividends declared would

a. be eliminated in consolidation.

b. be the investor's income from investment.

c. decrease the investor's investment account.

d. increase the investor's investment account.

e. None of the above.

Practice Quiz Question #4

Under the equity method, an investee's losses would

a. never reduce the investor's income.

b. normally reduce the investor's income.

c. always reduce the investor's income.

d. always be eliminated in consolidation.

e. None of the above.

Practice Quiz Question #4 *Solution*

Under the equity method, an investee's losses would

a. never reduce the investor's income.
b. normally reduce the investor's income.
c. always reduce the investor's income.
d. always be eliminated in consolidation.
e. None of the above.

Learning Objective 2-4

Understand and explain differences in accounting for investments carried at fair value and investments accounted for using the equity method.

Accounting for Investments in Common Stock (1 of 2)

- **Investments Carried at Fair Value**
  - Used for reporting investments in equity securities when both consolidation and equity-method reporting are inappropriate.
  - Investor does not have control of investee.
  - Conforms more closely to the traditional accounting and legal views of the realization of income in that the investee's earnings are not available to the investor until transferred as dividends.

Accounting for Investments in Common Stock (2 of 2)

- **The Equity Method**
  - Used when the investor exercises significant influence over the operating and financial policies of the investee.
  - May not be used in place of consolidation if consolidation is appropriate.
  - Its primary use is in reporting nonsubsidiary investments.
  - Investment in stock of another company is reported under the equity method as a single amount in the investor’s balance sheet regardless of the investee’s asset and capital structure.

The Fair Value and Equity Methods Compared

Figure 2-3

Item	Carried at Fair Value	Equity Method
Recorded amount of investment at date of acquisition	Original cost	Original cost
Usual carrying amount of investment subsequent to acquisition	Fair value at balance sheet date	Original cost increased (decreased) by investor's share of investee's income (loss) and decreased by investor's share of investee's dividends
Income recognition by investor	Investor's share of investee's dividends plus unrealized holding gains or losses during the period	Investor's share of investee's earnings since acquisition, whether distributed or not
Investee dividends	Recognized as income	Reduction of investment

Example: Equity Method versus Fair Value

Pie Corporation purchased a 20 percent ownership in Slice Corporation with a transfer of $500 cash on 1/1/Year 1. During Year 1, Slice generated a net loss of $500, paid no dividends and the fair value of Pie's investment was $475 at the end of Year 1. During Year 2, Slice generated net income of $1,000, paid dividends of $250 and the fair value of Pie's investment was $525 at the end of year 2. What is the balance in the Investment in Slice account on Pie's books at the end of year 2 using the **equity method**?

Investment in Slice

Beginning balance	500		
		100	Net Loss
Ending Balance	400		
Net Income	200		
		50	Dividends
Ending Balance	550		

$525 Fair Value!

- What if Pie records the investment at FV?
- What journal entries would Pie make under each method?

Summary of Year 1 Equity Method Entries

Investment in Slice Corp.	500	
Cash		500
Record the initial investment in Slice Corp.		

Income from Slice Corp.	100	
Investment in Slice Corp.		100
Record Pie Corp.'s 20% share of Slice Corp.'s Year 1 net loss.		

Investment in Slice Corp.

Acquisition Price	500	100	Net Loss
		0	Dividends
Ending Balance	400		

Income from Slice Corp.

Net Loss	100		
Ending Balance	100		

Summary of Year 2 Equity Method Entries

Investment in Slice Corp.	200	
Income from Slice Corp.		200
Record Pie Corp.'s 20% share of Slice Corp.'s Year 2 income.		

Cash	50	
Investment in Slice Corp.		50
Record Pie Corp.'s 20% share of Slice Corp.'s Year 2 dividends		

Investment in Slice Corp.

Beginning Balance	400		
Net Income	200		
		50	Dividends
Ending Balance	550		

Income from Slice Corp.

		Net Income	200
		Ending Balance	200

Example: Equity versus Fair Value

Equity Method

Investment in Slice Corp.	500	
Cash		500
Income from Slice Corp.	100	
Investment in Slice Corp.		100
Investment in Slice Corp.	200	
Income from Slice Corp.		200
Cash	50	
Investment in Slice Corp.		50

Fair Value Method

Investment in Slice Corp.	500	
Cash		500
Unrealized Loss – Slice Corp.	25	
Investment in Slice Corp.		25
Investment in Slice Corp.	50	
Unrealized Gain – Slice Corp.		50
Cash	50	
Dividend Income		50

Practice Quiz Question #5

On 1/1/X4, Phillip invested $650,000 in Sleeper (25% owned). For 20X4, Sleeper:

(1) *earned* $360,000,

(2) *declared* dividends of $240,000, and

(3) *paid* dividends of $160,000.

(4) *fair value* of investment at year end is $655,000.

What amounts does Phillip report?

	Fair Value	Equity
Investment income for 20X4	________	________
Investment in Sleeper at year-end	________	________
Retained earnings increase	________	________

Practice Quiz Question #5 *Solution*

On 1/1/X4, Phillip invested $650,000 in Sleeper (25% owned). For 20X4, Sleeper:

(1) *earned* $360,000,

(2) *declared* dividends of $240,000, and

(3) *paid* dividends of $160,000.

(4) *fair value* of investment at year end is $655,000.

What amounts does Phillip report?

	Fair Value	Equity
Investment income for 20X4	$65,000	$90,000
Investment in Sleeper at year-end	$655,000	$680,000
Retained earnings increase	$65,000	$90,000

Learning Objective 2-5

Make calculations and prepare basic consolidation entries for a simple consolidation.

Overview of the Consolidation Process (1 of 2)

- Chapter 2 introduces the most simple setting for a consolidation.
  - The subsidiary is wholly owned.
  - It is either a created subsidiary or we assume it is purchased for an amount equal to the book value of net assets.

	Wholly Owned Subsidiary	Partially Owned Subsidiary
Investment = Book Value	Chapter 2	Chapter 3
Investment > Book Value	Chapter 4	Chapter 5

Overview of the Consolidation Process (2 of 2)

- The objective is to combine the financial statements of two or more entities as if they are a single company.
- The consolidation worksheet facilitates the combining of the two companies.
- Certain accounts need to be eliminated in the consolidation process to avoid "double-counting."
  - Replaces "one-line" consolidation with the "detail."

Learning Objective 2-6

Prepare a consolidation worksheet.

Consolidation Worksheets

- Provides a mechanism for efficiently combining the amounts of the separate companies involved in the consolidation and for adjusting the combined balances to the amounts that would be reported if all consolidating companies were actually a single company.
- To prepare consolidated financial statements, the account balances are taken from the separate books of the parent and each subsidiary and placed in the consolidation worksheet.
- Consolidation statements are prepared, after adjustments, from the amounts in the consolidation worksheet.

The Consolidation Worksheet

Figure 2-4

	Parent	Subsidiary	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Revenues					
Expenses					
Net Income					
Statement of Retained Earnings					
Retained Earnings (1/1)					
Add: Net Income					
Less: Dividends					
Retained Earnings (12/31)					
Balance Sheet					
Assets					
Total Assets					
Liabilities					
Equity					
Common Stock					
Retained Earnings					
Total Liabilities & Equity					

Overview of the Consolidation Process

- In the consolidation worksheet, the three financial statements need to articulate
  - Net income from the income statement carries down to the statement of retained earnings.
  - The ending balance in retained earnings carries down to the balance sheet.
- Consolidation entries are entered into the "Consolidation Entries" column (debit or credit) to eliminate any amounts that would result in "double-counting."

