Lectures

Chapter 12 – Part 1 Accounting 351

Investments

Less than 20%

20-50%

Over 50%

ASC 320-10-25

ASC 323-10-15 and 35 **Equity Method**

Consolidation

Significant influence

Control

For investments with less than a 20% ownership, what was management's intent when making the investment?

> Trading Securities

Mark to Market Expected to be traded within 3

months.

Available for Sale

Mark to Market Not held-tomaturity or trading securities.

Held to Maturity

Amortized Cost Debt securities

Held to Maturity

Alpha purchased 10%, 10-year \$100,000 Beta bonds on July 1 for \$88,530 when other bonds are paying 12%. Interest is paid on June 30 and December 31.

 $$5,000 \times 11.46992 = $57,350$

 $$100,000 \times .31180 = 31,180$

\$88,530

Discount = \$100,000 - \$88,530 = \$11,470 (future interest revenue)

The bonds sell for \$88,530 or 88.53 (88.53% of \$100,000)

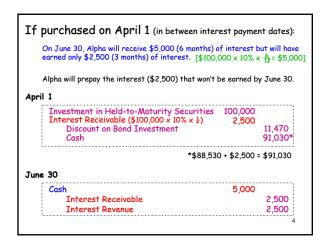
Investment in Held-to-Maturity Securities 100,000 Discount on Bond Investment 11,470 88,530

Cash

Discount on Bonds Payable

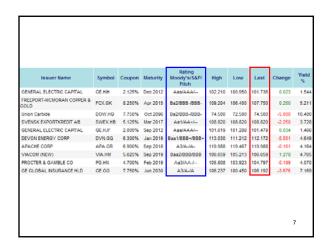
Bonds Payable

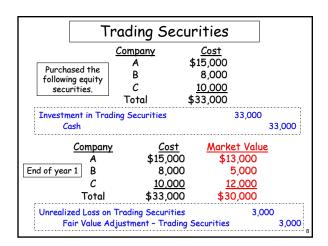
100,000



	Balance Sheet		
	Investment in HTM Securities Less: Discount on Bond Investmen	\$100,000 † <u>11,470</u> \$ 88,530	<u>)</u>
	e Method) \$11,470 discount/20 paterest Method) \$88,530 x 6% = \$5,31	,	
Dec 31	Discount on Bond Investment	312	312
	Interest Revenue		312
	Cash Interest Revenue	5,000	5,000
	Cash		

Bond interest rate = 10% Market interest rate = 12%		Bond interest rate = 12% Market interest rate = 10%	
Discount on Bond Inv	11,470	Investment in HTMS 100,000 Premium on Bond Inv 12,463	
Cash \$88,530×6%-\$5,000 = \$312	88,530 Rounded	Cash 1 \$6,000-(\$112,463×5%) = \$377	12,463 Rounded
Discount on Bond Inv Interest Revenue	312 312		377
Cash Interest Revenue	5,000 5,000	Cash 6,000 Interest Revenue	6,000
<u>In 6 months</u>		In 6 months	
(\$88,530+312)x6%-\$5,000 =	\$331	\$6,000 - (\$112,463-377)x5% =	\$396
Discount on Bond Inv Interest Revenue	331 331	Interest Revenue 396 Premium on Bond Inv	396
			6





	e of Trading S ment in Tradir			7,000 1,000 8,000
<u>c</u>	Company	<u>(</u>	Cost	Market Value
End of year 2	À	\$15	5,000	\$19,000
Lila or year =	С	<u>10</u>	0,000	8,000
	Total	\$25	5,000	\$27,000
	Fair Value A	Adjustmer	nt - Tradin	g Securities
			3,000	Year 1 Ending Balance
Required ent	ry in Year 2	5,000		
Year 2 Endi	ng Balance	2,000		

<u>Income Statement</u> (Year 1)	
Other expenses and losses: Unrealized loss on trading securities	\$3,000
<u>Balance Sheet</u> (Year 1) Assets	
Investment in trading securities Less: FV adjustment - trading securities	\$33,000 3,000
	10

<u>Income Statement</u> (Year 2)	
Other revenues and gains: Unrealized gain on trading securities	\$5,000
Other expenses and losses: Loss on sale of trading securities	\$1,000
Balance Sheet (Year 2) Assets Investment in trading securities Add: FV adjustment - trading securities	\$25,000 2,000
	11

<i>P</i>	Available fo	r Sale	
Purchased the following equity securities.	Company A B C Total	<u>Cost</u> \$15,000 8,000 <u>10,000</u> \$33,000	
Investment in Ava Cash	ilable-for-Sale Sec	urities 33,00	0 33,000
Compan	y Cost	Market Val	
Compan			_
A End of year 1 B	\$1 <u>5,000</u> 8,000	\$13,000 5,000	
À	\$15,000	\$13,000 5,000 12,000	

Cash Loss on Sale of Available Investment in Avail				000
Company		Cost	Market Value	
End of year 2	\$1	5,000	\$19,000	
C	1	0,000	8,000	
Total	\$2	5,000	\$27,000	
Fair Value Adjus	stment - A	vailable-for	-Sale Securities	
		3,000	Year 1 Ending Balan	ice
Required entry in Year 2	5,000			
Year 2 Ending Balance	2,000			

All changes in equity (net assets) except those resulting from investments by and distributions to owners. Controlled by external market conditions, not a result of operations. Net income + Other Comprehensive Income (OCI) Comprehensive Income Net Income Foreign Currency Translation Adjustment Unrealized Gains/Losses on Available-for-Sale Securities Impairment of Investment in Debt Securities Deferred Gains/Losses on Derivative Financial Instruments Minimum Pension Liability Comprehensive Income

