E17-1B (Investment Classifications)  For the following investments identify whether they are:

1. Trading securities
2. Available-for-sale securities
3. Held-to-maturity securities

Each case is independent of the other.

(a) Purchase bonds maturing in 20 years. The company intends to use the cash flow generated by the interest payments on the bond to provide employee bonuses.

(b) Common stock was purchased based on a recommendation from the CEO’s broker. The broker believes the price will increase substantially over the next couple of months.

(c) An investment grade bond that matures in 8 years was purchased. The company will probably hold the bonds until they mature at which time the proceeds will be used to retire maturing debt. The bonds mature in 2 months.

(d) Five-year bonds of a troubled company were purchased this year for substantially below par value. The bonds mature in 2 months.

(e) Excess cash was used to purchase preferred stock. The preferred stock may need to be sold within the next year if a planned expansion is completed.

(f) 15% of the outstanding stock of another company was purchased last year. The company is considering purchasing another 20% of the company.

E17-2B (Entries for Held-to-Maturity Securities) On July 1, 2014, Salt Mine Corporation purchased at par 8% bonds having a maturity value of $250,000. The bonds are dated July 1, 2014, and mature July 1, 2019, with interest payable on July 1 of each year. The bonds are classified in the held-to-maturity category, and the company does not use reversing entries.

Instructions
(a) Prepare the journal entry at the date of the bond purchase.

(b) Prepare the journal entry to record the interest earned and interest received for 2014.

(c) Prepare the journal entries to record the interest earned and interest received for 2015.

E17-3B (Entries for Held-to-Maturity Securities) On January 1, 2014, Hummer Company purchased 5% bonds, having a maturity value of $500,000, for $428,938. The bonds provide the bondholders with a 7% yield. They are dated January 1, 2014, and mature January 1, 2024, with interest receivable June 30 and December 31 of each year. Hummer Company uses the effective-interest method to allocate unamortized discount or premium. The bonds are classified in the held-to-maturity category.

Instructions
(a) Prepare the journal entry at the date of the bond purchase.

(b) Prepare the first 3 years of a bond amortization schedule.

(c) Prepare the journal entries to record the interest received and the amortization for 2014.

E17-4B (Entries for Available-for-Sale Securities) Assume the same information as in E17-3B except that the securities are classified as available-for-sale. The fair value of the bonds at December 31 of each year-end is as follows.

<table>
<thead>
<tr>
<th>Year</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$430,000</td>
<td>425,000</td>
<td>420,000</td>
<td>$450,000</td>
<td>470,000</td>
<td></td>
</tr>
</tbody>
</table>

Instructions
(a) Prepare the journal entry at the date of the bond purchase.

(b) Prepare the journal entries to record the interest received and recognition of fair value for 2014.

(c) Prepare the journal entry to record the recognition of fair value for 2015.

E17-5B (Effective-Interest versus Straight-Line Bond Amortization) On January 1, 2014, Falcon Electro acquires $400,000 of 8% bonds at a price of $442,376. The interest is payable each December 31, and the bonds mature December 31, 2034. The investment will provide Falcon Electro a 7% yield. The bonds are classified as held-to-maturity.

Instructions
(a) Prepare a 3-year schedule of interest revenue and bond discount amortization, applying the straight-line method.

(b) Prepare a 3-year schedule of interest revenue and bond discount amortization, applying the effective-interest method.
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(c) Prepare the journal entry for the interest receipt of December 31, 2015, and the discount amortization under the straight-line method.
(d) Prepare the journal entry for the interest receipt of December 31, 2015, and the discount amortization under the effective-interest method.

E17-6B (Entries for Available-for-Sale and Trading Securities) The following information is available for Quigley Company at December 31, 2014, regarding its investments.

<table>
<thead>
<tr>
<th>Securities</th>
<th>Cost</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>500 shares of Runner Corporation common stock</td>
<td>$25,000</td>
<td>$40,000</td>
</tr>
<tr>
<td>7,000 shares of Sher-tor Corporation preferred stock</td>
<td>$650,000</td>
<td>$620,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$675,000</strong></td>
<td><strong>$660,000</strong></td>
</tr>
</tbody>
</table>

The company did not have any investments prior to 2014.

