A Look at This Appendix

This appendix focuses on investments in securities. We explain how to identify, account for, and report investments in both debt and equity securities. We also explain accounting for transactions listed in a foreign currency.

Appendix

C Investments and International Operations

Learning Objectives

CAP

CONCEPTUAL

C1 Distinguish between debt and equity securities and between short-term and long-term investments. (p. C-1)

C2 Describe how to report equity securities with controlling influence. (p. C-8)

C3 *Appendix C-A*—Explain foreign exchange rates and record transactions listed in a foreign currency. (p. C-15)

ANALYTICAL

A1 Compute and analyze the components of return on total assets. (p. C-10)

LP-C

PROCEDURAL

P1 Account for trading securities. (p. C-4)

P2 Account for held-to-maturity securities. (p. C-5)

P3 Account for available-for-sale securities. (p. C-5)

P4 Account for equity securities with significant influence. (p. C-7)

Appendix Preview

This appendix's main focus is investments in securities. Many companies have investments, and many of these are in the form of debt and equity securities issued by other companies. We describe investments in these securities and how to account for them. An increasing number of companies also invest in international operations. We explain how to account for and report international transactions listed in foreign currencies.

Investments and International Operations

Basics of Investments
- Motivation for investments
- Short-term versus long-term
- Classification and reporting
- Accounting basics

Noninfluential Investments
- Trading securities
- Held-to-maturity securities
- Available-for-sale securities

Influential Investments
- Securities with significant influence
- Securities with controlling influence
- Accounting summary

BASICS OF INVESTMENTS

This section describes the motivation for investments, the distinction between short- and long-term investments, and the different classes of investments.

C1 Distinguish between debt and equity securities and between short-term and long-term investments.

Motivation for Investments

Companies make investments for at least three reasons. First, companies transfer *excess cash* into investments to produce higher income. Second, some entities, such as mutual funds and pension funds, are set up to produce income from investments. Third, companies make investments for strategic reasons. Examples are investments in competitors, suppliers, and even customers. Exhibit C.1 shows short-term (S-T) and long-term (L-T) investments as a percent of total assets for several companies.

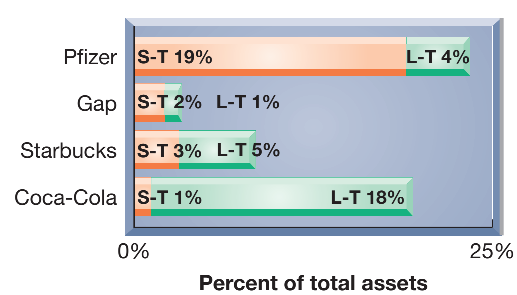


EXHIBIT C.1

Investments of Selected Companies

Short-Term Investments Cash equivalents are investments that are both readily converted to known amounts of cash and mature within three months. Many investments, however, mature between 3 and 12 months. These investments are **short-term investments,** also called *temporary investments* and *marketable securities*. Specifically, short-term investments are securities that (1) management intends to convert to cash within one year or the operating cycle, whichever is longer, and (2) are readily convertible to cash. Short-term investments are reported under current assets and serve a purpose similar to cash equivalents.

Long-Term Investments **Long-term investments** in securities are defined as those securities that are not readily convertible to cash or are not intended to be converted into cash in the short term. Long-term investments can also include funds earmarked for a special purpose, such as bond sinking funds and investments in land or other assets not used in the company's operations. Long-term investments are reported in the noncurrent section of the balance sheet, often in its own separate line titled *Long-Term Investments*.

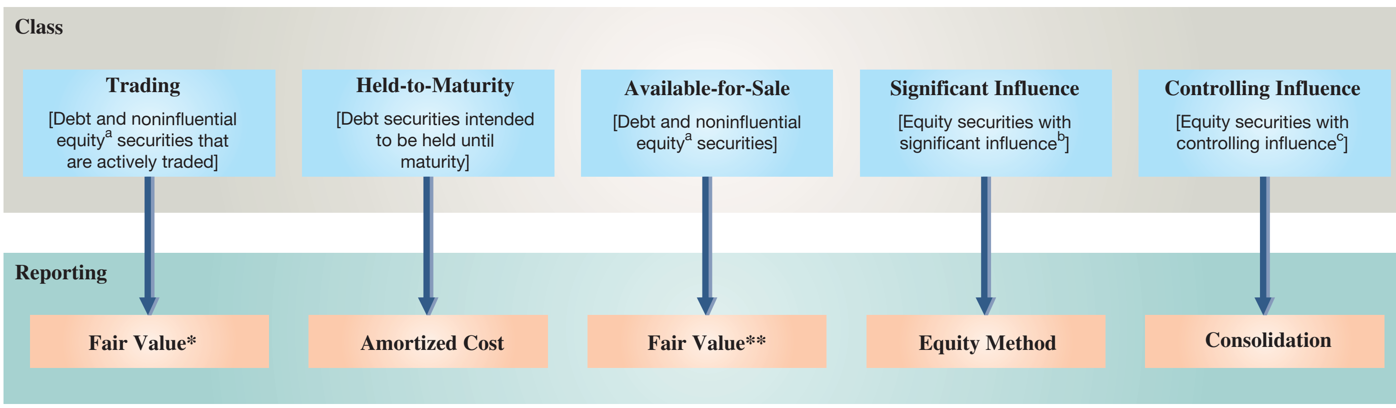
Debt Securities versus Equity Securities Investments in securities can include both debt and equity securities. *Debt securities* reflect a creditor relationship such as investments in notes, bonds, and certificates of deposit; they are issued by governments, companies, and individuals. *Equity securities* reflect an owner relationship such as shares of stock issued by companies.

Classification and Reporting

Accounting for investments in securities depends on three factors: (1) security type, either debt or equity, (2) the company's intent to hold the security either short term or long term, and (3) the company's (investor's) percent ownership in the other company's (investee's) equity securities. Exhibit C.2 identifies five classes of securities using these three factors. It describes each of these five classes of securities and the standard reporting required under each class.

EXHIBIT C.2

Investments in Securities



[a] Holding less than 20% of voting stock (equity securities only). [b] Holding 20% or more, but not more than 50%, of voting stock.
[c] Holding more than 50% of voting stock.
* Unrealized gains and losses reported on the income statement.
** Unrealized gains and losses reported in the equity section of the balance sheet and in comprehensive income.

Debt Securities: Accounting Basics

This section explains the accounting basics for *debt securities,* including that for acquisition, disposition, and any interest.

Acquisition. Debt securities are recorded at cost when purchased. To illustrate, assume that Music City paid $29,500 plus a $500 brokerage fee on September 1, 2010, to buy Dell's 7%, two-year bonds payable with a $30,000 par value. The bonds pay interest semiannually on August 31 and February 28. Music City intends to hold the bonds until they mature on August 31, 2012; consequently, they are classified as held-to-maturity (HTM) securities. The entry to record this purchase follows. (If the maturity of the securities was short term, and management's intent was to hold them until they mature, then they would be classified as Short-Term Investments—HTM.)

Assets = Liabilities + Equity
+30,000
−30,000

2010			
Sept. 1	Long-Term Investments—HTM (Dell)	30,000	
	Cash		30,000
	Purchased bonds to be held to maturity.		

Interest earned. Interest revenue for investments in debt securities is recorded when earned. To illustrate, on December 31, 2010, at the end of its accounting period, Music City accrues interest receivable as follows.

Assets = Liabilities + Equity
+700 +700

Dec. 31	Interest Receivable	700	
	Interest Revenue		700
	Accrued interest earned ($30,000 × 7% × 4⁄12).		

The $700 reflects 4/6 of the semiannual cash receipt of interest—the portion Music City earned as of December 31. Relevant sections of Music City's financial statements at December 31, 2010, are shown in Exhibit C.3.

On the income statement for year 2010:	
Interest revenue	**$ 700**
On the December 31, 2010, balance sheet:	
Long-term investments—Held-to-maturity securities (at amortized cost)	**$30,000**

EXHIBIT C.3

Financial Statement Presentation of Debt Securities

On February 28, 2011, Music City records receipt of semiannual interest.

Feb. 28	Cash	1,050	
	Interest Receivable		700
	Interest Revenue		350
	Received six months' interest on Dell bonds.		

Assets = Liabilities + Equity
+1,050 +350
−700

Disposition. When the bonds mature, the proceeds (not including the interest entry) are recorded as:

2012			
Aug. 31	Cash	30,000	
	Long-Term Investments—HTM (Dell)		30,000
	Received cash from matured bonds.		

Assets = Liabilities + Equity
+30,000
−30,000

The cost of a debt security can be either higher or lower than its maturity value. When the investment is long term, the difference between cost and maturity value is amortized over the remaining life of the security. We assume for ease of computations that the cost of a long-term debt security equals its maturity value.

Example: What is cost per share? *Answer:* Cost per share is the total cost of acquisition, including broker fees, divided by number of shares acquired.

Equity Securities: Accounting Basics

This section explains the accounting basics for *equity securities,* including that for acquisition, dividends, and disposition.

Acquisition. Equity securities are recorded at cost when acquired, including commissions or brokerage fees paid. To illustrate, assume that Music City purchases 1,000 shares of Intex common stock at par value for $86,000 on October 10, 2010. It records this purchase of available-for-sale (AFS) securities as follows.

Oct. 10	Long-Term Investments—AFS (Intex)	86,000	
	Cash		86,000
	Purchased 1,000 shares of Intex.		

Assets = Liabilities + Equity
+86,000
−86,000

Dividend earned. Any cash dividends received are credited to Dividend Revenue and reported in the income statement. To illustrate, on November 2, Music City receives a $1,720 quarterly cash dividend on the Intex shares, which it records as:

Nov. 2	Cash	1,720	
	Dividend Revenue		1,720
	Received dividend of $1.72 per share.		

Assets = Liabilities + Equity
+1,720 +1,720

Disposition. When the securities are sold, sale proceeds are compared with the cost, and any gain or loss is recorded. To illustrate, on December 20, Music City sells 500 of the Intex shares for $45,000 cash and records this sale as:

Dec. 20	Cash	45,000	
	Long-Term Investments—AFS (Intex)		43,000
	Gain on Sale of Long-Term Investments		2,000
	Sold 500 Intex shares ($86,000 × 500/1,000).		

Assets = Liabilities + Equity
+45,000 +2,000
−43,000

REPORTING OF NONINFLUENTIAL INVESTMENTS

Companies must value and report most noninfluential investments at *fair value.* The exact reporting requirements depend on whether the investments are classified as (1) trading, (2) held-to-maturity, or (3) available-for-sale.

Trading Securities

P1 Account for trading securities.

Trading securities are *debt and equity securities* that the company intends to actively manage and trade for profit. Frequent purchases and sales are expected and are made to earn profits on short-term price changes. Trading securities are *always* reported as current assets.

Valuing and reporting trading securities. The entire portfolio of trading securities is reported at its fair value; this requires a "fair value adjustment" from the cost of the portfolio. The term *portfolio* refers to a group of securities. Any unrealized gain (or loss) from a change in the fair value of the portfolio of trading securities is reported on the income statement. Most users believe accounting reports are more useful when changes in fair value for trading securities are reported in income.

Point: '*Unrealized gain (or loss)*' refers to a change in fair value that is not yet realized through actual sale.

Point: 'Fair Value Adjustment—Trading' is a *permanent account*, shown as a deduction or addition to 'Short-Term Investments—Trading.'

To illustrate, TechCom's portfolio of trading securities had a total cost of $11,500 and a fair value of $13,000 on December 31, 2010, the first year it held trading securities. The difference between the $11,500 cost and the $13,000 fair value reflects a $1,500 gain. It is an unrealized gain because it is not yet confirmed by actual sales. The fair value adjustment for trading securities is recorded with an adjusting entry at the end of each period to equal the difference between the portfolio's cost and its fair value. TechCom records this gain as follows.

Assets	= Liabilities	+ Equity
+1,500		+1,500

Dec. 31	Fair Value Adjustment—Trading	1,500	
	Unrealized Gain—Income		1,500
	To reflect an unrealized gain in fair values of trading securities.		

Example: If TechCom's trading securities have a cost of $14,800 and a fair value of $16,100 at Dec. 31, 2011, its adjusting entry is
Unrealized Loss—Income 200
Fair Value Adj.—Trading 200
This is computed as: $1,500 Beg. Dr. bal. + $200 Cr. = $1,300 End. Dr. bal.

The **Unrealized Gain (or Loss)** is reported in the Other Revenues and Gains (or Expenses and Losses) section on the income statement. Unrealized Gain (or Loss)—Income is a *temporary* account that is closed to Income Summary at the end of each period. Fair Value Adjustment—Trading is a *permanent* account, which adjusts the reported value of the trading securities portfolio from its prior period fair value to the current period fair value. The total cost of the trading securities portfolio is maintained in one account, and the fair value adjustment is recorded in a separate account. For example, TechCom's investment in trading securities is reported in the current assets section of its balance sheet as follows.

Current Assets		
Short-term investments—Trading (at cost)	$11,500	
Fair Value adjustment—Trading	1,500	
Short-term investments—Trading (at fair value)		$13,000
or simply		
Short-term investments—Trading (at fair value; cost is $11,500)		$13,000

Selling trading securities. When individual trading securities are sold, the difference between the net proceeds (sale price less fees) and the cost of the individual trading securities that are sold is recognized as a gain or a loss. Any prior period fair value adjustment to the portfolio is *not* used to compute the gain or loss from sale of individual trading securities. For example, if TechCom sold some of its trading securities that had cost $1,000 for $1,200 cash on January 9, 2011, it would record the following.

Point: Reporting securities at fair value is referred to as *mark-to-market* accounting.

Jan. 9	Cash	1,200	
	Short-Term Investments—Trading		1,000
	Gain on Sale of Short-Term Investments		200
	Sold trading securities costing $1,000 for $1,200 cash.		

