Chapter 2

STOCK INVESTMENTS — INVESTOR ACCOUNTING AND REPORTING

Answers to Questions

1 Only the investor's accounts are affected when outstanding stock is acquired from existing stockholders. The investor records the investment at its cost. Since the investee company is not a party to the transaction, its accounts are not affected.

Both investor and investee accounts are affected when unissued stock is acquired directly from the investee. The investor records the investment at its cost and the investee adjusts its asset and owners' equity accounts to reflect the issuance of previously unissued stock.

2 Goodwill arising from an equity investment of 20 percent or more is not recorded separately from the investment account. Under the equity method, the investment is presented on one line of the balance sheet in accordance with the one-line consolidation concept.

3 Dividends received from earnings accumulated before an investment is acquired are treated as decreases in the investment account balance under the fair value/cost method. Such dividends are considered a return of a part of the original investment.

4 The equity method of accounting for investments increases the investment account for the investor's share of the investee's income and decreases it for the investor's share of the investee's losses and for dividends received from the investee. In addition, the investment and investment income accounts are adjusted for amortization of any investment cost-book value differentials related to the interest acquired. Adjustments to the investment and investment income accounts are also needed for unrealized profits and losses from transactions between the investor and investee companies. A fair value adjustment is optional under SFAS No. 159.

5 The equity method is referred to as a one-line consolidation because the investment account is reported on one line of the investor's balance sheet and investment income is reported on one line of the investor's income statement (except when the investee has extraordinary or cumulative-effect type adjustments). In addition, the investment income is computed such that the parent company's income and stockholders' equity are equal to the consolidated net income and consolidated stockholders' equity that would result if the statements of the investor and investee were consolidated.

6 If the equity method of accounting is applied correctly, the income of the parent company will generally equal the controlling interest share of consolidated net income.

7 The difference in the equity method and consolidation lies in the detail reported, but not in the amount of income reported. The equity method reports investment income on one line of the income statement whereas the details of revenues and expenses are reported in the consolidated income statement.

8 The investment account balance of the investor will equal underlying book value of the investee if (a) the equity method is correctly applied, (b) the investment was acquired at book value which was equal to fair value, the pooling method was used, or the cost-book value differentials have all been amortized, and (c) there have been no intercompany transactions between the affiliated companies that have created investment account-book value differences.

9 The investment account balance must be converted from the cost to the equity method when acquisitions increase the interest held to 20 percent or more. The amount of the adjustment is the difference between the investment income reported under the cost method in prior years and the income that would have been reported if the equity method of accounting had been used. Changes from the cost to the equity method of accounting for equity investments are changes in the reporting entity that require restatement of prior years' financial statements when the effect is material.

10 The one-line consolidation is adjusted when the investee's income includes extraordinary items, gains or losses from discontinued operations, or cumulative-effect type adjustments. In this case, the investor's share of the investee's ordinary income is reported as investment income under a one-line consolidation, but the investor's share of extraordinary items, cumulative-effect type adjustments, and gains and losses from discontinued operations is combined with similar items of the investor.

11 The remaining 15 percent interest in the investee is accounted for under the fair value/cost method, and the investment account balance immediately after the sale becomes the new cost basis.

12 Yes. When an investee has preferred stock in its capital structure, the investor has to allocate the investee's income to preferred and common stockholders. Then, the investor takes up its share of the investee's income allocated to common stockholders in applying the equity method. The allocation is not necessary when the investee has only common stock outstanding.

13 Goodwill impairment losses are calculated by business reporting units. For each reporting unit, the company must first determine the fair values of net assets. The fair value of the reporting unit is the amount at which it could be purchased in a current market transaction. This may be based on market prices, discounted cash flow analyses, or similar current transactions. This is done in the same manner as is done to originally record a combination. Any excess measured fair value is the fair value of goodwill. The company then compares the goodwill fair value estimate to the carrying value of goodwill to determine if there has been an impairment during the period.

