Advanced Accounting Updated Canadian 1st Edition Fayerman Test Bank

Testbank
Chapter 1 – Accounting for Investments

True or False

1) If a company makes a non-strategic investment it is considered a financial asset.

Answer: True

Difficulty: Easy
Learning Objective: Identify and account for non-strategic investments in equity.
Section Reference: Non-Strategic Investments in Equity
Feedback: Review section “Criteria”

2) When a company has control over another company, a parent-subsidiary relationship is said to exist.

Answer: True

Difficulty: Easy
Learning Objective: Identify and account for parent-subsidiary relationships.
Section Reference: Strategic Investments - Parent-Subsidiary Relationships
Feedback: Review section “Identifying Parent-Subsidiary Relationships”

3) An associate is an entity, including an unincorporated company such as a partnership, over which the investor has significant influence and that is also a subsidiary or a joint venture.

Answer: False

Difficulty: Medium
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Identifying Associates”

4) Under the equity method, the investment account is updated for the investor’s share of profit and distributions.

Answer: True

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Difficulty: Medium
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Equity Method of Accounting”

5) A company is a party to a joint venture when it does not have the rights to the assets or the obligations for the liabilities.

Answer: True

Difficulty: Easy
Learning Objective: Identify and account for joint arrangements.
Section Reference: Strategic Investments – Joint Arrangements
Feedback: Review section “Identifying Joint Arrangements”

6) If Darlington Inc. owns 30% of a jointly controlled operation, it would reflect 100% of each asset, liability, income or expense that is part of the joint operation on its own financial statements.

Answer: False

Difficulty: Moderate
Learning Objective: Identify and account for joint arrangements.
Section Reference: Strategic Investments – Joint Arrangements
Feedback: Review section “Accounting and Reporting for Joint Arrangements”

7) When the non-strategic equity investment is initially recorded, it must be measured at its fair value.

Answer: True

Difficulty: Easy
Learning Objective: Identify and account for non-strategic investments in equity.
Section Reference: Non-Strategic Investments in Equity
Feedback: Review section “Recording Non-Strategic Investments in Equity”

8) Companies invest in non-strategic investments to obtain a higher return than holding cash in a bank account.

Answer: True

Difficulty: Easy

Learning Objective: Identify and account for non-strategic investments in equity.
Section Reference: Non-Strategic Investments in Equity
Feedback: Review section "Identifying Non-Strategic Investments in Equity"

9) The ability of a company to control another cannot be affected by relationships with other parties.

Answer: False

Difficulty: Medium
Learning Objective: Identify and account for parent-subsidiary relationships.
Section Reference: Strategic Investments - Parent-Subsidiary Relationships
Feedback: Review section "Identifying Parent-Subsidiary Relationships"

10) When reflecting an investment using the cost method, the investment is initially recorded at cost and the balance is not adjusted in subsequent periods unless there is an impairment.

Answer: True

Difficulty: Medium
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section "Equity Method of Accounting"

11) Generally speaking, all parent companies are responsible for the preparation of consolidated financial statements.

Answer: True

Difficulty: Medium
Learning Objective: Identify and account for parent-subsidiary relationships.
Section Reference: Strategic Investments - Parent-Subsidiary Relationships
Feedback: Review section "Presentation of Consolidated Financial Statements for Controlled Entities"

12) The investor does not need to hold shares in an associate, but where more than 20% of the voting power is held, significant influence is presumed to exist.

Answer: True

Difficulty: Medium

Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Identifying Associates”

13) The parties to a joint venture will initially record their share of the investment at the fair value of their contribution made. In subsequent periods, the cost method will be used for reporting purposes.

Answer: False

Difficulty: Medium
Learning Objective: Identify and account for joint arrangements.
Section Reference: Strategic investments – Joint Arrangements
Feedback: Review section “Accounting and Reporting for Joint Arrangements”

14) There is a general assumption that an ownership interest of less than 20% is a financial asset and not a strategic investment.

Answer: True

Difficulty: Easy
Learning Objective: Identify and account for non-strategic investments in equity.
Section Reference: Non-Strategic Investments in Equity
Feedback: Review section “Identifying Non-Strategic Investments in Equity”

15) There is a presumption that control exists where the company owns more than 50% of the voting shares of the investee.

