Financial & Managerial Accounting for Decision Makers, 3rd Edition by Dyckman, Hanlon, Magee, Pfeiffer, Hartgraves, and Morse

Chapter 12—Reporting and Analyzing Financial Investments

Solutions to Practice Quiz

1. On January 1, 2016, Dane Financial Company holds 200 shares of Company A common stock, reported at $ 4,400 on its balance sheet. During 2016, Dane Financial engaged in the following transactions:

I. Purchased 500 Shares of Company B common stock for $42 per share.
II. Sold 100 shares of Company A common stock at $20 per share.
III. Purchased 370 shares of Company C common stock for $17 per share.

Dane classifies these investments as trading securities. On December 31, 2016, the market prices of a share of Companies A, B and C common stock were respectively:
A - $21, B - $45, C - $19.

What amounts of gains or losses on investments should Dane report on its 2016 Income Statement?

a. Net realized loss of $1,940
b. Net unrealized holding gain of $1,940
c. Realized loss of $300 and Net unrealized holding gain of $2,240
d. Realized loss of $200 and Net unrealized holding gain of $2,140

Answer: d

Rationale: Dane will compute a realized loss on its sale of 100 shares of Company A common stock. Dane will also compute unrealized gains/losses on the changes in market values the securities that it holds as of December 31, 2016.

Realized loss on sale of A	100 shares × $2/share =	($200)
Unrealized loss on remaining shares of A	100 shares × $1/share =	($100)
Unrealized gain on B	500 shares × $3/share =	$1,500
Unrealized gain on C	370 shares × $2/share =	$ 740
Net unrealized holding gain		$2,140

Both realized and unrealized gains/losses will be reported on Dane's 2016 Income Statement because the securities are classified as trading.

2. Several years following an acquisition, Investor Company performs an annual review to assess possible goodwill impairment. The current market value of the Investee Company is $65,000, of which $63,000 is allocated to tangible net assets. The implied value of goodwill is, thus, $2,000. The book value of the investment on Investor's balance sheet is $72,000, $9,000 of which is goodwill on the date of the analysis.

Based on this information, is goodwill impaired and by how much?

a. No, goodwill is not impaired, since the book value is more than the market value.
b. Yes, goodwill is impaired by $7,000.
c. Yes, goodwill is impaired by $2,000.
d. Yes, goodwill is impaired by $9,000.

Answer: b
Rationale: $9,000 – 2,000 = $7,000 impairment

3. Georgia Inc. purchases an investment in Kramer Inc. at a purchase price of $6 million cash, representing 25% of stock value of Kramer. During the year, Kramer reports a net income of $200,000 and pays cash dividends of $40,000. At the end of the year the market value of the investment is $1.2 million.

Based on this information, at what amount will the investment be reported on Georgia's balance sheet?

a. $6,040,000
b. $1,200,000
c. $6,000,000
d. $1,240,000

Answer: a
Rationale: The year-end balance of the investment account is computed as follows:

Beginning balance	=	$6,000,000
% investee income earned	=	50,000
Dividends received	=	(10,000)
Ending balance	=	$6,040,000

4. Big Company bought 100% of Small Company for $1,000. Using the information in the following table, which of the following is not an adjustment needed to consolidate the balance sheets of the two companies as of the acquisition date?

	Big	**Small**	**Consolidating adjustments**	**Consolidated Balance Sheet**
Investment in Small	$1,000			
Other assets	10,880,000	$2,137		
Goodwill				
Total assets	$10,881,000	$2,137		
Liabilities	$5,682,000	$1,137		
Common stock	1,920,000	955		
Retained earnings	3,279,000	45		
Total liabilities & stockholders' equity	$10,881,000	$2,137		

a. $1,000 deduction for Big's Investment in Small
b. $2,137 deduction of Small's Other Assets
c. $955 deduction of Small's Common Stock
d. $45 deduction of Small's Retained Earnings

Answer: b
Rationale: Only adjustments for Big's Investment in Small and Small's Common Stock and Retained Earnings are needed.

Use the following information to answer Questions 5-7.

On March 15, 2015, Norton Company invested $650,000 in short-term available-for-sale marketable securities. The market value of this investment was $680,000 at December 31, 2015, but had slipped to $675,000 by December 31, 2016.