Assets = Liabilities + Equity
+1,200 +200
−1,000

A gain is reported in the Other Revenues and Gains section on the income statement, whereas a loss is shown in Other Expenses and Losses. When the period-end fair value adjustment for the portfolio of trading securities is computed, it excludes the cost and fair value of any securities sold.

Held-to-Maturity Securities

P2 Account for held-to-maturity securities.

Held-to-maturity (HTM) securities are *debt* securities a company intends and is able to hold until maturity. They are reported in current assets if their maturity dates are within one year or the operating cycle, whichever is longer. HTM securities are reported in long-term assets when the maturity dates extend beyond one year or the operating cycle, whichever is longer. All HTM securities are recorded at cost when purchased, and interest revenue is recorded when earned.

The portfolio of HTM securities is usually reported at (amortized) cost, which is explained in advanced courses. There is no fair value adjustment to the portfolio of HTM securities—neither to the short-term nor long-term portfolios. The basics of accounting for HTM securities were described earlier in this appendix.

Point: Only debt securities can be classified as *held-to-maturity;* equity securities have no maturity date.

Decision Maker

Answer — p. C-18

Money Manager You expect interest rates to sharply fall within a few weeks and remain at this lower rate. What is your strategy for holding investments in fixed-rate bonds and notes?

Available-for-Sale Securities

P3 Account for available-for-sale securities.

Available-for-sale (AFS) securities are *debt and equity securities* not classified as trading or held-to-maturity securities. AFS securities are purchased to yield interest, dividends, or increases in fair value. They are not actively managed like trading securities. If the intent is to sell AFS securities within the longer of one year or operating cycle, they are classified as short-term investments. Otherwise, they are classified as long-term.

Valuing and reporting available-for-sale securities. As with trading securities, companies adjust the cost of the portfolio of AFS securities to reflect changes in fair value. This is done with a fair value adjustment to its total portfolio cost. However, any unrealized gain or loss for the portfolio of AFS securities is *not* reported on the income statement. Instead, it is reported in the equity section of the balance sheet (and is part of *comprehensive income,* explained later). To illustrate, assume that Music City had no prior period investments in available-for-sale securities other than those purchased in the current period. Exhibit C.4 shows both the cost and fair value of those investments on December 31, 2010, the end of its reporting period.

Example: If fair value in Exhibit C.4 is $70,000 (instead of $74,550), what entry is made? *Answer:*
Unreal. Loss—Equity 3,000
Fair Value Adj.—AFS. . . 3,000

EXHIBIT C.4
Cost and Fair Value of Available-for-Sale Securities

	Cost	Fair Value	Unrealized Gain (Loss)
Improv bonds	$30,000	$29,050	$ (950)
Intex common stock, 500 shares	43,000	45,500	2,500
Total	$73,000	$74,550	**$1,550**

The year-end adjusting entry to record the fair value of these investments follows.

Dec. 31	Fair Value Adjustment—Available-for-Sale (LT)	1,550	
	Unrealized Gain—Equity		1,550
	To record adjustment to fair value of available-for-sale securities.		

Assets = Liabilities + Equity
+1,550 +1,550

Point: 'Unrealized Loss—Equity' and 'Unrealized Gain—Equity' are *permanent* (balance sheet) equity *accounts.*

Exhibit C.5 shows the December 31, 2010, balance sheet presentation—it assumes these investments are long term, but they can also be short term. It is also common to combine the cost of investments with the balance in the Fair Value Adjustment account and report the net as a single amount.

EXHIBIT C.5

Balance Sheet Presentation of Available-for-Sale Securities

Assets		
Long-term investments—Available-for-sale (at cost)	$73,000	
Fair value adjustment— Available-for-sale	1,550	
Long-term investments—Available-for-sale (at fair value)		$74,550
or simply		
Long-term investments—Available-for-sale (at fair value; cost is $73,000)		$74,550
Equity		
. . . consists of usual equity accounts . . .		
Add unrealized gain on available-for-sale securities*		$ 1,550

Reconciled

* Often included under the caption Accumulated Other Comprehensive Income.

Point: Income can be window-dressed upward by selling AFS securities with unrealized gains; income is reduced by selling those with unrealized losses.

Let's extend this illustration and assume that at the end of its next calendar year (December 31, 2011), Music City's portfolio of long-term AFS securities has an $81,000 cost and an $82,000 fair value. It records the adjustment to fair value as follows.

Assets	=	Liabilities	+	Equity
−550				−550

Dec. 31	Unrealized Gain—Equity	550	
	Fair Value Adjustment—Available-for-Sale (LT)		550
	To record adjustment to fair value of available-for-sale securities.		

Example: If cost is $83,000 and fair value is $82,000 at Dec. 31, 2011, it records the following adjustment:
Unreal. Gain—Equity 1,550
Unreal. Loss—Equity 1,000
Fair Value Adj.—AFS . . 2,550

The effects of the 2010 and 2011 securities transactions are reflected in the following T-accounts.

Unrealized Gain—Equity

Adj. 12/31/11	550	Bal. 12/31/10	1,550
		Bal. 12/31/11	**1,000**

Fair Value Adjustment—Available-for-Sale (LT)

Bal. 12/31/10	1,550	Adj. 12/31/11	550
Bal. 12/31/11	**1,000**		

Amounts reconcile.

Point: 'Fair Value Adjustment—Available-for-Sale' is a permanent account, shown as a deduction or addition to the Investment account.

Selling available-for-sale securities. Accounting for the sale of individual AFS securities is identical to that described for the sale of trading securities. When individual AFS securities are sold, the difference between the cost of the individual securities sold and the net proceeds (sale price less fees) is recognized as a gain or loss.

Quick Check

Answers — p. C-18

1. How are short-term held-to-maturity securities reported (valued) on the balance sheet?
2. How are trading securities reported (valued) on the balance sheet?
3. Where are unrealized gains and losses on available-for-sale securities reported?
4. Where are unrealized gains and losses on trading securities reported?

Alert *Both U.S. GAAP (and IFRS) permit companies to use fair value in reporting financial assets (referred to as the fair value option). This option allows companies to report any financial asset at fair value and recognize value changes in income. This method was previously reserved only for trading securities, but is now an option for available-for-sale and held-to-maturity securities (and other 'financial assets and liabilities' such as accounts and notes receivable, accounts and notes payable, and bonds). U.S. standards also set a 3-level system to determine fair value:*
—Level 1: Use quoted market values
—Level 2: Use observable values from related assets or liabilities
—Level 3: Use unobservable values from estimates or assumptions
To date, a fairly small set of companies has chosen to broadly apply the fair value option—but, we continue to monitor its use.

REPORTING OF INFLUENTIAL INVESTMENTS

Investment in Securities with Significant Influence

P4 Account for equity securities with significant influence.

A long-term investment classified as **equity securities with significant influence** implies that the investor can exert significant influence over the investee. An investor that owns 20% or more (but not more than 50%) of a company's voting stock is usually presumed to have a significant influence over the investee. In some cases, however, the 20% test of significant influence is overruled by other, more persuasive, evidence. This evidence can either lower the 20% requirement or increase it. The **equity method** of accounting and reporting is used for long-term investments in equity securities with significant influence, which is explained in this section.

Long-term investments in equity securities with significant influence are recorded at cost when acquired. To illustrate, Micron Co. records the purchase of 3,000 shares (30%) of Star Co. common stock at a total cost of $70,650 on January 1, 2010, as follows.

Jan. 1	Long-Term Investments—Star	70,650	
	Cash		70,650
	To record purchase of 3,000 Star shares.		

Assets	= Liabilities	+ Equity
+70,650		
−70,650		

The investee's (Star) earnings increase both its net assets and the claim of the investor (Micron) on the investee's net assets. Thus, when the investee reports its earnings, the investor records its share of those earnings in its investment account. To illustrate, assume that Star reports net income of $20,000 for 2010. Micron then records its 30% share of those earnings as follows.

Dec. 31	Long-Term Investments—Star	6,000	
	Earnings from Long-Term Investment		6,000
	To record 30% equity in investee earnings.		

Assets	= Liabilities	+ Equity
+6,000		+6,000

The debit reflects the increase in Micron's equity in Star. The credit reflects 30% of Star's net income. Earnings from Long-Term Investment is a *temporary* account (closed to Income Summary at each period-end) and is reported on the investor's (Micron's) income statement. If the investee incurs a net loss instead of a net income, the investor records its share of the loss and reduces (credits) its investment account. The investor closes this earnings or loss account to Income Summary.

The receipt of cash dividends is not revenue under the equity method because the investor has already recorded its share of the investee's earnings. Instead, cash dividends received by an investor from an investee are viewed as a conversion of one asset to another; that is, dividends reduce the balance of the investment account. To illustrate, Star declares and pays $10,000 in cash dividends on its common stock. Micron records its 30% share of these dividends received on January 9, 2011, as:

Jan. 9	Cash	3,000	
	Long-Term Investments—Star		3,000
	To record share of dividend paid by Star.		

Assets	= Liabilities	+ Equity
+3,000		
−3,000		

The book value of an investment under the equity method equals the cost of the investment plus (minus) the investor's equity in the *undistributed* (*distributed*) earnings of the investee. Once Micron records these transactions, its Long-Term Investments account appears as in Exhibit C.6.

EXHIBIT C.6

Investment in Star Common Stock (Ledger Account)

Long-Term Investment—Star			
1/ 1/2010 Investment acquisition	70,650		
12/31/2010 Share of earnings	6,000		
12/31/2010 Balance	76,650		
		1/ 9/2011 Share of dividend	3,000
1/ 9/2011 Balance	73,650		

Point: Security prices are sometimes listed in fractions. For example, a debt security with a price of $22\frac{1}{4}$ is the same as \$22.25.

Micron's account balance on January 9, 2011, for its investment in Star is \$73,650. This is the investment's cost *plus* Micron's equity in Star's earnings since its purchase *less* Micron's equity in Star's cash dividends since its purchase. When an investment in equity securities is sold, the gain or loss is computed by comparing proceeds from the sale with the book value of the investment on the date of sale. If Micron sells its Star stock for \$80,000 on January 10, 2011, it records the sale as:

Assets	= Liabilities	+ Equity
+80,000		+6,350
−73,650		

Jan. 10	Cash	80,000	
	Long-Term Investments—Star		73,650
	Gain on Sale of Investment		6,350
	Sold 3,000 shares of stock for \$80,000.		

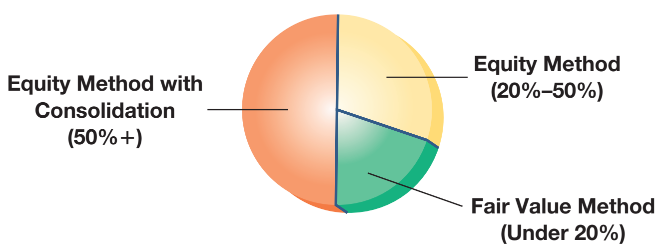
Investment in Securities with Controlling Influence

C2 Describe how to report equity securities with controlling influence.

A long-term investment classified as **equity securities with controlling influence** implies that the investor can exert a controlling influence over the investee. An investor who owns more than 50% of a company's voting stock has control over the investee. This investor can dominate all other shareholders in electing the corporation's board of directors and has control over the investee's management. In some cases, controlling influence can extend to situations of less than 50% ownership. Exhibit C.7 summarizes the accounting for investments in equity securities based on an investor's ownership in the stock.

EXHIBIT C.7

Accounting for Equity Investments by Percent of Ownership



The *equity method with consolidation* is used to account for long-term investments in equity securities with controlling influence. The investor reports *consolidated financial statements* when owning such securities. The controlling investor is called the **parent,** and the investee is called the **subsidiary.** Many companies are parents with subsidiaries. Examples are (1) **McGraw-Hill**, the parent of J.D. Power and Associates, Standard & Poor's, and Platt's; (2) **Gap, Inc.**, the parent of Gap, Old Navy, and Banana Republic; and (3) **Brunswick**, the parent of Mercury Marine, Sea Ray, and U.S. Marine. A company owning all the outstanding stock of a subsidiary can, if it desires, take over the subsidiary's assets, retire the subsidiary's stock, and merge the subsidiary into the parent. However, there often are financial, legal, and tax advantages if a business operates as a parent controlling one or more subsidiaries. When a company operates as a parent with subsidiaries, each entity maintains separate accounting records. From a legal viewpoint, the parent and each subsidiary are separate entities with all rights, duties, and responsibilities of individual companies.

Consolidated financial statements show the financial position, results of operations, and cash flows of all entities under the parent's control, including all subsidiaries. These statements are prepared as if the business were organized as one entity. The parent uses the equity method in its accounts, but the investment account is *not* reported on the parent's financial statements. Instead, the individual assets and liabilities of the parent and its subsidiaries are combined on one balance sheet. Their revenues and expenses also are combined on one income statement, and their cash flows are combined on one statement of cash flows. The procedures for preparing consolidated financial statements are in advanced courses.

IFRS

Unlike U.S. GAAP, IFRS requires uniform accounting policies be used throughout the group of consolidated subsidiaries. Also, unlike U.S. GAAP, IFRS offers no detailed guidance on valuation procedures.

Accounting Summary for Investments in Securities

Exhibit C.8 summarizes the standard accounting for investments in securities. Recall that many investment securities are classified as either short term or long term depending on management's intent and ability to convert them in the future. Understanding the accounting for these investments enables us to draw better conclusions from financial statements in making business decisions.