Answer: True

Difficulty: Moderate
Learning Objective: Identify and account for parent-subsidiary relationships.
Section Reference: Strategic Investments - Parent-Subsidiary Relationships
Feedback: Review section “Identifying Parent-Subsidiary Relationships”

Multiple Choice

16) Non-strategic investments can be classified as fair value through profit or loss (FVTPL) or as fair value through other comprehensive income (OCI)- through an irrevocable election. Which of the following statements is true?

a) Under both FVTPL and OCI, changes in the fair value of the investment are reported as other comprehensive income on the statement of comprehensive income.

b) Under both FVTPL and OCI, changes in the fair value of the investment are reported under the net income section on the statement of comprehensive income.
c) Under both FVTPL and OCI, dividends received from the investee are reported as other comprehensive income on the statement of comprehensive income.
d) Under both FVTPL and OCI, dividends received from the investee are reported under the net income section on the statement of comprehensive income.

Answer: d

Difficulty: Medium
Learning Objective: Identify and account for non-strategic investments in equity.
Section Reference: Non-Strategic Investments in Equity
Feedback: Review section “Recording Non-Strategic Equity Investments”

17) Leno Ltd. has invested in several domestic manufacturing corporations. Which of the following investments would most likely be accounted for under the equity method on Leno's financial statements?

a) A holding of 20,000 of the 25,000 outstanding common shares of Riser Co.
b) A holding of 3,000 of the 10,000 outstanding preferred shares of Riser Co.
c) A holding of 15,000 of the 50,000 outstanding common shares of Riser Co.
d) A holding of 5,000 of the 60,000 outstanding common shares of Riser Co.

Answer: c

Difficulty: Easy
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Identifying Associates”

18) Which of the following is NOT an indicator of significant influence?

a) The investor and the investee share office space and use the same accounting firm.
b) The investor has representation on the investee's board of directors.
c) There are material transactions between the investor and the investee.
d) The investor provides computing services to the investee.

Answer: a

Difficulty: Easy
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Identifying Associates”

19) How do joint ventures differ from private corporations?

a) A joint venture does not have a board of directors.
b) There can only be two parties in a joint venture.
c) Venturers cannot make unilateral decisions.
d) The venturers must share the risks and profits of the joint venture equally.

Answer: c

Difficulty: Medium
Learning Objective: Identify and account for joint arrangements.
Section Reference: Strategic investments – Joint Arrangements
Feedback: Review section "Identifying Joint Arrangements"

20) Clausen Ltd. has a passive investment in Kaitlin Ltd. Clausen has elected to treat Kaitlin as a fair value through other comprehensive income (OCI) investment under IFRS 9 *Financial Instruments*. Which of the following statements is TRUE?

a) Dividends that are a return of capital from Kaitlin are reported as a separate component of Clausen's shareholders' equity.
b) Year to year changes in the fair value of the Investment in Kaitlin are reported as net income in Clausen's SCI.
c) Fair value accumulated gains and losses in the Investment in Kaitlin should be reported as a separate component in Clausen's shareholders' equity.
d) Dividends from Kaitlin are reported as other comprehensive income in Clausen's Statement of Comprehensive Income.

Answer: a

Difficulty: Medium
Learning Objective: Identify and account for non-strategic investments in equity.
Section Reference: Non-Strategic Investments in Equity
Feedback: Review section "Recording Non-Strategic Equity Investments"

21) How are most significant influence investments in equity securities reported on the investor's financial statements?

a) Using the equity method.
b) Using proportionate consolidation.
c) On a fully consolidated basis.
d) Using the cost method.

