8 INTERCORPORATE INVESTMENTS

1. The change in the investment in the associates account (the account that reflects all non-consolidated investments in other companies) between January 3 and December 31 is:
   (A) $11,400.
   (B) $10,800.
   (C) $27,600.

Joseph Haggs, CFA, is an analyst working for Garvess Jones, a large publicly traded investment-banking firm. Haggs covers the internet sector. Recently, one of the more successful companies Haggs covers, Simpson Corporation, made an aggressive move to acquire another internet company, Bailey Corporation (BC). BC is a company specializing in graphics and animation on the World Wide Web and has 1,000,000 shares outstanding. Simpson also holds minimal investments in other technology companies both public and private. In 1999 Simpson saw an opportunity to substantially increase its share in BC. Simpson feels that their sophisticated animation can greatly improve Simpson's market share and sees an acquisition as an opportunity to expand their business. The relevant financial data are in the following tables.

Bailey Corporation
Selected Financial Data, Years Ended December 31
(in Thousands)

Item	1998	1999	2000
Sales	$50,000	$60,000	$70,000
Less: cost of goods sold (COGS)	37,000	43,700	47,250
Earnings before interest & taxes (EBIT)	13,000	16,300	22,750
Less: Interest	10,000	13,000	19,000
EBT	3,000	3,300	3,750
Less: Taxes	1,000	1,100	1,250
Net Income	$2,000	$2,200	$2,500
Dividends Paid	$1,000	$1,200	$1,500
Total Shares Outstanding	**1,000,000**		

Simpson's Purchase Transactions in BC's Stock

Date	January 1, 1998	January 1, 1999	January 1, 2000
Number of Shares	10,000	290,000	700,000
Price per share	10	11	15

Because this is the largest acquisition in Simpson's history, Mr. Haggs' supervisor has asked him to prepare a report for Garvess Jones' clients detailing the effects of the acquisition on Simpson's financial statements.

2. After the acquisitions, the liabilities reported by Company X will be:
   (A) $300,000.
   (B) $480,000.
   (C) $460,000.

3. Haggs wants to make sure that he assumes the proper accounting method when he does his analysis. The acquisition of BC stock will lead to Simpson's total net cash flow equaling which of the following for the year ending December 31, 1999?
   (A) $360,000.
   (B) $-3,190,000.
   (C) $-2,830,000.

4. After the acquisitions, minority interest reported by Company X will be:
   (A) $168,000.
   (B) $0.
   (C) $72,000.

5. Company X will report revenue for 2007 of:
   (A) $2,280,000.
   (B) $2,000,000.
   (C) $2,400,000.

6. Haggs wonders which accounting method Simpson uses to calculate the book value of the BC investment for the year ending December 31, 1999. Which is the correct method?
   (A) Acquisition method.
   (B) Equity method.
   (C) Investment in Financial Assets method.

7. Haggs wonders which accounting method Simpson uses to calculate the book value of the BC investment for the year ending December 31, 1998. Which is the correct method?
   (A) Investment in Financial Assets method.
   (B) Acquisition method.
   (C) Equity method.

8. Haggs wonders which accounting method Simpson uses to calculate the book value of the BC investment for the year ending December 31, 2000. Which is the correct method?
   (A) Acquisition method.
   (B) Equity method.
   (C) Proportional consolidation method.

9. Company X owns 15% of company S and exerts significant influence over the operations of the company. The book value of the investment on December 31, 2001, is $48,000. In 2002, company S earned $100,000 and paid dividends of $20,000. The value of the investment account on December 31, 2002, is:

(A) $48,000.

(B) $63,000.

(C) $60,000.

10. Under which of the following is a minority interest account most likely to appear on the consolidated balance sheet?

(I) The acquisition method.

(II) Equity method.

(A) I only.

(B) II only.

(C) Both I and II.

Prior to 2007, Company X (reporting under U.S. GAAP) had never made any acquisitions of other companies. However, on January 2, 2007, it went on a buying spree, purchasing 10% of Company A for $10,000; 30% of Company B for $20,000; 40% of Company C for $80,000; and 70% of Company D for $168,000.

Below are the balance sheets for the five companies (in thousands) just prior to the purchase.

Company	X	A	B	C	D
Cash	400	10	20	30	40
Other assets	1,600	90	180	270	360
Total assets	**2,000**	**100**	**200**	**300**	**400**
Liabilities	300	40	80	120	160
Equity	1,700	60	120	180	240
Total	**2,00**	**100**	**200**	**300**	**400**

During 2007, the companies generated the following sales, income and dividends:

Company	X	A	B	C	D
Revenue	2,000	100	200	300	400
Net income	200	10	20	30	40
Dividends		4	8	12	16

The company accounts for the acquisitions based on typical ownership proportion guidelines. Investment in financial assets are classified as FVOCI.

11. Which of the following methods of accounting for investments will reflect the highest net income on a company's income statement?

(A) Acquisition method.

(B) Equity method.

(C) Both methods report the same net income.

12. Cosmo Inc. (Cosmo) invests in two portfolios — Portfolio 1 and Portfolio 2. Portfolio 1 contains securities classified as fair value through P&L. Portfolio 2 contains equity securities classified as fair value through OCI. Which of the following treatments of Cosmo's reporting of the investments in Portfolios 1 and 2, respectively, is most accurate?

	Portfolio 1	Portfolio 2
(A)	Unrealized amounts reported on income statement.	Assets reported at cost.
(B)	Unrealized amounts reported on balance sheet.	Assets reported at fair value.
(C)	Unrealized amounts reported on income statement.	Assets reported at fair value.

