Problems For Self Study

(The solutions for these problems can be found in the separate Study Guide.)

Self Study Problem Two - 1

On June, 30, 2007, Laxator Inc. acquires 2,500 of the outstanding voting shares of Barnes Ltd. at a cost of $55.00 per share. Transaction costs total $500. Laxator classifies the investment in Barnes shares as held for trading.

Laxator has a December 31 year end. On December 31, 2007, the Barnes shares are trading at $61.50 per share. However, by December 31, 2008, their value has declined to $43.20 per share.

On September 5, 2009, Laxator sells the Barnes shares for proceeds of $56.25 per share. Transaction costs total $500.

The Barnes shares do not pay dividends during the period June 30, 2007 through September 5, 2009.

Required: Provide dated journal entries to account for the Barnes shares during the period June 30, 2007 through September 5, 2009. Calculate the effect of the investment in Barnes shares on Laxator's Net Income for the period June 30, 2007 through September 5, 2009.

Self Study Problem Two - 2

On June, 30, 2007, Laxator Inc. acquires 2,500 of the outstanding voting shares of Barnes Ltd. at a cost of $55.00 per share. Transaction costs total $500. Laxator classifies the investment in Barnes shares as available for sale and chooses to expense transaction costs.

Laxator has a December 31 year end. On December 31, 2007, the Barnes shares are trading at $61.50 per share. However, by December 31, 2008, their value has declined to $43.20 per share.

On September 5, 2009, Laxator sells the Barnes shares for proceeds of $56.25 per share. Transaction costs total $500.

The Barnes shares do not pay dividends during the period June 30, 2007 through September 5, 2009.

Required: Provide dated journal entries to account for the Barnes shares during the period June 30, 2007 through September 5, 2009. Calculate the effect of the investment in Barnes shares on Laxator's Net Income for the period June 30, 2007 through September 5, 2009.

Self Study Problem Two - 3

On January 1, the Lestor Company purchased 20 percent of the outstanding voting shares of the Rapone Company. The purchase price, all of which was paid in cash, amounted to $5 million. On the acquisition date, the carrying value and the fair value of the Rapone Company's net assets was $25 million. The Lestor Company's 20 percent shareholding does not result in the ability to exercise significant influence over the operations of the Rapone Company. Lester classifies the investment as available for sale and, because the Rapone shares do not trade in an active market, the investment will be accounted for by the cost method.

During the three years following the acquisition date the Rapone Company had Net Income and dividends declared and paid as follows:

Year	Net Income (Net Loss)	Dividends
1	$1,500,000	$1,000,000
2	(1,000,000)	1,000,000
3	4,000,000	1,000,000

There were no intercompany transactions, other than dividend payments, during any of the years under consideration. Both Companies close their books on December 31.

Required: Provide the Lestor Company's dated journal entries to account for its investment in the Rapone Company for each of the three years. In addition, calculate the balance in the Investment In Rapone account as at December 31 of year 3.

Self Study Problem Two - 4

On January 1, the Lestor Company purchased 20 percent of the outstanding voting shares of the Rapone Company. The purchase price, all of which was paid in cash, amounted to $5 million. On the acquisition date, the carrying value and the fair value of the Rapone Company's net assets was $25 million. The Lestor Company's 20 percent shareholding results in the ability to exercise significant influence over the operations of the Rapone Company.

During the three years following the acquisition date the Rapone Company had Net Income and dividends declared and paid as follows:

Year	Net Income (Net Loss)	Dividends
1	$1,500,000	$1,000,000
2	(1,000,000)	1,000,000
3	4,000,000	1,000,000

There were no intercompany transactions, other than dividend payments, during any of the years under consideration. Both Companies close their books on December 31.

Required: Provide the Lestor Company's dated journal entries to account for its investment in the Rapone Company for each of the three years. In addition, calculate the balance in the Investment In Rapone account as at December 31 of year 3.

Self Study Problem Two - 5

On January 1, 2007, the Buy Company purchased 25 percent of the outstanding voting shares of the Sell Company for cash of $1,500,000. On this date, the Sell Company had net assets of $6,000,000. On the acquisition date, all of the identifiable assets and liabilities of the Sell Company had fair values that were equal to their carrying values.