Nature of Consolidation Entries

- Used in the consolidation worksheet to adjust the totals of the individual account balances of the separate consolidating companies to reflect the amounts that would appear if the legally separate companies were actually a single company.
- Appear only in the consolidation worksheet and do not affect the books of the separate companies.
- These worksheet entries are sometimes called "elimination" entries.

Basic Consolidation Entry

- ***What needs to be eliminated?***
  - The parent's investment account.
    - It represents the initial investment adjusted for the parent's cumulative share of the subsidiary's income and dividends.
  - The parent's income from sub account.
  - The subsidiary's equity accounts.

100 Percent Ownership Acquired at Book Value (1 of 4)

Balance sheets of Peerless Products and Special Foods immediately before combination:

Figure 2-5

	Peerless Products	Special Foods
Assets		
Cash	$ 350,000	$ 50,000
Accounts Receivable	75,000	50,000
Inventory	100,000	60,000
Land	175,000	40,000
Buildings & Equipment	800,000	600,000
Accumulated Depreciation	(400,000)	(300,000)
Total Assets	$1,100,000	$500,000
Liabilities & Stockholders' Equity		
Accounts Payable	$ 100,000	$100,000
Bonds Payable	200,000	100,000
Common Stock	500,000	200,000
Retained Earnings	300,000	100,000
Total Liabilities & Equity	$1,100,000	$500,000

- Peerless acquires all of Special Foods' outstanding common stock for $300,000, an amount equal to the fair value of Special Foods Company as a whole.
- On the date of combination, the fair values of Special Foods' individual assets and liabilities are equal to their book values as shown.

100 Percent Ownership Acquired at Book Value (2 of 4)

As of 01/01/20X1

Before Acquisition

	Parent Company	Sub Company
Balance Sheet		
Cash	350,000	50,000
Other Assets	750,000	450,000
Total Assets	**1,100,000**	**500,000**
Total Liabilities	300,000	200,000
Common Stock	500,000	200,000
Retained Earnings	300,000	100,000
Total Liabilities & Equity	**1,100,000**	**500,000**

After Acquisition

	Parent Company	Sub Company
Balance Sheet		
Cash	50,000	50,000
Other Assets	750,000	450,000
Investment in Sub	300,000	
Total Assets	**1,100,000**	**500,000**
Total Liabilities	300,000	200,000
Common Stock	500,000	200,000
Retained Earnings	300,000	100,000
Total Liabilities & Equity	**1,100,000**	**500,000**

- Total assets and equity of Special Foods do ***not*** change with acquisition of Sub.
- Peerless exchanges one asset (cash) for another asset (investment in Sub).

Investment in Special Foods

Acq. Price	300,000	
	300,000	

Investment in Special Foods	300,000	
Cash		300,000

Record the purchase of Special Foods' stock.

100 Percent Ownership Acquired at Book Value (3 of 4)

As of 01/01/20X1

	Parent Company	Sub Company
Balance Sheet		
Cash	50,000	50,000
Other Assets	750,000	450,000
Investment in Sub	300,000	
Total Assets	**1,100,000**	**500,000**
Total Liabilities	300,000	200,000
Common Stock	500,000	200,000
Retained Earnings	300,000	100,000
Total Liabilities & Equity	**1,100,000**	**500,000**

Investment in Special Foods of 300,000

Net Assets = 300,000 = (50,000+ 450,000) – 200,000

Stockholder's Equity = 300,000

Net Assets = Owners Equity = Investment in Sub

Assets = Liabilities + Owners Equity

Owners Equity = Assets – Liabilities

Net Assets = Assets – Liabilities

Net Assets = Owners Equity

Peerless's investment in Special Foods, Special Foods' net assets, and Special Foods' owner's equity all represent the same amount.

100 Percent Ownership Acquired at Book Value (4 of 4)

What if we just add the two balance sheets together?

	Parent Company	Sub Company	Consolidated
Balance Sheet			
Cash	50,000	50,000	100,000
Other Assets	750,000	450,000	1,200,000
Investment in Sub	300,000		300,000
Total Assets	**1,100,000**	**500,000**	**1,600,000**
Total Liabilities	300,000	200,000	500,000
Common Stock	500,000	200,000	700,000
Retained Earnings	300,000	100,000	400,000
Total Liabilities & Equity	**1,100,000**	**500,000**	**1,600,000**

All Things Equal

1. Cash paid by Peerless — Count
2. Investment in Special Foods recorded by Peerless — Eliminate
3. Special Foods' net assets — Count
4. Special Foods' equity — Eliminate

Investment in Special Foods	300,000	
Cash		300,000

Record the purchase of Special Foods' stock.

- If we simply add the two balance sheets together, these items will be double-counted.
- We will need a "***consolidation entry***" to correct this problem.

Basic Consolidation Entry (1 of 2)

- In Chapters 2 and 3, the excess value of identifiable net assets and goodwill will always be equal to zero.
- The book value of Special Foods' equity as of the acquisition date is equal to the sum of common stock and retained earnings.

Book Value Calculations:

	Total investment	=	Common Stock	+	Retained Earnings
Original book value	300,000		200,000		100,000

Basic Consolidation Entry (2 of 2)

- Therefore, the consolidation entry simply credits the Investment in Special Foods Stock account from Peerless's balance sheet and the corresponding debits eliminate the beginning balances in the equity accounts of Special Foods.

Basic Consolidation Entry:

Common Stock	200,000		← Common stock balance
Retained Earnings	100,000		← Beginning balance in ret. earnings
Investment in Special Foods		300,000	← Book value in investment account

Worksheet for Consolidated Balance Sheet, January 1, 20X1, Date of Combination; 100 Percent Acquisition at Book Value

Figure 2-7

	Peerless Products	Special Foods	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Balance Sheet					
Cash	50,000	50,000			100,000
Accounts Receivable	75,000	50,000			125,000
Inventory	100,000	60,000			160,000
Investment in Special Foods	300,000			300,000	0
Land	175,000	40,000			215,000
Buildings & Equipment	800,000	600,000		300,000	1,100,000
Less: Accumulated Depreciation	(400,000)	(300,000)	300,000		(400,000)
Total Assets	**1,100,000**	**500,000**	**300,000**	**600,000**	**1,300,000**
Accounts Payable	100,000	100,000			200,000
Bonds Payable	200,000	100,000			300,000
Common Stock	500,000	200,000	200,000		500,000
Retained Earnings	300,000	100,000	100,000		300,000
Total Liabilities & Equity	**1,100,000**	**500,000**	**300,000**	**0**	**1,300,000**

Example: 100 Percent Ownership Acquired at Book Value (1 of 14)

Pea Corporation created Soup Corporation with a transfer of $500 cash. During Soup Corp.'s first year of operations, it generated a net loss of $100 and paid no dividends. During Soup Corp.'s second year of operations, it generated net income of $200 and paid dividends of $50. What is the balance in the Investment in Soup account on Pea's books at the end of year 2 using the **equity method**?

Investment in Soup

Beginning balance	500		
		100	Net Loss
Ending balance	400		
Net Income	200		
		50	Dividends
Ending Balance	550		

- What accounts need to be eliminated?
- How are they eliminated?

