Test Bank
Advanced Accounting, Fifteenth Edition
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Chapter 1

1. Award: **10.00 points**

Baker Company owns 15% of the common stock of Charlie Corporation and used the fair-value method to account for this investment. Charlie reported net income of $120,000 for 2024 and paid dividends of $70,000 on October 1, 2024. How much income should Baker recognize on this investment in 2024?

- $18,000
- → $10,500
- $28,500
- $7,500
- $50,000

$70,000 × 0.15 = $10,500

References

Multiple Choice	Difficulty: 3 Hard	Learning Objective: 01-02 Describe in general the various methods of accounting for an investment in equity shares of another company.

2. Award: **10.00 points**

Loeffler Company owns 35% of the common stock of Tetter Company and uses the equity method to account for the investment. During 2024, Tetter reported income of $260,000 and paid dividends of $90,000. There is no amortization associated with the investment. During 2024, how much income should Loeffler recognize related to this investment?

- $90,000
- → $91,000
- $122,500
- $31,500
- $59,500

$260,000 × 0.35 = $91,000

References

Multiple Choice	Difficulty: 3 Hard	Learning Objective: 01-04 Describe the financial reporting for equity method investments and prepare basic equity method journal entries for an investor.

3. Award: **10.00 points**

On January 1, 2024, Lee Company paid $1,870,000 for 80,000 shares of Thomas Company's voting common stock which represents a 45% investment. No allocation to goodwill or other specific account was necessary. Significant influence over Thomas was achieved by this acquisition. Thomas distributed a dividend of $2.00 per share during 2024 and reported net income of $720,000. What was the balance in the *Investment in Thomas Company* account found in the financial records of Lee as of December 31, 2024?

- ○ $2,114,000.
- ○ $2,194,000
- ○ $2,354,000
- ○ $2,158,000
- → ○ $2,034,000

$1,870,000 + ($720,000 × 0.45) − ($2.00 × 80,000) = $2,034,000

References

Multiple Choice	Difficulty: 3 Hard	Learning Objective: 01-04 Describe the financial reporting for equity method investments and prepare basic equity method journal entries for an investor.

4. Award: **10.00 points**

A necessary condition to use the equity method of reporting for an equity investment is that the investor company must

- → ○ have the ability to exercise significant influence over the operating and financial policies of the investee.
- ○ own at least 30% of the investee's voting stock.
- ○ possess a controlling interest in the investee's voting stock.
- ○ not have the ability to exercise significant influence over the operating and financial policies of the investee.

References

Multiple Choice	Difficulty: 1 Easy	Learning Objective: 01-03 Identify the sole criterion for applying the equity method of accounting and know the guidelines to assess whether the criterion is met.

5. Award: **10.00 points**

On January 1, 2022, Dermot Company purchased 15% of the voting common stock of Horne Corporation. On January 1, 2024, Dermot purchased 28% of Horne's voting common stock. If Dermot achieves significant influence with this new investment, how must Dermot account for the change to the equity method?

→ ○ It must use the equity method for 2024 but should make no changes in its financial statements for 2023 and 2022.

○ It should prepare consolidated financial statements for 2024.

○ It must restate the financial statements for 2023 and 2022 as if the equity method had been used for those two years.

○ It should record a prior period adjustment at the beginning of 2024 but should not restate the financial statements for 2023 and 2022.

○ It must restate the financial statements for 2023 as if the equity method had been used then.

References

Multiple Choice	Difficulty: 2 Medium	Learning Objective: 01-06a Understand the financial reporting consequences for a change to the equity method.

6. Award: **10.00 points**

During January 2023, Nelson, Incorporated acquired 30% of the outstanding common stock of Fuel Company for $1,600,000. This investment gave Nelson the ability to exercise significant influence over Fuel. Fuel's assets on that date were recorded at $7,200,000 with liabilities of $3,400,000. Any excess of cost over book value of Nelson's investment was attributed to unrecorded patents having a remaining useful life of ten years.

In 2023, Fuel reported net income of $650,000. For 2024, Fuel reported net income of $800,000. Dividends of $250,000 were paid in each of these two years. What was the reported balance of Nelson's *Investment in Fuel Company* at December 31, 2024?

→ ○ $1,793,000

○ $1,885,000

○ $1,943,000

○ $1,977,000

○ $1,054,300

$7,200,000 − $3,400,000 = $3,800,000 × 30% = $1,140,000
$1,600,000 − $1,140,000 = $460,000 ÷ 10years = $46,000 Unrecorded Patents Amortization
$1,600,000 + $195,000 − $75,000 − $46,000 + $240,000 − $75,000 − $46,000 = $1,793,000

References

Multiple Choice	Difficulty: 3 Hard	Learning Objective: 01-04 Describe the financial reporting for equity method investments and prepare basic equity method journal entries for an investor.