EXHIBIT C.8

Accounting for Investments in Securities

Classification	Accounting
Short-Term Investment in Securities	
Held-to-maturity (debt) securities	**Cost** (without any discount or premium amortization)
Trading (debt and equity) securities	**Fair value** (with fair value adjustment to income)
Available-for-sale (debt and equity) securities	**Fair value** (with fair value adjustment to equity)
Long-Term Investment in Securities	
Held-to-maturity (debt) securities	**Cost** (with any discount or premium amortization)
Available-for-sale (debt and equity) securities	**Fair value** (with fair value adjustment to equity)
Equity securities with significant influence	Equity method
Equity securities with controlling influence	Equity method (with consolidation)

Comprehensive Income **Comprehensive income** is defined as all changes in equity during a period except those from owners' investments and dividends. Specifically, comprehensive income is computed by adding or subtracting *other comprehensive income* to net income:

Net income	$ #
Other comprehensive income	#
Comprehensive income	$ #

Other comprehensive income includes unrealized gains and losses on available-for-sale securities, foreign currency adjustments, and pension adjustments. (*Accumulated other comprehensive income* is defined as the cumulative impact of *other comprehensive income.*)

Comprehensive income can be reported in financial statements:

1. As part of the statement of stockholders' equity
2. On the income statement
3. In a statement of comprehensive income

Option 1 is the most common. **Apple**, for example, reports comprehensive income as part of its statement of shareholders' equity in Appendix A near the end of the book as follows ($ millions):

Apple

Net income	$8,235	
Change in foreign currency translation	(14)	Other comprehensive income
Change in unrealized loss on AFS securities	118	Other comprehensive income
Change in unrealized gain on derivatives	(18)	Other comprehensive income
Comprehensive income	$8,321	

The 2009 *cumulative* total of Apple's *other comprehensive income* from all prior periods is $77, which is reported in its statement of shareholders' equity and is its *accumulated other comprehensive income*. That total is carried over to the equity section of its balance sheet as follows:

Common stock	$ 8,210
Retained earnings	23,353
Accumulated other comprehensive income	77
Total shareholders' equity	$31,640

Point: Some users believe that since AFS securities are not actively traded, reporting fair value changes in income would unnecessarily increase income variability and decrease usefulness.

Quick Check

Answers — p. C-18

5. Give at least two examples of assets classified as long-term investments.

6. What are the requirements for an equity security to be listed as a long-term investment?

7. Identify similarities and differences in accounting for long-term investments in debt securities that are held-to-maturity versus those available-for-sale.

8. What are the three possible classifications of long-term equity investments? Describe the criteria for each class and the method used to account for each.

GLOBAL VIEW

This section discusses similarities and differences for the accounting and reporting of investments when financial statements are prepared under U.S. GAAP vis-à-vis IFRS.

Accounting for Noninfluential Securities The accounting for noninfluential securities is broadly similar between U.S. GAAP and IFRS. *Trading securities* are accounted for using fair values with unrealized gains and losses reported in net income as fair values change. *Available-for-sale securities* are accounted for using fair values with unrealized gains and losses reported in other comprehensive income as fair values change (and later in net income when realized). *Held-to-maturity securities* are accounted for using amortized cost. Similarly, companies have the option under both systems to apply the fair value option for available-for-sale and held-to-maturity securities. Also, both systems review held-to-maturity securities for impairment. There are some differences in terminology under IFRS: (1) trading securities are commonly referred to as *financial assets at fair value through profit and loss,* and (2) available-for-sale securities are commonly referred to as *available-for-sale financial assets*. NOKIA reports the following categories for noninfluential securities: (1) ***Financial assets at fair value through profit or loss,*** consisting of financial assets held for trading and financial assets designated upon initial recognition as at fair value through profit or loss, (2) ***Available-for-sale financial assets,*** which are measured at fair value.

Accounting for Influential Securities The accounting for influential securities is broadly similar across U.S. GAAP and IFRS. Specifically, under the *equity method,* the share of investee's net income is reported in the investor's income in the same period the investee earns that income; also, the investment account equals the acquisition cost plus the share of investee income less the share of investee dividends (minus amortization of excess on purchase price above fair value of identifiable, limited-life assets). Under the *consolidation method,* investee and investor revenues and expenses are combined, absent intercompany transactions, and subtracting noncontrolling interests. Also, nonintercompany assets and liabilities are similarly combined (eliminating the need for an investment account), and noncontrolling interests are subtracted from equity. There are some differences in terminology: (1) U.S. GAAP companies commonly refer to earnings from long-term investments as *equity in earnings of affiliates* whereas IFRS companies commonly use *equity in earnings of associated (or associate) companies,* (2) U.S. GAAP companies commonly refer to noncontrolling interests in consolidated subsidiaries as *minority interests* whereas IFRS companies commonly use *noncontrolling interests.*

Decision Analysis

Components of Return on Total Assets

A1 Compute and analyze the components of return on total assets.

A company's **return on total assets** (or simply *return on assets*) is important in assessing financial performance. The return on total assets can be separated into two components, profit margin and total asset turnover, for additional analyses. Exhibit C.9 shows how these two components determine return on total assets.

EXHIBIT C.9

Components of Return on Total Assets

Return on total assets = Profit margin × Total asset turnover

$$\frac{\text{Net income}}{\text{Average total assets}} = \frac{\text{Net income}}{\text{Net sales}} \times \frac{\text{Net sales}}{\text{Average total assets}}$$

Profit margin reflects the percent of net income in each dollar of net sales. Total asset turnover reflects a company's ability to produce net sales from total assets. All companies desire a high return on total assets. By considering these two components, we can often discover strengths and weaknesses not revealed by return on total assets alone. This improves our ability to assess future performance and company strategy.

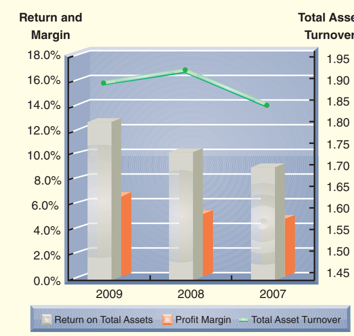
To illustrate, consider return on total assets and its components for **Gap Inc.** in Exhibit C.10.

EXHIBIT C.10

Gap's Components of Return on Total Assets

Fiscal Year	Return on Total Assets	=	Profit Margin	×	Total Asset Turnover
2009	12.6%	=	6.66%	×	1.89
2008	10.2*	=	5.28	×	1.92
2007	9.0	=	4.9	×	1.84
2006	11.8*	=	6.9	×	1.70
2005	11.1	=	7.1	×	1.57

* Differences due to rounding.



At least three findings emerge. First, Gap's return on total assets improved from 9.0% in 2007 to 12.6% in 2009. Second, total asset turnover has slightly improved over this period, from 1.84 to 1.89. Third, Gap's profit margin steadily increased over this period, from 4.9% in 2007 to 6.66% in 2009. These components reveal the dual role of profit margin and total asset turnover in determining return on total assets. They also reveal that the driver of Gap's recent improvement in return on total assets is not total asset turnover but profit margin.

Generally, if a company is to maintain or improve its return on total assets, it must meet any decline in either profit margin or total asset turnover with an increase in the other. If not, return on assets will decline. Companies consider these components in planning strategies. A component analysis can also reveal where a company is weak and where changes are needed, especially in a competitor analysis. If asset turnover is lower than the industry norm, for instance, a company should focus on raising asset turnover at least to the norm. The same applies to profit margin.

Decision Maker

Answer — p. C-18

Retailer You are an entrepreneur and owner of a retail sporting goods store. The store's recent annual performance reveals (industry norms in parentheses): return on total assets = 11% (11.2%); profit margin = 4.4% (3.5%); and total asset turnover = 2.5 (3.2). What does your analysis of these figures reveal?

DEMONSTRATION PROBLEM—1

Garden Company completes the following selected transactions related to its short-term investments during 2011.

May 8 Purchased 300 shares of FedEx stock as a short-term investment in available-for-sale securities at $40 per share plus $975 in broker fees.

Sept. 2 Sold 100 shares of its investment in FedEx stock at $47 per share and held the remaining 200 shares; broker's commission was $225.

Oct. 2 Purchased 400 shares of Ajay stock for $60 per share plus $1,600 in commissions. The stock is held as a short-term investment in available-for-sale securities.

Required

1. Prepare journal entries for the above transactions of Garden Company for 2011.
2. Prepare an adjusting journal entry as of December 31, 2011, if the fair values of the equity securities held by Garden Company are $48 per share for FedEx and $55 per share for Ajay. (Year 2011 is the first year Garden Company acquired short-term investments.)

SOLUTION TO DEMONSTRATION PROBLEM—1

1.

May 8	Short-Term Investments—AFS (FedEx)	12,975	
	Cash		12,975
	Purchased 300 shares of FedEx stock (300 × $40) + $975.		

[continued on next page]

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Sept. 2	Cash	4,475	
	Gain on Sale of Short-Term Investment		150
	Short-Term Investments—AFS (FedEx)		4,325
	Sold 100 shares of FedEx for $47 per share less a $225 commission. The original cost is ($12,975 × 100/300).		
Oct. 2	Short-Term Investments—AFS (Ajay)	25,600	
	Cash		25,600
	Purchased 400 shares of Ajay for $60 per share plus $1,600 in commissions.		

2. Computation of unrealized gain or loss follows.

Short-Term Investments in Available-for-Sale Securities	Shares	Cost per Share	Total Cost	Fair Value per Share	Total Fair Value	Unrealized Gain (Loss)
FedEx	200	$43.25	$ 8,650	$48.00	$ 9,600	
Ajay	400	64.00	25,600	55.00	22,000	
Totals			$34,250		$31,600	$(2,650)

The adjusting entry follows.

Dec. 31	Unrealized Loss—Equity	2,650	
	Fair Value Adjustment—Available-for-Sale (ST)		2,650
	To reflect an unrealized loss in fair values of available-for-sale securities.		

DEMONSTRATION PROBLEM—2

The following transactions relate to Brown Company's long-term investments during 2010 and 2011. Brown did not own any long-term investments prior to 2010. Show (1) the appropriate journal entries and (2) the relevant portions of each year's balance sheet and income statement that reflect these transactions for both 2010 and 2011.

2010

Sept.	9	Purchased 1,000 shares of Packard, Inc., common stock for $80,000 cash. These shares represent 30% of Packard's outstanding shares.
Oct.	2	Purchased 2,000 shares of AT&T common stock for $60,000 cash as a long-term investment. These shares represent less than a 1% ownership in AT&T.
	17	Purchased as a long-term investment 1,000 shares of Apple Computer common stock for $40,000 cash. These shares are less than 1% of Apple's outstanding shares.
Nov.	1	Received $5,000 cash dividend from Packard.
	30	Received $3,000 cash dividend from AT&T.
Dec.	15	Received $1,400 cash dividend from Apple.
	31	Packard's net income for this year is $70,000.
	31	Fair values for the investments in equity securities are Packard, $84,000; AT&T, $48,000; and Apple Computer, $45,000.
	31	For preparing financial statements, note the following post-closing account balances: Common Stock, $500,000, and Retained Earnings, $350,000.

2011

Jan.	1	Sold Packard, Inc., shares for $108,000 cash.
May	30	Received $3,100 cash dividend from AT&T.
June	15	Received $1,600 cash dividend from Apple.

Aug. 17 Sold the AT&T stock for $52,000 cash.
19 Purchased 2,000 shares of Coca-Cola common stock for $50,000 cash as a long-term investment. The stock represents less than a 5% ownership in Coca-Cola.
Dec. 15 Received $1,800 cash dividend from Apple.
31 Fair values of the investments in equity securities are Apple, $39,000, and Coca-Cola, $48,000.
31 For preparing financial statements, note the following post-closing account balances: Common Stock, $500,000, and Retained Earnings, $410,000.

PLANNING THE SOLUTION

- Account for the investment in Packard under the equity method.
- Account for the investments in AT&T, Apple, and Coca-Cola as long-term investments in available-for-sale securities.
- Prepare the information for the two years' balance sheets by including the relevant asset and equity accounts, and the two years' income statements by identifying the relevant revenues, earnings, gains, and losses.

SOLUTION TO DEMONSTRATION PROBLEM—2

1. Journal entries for 2010.

Sept. 9	Long-Term Investments—Packard	80,000	
	Cash		80,000
	Acquired 1,000 shares, representing a 30% equity in Packard.		
Oct. 2	Long-Term Investments—AFS (AT&T)	60,000	
	Cash		60,000
	Acquired 2,000 shares as a long-term investment in available-for-sale securities.		
Oct. 17	Long-Term Investments—AFS (Apple)	40,000	
	Cash		40,000
	Acquired 1,000 shares as a long-term investment in available-for-sale securities.		
Nov. 1	Cash	5,000	
	Long-Term Investments—Packard		5,000
	Received dividend from Packard.		
Nov. 30	Cash	3,000	
	Dividend Revenue		3,000
	Received dividend from AT&T.		
Dec. 15	Cash	1,400	
	Dividend Revenue		1,400
	Received dividend from Apple.		
Dec. 31	Long-Term Investments—Packard	21,000	
	Earnings from Investment (Packard)		21,000
	To record 30% share of Packard's annual earnings of $70,000.		
Dec. 31	Unrealized Loss—Equity	7,000	
	Fair Value Adjustment—Available-for-Sale (LT)*		7,000
	To record change in fair value of long-term available-for-sale securities.		

* Fair value adjustment computations:

	Cost	Fair Value	Unrealized Gain (Loss)
AT&T	$ 60,000	$48,000	$(12,000)
Apple	40,000	45,000	5,000
Total	$100,000	$93,000	$ (7,000)

Required balance of the Fair Value Adjustment—Available-for-Sale (LT) account (credit)	$(7,000)
Existing balance	0
Necessary adjustment (credit)	$(7,000)

2. The December 31, 2010, selected balance sheet items appear as follows.

Assets	
Long-term investments	
Available-for-sale securities (at fair value; cost is $100,000)	$ 93,000
Investment in equity securities	96,000
Total long-term investments	189,000
Stockholders' Equity	
Common stock	500,000
Retained earnings	350,000
Unrealized loss—Equity	(7,000)

The relevant income statement items for the year ended December 31, 2010, follow.