The Anderson Company acquired 100,000 shares of the Birschbach Company on January 1, 2012, at $25 per share. The market price of a share of Birschbach stock on December 31, 2012, was $35 per share. During 2012, Birschbach paid dividends of $1.50 per share and had earnings of $2.50 per share.

The Anderson Company did not buy or sell any additional shares in 2013. The market price of Birschbach stock on December 31, 2013 was $42.50 per share. During 2013 Birschbach paid dividends of $1.75 per share and had earnings of $2.25 per share

13. If Anderson Company accounts for the Birschbach Company shares as classified as fair value through OCI, the carrying amount of these shares on Anderson's balance sheet at the end of 2012 is:

(A) $3.5 million.

(B) $2.5 million.

(C) $2.6 million.

14. If Anderson Company accounts for the Birschbach Company shares using the equity method, the carrying amount of these shares on Anderson's balance sheet at the end of 2012 is closest to:

(A) $2.8 million.

(B) $2.6 million.

(C) $3.5 million.

15. For the year 2012, the investment income that Anderson Company reports on its investment in Birschbach Company shares, if Anderson classifies the shares as fair value through OCI, is:
    (A) $250,000.
    (B) $150,000.
    (C) $100,000.

16. If Anderson Company accounts for the Birschbach Company shares using the equity method, the change in carrying value from 2012 to 2013 is closest to:
    (A) +$2,650,000.
    (B) +$50,000.
    (C) +$225,000.

17. According to U.S. GAAP, goodwill is most likely to be considered impaired if the reporting unit's:
    (A) carrying value (including goodwill) is greater than its fair value.
    (B) tangible assets acquired in a business combination decrease in value.
    (C) implied value of goodwill is less than book value of goodwill.

18. Regarding accounting for joint ventures using the equity method or using proportionate consolidation, it would be most accurate to state that:
    (A) both IFRS and US GAAP require the proportionate consolidation method be used to account for joint ventures.
    (B) the equity method results in a single line item on the income statement, and a single line item on the balance sheet.
    (C) total net assets of the investor will differ between proportionate consolidation and the equity method.

19. The consolidation method results in:
    (A) same equity as the cost method.
    (B) same net income and shareholders' equity as the equity method.
    (C) same net income as the equity method but different shareholders' equity.

20. Under U.S. GAAP rules, where an investor owns 41% of the voting shares of an investee and is able to control the investee, which of the following methods of accounting is most appropriate to use?
    (A) Proportionate consolidation method.
    (B) Equity method.
    (C) Acquisition method.

21. When comparing companies that hold equity investments in other corporations, which of the following statements is most accurate? All else being equal, leverage measures for a firm using consolidation will appear:
    (A) less favorable than those for a comparable firm using the equity method.
    (B) more favorable than those for a comparable firm using the equity method.
    (C) more or less favorable depending on the leverage of the investee company.

22. Sawbuck Corporation recently acquired a 60% stake in Rawboard Inc. for $70 million in newly issued common stock. Given this information, which of the following methods should be used to account for the acquisition of Rawboard?
    (A) Proportionate consolidation.
    (B) The pooling of interest method.
    (C) Acquisition.

Rocky Mountain Air Cargo is a privately held commercial aviation company serving the western United States. It publishes financial statements in accordance with U.S. GAAP and uses a fiscal year that matches the calendar year.

Rocky Mountain was in good financial shape heading into 2003, with assets of $50 million at the beginning of the fiscal year. That year, it earned $3 million in net income and was easily able to maintain its traditional 50% dividend payout ratio. However, Rocky Mountain had a very difficult year in 2004, reporting a loss of $800,000. It managed to pay $1 million in dividends, but the decision to pay dividends in such a weak financial year further undermined the company's fiscal stability.

Flitenight Air Lines, a publicly-traded aviation firm serving the central and Midwestern United States, wanted to expand its range of service by coordinating its flight schedule with airlines serving different geographic regions of North America. One of these airlines was Rocky Mountain Air Cargo.

To cement the relationship, Flitenight's CEO, John "Bulldog" Basten, decided to make a significant investment in Rocky Mountain Air Cargo. He was easily able to convince both boards of the wisdom of the deal, and, in his usual brash style, personally negotiated the terms with his counterpart at Rocky Mountain, Buck Matthews. Flitenight Air Lines acquired a 20% stake in Rocky Mountain Air Cargo (with an option to purchase 40% more) for $10 million cash. The deal closed on January 1, 2003 and Flitenight accounted for the investment using the equity method.

Basten was not happy to find that he had invested right at the peak of Rocky Mountain's profitability and wound up with a money-losing airline. He had a difficult conversation with Matthews in early 2005, complaining about the impact of the Rocky Mountain investment on Flitenight's financials. Basten pointed out that he had a loss on his books: the original $10 million investment in Rocky Mountain was carried at only $9,940,000 on Flitenight's December 31, 2004 balance sheet. Matthews countered that this was just an accounting entry: on a cash basis, Flitenight had a gain of 5% on its investment over the two years.

Matthews' insistence that the investment had earned money for Flitenight did not sit well with Basten. Basten decided that Rocky Mountain was clearly being mismanaged and concluded it was time to gain control of the company.

Basten notified Matthews and Rocky Mountain's board that Flitenight intended to exercise its option. At the direction of Basten and Glenn, Flitenight purchased the additional shares for cash and gained control of Rocky Mountain on December 31, 2004.