14 Yes. Impairment losses for subsidiaries are computed as outlined in the solution to question 13. Companies compare fair values to book valuers for equity method investments as a whole. Firms may recognize impairments for equity method investments as a whole, but perform no separate goodwill impairment.

15 Initial impairment losses recorded upon adoption of SFAS 142 are treated as the cumulative effect of an accounting change. Impairment losses resulting from subsequent annual reviews are included in the calculation of income from operations.

16

17

18

19 SOLUTIONS TO EXERCISES

Solution E2-1

1 d
2 c
3 c
4 d
5 b

Solution E2-2 [AICPA adapted]

1 d
2 b
3 d
4 b
Grade's investment is reported at its $300,000 cost because the equity method is not appropriate and because Grade's share of Medium's income exceeds dividends received since acquisition [($260,000 × 15%) > $20,000].
5 c
Dividends received from Zafacon for the two years were $10,500 ($70,000 × 15% - all in 2009), but only $9,000 (15% of Zafacon's income of $60,000 for the two years) can be shown on Torquel's income statement as dividend income from the Zafacon investment. The remaining $1,500 reduces the investment account balance.
6 c
[$50,000 + $150,000 + ($300,000 × 10%)]
7 a
8 d

Investment balance January 2	$250,000
Add: Income from Pod ($100,000 × 30%)	30,000
Investment in Pod December 31	$280,000

Solution E2-3

1 *Bowman's percentage ownership in Trevor*

Bowman's 20,000 shares/(60,000 + 20,000) shares = 25%

2 *Goodwill*

Investment cost	$500,000
Book value ($1,000,000 + $500,000) × 25%	(375,000)
Goodwill	$125,000

Solution E2-4

Income from Medley for 2009

Share of Medley's income ($200,000 × 1/2 year × 30%)	$ 30,000

Solution E2-5

1 *Income from Oakey*

Share of Oakey's reported income ($800,000 × 30%)	$ 240,000
Less: Excess allocated to inventory	(100,000)
Less: Depreciation of excess allocated to building ($200,000/4 years)	(50,000)
Income from Oakey	$ 90,000

2 *Investment account balance at December 31*

Cost of investment in Oakey	$2,000,000
Add: Income from Oakey	90,000
Less: Dividends ($200,000 x 30%)	(60,000)
Investment in Oakey December 31	$2,030,000

Alternative solution	
Underlying equity in Oakey at January 1 ($1,500,000/.3)	$5,000,000
Income less dividends	600,000
Underlying equity December 31	5,600,000
Interest owned	30%
Book value of interest owned December 31	1,680,000
Add: Unamortized excess	350,000
Investment in Oakey December 31	$2,030,000

Solution E2-6

Journal entry on Martin's books

Investment in Neighbors ($300,000 x 40%)	120,000	
Loss from discontinued operations	20,000	
Income from Kelly		140,000

To recognize income from 40% investment in Neighbors.

Solution E2-7

1	a	
	Dividends received from Bennett ($120,000 × 15%)	$ 18,000
	Share of income since acquisition of interest	
	2008 ($20,000 × 15%)	(3,000)
	2009 ($80,000 × 15%)	(12,000)
	Excess dividends received over share of income	$ 3,000
	Investment in Bennett January 3, 2008	$ 50,000
	Less: Excess dividends received over share of income	(3,000)
	Investment in Bennett December 31, 2009	$ 47,000
2	b	
	Cost of 10,000 of 40,000 shares outstanding	$1,400,000
	Book value of 25% interest acquired ($4,000,000 stockholders' equity at December 31, 2008 + $1,400,000 from additional stock issuance) × 25%	1,350,000
	Excess fair value over book value(goodwill)	$ 50,000
3	d	
	The investment in Monroe balance remains at the original cost.	
4	c	
	Income before extraordinary item	$ 200,000
	Percent owned	40%
	Income from Krazy Products	$ 80,000

