

# Chapter 16

## Investments and International Operations

### T Questions

1. Stock prices are quoted in dollars and cents. The cost of the investment in Ford Motor Company stock would be \$55,750 (1,000 × \$55.75).
2. Type of Investments Accounting Method


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Short-term investment:

Trading investment..... Market value

Long-term investment:

Investor owns less than 20% of investee stock

Available-for-sale investment..... Market value

Investor owns between 20 and 50% of investee stock..... Equity

Investment in a joint venture..... Equity

Investor owns more than 50% of investee stock..... Consolidation

Long-term investment in bonds (Held-to-maturity investment)..... Amortized cost
3. Receipt of a cash dividend is recorded by debiting Cash and crediting Dividend Revenue. Receipt of a stock dividend is recorded in a memorandum entry that records the new number of shares of stock owned after receipt of the dividend and the new cost per share.

4. Gain of \$800 (\$11,800 ! \$11,000).
5. An investment of between 20 and 50% of the investee's voting stock is accounted for by the equity method.
  - The investment is recorded at cost when purchased.
  - When the investee company reports net income, the investor debits the Investment account and credits Equity-Method Investment Revenue for the investor's proportionate ownership.
  - Receipt of a cash dividend from the investee is recorded as a debit to Cash and a credit to the Investment account.
6. *Goodwill* is the excess of the cost to purchase another company over the market value of the subsidiary's owners' equity (net assets). Goodwill is an intangible asset, reported after plant assets on the balance sheet.
7. Purchase of more than 50%, but less than 100%, of a subsidiary's stock creates an account called *Minority Interest* that most companies report as a liability.
8. Paid \$101,300 (\$100,000 × 1.013)  
Will collect at maturity \$100,000
9. The complexity is the need to convert dollars into the foreign currency and vice versa. The new risk is that the foreign currency (or the dollar) may lose value and cause the company not to earn as much (or lose more) than expected.
10. A foreign-currency *hedge* is an action taken to protect from loss by engaging in a counterbalancing transaction. Companies hedge their foreign-currency transactions to minimize losses. A company with both foreign-currency receivables and payables may be able to offset losses on the receivables (or payables) with gains on the other.

- 11. Foreign-Currency Loss
- 12. United Kingdom (Great Britain)

## T Daily Exercises

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(5-10 min.) **DE 16-1**

- a. \$17,076 ( $200 \times \$85.38$ )
- b. \$44,914.50 ( $450 \times \$99.81$ )  
The dividend is irrelevant.
- c. \$372,000 ( $8,000 \times \$46.50$ )
- d. \$3,692.50 ( $70 \times \$52.75$ )

(5-10 min.) **DE 16-2**

1. A *trading investment* is always a current asset because the investor intends to sell the trading investment in the very near future—days, weeks, or only a few months. A current asset is one that is to be used, converted to cash, or sold within one year or within the company's operating cycle if longer than a year.
2. An *available-for-sale investment* can be either a current asset or a long-term asset, depending upon whether the investor expects to sell the investment within the next year or within the company's operating cycle if longer than a year (a current asset). All other available-for-sale investments are long-term.

(5-10 min.) **DE 16-3**

- a. Current asset  
    Available-for-sale investment
- b. Current asset  
    Trading investment
- c. Long-term asset  
    Available-for-sale investment

(10 min.) **DE 16-4**

- 1. Paid \$25,000
- 2. Current market value \$20,000
- 3.

<b>Journal</b>					
DATE		ACCOUNTS AND EXPLANATIONS	POST. REF.	DEBIT	CREDIT
20X5					
Dec.	31	Short-Term Investment		5,000	
		(\$30,000 ! \$25,000)			
		Gain on Trading Investment			5,000
		Adjusted trading investment to market value.			

**ASSETS**

Current assets:

    Short-term investments, at market  
    value (\$25,000 + \$5,000)..... \$30,000

(10 min.) **DE 16-5**

- 1. Trading investment

2.