Example: 100 Percent Ownership Acquired at Book Value (2 of 14)

- The investment account represents the initial investment adjusted for the parent's cumulative share of the subsidiary's income and dividends.
- Therefore, the consolidation entry eliminates:
  - The subsidiary's paid-in capital accounts (original investment)
  - Beginning retained earnings (past earnings/dividends)
  - The subsidiary's current year earnings and dividends
- Generically, the basic consolidation entry looks like this:

Common Stock	XXX	
Additional Paid-in Capital	XXX	
Retained Earnings (Beginning Balance)	XXX	
Income from Sub	XXX	
Dividends Declared		XXX
Investment in Sub		XXX

Example: 100 Percent Ownership Acquired at Book Value (3 of 14)

	Parent's Investment	=	Common Stock	+	Additional Paid-In Capital	+	Retained Earnings
Beginning Book Value	400		50		450		**(100)**
+ Net Income	**200**						200
– Dividends	(50)						**(50)**
Ending Book Value	**550**		**50**		**450**		50

Note that the **"blue"** numbers appear in the basic consolidation entry.

Note that this is a deficit balance!

Basic Consolidation Entry

Common Stock	← Original amount invested (100%)
Additional Paid-in Capital	← Original amount invested (100%)
Income from Soup Corp.	← Soup Corp.'s reported income
Retained Earnings (BB)	← Beginning balance in retained earnings
Dividends Declared	← 100% of Soup Corp.'s dividends
Investment in Soup Corp.	← Net book value in investment account

Example: 100 Percent Ownership Acquired at Book Value (4 of 14)

	Parent's Investment	=	Common Stock	+	Additional Paid-In Capital	+	Retained Earnings
Beginning Book Value	400		50		450		(100)
+ Net Income	200						200
– Dividends	(50)						(50)
Ending Book Value	550		50		450		50

Note that the "blue" numbers appear in the basic consolidation entry.

Note that this is a deficit balance!

Basic Consolidation Entry

Common Stock	50		← Original amount invested (100%)
Additional Paid-in Capital	450		← Original amount invested (100%)
Income from Soup Corp.	200		← Soup Corp.'s reported income
Retained Earnings (BB)		100	← Beginning balance in retained earnings
Dividends Declared		50	← 100% of Soup Corp.'s dividends
Investment in Soup Corp.		550	← Net book value in investment account

Example: 100 Percent Ownership Acquired at Book Value (5 of 14)

Basic Consolidation Entry

Common Stock	50	
Additional Paid-In Capital	450	
Income from Soup Corp.	200	
Retained Earnings (BB)		100
Dividends Declared		50
Investment in Soup Corp.		550

Investment in Soup Corp.

Beginning Balance	400		
Net Income	200		
		50	Dividends
Ending Balance	550		
		550	**Basic**
	0		

Income from Soup Corp.

		Net Income	200
		Ending Balance	200
Basic	**200**		
			0

Example: 100 Percent Ownership Acquired at Book Value (6 of 14)

	Pea Corp.	Soup Corp.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	1,200	600			
Less: COGS	(600)	(300)			
Less: Other Expenses	(450)	(100)			
Income from Soup Corp.	200				
Net Income	**350**	**200**			
Statement of Retained Earnings					
Beginning Balance	150	(100)			
Net Income	**350**	**200**			
Less: Dividends Declared	(100)	(50)			
Ending Balance	**400**	**50**			
Balance Sheet					
Cash	250	100			
Investment in Soup Corp.	550				
PP&E (net)	900	600			
Total Assets	**1,700**	**700**			
Liabilities	300	150			
Common Stock	200	50			
Additional Paid-In Capital	800	450			
Retained Earnings	**400**	**50**			
Total Liabilities & Equity	**1,700**	**700**			

Example: 100 Percent Ownership Acquired at Book Value (7 of 14)

	Pea Corp.	Soup Corp.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	1,200	600			
Less: COGS	(600)	(300)			
Less: Other Expenses	(450)	(100)			
Income from Soup Corp.	200				
Net Income	**350**	**200**			
Statement of Retained Earnings					
Beginning Balance	150	(100)			
Net Income	**350**	**200**			
Less: Dividends Declared	(100)	(50)			
Ending Balance	**400**	**50**			
Balance Sheet					
Cash	250	100			
Investment in Soup Corp.	550				
PP&E (net)	900	600			
Total Assets	**1,700**	**700**			
Liabilities	300	150			
Common Stock	200	50			
Additional Paid-in Capital	800	450			
Retained Earnings	**400**	**50**			
Total Liabilities & Equity	**1,700**	**700**			

Example: 100 Percent Ownership Acquired at Book Value (8 of 14)

	Pea Corp.	Soup Corp.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	1,200	600			
Less: COGS	(600)	(300)			
Less: Other Expenses	(450)	(100)			
Income from Soup Corp.	200		200		
Net Income	**350**	**200**			
Statement of Retained Earnings					
Beginning Balance	150	(100)		100	
Net Income	**350**	**200**			
Less: Dividends Declared	(100)	(50)		50	
Ending Balance	**400**	**50**			
Balance Sheet					
Cash	250	100			
Investment in Soup Corp.	550			550	
PP&E (net)	900	600			
Total Assets	**1,700**	**700**			
Liabilities	300	150			
Common Stock	200	50	50		
Additional Paid-in Capital	800	450	450		
Retained Earnings	**400**	**50**			
Total Liabilities & Equity	**1,700**	**700**			

Example: 100 Percent Ownership Acquired at Book Value (9 of 14)

	Pea Corp.	Soup Corp.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	1,200	600			
Less: COGS	(600)	(300)			
Less: Other Expenses	(450)	(100)			
Income from Soup Corp.	200		200		
Net Income	**350**	**200**	**200**	**0**	
Statement of Retained Earnings					
Beginning Balance	150	(100)		100	
Net Income	**350**	**200**	**200**	**0**	
Less: Dividends Declared	(100)	(50)		50	
Ending Balance	**400**	**50**	**200**	**150**	
Balance Sheet					
Cash	250	100			
Investment in Soup Corp.	550			550	
PP&E (net)	900	600			
Total Assets	**1,700**	**700**	**0**	**550**	
Liabilities	300	150			
Common Stock	200	50	50		
Additional Paid-in Capital	800	450	450		
Retained Earnings	**400**	**50**	**200**	**150**	
Total Liabilities & Equity	**1,700**	**700**	**700**	**150**	

Example: 100 Percent Ownership Acquired at Book Value (10 of 14)

	Pea Corp.	Soup Corp.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	1,200	600			
Less: COGS	(600)	(300)			
Less: Other Expenses	(450)	(100)			
Income from Soup Corp.	200		200		
Net Income	**350**	**200**	**200**	**0**	
Statement of Retained Earnings					
Beginning Balance	150	(100)		100	
Net Income	**350**	**200**	**200**	**0**	
Less: Dividends Declared	(100)	(50)		50	
Ending Balance	**400**	**50**	**200**	**150**	
Balance Sheet					
Cash	250	100			
Investment in Soup Corp.	550			550	
PP&E (net)	900	600			
Total Assets	**1,700**	**700**	**0**	**550**	
Liabilities	300	150			
Common Stock	200	50	50		
Additional Paid-in Capital	800	450	450		
Retained Earnings	**400**	**50**	**200**	**150**	
Total Liabilities & Equity	**1,700**	**700**	**700**	**150**	

Example: 100 Percent Ownership Acquired at Book Value (11 of 14)