23. In 2003, Flitenight would reflect its investment in Rocky Mountain on its income statement by recording:
    - (A) $300,000.
    - (B) $600,000.
    - (C) –$200,000.

24. If Flitenight were to account for its Rocky Mountain investment as an investment in financial assets instead of the equity method, Flitenight's 2004 income statement would reflect its investment in Rocky Mountain by including which of the following?
    - (A) Nothing, since the cost of the acquisition is not adjusted until the asset is sold.
    - (B) Only income of $200,000.
    - (C) Only a loss of $160,000.

25. Under the acquisition method, minority interest is considered:
    - (A) a liability under IFRS and US GAAP.
    - (B) equity under IFRS and a liability under US GAAP.
    - (C) equity under IFRS and US GAAP.

26. Regarding Basten's and Matthews' statements about the gain/loss that Flitenight had at the end of 2004 on its investment in Rocky Mountain, which is most accurate?
    - (A) Basten's statement is correct and Matthews' statement is incorrect.
    - (B) Basten's statement is incorrect and Matthews' statement is correct.
    - (C) Basten's statement is correct and Matthews' statement is correct.

27. Firm A recently leased equipment used in its manufacturing plant. If the leased asset is worth less than $100,000 at the end of the lease, Firm A will pay the lessor the difference.

    Firm B provided debt financing to an unrelated entity. The debt has a provision whereby Firm B cannot be repaid until all other senior debt is satisfied.

    Do Firm A and Firm B have a variable interest?
    - (A) Both have a variable interest.

(B) Only one has a variable interest.

(C) Neither have a variable interest.

28. On December 31, 2008 Company P invests $5,000 in Company S in exchange for 25% of the company. During 2009, Company S earns $2,000 and pays a dividend of $500. If Company P uses the equity method of accounting, what values will be reported on the balance sheet and income statement? How much cash will be recognized from the investment?

	Balance Sheet	Income Statement	Cash
(A)	$5,375	$125	$125
(B)	$5,500	$0	$0
(C)	$5,375	$500	$125

29. Which of the following statements about variable interest entities (VIE) are correct or incorrect?

Statement #1:	One potential benefit of a VIE is a lower cost of capital since the assets and liabilities of the VIE are isolated in the event the sponsor experiences financial difficulties.
Statement #2:	The organizational form of a VIE must be either a partnership or a joint venture and it is necessary for the VIE to have separate management and employees.

(A) Only one is correct.

(B) Both are incorrect.

(C) Both are correct.

30. When comparing companies that hold equity investments in other corporations, which of the following statements is most accurate? All else being equal, return on asset measures for a firm using the acquisition method will appear:

(A) less favorable than those for a comparable firm using the equity method.

(B) same as for a comparable firm using the equity method.

(C) more favorable than those for a comparable firm using the equity method.

31. Which of the following methods of accounting for investments will reflect the highest assets and liabilities on company's balance sheet?

(A) Both methods result in reporting the same balances for assets and liabilities.

(B) Equity method.

(C) Acquisition method.

32. Which of the following statements about special purpose entities (SPE) are correct or incorrect?

Statement #1:	The sponsor usually maintains the decision-making power and voting control over the SPE.
Statement #2:	The equity owners of an SPE usually receive a rate of return that is tied to the performance of the SPE.

(A) Only one is correct.

(B) Both are correct.

(C) Both are incorrect.

33. Which of the following statements regarding special purpose entities (SPEs) is least accurate?

(A) Under IFRS, a special purpose entity must be consolidated by the entity which exercises control over that entity.

(B) According to U.S. GAAP, if a SPE is considered a VIE, it must be only consolidated by the primary beneficiary.

(C) According to U.S. GAAP, a special purpose entity is classified as a variable interest entity (VIE) if it has at-risk equity that is sufficient to finance its own activities without additional financial support.

34. Maverick Incorporated formed a special purpose entity (SPE) to purchase and lease a 50,000 acre ranch. The SPE financed 95% of the purchase price with debt. The remaining 5% was financed with equity capital received from two separate independent investors. The lender would not make the loan without Maverick's guarantee. How should Maverick treat the SPE in its financial statements if Maverick is the lessee?

(A) Maverick must consolidate the SPE.

(B) Each equity investor must proportionately consolidate the SPE.

(C) No firm must consolidate the SPE.

Assume that on the balance sheet date shown below TME Corporation acquires 70% of Abcor, Inc. common stock for $25,000 in cash.

Pre-acquisition Balance Sheets
December 31, 2001

	TME Corp.	**Abcor, Inc.**
Current assets	$80,000	$38,000
Other assets	28,000	15,000
Total assets	$108,000	$53,000
Current liabilities	$60,000	$32,000
Common stock	15,000	14,000
Retained earnings	33,000	7,000
Total liabilities and equity	**$108,000**	**$53,000**

35. What will be the post-acquisition current ratio, using both the acquisition method and the equity method, respectively, for TME? The choices below represent Acquisition and Equity, respectively.

(A) 1.01, 0.92.

(B) 1.04, 1.11.

(C) 1.21, 1.02.

36. Using the acquisition method to account for the acquisition, what will be the post-acquisition current assets of TME?
    (A) $105,000.
    (B) $93,000.
    (C) $118,000.

37. Using the acquisition method to account for the acquisition, which of the following is closest to the post-acquisition amount that will be recorded as the minority interest under US GAAP?
    (A) $21,000.
    (B) $10,700.
    (C) $6,300.

38. Last year, Parent Company acquired Sub Company for $2,000,000. On the date of acquisition, the fair value of Sub's net assets was $1,700,000.