Instructions
(a) Prepare the adjusting entry (if any) for 2014, assuming the securities are classified as trading.
(b) Prepare the adjusting entry (if any) for 2014, assuming the securities are classified as available-for-sale.
(c) Discuss how the amounts reported in the financial statements are affected by the entries in (a) and (b).

E17-7B (Trading Securities Entries) On December 31, 2014, InterSteel Inc. provided you with the following information regarding its trading securities.

<table>
<thead>
<tr>
<th>Investments (Trading)</th>
<th>December 31, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Cost</td>
</tr>
<tr>
<td>JAK Inc. stock</td>
<td>$40,000</td>
</tr>
<tr>
<td>Kibby Co. stock</td>
<td>101,000</td>
</tr>
<tr>
<td>Lorton Corp. stock</td>
<td>31,000</td>
</tr>
<tr>
<td><strong>Total of portfolio</strong></td>
<td><strong>$172,000</strong></td>
</tr>
</tbody>
</table>

All of the securities were purchased during 2014. During 2015, InterSteel sold its Lorton Corp. stock for $33,200. The fair value of the stock on December 31, 2015, was: JAK Inc. stock—$47,600; Kibby Co. stock—$95,400.

Instructions
(a) Prepare the adjusting journal entry needed on December 31, 2014.
(b) Prepare the journal entry to record the sale of the Lorton Corp. stock during 2015.
(c) Prepare the adjusting journal entry needed on December 31, 2015.

E17-8B (Available-for-Sale Securities Entries and Reporting) U-For Corporation purchases equity securities costing $163,480 and classifies them as available-for-sale securities. At December 31, the fair value of the portfolio is $167,500.

Instructions
Prepare the adjusting entry to report the securities properly and indicate the statement presentation of the accounts in your entry.

E17-9B (Available-for-Sale Securities Entries and Financial Statement Presentation) At December 31, 2014, the available-for-sale equity portfolio for Zorro Foods Corp. is as follows.

<table>
<thead>
<tr>
<th>Security</th>
<th>Cost</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apple</td>
<td>$33,600</td>
<td>$31,000</td>
</tr>
<tr>
<td>Banana</td>
<td>175,000</td>
<td>174,000</td>
</tr>
<tr>
<td>Crisp</td>
<td>59,400</td>
<td>68,500</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$268,000</strong></td>
<td><strong>$273,500</strong></td>
</tr>
</tbody>
</table>

December 31, 2013, securities fair value adjustment balance—Dr. 5,400
On January 20, 2015, Zorro sold Apple for $31,100. The sale proceeds are net of brokerage fees.

Instructions
(a) Prepare the adjusting entry at December 31, 2014, to report the portfolio at fair value.
(b) Show the balance sheet presentation of the investment related accounts at December 31, 2014.
   (Ignore notes presentation.)
(c) Prepare the journal entry for the 2015 sale of Apple.
E17-10B (Comprehensive Income Disclosure) Assume the same information as E17-9B and that Zorro Foods Corp. reports net income in 2014 of $689,600 and in 2015 of $235,000. Total unrealized holding gains (including any realized holding gain or loss) arising during 2015 totals $26,600.

Instructions
(a) Prepare a statement of comprehensive income for 2014 starting with net income.
(b) Prepare a statement of comprehensive income for 2015 starting with net income.

E17-11B (Equity Securities Entries) Grander Skys Corporation made the following cash purchases of securities during 2014, which is the first year in which Grander Skys invested in securities.

1. On March 31, purchased 25,000 shares of Carrot Corp.’s preferred stock at $21.60 per share plus commission $3,650.
2. On May 10, purchased 1,000 shares of Pepper Co.’s common stock at $6.50 per share plus commission $890.
3. On August 25, purchased 17,000 shares of Onions Inc.’s preferred stock at $13.75 per share plus commission $1,860.

