

**LO.a: Describe the classification, measurement, and disclosure under International Financial Reporting Standards (IFRS) for 1) investments in financial assets, 2) investments in associates, 3) joint ventures, 4) business combinations, and 5) special purpose and variable interest entities.**

1. The minority interest account will *most likely* appear on the consolidated balance sheet under:
  - A. the proportionate consolidation method.
  - B. the acquisition method.
  - C. both proportionate consolidation and acquisition method.
2. Company A acquired 20% of the 1 million outstanding shares of company B on January 1. During the year, company B earned \$2 per share and had a dividend payout ratio of 50%. As of December 31, company B shares were trading at a price of \$10 per share. Under the equity method, the impact on company A's income statement for its investment in company B will be closest to:
  - A. \$100,000.
  - B. \$200,000.
  - C. \$400,000.
3. Analyst 1: The sponsor usually maintains the decision-making power and voting control over the SPE.  
Analyst 2: The equity owners of an SPE usually receive a rate of return that is tied to the performance of the SPE.
  - A. Analyst 1 is correct.
  - B. Analyst 2 is correct.
  - C. Both analysts are incorrect.
4. Analyst 1: One potential benefit of a VIE is a lower cost of capital since the assets and liabilities of the VIE are isolated in the event the sponsor experiences financial difficulties.  
Analyst 2: The organizational form of a VIE must be either a partnership or a joint venture and it is necessary for the VIE to have separate management and employees.
  - A. Analyst 1 is correct.
  - B. Analyst 2 is correct.
  - C. Both analysts are incorrect.
5. Which of the following securities will *most likely* be classified as an available for sale security?
  - A. Equity securities representing 25% ownership in another firm.
  - B. Debt securities that a company has a positive intent and ability to hold to maturity.
  - C. Debt or equity securities that are carried on the balance sheet at fair market value and may be sold for liquidity purposes.
6. Company A purchased a 5% interest in Company B. It is now the single largest shareholder of Company B. It will hold a seat on the Board of Directors of Company B. Company A will account for its investment in Company B using the:



- A. equity method.
  - B. lower of cost or market method.
  - C. acquisition
7. Company A recently acquired a 55% stake in Company B. Which of the following methods will Company A use to account for its investment in Company B?
- A. equity method.
  - B. purchase method.
  - C. acquisition.
8. Which of the following would *most likely* be classified as a held-to-maturity security?
- I. Debt security
  - II. Equity security that the management has decided to hold for more than 5 years.
- A. Only I.
  - B. Only II.
  - C. Both I and II.

**LO.b: Distinguish between IFRS and US GAAP in the classification, measurement, and disclosure of investments in financial assets, investments in associates, joint ventures, business combinations, and special purpose and variable interest entities.**

9. Company A owns 40% of the voting shares in Company B and is able to control Company B. Under U.S. GAAP which of the following methods is *most appropriate* to use?
- A. Equity method.
  - B. Proportionate consolidation method.
  - C. Acquisition method.
10. In case of joint ventures with shared control, which of the following accounting treatments is *most preferred* under IFRS?
- A. Equity method.
  - B. Proportionate consolidation method.
  - C. Acquisition method.
11. Which of the following methods is not allowed under U.S. GAAP but is permitted under IFRS?
- A. Equity method.
  - B. Proportionate consolidation method.
  - C. Acquisition method.

**LO.c: Analyze how different methods used to account for intercompany investments affect financial statements and ratios.**

12. Which of the following methods will result in the *lowest* assets and liabilities on a company's balance sheet?
- A. Equity method.



- B. Acquisition method.
  - C. Both methods will result in the same amount of assets and liabilities.
13. Which of the following methods will result in the *lowest* net income on a company's income statement?
- A. Equity method.
  - B. Acquisition method.
  - C. Both methods will result in the same amount of net income.
14. Which of the following methods will generally report the *most* favorable results for an intercompany investment?
- A. Equity method.
  - B. Proportionate Consolidation method.
  - C. Acquisition method.



**Solutions**

1. B is correct. In proportionate consolidation the investor only reports the proportionate share of the assets, liabilities, revenues, and expenses of the joint venture. Therefore reporting minority owners' interest is not necessary.
2. C is correct. Under the equity method, the investor recognizes its pro-rata share of the affiliate's income on the income statement. Since Company A owns 200,000 shares of Company B and Company B earned \$2 per share, the income statement impact of the investment is \$400,000.
3. C is correct. Both statements are incorrect. The sponsor does not usually have voting control over the SPE. The activities of an SPE are specifically detailed in governing documents created at the origination of the SPE. The structure of the SPE transfers the risks and rewards from the equity owners to the variable interest owners. In return, the equity owners usually receive a fixed rate of return.
4. A is correct. Analyst 1 is correct. A lower cost of capital is a potential benefit of forming a VIE. Analyst 2 is incorrect. The organizational form can be a corporation, partnership, joint venture or trust. It is not necessary for the VIE to have separate management and employees.
5. C is correct. Debt or equity securities that are carried on the balance sheet at fair market value and may be sold for liquidity purposes are likely to be considered as available-for-sale.
6. A is correct. Even though Company A's interest is low at 5%, it has significant influence by having a seat on Company B's board. They must therefore use the equity method.
7. C is correct. When the parent company has at least a 50% ownership stake and control over the subsidiary, the acquisition method is used.
8. A is correct. Only debt securities, which the firm has the positive intent and ability to hold until final maturity, may be classified as held to maturity.
9. C is correct. It is possible to control with less than a 50% ownership interest. In this case, the investment is still considered controlling and the acquisition method would be most appropriate.
10. B is correct. Although the equity method is permitted under IFRS, proportionate consolidation is the preferred accounting method.
11. B is correct. The proportionate consolidation method is not allowed under U.S. GAAP.



12. A is correct. The equity method will reflect the lowest assets and liabilities. The acquisition method would reflect the highest.
13. C is correct. Both methods will report the same net income.
14. A is correct. Generally, the equity method will provide the most favorable results, while the acquisition method will provide the least favorable results.