Dividend revenue	$ 4,400
Earnings from investment	21,000

1. Journal entries for 2011.

Jan. 1	Cash	108,000	
	Long-Term Investments—Packard		96,000
	Gain on Sale of Long-Term Investments		12,000
	Sold 1,000 shares for cash.		
May 30	Cash	3,100	
	Dividend Revenue		3,100
	Received dividend from AT&T.		
June 15	Cash	1,600	
	Dividend Revenue		1,600
	Received dividend from Apple.		
Aug. 17	Cash	52,000	
	Loss on Sale of Long-Term Investments	8,000	
	Long-Term Investments—AFS (AT&T)		60,000
	Sold 2,000 shares for cash.		
Aug. 19	Long-Term Investments—AFS (Coca-Cola)	50,000	
	Cash		50,000
	Acquired 2,000 shares as a long-term investment in available-for-sale securities.		
Dec. 15	Cash	1,800	
	Dividend Revenue		1,800
	Received dividend from Apple.		
Dec. 31	Fair Value Adjustment—Available-for-Sale (LT)*	4,000	
	Unrealized Loss—Equity		4,000
	To record change in fair value of long-term available-for-sale securities.		

* Fair value adjustment computations:

	Cost	Fair Value	Unrealized Gain (Loss)
Apple	$40,000	$39,000	$(1,000)
Coca-Cola	50,000	48,000	(2,000)
Total	$90,000	$87,000	$(3,000)

Required balance of the Fair Value Adjustment—Available-for-Sale (LT) account (credit)	$(3,000)
Existing balance (credit)	(7,000)
Necessary adjustment (debit)	$ 4,000

2. The December 31, 2011, balance sheet items appear as follows.

Assets	
Long-term investments	
Available-for-sale securities (at fair value; cost is $90,000)	$ 87,000
Stockholders' Equity	
Common stock	500,000
Retained earnings	410,000
Unrealized loss—Equity	(3,000)

The relevant income statement items for the year ended December 31, 2011, follow.

Dividend revenue	$ 6,500
Gain on sale of long-term investments	12,000
Loss on sale of long-term investments	(8,000)

APPENDIX

Investments in International Operations C-A

Many entities from small entrepreneurs to large corporations conduct business internationally. Some entities' operations occur in so many different countries that the companies are called **multinationals.** Many of us think of **Coca-Cola** and **McDonald's**, for example, as primarily U.S. companies, but most of their sales occur outside the United States. Exhibit C-A.1 shows the percent of international sales and income for selected U.S. companies. Managing and accounting for multinationals present challenges. This section describes some of these challenges and how to account for and report these activities.

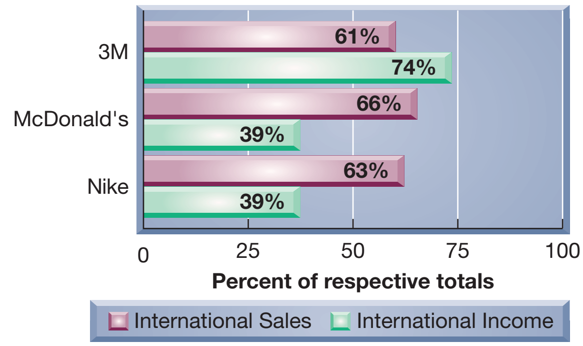

EXHIBIT C-A.1

International Sales and Income as a Percent of Their Totals

Two major accounting challenges that arise when companies have international operations relate to transactions that involve more than one currency. The first is to account for sales and purchases listed in a foreign currency. The second is to prepare consolidated financial statements with international subsidiaries. For ease in this discussion, we use companies with a U.S. base of operations and assume the need to prepare financial statements in U.S. dollars. This means the *reporting currency* of these companies is the U.S. dollar.

Point: Transactions *listed* or *stated* in a foreign currency are said to be *denominated* in that currency.

Exchange Rates between Currencies Markets for the purchase and sale of foreign currencies exist all over the world. In these markets, U.S. dollars can be exchanged for Canadian dollars, British pounds, Japanese yen, Euros, or any other legal currencies. The price of one currency stated in terms of another currency is called a **foreign exchange rate.** Exhibit C-A.2 lists recent exchange rates for selected currencies. The exchange rate for British pounds and U.S. dollars is $1.8980, meaning 1 British pound could be purchased for $1.8980. On that same day, the exchange rate between Mexican pesos and U.S. dollars is $0.0925, or 1 Mexican peso can be purchased for $0.0925. Exchange rates fluctuate due to changing economic and political conditions, including the supply and demand for currencies and expectations about future events.

C3 Explain foreign exchange rates and record transactions listed in a foreign currency.

Point: To convert currency, see XE.com

Decision Insight

Rush to Russia Investors are still eager to buy Russian equities even in the face of rampant crime, corruption, and slow economic growth. Why? Many argue Russia remains a bargain-priced, if risky, bet on future growth. Some analysts argue that natural-resource-rich Russia is one of the least expensive emerging markets.

EXHIBIT C-A.2

Foreign Exchange Rates for Selected Currencies*

Source (unit)	Price in \$U.S.	Source (unit)	Price in \$U.S.
Britain (pound)	\$1.8980	Canada (dollar)	\$0.9793
Mexico (peso)	0.0925	Japan (yen)	0.0090
Taiwan (dollar)	0.0305	Europe (Euro)	1.2920

* Rates will vary over time based on economic, political, and other changes.

Sales and Purchases Listed in a Foreign Currency When a U.S. company makes a credit sale to an international customer, accounting for the sale and the account receivable is straightforward if sales terms require the international customer's payment in U.S. dollars. If sale terms require (or allow) payment in a foreign currency, however, the U.S. company must account for the sale and the account receivable in a different manner.

Sales in a Foreign Currency To illustrate, consider the case of the U.S.-based manufacturer Boston Company, which makes credit sales to London Outfitters, a British retail company. A sale occurs on December 12, 2010, for a price of £10,000 with payment due on February 10, 2011. Boston Company keeps its accounting records in U.S. dollars. To record the sale, Boston Company must translate the sales price from pounds to dollars. This is done using the exchange rate on the date of the sale. Assuming the exchange rate on December 12, 2010, is \$1.80, Boston records this sale as follows.

Assets = Liabilities + Equity
+18,000 +18,000

Dec. 12	Accounts Receivable—London Outfitters	18,000	
	Sales*		18,000
	To record a sale at £10,000, when the exchange rate equals \$1.80. * (£10,000 × \$1.80/£)		

When Boston Company prepares its annual financial statements on December 31, 2010, the current exchange rate is \$1.84. Thus, the current dollar value of Boston Company's receivable is \$18,400 (£10,000 × \$1.84/£). This amount is \$400 higher than the amount recorded on December 12. Accounting principles require a receivable to be reported in the balance sheet at its current dollar value. Thus, Boston Company must make the following entry to record the increase in the dollar value of this receivable at year-end.

Assets = Liabilities + Equity
+400 +400

Dec. 31	Accounts Receivable—London Outfitters	400	
	Foreign Exchange Gain		400
	To record the increased value of the British pound for the receivable.		

Point: Foreign exchange gains are credits, and foreign exchange losses are debits.

On February 10, 2011, Boston Company receives London Outfitters' payment of £10,000. It immediately exchanges the pounds for U.S. dollars. On this date, the exchange rate for pounds is \$1.78. Thus, Boston Company receives only \$17,800 (£10,000 × \$1.78/£). It records the cash receipt and the loss associated with the decline in the exchange rate as follows.

Assets = Liabilities + Equity
+17,800 −600
−18,400

Feb. 10	Cash	17,800	
	Foreign Exchange Loss	600	
	Accounts Receivable—London Outfitters		18,400
	Received foreign currency payment of an account and converted it into dollars.		

Gains and losses from foreign exchange transactions are accumulated in the Foreign Exchange Gain (or Loss) account. After year-end adjustments, the balance in the Foreign Exchange Gain (or Loss) account is reported on the income statement and closed to the Income Summary account.

Example: Assume that a U.S. company makes a credit purchase from a British company for £10,000 when the exchange rate is \$1.62. At the balance sheet date, this rate is \$1.72. Does this imply a gain or loss for the U.S. company? *Answer:* A loss.

Purchases in a Foreign Currency Accounting for credit purchases from an international seller is similar to the case of a credit sale to an international customer. In particular, if the U.S. company is required to make payment in a foreign currency, the account payable must be translated into dollars before the U.S. company can record it. If the exchange rate is different when preparing financial statements and when paying for the purchase, the U.S. company must recognize a foreign exchange gain or loss at those dates. To illustrate, assume NC Imports, a U.S. company, purchases products costing €20,000 (euros) from

Hamburg Brewing on January 15, when the exchange rate is $1.20 per euro. NC records this transaction as follows.

Jan. 15	Inventory	24,000	
	Accounts Payable—Hamburg Brewing		24,000
	To record a €20,000 purchase when exchange rate is $1.20 (€20,000 × $1.20/€)		

Assets = Liabilities + Equity
+24,000 +24,000

NC Imports makes payment in full on February 14 when the exchange rate is $1.25 per euro, which is recorded as follows.

Feb. 14	Accounts Payable—Hamburg Brewing	24,000	
	Foreign Exchange Loss	1,000	
	Cash		25,000
	To record cash payment towards €20,000 account when exchange rate is $1.25 (€20,000 × $1.25/€).		

Assets = Liabilities + Equity
−25,000 −24,000 −1,000

Decision Insight

Global Greenback What do changes in foreign exchange rates mean? A decline in the price of the U.S. dollar against other currencies usually yields increased international sales for U.S. companies, without hiking prices or cutting costs, and puts them on a stronger competitive footing abroad. At home, they can raise prices without fear that foreign rivals will undercut them. ■

Consolidated Statements with International Subsidiaries A second challenge in accounting for international operations involves preparing consolidated financial statements when the parent company has one or more international subsidiaries. Consider a U.S.-based company that owns a controlling interest in a French subsidiary. The reporting currency of the U.S. parent is the dollar. The French subsidiary maintains its financial records in euros. Before preparing consolidated statements, the parent must translate financial statements of the French company into U.S. dollars. After this translation is complete (including that for accounting differences), it prepares consolidated statements the same as for domestic subsidiaries. Procedures for translating an international subsidiary's account balances depend on the nature of the subsidiary's operations. The process requires the parent company to select appropriate foreign exchange rates and to apply those rates to the foreign subsidiary's account balances. This is described in advanced courses.

Global: A weaker U.S. dollar often increases global sales for U.S. companies.

Decision Maker

Answer — p. C-18

Entrepreneur You are a U.S. home builder that purchases lumber from mills in both the U.S. and Canada. The price of the Canadian dollar in terms of the U.S. dollar jumps from US$0.70 to US$0.80. Are you now more or less likely to buy lumber from Canadian or U.S. mills? ■

Summary

C1 Distinguish between debt and equity securities and between short-term and long-term investments. *Debt securities* reflect a creditor relationship and include investments in notes, bonds, and certificates of deposit. *Equity securities* reflect an owner relationship and include shares of stock issued by other companies. Short-term investments in securities are current assets that meet two criteria: (1) They are expected to be converted into cash within one year or the current operating cycle of the business, whichever is longer and (2) they are readily convertible to cash, or *marketable*. All other investments in securities are long-term. Long-term investments also include assets not used in operations and those held for special purposes, such as land for expansion. Investments in securities are classified into one of five groups: (1) trading securities, which are always short-term, (2) debt securities held-to-maturity, (3) debt and equity securities available-for-sale, (4) equity securities in which an investor has a significant influence over the investee, and (5) equity securities in which an investor has a controlling influence over the investee.

C2 Describe how to report equity securities with controlling influence. If an investor owns more than 50% of another company's voting stock and controls the investee, the investor's financial reports are prepared on a consolidated basis. These reports are prepared as if the company were organized as one entity.

C3A Explain foreign exchange rates and record transactions listed in a foreign currency. A foreign exchange rate is the price of one currency stated in terms of another. An entity with transactions in a foreign currency when the exchange rate changes between the transaction dates and their settlement will experience exchange gains or losses. When a company makes a credit sale to a foreign customer and sales terms call for payment in a foreign currency, the company must translate the foreign currency into dollars to record the receivable. If the exchange rate changes before payment is received, exchange gains or losses are recognized in the year they occur. The same treatment is used when a company makes a credit purchase from a foreign supplier and is required to make payment in a foreign currency.

A1 Compute and analyze the components of return on total assets. Return on total assets has two components: profit margin and total asset turnover. A decline in one component must be met with an increase in another if return on assets is to be maintained. Component analysis is helpful in assessing company performance compared to that of competitors and its own past.

P1 Account for trading securities. Investments are initially recorded at cost, and any dividend or interest from these investments is recorded in the income statement. Investments classified as trading securities are reported at fair value. Unrealized gains and losses on trading securities are reported in income. When investments are sold, the difference between the net proceeds from the sale and the cost of the securities is recognized as a gain or loss.

P2 Account for held-to-maturity securities. Debt securities held-to-maturity are reported at cost when purchased. Interest revenue is recorded as it accrues. The cost of long-term held-to-maturity securities is adjusted for the amortization of any difference between cost and maturity value.

P3 Account for available-for-sale securities. Debt and equity securities available-for-sale are recorded at cost when purchased. Available-for-sale securities are reported at their fair values on the balance sheet with unrealized gains or losses shown in the equity section. Gains and losses realized on the sale of these investments are reported in the income statement.

P4 Account for equity securities with significant influence. The equity method is used when an investor has a significant influence over an investee. This usually exists when an investor owns 20% or more of the investee's voting stock but not more than 50%. The equity method means an investor records its share of investee earnings with a debit to the investment account and a credit to a revenue account. Dividends received reduce the investment account balance.

Guidance Answers to Decision Maker

Money Manager If you have investments in fixed-rate bonds and notes when interest rates fall, the value of your investments increases. This is so because the bonds and notes you hold continue to pay the same (high) rate while the market is demanding a new lower interest rate. Your strategy is to continue holding your investments in bonds and notes, and, potentially, to increase these holdings through additional purchases.