Answer: a

Difficulty: Medium
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Equity Method of Accounting”

22) At the beginning of 2013, Zed Ltd. acquired 15% of the voting shares of Pine Co (a private company) for $150,000. Zed does not have any significant influence over Pine. Zed follows ASPE. In 2013, Pine earned net income of $70,000 and paid dividends of $40,000. In 2014, Pine earned net income of $80,000 and paid dividends of $100,000. At the end of 2014, what journal entry should Zed make to record the dividends from Pine?

a) No entry is required
b)

DR Cash	12,000
CR Investment in Pine	12,000

c)

DR Cash	15,000
CR Investment in Pine	15,000

d)

DR Cash	15,000
CR Dividend income	15,000

Answer: d

Difficulty: Medium
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Equity Method of Accounting”

23) Walton Ltd. has the following shareholders:

Sifter Co. — 60%
Fallwell — 30%
Garney Ltd. — 10%

Fallwell does not conduct any business with Walton, nor has it been able to secure a seat on the Board of Directors. Which of the following statements is TRUE?

a) Falwell has significant influence over Walton.
b) Fallwell should treat Walton as a non-strategic investment.
c) Fallwell should consider Walton to be a structured entity.
d) Fallwell should consider Walton to be an associated company.

Answer: b

Difficulty: Hard
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Identifying Associates”

24) In Canada, which subsidiaries must be included in consolidated financial statements?

a) All subsidiaries, except for ones in unrelated industries.
b) All domestic subsidiaries.
c) All subsidiaries, except for ones where control is impaired.
d) All subsidiaries.

Answer: c

Difficulty: Medium
Learning Objective: Identify and account for parent-subsidiary relationships.
Section Reference: Strategic Investments - Parent-Subsidiary Relationships
Feedback: Review section “Identifying Parent-Subsidiary Relationships”

25) Where are the consolidating adjustments recorded?

a) Only on the consolidated financial statements.
b) In the general journal of both the parent company and on the consolidated financial statements.
c) In the general journal of both the parent and subsidiary companies and on the consolidated financial statements.
d) In the general journal of both the parent and subsidiary companies.

Answer: a

Difficulty: Medium
Learning Objective: Identify and account for parent-subsidiary relationships.
Section Reference: Strategic Investments - Parent-Subsidiary Relationships
Feedback: Review section “Presentation of Consolidated Financial Statements for Controlled Entities”

26) Under ASPE, what are the types of joint ventures?

a) Jointly controlled operations, jointly controlled assets, and jointly controlled enterprises.
b) Jointly controlled operations, jointly controlled liabilities, and jointly controlled

enterprises.
c) Jointly controlled operations, jointly controlled assets, and jointly controlled ventures.
d) Jointly controlled operations, jointly controlled liabilities, and jointly controlled ventures.

Answer: a

Difficulty: Medium
Learning Objective: Identify and account for joint arrangements.
Section Reference: Strategic Investments-Joint Arrangements
Feedback: Review section "Applying ASPE to Each Type of Joint Venture Investment"

27) At the beginning of 2013, Zylon Ltd. acquired 15% of the voting shares of Hendrick Co. a public company for $150,000. Zylon does not have any significant influence over Hendrick.. In 2013, Hendrick earned net income of $70,000 and paid dividends of $40,000. The fair value of the 15% at the end of 2013 was $160,000. In 2014, Hendrick earned net income of $80,000 and paid dividends of $100,000. The fair value of the 15% at the end of 2014 was $157,000. At the end of 2014, what journal entry should Zylon make regarding its investment in Hendrick Co. in net income?

a)

DR Investment in Hendrick	12,000	
CR Investment income		12,000

b)

DR Investment in Hendrick	80,000	
CR Investment income		80,000

c) No entry is required
d)

DR Investment in Hendrick	15,000	
CR Investment income		15,000

Answer: c

Difficulty: Hard
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section "Equity Method of Accounting"

28) If an investment is owned 100%, which methods will result in the same income and shareholders' equity appearing on the financial statements?

a) Cost and consolidation.
b) Equity and consolidation.
c) Cost and equity.

d) Each method results in different income and shareholder's equity amounts.

Answer: b

Difficulty: Medium
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Equity Method of Accounting”

29) Which of the following best illustrates a parent-subsidiary relationship?

a) Company A owns 55% of the outstanding voting shares of Company B. They have the right to appoint 8/10 members of the board of directors of Company B, however they choose not to get involved in the day-to-day operations of Company B.
b) Company A owns 75% of the outstanding shares of Company B and they have the right to appoint 1/10 members of the board of directors of Company B.
c) Company A and Company B have set up a separate entity that they each jointly control.
d) Company A owns 45% of the outstanding shares of Company B and provides accounting function assistance as their controller quit during the year.