Solution E2-8

Preliminary computations	
Cost of 40% interest January 1, 2008	$2,400,000
Book value acquired ($4,000,000 × 40%)	(1,600,000)
Excess fair value over book value	$ 800,000
Excess allocated to	
Inventories $100,000 × 40%	$ 40,000
Equipment $200,000 × 40%	80,000
Goodwill for the remainder	680,000
Excess fair value over book value	$ 800,000
Raython's underlying equity in Treaton ($5,500,000 × 40%)	$2,200,000
Add: Goodwill	680,000
Investment balance December 31, 2012	$2,880,000
Alternative computation	
Raython's share of the change in Treaton's stockholders' equity ($1,500,000 × 40%)	$ 600,000
Less: Excess allocated to inventories ($40,000 × 100%)	(40,000)
Less: Excess allocated to equipment ($80,000/4 years × 4 years)	(80,000)
Increase in investment account	480,000
Original investment	2,400,000
Investment balance December 31, 2012	$2,880,000

Solution E2-9

1	*Income from Runner*	
	Share of income to common ($400,000 - $30,000 preferred dividends) × 30%	$ 111,000
2	*Investment in Runner December 31, 2009*	
	NOTE: The $50,000 direct costs of acquiring the investment must be expensed when incurred. They are not a part of the cost of the investment.	
	Investment cost	$1,200,000
	Add: Income from Runner	111,000
	Less: Dividends from Runner ($200,000 dividends - $30,000 dividends to preferred) × 30%	(51,000)
	Investment in Runner December 31, 2009	$1,260,000

Solution E2-10

1	*Income from Tree* ($300,000 – $200,000) × 25%	
	Investment income October 1 to December 31	$ 25,000
2	*Investment balance December 31*	
	Investment cost October 1	$ 600,000
	Add: Income from Tree	25,000
	Less: Dividends	---
	Investment in Tree at December 31	$ 625,000

Solution E2-11

Preliminary computations				
Goodwill from first 10% interest:				
Cost of investment				$ 50,000
Book value acquired ($420,000 × 10%)				(42,000)
Excess fair value over book value				$ 8,000
Goodwill from second 10% interest:				
Cost of investment				$ 100,000
Book value acquired ($500,000 × 10%)				(50,000)
Excess fair value over book value				$ 50,000
1	Correcting entry as of January 2, 2009 to convert investment to the equity basis			
	Accumulated gain/loss on stock available for Sale		50,000	
	Valuation allowance to record SAS at fair value			50,000
	To remove the valuation allowance entered on December 31, 2009 under the fair value method for an available for sale security.			
	Investment in Twizzle		8,000	
	Retained earnings			8,000
	To adjust investment account to an equity basis computed as follows:			
	Share of Twizzle's income for 2009			$ 20,000
	Less: Share of dividends for 2009			(12,000)
				$ 8,000
2	*Income from Twizzle for 2009*			
	Income from Twizzle on original 10% investment			$ 10,000
	Income from Twizzle on second 10% investment			10,000
	Income from Twizzle			$ 20,000

Solution E2-12

Preliminary computations		
Stockholders' equity of Tall on December 31, 2008		$380,000
Sale of 12,000 previously unissued shares on January 1, 2009		250,000
Stockholders' equity after issuance on January 1, 2009		$630,000
Cost of 12,000 shares to River		$250,000
Book value of 12,000 shares acquired		
$630,000 × 12,000/36,000 shares		210,000
Excess fair value over book value		$ 40,000
Excess is allocated as follows		
Buildings $60,000 × 12,000/36,000 shares		$ 20,000
Goodwill		20,000
Excess fair value over book value		$ 40,000

Journal entries on River's books during 2009

January 1		
Investment in Tall	250,000	
Cash		250,000
To record acquisition of a 1/3 interest in Tall.		
During 2009		
Cash	30,000	
Investment in Tall		30,000
To record dividends received from Tall ($90,000 × 1/3).		
December 31		
Investment in Tall	38,000	
Income from Tall		38,000
To record investment income from Tall computed as follows:		
Share of Tall's income ($120,000 × 1/3)		$ 40,000
Depreciation on building ($20,000/10 years)		(2,000)
Income from Tall		$ 38,000