	Pea Corp.	Soup Corp.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	1,200	600			1,800
Less: COGS	(600)	(300)			(900)
Less: Other Expenses	(450)	(100)			(550)
Income from Soup Corp.	200		200		0
Net Income	**350**	**200**	**200**	**0**	**350**
Statement of Retained Earnings					
Beginning Balance	150	(100)		100	
Net Income	**350**	**200**	**200**	**0**	
Less: Dividends Declared	(100)	(50)		50	
Ending Balance	**400**	**50**	**200**	**150**	
Balance Sheet					
Cash	250	100			
Investment in Soup Corp.	550			550	
PP&E (net)	900	600			
Total Assets	**1,700**	**700**	**0**	**550**	
Liabilities	300	150			
Common Stock	200	50	50		
Additional Paid-in Capital	800	450	450		
Retained Earnings	**400**	**50**	**200**	**150**	
Total Liabilities & Equity	**1,700**	**700**	**700**	**150**	

Example: 100 Percent Ownership Acquired at Book Value (12 of 14)

	Pea Corp.	Soup Corp.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	1,200	600			1,800
Less: COGS	(600)	(300)			(900)
Less: Other Expenses	(450)	(100)			(550)
Income from Soup Corp.	200		200		0
Net Income	**350**	**200**	**200**	**0**	**350**
Statement of Retained Earnings					
Beginning Balance	150	(100)		100	150
Net Income	**350**	**200**	**200**	**0**	350
Less: Dividends Declared	(100)	(50)		50	(100)
Ending Balance	**400**	**50**	**200**	**150**	**400**
Balance Sheet					
Cash	250	100			
Investment in Soup Corp.	550			550	
PP&E (net)	900	600			
Total Assets	**1,700**	**700**	**0**	**550**	
Liabilities	300	150			
Common Stock	200	50	50		
Additional Paid-in Capital	800	450	450		
Retained Earnings	**400**	**50**	**200**	**150**	
Total Liabilities & Equity	**1,700**	**700**	**700**	**150**	

Example: 100 Percent Ownership Acquired at Book Value (13 of 14)

	Pea Corp.	Soup Corp.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	1,200	600			1,800
Less: COGS	(600)	(300)			(900)
Less: Other Expenses	(450)	(100)			(550)
Income from Soup Corp.	200		200		0
Net Income	**350**	**200**	**200**	**0**	**350**
Statement of Retained Earnings					
Beginning Balance	150	(100)		100	150
Net Income	**350**	**200**	**200**	**0**	350
Less: Dividends Declared	(100)	(50)		50	(100)
Ending Balance	**400**	**50**	**200**	**150**	**400**
Balance Sheet					
Cash	250	100			350
Investment in Soup Corp.	550			550	0
PP&E (net)	900	600			1,500
Total Assets	**1,700**	**700**	**0**	**550**	**1,850**
Liabilities	300	150			
Common Stock	200	50	50		
Additional Paid-in Capital	800	450	450		
Retained Earnings	**400**	**50**	**200**	**150**	
Total Liabilities & Equity	**1,700**	**700**	**700**	**150**	

Example: 100 Percent Ownership Acquired at Book Value (14 of 14)

	Pea Corp.	Soup Corp.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	1,200	600			1,800
Less: COGS	(600)	(300)			(900)
Less: Other Expenses	(450)	(100)			(550)
Income from Soup Corp.	200		200		0
Net Income	**350**	**200**	**200**	**0**	**350**
Statement of Retained Earnings					
Beginning Balance	150	(100)		100	150
Net Income	**350**	**200**	**200**	**0**	350
Less: Dividends Declared	(100)	(50)		50	(100)
Ending Balance	**400**	**50**	**200**	**150**	**400**
Balance Sheet					
Cash	250	100			350
Investment in Soup Corp.	550			550	0
PP&E (net)	900	600			1,500
Total Assets	**1,700**	**700**	**0**	**550**	**1,850**
Liabilities	300	150			450
Common Stock	200	50	50		200
Additional Paid-in Capital	800	450	450		800
Retained Earnings	**400**	**50**	**200**	**150**	400
Total Liabilities & Equity	**1,700**	**700**	**700**	**150**	**1,850**

The Equity Method: Things to Remember in Consolidation

- **Consolidated net income EQUALS the parent's net income**

Parent		Consolidated
$350	=	$350

- **Consolidated retained earnings EQUALS the parent's retained earnings**

Parent		Consolidated
$400	=	$400

Group Exercise 1 (1 of 2)

	Pinkett, Inc.	Smith, Inc.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	840,000	300,000			
Less: COGS	(516,000)	(156,000)			
Less: Depreciation Expense	(12,000)	(10,000)			
Less: Other Expenses	(192,000)	(98,000)			
Income from Smith, Inc.	36,000				
Net Income	**156,000**	**36,000**			
Statement of Retained Earnings					
Beginning Balance	132,000	72,000			
Net Income	**156,000**	**36,000**			
Less: Dividends Declared	(108,000)	(12,000)			
Ending Balance	**180,000**	**96,000**			
Balance Sheet					
Cash	54,000	48,000			
Accounts Receivable	114,000	66,000			
Inventory	204,000	90,000			
Investment in Smith, Inc.	156,000				
Property, Plant, & Equipment	336,000	210,000			
Less: Accumulated Depreciation	(144,000)	(30,000)			
Total Assets	**720,000**	**384,000**			
Accounts Payable	168,000	84,000			
Long-term Debt	360,000	144,000			
Common Stock	12,000	60,000			
Retained Earnings	**180,000**	**96,000**			
Total Liabilities & Equity	**720,000**	**384,000**			

REQUIRED

- **Assume Pinkett acquired Smith on 1/1/X1**
- **Prepare all consolidation entries as of 12/31/X1.**
- **Prepare a consolidation worksheet at 12/31/X1.**
- **Assume Smith's accumulated depreciation on 1/1/X1 was $20,000.**

Group Exercise 1 (2 of 2)

Objective:

- Eliminate equity accounts of Subsidiary.
- Eliminate equity method accounts of Parent.

Book Value Calculations

	Parent's Investment Acct	=	Common Stock	+	Retained Earnings
Original Book Value					
+ Net Income					
– Dividends					
Ending Book Value					

Basic consolidation Entry

Common Stock
Retained Earnings (BB)
Income from Smith, Inc.
    Dividends Declared
    Investment in Smith, Inc.

Group Exercise 1: *Solution* (1 of 6)

Objective:

- Eliminate equity accounts of Subsidiary.
- Eliminate equity method accounts of Parent.

Note that the **"blue"** numbers appear in the basic consolidation entry.

Book Value Calculations

	Parent's Investment Acct	=	Common Stock	+	Retained Earnings
Original Book Value	132,000		60,000		**72,000**
+ Net Income	**36,000**				36,000
– Dividends	(12,000)				**(12,000)**
Ending Book Value	**156,000**		**60,000**		96,000

Basic Consolidation Entry

Common Stock
Retained Earnings (BB)
Income from Smith, Inc.
    Dividends Declared
    Investment in Smith, Inc.

Group Exercise 1: *Solution* (2 of 6)

Objective:

- Eliminate equity accounts of Sub
- Eliminate equity method accounts of Parent.

Book Value Calculations

	Parent's Investment Acct	=	Common Stock	+	Retained Earnings
Original Book Value	132,000		60,000		**72,000**
+ Net Income	**36,000**				36,000
– Dividends	(12,000)				**(12,000)**
Ending Book Value	**156,000**		**60,000**		96,000

Basic Consolidation Entry

Common Stock	60,000	
Retained Earnings (BB)	72,000	
Income from Smith, Inc.	36,000	
Dividends Declared		12,000
Investment in Smith, Inc.		156,000

Group Exercise 1: *Solution* (3 of 6)

The accumulated depreciation elimination entry:

Accumulated Depreciation	20,000	
Buildings and Equipment		20,000

Property, Plant & Equipment

210,000	

Accumulated Depreciation

	20,000

Group Exercise 1: *Solution* (4 of 6)

The accumulated depreciation elimination entry:

Accumulated Depreciation	20,000	
Buildings and Equipment		20,000

Property, Plant & Equipment

210,000	
	20,000
190,000	

Accumulated Depreciation

	20,000
20,000	
	0

Shows the Buildings and Equipment "as if" they have been recorded on the Sub's books as new assets at book value.