On August 25, 2014, Grander Skys sold 10,000 shares of Carrot Corp.’s preferred stock at a market price of $26.25 per share less brokerage commissions, taxes, and fees of $1,550. The year-end fair values per share were: Carrot $30.00, Pepper $6.10, and Onion $14.50. In addition, the chief accountant of Grander Skys told you that Grander Skys Corporation plans to hold these securities for the long term but may sell them in order to earn profits from appreciation in prices.

Instructions
(a) Prepare the journal entries to record the above three security purchases.
(b) Prepare the journal entry for the security sale on August 25.
(c) Compute the unrealized gains or losses and prepare the adjusting entries for Grander Skys on December 31, 2014.

E17-12B (Journal Entries for Fair Value and Equity Methods) Presented below are two independent situations.

Situation 1
People Tables acquired 15% of the 5,000,000 shares of common stock of Robot Sofas at a total cost of $8.50 per share on April 1, 2014. On August 8, Robot Sofas declared and paid a $250,000 cash dividend. On December 31, Robot Sofas market price was $9.00 per share and the company reported net income of $685,000 for the year. The securities are classified as available-for-sale.

Situation 2
On January 1, 2014, Mica Company purchased 40% of Santos Corporation 500,000 outstanding shares of common stock at a total cost of $13 per share. On October 25, Santos declared and paid a cash dividend of $0.40 per share. On December 31, Santos reported a net income of $860,000 for the year and the market price of its common stock was $14 per share.

Instructions
Prepare all necessary journal entries in 2012 for both situations.

E17-13B (Equity Method) Parent Co. invested $5,000,000 in Sub Co. for 30% of its outstanding stock. At the time of the purchase, Sub Co. had a book value of $15,000,000. Sub Co. pays out 75% of net income in dividends each year.

Instructions
Use the information in the following T-account for the investment in Sub to answer the following questions.

<table>
<thead>
<tr>
<th>Investment in Sub Co.</th>
</tr>
</thead>
<tbody>
<tr>
<td>5,000,000</td>
</tr>
<tr>
<td>360,000</td>
</tr>
<tr>
<td>270,000</td>
</tr>
</tbody>
</table>

(a) How much was Parent Co.’s share of Sub Co.’s net income for the year?
(b) How much was Parent Co.’s share of Sub Co.’s dividends for the year?
(c) What was Sub Co.’s total net income for the year?
(d) What was Sub Co.’s total dividends for the year?

E17-14B (Equity Investment—Trading) AEP Co. purchased 1,000 shares of Sugarland Company for $22 each this year and classified the investment as a trading security. AEP sold 300 shares of the stock for $25 each. At year end the price per share of the Sugarland Company had increased to $26.
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Instructions
Prepare the journal entries for these transactions and any year-end adjustments.

E17-15B (Equity Investments—Trading) EverOne Corp. has the following securities in its trading portfolio of securities on December 31, 2014.

<table>
<thead>
<tr>
<th>Investments (Trading)</th>
<th>Cost</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,200 shares of Dora Corp., common</td>
<td>$268,500</td>
<td>$271,600</td>
</tr>
<tr>
<td>800 shares of Swiper Inc., preferred</td>
<td>199,600</td>
<td>209,400</td>
</tr>
<tr>
<td>2,500 shares of Boots and Boots, preferred</td>
<td>100,000</td>
<td>105,600</td>
</tr>
<tr>
<td></td>
<td>$568,100</td>
<td>$586,600</td>
</tr>
</tbody>
</table>

All of the securities were purchased in 2014.

In 2015, EverOne completed the following securities transactions.

May 1   Sold 500 shares of Swiper Inc., preferred, @ $230 less fees of $2,650.
Oct. 21 Sold the balance of Swiper Inc., preferred, @ $220 plus fees of $3,230.

EverOne Corp.’s portfolio of trading securities appeared as follows on December 31, 2013.