Retailer Your store's return on assets is 11%, which is similar to the industry norm of 11.2%. However, disaggregation of return on assets reveals that your store's profit margin of 4.4% is much higher than the norm of 3.5%, but your total asset turnover of 2.5 is much lower than the norm of 3.2. These results suggest that, as compared with competitors, you are less efficient in using assets. You need to focus on increasing sales or reducing assets. You might consider reducing prices to increase sales, provided such a strategy does not reduce your return on assets. For instance, you could reduce your profit margin to 4% to increase sales. If total asset turnover increases to more than 2.75 when profit margin is lowered to 4%, your overall return on assets is improved.

Entrepreneur You are now less likely to buy Canadian lumber because it takes more U.S. money to buy a Canadian dollar (and lumber). For instance, the purchase of lumber from a Canadian mill with a $1,000 (Canadian dollars) price would have cost the U.S. builder $700 (U.S. dollars, computed as C$1,000 × US$0.70) before the rate change, and $800 (US dollars, computed as C$1,000 × US$0.80) after the rate change.

Guidance Answers to Quick Checks

1. Short-term held-to-maturity securities are reported at cost.
2. Trading securities are reported at fair value.
3. The equity section of the balance sheet (and in comprehensive income).
4. The income statement.
5. Long-term investments include (1) long-term funds earmarked for a special purpose, (2) debt and equity securities that do not meet current asset requirements, and (3) long-term assets not used in the regular operations of the business.
6. An equity investment is classified as long term if it is not marketable or, if marketable, it is not held as an available source of cash to meet the needs of current operations.
7. Debt securities held-to-maturity and debt securities available-for-sale are both recorded at cost. Also, interest on both is accrued as earned. However, only long-term securities held-to-maturity require amortization of the difference between cost and maturity value. In addition, only securities available-for-sale require a period-end adjustment to fair value.
8. Long-term equity investments are placed in one of three categories and accounted for as follows: (a) **available-for-sale** (noninfluential, less than 20% of outstanding stock)—fair value; (b) **significant influence** (20% to 50% of outstanding stock)—equity method; and (c) **controlling influence** (holding more than 50% of outstanding stock)—equity method with consolidation.

Key Terms

Available-for-sale (AFS) securities (p. C-5)
Comprehensive income (p. C-9)
Consolidated financial statements (p. C-8)
Equity method (p. C-7)
Equity securities with controlling influence (p. C-8)
Equity securities with significant influence (p. C-7)
Foreign exchange rate (p. C-15)
Held-to-maturity (HTM) securities (p. C-5)
Long-term investments (p. C-1)
Multinational (p. C-15)
Other comprehensive income (p. C-9)
Parent (p. C-8)
Return on total assets (p. C-10)
Short-term investments (p. C-1)
Subsidiary (p. C-8)
Trading securities (p. C-4)
Unrealized gain (loss) (p. C-4)

Multiple Choice Quiz

Answers on p. C-35 mhhe.com/wildFA6e

Additional quiz questions are available at the book's Website.

1. A company purchased $30,000 of 5% bonds for investment purposes on May 1. The bonds pay interest on February 1 and August 1. The amount of interest revenue accrued at December 31 (the company's year-end) is:
   a. $1,500
   b. $1,375
   c. $1,000
   d. $625
   e. $300
2. Earlier this period, Amadeus Co. purchased its only available-for-sale investment in the stock of Bach Co. for $83,000. The period-end fair value of this stock is $84,500. Amadeus records a:
   a. Credit to Unrealized Gain—Equity for $1,500.
   b. Debit to Unrealized Loss—Equity for $1,500.
   c. Debit to Investment Revenue for $1,500.
   d. Credit to Fair Value Adjustment—Available-for-Sale for $3,500.
   e. Credit to Cash for $1,500.
3. Mozart Co. owns 35% of Melody Inc. Melody pays $50,000 in cash dividends to its shareholders for the period. Mozart's entry to record the Melody dividend includes a:
   a. Credit to Investment Revenue for $50,000.
   b. Credit to Long-Term Investments for $17,500.
   c. Credit to Cash for $17,500.
   d. Debit to Long-Term Investments for $17,500.
   e. Debit to Cash for $50,000.
4. A company has net income of $300,000, net sales of $2,500,000, and total assets of $2,000,000. Its return on total assets equals:
   a. 6.7%
   b. 12.0%
   c. 8.3%
   d. 80.0%
   e. 15.0%
5. A company had net income of $80,000, net sales of $600,000, and total assets of $400,000. Its profit margin and total asset turnover are:

	Profit Margin	Total Asset Turnover
a.	1.5%	13.3
b.	13.3%	1.5
c.	13.3%	0.7
d.	7.0%	13.3
e.	10.0%	26.7

A *Superscript A denotes assignments based on Appendix C-A.*
Icon denotes assignments that involve decision making.

Discussion Questions

1. Under what two conditions should investments be classified as current assets?
2. On a balance sheet, what valuation must be reported for short-term investments in trading securities?
3. If a short-term investment in available-for-sale securities costs $6,780 and is sold for $7,500, how should the difference between these two amounts be recorded?
4. Identify the three classes of noninfluential and two classes of influential investments in securities.
5. Under what conditions should investments be classified as current assets? As long-term assets?
6. If a company purchases its only long-term investments in available-for-sale debt securities this period and their fair value is below cost at the balance sheet date, what entry is required to recognize this unrealized loss?
7. On a balance sheet, what valuation must be reported for debt securities classified as available-for-sale?

8. Under what circumstances are long-term investments in debt securities reported at cost and adjusted for amortization of any difference between cost and maturity value?

9. For investments in available-for-sale securities, how are unrealized (holding) gains and losses reported?

10. In accounting for investments in equity securities, when should the equity method be used?

11. Under what circumstances does a company prepare consolidated financial statements?

12.[A] What are two major challenges in accounting for international operations?

13.[A] Assume a U.S. company makes a credit sale to a foreign customer that is required to make payment in its foreign currency. In the current period, the exchange rate is $1.40 on the date of the sale and is $1.30 on the date the customer pays the receivable. Will the U.S. company record an exchange gain or loss?

14.[A] If a U.S. company makes a credit sale to a foreign customer required to make payment in U.S. dollars, can the U.S. company have an exchange gain or loss on this sale?

15. Refer to **Apple**'s statement of changes in shareholders' equity in Appendix A. What is the amount of foreign currency translation adjustment for the year ended September 26, 2009? Is this adjustment an unrealized gain or an unrealized loss?

16. Refer to **Palm**'s statement of stockholders' equity. What was the amount of its fiscal 2009 unrealized gain or loss on securities?

17. Refer to the balance sheet of **Nokia** in Appendix A. How can you tell that Nokia uses the consolidated method of accounting?

18. Refer to the financial statements of **Research In Motion** in Appendix A. Compute its return on total assets for the year ended February 27, 2010.

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QUICK STUDY

QS C-1
Describing investments in securities
C1 C2

Complete the following descriptions by filling in the blanks.

1. Accrual of interest on bonds held as long-term investments requires a credit to ______ ______.
2. The controlling investor (more than 50% ownership) is called the ______, and the investee company is called the ______.
3. Trading securities are classified as ______ assets.
4. Equity securities giving an investor significant influence are accounted for using the ______ ______.
5. Available-for-sale debt securities are reported on the balance sheet at ______ ______.

QS C-2
Identifying long-term investments
C1

Which of the following statements are true of long-term investments?

a. They can include investments in trading securities.
b. They are always easily sold and therefore qualify as being marketable.
c. They can include debt and equity securities available-for-sale.
d. They are held as an investment of cash available for current operations.
e. They can include debt securities held-to-maturity.
f. They can include bonds and stocks not intended to serve as a ready source of cash.
g. They can include funds earmarked for a special purpose, such as bond sinking funds.

QS C-3
Short-term equity investments P1

On April 18, Dice Co. made a short-term investment in 500 common shares of XLT Co. The purchase price is $45 per share and the broker's fee is $150. The intent is to actively manage these shares for profit. On May 30, Dice Co. receives $1 per share from XLT in dividends. Prepare the April 18 and May 30 journal entries to record these transactions.

QS C-4
Available-for-sale securities
P3

Fender Co. purchased short-term investments in available-for-sale securities at a cost of $100,000 on November 25, 2011. At December 31, 2011, these securities had a fair value of $94,000. This is the first and only time the company has purchased such securities.

1. Prepare the December 31, 2011, year-end adjusting entry for the securities' portfolio.
2. For each account in the entry for part 1, explain how it is reported in financial statements.
3. Prepare the April 6, 2012, entry when Fender sells one-half of these securities for $52,000.

QS C-5
Available-for-sale securities
P3

Prepare Hoffman Company's journal entries to reflect the following transactions for the current year.

May 7 Purchases 100 shares of Lov stock as a short-term investment in available-for-sale securities at a cost of $25 per share plus $200 in broker fees.

June 6 Sells 100 shares of its investment in Lov stock at $28 per share. The broker's commission on this sale is $75.

QS C-6 Available-for-sale securities P3

Galaxy Company completes the following transactions during the current year.

May 9 Purchases 400 shares of X&O stock as a short-term investment in available-for-sale securities at a cost of $50 per share plus $400 in broker fees.
June 2 Sells 200 shares of its investment in X&O stock at $56 per share. The broker's commission on this sale is $180.
Dec. 31 The closing market price (fair value) of the X&O stock is $46 per share.

Prepare the May 9 and June 2 journal entries and the December 31 adjusting entry. This is the first and only time the company purchased such securities.

QS C-7 Recording equity securities P3

On May 20, 2011, Alexis Co. paid $750,000 to acquire 25,000 common shares (10%) of TKR Corp. as a long-term investment. On August 5, 2012, Alexis sold one-half of these shares for $475,000. What valuation method should be used to account for this stock investment? Prepare entries to record both the acquisition and the sale of these shares.

QS C-8 Equity method transactions P4

Assume the same facts as in QS C-7 except that the stock acquired represents 40% of TKR Corp.'s outstanding stock. Also assume that TKR Corp. paid a $125,000 dividend on November 1, 2011, and reported a net income of $550,000 for 2011. Prepare the entries to record (*a*) the receipt of the dividend and (*b*) the December 31, 2011, year-end adjustment required for the investment account.

QS C-9 Debt securities transactions P2

On February 1, 2011, Charo Mendez purchased 6% bonds issued by CR Utilities at a cost of $30,000, which is their par value. The bonds pay interest semiannually on July 31 and January 31. For 2011, prepare entries to record Mendez's July 31 receipt of interest and its December 31 year-end interest accrual.

QS C-10 Recording fair value adjustment for securities P3

During the current year, Patton Consulting Group acquired long-term available-for-sale securities at a $35,000 cost. At its December 31 year-end, these securities had a fair value of $29,000. This is the first and only time the company purchased such securities.

1. Prepare the necessary year-end adjusting entry related to these securities.
2. Explain how each account used in part 1 is reported in the financial statements.

QS C-11 Return on total assets A1

The return on total assets is the focus of analysts, creditors, and other users of financial statements.

1. How is the return on total assets computed?
2. What does this important ratio reflect?

QS C-12 Component return on total assets A1

Return on total assets can be separated into two important components.

1. Write the formula to separate the return on total assets into its two basic components.
2. Explain how these components of the return on total assets are helpful to financial statement users for business decisions.

QS C-13[A] Foreign currency transactions C3

A U.S. company sells a product to a British company with the transaction listed in British pounds. On the date of the sale, the transaction total of $16,000 is billed as £10,000, reflecting an exchange rate of 1.60 (that is, $1.60 per pound). Prepare the entry to record (1) the sale and (2) the receipt of payment in pounds when the exchange rate is 1.50.

QS C-14[A] Foreign currency transactions C3

On March 1, 2011, a U.S. company made a credit sale requiring payment in 30 days from a Malaysian company, Hamac Sdn. Bhd., in 20,000 Malaysian ringgits. Assuming the exchange rate between Malaysian ringgits and U.S. dollars is $0.6811 on March 1 and $0.6985 on March 31, prepare the entries to record the sale on March 1 and the cash receipt on March 31.

QS C-15 Equity securities with controlling influence C2

Complete the following descriptions by filling in the blanks.

1. A long-term investment classified as equity securities with controlling influence implies that the investor can exert a ______ influence over the investee.
2. The controlling investor is called the ______, and the investee is called the ______.

QS C-16
International accounting for investments
P1

The **Carrefour Group** reports the following description of its trading securities (titled "financial assets reported at fair value in the income statement").

> These are financial assets held by the Group in order to make a short-term profit on the sale. These assets are valued at their fair value with variations in value recognized in the income statement.

Note 10 to Carrefour's 2008 financial statements reports €117 million in unrealized gains for 2008 and €63 million in unrealized losses for 2008, both included in the fair value of those financial assets held for trading. What amount of these unrealized gains and unrealized losses, if any, are reported in its 2008 income statement? Explain.

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EXERCISES

Exercise C-1
Accounting for short-term held-to-maturity securities P2

Prepare journal entries to record the following transactions involving the short-term securities investments of Maxwell Co., all of which occurred during year 2011.

a. On February 15, paid $100,000 cash to purchase FTR's 90-day short-term debt securities ($100,000 principal), dated February 15, that pay 8% interest (categorized as held-to-maturity securities).

b. On May 16, received a check from FTR in payment of the principal and 90 days' interest on the debt securities purchased in transaction *a*.

Exercise C-2
Accounting for short-term trading securities
P1

(*c*) Dr. Cash $13,860

Prepare journal entries to record the following transactions involving the short-term securities investments of Smart Co., all of which occurred during year 2011.

a. On March 22, purchased 700 shares of FIX Company stock at $30 per share plus a $150 brokerage fee. These shares are categorized as trading securities.

b. On September 1, received a $1.00 per share cash dividend on the FIX Company stock purchased in transaction *a*.

c. On October 8, sold 350 shares of FIX Co. stock for $40 per share, less a $140 brokerage fee.

