Financial Accounting for Executives & MBAs
5th Edition
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PRACTICE QUIZ

Chapter 8: Investing in Other Entities

Identify the answer that BEST completes the statement or answers the question.

1. The Claremont Company acquired a 30% interest in Pomona Enterprises for $8,200,000 and appropriately applied the equity method. During the first year, Pomona reported net income of $500,000 and paid cash dividends totaling $90,000.

What amount will The Claremont Company report regarding its Pomona investment at the end of the first year on its income statement?

a. Investment earnings totaling $150,000
b. Investment earnings totaling $27,000
c. Net investment earnings totaling $123,000
d. Dividend income totaling $27,000

2. Pomona Enterprises received dividends from its common stock investments during the year ended December 31 as follows:

- A cash dividend totaling $10,000 from its trading security investment in Keck Corporation, when the market price of Keck's shares was $15 per share
- A cash dividend of $75,000 from Drucker Corp. in which Pomona owns a 32% interest

How much dividend income should Pomona report in its income statement?

a. $25,000
b. $15,000
c. $10,000
d. $0

3. Smith & Sons acquired a 55% interest in the Claremont Company on December 31 for $2,200,000. Smith & Sons has the ability to exercise significant influence on management decisions. The Claremont stock is publically traded. During the year, Claremont reported net income of $350,000 and paid cash dividends of $85,000.

How should Smith & Sons account for its investment in Claremont?

a. Apply the equity method and report the investment at market value at year end
b. Apply the equity method and perform a full consolidation at year end
c. Apply mark-to-market accounting and consolidate the statements at year end
d. Account for the investment as a special purpose entity

4. On December 30, Phoenix Corporation acquired a 100% ownership interest in Scottsdale Corporation at a cost of $750,000. Phoenix determined that Scottsdale's inventory was undervalued by $40,000 on the acquisition date. Phoenix had retained earnings totaling $430,000, common stock totaling $120,000, total assets of $1,200,000, and total liabilities of $650,000 just prior to the consolidation. Scottsdale's net assets had a book value of $550,000 at the time of acquisition, with $150,000 reported as common stock and $400,000 reported as retained earnings.

How much will Phoenix report as goodwill on its consolidated balance sheet immediately after the acquisition?

a. $100,000
b. $160,000
c. $640,000
d. $ 60,000

5. On December 30, Phoenix Corporation acquired a 100% ownership interest in Scottsdale Corporation at a cost of $750,000. Phoenix determined that Scottsdale's inventory was undervalued by $40,000 on the acquisition date. Phoenix had retained earnings totaling $430,000, common stock totaling $120,000, total assets of $1,200,000, and total liabilities of $650,000 just before the consolidation. Scottsdale's book value and fair market value of net assets were both $550,000 at the time of acquisition, with $150,000 reported as common stock and $400,000 reported as retained earnings.

How much will Phoenix report as total stockholders' equity on its consolidated balance sheet immediately after the acquisition?

a. $ 550,000
b. $1,050,000
c. $ 590,000
d. $1,150,000

6. Inspire Pharmaceuticals transferred $2,000,000 of accounts receivable to a newly established company, Inspire Inc., whose sole purpose was to buy and service accounts receivable from Inspire Pharmaceuticals. Inspire Pharmaceuticals received an 80 percent interest in Inspire, Inc., which is a variable interest entity (VIE). The remainder of the stock was publicly traded.

Which method should Inspire Pharmaceuticals use to account for this variable interest entity?

a. Equity method
b. Mark-to-market accounting as a trading security
c. Mark-to-market accounting as available-for-sale investment
d. Consolidation accounting

7. The Claremont Company accounts for its investment in its unconsolidated affiliate Pomona Enterprises using the equity method. The Claremont Company's annual report disclosed the book value of its 36 percent ownership interest in Pomona as follows:

Amounts in millions	Year 4	Year 5
Equity investment in Pomona	$1,669	$1,731

During Year 5, Pomona reported net income of $114 million.

What amount of dividends was paid by Pomona to Claremont in Year 5?
a. $162.00 million
b. $185.40 million
c. $ 20.96 million
d. $ 58.32 million

8. The shareholders' equity section of Smith & Sons' balance sheet disclosed the following amounts:

(in millions)	Dec. 29, Year 7	Dec. 28, Year 6
Accumulated other comprehensive income	$15,632,000	$14,543,000

Additional disclosures indicated that the only component included in comprehensive income beyond net income resulted from foreign currency translation adjustments. Net income totaled $22,131,000 and $15,223,000 for the years ending December 29, Year 7, and December 28, Year 6, respectively.

How much is the company's comprehensive income for Year 7?
a. $27,763,000
b. $21,042,000
c. $23,220,000
d. $ 7,997,000

9. How does an investor report dividends received from an investment properly accounted for under the equity method?
a. As investment revenue on its income statement
b. As a reduction of the investment asset
c. As a minority interest
d. As part of other comprehensive income

10. On January 1, K9 Corporation purchased 25% of the outstanding common stock of the Feline Corporation for $200,000. During the year, Feline Corporation reported net income of $80,000 and paid cash dividends of $40,000.

The balance of the Investment in the Feline Corporation account on the books of K9 Corporation at December 31 is:
a. $200,000
b. $210,000
c. $220,000
d. $190,000

1. a

Rationale: (30% x $500,000)

2. c

3. b

4. b

Rationale: [$750,000 – ($550,000 + $40,000)]

5. a

Rationale: ($120,000 + $430,000)

6. d

7. c

Rationale: [($1,731 – $1,669) – (36% x $114)]

8. c

Rationale: [$22,131,000 + ($15,632,000 – $14,543,000)]

9. b

10. b

Rationale: [$200,000 + (25% x $80,000) – (25% x $40,000)]