Answer: a

Difficulty: Hard
Learning Objective: Identify and account for parent-subsidiary relationships.
Section Reference: Strategic Investments – Parent-Subsidiary Relationship
Feedback: Review section “Identifying Parent-Subsidiary Relationships”

30) Which of the following is false regarding structured entities?

a).They may take the form of a corporation, trust, partnership, or unincorporated entity.
b).Using the definition of control, these types of arrangements are dealt with in the same manner as other types of strategic investments.
c). As the company may not own shares of the entity, consolidation would not be required.
d) The company may not own any shares of the entity but typically the equity is not sufficient to sustain the entity.

Answer: c

Difficulty: Medium
Learning Objective: Identify and account for parent-subsidiary relationships.
Section Reference: Identifying Parent-Subsidiary Relationships
Feedback: Review section “Structured Entities”

31) Larsen Ltd. has the following shareholders:

Miller Co. — 60%
Sadaat Ltd. — 30%
Peterson Ltd. — 10%

Sadaat has two seats on Larsen's five-person board of directors. Which of the following statements is TRUE?

a) Larsen is a structured entity to Sadaat.
b) Sadaat has control over Larsen.
c) Sadaat should treat Larsen as a non-strategic investment.
d) Sadaat has significant influence over Larsen.

Answer: d

Difficulty: Hard
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Identifying Associates”

32) Which of the following would be considered to be a joint operation?

a) Two investors create a separate company which provides for joint control. The assets and liabilities of the company are the responsibility of the investors up to their ownership interest.
b) Two investors create a separate company which provides for joint control. The assets and liabilities of the company are the responsibility of the company.
c) Two investors create a company. Neither investor controls the individual assets or is obligated to pay for the liabilities and expenses of the separate company.
d) None of the above would be considered a joint operation.

Answer: a

Difficulty: Medium
Learning Objective: Identify and account for joint arrangements.
Section Reference: Strategic Investments – Joint Arrangements
Feedback: Review section “Identifying Joint Arrangements”

33) At the beginning of 2013, Ridley Ltd. acquired 25% of the voting shares of Gasser Co. for $150,000. Ridley has significant influence over Gasser. In 2013, Gasser earned net income of $70,000 and paid dividends of $40,000. In 2014, Gasser earned net income

of $80,000 and paid dividends of $100,000. At the end of 2014, what is the balance of Ridley's "Investment in Gasser" account?

a) $150,000
b) $147,500
c) $152,500
d) $222,500

Answer: c

Difficulty: Hard
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Equity Method of Accounting”

34) Jamison Co. owned 60% of Tyler Co.'s voting shares and 25% of Simon Ltd.'s voting shares. Tyler owns 30% of Simon's voting shares. Which of the following statements is TRUE?

a) Tyler is the only subsidiary of Jamison.
b) Simon is a subsidiary of both Tyler and Jamison.
c) Simon is the only subsidiary of Tyler.
d) Both Tyler and Simon are subsidiaries of Jamison.

Answer: d

Difficulty: Medium
Learning Objective: Identify and account for parent-subsidiary relationships.
Section Reference: Strategic Investments - Parent-Subsidiary Relationships
Feedback: Review section “Presentation of Consolidated Financial Statements for Controlled Entities”

35) There is a presumption that a company which owns less than 20% of the voting shares of another company has:

a) Total control.
b) Joint control.
c) Significant influence.
d) A non-strategic investment.

Answer: d

Difficulty: Easy
Learning Objective: Identify and account for non-strategic investments in equity.

Section Reference: 1 Non-Strategic Investments in Equity
Feedback: Review section “Identifying Non-Strategic Equity Investments”

36) A joint arrangement that is not structured as a separate entity is a(n) __________.

a) association.
b) joint operation.
c) consolidation.
d) passive investment.