Exercise C-3
Accounting for short-term available-for-sale securities
P3

Prepare journal entries to record the following transactions involving the short-term securities investments of Prairie Co., all of which occurred during year 2011.

a. On August 1, paid $60,000 cash to purchase Better Buy's 10% debt securities ($60,000 principal), dated July 30, 2011, and maturing January 30, 2012 (categorized as available-for-sale securities).

b. On October 30, received a check from Better Buy for 90 days' interest on the debt securities purchased in transaction *a*.

Exercise C-4
Debt and equity securities and short- and long-term investments
C1

Complete the following descriptions by filling in the blanks.

1. Short-term investments are securities that (1) management intends to convert to cash within ____ ____ or the ____ ____ whichever is longer, and (2) are readily convertible to _____.

2. Long-term investments in securities are defined as those securities that are ____ ____ convertible to cash or are ____ ____ to be converted into cash in the short term.

3. Debt securities reflect a _______ relationship such as investments in notes, bonds, and certificates of deposit.

4. Equity securities reflect an _______ relationship such as shares of stock issued by companies.

Exercise C-5
Equity securities with controlling influence
C2

Complete the following descriptions by filling in the blanks.

1. The equity method with _______ is used to account for long-term investments in equity securities with controlling influence.

2. Consolidated _______ _______ show the financial position, results of operations, and cash flows of all entities under the parent's control, including all subsidiaries.

Exercise C-6
Accounting for trading securities
P1

Check (3) Gain, $2,000

Forex Co. purchases various investments in trading securities at a cost of $56,000 on December 27, 2011. (This is its first and only purchase of such securities.) At December 31, 2011, these securities had a fair value of $66,000.

1. Prepare the December 31, 2011, year-end adjusting entry for the trading securities' portfolio.

2. Explain how each account in the entry of part 1 is reported in financial statements.

3. Prepare the January 3, 2012, entry when Forex sells a portion of its trading securities (that had originally cost $28,000) for $30,000.

Exercise C-7
Adjusting available-for-sale securities to fair value
P3

On December 31, 2011, Rollo Company held the following short-term investments in its portfolio of available-for-sale securities. Rollo had no short-term investments in its prior accounting periods. Prepare the December 31, 2011, adjusting entry to report these investments at fair value.

	Cost	Fair Value
Vicks Corporation bonds payable	$79,600	$90,600
Pace Corporation notes payable	60,600	52,900
Lake Lugano Company common stock	85,500	82,100

Check Unrealized loss, $100

Exercise C-8
Transactions in short-term and long-term investments
P1 P2 P3

Prepare journal entries to record the following transactions involving both the short-term and long-term investments of Sophia Corp., all of which occurred during calendar year 2011. Use the account Short-Term Investments for any transactions that you determine are short term.

a. On February 15, paid $150,000 cash to purchase American General's 120-day short-term notes at par, which are dated February 15 and pay 10% interest (classified as held-to-maturity).

b. On March 22, bought 700 shares of Frain Industries common stock at $25 cash per share plus a $250 brokerage fee (classified as long-term available-for-sale securities).

c. On June 15, received a check from American General in payment of the principal and 120 days' interest on the notes purchased in transaction *a*.

d. On July 30, paid $50,000 cash to purchase MP3 Electronics' 8% notes at par, dated July 30, 2011, and maturing on January 30, 2012 (classified as trading securities).

e. On September 1, received a $0.50 per share cash dividend on the Frain Industries common stock purchased in transaction *b*.

f. On October 8, sold 350 shares of Frain Industries common stock for $32 cash per share, less a $175 brokerage fee.

g. On October 30, received a check from MP3 Electronics for three months' interest on the notes purchased in transaction *d*.

Exercise C-9
Fair value adjustment to available-for-sale securities
P3

On December 31, 2011, Manhattan Co. held the following short-term available-for-sale securities.

	Cost	Fair Value
Nintendo Co. common stock	$68,900	$75,300
Atlantic bonds payable	24,500	22,800
Kellogg Co. notes payable	50,000	47,200
McDonald's Corp. common stock	91,400	86,600

Manhattan had no short-term investments prior to the current period. Prepare the December 31, 2011, year-end adjusting entry to record the fair value adjustment for these securities.

Exercise C-10
Fair value adjustment to available-for-sale securities
P3

Berroa Co. began operations in 2010. The cost and fair values for its long-term investments portfolio in available-for-sale securities are shown below. Prepare Berroa's December 31, 2011, adjusting entry to reflect any necessary fair value adjustment for these investments.

	Cost	Fair Value
December 31, 2010	$79,483	$72,556
December 31, 2011	85,120	90,271

Exercise C-11
Multiyear fair value adjustments to available-for-sale securities
P3

Ticker Services began operations in 2009 and maintains long-term investments in available-for-sale securities. The year-end cost and fair values for its portfolio of these investments follow. Prepare journal entries to record each year-end fair value adjustment for these securities.

	Cost	Fair Value
December 31, 2009	$374,000	$362,560
December 31, 2010	426,900	453,200
December 31, 2011	580,700	686,450
December 31, 2012	875,500	778,800

Exercise C-12
Classifying investments in securities; recording fair values
C1 P2 P3 P4

Information regarding Central Company's individual investments in securities during its calendar-year 2011, along with the December 31, 2011, fair values, follows.

a. Investment in Beeman Company bonds: $418,500 cost, $455,000 fair value. Central intends to hold these bonds until they mature in 2016.

b. Investment in Baybridge common stock: 29,500 shares; $332,450 cost; $361,375 fair value. Central owns 32% of Baybridge's voting stock and has a significant influence over Baybridge.

c. Investment in Carroll common stock: 12,000 shares; $169,750 cost; $183,000 fair value. This investment amounts to 3% of Carroll's outstanding shares, and Central's goal with this investment is to earn dividends over the next few years.

d. Investment in Newtech common stock: 3,500 shares; $95,300 cost; $93,625 fair value. Central's goal with this investment is to reap an increase in fair value of the stock over the next three to five years. Newtech has 30,000 common shares outstanding.

e. Investment in Flock common stock: 16,300 shares; $102,860 cost; $109,210 fair value. This stock is marketable and is held as an investment of cash available for operations.

Required

1. Identify whether each investment should be classified as a short-term or long-term investment. For each long-term investment, indicate in which of the long-term investment classifications it should be placed.

2. Prepare a journal entry dated December 31, 2011, to record the fair value adjustment of the long-term investments in available-for-sale securities. Central had no long-term investments prior to year 2011.

Check (2) Unrealized gain, $11,575

Exercise C-13
Securities transactions; equity method
P4

Prepare journal entries to record the following transactions and events of Kash Company.

2011

Jan.	2	Purchased 30,000 shares of Bushtex Co. common stock for $204,000 cash plus a broker's fee of $3,480 cash. Bushtex has 90,000 shares of common stock outstanding and its policies will be significantly influenced by Kash.
Sept.	1	Bushtex declared and paid a cash dividend of $3.10 per share.
Dec.	31	Bushtex announced that net income for the year is $624,900.

2012

June	1	Bushtex declared and paid a cash dividend of $3.60 per share.
Dec.	31	Bushtex announced that net income for the year is $699,750.
Dec.	31	Kash sold 10,000 shares of Bushtex for $162,500 cash.

Exercise C-14
Return on total assets
A1

The following information is available from the financial statements of Wright Industries. Compute Wright's return on total assets for 2011 and 2012. (Round returns to one-tenth of a percent.) Comment on the company's efficiency in using its assets in 2011 and 2012.

	2010	2011	2012
Total assets, December 31	$190,000	$320,000	$750,000
Net income	28,200	36,400	58,300

Exercise C-15A
Foreign currency transactions
C3

Desi of New York sells its products to customers in the United States and the United Kingdom. On December 16, 2011, Desi sold merchandise on credit to Bronson Ltd. of London at a price of 17,000 pounds. The exchange rate on that day for £1 was $1.5238. On December 31, 2011, when Desi prepared its financial statements, the rate was £1 for $1.4990. Bronson paid its bill in full on January 15, 2012, at which time the exchange rate was £1 for $1.5156. Desi immediately exchanged the 17,000 pounds for U.S. dollars. Prepare Desi's journal entries on December 16, December 31, and January 15 (round to the nearest dollar).

Exercise C-16^A
Computing foreign exchange gains and losses on receivables
C3

On May 8, 2011, Jett Company (a U.S. company) made a credit sale to Lopez (a Mexican company). The terms of the sale required Lopez to pay 800,000 pesos on February 10, 2012. Jett prepares quarterly financial statements on March 31, June 30, September 30, and December 31. The exchange rates for pesos during the time the receivable is outstanding follow.

May 8, 2011	$0.1984
June 30, 2011	0.2013
September 30, 2011	0.2029
December 31, 2011	0.1996
February 10, 2012	0.2047

Compute the foreign exchange gain or loss that Jett should report on each of its quarterly income statements for the last three quarters of 2011 and the first quarter of 2012. Also compute the amount reported on Jett's balance sheets at the end of each of its last three quarters of 2011.

Exercise C-17
International accounting for investments
P3

The **Carrefour Group** reports the following description of its financial assets available-for-sale.

> Assets available for sale are . . . valued at fair value. Unrealized . . . gains or losses are recorded as shareholders' equity until they are sold.

Note 10 to Carrefour's 2008 financial statements reports €6 million in *net* unrealized losses (net of unrealized gains) for 2008, which is included in the fair value of its available-for-sale securities reported on the balance sheet.

1. What amount of the €6 million net unrealized losses, if any, is reported in its 2008 income statement? Explain.
2. If the €6 million net unrealized losses are not reported in the income statement, in which statement are they reported, if any? Explain.

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PROBLEM SET A

Problem C-1A
Recording transactions and fair value adjustments for trading securities
P1

Ryder Company, which began operations in 2011, invests its idle cash in trading securities. The following transactions are from its short-term investments in its trading securities.

2011

Jan. 20 Purchased 900 shares of Ford Motor Co. at $36 per share plus a $125 commission.
Feb. 9 Purchased 4,400 shares of Lucent at $10 per share plus a $200 commission.
Oct. 12 Purchased 500 shares of Z-Seven at $8 per share plus a $100 commission.

2012

Apr. 15 Sold 900 shares of Ford Motor Co. at $39 per share less a $185 commission.
July 5 Sold 500 shares of Z-Seven at $10.25 per share less a $100 commission.
July 22 Purchased 800 shares of Hunt Corp. at $30 per share plus a $225 commission.
Aug. 19 Purchased 1,000 shares of Donna Karan at $12 per share plus a $100 commission.

2013

Feb. 27 Purchased 3,400 shares of HCA at $22 per share plus a $220 commission.
Mar. 3 Sold 800 shares of Hunt at $25 per share less a $125 commission.
June 21 Sold 4,400 shares of Lucent at $8 per share less a $180 commission.
June 30 Purchased 1,000 shares of Black & Decker at $47.50 per share plus a $195 commission.
Nov. 1 Sold 1,000 shares of Donna Karan at $22 per share less a $208 commission.

Required

1. Prepare journal entries to record these short-term investment activities for the years shown. (Ignore any year-end adjusting entries.)
2. On December 31, 2013, prepare the adjusting entry to record any necessary fair value adjustment for the portfolio of trading securities when HCA's share price is $24 and Black & Decker's share price is $43.50. (Assume the Fair Value Adjustment—Trading account had an unadjusted balance of zero.)

Check (2) Dr. Fair Value Adjustment—Trading $2,385

Problem C-2A
Recording, adjusting, and reporting short-term available-for-sale securities
P3

Perry Company had no short-term investments prior to year 2011. It had the following transactions involving short-term investments in available-for-sale securities during 2011.

Apr.	16	Purchased 8,000 shares of Gem Co. stock at $24.25 per share plus a $360 brokerage fee.
May	1	Paid $200,000 to buy 90-day U.S. Treasury bills (debt securities): $200,000 principal amount, 6% interest, securities dated May 1.
July	7	Purchased 4,000 shares of PepsiCo stock at $49.25 per share plus a $350 brokerage fee.
	20	Purchased 2,000 shares of Xerox stock at $16.75 per share plus a $410 brokerage fee.
Aug.	3	Received a check for principal and accrued interest on the U.S. Treasury bills that matured on July 29.
	15	Received an $0.85 per share cash dividend on the Gem Co. stock.
	28	Sold 4,000 shares of Gem Co. stock at $30 per share less a $450 brokerage fee.
Oct.	1	Received a $1.90 per share cash dividend on the PepsiCo shares.
Dec.	15	Received a $1.05 per share cash dividend on the remaining Gem Co. shares.
	31	Received a $1.30 per share cash dividend on the PepsiCo shares.

Required

1. Prepare journal entries to record the preceding transactions and events.

Check (2) Cost = $328,440

2. Prepare a table to compare the year-end cost and fair values of Perry's short-term investments in available-for-sale securities. The year-end fair values per share are: Gem Co., $26.50; PepsiCo, $46.50; and Xerox, $13.75.

(3) Dr. Unrealized Loss—Equity $8,940

3. Prepare an adjusting entry, if necessary, to record the year-end fair value adjustment for the portfolio of short-term investments in available-for-sale securities.

Analysis Component

4. Explain the balance sheet presentation of the fair value adjustment for Perry's short-term investments.

5. How do these short-term investments affect Perry's (*a*) income statement for year 2011 and (*b*) the equity section of its balance sheet at year-end 2011?

Problem C-3A
Recording, adjusting, and reporting long-term available-for-sale securities
P3

Shaq Security, which began operations in 2011, invests in long-term available-for-sale securities. Following is a series of transactions and events determining its long-term investment activity.

2011

Jan.	20	Purchased 900 shares of Johnson & Johnson at $18.75 per share plus a $590 commission.
Feb.	9	Purchased 2,200 shares of Sony at $46.88 per share plus a $2,578 commission.
June	12	Purchased 500 shares of Mattel at $55.50 per share plus an $832 commission.
Dec.	31	Per share fair values for stocks in the portfolio are Johnson & Johnson, $20.38; Mattel, $57.25; Sony, $39.