Group Exercise 1: *Solution* (5 of 6)

	Pinkett, Inc.	Smith, Inc.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	840,000	300,000			
Less: COGS	(516,000)	(156,000)			
Less: Depreciation Expense	(12,000)	(10,000)			
Less: Other Expenses	(192,000)	(98,000)			
Income from Smith, Inc.	36,000		36,000		
Net Income	**156,000**	**36,000**	36,000	0	
Statement of Retained Earnings					
Beginning Balance	132,000	72,000	72,000		
Net Income	**156,000**	**36,000**	36,000	0	
Less: Dividends Declared	(108,000)	(12,000)		12,000	
Ending Balance	**180,000**	**96,000**	108,000	12,000	
Balance Sheet					
Cash	54,000	48,000			
Accounts Receivable	114,000	66,000			
Inventory	204,000	90,000			
Investment in Smith, Inc.	156,000			156,000	
Property, Plant, & Equipment	336,000	210,000		20,000	
Less: Accumulated Depreciation	(144,000)	(30,000)	20,000		
Total Assets	**720,000**	**384,000**	20,000	176,000	
Accounts Payable	168,000	84,000			
Long-term Debt	360,000	144,000			
Common Stock	12,000	60,000	60,000		
Retained Earnings	**180,000**	**96,000**	108,000	12,000	
Total Liabilities & Equity	**720,000**	**384,000**	168,000	12,000	

Group Exercise 1: *Solution* (6 of 6)

	Pinkett, Inc.	Smith, Inc.	Consolidation Entries DR	CR	Consolidated
Income Statement					
Sales	840,000	300,000			1,140,000
Less: COGS	(516,000)	(156,000)			(672,000)
Less: Depreciation Expense	(12,000)	(10,000)			(22,000)
Less: Other Expenses	(192,000)	(98,000)			(290,000)
Income from Smith, Inc.	36,000		36,000		0
Net Income	**156,000**	**36,000**	**36,000**	**0**	**156,000**
Statement of Retained Earnings					
Beginning Balance	132,000	72,000	72,000		132,000
Net Income	**156,000**	**36,000**	**36,000**	**0**	156,000
Less: Dividends Declared	(108,000)	(12,000)		12,000	(108,000)
Ending Balance	**180,000**	**96,000**	**108,000**	**12,000**	**180,000**
Balance Sheet					
Cash	54,000	48,000			102,000
Accounts Receivable	114,000	66,000			180,000
Inventory	204,000	90,000			294,000
Investment in Smith, Inc.	156,000			156,000	0
Property, Plant, & Equipment	336,000	210,000		20,000	526,000
Less: Accumulated Depreciation	(144,000)	(30,000)	20,000		(154,000)
Total Assets	**720,000**	**384,000**	**20,000**	**176,000**	**948,000**
Accounts Payable	168,000	84,000			252,000
Long-term Debt	360,000	144,000			504,000
Common Stock	12,000	60,000	60,000		12,000
Retained Earnings	**180,000**	**96,000**	**108,000**	**12,000**	180,000
Total Liabilities & Equity	**720,000**	**384,000**	**168,000**	**12,000**	**948,000**

Consolidated Financial Statements—100 Percent Ownership, Created or Acquired at Book Value (1 of 2)

- Assume that on January 1, 20X1, Peerless Products Corporation acquires all of the common stock of Special Foods Inc. for $300,000, an amount equal to Special Foods' book value on that date. At that time, Special Foods has $200,000 of common stock outstanding and retained earnings of $100,000.
- Peerless accounts for its investment in Special Foods stock using the equity method.

Consolidated Financial Statements—100 Percent Ownership, Created or Acquired at Book Value (2 of 2)

- The following table includes information about Peerless and Special Foods as of the date of combination and for the years 20X1 and 20X2:

Figure 2-9

	Peerless Products	Special Foods
Common Stock, January 1, 20X1	$500,000	$200,000
Retained Earnings, January 1, 20X1	300,000	100,000
20X1:		
Separate Operating Income, Peerless	140,000	
Net Income, Special Foods		50,000
Dividends	60,000	30,000
20X2:		
Separate Operating Income, Peerless	160,000	
Net Income, Special Foods		75,000
Dividends	60,000	40,000

Initial Year of Ownership

- On January 1, 20X1, Peerless records its purchase of Special Foods common stock with the following entry:

Investment in Special Foods	300,000	
Cash		300,000

Record purchase of Special Foods stock.

- During 20X1, Peerless records operating earnings of $140,000, excluding its income from investing in Special Foods, and declares dividends of $60,000.
- Special Foods reports 20X1 net income of $50,000 and declares dividends of $30,000.

Parent Company Entries

- Peerless records its 20X1 income and dividends from Special Foods under the equity method as follows:

Investment in Special Foods	50,000	
Income from Special Foods		50,000

Record Peerless's 100% share of Special Foods' 20X1 income.

Cash	30,000	
Investment in Special Foods		30,000

Record Peerless's 100% share of Special Foods' 20X1 dividend.

Consolidation Worksheet—Initial Year of Ownership (1 of 5)

	Parent Company	Sub Company	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	400,000	200,000			
Less: COGS	(170,000)	(115,000)			
Less: Depreciation Expense	(50,000)	(20,000)			
Less: Other Expenses	(40,000)	(15,000)			
Income from Sub Company	50,000				
Net Income	**190,000**	**50,000**			
Statement of Retained Earnings					
Beginning Balance	300,000	100,000			
Net Income	**190,000**	**50,000**			
Less: Dividends Declared	(60,000)	(30,000)			
Ending Balance	**430,000**	**120,000**			
Balance Sheet					
Cash	210,000	75,000			
Accounts Receivable	75,000	50,000			
Inventory	100,000	75,000			
Investment in Sub Co.	320,000				
Land	175,000	40,000			
Buildings & Equipment	800,000	600,000			
Less: Accumulated Depreciation	(450,000)	(320,000)			
Total Assets	**1,230,000**	**520,000**			
Accounts Payable	100,000	100,000			
Long-Term Debt	200,000	100,000			
Common Stock	500,000	200,000			
Retained Earnings	**430,000**	**120,000**			
Total Liabilities & Equity	**1,230,000**	**520,000**			

Consolidation Worksheet—Initial Year of Ownership (2 of 5)

Balance Sheet	Parent	Sub
Cash	210,000	75,000
Accounts Receivable	75,000	50,000
Inventory	100,000	75,000
Investment in Sub Co.	320,000	
Land	175,000	40,000
Buildings & Equipment	800,000	600,000
Less: Accumulated Depreciation	(450,000)	(320,000)
Total Assets	**1,230,000**	**520,000**
Accounts Payable	100,000	100,000
Long-Term Debt	200,000	100,000
Common Stock	500,000	200,000
Retained Earnings	**430,000**	**120,000**
Total Liabilities & Equity	**1,230,000**	**520,000**

Net Assets = 320,000 (520,000 – 200,000)

Investment in Sub = 320,000

Stockholder's Equity = 320,000

S Net Assets = S Owner's Equity = P Investment in S

- In the consolidated statements, we will include Sub's net assets.
- Therefore, to avoid double counting, we cannot include Sub's owner's equity or Parent's investment in Sub.