Answer: b

Difficulty: Medium
Learning Objective: Identify and account for joint arrangements.
Section Reference: Strategic investments – Joint Arrangements
Feedback: Review section “Identifying Joint Arrangements”

37) A financial asset includes all of the following EXCEPT:

a) Cash.
b) A contractual right to receive cash or another financial asset from another company.
c) A contractual right to exchange financial instruments under conditions that are potentially favourable.
d) All of the above are financial assets

Answer: d

Difficulty: Easy
Learning Objective: Identify and account for non-strategic investments in equity.
Section Reference: Non-Strategic Investments in Equity
Feedback: Review section “Identifying Non-Strategic Investments in Equity”

38) Which of the following statements is FALSE?

a) A joint arrangement is a contractual arrangement which provides for joint control.
b) Joint control requires majority agreement among the parties sharing control.
c) Two types of joint arrangements exist: joint operations and joint ventures.
d) The parties to a joint operation are required to report their share of each asset and liability.

Answer: b

Difficulty: Medium

Learning Objective: Identify and account for joint arrangements.
Section Reference: Strategic investments – Joint Arrangements
Feedback: Review section “Identifying Joint Arrangements”

39) The parties to a joint venture will initially record their share of the investment at:

a) Fair value.
b) Cost.
c) Amortized value.
d) Equity value.

Answer: a

Difficulty: Easy
Learning Objective: Identify and account for joint arrangements.
Section Reference: Strategic investments – Joint Arrangements
Feedback: Review section “Accounting and Reporting for Joint Arrangements”

40) Which of the following statements is FALSE?

a) Entities are required to present non-strategic investments in equity as financial assets.
b) Financial assets under IFRS 9 are shown at fair value with the difference in fair value going through income.
c) Entities may make an irrevocable election to show the gains and losses of financial assets through other comprehensive income.
d) Under ASPE, all financial investments in shares are reflected at fair value unless the shares trade in a public market.

Answer: d

Difficulty: Hard
Learning Objective: Identify and account for non-strategic investments in equity.
Section Reference: Non-Strategic Investments in Equity
Feedback: Review section “Recording Non-Strategic Equity Investments”

41) Which of the following is the first step in determining if one company controls another such that a parent/subsidiary relationship exists?

a) Determine the relevant activities of the investee.
b) Determine how decisions are made regarding the relevant activities.
c) Determine whether the investor has the current ability to direct those relevant activities.
d) Determine the purpose and design of the investee.

Answer: d

Difficulty: Medium
Learning Objective: Identify and account for parent-subsidiary relationships.
Section Reference: Strategic Investments - Parent-Subsidiary Relationships
Feedback: Review section "Identifying Parent-Subsidiary Relationships"

42) Which of the following factors does NOT provide evidence of the existence of significant influence?

a) Representation on the board of directors or equivalent governing body of the investee.
b) Material transactions between the investor and the investee.
c) Interchange of managerial personnel.
d) All of the above provide evidence of the existence of significant influence

Answer: d

Difficulty: Medium
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section "Identifying Associates"

43) Which of the following statements regarding joint ventures is FALSE?

a) A joint venture must be set up as a separate vehicle.
b) A company is a party to a joint venture when it does not have the right to the assets or the obligations for the liabilities.
c) A company is a party to a joint venture when it has the rights to the venture's net assets.
d) None of the above is false.

Answer: d

Difficulty: Medium
Learning Objective: Identify and account for joint arrangements.
Section Reference: Strategic investments – Joint Arrangements
Feedback: Review section "Identifying Joint Arrangements"

44) The equity method is applied:

a) when one of the parties is designated as no longer being a subsidiary.
b) when a contractual agreement is written up providing joint control.

c) from the date the investor obtains significant influence over the investee.
d) on that date when it becomes clear that an investor has no power to participate in the financial and operating decisions of the investee.

Answer: c

Difficulty: Medium
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Equity Method of Accounting”

45) ______________ has sometimes been described as ‘one-line consolidation’.

a) The equity method of accounting
b) A joint venture
c) A passive investment
d) Significant influence

Answer: a

Difficulty: Medium
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Equity Method of Accounting”

46) On January 1, 2013, Tonya Ltd. started Chen Ltd. by contributing $600,000 and received 100% of the common shares of Chen. Chen reported net income of $40,000 in 2013 and $85,000 in 2014 and paid out 40% of its net income as dividends in each year. Under the equity method, which of the following amounts should be reported on Tonya's separate-entity 2014 financial statements?

a)

Investment in Chen	Investment Income
$600,000	$34,000

b)

Investment in Chen	Investment Income
$675,000	$85,000

c)

Investment in Chen	Investment Income
$625,000	$34,000

d)

Investment in Chen	Investment Income
$625,000	$40,000

Answer: b

Difficulty: Hard
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Equity Method of Accounting”

47) Foster Corporation uses the equity method to account for its 25% investment in Vector Corporation and receives $25,000 in dividends. How should Foster account for these dividends?

a) An increase in assets.
b) An increase in income.
c) A decrease in the investment.
d) A decrease in income.