    At the end of the year, the fair value of Sub is $1,950,000, and the fair value of Sub's net assets is $1,775,000. If the carrying value of Sub is $1,980,000, the impairment loss under U.S. GAAP is closest to:
    (A) $30,000.
    (B) $125,000.
    (C) $0.

On January 9, 2006, Company X paid $2,000,000 for 100,000 shares of stock in Company S. Originally the company classified the shares as fair value through OCI. As of December 31, the stocks were valued at $2,200,000. In 2006, Company S had earnings per share of $0.90 and paid dividends per share of $0.20. In late December 2006 the company wonders what would be the change if the company had classified the shares as fair value through P&L.

39. What is the impact if the company had originally classified the shares as fair value through P&L on the value of the assets of Company X?
    (A) $70,000.00
    (B) $200,000.00
    (C) $0.00

40. If the shares were classified as fair value through P&L, what would have been the impact on the income and the stockholders' equity of Company X?
    (A) Stockholders' equity will rise by $200,000, but income will not change.

(B) Income will rise by $200,000, but stockholders' equity will not change.
(C) Income and stockholder's equity will rise by $200,000.

41. Under IFRS, where an investor owns a significant number (39%) of the voting shares of an investee but has no involvement in policy making and no Board of Directors' representation, which of the following investment classifications is most appropriate to characterize the situation?
(A) Investment in associates.
(B) Investment in financial assets.
(C) Significant influence.

42. Equity method is:
(A) recommended under U.S. GAAP for jointly controlled entities, but is not normally permitted under IFRS.
(B) required under IFRS and under U.S. GAAP for jointly controlled entities.
(C) recommended under IFRS and U.S. GAAP for jointly controlled entities.

Omricon Capital Associates specializes in making investments in the small cap market sector. In some cases the firm operates as a supplier of private equity for restructurings. In this instance, the firm views itself as having a value investment focus. In others, it acts as a venture capital firm. Here, the investment focus is usually growth. Finally, in some cases it simply takes passive investment positions in publicly-traded firms. The positions in marketable securities are sometimes considered trading positions, and other times the view is to hold for a longer period until valuation parameters are met or exceeded.

Omricon's chief compliance officer, Raymond "Buzz" Richards has recently become concerned that the firm may not be correctly following the relevant accounting standards for these investments. To ensure that the rules are being effectively adhered to, he is seeking advice from the accounting firm of Merz-Brokaw and Associates on the matter. Sally Lee is the Merz-Brokaw partner heading up the consulting team assigned to review the situation.

The size of the investments ranges from a few percent of the firm's outstanding equity, to positions of greater than 50%. Richards says that it has always been his understanding that the percentage of the equity held is the major determinant with respect to which accounting method applies. Lee reminds him that the firm's intent for its investments also plays a role in determining how they are accounted for.

Some of the firm's investments have not worked out as planned. Richards has conferred with the firm's portfolio managers regarding securities being held by the firm that are worth less than when they were acquired, and has presented a list of these investments to Lee. His concern is what this implies for the accounting for these investments. Lee tells him that the issue here is whether or not the security can be considered impaired, and that designating a security as impaired implies that the decline in value is permanent.

Top managers at Omricon have asked Lee to help them evaluate the impact of the choice of accounting method on the firm's profitability. Some members of the management team are of the belief that the accounting method does not affect financial measures because these are driven by underlying economic factors. Others believe that these measures can be affected by the accounting method chosen.

43. Assuming no significant influence exists, which of the following statements concerning percentage ownership and accounting method is most accurate?
(A) When the ownership is less than 20%, both US GAAP and IFRS require the investment in financial assets method.
(B) When the ownership is less than 20%, US GAAP requires the investment in financial assets method, IFRS the equity method.
(C) When the ownership is less than 20%, both US GAAP and IFRS require the equity method.

44. For instances in which Omricon holds exactly 50% of the outstanding equity of the investee firm's equity (i.e., the investee firm is a joint venture), which of the following statements is most accurate?
(A) IFRS and US GAAP both permit a choice between the equity method and proportional consolidation.
(B) IFRS requires that the equity method be used'; US GAAP permits a choice between the equity method and proportional consolidation.
(C) Both US GAAP and IFRS require that the equity method be used.

45. Relative to consolidation, using the equity method of accounting for investments results in:
(A) ROA being higher than under consolidation.
(B) ROA being lower and leverage being higher than under consolidation.
(C) ROA being higher and leverage being higher than under consolidation.

46. Barrett Inc. is advised by its banker to create a special purpose entity (SPE) to convert its existing $15 million loan off-balance sheet. Under the terms of the deal, SPE would obtain a loan for $15 million from the bank with Barrett providing loan guarantee. Barrett would then sell $15 million of accounts receivable to the SPE and use the proceeds to pay off the current loan. Barrett prepares its financial statements under U.S. GAAP. Which of the following statements is most accurate regarding the impact of such an arrangement on Barrett's ratios?
(A) Barrett's leverage would decrease and receivable turnover would increase.
(B) Barrett's leverage as well as receivables turnover would remain the same.
(C) Barrett's leverage would remain the same while receivable turnover would increase.

47. Harter Company recently acquired a 40% stake in Compton Corp. for $40 million in cash by borrowing at 10%. Harter will account for this acquisition using which of the following methods:

(A) Equity method.

(B) Acquisition Method.

(C) Held to maturity debt securities method.

48. Which of the following statements regarding asset securitizations and special purpose entities (SPEs) is most accurate?