Consolidation Worksheet—Initial Year of Ownership (3 of 5)

- The book value portion of Peerless's investment has changed because earnings and dividends have adjusted the investment account balance.
- The book value portion of the investment account can be summarized as follows:

Book Value Calculations:

	Total Investment	=	Common Stock	+	Retained Earnings
Original book value	300,000		200,000		100,000
+ Net income	50,000				50,000
– Dividends	(30,000)				(30,000)
Ending book value	320,000		200,000		120,000

Consolidation Worksheet—Initial Year of Ownership (4 of 5)

- The basic consolidation entry removes both the equity method income from Special Foods and also all dividends declared by the subsidiary during the period.

Basic Elimination Entry:

Common stock	**200,000**		Common stock balance
Retained earnings	**100,000**		Beginning balance in ret. earnings
Income from Special Foods	**50,000**		Special Foods' reported income
Dividends declared		**30,000**	100% of Special Foods' dividends
Investment in Special Foods		**320,000**	Net BV in investment account

- The basic consolidation entry removes:
  - Special Foods' equity accounts
  - Special Foods' dividends declared
  - Peerless's Income from Special Foods account
  - Peerless's Investment in Special Foods account

Consolidation Worksheet—Initial Year of Ownership (5 of 5)

Investment in Special Foods

Acquisition Price	300,000		
Net Income	50,000		
		30,000	Dividends
Ending Balance	320,000		
		320,000	Basic
	0		

Income from Special Foods

		50,000	Net Income
		50,000	Ending Balance
Basic	50,000		
		0	

- We show the worksheet entry in these T-accounts only to illustrate how these accounts are eliminated in the consolidation worksheet.
- Consolidation entries do not affect the actual books of either the parent or the subsidiary.

December 31, 20X1, Equity-Method Worksheet for Consolidated Financial Statements, Initial Year of Ownership; 100 Percent Acquisition at Book Value

Figure 2-10

	Peerless Products	Special Foods	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	400,000	200,000			600,000
Less: Cost of Goods Sold (COGS)	(170,000)	(115,000)			(285,000)
Less: Depreciation Expense	(50,000)	(20,000)			(70,000)
Less: Other Expenses	(40,000)	(15,000)			(55,000)
Income from Special Foods	50,000		50,000		0
Net Income	**190,000**	**50,000**	**50,000**	**0**	**190,000**
Statement of Retained Earnings					
Beginning Balance	300,000	100,000	100,000		300,000
Net Income	**190,000**	**50,000**	**50,000**	**0**	190,000
Less: Dividends Declared	(60,000)	(30,000)		30,000	(60,000)
Ending Balance	**430,000**	**120,000**	**150,000**	**30,000**	**430,000**
Balance Sheet					
Cash	210,000	75,000			285,000
Accounts Receivable	75,000	50,000			125,000
Inventory	100,000	75,000			175,000
Investment in Special Foods	320,000			320,000	0
Land	175,000	40,000			215,000
Buildings & Equipment	800,000	600,000		300,000	1,100,000
Less: Accumulated Depreciation	(450,000)	(320,000)	300,000		(470,000)
Total Assets	**1,230,000**	**520,000**	**300,000**	**620,000**	**1,430,000**
Accounts Payable	100,000	100,000			200,000
Long-Term Debt	200,000	100,000			300,000
Common Stock	500,000	200,000	200,000		500,000
Retained Earnings	**430,000**	**120,000**	**150,000**	**30,000**	430,000
Total Liabilities & Equity	**1,230,000**	**520,000**	**350,000**	**30,000**	**1,430,000**

Worksheet Relationships (1 of 2)

1. The bottom-line number from each of the first two sections of the worksheet carries down to the next financial statement in a logical progression.
   - The net income is carried down to the retained earnings statement section of the worksheet.
   - The ending retained earnings line is carried down to the balance sheet section of the worksheet.
   - In both cases, the entire line (including total adjustments) is carried forward.
2. Total debits must equal total credits for any single consolidation entry and for the worksheet as a whole.
   - Because some consolidation entries extend to more than one section of the worksheet, totals of the debit and credit adjustments are not likely to be equal in either of the first two sections of the worksheet.

Worksheet Relationships (2 of 2)

3. In the balance sheet portion of the worksheet, total debit balances must equal total credit balances for each company and the consolidated entity.
4. When the parent uses the full equity method of accounting for the investment, consolidated net income should equal the parent's net income, and consolidated retained earnings should equal the parent's retained earnings.
5. Other clerical safeguards:
   - The amounts reflected in the bottom line of the income statement section, when summed (algebraically) across, must equal the number reported as consolidated net income.
   - The amounts in the last line of the retained earnings statement section must equal consolidated retained earnings when summed across.

Second and Subsequent Years of Ownership

- Consolidation procedures employed here are basically the same as those used at the end of the first year.
- Adjusted trial balance data of individual companies are used as the starting point each time consolidated statements are prepared.
- Check that each period following acquisition has the beginning balance of consolidated retained earnings equal to the balance reported at the end of the prior period.
- In all other respects, the consolidation entries and worksheet entries are comparable with those shown for the first year.

Parent Company Entries: Second Year

- We illustrate consolidation after two years of ownership by continuing the example of Peerless Products and Special Foods.
- Peerless's separate income from its own operations for 20X2 is $160,000, and its dividends total $60,000.
- Special Foods reports net income of $75,000 in 20X2 and pays dividends of $40,000.
- Peerless records the following equity-method entries in 20X2:

Investment in Special Foods	75,000	
Income from Special Foods		75,000

Record Peerless's 100% share of Special Foods' 20X2 income.

Cash	40,000	
Investment in Special Foods		40,000

Record Peerless's 100% share of Special Foods' 20X2 dividend.

Consolidation Worksheet—Second Year of Ownership (1 of 4)

- The book value of Peerless's investment in Special Foods (which is equal to the book value of the subsidiary, Special Foods', equity accounts) can be analyzed and summarized as follows:

Book Value Calculations:

	Total Investment	=	Common Stock	+	Retained Earnings
Beginning book value	320,000		200,000		120,000
+ Net income	75,000				75,000
– Dividends	(40,000)				(40,000)
Ending book value	355,000		200,000		155,000

Consolidation Worksheet—Second Year of Ownership (2 of 4)

- The basic consolidation entry removes
  - Special Foods' equity accounts
  - Special Foods' dividends declared
  - Peerless's Income from Special Foods account
  - Peerless's Investment in Special Foods account

Basic Consolidation Entry:

Common Stock	200,000		← Common stock balance
Retained Earnings	120,000		← Beginning balance in RE
Income from Special Foods	75,000		← Special Foods' reported income
Dividends Declared		40,000	← 100% of Special Foods' dividends
Investment in Special Foods		355,000	← Net BV in investment account

- The beginning retained earnings in 20X2 is different than the balance in 20X1 because of income earned and dividends declared during 20X1.

Consolidation Worksheet—Second Year of Ownership (3 of 4)

- The basic consolidation entry completely eliminates the balance in Peerless's investment account on the balance sheet as well as the Income from Special Foods account on the income statement in the worksheet.