<b>Journal</b>					
DATE		ACCOUNTS AND EXPLANATIONS	POST. REF.	DEBIT	CREDIT
20X1					
Dec.	6	Short-Term Investment (1,000 × \$92.25)		92,250	
		Cash			92,250
	23	Cash (1,000 × \$1.12)		1,120	
		Dividend Revenue			1,120
	31	Loss on Trading Investment			
		[\$92,250 ! (1,000 × \$91)]		1,250	
		Short-Term Investment			1,250
20X2					
Jan.	27	Cash (1,000 × \$88.38)		88,380	
		Loss on Sale of Investment		2,620	
		Short-Term Investment			
		(\$92,250 ! \$1,250)			91,000

(10 min.) **DE 16-6**

1. Trading investment

2.

<b>Journal</b>					
DATE		ACCOUNTS AND EXPLANATIONS	POST. REF.	DEBIT	CREDIT
20X6					
Dec.	12	Short-Term Investment (500 × \$41.13)		20,565	
		Cash			20,565
	21	Cash (500 × \$.23)		115	
		Dividend Revenue			115
	31	Short-Term Investment [500 × (\$43.13 ! \$41.13)]		1,000	
		Gain on Trading Investment			1,000
20X7					
Jan.	16	Cash (500 × \$44.50)		22,250	
		Short-Term Investment (\$20,565 + \$1,000)			21,565
		Gain on Sale of Investment			685

(5-10 min.) **DE 16-7**

20X6 Loss of \$2,000 (\$85,000 ! \$83,000)

20X7 Gain on sale, in the amount of \$7,000 (\$90,000 ! \$83,000)

(5-10 min.) **DE 16-8**

1. Cost of the investment = 500 × \$64 = \$32,000

New number of shares held = 500 + .10 (500) = 550

New cost per share =  $\frac{\$32,000}{550} = \$58.18$

2. Cash received from sale = 550 × \$58 = \$31,900

Cost..... (32,000)

Gain (loss) on sale..... \$ (100)

1.

Journal					
DATE		ACCOUNTS AND EXPLANATIONS	POST. REF.	DEBIT	CREDIT
20X7					
Jan.	14	Long-Term Available-for-Sale			
		Investment (300 × \$19.75)		5,925	
		Cash			5,925
Aug.	22	Cash (300 × \$1.25)		375	
		Dividend Revenue			375
Dec.	31	Unrealized Loss on Available-for-Sale Investment		411	
		Allowance to Adjust Investment to Market (\$5,925 ! \$5,514)			411

2.

**ASSETS**

Total current assets.....	\$ XXX
Long-term available-for-sale investments, at market value.....	5,514

**STOCKHOLDERS' EQUITY**

Common stock.....	\$ XXX
Retained earnings.....	XXX
Loss on available-for-sale investments.....	(411)

1.

Journal					
DATE		ACCOUNTS AND EXPLANATIONS	POST. REF.	DEBIT	CREDIT
20X8					
Aug.	4	Cash (300 × \$20.75)		6,225	
		Long-Term Available-for-Sale			
		Investment			5,925
		Gain on Sale of Investment			300

2. This gain on sale of investment is a *realized* gain. The loss recorded at December 31, 20X7 was *unrealized* because it resulted from a change in the investment's market value, not from the sale of the investment.

1. *Equity method* is appropriate because the investor holds a 40% investment in the investee company.

2.

<b>Journal</b>				
	ACCOUNTS AND EXPLANATIONS	POST. REF.	DEBIT	CREDIT
			<i>Millions</i>	
a.	Long-Term Equity-Method Investment		100	
	Cash			100
	Purchased equity-method investment.			
b.	Long-Term Equity-Method Investment			
	(\$15.0 × .40)		6	
	Equity-Method Investment Revenue			6
	Recorded investment revenue.			
c.	Cash (\$10 × .40)		4	
	Long-Term Equity-Method Investment			4
	Received cash dividend on equity-method investment.			

3.

Long-Term Equity-Method Investment <i>(amounts in millions)</i>			
Purchase	100	Dividends received	4
Net income	6		
Balance	102		

	<i>Millions</i>
Sale proceeds.....	\$59
! Carrying amount of the investment (\$102 / 2).....	<u>(51)</u>
= Gain on sale of investment.....	<u>\$ 8</u>

(10 min.) **DE 16-13**

1. A *parent company* is a corporation that owns a controlling (more than 50%) interest in another company. A *subsidiary company* is a company that is controlled by another corporation.
2. The *parent company's name* appears on the consolidated financial statements. To consolidate, the parent company must own *more than 50%* of the subsidiary's stock.
3. *Consolidated financial statements* combine the balance sheets, income statements, and other statements of a parent company with those of its majority-owned subsidiaries. The result is a single set of financial statements, as if the parent and its subsidiaries were all the same entity.