Answer: c

Difficulty: Medium
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Equity Method of Accounting”

48) Which of the following statements regarding non-strategic investments in equity is FALSE?

a) There are possible exceptions to FVTPL.
b) At the day of acquisition when the investment in shares is originally recorded, the company has the option of making an “irrevocable election” where it decides that subsequent changes to fair value will be put in other comprehensive income rather than through income.
c) The “irrevocable election” can be made for investments that are held for trading.
d) Items that are originally placed in Other Comprehensive Income cannot be recycled through profit and loss.

Answer: c

Difficulty: Hard
Learning Objective: Identify and account for non-strategic investments in equity.
Section Reference: Non-Strategic Investments in Equity
Feedback: Review section “Recording Non-Strategic Equity Investments”

49) A subsidiary is defined as an entity that is controlled by another company. Three criteria must be present in order for there to be control. The parent must have all of the following except:

a) The ability to direct the financial and operating policies of another company.
b) The ability to obtain returns from another company.
c) The ability to use its power to affect the returns from another company.
d) The ability to issue any class of securities in a public market on behalf of another company.

Answer: d

Difficulty: Medium
Learning Objective: Identify and account for parent-subsidiary relationships.
Section Reference: Strategic Investments - Parent-Subsidiary Relationships
Feedback: Review section “Identifying Parent-Subsidiary Relationships”

50) Regarding significant influence with respect to an associate, which of the following statements is TRUE?

a) The investor–associate relationship is directly opposite in nature compared to that existing between a parent and subsidiary.
b) There is a requirement for the investor to hold shares, or have a beneficial interest, in the associate.
c) The cost method is used to account for investments in associates under IFRS.
d) If significant influence is exercised by one company over another by virtue of an association or contract other than from the holding of shares, then the equity method cannot be applied in relation to the associate.

Answer: d

Difficulty: Easy
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section “Identifying Associates”

Short Answer

51) If a company makes a non-strategic investment, it is considered a financial asset. What is a financial asset?

A financial asset is defined as: (IAS 32.11)

- Cash
- An equity instrument of another company
- A contractual right to receive cash or another financial asset from another company
- A contractual right to exchange financial instruments under conditions that are potentially favourable

Investments in the equity of other companies, which are non-strategic, meet the second criteria of the definition of a financial asset.

Difficulty: Medium
Learning Objective: Identify and account for non-strategic investments in equity.
Section Reference: Non-Strategic Investments in Equity
Feedback: Review section "Identifying Non-Strategic Investments in Equity"

52) What are the steps to follow to determine if one company controls another and therefore a parent/subsidiary relationship exists?

The following are the steps to follow to determine if one company controls another and therefore a parent/subsidiary relationship exists.

a. Determine the purpose and design of the investee.
b. Determine the relevant activities of the investee.
c. Determine how decisions are made regarding the relevant activities.
d. Determine whether the investor has the current ability to direct those relevant activities.
e. Determine whether the investor has the right and risks to the variable returns of the investee.
f. Determine whether the investor has the ability to use its power to affect those returns.

If the answer in points d, e, and f is yes, then the investor has control over the investee.

Difficulty: Medium
Learning Objective: Identify and account for parent-subsidiary relationships.
Section Reference: Strategic Investments - Parent-Subsidiary Relationships
Feedback: Review section "Identifying Parent-Subsidiary Relationships"

53) Outline and describe the basics of the equity method.

