

Exercise 15-13

21e

Exercise 15-13 covers recording transactions using the Equity Method. The Equity Method is used when an investor is deemed to have significant influence over the investee. Significant Influence is generally determined by an investor owning between 20% and 50% of the investee's outstanding voting stock. See page 621 of your textbook for problem details.

Instructor comments are in purple.

2013

Investment Acquisition

Jan. 2	Long-Term Investments—Grecco*	411,000	
	Cash		411,000
	<i>Record purchase of investment (\$408,000 + \$3,000).</i>		

* Kodax's investment equals 33 1/3% of Grecco's stock (30,000/90,000). Kodax should use the equity method to account for its investment.

Note that the entry for an investment acquisition is the same with the equity method as for non-influential investments.

Receipt of Dividends

Sept. 1	Cash	45,000	
	Long-Term Investments—Grecco		45,000
	<i>Record receipt of cash dividend (30,000 x \$1.50).</i>		

When using the Equity Method, dividends are considered a return of investment and are therefore credited to the asset account Long-Term Investments. This has the effect of reducing the book value of the investment asset.

Recognition of Investee Earnings

Dec. 31	Long-Term Investments—Bushtex	162,300	
	Earnings from Long-Term Investment		162,300
	<i>Record equity in investee earnings</i>		

Ownership percentage:

(486,900 X [30,000/90,000])

Since the investor is deemed to have "significantly influenced" the investee, the Equity Method requires the investor to recognize income from the investee. The income recognized is equal to the proportion of voting stock owned by the investor. In this case 33.33% of the investee's outstanding voting stock is owned by the investor. Therefore, the investor recognizes 33.33% of the investee's earnings. This transaction has the affect of increasing the basis in the asset account, Long-term Investments, and increasing equity for the investor, Earnings from Long-Term Investment.

2014 Receipt of Dividends

Jun. 1	Cash	63,000	
	Long-Term Investments—Grecco		63,000
	<i>Record receipt of cash dividend (30,000 x \$2.10).</i>		

Recognition of Investee Earnings

Dec. 31	Long-Term Investments—Grecco	234,250	
	Earnings from Long-Term Investment		234,250
	<i>Record equity in investee earnings (\$702,750/3). (702,750 X [30,000/90,000])</i>		

Disposition of Investment

Dec. 31	Cash	320,000	
	Gain on Sale of Investments		86,817
	Long-Term Investments—Grecco*		233,183
	<i>Record sale of investment.</i>		

When an investment is sold under the equity method, the asset account (Long-Term Investments) is credited for the book value of the asset at the time of sale. The book value is simply determined by taking the original investment and adding all debits to the investment account (earnings from investee) and deducting all credits to the investment account (dividends).

In this entry only 10,000 shares were sold so the investment account is credited for the book value of the 10,000 shares. The calculations of total investment book value and book value of shares sold are shown below.

* Book value (Grecco stock) at 12/31/2014:

Original Cost	\$411,000
Less 2013 dividends	-45,000
Plus share of 2013 earnings	162,300
Less 2014 dividends	-63,000
Plus share of 2014 earnings	<u>234,250</u>
Book value at date of sale	<u>\$699,550</u>

Book value of shares sold (\$699,550 x [10,000/30,000])	<u>\$233,183[†]</u>
---	------------------------------

[†]Rounded to nearest dollar.

Extra Now try this one:

Assume that on Dec 31, 2015 Grecco announced a net loss of \$72,000. Also assume that no dividends were declared in 2014.

2015 **Recognition of Investee Earnings (Loss)**

Dec. 31	Loss from Long-Term Investments	16,000	
	Long-Term Investments—Goreten		16,000
	<i>Record equity in investee earnings (\$702,750/3).</i>		
	<i>([20,000/90,000] X \$72,000)</i>		
	<i>*20,000 shares were used in this problem because 10,000 shares were sold on Dec 31, 2014.</i>		

Extra *On Dec 31, Kodax sold the remaining shares of Grecco stock for \$400,000 cash.*

Disposition of Investment

Dec. 31	Cash	400,000	
	Loss on Sale of Investments	50,367	
	Long-Term Investments—Grecco*		450,367
	<i>Record sale of investment.</i>		

* Book value Grecco stock at 12/31/2015:

Book value as of 12/31/2014 (\$699,550-\$233,183)	\$466,367
Less share of 2015 loss	-16,000
Book value at date of sale	<u>\$450,367</u>