(A) The SPE usually issues debt to purchase receivables from the sponsor.

(B) If the sponsor has no recourse, then the transaction is nothing more than a collateralized borrowing.

(C) When receivables are securitized, the sponsor reports the cash inflow as an investing activity in the cash flow statement.

Global Life Insurance (GLI) holds a wide range of assets in a range of different portfolios across its various divisions. Some of these assets are held long term to meet future liabilities, whereas others are held short term to make profits and meet shorter term liquidity needs.

GLI set up a small portfolio of U.S. equities in one of its smaller divisions last year. GLI's chief investment officer has recently contacted the accounting department to discuss the correct treatment of the portfolio in the group accounts.

Details of the portfolio's transactions and results for the previous period are shown below in Exhibit 1.

Exhibit 1 - Equity Portfolio Results

	2013 Q1	2013 Q2	2013 Q3	2013 Q4
Shares purchased (sold)	1,000	(200)	700	0
Total shares quarter-end	1,000	800	1,500	1,500
Purchase price	50.00		45.00	
Sale price		45.00		
Quarter-end market price	52.00	43.00	52.00	60.00
Total dividends	**500**	**400**	**750**	**750**

The chief investment officer's also provides the following extract from the portfolio's investment policy statement:

IPS Extract

(1) The portfolio should consist solely of U.S. mid-cap equities.

(2) The number of transactions in the portfolio should be kept to a minimum. Shares should not be purchased on a speculative basis for short term profits.

(3) The anticipated average holding period for securities in the portfolio is 3.5 - 4 years.

(4) Securities should only be sold to meet urgent liquidity needs.

Another reporting issue the accounting department is looking at concerns a fixed income portfolio. An overview of the portfolio is given in Exhibit 2:

Exhibit 2 - Fixed Income Portfolio

Par Value	$25,000,000
Coupon rate	5% (paid semi-annually)
Current Market Value	$27,000,000

The portfolio consists of $1000 par value, 5 year bonds issued by RTF Inc. They were purchased on the date of issue 1st January 2012 for $25,893,577. For the year ending 31st December the bonds were carried at amortized cost.

The chief investment officer believes a more appropriate classification would be fair value through profit or loss, as he is not convinced the bonds will be held for the remaining 3 years.

49. What is the income from the equity portfolio if the securities are classified as FVPL?
   (A) $19,900.
   (B) $20,900.
   (C) –$6,600.

50. What is the balance sheet carrying value of the securities under each of the classifications at year-end?

	FVPL	FVOCI
(A)	$71,500	$71,500
(B)	$90,000	$71,500
(C)	$90,000	$90,000

51. If the fixed income portfolio outlined in Exhibit 2 is remains classified as amortized cost, which of the following is closest to the interest income reported in the income statement for the year ending 31st December 2013?
   (A) $1,079,000.
   (B) $1,086,000.
   (C) $1,088,000.

52. If the bonds are reclassified as suggested by the chief investment officer, which of the

following statements is most likely correct?

(A) The difference between the amortized cost and fair value will be shown in other comprehensive income.

(B) The difference between the amortized cost and fair value will be shown in net income.

(C) The difference between the purchase price and fair value will be shown in other comprehensive income.

53. Milburne Company purchased 1,000 shares of Marino Co. for $20 per share on January 1. By December 31, shares of Marino were trading at $15 per share in the open market. Marino Co. has 100,000 shares outstanding with a dividend yield of 2% at year end. Milburne choose FVOCI classification for these shares. The impact of the Marino holding on the Milburne income statement is:

(A) -$4,700.

(B) -$5,000.

(C) $300.

On January 9, 20X6, Company X, reporting under IFRS, purchased $1,000,000 of government bonds at par and 100,000 shares of stock in Company S for $2,000,000. The stock investment was held at fair value through OCI while the bonds were held at amortized cost. As of December 31, the bonds were valued at $900,000, and the stocks were valued at $2,200,000. The bonds paid $50,000 of interest and the stocks paid $20,000 of dividends. In 2006, Company S had earnings per share of $0.90.

54. The marketable securities balance amount shown on the balance sheet is:

(A) $3,000,000.00.

(B) $3,100,000.00.

(C) $3,200,000.00.

55. In late 20X6, Company X decided to reclassify the investments in stock. What classification can the company classify the investment in stocks to?

(A) Fair value through profit or loss or amortized cost.

(B) Reclassification would not be allowed.

(C) Fair value through profit or loss only.

56. The appropriate classification for the investment in government bonds would be:

(A) amortized cost, fair value through OCI, or fair value through profit or loss.

(B) amortized cost or fair value through OCI.

(C) amortized cost or fair value through profit or loss.

57. Assuming that the investments were initially classified as fair value through profit or loss. The company can reclassify:
   (A) debt security only if the business model has changed.
   (B) equity security but only into fair value through OCI.
   (C) both debt and equity securities into fair value through OCI.

58. Carter Schmitz, Inc. (Schmitz) purchased 200 shares of Intelismart at $21 a share in June 2006 and classifies 80 shares as fair value through profit or loss securities and holds the remaining 120 shares as classified as fair value through OCI. Intelismart's closing price was $26 on December 31, 2006, and Schmitz did not sell any of its shares.
   What amount should Schmitz report on this investment under the income statement?
   (A) $1,000.
   (B) $600.
   (C) $400.

59. Under IFRS rules, which of the following accounting treatments is most preferred for joint ventures where there is shared control?
   (A) Acquisition method.
   (B) Proportionate consolidation method.
   (C) Equity method.