Solution E2-13

1 *Journal entries on BIP's books for 2009*

Cash	30,000	
Investment in Crown (30%)		30,000
To record dividends received from Crown ($100,000 × 30%).		
Investment in Crown (30%)	60,000	
Extraordinary loss (from Crown)	6,000	
Income from Crown		66,000
To record investment income from Crown computed as follows:		

Share of income before extraordinary item $170,000 × 30%	$ 51,000
Add: Excess fair value over cost realized in 2009 $50,000 × 30%	15,000
Income from Crown before extraordinary loss	$ 66,000

2 *Investment in Crown balance December 31, 2009*

Investment cost	$ 195,000
Add: Income from Crown after extraordinary loss	60,000
Less: Dividends received from Crown	(30,000)
Investment in Crown December 31	$225,000

Check: Investment balance is equal to underlying book value
($700,000 + $150,000 - $100,000) × 30% = $225,000

3

BIP Corporation
Income Statement
for the year ended December 31, 2009

Sales	$1,000,000
Expenses	700,000
Operating income	300,000
Income from Crown (before extraordinary item)	66,000
Income before extraordinary item	366,000
Extraordinary loss (net of tax effect)	6,000
Net income	$ 360,000

Solution E2-14

1 *Income from Water for 2009*

Equity in income ($108,000 - $8,000 preferred) × 40%	$ 40,000

2 *Investment in Water December 31, 2009*

Cost of investment in Water common	$ 290,000
Add: Income from Water	40,000

Less: Dividends * ($40,000 x 40%)	(16,000)
Investment in Water December 31	$ 314,000

* $48,000 toal dividends less $8,000 preferred dividend

Solution E2-15

Since the total value of Steele has declined by $60,000 while the fair value of the net identifiable assets is unchanged, the $60,000 decline is the impairment in goodwill for the period. Assuming this is not the initial adoption of SFAS 142, the $60,000 impairment loss is deducted in calculating Park's income from continuing operations.

Solution E2-16

Goodwill impairments are calculated at the business reporting unit level. Increases and decreases in fair values across business units are not offsetting. Flash must report an impairment loss of $5,000 in calculating 2009 income from continuing operations.

SOLUTIONS TO PROBLEMS

Solution P2-1

1	*Goodwill*			
	Cost of investment in Telly on April 1			$ 343,000
	Book value acquired:			
	Net assets at December 31	$1,000,000		
	Add: Income for 1/4 year ($120,000 × 25%)	30,000		
	Less: Dividends paid March 15	(20,000)		
	Book value at April 1	1,010,000		
	Interest acquired		30%	303,000
	Goodwill from investment in Telly			$ 40,000
2	*Income from Telly for 2009*			
	Equity in income before extraordinary item ($120,000 × 3/4 year × 30%)			$ 27,000
	Extraordinary gain from Telly ($40,000 × 30%)			12,000
	Income from Telly			$ 39,000
3	*Investment in Telly at December 31, 2009*			
	Investment cost April 1			$ 343,000
	Add: Income from Telly plus extraordinary gain			39,000
	Less: Dividends ($20,000 × 3 quarters) × 30%			(18,000)
	Investment in Shelly December 31			$ 364,000
4	*Equity in Telly's net assets at December 31, 2009*			
	Telly's stockholders' equity January 1			$1,000,000
	Add: Net income			160,000
	Less: Dividends			(80,000)
	Telly's stockholders' equity December 31			1,080,000
	Investment interest			30%
	Equity in Telly's net assets			$ 324,000
5	*Extraordinary gain for 2009 to be reported by Ritter*			
	Telly's extraordinary gain × 30%			$ 12,000

Solution P2-2

1 *Cost method*

Investment in Siegel July 1, 2009 (at cost)		$110,000
Dividends charged to investment		(2,400)
Investment in Siegel balance at December 31, 2009		$107,600

July 1, 2009

Investment in Siegel	110,000	
Cash		110,000

To record initial investment for 80% interest.