1. *Minority interest* is the portion (less than 50%) of a subsidiary's stock that is owned by stockholders other than the parent company. The parent company reports Minority Interest on its consolidated balance sheet, usually among the liabilities.
2. *Goodwill* is an intangible asset. Goodwill is the excess of the purchase price to acquire a subsidiary company over the sum of the market value of the subsidiary's net assets (assets minus liabilities). Only the parent company reports the goodwill. Goodwill appears as an intangible asset on the consolidated balance sheet.

(10-15 min.) DE 16-15

1. Paid \$1,440,000 ( $\$1,500,000 \times .96$ )  
Will collect at maturity \$1,500,000
2. Annual cash interest = \$105,000 ( $\$1,500,000 \times .07$ )
3. Annual interest revenue will be more than the amount of cash interest received each year because the investor bought the bonds at a discount.
4. Cash interest received each year..... \$105,000  
+ Amortization  $\frac{\$1,500,000 - \$1,440,000}{5 \text{ years}} =$  12,000  
= Annual interest revenue..... \$117,000

Journal					
DATE		ACCOUNTS AND EXPLANATIONS	POST. REF.	DEBIT	CREDIT
20X1					
a.	Jan.	2	Long-Term Investment in Bonds		
			(\$1,500,000 × .96)	1,440,000	
			Cash		1,440,000
			Purchased bond investment.		
b.	Dec.	31	Cash ( $\$1,500,000 \times .07$ )	105,000	
			Interest Revenue		105,000
			Received annual interest.		
c.		31	Long-Term Investment in Bonds		
			$[(\$1,500,000 - \$1,440,000) / 5]$	12,000	
			Interest Revenue		12,000
			Amortized discount on bond investment.		
20X6					
d.	Jan.	2	Cash	1,500,000	
			Long-Term Investment in Bonds		1,500,000
			Received face value at maturity.		

Journal				
DATE		ACCOUNTS AND EXPLANATIONS	POST. REF.	CREDIT
20X2				
Dec.	31	Interest Receivable		
		(\$10,000 × .06 × 1/12)		50
		Interest Revenue		50
		Accrued interest revenue.		
	31	Long-Term Investment in Bonds		
		[((\$10,000 - \$9,520) / 48) × 1 month]		10
		Interest Revenue		10
		Amortized discount on investment.		

Journal				
DATE		ACCOUNTS AND EXPLANATIONS	POST. REF.	CREDIT
Mar.	14	Accounts Receivable		
		(2,000,000 rubles × \$0.036)		72,000
		Sales Revenue		72,000
		Sale on account.		
Apr.	19	Cash (1,000,000 rubles × \$0.034)		34,000
		Foreign-Currency Loss		2,000
		Accounts Receivable (\$72,000 × 1/2)		36,000
		Collection on account.		
May	10	Cash (1,000,000 rubles × \$0.037)		37,000
		Accounts Receivable (\$72,000 × 1/2)		36,000
		Foreign-Currency Gain		1,000
		Collection on account.		

Overall, Nike had a net foreign-currency loss of \$1,000 (loss of \$2,000 minus a gain of \$1,000).

<b>Journal</b>					
DATE		ACCOUNTS AND EXPLANATIONS	POST. REF.	DEBIT	CREDIT
July	2	Cash (1,000,000 pesos × \$0.118)		118,000	
		Accounts Receivable – Artes			107,000
		Foreign-Currency Gain			11,000
		Collection on account.			
Aug.	24	Accounts Payable – Gesellschaft Ltd.		16,000	
		Foreign-Currency Loss		400	
		Cash			
		(20,000 Swiss francs × \$0.82)			16,400
		Payment on account.			

In the United States, companies can use a number of different *inventory* accounting methods, which include LIFO. In the United Kingdom, LIFO is unacceptable for tax purposes and is not widely used.