60. Company X owns 15% of company S and exerts significant influence over the operations of the company. The book value of the investment on December 31, 2008, is $48,000. In 2009, company S earned $100,000 and paid dividends of $20,000. The impact of the investment on the income statement of company X is:
   (A) $3,000.
   (B) $15,000.
   (C) $12,000.

61. Alpha Inc. owns 70% of the outstanding shares of Beta Inc. Compared to the debt-to-equity ratio under the partial goodwill method, Alpha's debt-to-equity ratio under the full goodwill method is most likely be:
   (A) higher.
   (B) lower.
   (C) the same.

62. Acme Corporation purchases a 3% interest in Bandy Company to become the single largest shareholder of Bandy. Acme will hold a seat on the Board of Directors of Bandy. Acme will account for its investment in Bandy using the:
   (A) acquisition method.
   (B) equity method.

(C) lower of cost or market method.

63. Fiduciary Investors held two portfolios of marketable securities:

- $50 million in Portfolio A was accounted for as Fair value through profit or loss.
- $50 million in Portfolio B was accounted for as amortized cost securities.

Assume that Fiduciary reclassified securities ($10 million carrying value, $8 million market value) from Portfolio B into Portfolio A. If no previous write downs were made, Fiduciary must:

(A) do nothing to its income statement or equity section of its balance sheet.

(B) charge $2 million to its income statement.

(C) charge $2 million to the equity section of its balance sheet.

64. Accounting standards for intercorporate investments establish different categories of securities with distinct ways of treating them on the financial statements of the company. One category requires the securities to be carried at fair value on the balance sheet with unrealized gains and losses excluded from the income statement. This category of security classification is called debt:

(A) securities classified at amortized cost.

(B) and equity classified as fair value through P&L securities.

(C) and equity securities classified as fair value through OCL.

65. Mashburn Company acquired 25% of the 100,000 outstanding shares of Humm Co. on January 1 for $250,000 in cash. Humm Co. earned $1 per share and had a dividend payout ratio of 40%. As of December 31, Humm Co. shares were trading in the open market at $12 per share. Calculate the income statement treatment of the Humm Co. investment as of December 31.

(A) $25,000.

(B) $10,000.

(C) $75,000.

66. Mustang Corporation formed a special purpose entity (SPE) for purposes of providing research and development. An unrelated firm absorbs the expected losses of the SPE and the independent shareholders of the SPE receive the expected residual returns. Is the SPE considered a variable interest entity (VIE) according to FASB Interpretation No. 46(R) and is consolidation required by Mustang, respectively?

(A) No ; No.

(B) Yes ; Yes.

(C) Yes ; No.

Birch Corporation is a large conglomerate based in the U.S. that has grown primarily through acquisition. On the first day of this reporting year, January 1, 2012, Birch acquired 1,500,000 shares of the common stock of TRQ Inc. TRQ Inc. produces high quality fabrics for use in the fashion industry. Exhibit 1 shows key numbers from TRQ

Inc.'s accounts.

Exhibit 1 - TRQ Financial Statement Extracts

TRQ Inc	
Income – year ending 31 Dec 12	$700,000
Dividend paid	$210,000
Number of common shares in Issue	6,000,000
Number preferred shares in issue	3,000,000
Total number of shares in issue	9,000,000

Both Birch and TRQ prepare their accounts using US GAAP.

Dan Fitzroy is the CFO of Birch, and is currently preparing with a meeting with the auditors to discuss the correct treatment of the TRQ investment in Birch's group accounts. Fitzroy is of the opinion that the equity method of accounting should be used for the following reasons:

(1) The proportion of TRQ's common shares owned by Birch suggests that Birch has significant influence over TRQ's operations.

(2) The lack of ownership of preferred shares suggests that Birch has no significant influence over TRQ's operations

(3) The proportion of TRQ's total shares owned by Birch suggests that Birch has significant influence over TRQ's operations.

67. Assuming the equity method of accounting is used, what will be the reported investment income for Birch?
(A) $60,000.00.
(B) $175,000.00.
(C) $115,000.00.

68. Assuming the equity method of accounting is used, what will be the cash flow received by Birch, due to their investment in TRQ?
(A) $65,400.
(B) $227,500.
(C) $52,500.

69. If the consolidation method is used, how much of TRQ's net income will Birch recognize in the group income statement?
(A) $122,500.
(B) $175,000.
(C) $700,000.

70. Which of Fitzroy's reasons would most likely support the equity accounting method being

appropriate for TRQ?

(A) Reason 2.

(B) Reason 1.

(C) Reason 3.

71. Milburne Company purchased 1,000 shares of Marino Co. for $20 per share on January 1 classified as FVPL. By December 31, shares of Marino were trading at $15 per share in the open market.

Marino Co. has 100,000 shares outstanding with a dividend yield of 2% at year end. The impact of the Marino holding on the Milburne income statement is:

(A) —$4,700.

(B) —$5,300.

(C) —$5,000.

On December 15, 2009, the Zeisler Company faces a financial crisis. Zeisler's industry has gone into recession and net income has declined to nearly zero. Jeremiah Welch, the company's CFO, is extremely concerned that, when the final figures for 2009 come in, the poor operating results will throw the firm into violation of its debt covenants, which specify that it must meet a certain return on assets (ROA) and not exceed a certain debt-to-asset ratio. A violation of either covenant would trigger a provision in the lending agreement allowing lenders to put Zeisler's debt back to the firm and likely force Zeisler into bankruptcy.

