

Stock Investment – Investor Accounting and Reporting

Patriani Wahyu Dewanti, S.E., M.Acc.

Accounting Department

Faculty of Economics

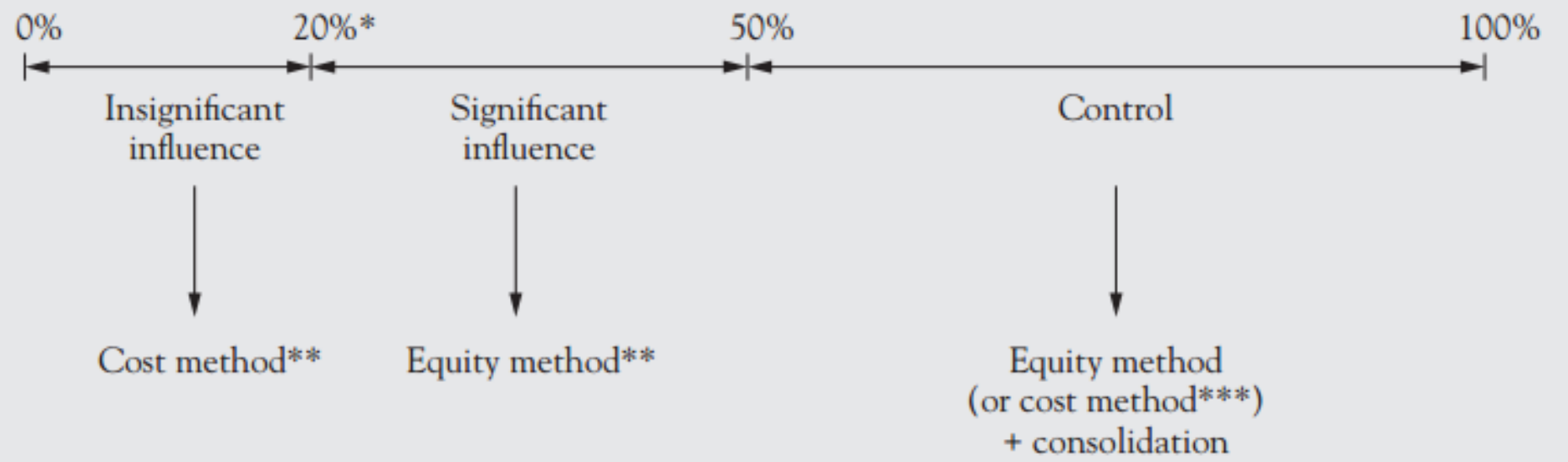
Yogyakarta State University





ACCOUNTING FOR INVESTMENTS IN COMMON STOCK

Summary of Accounting for Equity Investment Securities
(based on the normal level of stock ownership)



* The normal 20% threshold for determining “significant influence” may vary depending on circumstances.
** Investments not intended to be held long term are marked-to-market as trading or available-for-sale securities. The investor may choose the fair value option instead (ASC 825-10-25).
*** Appendix 2B illustrates how the cost method can be used under consolidation.



Summary of Consolidation Coverage in Chapters 2–5

	Wholly Owned Subsidiary	Partially Owned Subsidiary
Investment = Book value	Chapter 2	Chapter 3
Investment > Book value	Chapter 4	Chapter 5



THE COST METHOD

Accounting Procedures under the Cost Method

(1)	Investment in XYZ Company Stock	100,000	
	Cash		100,000
	Record purchase of XYZ Company stock.		
(2)	Dividends Receivable	4,000	
	Dividend Income		4,000
	Record dividend declared by XYZ Company ($\$20,000 \times 0.20$).		



Declaration of Dividends in Excess of Earnings since Acquisition

Year	Investee Company			Investor Company		
	Net Income	Dividends	Cumulative Undistributed Income	Cash Received	Dividend Income	Reduction of Investment
20X1	\$100,000	\$ 70,000	\$30,000	\$ 7,000	\$ 7,000	
20X2	100,000	120,000	10,000	12,000	12,000	
20X3	100,000	120,000	0	12,000	11,000	\$1,000
20X4	100,000	120,000	0	12,000	10,000	2,000
20X5	100,000	70,000	30,000	7,000	7,000	



(3)

Cash	12,000	
Investment in Investee		1,000
Dividend Income		11,000

Record receipt of 20X3 dividend from Investee.

$$\$12,000 = \$120,000 \times 0.10.$$

$$\$1,000 = (\$310,000 - \$300,000) \times 0.10.$$

$$\$11,000 = (\$120,000 - \$10,000) \times 0.10.$$



THE EQUITY METHOD

Reported by Investee	Effect on Investor's Accounts
Net income	Record income from investment Increase investment account
Net loss	Record loss from investment Decrease investment account
Dividend declaration	Record asset (cash or receivable) Decrease investment account



(4)	Investment in XYZ Company Stock	100,000	
	Cash		100,000

Record purchase of XYZ Company stock.

