

Chapter 1– Advanced Accounting, 1st edition by Hamlen, Huefner, and Largay

Solutions to Practice Quiz

1. Topic: Motivations for intercorporate investments
LO 1
Coca-Cola Company owns 300 shares of Cisco Systems, and classifies the investment as a current asset, trading securities. The *most* likely reason Coca-Cola made this investment is to:
 - a. Earn investment income and capital gains
 - b. Establish a joint venture with Cisco Systems
 - c. Exert a significant influence on Cisco Systems
 - d. Facilitate activity along Coca-Cola's supply chain

ANS: a

Rationale: Trading securities are held as investments of temporarily idle cash, to provide investment income and gains in value.

2. Topic: Motivations for intercorporate investments
LO 1
Which category below is *not* one of the reporting categories for intercorporate *equity* investments?
 - a. Available-for-sale investments
 - b. Subsidiaries
 - c. Held-to-maturity investments
 - d. Trading investments.

ANS: c

Rationale: Held-to-maturity investments are debt securities, not equity securities.

3. Topic: Trading and available-for-sale investments

LO 2

A company buys stock in Acme Industries for \$35,000 on August 1, 2012. The fair value of the investment on December 31, 2012, the company's year-end, is \$32,000. The company sells the stock for \$40,000 on February 1, 2013. How will the company's income statements for 2012 and 2013 be affected by the investment, if it is categorized as (1) trading, or (2) available-for-sale?

		2012	2013
a.	(1)	\$0	\$5,000 gain
	(2)	\$3,000 loss	\$8,000 gain
b.	(1)	\$3,000 loss	\$5,000 gain
	(2)	\$3,000 loss	\$8,000 gain
c.	(1)	\$3,000 loss	\$8,000 gain
	(2)	\$0	\$5,000 gain
d.	(1)	\$0	\$5,000 gain
	(2)	\$0	\$5,000 gain

ANS: c

Rationale: The change in value of trading securities is reported in income as incurred. The change in value of AFS securities is reported in income when the securities are sold.

4. Topic: Held-to-maturity investments

LO 2

At the beginning of the year, a U.S. company invests in a \$10,000,000 face value 4% coupon corporate bond, and pays \$9,727,675, a price that yields 5%. Interest is paid at the end of the year. The bond is classified as held-to-maturity. At the end of the year, the fair value of the bond is determined to be only \$7,000,000. The decline in value is other than temporary. What is the impairment loss for the year?

- a. \$3,000,000
- b. \$2,727,675
- c. \$2,641,291
- d. \$2,814,059

ANS: d

Rationale: Investment book value, end of year:

$$\$9,727,675 + [(5\% \times \$9,727,675) - \$400,000] = \$9,814,059$$

$$\text{Loss} = \$9,814,059 - \$7,000,000 = \$2,814,059$$

5. Topic: Equity method investments

LO 3

Eton Corporation acquires 30% of the voting stock of Fairfield Company for \$60,000,000 on January 1, 2012, and classifies the investment as an equity method investment. At the time, the book value of the company was \$200,000,000. During 2012 Fairfield reported net income of \$2,400,000 and declared and paid dividends of \$1,000,000. Both companies have December 31 year-ends. At what amount will Eton report its investment in Fairfield on its December 31, 2012 balance sheet?

- a. \$60,000,000
- b. \$61,400,000
- c. \$60,420,000
- d. \$60,720,000

ANS: c

Rationale: $\$60,000,000 + 30\% \times (\$2,400,000 - \$1,000,000) = \$60,420,000$

6. Topic: Equity method investments

LO 3

Eton Corporation acquires 30% of the voting stock of Fairfield Company for \$60,000,000 on January 1, 2012, and classifies the investment as an equity method investment. At the time, the book value of the company was \$200,000,000. Eton determined that the book value of Fairfield's plant assets (15 year life, straight-line) were overstated by \$10,000,000, and Fairfield had unreported intangible assets (5 year life, straight-line) with a fair value of \$8,000,000. During 2012 Fairfield reported net income of \$2,400,000 and declared and paid dividends of \$1,000,000. Both companies have December 31 year-ends. At what amount will Eton report its investment in Fairfield on its December 31, 2012 balance sheet?