With only two weeks before the close of the firm's fiscal year on December 31, there is no way to avoid bankruptcy through improved operations. Welch calls an emergency meeting with Olivia Dupree, the firm's controller, to come up with a plan of action to keep Zeisler out of bankruptcy. He explains to Dupree that they need to increase Zeigler's reported ROA and reduce its reported debt-to-assets ratio relative to the numbers that would otherwise be reported for 2009.

Dupree suggests that Zeisler's equity investments might be useful in staving off bankruptcy. Zeisler acquired 100,000 shares of the Market Square Corporation on January 1, 2009, at $25 per share.

Market Square paid dividends during 2009 of $1.50 per share and was expected to have earnings for 2009 of $2.50 per share. Zeisler also holds 250,000 shares of General Nuclear, purchased for $72 per share. General Nuclear has no dividends and is expected to report a loss for 2009. Both securities are classified on the financial statements as FVOCI.

Dupree left the meeting with Welch for a moment to check the stock market. She found that Market Square was trading at $35 per share and General Nuclear was at $43.

72. What is the investment income that Zeisler Company will report for the year 2009 on its

investment in Market Square Corporation shares if it continues to account for the shares as an FVOCI investment?

(A) $150,000.

(B) $200,000.

(C) $250,000.

73. If Zeisler were to account for the Market Square Corporation shares as FVPL, assuming that the securities do not change in value between the December 15th meeting and the end of the year, the carrying amount of these shares on Zeisler's December 31, 2009 balance sheet would be:

(A) $2.50 million.

(B) $2.75 million.

(C) $3.50 million.

74. If Zeisler reclassified the common stock of General Nuclear as FVPL, what effect would it have on Zeisler's 2009 income statement?

(A) Reclassifying the security would have no effect on the income statement because gains and losses would be recognized in equity.

(B) Net income would increase.

(C) None, reclassification is prohibited under IFRS 9.

75. If Zeisler were to account for the Market Square Corporation shares using the equity method, assuming that the securities do not change in value between the December 15th meeting and the end of the year, the carrying amount of these shares on Zeisler's December 31, 2009 balance sheet would be:

(A) $2.75 million.

(B) $2.60 million.

(C) $3.50 million.

76. Company A acquired a 50% stake in Company T on January 1, 2003 by paying T's shareholders $100,000 in cash. Pre-acquisition balance sheets for the two firms are presented below:

Balance Sheet		
	Company A	**Company T**
Current assets	$400,000	600,000
Fixed assets	600,000	100,000
Total	**$1,000,000**	**$160,000**
Current liabilities	$50,000	$30,000
Common stock	350,000	60,000
Retained earnings	600,000	70,000
Total	**$1,000,000**	**$160,000**

The fair values of company T assets and liabilities was same as the book value. Company A reports under U.S. GAAP. What are the post-acquisition balance sheet values for total assets for Company A under the equity and acquisition methods of accounting respectively?

(A) $1,060,000 and $1,095,000.

(B) $1,000,000 and $1,130,000.

(C) $1,000,000 and $1,095,000.

77. A company reports an intercorporate investment using the acquisition method. Which of the following statements is most accurate?

(A) The use of the acquisition method by a company will generally report the more favourable results.

(B) The use of the acquisition method by a company will generally report the less favourable results.

(C) The use of the equity method by a company will generally report the same results.

Evergreen Brothers is a large producer of bedding plants and shrubs that are sold to various retail nurseries and home improvement stores located across the western coast of the United States with approximately $85 million in annual sales. Evergreen grows its products at two facilities, one in Northern California and the other in the Southern part of the state. Each production facility currently distributes its products within an approximate 150 mile radius of its location. All aspects of the shipping and delivery of products have historically been provided by an independent, third-party distribution company.

Because of impressive growth in the company's sales over the past several years, management has decided to pursue plans to bring "in-house" the distribution of the company's products. They believe that the projected decreased freight costs as well as the increased efficiencies in more actively managing the distribution of their production should immediately yield increased profit margins. As an initial step, Evergreen has negotiated the price for ten delivery trucks, which could provide all distribution capacity needed for the company's Northern production facility for the upcoming season. Current plans are to continue the use of the independent distribution company for the needs of the firm's Southern facility for at least the next several years.

Under advice from the company's CFO, Evergreen has created a new special purpose entity (SPE), QuickTime, Inc., which will serve as the entity that will purchase the trucks from the dealer. The purchase will be financed through a combination of debt and equity, with the dealer lending 75% of the total cost. The loan is collateralized by both the trucks and Evergreen's guarantee of the debt, as required by the dealer.

Evergreen has arranged for an outside investor to provide the remaining 25% of the upfront costs of the equipment in exchange for 100% of QuickTime's nonvoting stock.

In addition, the outside investor is guaranteed an 8% annual return for the life of the financing term. At the end of seven years, QuickTime will be liquidated and Evergreen will have the option of purchasing the equipment for its fair value at that time. The proceeds of the liquidation will be used to repurchase the outside investor's stock at par value. In the event that the liquidation value is insufficient to buy back the outside investor's, Evergren has committed to fund the shortfall.

Management has given its tentative approval of the project and the proposed structure. Questions remain, however, as to the effect of the creation of QuickTime on Evergreen's financial statements. With the relatively recent issuance of FASB Interpretation No. 46(R), "Consolidation of Variable Interest Entities" (FIN 46(R)), the management of Evergreen has not had prior experience with the new consolidation requirements for SPEs.

