

# ACCOUNTING 202

## CHAPTER 13

### TRUE-FALSE STATEMENTS

1. Corporations purchase investments in debt or stock securities generally for one of two reasons.
2. A reason some companies purchase investments is because they generate a significant portion of their earnings from investment income.
3. The accounting for short-term debt investments and for long-term debt investments is similar.
4. For short-term debt investments, any bond premium or discount is amortized to interest revenue over the remaining term of the bonds.
5. Debt investments are investments in government and corporation bonds.
6. In accordance with the cost principle, brokerage fees should be added to the cost of an investment.
7. In accordance with the cost principle, the cost of debt investments includes brokerage fees and accrued interest.
8. In accounting for stock investments of less than 20%, the equity method is used.
9. If the equity method is used to account for an investment, the investor will always report Dividend Income.
10. When the equity method of accounting is used, the revenue account is increased by the investor's share of the investee's net income and decreased by the investor's share of the investee's dividends.

### MULTIPLE CHOICE QUESTIONS

Use the following information for questions 11-13..

On January 1, 2005, Tucker Company purchased at face value, a \$1,000, 6%, bond that pays interest on January 1 and July 1. Tucker Company has a calendar year end.

11. The entry for the receipt of interest on July 1, 2005, is

a. Cash .....	30	
Interest Revenue.....		30
b. Cash .....	60	
Interest Revenue.....		60
c. Interest Receivable.....	30	
Interest Revenue.....		30
d. Interest Receivable.....	60	
Interest Revenue.....		60
12. The adjusting entry on December 31, 2005, is

a. not required.		
b. Cash .....	30	
Interest Revenue.....		30
c. Interest Receivable.....	30	
Interest Revenue.....		30
d. Interest Receivable.....	30	

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|-----|---|-------|-------|
|     | Debt Investments .....  |       | 30    |
| 13. | The entry for the receipt of interest on January 1, 2006 is   |       |       |
|     | a. Cash .....   | 60    |       |
|     | Interest Revenue.....   |       | 60    |
|     | b. Cash .....   | 60    |       |
|     | Interest Receivable.....  |       | 60    |
|     | c. Cash .....   | 30    |       |
|     | Interest Revenue.....   |       | 30    |
|     | d. Cash .....   | 30    |       |
|     | Interest Receivable.....  |       | 30    |
| 14. | Jacobs Corporation makes a short-term investment in 100 shares of Starr Company's common stock. The stock is purchased for \$40 a share plus brokerage fees of \$300. The entry for the purchase is   |       |       |
|     | a. Debt Investments .....   | 4,000 |       |
|     | Cash .....  |       | 4,000 |
|     | b. Stock Investments.....   | 4,300 |       |
|     | Cash .....  |       | 4,300 |
|     | c. Stock Investments.....   | 4,000 |       |
|     | Brokerage Fee Expense.....  | 300   |       |
|     | Cash .....  |       | 4,300 |
|     | d. Stock Investments.....   | 4,000 |       |
|     | Cash .....  |       | 4,000 |
| 15. | Carson Corporation sells 100 shares of common stock being held as a short-term investment. The shares were acquired six months ago at a cost of \$50 a share. Carson sold the shares for \$40 a share. The entry to record the sale is  |       |       |
|     | a. Cash .....   | 4,000 |       |
|     | Loss on Sale of Stock Investments .....   | 1,000 |       |
|     | Stock Investments .....   |       | 5,000 |
|     | b. Cash .....   | 5,000 |       |
|     | Gain on Sale of Stock Investments .....   |       | 1,000 |
|     | Stock Investments .....   |       | 4,000 |
|     | c. Cash .....   | 4,000 |       |
|     | Stock Investments .....   |       | 4,000 |
|     | d. Stock Investments.....   | 4,000 |       |
|     | Loss on Sale of Stock Investments .....   | 1,000 |       |
|     | Cash .....  |       | 5,000 |
| 16. | If the cost method is used to account for a long-term investment in common stock, dividends received should be  |       |       |
|     | a. credited to the Stock Investments account.   |       |       |
|     | b. credited to the Dividend Revenue account.  |       |       |
|     | c. debited to the Stock Investments account.  |       |       |
|     | d. recorded only when 20% or more of the stock is owned.  |       |       |
| 17. | On January 1, 2005, Belle Corporation purchased 25% of the common stock outstanding of Lane Corporation for \$500,000. During 2005, Lane Corporation reported net income of \$200,000 and paid cash dividends of \$100,000. The balance of the Stock Investments—Lane account on the books of Belle Corporation at December 31, 2005 is |       |       |
|     | a. \$500,000.   |       |       |
|     | b. \$525,000.   |       |       |
|     | c. \$550,000.   |       |       |
|     | d. \$475,000.   |       |       |

18. If a common stock investment is sold at a gain, the gain
- is reported as operating revenue.
  - is reported under a special section, "Discontinued investments," on the income statement.
  - is reported in the Other Revenue and Gain section of the income statement.
  - contributes to gross profit on the income statement.
19. Ridge Company uses the equity method to account for its 60% investment in FMP Enterprises. During 2005, FMP earned net income of \$65,000 and paid dividends of \$19,000. In accounting for the investment during 2005, Ridge will
- credit Dividend Revenue, \$11,400.
  - credit Investment Income, \$39,000.
  - credit Revenue from Investment, \$27,600.
  - debit Cash, \$27,600.
20. Blackstone Company uses the equity method to account for its 30% investment in Merliton Enterprises. During 2005, Merliton earned net income of \$45,000 and paid dividends of \$13,000. In accounting for the investment during 2005, Blackstone will
- credit Dividend Revenue, \$3,900.
  - credit Investment Income, \$13,500.
  - credit Revenue from Investment, \$9,600.
  - debit Cash, \$9,600.

## **ANSWERS**

### **True and False**

**1. F 2. T 3. T 4. F 5. T 6. T 7. F 8. F 9. F 10. F**

### **Multiple Choice**

**11. A 12. C 13. D 14. B 15. A 16. B 17. B 18. C 19. B 20. B**