November 1, 2009

Cash	6,400	
Dividend income		6,400

To record receipt of dividends ($8,000 × 80%).

December 31, 2009

Dividend income	2,400	
Investment in Siegel		2,400

To reduce investment for dividends in excess of earnings ($8,000 dividends - $5,000 earnings) × 80%.

2 *Equity method*

Investment in Siegel July 1, 2009	$110,000
Add: Share of reported income	4,000
Deduct: Dividends charged to investment	(6,400)
Deduct: Excess Depreciation	(1,100)
Investment in Siegel balance at December 31, 2009	$106,500

July 1, 2009

Investment in Siegel	110,000	
Cash		110,000

To record initial investment for 80% interest of Siegel.

November 1, 2009

Cash	6,400	
Investment in Siegel		6,400

To record receipt of dividends ($8,000 × 80%).

December 31, 2009

Investment in Siegel	2,900	
Income from Siegel		2,900

To record income from Siegel computed as follows:
Share of Siegel's income ($10,000 × 1/2 year × 80%)
less excess depreciation ($22,000/10 years × 1/2 year).

Solution P2-3

Preliminary computations		
Cost of investment in Zelda		$331,000
Book value acquired ($1,000,000 × 30%)		300,000
Excess fair value over book value		$ 31,000
Excess allocated		
Undervalued inventories ($30,000 × 30%)		$ 9,000
Overvalued building (-$60,000 × 30%)		(18,000)
Goodwill for the remainder		40,000
Excess fair value over book value		$ 31,000
1 *Income from Zelda*		
Share of Zelda's reported income ($100,000 × 30%)		$ 30,000
Less: Excess allocated to inventories sold in 2009		(9,000)
Add: Amortization of excess allocated to overvalued building $18,000/10 years		1,800
Income from Zelda — 2009		$ 22,800
2 *Investment balance December 31, 2009*		
Cost of investment		$331,000
Add: Income from Zelda		22,800
Less: Share of Zelda's dividends ($50,000 × 30%)		(15,000)
Investment in Zelda balance December 31		$338,800
3 *Vatter's share of Zelda's net assets*		
Share of stockholders' equity ($1,000,000 + $100,000 income - $50,000 dividends) × 30%		$315,000

Solution P2-4

Preliminary computations		
Investment cost of 40% interest		$380,000
Book value acquired [$500,000 + ($100,000 × 1/2 year)] × 40%		220,000
Excess fair value over book value		$160,000
Excess allocated		
Land $30,000 × 40%		$ 12,000
Equipment $50,000 × 40%		20,000
Remainder to goodwill		128,000
Excess fair value over book value		$160,000
July 1, 2009		
Investment in Dormer	380,000	
Cash		380,000
To record initial investment for 40% interest in Dormer.		
November 2009		
Cash (other receivables)	20,000	
Investment in Dormer		20,000
To record receipt of dividends ($50,000 × 40%).		
December 31, 2009		
Investment in Dormer	20,000	
Income from Dormer		20,000
To record share of Dormer's income ($100,000 × 1/2 year × 40%).		
December 31, 2009		
Income from Dormer	2,000	
Investment in Dormer		2,000
To record depreciation on excess allocated to Undervalued equipment ($20,000/5 years × 1/2 year).		

Solution P2-5

1 *Schedule to allocate fair value — book value differentials*

Investment cost January 1	$1,680,000
Book value acquired ($3,900,000 net assets × 30%)	1,170,000
Excess fair value over book value	$ 510,000

Allocation of excess

	Fair Value — Book Value	Percent Acquired	Allocation
Inventories	$200,000	30%	$ 60,000
Land	800,000	30%	240,000
Buildings — net	500,000	30%	150,000
Equipment — net	(700,000)	30%	(210,000)
Bonds payable	(100,000)	30%	(30,000)
Assigned to identifiable net assets			210,000
Remainder to goodwill			300,000
Excess fair value over book value			$ 510,000