2012

Apr.	15	Sold 900 shares of Johnson & Johnson at $21.75 per share less a $685 commission.
July	5	Sold 500 shares of Mattel at $49.13 per share less a $491 commission.
July	22	Purchased 1,600 shares of Sara Lee at $36.25 per share plus a $1,740 commission.
Aug.	19	Purchased 1,800 shares of Eastman Kodak at $28 per share plus a $1,260 commission.
Dec.	31	Per share fair values for stocks in the portfolio are: Kodak, $31.75; Sara Lee, $30.00; Sony, $36.50.

2013

Feb.	27	Purchased 3,400 shares of Microsoft at $23.63 per share plus a $1,606 commission.
June	21	Sold 2,200 shares of Sony at $40.00 per share less a $2,640 commission.
June	30	Purchased 1,200 shares of Black & Decker at $47.50 per share plus a $1,995 commission.
Aug.	3	Sold 1,600 shares of Sara Lee at $31.25 per share less a $1,750 commission.
Nov.	1	Sold 1,800 shares of Eastman Kodak at $42.75 per share less a $2,309 commission.
Dec.	31	Per share fair values for stocks in the portfolio are: Black & Decker, $56.50; Microsoft, $28.

Required

1. Prepare journal entries to record these transactions and events and any year-end fair value adjustments to the portfolio of long-term available-for-sale securities.

2. Prepare a table that summarizes the (*a*) total cost, (*b*) total fair value adjustment, and (*c*) total fair value of the portfolio of long-term available-for-sale securities at each year-end.

3. Prepare a table that summarizes (*a*) the realized gains and losses and (*b*) the unrealized gains or losses for the portfolio of long-term available-for-sale securities at each year-end.

Check (2b) Fair Value Adjustment bal.: 12/31/11, $(18,994); 12/31/12; $(31,664)

(3b) Unrealized Gain at 12/31/2013, $22,057

Problem C-4A
Long-term investment transactions; unrealized and realized gains and losses
C2 P3 P4

Park Co.'s long-term available-for-sale portfolio at December 31, 2010, consists of the following.

Available-for-Sale Securities	Cost	Fair Value
80,000 shares of Company A common stock	$1,070,600	$ 980,000
14,000 shares of Company B common stock	318,750	308,000
35,000 shares of Company C common stock	1,325,500	1,281,875

Park enters into the following long-term investment transactions during year 2011.

Jan. 29 Sold 7,000 shares of Company B common stock for $158,375 less a brokerage fee of $3,100.
Apr. 17 Purchased 20,000 shares of Company W common stock for $395,000 plus a brokerage fee of $3,500. The shares represent a 30% ownership in Company W.
July 6 Purchased 9,000 shares of Company X common stock for $253,125 plus a brokerage fee of $3,500. The shares represent a 10% ownership in Company X.
Aug. 22 Purchased 100,000 shares of Company Y common stock for $750,000 plus a brokerage fee of $8,200. The shares represent a 51% ownership in Company Y.
Nov. 13 Purchased 17,000 shares of Company Z common stock for $533,800 plus a brokerage fee of $6,900. The shares represent a 5% ownership in Company Z.
Dec. 9 Sold 80,000 shares of Company A common stock for $1,030,000 less a brokerage fee of $4,100.

The fair values of its investments at December 31, 2011, are: B, $162,750; C, $1,220,625; W, $382,500; X, $236,250; Y, $1,062,500; and Z, $557,600.

Required

1. Determine the amount Park should report on its December 31, 2011, balance sheet for its long-term investments in available-for-sale securities.

2. Prepare any necessary December 31, 2011, adjusting entry to record the fair value adjustment for the long-term investments in available-for-sale securities.

Check (2) Cr. Unrealized Loss—Equity, $40,000

3. What amount of gains or losses on transactions relating to long-term investments in available-for-sale securities should Park report on its December 31, 2011, income statement?

Problem C-5A
Accounting for long-term investments in securities; with and without significant influence
P3 P4

Pillar Steel Co., which began operations on January 4, 2011, had the following subsequent transactions and events in its long-term investments.

2011

Jan. 5 Pillar purchased 30,000 shares (20% of total) of Kildaire's common stock for $780,000.
Oct. 23 Kildaire declared and paid a cash dividend of $1.60 per share.
Dec. 31 Kildaire's net income for 2011 is $582,000, and the fair value of its stock at December 31 is $27.75 per share.

2012

Oct. 15 Kildaire declared and paid a cash dividend of $1.30 per share.
Dec. 31 Kildaire's net income for 2012 is $738,000, and the fair value of its stock at December 31 is $30.45 per share.

2013

Jan. 2 Pillar sold all of its investment in Kildaire for $947,000 cash.

Part 1

Assume that Pillar has a significant influence over Kildaire with its 20% share of stock.

Required

1. Prepare journal entries to record these transactions and events for Pillar.

2. Compute the carrying (book) value per share of Pillar's investment in Kildaire common stock as reflected in the investment account on January 1, 2013.

Check (2) Carrying value per share, $31.90

3. Compute the net increase or decrease in Pillar's equity from January 5, 2011, through January 2, 2013, resulting from its investment in Kildaire.

Part 2

Assume that although Pillar owns 20% of Kildaire's outstanding stock, circumstances indicate that it does not have a significant influence over the investee and that it is classified as an available-for-sale security investment.

Required

(1) 1/2/2013 Dr. Unrealized Gain—Equity $133,500

(3) Net increase, $254,000

1. Prepare journal entries to record the preceding transactions and events for Pillar. Also prepare an entry dated January 2, 2013, to remove any balance related to the fair value adjustment.
2. Compute the cost per share of Pillar's investment in Kildaire common stock as reflected in the investment account on January 1, 2013.
3. Compute the net increase or decrease in Pillar's equity from January 5, 2011, through January 2, 2013, resulting from its investment in Kildaire.

Problem C-6A[A]
Foreign currency transactions
C3

Roundtree Company, a U.S. corporation with customers in several foreign countries, had the following selected transactions for 2011 and 2012.

2011

Apr. 8 Sold merchandise to Salinas & Sons of Mexico for $7,938 cash. The exchange rate for pesos is $0.1323 on this day.
July 21 Sold merchandise on credit to Sumito Corp. in Japan. The price of 1.5 million yen is to be paid 120 days from the date of sale. The exchange rate for yen is $0.0096 on this day.
Oct. 14 Sold merchandise for 19,000 pounds to Smithers Ltd. of Great Britain, payment in full to be received in 90 days. The exchange rate for pounds is $1.5181 on this day.
Nov. 18 Received Sumito's payment in yen for its July 21 purchase and immediately exchanged the yen for dollars. The exchange rate for yen is $0.0091 on this day.
Dec. 20 Sold merchandise for 17,000 ringgits to Hamid Albar of Malaysia, payment in full to be received in 30 days. On this day, the exchange rate for ringgits is $0.6852.
Dec. 31 Recorded adjusting entries to recognize exchange gains or losses on Roundtree's annual financial statements. Rates for exchanging foreign currencies on this day follow.

Pesos (Mexico)	$0.1335
Yen (Japan)	0.0095
Pounds (Britain)	1.5235
Ringgits (Malaysia)	0.6807

2012

Jan. 12 Received full payment in pounds from Smithers for the October 14 sale and immediately exchanged the pounds for dollars. The exchange rate for pounds is $1.5314 on this day.
Jan. 19 Received Hamid Albar's full payment in ringgits for the December 20 sale and immediately exchanged the ringgits for dollars. The exchange rate for ringgits is $0.6771 on this day.

Required

1. Prepare journal entries for the Roundtree transactions and adjusting entries (round amounts to the nearest dollar).
2. Compute the foreign exchange gain or loss to be reported on Roundtree's 2011 income statement.

Check (2) 2011 total foreign exchange loss, $723

Analysis Component

3. What actions might Roundtree consider to reduce its risk of foreign exchange gains or losses?

PROBLEM SET B

Problem C-1B
Recording transactions and fair value adjustments for trading securities P1

Deal Company, which began operations in 2011, invests its idle cash in trading securities. The following transactions relate to its short-term investments in its trading securities.

2011

Mar. 10 Purchased 1,200 shares of AOL at $59.15 per share plus a $773 commission.
May 7 Purchased 2,500 shares of MTV at $36.25 per share plus a $1,428 commission.
Sept. 1 Purchased 600 shares of UPS at $57.25 per share plus a $625 commission.

2012

Apr. 26 Sold 2,500 shares of MTV at $34.50 per share less a $1,025 commission.
Apr. 27 Sold 600 shares of UPS at $60.50 per share less an $894 commission.

June 2 Purchased 1,800 shares of SPW at $172 per share plus a $1,625 commission.
June 14 Purchased 450 shares of Walmart at $50.25 per share plus a $541.50 commission.

2013

Jan. 28 Purchased 1,000 shares of PepsiCo at $43 per share plus a $1,445 commission.
Jan. 31 Sold 1,800 shares of SPW at $168 per share less a $1,020 commission.
Aug. 22 Sold 1,200 shares of AOL at $56.75 per share less a $1,240 commission.
Sept. 3 Purchased 750 shares of Vodaphone at $40.50 per share plus an $840 commission.
Oct. 9 Sold 450 shares of Walmart at $53.75 per share less a $610.50 commission.

Required

1. Prepare journal entries to record these short-term investment activities for the years shown. (Ignore any year-end adjusting entries.)

2. On December 31, 2013, prepare the adjusting entry to record any necessary fair value adjustment for the portfolio of trading securities when PepsiCo's share price is $41 and Vodaphone's share price is $37. (Assume the Fair Value Adjustment—Trading account had an unadjusted balance of zero.)

Check (2) Cr. Fair Value Adjustment—Trading $6,910

Problem C-2B
Recording, adjusting, and reporting short-term available-for-sale securities
P3

Day Systems had no short-term investments prior to 2011. It had the following transactions involving short-term investments in available-for-sale securities during 2011.

Feb. 6 Purchased 1,700 shares of Nokia stock at $41.25 per share plus a $1,500 brokerage fee.
15 Paid $10,000 to buy six-month U.S. Treasury bills (debt securities): $10,000 principal amount, 6% interest, securities dated February 15.
Apr. 7 Purchased 600 shares of Dell Co. stock at $39.50 per share plus a $627 brokerage fee.
June 2 Purchased 1,250 shares of Merck stock at $72.50 per share plus a $1,945 brokerage fee.
30 Received a $0.19 per share cash dividend on the Nokia shares.
Aug. 11 Sold 425 shares of Nokia stock at $46 per share less a $525 brokerage fee.
16 Received a check for principal and accrued interest on the U.S. Treasury bills purchased February 15.
24 Received a $0.10 per share cash dividend on the Dell shares.
Nov. 9 Received a $0.20 per share cash dividend on the remaining Nokia shares.
Dec. 18 Received a $0.15 per share cash dividend on the Dell shares.

Required

1. Prepare journal entries to record the preceding transactions and events.

2. Prepare a table to compare the year-end cost and fair values of the short-term investments in available-for-sale securities. The year-end fair values per share are: Nokia, $40.25; Dell, $41; and Merck, $59.

Check (2) Cost = $170,616

3. Prepare an adjusting entry, if necessary, to record the year-end fair value adjustment for the portfolio of short-term investments in available-for-sale securities.

(3) Dr. Unrealized Loss—Equity, $20,947

Analysis Component

4. Explain the balance sheet presentation of the fair value adjustment to Day's short-term investments.

5. How do these short-term investments affect (*a*) its income statement for year 2011 and (*b*) the equity section of its balance sheet at the 2011 year-end?

Problem C-3B
Recording, adjusting, and reporting long-term available-for-sale securities
P3

Venice Enterprises, which began operations in 2011, invests in long-term available-for-sale securities. Following is a series of transactions and events involving its long-term investment activity.

2011

Mar. 10 Purchased 2,400 shares of Apple at $33.25 per share plus $1,995 commission.
Apr. 7 Purchased 5,000 shares of Ford at $17.50 per share plus $2,625 commission.
Sept. 1 Purchased 1,200 shares of Polaroid at $49.00 per share plus $1,176 commission.
Dec. 31 Per share fair values for stocks in the portfolio are: Apple, $35.50; Ford, $17.00; Polaroid, $51.75.

2012

Apr. 26 Sold 5,000 shares of Ford at $16.38 per share less a $2,237 commission.
June 2 Purchased 3,600 shares of Duracell at $18.88 per share plus a $2,312 commission.
June 14 Purchased 900 shares of Sears at $24.50 per share plus a $541 commission.
Nov. 27 Sold 1,200 shares of Polaroid at $52 per share less a $1,672 commission.
Dec. 31 Per share fair values for stocks in the portfolio are: Apple, $35.50; Duracell, $18.00; Sears, $26.00.

2013

Jan. 28 Purchased 2,000 shares of Coca-Cola Co. at $41 per share plus a $3,280 commission.
Aug. 22 Sold 2,400 shares of Apple at $29.75 per share less a $2,339 commission.
Sept. 3 Purchased 1,500 shares of Motorola at $29 per share plus a $870 commission.
Oct. 9 Sold 900 shares of Sears at $27.50 per share less a $619 commission.
Oct. 31 Sold 3,600 shares of Duracell at $16.00 per share less a $1,496 commission.
Dec. 31 Per share fair values for stocks in the portfolio are: Coca-Cola, $46.00; Motorola, $22.00.

Required

1. Prepare journal entries to record these transactions and events and any year-end fair value adjustments to the portfolio of long-term available-for-sale securities.
2. Prepare a table that summarizes the (*a*) total cost, (*b*) total fair value adjustment, and (*c*) total fair value for the portfolio of long-term available-for-sale securities at each year-end.
3. Prepare a table that summarizes (*a*) the realized gains and losses and (*b*) the unrealized gains or losses for the portfolio of long-term available-for-sale securities at each year-end.