Investment in Special Foods

Beginning Balance	**320,000**		
Net Income	**75,000**		
		40,000	**Dividends**
Ending Balance	**355,000**		
		355,000	**Basic**
	0		

Income from Special Foods

		75,000	**Net Income**
		75,000	**Ending Balance**
Basic	**75,000**		
		0	

Consolidation Worksheet—Second Year of Ownership (4 of 4)

- We repeat the same accumulated depreciation consolidation entry this year (and every year as long as the subsidiary, Special Foods, owns the assets) that we used in the initial year.

Accumulated Depreciation Consolidation Entry:

Accumulated Depreciation	300,000	
Buildings & Equipment		300,000

← Accumulated depreciation at the time of the acquisition netted against cost

December 31, 20X2, Equity-Method Worksheet for Consolidated Financial Statements, Second Year of Ownership; 100 Percent Acquisition at Book Value

Figure 2-11

	Peerless Products	Special Foods	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	450,000	300,000			750,000
Less: COGS	(180,000)	(160,000)			(340,000)
Less: Depreciation Expense	(50,000)	(20,000)			(70,000)
Less: Other Expenses	(60,000)	(45,000)			(105,000)
Income from Special Foods	75,000		75,000		0
Net Income	**235,000**	**75,000**	**75,000**	**0**	**235,000**
Statement of Retained Earnings					
Beginning Balance	430,000	120,000	120,000		430,000
Net Income	**235,000**	**75,000**	**75,000**	**0**	235,000
Less: Dividends Declared	(60,000)	(40,000)		40,000	(60,000)
Ending Balance	**605,000**	**155,000**	**195,000**	**40,000**	**605,000**
Balance Sheet					
Cash	245,000	85,000			330,000
Accounts Receivable	150,000	80,000			230,000
Inventory	180,000	90,000			270,000
Investment in Special Foods	355,000			355,000	0
Land	175,000	40,000			215,000
Buildings & Equipment	800,000	600,000		300,000	1,100,000
Less: Accumulated Depreciation	(500,000)	(340,000)	300,000		(540,000)
Total Assets	**1,405,000**	**555,000**	**300,000**	**655,000**	**1,605,000**
Accounts Payable	100,000	100,000			200,000
Long-Term Debt	200,000	100,000			300,000
Common Stock	500,000	200,000	200,000		500,000
Retained Earnings	**605,000**	**155,000**	**195,000**	**40,000**	605,000
Total Liabilities & Equity	**1,405,000**	**555,000**	**395,000**	**40,000**	**1,605,000**

Consolidated Net Income

- Consolidated net income for 20X1 and 20X2 appear as the last numbers in the income statement section of the worksheet in the Consolidated column on the far right.
- The numbers can be computed as follows:

	20X1	20X2
Peerless's net income	$190,000	$235,000
Peerless's equity income from Special Foods	(50,000)	(75,000)
Special Foods' net income	50,000	75,000
Consolidated net income	$190,000	$235,000

Consolidated Retained Earnings

- The ending consolidated retained earnings number is equal to the beginning balance of consolidated retained earnings plus consolidated net income, less dividends declared on the parent's common stock.
- It can be computed as follows:

	20X1	20X2
Peerless's beginning retained earnings from its own operations	$300,000	$380,000
Peerless's income from its own operations	140,000	160,000
Peerless's income from Special Foods since acquisition (cumulative)	50,000	125,000
Peerless's dividends declared	(60,000)	(60,000)
Consolidated retained earnings	$430,000	$605,000

Appendix 2B

Consolidation When Parent Companies Choose to Carry at Cost Investments That Are To Be Consolidated

Cost Method Consolidation

- Not all parent companies use the equity method to account for their subsidiary investments that are to be consolidated.
- The choice of historical cost or equity method has no effect on the consolidated financial statements.
  - The parent is free to use either the historical cost or some version of the equity method on its separate books in accounting for investments in subsidiaries that are to be consolidated.
- Because the cost method uses different parent company entries than the equity method, it also requires different consolidation entries in preparing the consolidation worksheet.
- **Keep in mind that the consolidated financial statements appear the same regardless of whether the parent uses the cost or the equity method on its separate books.**

Equity versus Cost Method Comparison

Item	Cost Method	Equity Method
Recorded amount of investment at date of acquisition	Original cost	Original cost
Usual carrying amount of investment subsequent to acquisition	Original cost	Original cost increased (decreased) by investor's share of investee's income (loss) and decreased by investor's share of investee's dividends
Income recognition by investor	Investor's share of investee's dividends declared from earnings since acquisition	Investor's share of investee's earnings since acquisition whether distributed or not
Investee dividends from earnings since acquisition by investor	Income	Reduction of investment
Investee dividends in excess of earnings since acquisition by investor	Reduction of investment	Reduction of investment

Parent Company Cost-Method Entries

- Parent (Peerless) only records two journal entries in 20X1 related to its investment in Sub (Special Foods).

Investment in Special Foods	300,000	
Cash		300,000

Record the initial investment in Special Foods.

Cash	30,000	
Dividend Income		30,000

Record Parent's 100% share of Sub's 20X1 dividend.

- No entries are made on the parent's books with respect to the subsidiary's income in 20X1, as would be done under the equity method.

Consolidation Worksheet—Year of Combination (1 of 2)

- Basic consolidation entry can be divided into two parts.
- This consolidation entry is the same each year (assuming no impairment of the investment account) because it relates to the original acquisition price and the original balances in the subsidiary's (Special Foods') equity accounts.

Investment Consolidation Entry:

Common Stock	200,000	
Retained Earnings	100,000	
Investment in Special Foods		300,000

Dividend Consolidation Entry:

Dividend Income	30,000	
Dividends Declared		30,000

Consolidation Worksheet—Year of Combination (2 of 2)

- The accumulated depreciation consolidation entry is the same as under the equity method.

Accumulated Depreciation Consolidation Entry:

Accumulated Depreciation	**300,000**	
Building & Equipment		**300,000**

December 31, 20X1, Equity-Method Worksheet for Consolidated Financial Statements, Initial Year of Ownership; 100% Acquisition at Book Value

Figure 2-10

	Peerless Products	Special Foods	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	400,000	200,000			600,000
Less: Cost of Goods Sold (COGS)	(170,000)	(115,000)			(285,000)
Less: Depreciation Expense	(50,000)	(20,000)			(70,000)
Less: Other Expenses	(40,000)	(15,000)			(55,000)
Income from Special Foods	50,000		50,000		0
Net Income	**190,000**	**50,000**	50,000	0	**190,000**
Statement of Retained Earnings					
Beginning Balance	300,000	100,000	100,000		300,000
Net Income	**190,000**	**50,000**	50,000	0	190,000
Less: Dividends Declared	(60,000)	(30,000)		30,000	(60,000)
Ending Balance	**430,000**	**120,000**	**150,000**	**30,000**	**430,000**
Balance Sheet					
Cash	210,000	75,000			285,000
Accounts Receivable	75,000	50,000			125,000
Inventory	100,000	75,000			175,000
Investment in Special Foods	320,000			320,000	0
Land	175,000	40,000			215,000
Buildings & Equipment	800,000	600,000		300,000	1,100,000
Less: Accumulated Depreciation	(450,000)	(320,000)	300,000		(470,000)
Total Assets	**1,230,000**	**520,000**	**300,000**	**620,000**	**1,430,000**
Accounts Payable	100,000	100,000			200,000
Long-Term Debt	200,000	100,000			300,000
Common Stock	500,000	200,000	200,000		500,000
Retained Earnings	**430,000**	**120,000**	**150,000**	**30,000**	430,000
Total Liabilities & Equity	**1,230,000**	**520,000**	**350,000**	**30,000**	**1,430,000**