Chatanant of Commistantin Transport		
Statement of Comprehensive Income (Year 1)		
Net income	xxxxx	
Other comprehensive income		
Unrealized loss on available-for-sale securities	\$3,000	
<u>Balance Sheet</u> (Year 1)		
Investment in available-for-sale securities	\$33,000	
Less: FV adjustment - available-for-sale securities	3,000	
Less: 1 v adjustifient - available-101-sale securities	\$30,000	
Stockholders' Equity	ψ30,000	
Capital stock	xxxxx	
Retained earnings	xxxxx	
Accumulated other comprehensive income:		
Less: Unrealized loss on available-for-sale		
securities	\$3,000	

Income Statement (Year 2) Other expenses and losses: Loss on sale of available-for-sale securities	\$1,000	
Statement of Comprehensive Income (Year 1)		
Net income	xxxxx	
Other comprehensive income Unrealized gain on available-for-sale securities	\$5,000	
Balance Sheet (Year 2)		
Assets		
Investment in available-for-sale securities	\$25,000	
Add: FV adjustment – available–for–sale securities	2,000	
	\$27,000	
Stockholders' Equity		
Capital stock	xxxxxx	
Retained earnings	XXXXXX	
Accumulated other comprehensive income:		
Add: Unrealized gain on available-for-sale securities	\$2,000	16

Facts: Purchased an equity securit	ty for \$10.
Investment - TS 10 Cash 10	Investment - AFSS 10 Cash 10
At year-end, the value is \$15.	
FV Adjustment - TS 5 Unrealized Gain 5 NI	FV Adjustment - AFSS 5 Unrealized Gain 5 OCI
The security is sold for \$12.	
Cash 12 Investment - TS 10 Gain on Sale 2 NI	Cash 12 Investment - AFSS 10 Gain on Sale 2 NI
Unrealized Loss - TS 5 NI FV Adjustment - TS 5	Unrealized Loss 5 OCT FV Adjustment - AFSS 5
or	or
Unrealized Loss - TS 5 Cash 12 FV Adjustment - TS 5 Investment - TS 10 Gain on Sale 2	Unrealized Loss 5 Cash 12 FV Adjustment - AFSS 5 Investment - AFSS 10 Gain on Sale 2 17

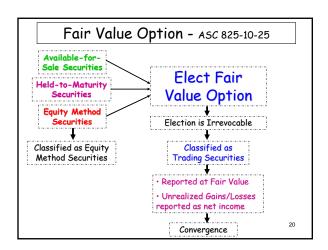
Lectures

Chapter 12 - Part 2
Accounting
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California State University, Northridge

Equity Method Used when the investor is able to exercise significant control or influence over the investee (20-50% guideline). Alpha purchased 25% of the common stock of Beta for \$200,000. Investment in Beta Stock 200,000 200,000 Beta reported net income for the year of \$240,000. Investment in Beta Stock 60,000 Investment Revenue 60,000 Beta paid a dividend of \$36,000. Cash 9,000 Investment in Beta Stock 9,000 Investment in Beta Stock 9,000

Cost	\$200,000 \$150,000 \$50	0,000 Goodwill
FV (\$600,000 × 25%)	\$150,000	7,000 B00dwiii
BV (\$540,000 x 25%)	\$135,000 \$15	5,000
	Inventory \$5,000	Depreciable Assets \$10,000/ 5-year life
Investment Revenue Investment in B		5,000 5,000
Investment Revenue Investment in B		2,000



Alpha purchased 25% of Beta for \$200,000 and elected the fair value option. Both the fair value and book value of Beta's net assets were \$800,000. At year-end, Beta reported the following:

Net income = \$240,000 (\$240,000×25%=\$60,000)

Dividends paid = \$36,000 (\$36,000x25%=\$9,000)

Fair value of Beta stock = \$1,100,000 (\$1,100,000×25%=\$275,000)

Use the equity method for the entire year and make the fair value adjustment at year-end.

(1) Compute the carrying value at year-end.

Cost \$200,000
Share of Beta's income +60,000
Share of Dividends -9,000
Carrying value \$251,000

(2) Compute the unrealized gain or loss.

Unrealized gain = \$275,000 - 251,000 = \$24,000

Fair Value Adjustment 24,000 Unrealized Gain 24,000

(3) Compute what is included in net income.

Share of Beta's income
Unrealized gain

Included in net income
\$60,000

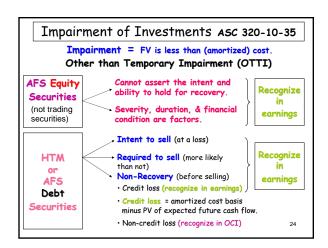
24,000

\$84,000

22

21

Treat as a trading security for t make the fair value adjustment of		ana
(1) Compute the unrealized gain or	loss.	
Unrealized gain = \$275,000 - 200	,000 = \$75,000	
Fair Value Adjustment Unrealized Gain	75,000 7!	5,000
(2) Compute what is included in net	income.	
	\$ 9,000	



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Facts:
  5%, 10-year, $10,000 bond
  Cost = $10,000
  Interest = $500 per year
   After 5 years, FV = $6,000
Loss = $10,000 - $6,000 = $4,000
  Future cash flow:
     Principal = $7,000
     Interest = 4% or $400
  PV of principal = $7,000 \times .78353 = $5,485
  PV of interest = $400 \times 4.32948 = 1,732
  PV of future cash flow =
                                     $7,217
Credit loss = $10,000 - $7,217 = $2,783
                                                +Earnings
Non-credit loss = $4,000 - $2,783 = $1,217 --- OCI
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