Check (2b) Fair Value Adjustment bal.: 12/31/11, $404; 12/31/12, $(1,266)

(3b) Unrealized Loss at 12/31/2013, $4,650

Problem C-4B
Long-term investment transactions; unrealized and realized gains and losses
C2 P3 P4

Capollo's long-term available-for-sale portfolio at December 31, 2010, consists of the following.

Available-for-Sale Securities	Cost	Fair Value
45,000 shares of Company R common stock	$1,118,250	$1,198,125
17,000 shares of Company S common stock	616,760	586,500
22,000 shares of Company T common stock	294,470	303,600

Capollo enters into the following long-term investment transactions during year 2011.

Jan. 13 Sold 4,250 shares of Company S stock for $144,500 less a brokerage fee of $2,390.
Mar. 24 Purchased 31,000 shares of Company U common stock for $565,750 plus a brokerage fee of $9,900. The shares represent a 62% ownership interest in Company U.
Apr. 5 Purchased 85,000 shares of Company V common stock for $267,750 plus a brokerage fee of $4,500. The shares represent a 10% ownership in Company V.
Sept. 2 Sold 22,000 shares of Company T common stock for $313,500 less a brokerage fee of $5,400.
Sept. 27 Purchased 5,000 shares of Company W common stock for $101,000 plus a brokerage fee of $2,100. The shares represent a 25% ownership interest in Company W.
Oct. 30 Purchased 10,000 shares of Company X common stock for $97,500 plus a brokerage fee of $2,340. The shares represent a 13% ownership interest in Company X.

The fair values of its investments at December 31, 2011, are: R, $1,136,250; S, $420,750; U, $545,600; V, $269,875; W, $109,375; and X, $91,250.

Required

1. Determine the amount Capollo should report on its December 31, 2011, balance sheet for its long-term investments in available-for-sale securities.
2. Prepare any necessary December 31, 2011, adjusting entry to record the fair value adjustment of the long-term investments in available-for-sale securities.
3. What amount of gains or losses on transactions relating to long-term investments in available-for-sale securities should Capollo report on its December 31, 2011, income statement?

Check (2) Dr. Unrealized Loss—Equity, $34,785; Cr. Fair Value Adjustment—AFS (LT), $93,530

Problem C-5B
Accounting for long-term investments in securities; with and without significant influence
P3 P4

Bengal Company, which began operations on January 3, 2011, had the following subsequent transactions and events in its long-term investments.

2011

Jan. 5 Bengal purchased 15,000 shares (25% of total) of Bloch's common stock for $187,500.
Aug. 1 Bloch declared and paid a cash dividend of $0.95 per share.
Dec. 31 Bloch's net income for 2011 is $92,000, and the fair value of its stock is $12.90 per share.

2012

Aug. 1 Bloch declared and paid a cash dividend of $1.25 per share.
Dec. 31 Bloch's net income for 2012 is $76,000, and the fair value of its stock is $13.55 per share.

2013

Jan. 8 Bengal sold all of its investment in Bloch for $204,750 cash.

Part 1

Assume that Bengal has a significant influence over Bloch with its 25% share.

Required

1. Prepare journal entries to record these transactions and events for Bengal.
2. Compute the carrying (book) value per share of Bengal's investment in Bloch common stock as reflected in the investment account on January 7, 2013.
3. Compute the net increase or decrease in Bengal's equity from January 5, 2011, through January 8, 2013, resulting from its investment in Bloch.

Check (2) Carrying value per share, $13.10

Part 2

Assume that although Bengal owns 25% of Bloch's outstanding stock, circumstances indicate that it does not have a significant influence over the investee and that it is classified as an available-for-sale security investment.

Required

1. Prepare journal entries to record these transactions and events for Bengal. Also prepare an entry dated January 8, 2013, to remove any balance related to the fair value adjustment.
2. Compute the cost per share of Bengal's investment in Bloch common stock as reflected in the investment account on January 7, 2013.
3. Compute the net increase or decrease in Bengal's equity from January 5, 2011, through January 8, 2013, resulting from its investment in Bloch.

(1) 1/8/2013 Dr. Unrealized Gain—Equity $15,750

(3) Net increase, $50,250

Problem C-6B[A]
Foreign currency transactions
C3

Datamix, a U.S. corporation with customers in several foreign countries, had the following selected transactions for 2011 and 2012.

2011

May 26 Sold merchandise for 6.5 million yen to Fuji Company of Japan, payment in full to be received in 60 days. On this day, the exchange rate for yen is $0.0094.

June 1 Sold merchandise to Fordham Ltd. of Great Britain for $72,613 cash. The exchange rate for pounds is $1.5277 on this day.

July 25 Received Fuji's payment in yen for its May 26 purchase and immediately exchanged the yen for dollars. The exchange rate for yen is $0.0090 on this day.

Oct. 15 Sold merchandise on credit to Martinez Brothers of Mexico. The price of 373,000 pesos is to be paid 90 days from the date of sale. On this day, the exchange rate for pesos is $0.1340.

Dec. 6 Sold merchandise for 242,000 yuans to Chi-Ying Company of China, payment in full to be received in 30 days. The exchange rate for yuans is $0.1975 on this day.

Dec. 31 Recorded adjusting entries to recognize exchange gains or losses on Datamix's annual financial statements. Rates of exchanging foreign currencies on this day follow.

Yen (Japan)	$0.0094
Pounds (Britain)	1.5318
Pesos (Mexico)	0.1560
Yuans (China)	0.2000

2012

Jan. 5 Received Chi-Ying's full payment in yuans for the December 6 sale and immediately exchanged the yuans for dollars. The exchange rate for yuans is $0.2060 on this day.

Jan. 13 Received full payment in pesos from Martinez for the October 15 sale and immediately exchanged the pesos for dollars. The exchange rate for pesos is $0.1420 on this day.

Required

1. Prepare journal entries for the Datamix transactions and adjusting entries.
2. Compute the foreign exchange gain or loss to be reported on Datamix's 2011 income statement.

Check (2) 2011 total foreign exchange gain, $6,211

Analysis Component

3. What actions might Datamix consider to reduce its risk of foreign exchange gains or losses?

SERIAL PROBLEM

Business Solutions

P1

(This serial problem began in Chapter 1 and continues through most of the book. If previous chapter segments were not completed, the serial problem can begin at this point. It is helpful, but not necessary, to use the Working Papers that accompany the book.)

SP C While reviewing the March 31, 2012, balance sheet of Business Solutions, Santana Rey notes that the business has built a large cash balance of $68,057. Its most recent bank money market statement shows that the funds are earning an annualized return of 0.75%. S. Rey decides to make several investments with the desire to earn a higher return on the idle cash balance. Accordingly, in April 2012, Business Solutions makes the following investments in trading securities:

April 16 Purchases 400 shares of Johnson & Johnson stock at $50 per share plus $300 commission.
April 30 Purchases 200 shares of Starbucks Corporation at $22 per share plus $250 commission.

On June 30, 2012, the per share market price (fair value) of the Johnson & Johnson shares is $55 and the Starbucks shares is $19.

Required

1. Prepare journal entries to record the April purchases of trading securities by Business Solutions.
2. On June 30, 2012, prepare the adjusting entry to record any necessary fair value adjustment to its portfolio of trading securities.

Beyond the Numbers

REPORTING IN ACTION

C3 A1

RIM

BTN C-1 Refer to **Research In Motion**'s financial statements in Appendix A to answer the following.

1. Are Research In Motion's financial statements consolidated? How can you tell?
2. What is Research In Motion's *comprehensive income* for the year ended February 27, 2010?
3. Does Research In Motion have any foreign operations? How can you tell?
4. Compute Research In Motion's return on total assets for the year ended February 27, 2010.

Fast Forward

5. Access Research In Motion's annual report for a fiscal year ending after February 27, 2010, from either its Website (RIM.com) or the SEC's database (www.sec.gov). Recompute Research In Motion's return on total assets for the years subsequent to February 27, 2010.

COMPARATIVE ANALYSIS

A1

RIM

Apple

BTN C-2 Key figures for **Research In Motion** and **Apple** follow.

	Research In Motion			Apple		
($ millions)	Current Year	1 Year Prior	2 Years Prior	Current Year	1 Year Prior	2 Years Prior
Net income	$ 2,457	$1,893	$1,294	$ 8,235	$ 6,119	$ 3,495
Net sales	12,536	9,411	4,914	42,905	37,491	24,578
Total assets	10,204	8,101	5,511	47,501	36,171	25,347

Required

1. Compute return on total assets for Research In Motion and Apple for the two most recent years.
2. Separate the return on total assets computed in part 1 into its components for both companies and both years according to the formula in Exhibit C.9.
3. Which company has the highest total return on assets? The highest profit margin? The highest total asset turnover? What does this comparative analysis reveal? (Assume an industry average of 10.0% for return on assets.)

ETHICS CHALLENGE

P2 P3

BTN C-3 Kendra Wecker is the controller for Wildcat Company, which has numerous long-term investments in debt securities. Wildcat's investments are mainly in 10-year bonds. Wecker is preparing its year-end financial statements. In accounting for long-term debt securities, she knows that each long-term investment must be designated as a held-to-maturity or an available-for-sale security. Interest rates rose sharply this past year causing the portfolio's fair value to substantially decline. The company does not intend to hold the bonds for the entire 10 years. Wecker also earns a bonus each year, which is computed as a percent of net income.

Required

1. Will Wecker's bonus depend in any way on the classification of the debt securities? Explain.
2. What criteria must Wecker use to classify the securities as held-to-maturity or available-for-sale?
3. Is there likely any company oversight of Wecker's classification of the securities? Explain.

COMMUNICATING IN PRACTICE

P4

BTN C-4 Assume that you are Jackson Company's accountant. Company owner Abel Terrio has reviewed the 2011 financial statements you prepared and questions the $6,000 loss reported on the sale of its investment in Blackhawk Co. common stock. Jackson acquired 50,000 shares of Blackhawk's common stock on December 31, 2009, at a cost of $500,000. This stock purchase represented a 40% interest in Blackhawk. The 2010 income statement reported that earnings from all investments were $126,000. On January 3, 2011, Jackson Company sold the Blackhawk stock for $575,000. Blackhawk did not pay any dividends during 2010 but reported a net income of $202,500 for that year. Terrio believes that because the Blackhawk stock purchase price was $500,000 and was sold for $575,000, the 2011 income statement should report a $75,000 gain on the sale.

Required

Draft a one-half page memorandum to Terrio explaining why the $6,000 loss on sale of Blackhawk stock is correctly reported.

TAKING IT TO THE NET

C1

BTN C-5 Access the July 30, 2009, 10-K filing (for year-end June 30, 2009) of **Microsoft** (MSFT) at www.sec.gov. Review its note 4, "Investments."

Required

1. How does the "cost-basis" total amount for its investments as of June 30, 2009, compare to the prior year-end amount?
2. Identify at least eight types of short-term investments held by Microsoft as of June 30, 2009.
3. What were Microsoft's unrealized gains and its unrealized losses from its investments for 2009?
4. Was the cost or fair value ("recorded basis") of the investments higher as of June 30, 2009?

TEAMWORK IN ACTION

C1 C2 P1 P2 P3 P4

BTN C-6 Each team member is to become an expert on a specific classification of long-term investments. This expertise will be used to facilitate other teammates' understanding of the concepts and procedures relevent to the classification chosen.

1. Each team member must select an area for expertise by choosing one of the following classifications of long-term investments.
   a. Held-to-maturity debt securities
   b. Available-for-sale debt and equity securities
   c. Equity securities with significant influence
   d. Equity securities with controlling influence
2. Learning teams are to disburse and expert teams are to be formed. Expert teams are made up of those who select the same area of expertise. The instructor will identify the location where each expert team will meet.
3. Expert teams will collaborate to develop a presentation based on the following requirements. Students must write the presentation in a format they can show to their learning teams in part (4).

Requirements for Expert Presentation

a. Write a transaction for the acquisition of this type of investment security. The transaction description is to include all necessary data to reflect the chosen classification.

b. Prepare the journal entry to record the acquisition.

[*Note:* The expert team on equity securities with controlling influence will substitute requirements (*d*) and (*e*) with a discussion of the reporting of these investments.]

c. Identify information necessary to complete the end-of-period adjustment for this investment.
d. Assuming that this is the only investment owned, prepare any necessary year-end entries.
e. Present the relevant balance sheet section(s).

4. Re-form learning teams. In rotation, experts are to present to their teams the presentations they developed in part 3. Experts are to encourage and respond to questions.

HITTING THE ROAD

C3

BTN C-7[A] Assume that you are planning a spring break trip to Europe. Identify three locations where you can find exchange rates for the dollar relative to the Euro or other currencies.

GLOBAL DECISION

A1

NOKIA
RIM
Apple

BTN C-8 **Nokia**, **Research In Motion**, and **Apple** are competitors in the global marketplace. Following are selected data from each company.

	Nokia (Euro millions)			Research In Motion		Apple	
Key Figure	Current Year	One Year Prior	Two Years Prior	Current Year	Prior Year	Current Year	Prior Year
Net income	€ 260	€ 3,889	€ 6,746	—	—	—	—
Net sales	40,984	50,710	51,058	—	—	—	—
Total assets	35,738	39,582	37,599	—	—	—	—
Profit margin	?	?	—	19.6%	20.1%	19.2%	16.3%
Total asset turnover	?	?	—	1.37	1.38	1.03	1.22

Required

1. Compute Nokia's return on total assets, and its components of profit margin and total asset turnover, for the most recent two years using the data provided.

2. Which of these three companies has the highest return on total assets? Highest profit margin? Highest total asset turnover? Interpret these results.

ANSWERS TO MULTIPLE CHOICE QUIZ

1. d; $30,000 × 5% × 5/12 = $625
2. a; Unrealized gain = $84,500 − $83,000 = $1,500
3. b; $50,000 × 35% = $17,500
4. e; $300,000/$2,000,000 = 15%
5. b; Profit margin = $80,000/$600,000 = 13.3%
Total asset turnover = $600,000/$400,000 = 1.5