The Buy Company's 25 percent investment in the shares of the Sell Company gives it significant influence over the Sell Company. As result, the equity method is used to account for its Investment In Sell.

Between January 1, 2007 and December 31, 2009, the Sell Company had a total Net Income of $3,000,000 and paid dividends which totalled $2,000,000. During this period, dividend payments were the only intercompany transactions.

For the year ending December 31, 2010, prior to the Buy Company taking into account any amounts for Investment Income from the Sell Company, the two Companies have the following Income Statements:

Buy And Sell Companies
Income Statements
For the Year Ending December 31, 2010

	Buy	Sell
Revenues Before Investment Income	$5,000,000	$2,000,000
Cost Of Goods Sold	$3,000,000	$1,800,000
Other Expenses	800,000	400,000
Total Expenses	$3,800,000	$2,200,000
Income (Loss) Before Investment Income and Extraordinary Items	$1,200,000	($ 200,000)
Extraordinary Gain	Nil	600,000
Income Before Investment Income	$1,200,000	$ 400,000

On January 1, 2010, the Retained Earnings balance of the Buy Company was $15,000,000. This balance included the Investment Income calculated by the equity method for Buy's Investment In Sell during the period January 1, 2007 through December 31, 2009.

During the year ending December 31, 2010, the Buy Company declares and pays dividends in the amount of $500,000, while the corresponding dividend figure for the Sell Company is $150,000. Also during 2010, the Sell Company discovers a $50,000 expense which was overlooked in 2009.

Required: Prepare the Buy Company's Income Statement and Statement Of Retained Earnings for the year ending December 31, 2010. In addition, calculate the balance in the Investment In Sell account as at December 31, 2010.

Self Study Problem Two - 6

Carson Investments is a manufacturing company with a variety of investments in Canadian companies. These investments can be described as follows:

Best Parts Inc. Carson Investments owns 48 percent of the outstanding common shares of Best Parts Inc. Over 90 percent of this Company's sales are made to Carson Investments. In addition to the holding of common shares, Carson owns 60 percent of the outstanding 7 percent, cumulative preferred shares of Best Parts Inc.

Research Tech Ltd. Carson owns 25 percent of the outstanding common shares of Research Tech Ltd., a company established with three other investors to do research on a new manufacturing process. The other investors each have 25 percent of the outstanding common shares. However, two of these investors do not participate in the management of the Company, leaving all operating decisions in the hands of Carson and one other investor.

Entell Ltd. Carson owns 46 percent of the outstanding voting shares of Entell Ltd. Included in the assets of Entell is an investment in 18 percent of the outstanding common shares of Chelsea Distributors Inc. In recent years, Chelsea has experienced adverse operating results and there is some question as to whether it will be able to continue as a going concern.

Chelsea Distributors Inc. Carson owns, directly, 37 percent of the outstanding common shares of Chelsea Distributors Inc. In addition, Chelsea owns 3 percent of the outstanding voting shares of Carson Investments Ltd.

Required: Describe and justify the recommended accounting treatment for each of the investments, including those made by Carson Investments' investees.

Assignment Problems

(The solutions for these problems are only available in
the solutions manual that has been provided to your instructor.)

Assignment Problem Two - 1

On December 31, 2007, Vonex Ltd. acquires 4,200 of the outstanding voting shares of Morex Inc. at a cost of $72.00 per share. Vonex Ltd. pays no transaction costs on its purchase or sale of Morex Inc. shares. Vonex has a December 31 year end.

During the year ending December 31, 2008, Morex Inc. declares and pays dividends of $1.05 per share.

On December 31, 2008, the Morex shares are trading at $78.00 per share.

On May 1, 2009, Vonex sells the 4,200 Morex shares for proceeds of $56.00 per share. Morex did not declare any 2009 dividends prior this disposition.

Required: For the period December 31, 2007 through May 1, 2009, provide the dated journal entries to account for the Morex shares, and calculate the effect of the investment in Morex shares on Venox's Net Income under the following assumptions:

A. Venox classifies the investment in Morex shares as held for trading.

B. Venox classifies the investment in Morex shares as available for sale.

Assignment Problem Two - 2

On December 31, 2007, the Miser Company purchased 25 percent of the outstanding voting shares of the Mercy Company for $4 million in cash. On the acquisition date, all of the net identifiable assets of the Mercy Company had fair values that were equal to their carrying values. The carrying value of Mercy Company's net assets was $16 million.