IAS 28 provides a description of the basics of the equity method. The key steps are:

- Recognize the initial investment in the associate or joint venture at cost.
- Increase or decrease the carrying amount of the investment by the investor's share of the profit or loss of the investee after the date of acquisition (post-acquisition profit or loss).
- Reduce the carrying amount of the investment by distributions (such as dividends) received from the associate or joint venture.
- Increase or decrease the carrying amount of the investment for changes in the investor's share of the changes in the investee's other comprehensive income. This may apply to changes arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognized in other comprehensive income of the investor.

Although potential voting rights may be used in the assessment of the existence of significant influence, they are not used in any of the above calculations (paragraph 12 IAS 28).

Difficulty: Medium
Learning Objective: Identify and account for associates.
Section Reference: Strategic Investments - Associates
Feedback: Review section "Equity Method of Accounting"

54) What is a joint operation?

In a joint operation, the investor has a contractual right or obligation to the assets and liabilities of the operation.

A joint arrangement that is not structured as a separate entity is a joint operation. However, a separate entity could still be a joint operation. A joint operation is usually a joint arrangement that involves the use of the assets and other resources of the parties, often to manufacture and sell joint products.

Difficulty: Medium
Learning Objective: Identify and account for joint arrangements.
Section Reference: Strategic investments – Joint Arrangements
Feedback: Review section "Identifying Joint Arrangements"

Problems

55) On January 1, 2013, Donner Co. purchased 3,000 shares, representing 30% of Ishwar Limited, for $390,000. Donner is a publicly traded company. Ishwar's total net income was $86,000 for the year ended December 31, 2013. Ishwar also paid dividends in total of $25,000 during 2013. At the year end, each share of Ishwar was trading at $150 per share.

Required:
Based on the information above, show the journal entries that Donner would have used to report its original purchase and any related investment income for Ishwar for 2013 assuming that Donner reports its investment in Ishwar using FVTPL. What is the investment account balance at the end of December 31, 2013?

Answer:

Journal entries during 2013 would be for the investment recorded at FVTPL
January 1, 2013 — To record initial investment in Ishwar

Dr. Investment in Ishwar	390,000	
Cr. Cash	390,000	

To record receipt of dividends during the year from Ishwar

Dr. Cash (30% × $25,000)	7,500	
Cr. Dividend income	7,500	

December 31, 2013 — To adjust the investment to fair value at year end report date.

Dr. Investment in Ishwar ($150 × 3,000) - $390,000 60,000
Cr. Change in fair value (Statement of Comprehensive Income) 60,000

The balance in the Investment in Ishwar account is $450,000 at December 31, 2013.

Difficulty: Hard
Learning Objective: Identify and account for non-strategic investments in equity.
Section Reference: Non-Strategic Investments in Equity
Feedback: Review section “Recording Non-Strategic Equity Investments”

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56) Sibery Inc. uses the equity method of reporting its 40% investment in Alway Co. The balance in the Investment in Alway was $70,750 at January 1, 2012. During the next three years, Alway reported the following net earnings (losses) and dividends paid.

	Net earnings (loss) $	Dividends paid $
2012	155,600	140,000
2013	35,700	140,000
2014	(123,400)	0

Required:
Calculate the balance of the Investment in Alway account at December 31, 2014.

Answer:

The table below shows the calculation of the Investment in Alway account for each year.

	Balance $
Balance Jan 1, 2012	70,750
Proportionate share of earnings for 2012 - 155,600 × 40%	62,240
Dividends received during 2012 140,000 × 40%	(56,000)
Balance Dec 31, 2012	76,990
Proportionate share of earnings for 2013 - 35,700 × 40%	14,280
Dividends received during 2013 140,000 × 40%	(56,000)
Balance Dec 31, 2013	35,270
Proportionate share of losses for 2014 - 123,400 × 40% = 49,360, but there is only $35,270 in account - see note below	(35,270)
Balance Dec 31, 2014	0

Note: In 2014, Sibery's share of losses of Alway exceeded the balance in the investment account. Therefore, Sibery must stop recognizing further losses since the account would go into a credit position, representing a liability which is not the case here. Once the investee resumes making profits, then Sibery will record its portion of the profits once they exceed the losses not recognized previously. In this case, to date, there are $14,090 (49,360-35,270) in losses which have not been recognized. Sibery would not commence reporting its proportionate share of profits until profits of more than $14,090 had been earned.

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