December 31, 20X1, Cost-Method Worksheet for Consolidated Financial Statements, Initial Year of Ownership; 100% Acquisition at Book Value

Figure 2-12

	Peerless Products	Special Foods	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	400,000	200,000			600,000
Less: COGS	(170,000)	(115,000)			(285,000)
Less: Depreciation Expense	(50,000)	(20,000)			(70,000)
Less: Other Expenses	(40,000)	(15,000)			(55,000)
Dividend Income	30,000		30,000		0
Net Income	**170,000**	**50,000**	**30,000**	**0**	**190,000**
Statement of Retained Earnings					
Beginning Balance	300,000	100,000	100,000		300,000
Net Income	**170,000**	**50,000**	**30,000**	**0**	190,000
Less: Dividends Declared	(60,000)	(30,000)		30,000	(60,000)
Ending Balance	**410,000**	**120,000**	**130,000**	**30,000**	**430,000**
Balance Sheet					
Cash	210,000	75,000			285,000
Accounts Receivable	75,000	50,000			125,000
Inventory	100,000	75,000			175,000
Investment in Special Foods	300,000			300,000	0
Land	175,000	40,000			215,000
Buildings & Equipment	800,000	600,000		300,000	1,100,000
Less: Accumulated Depreciation	(450,000)	(320,000)	300,000		(470,000)
Total Assets	**1,210,000**	**520,000**	**300,000**	**600,000**	**1,430,000**
Accounts Payable	100,000	100,000			200,000
Bonds Payable	200,000	100,000			300,000
Common Stock	500,000	200,000	200,000		500,000
Retained Earnings	**410,000**	**120,000**	**130,000**	**30,000**	430,000
Total Liabilities & Equity	**1,210,000**	**520,000**	**330,000**	**30,000**	**1,430,000**

Equity versus Cost Method

- The amounts in the consolidated column of the cost and equity method worksheets match.
  - The method used on the parent's books to account for the subsidiary investment does not affect the consolidated financial statements.
- While the separate books and consolidation entries are different under the cost method, the final consolidated results are the same as the equity method.

Group Exercise 2: Cost Method Consolidation (1 of 2)

	Pinkett, Inc.	Smith, Inc.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	$ 840,000	$ 300,000			
Less: COGS	(516,000)	(156,000)			
Less: Expenses	(204,000)	(108,000)			
Dividend Income	12,000				
Net Income	**$ 132,000**	**$ 36,000**			
Statement of Retained Earnings					
Balances, 1/1/X3	$ 60,000	$ 72,000			
Add: Net Income	132,000	36,000			
Less: Dividends	(108,000)	(12,000)			
Balances, 12/31/X3	**$ 84,000**	**$ 96,000**			
Balance Sheet					
Cash	$ 54,000	$ 48,000			
Accounts Receivable	114,000	66,000			
Inventory	204,000	90,000			
Investment in Sub	60,000				
Property & Equipment	336,000	210,000			
Accumulated Depreciation	(144,000)	(30,000)			
Total Assets	**$ 624,000**	**$ 384,000**			
Payables & Accruals	$ 168,000	84,000			
Long-term Debt	360,000	144,000			
Common Stock	12,000	60,000			
Retained Earnings	84,000	96,000			
Total Liabilities & Equity	**$ 624,000**	**384,000**			

REQUIRED

- Prepare all consolidation entries as of 12/31/X3.
- Prepare a consolidation worksheet at 12/31/X3.
- What is the maximum dividend the parent could declare ($84,000 or $180,000) if cash were available?

Group Exercise 2: Cost Method Consolidation (2 of 2)

	Pinkett, Inc.	Smith, Inc.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	$ 840,000	$ 300,000			
Less: COGS	(516,000)	(156,000)			
Less: Expenses	(204,000)	(108,000)			
Dividend Income	12,000				
Net Income	**$ 132,000**	**$ 36,000**			
Statement of Retained Earnings					
Balances, 1/1/X3	$ 60,000	$ 72,000			
Add: Net Income	132,000	36,000			
Less: Dividends	(108,000)	(12,000)			
Balances, 12/31/X3	**$ 84,000**	**$ 96,000**			
Balance Sheet					
Cash	$ 54,000	$ 48,000			
Accounts Receivable	114,000	66,000			
Inventory	204,000	90,000			
Investment in Sub	60,000				
Property & Equipment	336,000	210,000			
Accumulated Depreciation	(144,000)	(30,000)			
Total Assets	**$ 624,000**	**$ 384,000**			
Payables & Accruals	$ 168,000	84,000			
Long-term Debt	360,000	144,000			
Common Stock	12,000	60,000			
Retained Earnings	84,000	96,000			
Total Liabilities & Equity	**$ 624,000**	**384,000**			

Basic Consolidation Entry

Investment consolidation entry

Common Stock	60,000	
Investment in Sub		60,000

Dividend consolidation entry

Dividend Income	12,000	
Dividend Declared		12,000

Group Exercise 2: Cost Method Consolidation *Solution*

	Pinkett, Inc.	Smith, Inc.	Consolidation Entries DR	Consolidation Entries CR	Consolidated
Income Statement					
Sales	$ 840,000	$ 300,000			$ 1,140,000
Less: COGS	(516,000)	(156,000)			(672,000)
Less: Expenses	(204,000)	(108,000)			(312,000)
Dividend Income	12,000		**12,000**		
Net Income	**$ 132,000**	**$ 36,000**	**12,000**		**$ 156,000**
Statement of Retained Earnings					
Balances, 1/1/X3	$ 60,000	$ 72,000			$ 132,000
Add: Net Income	132,000	36,000	**12,000**		156,000
Less: Dividends	(108,000)	(12,000)		**12,000**	(108,000)
Balances, 12/31/X3	**$ 84,000**	**$ 96,000**	**12,000**	**12,000**	**$ 180,000**
Balance Sheet					
Cash	$ 54,000	$ 48,000			$ 102,000
Accounts Receivable	114,000	66,000			180,000
Inventory	204,000	90,000			294,000
Investment in Sub	60,000			**60,000**	
Property & Equipment	336,000	210,000			546,000
Accumulated Depreciation	(144,000)	(30,000)			(174,000)
Total Assets	**$ 624,000**	**$ 384,000**		**60,000**	**$ 948,000**
Payables & Accruals	$ 168,000	84,000			$ 252,000
Long-term Debt	360,000	144,000			504,000
Common Stock	12,000	60,000	**60,000**		12,000
Retained Earnings	84,000	96,000	**12,000**	**12,000**	180,000
Total Liabilities & Equity	**$ 624,000**	**384,000**	**72,000**	**12,000**	**$ 948,000**

The Cost Method: Things to Remember in Consolidation

- Consolidated net income does NOT equal the parent's net income.

P		S		Sub's Div		CONS
$200	**+**	**$200**	**–**	**$50**	**=**	**$350**

- Consolidated retained earnings do NOT equal the parent's retained earnings.

P		S		CONS
$350	**+**	**$50**	**=**	**$400**

Consolidation: The Most Important Point of All on Investment Basis

The **consolidated statement amounts** are **identical** whether the parent uses the **cost method** or the **equity method**—this holds true for **all three statements.**

Equity Method Consolidated Statements	=	Cost Method Consolidated Statements

PCO Statements: Presented in Notes to the Consolidated Statements

- **Retained Earnings Available for Dividends:**
  - Based on the parent's G/L amount, not on the consolidated retained earnings amount.
  - Use of the equity method in Parent Co statements produces identical retained earnings amounts.
  - Use of the cost method in Parent Co statements creates confusion.

The End