XYZ reports income of \$60,000 for the year. ABC records its 20 percent share of XYZ's income (\$12,000) in an account called "Income from XYZ Company" as follows:

(5)	Investment in XYZ Company Stock	12,000	
	Income from XYZ Company		12,000

Record income from XYZ Company ($\$60,000 \times 0.20$).



(6)	Dividends Receivable	4,000	
	Investment in XYZ Company Stock		4,000

Record dividend from XYZ Company ($\$20,000 \times 0.20$).

The following T-accounts summarize all of the normal equity method entries (journal entries 4–6) on the investor company’s books:

	Investment in XYZ Company			Income from XYZ Company	
Purchase	100,000				
20% of NI	12,000			12,000	20% of NI
		4,000	20% of Dividend		
Ending Balance	108,000			12,000	Ending Balance



Acquisition at Interim Date

	Investment in XYZ Company			Investment in XYZ Company	
Stock Purchase	100,000				
$20\% \times NI \times 1/4$	3,000			3,000	$20\% \times NI \times 1/4$
		4,000	20% Dividends		
Ending Balance	99,000				



Changes in the Number of Shares Held

Income, January 2 to June 30: $\$25,000 \times 0.20$	\$ 5,000
Income, July 1 to December 31: $\$35,000 \times 0.30$	<u>10,500</u>
Investment Income, 20X1	<u><u>\$15,500</u></u>



	Investment in XYZ Company			Income from XYZ Company	
1/2/X1 Purchase	100,000				
20% NI to 6/30	5,000	2,000	20% Div. to 6/30	5,000	20% NI to 6/30
7/1/X1 Purchase	50,000				
30% NI from 7/1	10,500	3,000	30% Div. from 7/1	10,500	30% NI from 7/1
Ending Balance	160,500			15,500	Ending Balance



Year	Zenon		Aron's Reported Investment Income	
	Net Income	Dividends	Originally under Cost ^a	Restated under Equity ^b
20X1	\$15,000	\$10,000	\$1,500	\$2,250
20X2	18,000	10,000	1,500	2,700
20X3	22,000	10,000	1,500	3,300
	<u>\$55,000</u>	<u>\$30,000</u>	<u>\$4,500</u>	<u>\$8,250</u>

^a15 percent of Zenon's dividends for the year.

^b15 percent of Zenon's net income for the year.

(7)	Investment in Zenon Company Stock	3,750	
	Retained Earnings		3,750

Restate investment account from cost to equity method:
 \$8,250 – \$4,500.



THE COST AND EQUITY METHODS COMPARED

Item	Cost Method	Equity Method
Recorded amount of investment at date of acquisition	Original cost	Original cost
Usual carrying amount of investment subsequent to acquisition	Original cost	Original cost increased (decreased) by investor's share of investee's income (loss) and decreased by investor's share of investee's dividends
Income recognition by investor	Investor's share of investee's dividends declared from earnings since acquisition	Investor's share of investee's earnings since acquisition, whether distributed or not
Investee dividends from earnings since acquisition by investor	Income	Reduction of investment
Investee dividends in excess of earnings since acquisition by investor	Reduction of investment	Reduction of investment



	Investee 1	Investee 2
Sales	\$ 50,000	\$ 500,000
Operating Expenses	<u>(30,000)</u>	<u>(620,000)</u>
Operating Income (Loss)	\$ 20,000	\$(120,000)
Gain on Sale of Land		<u>140,000</u>
Net Income	<u><u>\$ 20,000</u></u>	<u><u>\$ 20,000</u></u>



Additional Considerations Relating to the Equity Method

- Accounting for investments in subsidiaries
 - Because investments in consolidated subsidiaries are eliminated when consolidated statements are prepared, the consolidated statements are not affected by the procedures used to account for the investments on the parent's books
 - Companies follow three different approaches in accounting for their consolidated subsidiaries:
 - Fully adjusted equity method
 - Modified version of the equity method
 - Cost method



THANK YOU