In the U.S., *goodwill* is amortized over a period not to exceed 40 years. In the U.K., companies may elect not to amortize goodwill if they believe its life is indefinite.

In the U.S., companies must expense *research and development* costs as incurred. British companies must also expense research costs, but they are allowed to capitalize some development costs.

**T Exercises**

(10-15 min.) **E 16-2**

(15-20 min.) **E 16-1**

Req. 1

Journal				
DATE		ACCOUNTS AND EXPLANATIONS	POST. REF.	CREDIT
20X1				
Dec.	6	Short-Term Investment		70,000
		Cash		70,000
	30	Cash (1,000 shares × \$.85)		850
		Dividend Revenue		850
	31	Loss on Trading Investment (\$70,000 ! \$67,000)		3,000
		Short-Term Investment		3,000
20X2				
Jan.	14	Cash		71,000
		Short-Term Investment		67,000
		Gain on Sale of Investment		4,000

Req. 2

December 31, 20X1

Balance sheet:

Current assets:

Short-term investments, at market value..... \$67,000

Journal				
DATE		ACCOUNTS AND EXPLANATIONS	POST. REF.	CREDIT
	a.	Long-Term Available-for-Sale Investment (400 × \$38)		15,200
		Cash		15,200
	b.	Cash (400 × \$1)		400
		Dividend Revenue		400
	c.	Allowance to Adjust Investment to Market [400 × (\$45 ! \$38)]		2,800
		Unrealized Gain on Available-for-Sale Investment		2,800
	d.	Cash (400 × \$42)		16,800
		Long-Term Available-for-Sale Investment		15,200
		Gain on Sale of Investment		1,600

<b>Journal</b>					
DATE		ACCOUNTS AND EXPLANATIONS	POST. REF.	DEBIT	CREDIT
Aug.	1	Long-Term Available-for-Sale			
		Investment (500 × \$44)		22,000	
		Cash			22,000
		Purchased investment.			
Sep.	12	Cash (500 × \$1)		500	
		Dividend Revenue			500
		Received cash dividend.			
Nov.	23	<i>Note:</i> Received 250 shares of Vardaman common stock in 50% stock dividend. New cost per share is \$29.333 (\$22,000 / 750 shares).			
Dec.	4	Cash (750 × \$29)		21,750	
		Loss on Sale of Investment		250	
		Long-Term Available-for-Sale			
		Investment (750 × \$29.333)			22,000
		Sold investment.			

*Req. 1*

Stock	Cost	Current Market Value
National Geographic	$(3,000 \times \$81.88) = \$245,640$	$(3,000 \times \$80.38) = \$241,140$
AT&T Corp.	$(600 \times \$46.75) = 28,050$	$(600 \times \$48.50) = 29,100$
Hitachi	$(1,400 \times \$79) = 110,600$	$(1,400 \times \$68.25) = 95,550$
Total.....	<u>\$384,290</u> .....	<u>\$365,790</u>

*Req. 2*

<b>Journal</b>					
DATE		ACCOUNTS AND EXPLANATIONS	POST. REF.	DEBIT	CREDIT
Dec.	31	Unrealized Loss on Available-for-Sale			
		Investment (\$384,290 - \$365,790)		18,500	
		Allowance to Adjust Investment			
		to Market			18,500

*Req. 3**Balance Sheet (partial):*

## ASSETS

Long-term available-for-sale investments, at market value.. \$365,790

## STOCKHOLDERS' EQUITY

Unrealized loss on available-for-sale investments..... \$(18,500)

<b>Journal</b>				
DATE	ACCOUNTS AND EXPLANATIONS	POST. REF.	DEBIT	CREDIT
a.	Long-Term Equity-Method Investment		2,000,000	
	Cash			2,000,000
	Purchased equity-method investment.			
b.	Long-Term Equity-Method Investment			
	(\$780,000 × .25)		195,000	
	Equity-Method Investment Revenue			195,000
	Recorded investment revenue.			
c.	Cash (\$500,000 × .25)		125,000	
	Long-Term Equity-Method Investment			125,000
	Received cash dividend on equity-method investment.			