2 *Income from Tremor for 2009*

Equity in income ($1,200,000 × 30%)	$ 360,000
Less: Amortization of differentials	
Inventories (sold in 2009)	(60,000)
Buildings — net ($150,000/10 years)	(15,000)
Equipment — net ($210,000/7 years)	30,000
Bonds payable ($30,000/5 years)	6,000
Income from Tremor	$ 321,000

3 *Investment in Tremor balance December 31, 2009*

Investment cost	$1,680,000
Add: Income from Tremor	321,000
Less: Dividends ($600,000 × 30%)	(180,000)
Investment in Tremor December 31	$1,821,000

Check:

Underlying equity ($4,500,000 × 30%)	$1,350,000
Unamortized excess:	
Land	240,000
Buildings — net ($150,000 - $15,000)	135,000
Equipment — net ($210,000 - $30,000)	(180,000)
Bonds payable ($30,000 - $6,000)	(24,000)
Goodwill	300,000
Investment in Tremor account	$1,821,000

Solution P2-6

1	*Income from Stapleton*	
	Investment in Stapleton July 1, 2009 at cost	$96,000
	Book value acquired ($130,000 × 60%)	78,000
	Excess fair value over book value	$18,000
	Pauly's share of Stapleton's income for 2009	
	($20,000 × 1/2 year × 60%)	$ 6,000
	Less: Excess Depreciation ($18,000/10 years × 1/2 year)	900
	Income from Stapleton for 2009	$ 5,100
2	*Investment balance December 31, 2009*	
	Investment cost July 1	$96,000
	Add: Income from Stapleton	5,100
	Less: Dividends ($12,000 × 60%)	(7,200)
	Investment in Stapleton December 31	$93,900

Solution P2-7

Dill Corporation
Partial Income Statement
for the year ended December 31, 2011

Investment income	
Income from Larkspur (equity basis)	$45,000
Income before extraordinary item	45,000
Extraordinary gain	
Share of Larkspur's operating loss carryforward	30,000
Net income	$75,000

Solution P2-8

1 *Investment income — 2011*

Income from 10% investment:		
Share of income ($70,000 × 10%) × 1 year	$7,000	
Less: Excess depreciation ($20,000 - $15,000) × 10% × 1 year	(500)	$ 6,500
Income from 20% investment:		
Share of income ($70,000 × 20%) × 1/2 year	$7,000	
Less: Excess depreciation ($50,000 - $47,000) × 10% × 1/2 year	(150)	6,850
Investment income		$13,350

2 Prior period adjustment and other journal entries to record additional purchase of Brady stock

The 10% interest is converted to the equity method as of January 1, 2011 with the following entry:

Investment in Brady	4,000	
Retained earnings		4,000

The adjustment is equal to $50,000 retained earnings increase for 2008 and 2009 times 10% interest, less excess depreciation of $1,000 for 2008 and 2009.

Unrealized gains on available for sale	5,000	
Valuation allowance - available for sale		5,000

This entry reverses the cumulative fair value adjustment made in prior periods. Since the security was available for sale rather than a trading security, the adjustment has had no impact on prior income statements.

Investment in Brady	50,000	
Cash		50,000

Record the purchase of the additional 20% interest in Brady.

3 *Investment in Brady at December 31, 2011*

Share of Brady's underlying equity at December 31, 2011	
* ($290,000 stockholders' equity × 30%)	$87,000
Add: Unamortized equipment excess on 10% interest	3,000
Add: Unamortized equipment excess on 20% interest	2,550
Investment account balance December 31	$92,550

* Equity at 1/1/2008	$150,000
2008 Net income - Dividedns	20,000
2009 Net income - Dividends	30,000
2010 net income - Dividends	40,000
2011 net income - Dividends	50,000
Total Brady equity at 12/31/2011	$290,000

4 Adjustment for Hazel's purchase of additional stock from Brady

Hazel increases its investment in Brady account by $70,000, the amount of the additional investment. The new balance of the investment in Brady account will be $162,550.