Mercy's Net Income, dividends declared and paid, and the December 31 fair value of its outstanding shares, for the year of acquisition and the three subsequent years are as follows:

Year	Net Income (Net Loss)	Dividends Declared And Paid	December 31 Fair Value (100 Percent)
2007	$ 600,000	$ 600,000	$16,000,000
2008	(2,000,000)	400,000	17,600,000
2009	1,500,000	500,000	15,500,000
2010	3,000,000	1,000,000	18,200,000

Both Companies close their books on December 31. The 2010 Net Income figure of the Mercy Company includes an Extraordinary Loss of $800,000. There were no intercompany transactions, other than dividend payments, during any of the years under consideration.

Required: Provide the Miser Company's dated journal entries to account for its investment in the Mercy Company for each of the four years and the December 31, 2010 balance in the Investment in Mercy account assuming that:

A. Miser Company's 25 percent holding does not give it significant influence in the operations of Mercy Company. Miser classifies the investment as held for trading.

B. Miser Company's 25 percent holding does not give it significant influence in the operations of Mercy Company. Miser classifies the investment as available for sale.

C. Miser Company's 25 percent holding gives it significant influence in the operations of Mercy Company.

Assignment Problem Two - 3

On January 1, 2007, the Bronson Company purchased 18 percent of the outstanding shares of the Somerset Company. The purchase price, all of which was paid in cash, amounted to $1.8 million. On the acquisition date, the fair value of the Somerset Company's net assets was $10 million and all of the assets and liabilities had fair values that were equal to their carrying values. Both Companies have a fiscal year which ends on December 31.

During the four years following the Bronson Company's acquisition of the Somerset Company's shares, the Somerset Company had income and declared and paid dividends as follows:

Year	Net Income (Net Loss)	Dividends
2007	$ 950,000	$350,000
2008	(1,140,000)	140,000
2009	750,000	160,000
2010	840,000	320,000

Other Information:

1. The Somerset Company's 2009 Net Income includes an Extraordinary Loss of $163,000.

2. During 2010, the Somerset Company changed its accounting policy with respect to the calculation of Depreciation Expense. The change was accounted for retroactively, resulting in an addition to Retained Earnings of $246,000 to reflect the effects of this change on prior periods.

3. There were no intercompany transactions between Bronson and Somerset, other than dividend payments, during any of the years under consideration.

4. Bronson's 18 percent shareholding gives the company significant influence over the operations of Somerset.

Required: Provide the Bronson Company's dated journal entries to account for its Investment In Somerset for the years 2007 through 2010 assuming:

A. that Bronson is a qualifying enterprise for differential reporting purposes and elects to account for its Investment In Bronson using the cost method.

B. that Bronson is a public company and it uses the equity method to account for its Investment In Somerset.

Assignment Problem Two - 4

The Fostor Company purchased 30 percent of the outstanding voting shares of the Festee Company for $1,200,000 in cash on January 1, 2007. On that date, the Festee Company's net assets had a carrying value of $4,000,000. There were no differences between the carrying values and the fair values of any of its identifiable assets or liabilities.

This investment gives the Fostor Company significant influence over the affairs of the Festee Company. The net income and dividends declared and paid by the Festee Company for the two years subsequent to its acquisition were as follows:

	2007	2008
Net Income (Loss)	($100,000)	$160,000
Dividends	40,000	50,000

The Income Statements for the year ending December 31, 2009, prior to the recognition of any Investment Income, for the Fostor and Festee Companies are as follows:

Foster and Festee Companies
Income Statements
Year Ending December 31, 2009

	Fostor	**Festee**
Sales	$2,000,000	$550,000
Other Revenues	100,000	Nil
Total Revenue	$2,100,000	$550,000
Cost Of Goods Sold	$1,000,000	$300,000
Other Expenses	200,000	50,000
Total Expenses	$1,200,000	$350,000
Income Before Extraordinary Items	$ 900,000	$200,000
Extraordinary Loss	Nil	(30,000)
Net Income	$ 900,000	$170,000

During 2009, the Fostor Company declared and paid dividends of $100,000 while Festee Company declared and paid dividends of $70,000. Other than dividends, there were no transactions between the two companies in any of the years under consideration.