<table>
<thead>
<tr>
<th>Investments (Trading)</th>
<th>Cost</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,200 shares of Dora Corp., common</td>
<td>$268,500</td>
<td>$272,000</td>
</tr>
<tr>
<td>2,500 shares of Boots and Boots, preferred</td>
<td>100,000</td>
<td>103,900</td>
</tr>
<tr>
<td></td>
<td>$368,500</td>
<td>$375,900</td>
</tr>
</tbody>
</table>

Instructions
Prepare the general journal entries for EverOne Corp. for:
(a) The 2014 adjusting entry.
(b) The May sale of the Swiper stock.
(c) The October sale of the Swiper stock.
(d) The 2015 adjusting entry for the trading portfolio.

E17-16B (Fair Value and Equity Method Compared) Blank Co. acquired 25% of the 500,000 shares of outstanding common stock of Overload Inc. on December 31, 2014. The purchase price was $3,600,000. Overload declared and paid $1.20 per share cash dividends on June 18, 2015, and on November 29, 2015. Overload reported net income of $1,200,000 for 2015. The fair value of Overload common stock was $27 per share at December 31, 2015.

Instructions
(a) Prepare the journal entries for Blank Co. for 2015, assuming that Blank cannot exercise significant influence over Overload. The securities should be classified as available-for-sale.
(b) Prepare the journal entries for Blank Co. for 2015, assuming that Blank can exercise significant influence over Overload.
(c) At what amount is the investment in securities reported on the balance sheet under each of these methods at December 31, 2015? What is the total net income reported in 2015 under each of these methods?

E17-17B (Equity Method) On January 1, 2014, LabTech Inc. purchased 40% of the common shares of UnderTech Company for $280,000. During the year, UnderTech earned net income of $120,000 and paid dividends of $36,000.

Instructions
Prepare the entries for LabTech to record the purchase and any additional entries related to this investment in UnderTech Company in 2014.

E17-18B (Impairment of Debt Securities) Waxer Corporation has an investment in corporate bonds classified as available-for-sale at December 31, 2014. These bonds have a par value of $500,000, an amortized cost of $500,000, and a fair value of $425,000. The unrealized loss of $75,000 previously recognized as other comprehensive income and as a separate component of stockholders’ equity is now determined to be other than temporary. That is, the company believes that impairment accounting is now appropriate for these bonds.

Instructions
(a) Prepare the journal entry to recognize the impairment.
(b) What is the new cost basis of the corporate bonds? Given that the maturity value of the bonds is $500,000, should Waxer Corporation accrete the difference between the carrying amount and the maturity value over the life of the bonds?
(c) At December 31, 2015, the fair value of the bonds is $450,000. Prepare the entry (if any) to record this information.
Presented below is information related to the purchases of common stock by Thomlin Company during 2014.

<table>
<thead>
<tr>
<th></th>
<th>Cost (at purchase date)</th>
<th>Fair Value (at December 31)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment in Azul Company stock</td>
<td>$200,000</td>
<td>$221,000</td>
</tr>
<tr>
<td>Investment in Justin Corporation stock</td>
<td>$271,000</td>
<td>$285,000</td>
</tr>
<tr>
<td>Investment in Tiger Inc. stock</td>
<td>$185,000</td>
<td>$260,000</td>
</tr>
<tr>
<td>Total</td>
<td>$656,000</td>
<td>$766,000</td>
</tr>
</tbody>
</table>

Instructions
(a) What entry would Thomlin make at December 31, 2014, to record the investment in Azul Company stock if it chooses to report this security using the fair value option?
(b) What entry would Thomlin make at December 31, 2014, to record the investment in Justin Corporation, assuming that Thomlin wants to classify this security as available-for-sale? This security is the only available-for-sale security that Thomlin presently owns.
(c) What entry would Thomlin make at December 31, 2014, to record the investment in Tiger Inc., assuming that Thomlin wants to classify this investment as a trading security?

Assume the same information as in E17-19B for Thomlin Company. In addition, assume that the investment in the Tiger Inc. stock was sold during 2015 for $278,000. At December 31, 2015, the following information relates to its two remaining investments of common stock.