- a. \$60,000,000
- b. \$60,140,000
- c. \$60,540,000
- d. \$60,040,000

ANS: b

Rationale:

Equity in net income for 2012:

30% x \$2,400,000 =	\$720,000
30% x (\$10,000,000/15) =	200,000
30% x (\$8,000,000/5) =	<u>(480,000)</u>
Equity in net income	\$440,000

$\$60,000,000 + \$440,000 - (30\% \times \$1,000,000) = \$60,140,000$

7. Topic: Controlling investments

LO 4

Gigo Company acquires all of the voting stock of Hanna Corporation for \$100,000,000 on January 1, 2012, in a statutory merger. Hanna's January 1, 2012 book value is \$10,000,000. Its plant and equipment is overvalued by \$8,000,000 and it has unreported intangibles with a fair value of \$25,000,000. How much goodwill is reported for this acquisition?

- a. \$73,000,000
- b. \$60,000,000
- c. \$57,000,000
- d. \$83,000,000

ANS: a

Rationale: $\$100,000,000 - (\$10,000,000 - 8,000,000 + \$25,000,000) = \$73,000,000$

8. Topic: Controlling investments

LO 4

Gigo Company acquires all of the voting stock of Hanna Corporation for \$100,000,000 in cash on January 1, 2012, in a statutory merger. Hanna's balance sheet at the date of acquisition is as follows:

	Dr (Cr)
Current assets	\$ 25,000,000
Plant and equipment	400,000,000
Liabilities	(415,000,000)
Capital stock	(1,000,000)
Retained earnings	(9,000,000)

Hanna's plant and equipment is overvalued by \$8,000,000 and it has unreported intangibles with a fair value of \$25,000,000. Gigo's entry to record its acquisition of Hanna Corporation will include a:

- a. Credit of \$1,000,000 to capital stock
- b. Debit of \$415,000,000 to liabilities
- c. Debit of \$392,000,000 to plant and equipment
- d. Debit of \$81,000,000 to goodwill

ANS: c

Rationale: Gigo's acquisition entry is as follows:

Current assets	25,000,000	
Plant and equipment	392,000,000	
Intangibles	25,000,000	
Goodwill	73,000,000	
Liabilities		415,000,000
Cash		100,000,000

9. Topic: IFRS for intercorporate investments

LO 5

At the beginning of 2012, Nokia enters a joint venture with another company to develop a communications network. Each company invests €6,000,000 for a 50% interest in the joint venture. During the year, the joint venture reports income of €1,000,000 and pays no dividends. At the end of 2012, the joint venture's balance sheet reports €16,000,000 in assets and €3,000,000 in liabilities. Nokia reports €100,000,000 in assets and €70,000,000 in liabilities from its own operations. Using proportionate consolidation, Nokia's total assets at the end of 2012 are

- a. €100,000,000
- b. €106,000,000
- c. €106,500,000
- d. €108,000,000

ANS: d

Rationale: $€100,000,000 + (50\% \times €16,000,000) = €108,000,000$

10. Topic: IFRS for intercorporate investments

LO 5

At the beginning of 2012, Nokia enters a joint venture with another company to develop a communications network. Each company invests €6,000,000 for a 50% interest in the joint venture. During the year, the joint venture reports income of €1,000,000 and pays no dividends. At the end of 2012, the joint venture's balance sheet reports €16,000,000 in assets and €3,000,000 in liabilities. Nokia reports €100,000,000 in assets and €70,000,000 in liabilities from its own operations. Nokia follows IFRS and has a choice of using the equity method or proportionate consolidation to report its joint venture. A comparison of the two methods reveals that Nokia's:

- a. Total liabilities are higher using the equity method
- b. Net income is higher using proportionate consolidation
- c. Total assets are higher using proportionate consolidation
- d. Equity is higher using the equity method

ANS: c

Rationale: Both methods report the same net income and equity. If Nokia uses proportionate consolidation, it includes 50% of the joint venture's assets with its assets, and 50% of the joint venture's liabilities with its liabilities. Using the equity method, Nokia's share of the joint venture's net assets are included with its assets.