Solution P2-9

Preliminary computations		
Investment cost of 90% interest in Sigma		$1,980,000
Implied total fair value of sigma ($1,980,000 / 90%)		$2,200,000
Book value($2,525,000 + $125,000)		(2,650,000)
Excess book value over fair value		$ (450,000)
Excess allocated		
Overvalued plant assets		$ (500,000)
Undervalued inventories		50,000
Excess book value over fair value		$ (450,000)
1 *Investment income for 2009*		
Share of reported income ($250,000 × 1/2 year × 90%)		$ 112,500
Add: Depreciation on overvalued plant assets		
(($500,000 x 90%) / 9 years) × 1/2 year		25,000
Less: 90% of Undervaluation allocated to inventories		(45,000)
Income from Sigma — 2009		$ 92,500
2 *Investment balance at December 31, 2010*		
Underlying book value of 90% interest in Sigma		
(Sigma's December 31, 2010 equity of $2,700,000 × 90%)		$2,430,000
Less: Unamortized overvaluation of plant assets		
($50,000 per year × 7 1/2 years)		(375,000)
Investment balance December 31, 2010		$2,055,000

3 *Journal entries to account for investment in 2011*

Cash (or Dividends receivable)	135,000	
Investment in Sigma		135,000

To record receipt of dividends ($150,000 × 90%).

Investment in Sigma	230,000	
Income from Sigma		230,000

To record income from Sigma computed as follows: Provo's share of Sigma's reported net income ($200,000 × 90%) plus $50,000 amortization of overvalued plant assets.

Check: Investment balance December 31, 2010 of $2,055,000 + $230,000 income from Sigma - $135,000 dividends = $2,150,000 balance December 31, 2011

Alternatively, Sigma's underlying equity ($2,000,000 paid-in capital + $750,000 retained earnings) × 90% interest - $325,000 unamortized excess allocated to plant assets = $2,150,000 balance December 31, 2011.

Solution P2-10

1 *Market price of $12 for Creape's shares*

Cost of investment in Tantani (40,000 shares × $12) The $40,000 direct costs must be expensed.	$ 480,000
Book value acquired ($1,000,000 net assets × 40%)	400,000
Excess fair value over book value	$ 80,000

Allocation of excess

	Fair Value — Book Value	Percent Acquired	Allocation
Inventories	$ 100,000	40%	$ 40,000
Land	200,000	40%	80,000
Buildings — net	(200,000)	40%	(80,000)
Equipment — net	100,000	40%	40,000
Assigned to identifiable net assets			80,000
Remainder assigned to goodwill			0
Total allocated			$ 80,000

2 *Market price of $8 for Creape's shares*

Cost of investment in Tantani (40,000 shares × $8) Other direct costs are $0	$ 320,000
Book value acquired ($1,000,000 net assets × 40%)	400,000
Excess book value over fair value	$ (80,000)

Excess allocated to

	Fair Value — Book Value	Percent Acquired	Allocation
Inventories	$100,000	40%	$40,000
Land	200,000	40%	80,000
Buildings — net	(200,000)	40%	(80,000)
Equipment — net	100,000	40%	40,000
Bargain purchase			(160,000)
			$(80,000)

Solution P2-11

1 *Income from Spandix — 2008*

Prudy's share of Spandix's income for 2008	
$40,000 × 1/2 year × 15%	$ 3,000

2 *Investment in Spandix balance December 31, 2008*

Investment in Spandix at cost	$ 48,750
Add: Income from Spandix	3,000
Less: Dividends from Spandix November 1 ($15,000 × 15%)	(2,250)
Investment in Spandix balance December 31	$ 49,500

3 *Income from Spandix — 2009*

Prudy's shares of Spandix's income for 2009:	
$60,000 income × 15% interest × 1 year	$ 9,000
$60,000 income × 30% interest × 1 year	18,000
$60,000 income × 45% interest × 1/4 year	6,750
Prudy's share of Spandix's income for 2009	$ 33,750

