

Toward Business Literacy: Accounting Outlines



Investments and Mergers/Acquisitions

Short term Investments → Three classes:

1. **Traded securities** are valued as a basket at market value
 - a. Basket carries an unrealized loss or gain combined with cost
 - b. Losses and gains are realized on specific investment sale
2. **Available for sale securities** are held for more than one year and are revalued at market value at year end, with unrealized gain or losses not on income statement, but as comprehensive income in equity section
3. **Held to maturity securities** are normally debt securities; carried at cost less amortization of premium or discount with the cost adjusted for interest earned. These investments are typically bonds.

Dividend and interest income is recognized in other income and expenses.

Methods to Account for Investments

- Fair Value Method → Less than 20% ownership in another company
 - No impact on investee's operations or decisions
 - Stock is held for dividends and stock appreciation
 - Record at cost and periodically adjust to fair value
- Consolidation of financials (parent ← subsidiary)
 - Investor has more than 50% of outstanding voting stock
 - Can direct decision-making process
- ARB #51: control requires consolidation of assets, Liabilities, revenues and expenses
- Equity method (Test: between 20% and 50% of voting stock)
 - Investor can have influence, especially timing of dividend distributions
 - Investor representation on the board and participation in policy-making,
 - Material inter-company transactions and interchange of management
 - Technological dependency
 - Extent of ownership
 - Income is recognized by investor when earned by investee
 - Carrying amount of investment: add share of earnings and subtract losses and dividends received
 - If losses > carrying value, discontinue equity method or continue if there is a reasonable ability to return

Toward Business Literacy: Accounting Outlines



Accounting Issues

- Changes to Equity Method
 - If new fair value of stock requires the Equity method, must make retroactive adjustment as if equity method had been applied since acquisition
 - Prior period adjustment JE:

Investment in _____	xxx	
Retained Earnings- PPA		xxx

Unrealized holding gain-Stockholder's Equity	xxx	
Fair Value Adjustment		xxx

To remove increase in FMV from equity and portfolio valuation account

- Investor classification of income and losses
 - If the equity method is used, investee's income is classified as ordinary, extraordinary, etc.
 - Investor using equity method recognizes losses

Equity in investee loss	xxx	
Investment account		xxx

- If FMV > book value, and the difference is due to excess value in a particular account → write up that account
- If the FMV difference is due to the anticipation of future benefits, then the excess is goodwill
 - Goodwill is subject to annual impairment reviews
 - Goodwill less new goodwill after impairment review is the amortization amount.