78. Which of the following statements regarding special purpose entities (SPEs) is least accurate?

(A) An SPE can be established as one of several legal forms, such as corporations, partnerships, or trusts, but must establish separate management from that of the sponsor.

(B) In general, the equity investors in an SPE can expect to receive a limited rate of return on their investment in exchange for limited risk exposure.

(C) An SPE can be formed to isolate specific assets from the sponsor, thus lowering the cost of capital by protecting the assets of the SPE in the event the sponsor experiences financial distress.

79. Assuming that QuickTime is considered a VIE in accordance with FIN 46(R), which of the following statements regarding the consolidation of QuickTime on Evergreen's financial statements is most accurate?

(A) The truck dealer is supplying the financing for the majority (75%) of QuickTime's debt, so Evergreen may not consolidate QuickTime on its financial statements.

(B) Evergreen is exposed to the majority of QuickTime's risks and rewards, so Evergreen must consolidate QuickTime on its financial statements.

(C) Because the outside investor holds only nonvoting stock, Evergreen holds the majority controlling financial interest in QuickTime and must consolidate QuickTime on its financial statements.

80. GTH Corporation has just purchased 18% of the common stock of Pittor Corporation, one of their major suppliers, making GTH the largest single shareholder in Pittor. The primary motivation for the purchase is that managerial problems at Pittor have resulted in quality control difficulties, thereby affecting the reliability of several critical component parts for GTH

products. At the time of the purchase, GTH management announced they plan to be an active investor and exercise significant influence on Pittor so the quality problems can be resolved. Given these circumstances, the accounting method used to record the intercorporate investment will most likely be the:

(A) investment in financial assets method.

(B) equity method.

(C) acquisition method.

Luna Life Insurance is a publicly traded corporation with total assets in excess of $500 million. Joy Manning, CFA, has served as Luna's chief investment officer for the past decade. Recent poor performance of Luna investment portfolio has led to the formation of a special task force to review Luna's investment holdings as well as its operating policies. The task force is composed of two current Luna board members (who are not employees of Luna) and three independent investment professionals. Their assignment is to thoroughly review Luna's financial statements for evidence of impropriety or mishandling of corporate assets. The task force is expected to complete their review within one month and report back to Luna's board of directors shortly thereafter.

Luna's most recent financial statements reflect approximately $200 million in various equity holdings and $100 million in debt instruments. A broad classification of the portfolio (in millions of $) as of December 31, 2006 is as follows:

	Held-to-Maturity	Available-for-Sale	Trading
Equity	$0	$125	$75
Debt	$50	$25	$25

In the footnotes, there is a reference to $10 million of available-for-sale securities that were transferred to the held-to-maturity portfolio last year. The securities were transferred at fair market value, and an unrealized loss of $1 million was included in that period's income. Several members of the task force believe the transaction deserves further analysis to determine if the securities' transfer between portfolios was executed in accordance with SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities" as Manning has represented.

Also, in 2006, Luna transferred $5 million of shares in ABC Corp from the available-for-sale portfolio to the trading portfolio. In association with this transaction, $1 million in unrealized gains were included in the year's income. The task force observes that after the transfer, there are $2.5 million of ABC Corp remaining in the available-for-sale portfolio. Manning has stated that the firm's desire to reduce exposure to the equity market was the reason for selling only a portion of the position in ABC Corp.

In addition, the group is performing its own analysis on the impact of last year's acquisition of a 20% stake in Instate, a regional provider of commercial insurance. Instate reported $15 million in earnings for the year ending December 31, 2006, and paid approximately $1 million in dividends. Manning directed Luna's accountants to record the purchase using the equity method, and thus has included a proportional share of Instate's net income for the year. The acquisition was effective as of January 1st of 2006, and operating results for the investment stake in Instate are incorporated into Luna's 2006 financial statements. The group will perform basic analysis both with and without the operating results of Instate in order to better evaluate what financial impact the inclusion of Luna's results had on Instate's overall performance.

81. Luna has recorded its investment in Instate utilizing the equity method of accounting for intercorporate investments. According to FASB, which of the following statements most accurately reflects the impact on an investor's financial statements by using the equity method?

(A) The investing firm can include a proportionate share of the investee's income in its earnings, regardless of whether or not there are actual cash flows (i.e. dividends).

(B) The investing firm will not make any adjustments to its financial statements to reflect its proportionate share of the investee's net assets, but will reference the investment in the footnotes.

(C) Market values can be compared with the carrying amount for analysis purposes, but only market values may be used in the financial statements.

82. As outlined in FIN 46(R), the primary beneficiary of a VIE is that entity which meets which of the following conditions?

(A) Holds the majority voting control of the VIE and has separate management from the VIE.

(B) Has exposure to the majority of the loss risks or receives the majority of the residual benefits of the VIE.

(C) Holds the majority voting control of the VIE and shares management with the VIE.

83. Which of the following investments would most likely be reported under the equity method?

(A) An investment in 40% of the equity of an entity that gives the owner control over that entity.

(B) An investment in 80% of the equity of an entity that gives the owner control over that entity.

(C) An investment in 5% of the equity of an entity that gives the owner significant influence over that entity.

84. According to US GAAP, if an SPE is to be considered a variable interest entity (VIE), it must meet which of the following conditions?

(A) The equity investors in the VIE must bear all of the SPE's risk up to a pre-determined level as outlined in the governing documents.

(B) The SPE must be consolidated by the primary beneficiary, whose status as primary beneficiary is defined by the level of the firm's percentage of voting control.

(C) The total at-risk equity of the SPE is not sufficient to finance the entity's activities without additional subordinated financial support.