4 *Investment in Spandix December 31, 2009*

Investment balance December 31, 2008 (from 2)	$ 49,500
Add: Additional investments ($99,000 + $162,000)	261,000
Add: Income for 2009 (from 3)	33,750
Less: Dividends for 2009 ($15,000 × 45%) + ($15,000 × 90%)	(20,250)
Investment in Spandix balance at December 31	$324,000

Alternative solution

Investment cost ($48,750 + $99,000 + $162,000)		$309,750
Add: Share of reported income		
2008 — $40,000 × 1/2 year × 15%	$ 3,000	
2009 — $60,000 × 1 year × 45%	27,000	
2009 — $60,000 × 1/4 year × 45%	6,750	36,750
Less: Dividends		
2008 — $15,000 × 15%	$ 2,250	
2009 — $15,000 × 45%	6,750	
2009 — $15,000 × 90%	13,500	(22,500)
Investment in Spandix		$324,000

Note: Since Prudy's investment in Spandix consisted of 9,000 shares (a 45% interest) on January 1, 2009, Prudy correctly used the equity method of accounting for the 15% investment interest held during 2008. The alternative of reporting income for 2008 on a fair value/cost basis and recording a prior period adjustment for 2009 is not appropriate in view of the overwhelming evidence of an ability to exercise significant influence by the time 2008 income is recorded.

Solution P2-12

Income from Sassy

	2008	2009	2010	2011	Total
As reported	$40,000	$32,000	$52,000	$48,000	$172,000
Correct amounts	20,000[a]	32,000[b]	52,000[c]	48,000[d]	152,000
Overstatement	$20,000	$ -0-	$ -0-	$ -0-	$ 20,000

[a]($100,000 × 1/2 year × 40%)
[b]($80,000 × 40%)
[c]($130,000 × 40%)
[d]($120,000 × 40%)

1 *Investment in Sassy balance December 31, 2011*

Investment in Sassy per books December 31	$400,000
Less: Overstatement	20,000
Correct investment in Sassy balance December 31	$380,000

Check

Underlying equity in Sassy ($900,000 × 40%)	$360,000
Add: Goodwill ($300,000-(700,000 × 40%))	20,000
Investment balance	$380,000

2 *Correcting entry (before closing for 2011)*

Retained earnings	20,000	
Investment in Sassy		20,000

To record investment and retained earnings accounts for prior errors.

Solution P2-13

1 *Schedule to allocate excess cost over book value*

Investment cost (14,000 shares × $13) $10,000 direct costs must be expensed.	$182,000
Book value acquired $190,000 × 70%	133,000
Excess fair value over book value	$ 49,000

Excess allocated

	Fair Value —	Book Value ×	Interest Acquired =	Allocation
Inventories	$ 50,000	$60,000	70%	$ (7,000)
Land	50,000	30,000	70%	14,000
Equipment — net	135,000	95,000	70%	28,000
Remainder to goodwill				14,000
Excess fair value over book value				$ 49,000

2 *Investment income from Samaritan*

Share of Samaritan's reported income $60,000 × 70%	$ 42,000
Add: Overvalued inventory items	7,000
Less: Depreciation on undervalued equipment ($28,000/4 years) × 3/4 year	(5,250)
Investment income from Samaritan	$ 43,750

3 *Investment in Samaritan account at December 31, 2008*

Investment cost	$182,000
Add: Income from Samaritan	43,750
Less: Dividends received (14,000 shares × $2)	(28,000)
Investment in Samaritan balance December 31	$197,750

Check

Underlying equity at December 31, 2008 ($210,000 × 70%)*	$147,000
Add: Unamortized excess of cost over book value	
Land	14,000
Equipment	22,750
Goodwill	14,000
Investment balance	$197,750

* $100,000 (C/S) + $70,000 (R/E) + $80,000 (current earnings) -$40,000 (Dividends) = $210,000