5. Based on the information, Norton Company should report which of the following in its December 31, 2015 financial statements?

a. The asset Investments in Marketable Securities at $680,000, and a $30,000 gain recognized in the income statement.
b. The asset Investments in Marketable Securities at $650,000, and a $30,000 Unrealized Holding Gain included in total stockholders' equity.
c. The asset Investments in Marketable Securities at $650,000 with footnote disclosure of the fair value of $680,000.
d. The asset Investments in Marketable Securities at $680,000, and a $30,000 Unrealized Holding Gain included in total stockholders' equity.

Answer: d
Rationale: The investments would be reported at fair value $680,000 along with a $30,000 unrealized holding gain included in total stockholders' equity.

6. If you assume that Norton does not sell this investment, the fair value adjustment necessary at December 31, 2016, includes:

a. A $5,000 debit to Investments in Marketable Securities.
b. A $675,000 debit to Investments in Marketable Securities.
c. A $5,000 debit to Unrealized Holding Gain on Investments.
d. A $25,000 credit to Unrealized Holding Gain on Investments.

Answer: c
Rationale: Since the fair value has slipped $5,000, Norton would debit the Unrealized Holding Gain account for $5,000 to adjust it to a net of $25,000.

7. Based on this information and assuming that Norton does not sell this investment, which of the following best presents what will be reported in the December 31, 2016 financial statements?

a. The asset Investments in Marketable Securities of $675,000, and a $5,000 Unrealized Holding Loss deducted from total stockholders' equity.
b. Investment in Marketable Securities of $675,000 in the asset section of the balance sheet, with a $25,000 Unrealized Holding Gain on Investments included in the stockholders' equity section.
c. Investments in Marketable Securities of $650,000, reduced by a $30,000 Unrealized Holding Gain on Investments, in the asset section of the balance sheet.
d. The asset Investments in Marketable Securities of $650,000 in the balance sheet, and a $25,000 Unrealized Holding Loss on Investments in the income statement.

Answer: b
Rationale: The current fair of $675,000 should be shown in the Investment account, along with a net Unrealized Holding Gain of $25,000 in the stockholders' equity section.

8. Assume that Canine Company shares are traded on the Exchange at $58.75 on March 25, 2016. On March 25, a company can purchase a call option to buy Canine at an exercise price of $60 for $1.50. This option will expire on April 15, 2016.

Based on this information, which of the following best explains the consequences to the company considering this call option if Canine increases to $65?

a. The company purchasing the option would profit by $3.50
b. The company purchasing the option would profit by $6.25
c. The company purchasing the option would profit by $5.00
d. The company purchasing the option would profit by $1.25

Answer: a
Rationale: This means that the company buying the option can exercise the right to buy the shares at a price of $60 at any time on or before April 15, 2016. If the price of Canine increases beyond $60, then the company will stand to gain to the extent the price is over and above the premium paid, which amounts to $1.50 per share.

Use the following information to answer Questions 9 & 10.

Sampson Inc. acquired 32% of Cox Company's voting stock on January 1, 2015 for \$300,000. During 2015, Cox earned \$120,000 and paid dividends of \$75,000. Sampson's 32% interest in Cox gives Sampson the ability to exercise significant influence over Cox's operating and financial policies. During 2016, Cox earned \$150,000 and paid dividends of \$45,000 on April 1 and \$65,000 on October 1. On July 1, 2016, Sampson sold half of its stock in Cox for \$226,000 cash.

9. Based on this information, what should be the carrying amount of this investment in Sampson's December 31, 2015 balance sheet?

a. \$314,400
b. \$345,000
c. \$362,400
d. \$237,600

Answer: a
Rationale: \$300,000 + (\$120,000 x 32%) – (\$75,000 × 32%) = \$314,400.

10. Based on this information, what should be the gain or loss on sale of this investment in Sampson's 2016 income statement?

a. \$74,000 loss
b. \$53,500 loss
c. \$64,000 gain
d. \$48,700 gain

Answer: c
Rationale:
\$300,000 + (\$120,000 x 32%) – (\$75,000 × 32%) = \$314,400
\$314,400 – (\$45,000 × 32%) + (\$150,000 × 50% × 32%) = \$324,000
\$226,000 – (\$324,000 ÷ 2) = \$64,000