<table>
<thead>
<tr>
<th></th>
<th>Cost (at purchase date)</th>
<th>Fair Value (at December 31)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment in Azul Company stock</td>
<td>$200,000</td>
<td>$195,000</td>
</tr>
<tr>
<td>Investment in Justin Corporation stock</td>
<td>$271,000</td>
<td>$290,000</td>
</tr>
<tr>
<td>Total</td>
<td>$471,000</td>
<td>$485,000</td>
</tr>
</tbody>
</table>

Net income before any security gains and losses for 2015 was $1,200,000.

Instructions
(a) Compute the amount of net income or net loss that Thomlin should report for 2015, taking into consideration Thomlin’s security transactions for 2015.
(b) Prepare the journal entry to record unrealized gain or loss related to the investment in Azul Company stock at December 31, 2015.

Presented below is selected information related to the financial instruments of Kirkland Company at December 31, 2014. This is Kirkland Company’s first year of operations.

<table>
<thead>
<tr>
<th></th>
<th>Carrying Amount</th>
<th>Fair Value (at December 31)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment in debt securities (intent is to hold to maturity)</td>
<td>$60,000</td>
<td>$59,000</td>
</tr>
<tr>
<td>Investment in Olive Company stock</td>
<td>400,000</td>
<td>430,000</td>
</tr>
<tr>
<td>Bonds payable</td>
<td>500,000</td>
<td>490,000</td>
</tr>
</tbody>
</table>

Instructions
(a) Kirkland elects to use the fair value option whenever possible. Assuming that Kirkland’s net income is $360,000 in 2014 before reporting any securities gains or losses, determine Kirkland’s net income for 2014.
(b) Record the journal entry, if any, necessary at December 31, 2014, to record the fair value option for the bonds payable.

On April 16, 2014, ColorCo purchased a put option for $800 on Choco common stock. The put option gives ColorCo the option to sell 5,000 shares of Choco at a strike price of $25 per share for a period of one year. The market price of a Choco share is $25 on April 16, 2014 (the intrinsic value is therefore $0). On June 30, 2014, the market price for Choco stock is $24 per share, and the time value of the option is $550.

Instructions
(a) Prepare the journal entry to record the purchase of the put option on April 16, 2014.
(b) Prepare the journal entry(ies) to recognize the change in the fair value of the call option as of June 30, 2014.
(c) What was the effect on net income of entering into the derivative transaction for the 3-month period ending June 30, 2014?
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12 *E17-23B (Fair Value Hedge) On January 1, 2014, K-Store Inc. issued a 10-year, $500,000 note at 8% fixed interest, interest payable semiannually. K-Store preferred a variable-rate note, but its lender offered only fixed-rate loans. As a result, K-Store entered into an interest rate swap on the same day where it agrees to receive 8% fixed and pay LIBOR of 5.6% for the first 6 months on $500,000. At each 6-month period, the variable rate will be reset. The variable rate is reset to 6.2% on June 30, 2014.

Instructions
(a) Compute the net interest expense to be reported for this note and related swap transaction as of June 30, 2014.
(b) Compute the net interest expense to be reported for this note and related swap transaction as of December 31, 2014.

12 *E17-24B (Cash Flow Hedge) On January 1, 2014, NorthLake Office Services issues a 10-year, $1,000,000 note at LIBOR plus 1%, with interest paid annually. The variable rate is reset at the end of each year. The LIBOR rate for the first year is 5.2%.
NorthLake decides it prefers fixed-rate financing and wants to lock in a rate of 7%. As a result, NorthLake enters into an interest rate swap to pay 7% fixed and receive LIBOR plus 1% based on $1 million. LIBOR increases to 5.9% on January 1, 2015.

Instructions
(a) Compute the net interest expense to be reported for this note and related swap transactions as of December 31, 2014.
(b) Compute the net interest expense to be reported for this note and related swap transactions as of December 31, 2015.