Required: Provide the following:

A. The dated journal entries of the Fostor Company related to its investment in Festee Company for the years ending December 31, 2007, 2008 and 2009.

B. The Income Statement of the Fostor Company, including recognition of any investment income or loss, for the year ending December 31, 2009.

C. The balance in the Investment In Festee account as it would appear on the December 31, 2009 Balance Sheet of the Fostor Company.

Assignment Problem Two - 5

On January 1, 2007, Tribble Company purchased 40 percent of the outstanding voting shares of the Marcus Company for $320,000 in cash. On that date, Marcus had Common Stock - No Par of $500,000, Retained Earnings of $300,000 and all of its identifiable assets and liabilities had fair values that were equal to their carrying values. This investment gives Tribble significant influence over the affairs of Marcus.

Between January 1, 2007 and December 31, 2009, Marcus had Net Income and paid dividends as follows:

	2007	**2008**	**2009**
Net Income (Loss)	$300,000	($400,000)	$320,000
Dividends	100,000	50,000	70,000

There were no extraordinary items or prior period adjustments for Marcus in the three years 2007 through 2009. For the year ending December 31, 2010, the Income Statements of the Tribble and Marcus Companies, before recognition of any investment income, were as follows:

Tribble and Marcus Companies
Income Statements
For the Year Ending December 31, 2010

	Tribble	Marcus
Sales	$2,300,000	$850,000
Other Revenues	200,000	Nil
Total Revenues	$2,500,000	$850,000
Cost Of Goods Sold	$1,000,000	$500,000
Other Expenses	500,000	80,000
Total Expenses	$1,500,000	$580,000
Income Before Discontinued Operations	$1,000,000	$270,000
Loss From Discontinued Operations	Nil	(20,000)
Net Income	$1,000,000	$250,000

During 2010, Marcus initiated a change in accounting policy. The change was accounted for retroactively, resulting in a prior period addition to the Company's Retained Earnings balance in the amount of $700,000.

Tribble declared $150,000 in dividends in 2010. Marcus declared and paid dividends of $120,000 in 2010. Assuming the use of the cost method to account for its Investment in Marcus since its acquisition, Tribble has a Retained Earnings balance of $4,600,000 on January 1, 2010.

Required: Prepare the dated journal entries for the Tribble Company related to its investment in the Marcus Company for the years 2007 through 2010, the Income Statement for the Tribble Company for the year ending December 31, 2010, and the Statement of Retained Earnings for the Tribble Company for the year ending December 31, 2010 assuming:

A. that the Tribble Company is a qualifying enterprise and uses the Section 3051 differential reporting option to account for its Investment In Marcus by the cost method.

B. that the Tribble Company is not a qualifying enterprise and, since it was acquired, the Investment In Marcus has been carried by the equity method. (This will require a recalculation of the January 1, 2010 Retained Earnings balance of Tribble.)

Assignment Problem Two - 6

Small World Limited owns a chain of retail stores which sell children's books and toys. The President of Small World, Ted Kidd, hopes that his Company will eventually achieve vertical integration with many of its suppliers. At the moment, Small World owns 52 percent of the outstanding voting shares of Blocks N Things, a toy wholesaler.

Blocks N Things owns 22 percent of the outstanding common shares and 53 percent of the outstanding non-cumulative, non-participating preferred shares of Craftco Limited, a manufacturer of wooden toys. No other Craftco shareholder, or group of related shareholders, holds preferred or common shares to the same extent as Blocks N Things.

Craftco currently owns 13 percent of the outstanding common shares of Delta Inc., a major Canadian pulp and paper company. The market value of Delta's shares has decreased substantially since acquisition.

Small World Limited also owns 40 percent of the outstanding common shares of Delta Inc.

Required: For each of the investments in equity securities that are described, indicate the appropriate classification and accounting treatment. Explain your conclusions.