Long-Term Equity-Method Investment in Italian Imports			
a. Purchase	2,000,000	c. Dividends	125,000
b. Net income	195,000		
Balance	2,070,000		

Sale of investment for cash of.....	\$2,600,000
! Carrying amount of investment.....	<u>(2,070,000)</u>
= Gain on sale of investment.....	<u>\$ 530,000</u>

*Req. 1*

Equity method is appropriate for a 40% investment in another company's common stock. Equity method is used for 20-50% investments.

*Req. 2***Balance sheet** (partial):

## ASSETS

Long-term equity-method investments..... \$172,200\*

**Income statement** (partial):

## Other revenue:

Equity-method investment revenue..... \$ 33,600

## \*Explanation:

Long-Term Equity-Method Investment			
Cost	145,000		
Share of net income		Share of dividends	
(\$84,000 X .40)	33,600	(\$16,000 × .40)	6,400
Balance	172,200		

*Req. 3*

Market value plays no role in accounting for an equity-method investment.

*Req. 1*

Remke should use the *amortized-cost method*.

*Req. 2*

Journal					
DATE		ACCOUNTS AND EXPLANATIONS	POST. REF.	DEBIT	CREDIT
Mar.	31	Long-Term Investment in Bonds			
		(\$30,000 × .9225)		27,675	
		Cash			27,675
		Purchased bond investment.			
Sep.	30	Cash (\$30,000 × .07 × 6/12)		1,050	
		Interest Revenue			1,050
		Received semiannual dividend.			
	30	Long-Term Investments in Bonds			
		[((\$30,000 ! \$27,675) / 54) × 6		258	
		Interest Revenue			258
		Amortized discount on bond investment.			
Dec.	31	Interest Receivable (\$30,000 × .07 × 3/12)		525	
		Interest Revenue			525
		Accrued interest revenue.			
	31	Long-Term Investment in Bonds			
		[((\$30,000 ! \$27,675) / 54) × 3		129	
		Interest Revenue			129
		Amortized discount on bond investment.			

*Req. 3*

## Balance sheet (partial)

## ASSETS

Long-term investment in bonds, at amortized cost  
 (\$27,675 + \$258 + \$129)..... \$28,062

<b>Journal</b>					
DATE		ACCOUNTS AND EXPLANATIONS	POST. REF.	DEBIT	CREDIT
Nov.	17	Inventory		1,760	
		Accounts Payable (200,000 × \$.0088)			1,760
Dec.	16	Accounts Payable		1,760	
		Foreign-Currency Loss		60	
		Cash (200,000 × \$.0091)			1,820
	19	Accounts Receivable (60,000 × \$.15)		9,000	
		Sales Revenue			9,000
	30	Cash (60,000 × \$.17)		10,200	
		Accounts Receivable			9,000
		Foreign-Currency Gain			1,200

On November 18, we wanted the dollar to strengthen in order to pay the Japanese company with yen that cost fewer dollars. As it turned out, the yen strengthened against the dollar, and the purchase wound up costing more dollars than expected. This explains the foreign-currency loss on December 16.

On December 20, we wanted the franc to strengthen in order to receive francs worth more in dollars. The franc did strengthen against the dollar, and on December 30 we experienced a foreign-currency gain on the collection.

Req. 1

Available-for-sale investments:	<i>Millions</i>
<i>Cost</i>	
(must solve for <i>cost = market value !unrealized gain</i> )...	\$266
+ Unrealized gain (amount given on the balance sheet).....	<u>22</u>
= <i>Current market value</i>	
(amount reported on the balance sheet, as given).....	\$288

Req. 2

	<i>Millions</i>
Cash received for sale of the investments.....	<u>(259)</u>
! Cost of investments (from <i>Req. 1</i> ).....	\$266
= Gain ( <i>Loss</i> ) on sale.....	<u>\$ (7)</u>

Equity-Method Investments  
(Millions of dollars)

Beg. bal. 19X9	286	
Investments	42	Equity-method investment losses 13
End bal. 19X9	296	Dividends received X = 19

$$\text{Dividends received (X)} = \$286 + \$42 - \$13 - X = \$296$$

$$X = \$19 \text{ million}$$