12 *E17-25B (Fair Value Hedge) On January 1, 2014, VB Technical Inc. issues a 5-year, 6% fixed-rate interest only, nonprepayable $5,000,000 note with interest payable on June 30 and December 31 of each year. VB decides to change the interest rate from a fixed rate to variable rate and enters into a swap agreement with Last Bank Financial. The swap agreement specifies that VB will receive a fixed rate at 6% and pay variable with settlement dates that match the interest payments on the debt. Assume that interest rates have increased during 2014 and that VB paid $37,500 as an adjustment to interest expense for the settlement at June 30, 2014. The gain related to the debt (due to interest rate changes) was $122,000. The value of the obligation under the swap contract increased $122,000.

Instructions
(a) Prepare the journal entry to record the payment of interest expense on June 30, 2014.
(b) Prepare the journal entry to record the receipt of the swap settlement on June 30, 2014.
(c) Prepare the journal entry to record the change in the fair value of the swap contract on June 30, 2014.
(d) Prepare the journal entry to record the change in the fair value of the debt on June 30, 2014.

11 *E17-26B (Call Option) On July 10, 2014. Outback Co. invested idle cash by purchasing a call option on Toby Inc. common shares for $700. The notional value of the call option is 700 shares, and the option price is $31. (Market price of an Outback share is $31.) The option expires on February 12, 2015. The following data are available with respect to the call option.

<table>
<thead>
<tr>
<th>Date</th>
<th>Market Price of Toby Shares</th>
<th>Time Value of Call Option</th>
</tr>
</thead>
<tbody>
<tr>
<td>September 30, 2014</td>
<td>$32 per share</td>
<td>$410</td>
</tr>
<tr>
<td>December 31, 2014</td>
<td>$35 per share</td>
<td>50</td>
</tr>
<tr>
<td>January 31, 2015</td>
<td>$34 per share</td>
<td>20</td>
</tr>
</tbody>
</table>

Instructions
Prepare the journal entries for Outback for the following dates.
(a) Investment in call option on Toby shares on July 10, 2014.
(b) September 30, 2014—Outback prepares financial statements.
(c) December 31, 2014—Outback prepares financial statements.
(d) January 31, 2015—Outback settles the call option on the Toby shares.

12 *E17-27B (Cash Flow Hedge) Locket Jewellery Co. uses gold in the production of its products. Locket anticipates that it will need to purchase 100 ounces of gold in November 2014, for jewelry that will be shipped prior to Valentines Day. However, if the price of gold increases, this will increase the cost to produce the jewelry, which will result in lower profit margins.
To hedge the risk of increased gold prices, on June 1, 2014, Locket enters into a gold futures contract and designates this futures contract as cash flow hedge of the anticipated gold purchase. The notional amount
of the contract is 100 ounces, and the terms of the contract give Lockert the option to purchase gold at a
price of $700 per ounce. The price will be good until the contract expires on November 30, 2014.
Assume the following data with respect to the price of the call options and the gold inventory purchase.

<table>
<thead>
<tr>
<th>Date</th>
<th>Spot Price for November Delivery</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 1, 2014</td>
<td>$700 per ounce</td>
</tr>
<tr>
<td>June 30, 2014</td>
<td>750 per ounce</td>
</tr>
<tr>
<td>September 30, 2014</td>
<td>825 per ounce</td>
</tr>
</tbody>
</table>

**Instructions**
Present the journal entries for the following dates/transactions.

(a) June 1, 2014—Inception of futures contract, no premium paid.
(b) June 30, 2014—Lockert prepares financial statements.
(c) September 30, 2014—Lockert prepares financial statements.
(d) November 1, 2014—Lockert purchases 100 ounces of gold at $825 per ounce and settles the futures
contract.
(e) December 15, 2014—Lockert sells jewelry containing the gold purchased in November 2014 for
$710,000. The cost of the finished goods inventory is $318,000.
(f) Indicate the amount(s) reported in the income statement related to the futures contract and the in-
ventory transactions on December 31, 2014.