

## INVESTMENTS IN EQUITY SECURITIES

**Equity securities:** represent ownership interests such as common, preferred, or other capital stock. They also include rights to acquire or dispose of ownership interests at an agreed-upon or determinable price, such as in warrants, rights, and call or put options. The degree to which one corporation (investor) المستثمرة acquires an interest in the common stock of another corporation (investee) لديها المستثمر generally determines the accounting treatment for the investment subsequent to acquisition. The classification of such investments depends on the percentage of the investee voting stock that is held by the investor:

1. Holdings of less than 20 percent (**fair value method**)—investor has passive interest.
2. Holdings between 20 percent and 50 percent (**equity method**)—investor has significant influence.
3. Holdings of more than 50 percent (**consolidated statements**)—investor has controlling interest.

**Holdings of Less Than 20%:** Upon acquisition, companies record equity securities at cost

### Illustration:

Assume that on November 3, 2017, Republic Corporation purchased common stock of three companies, each investment representing less than a 20 percent interest.

	Cost
<b>Ali's Industries, Inc.</b>	\$259700
<b>Campbell Soup Co.</b>	317500
<b>Baghdad Co.</b>	141350
Total cost	\$718550

Republic records these investments as follows.

November 3, 2017

Equity Investments	718550
Cash	718550

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On December 6, 2017, Republic receives a cash dividend of \$4200 on its investment in the common stock of Campbell Soup Co. It records the cash dividend as follows.

**December 6, 2017**

Cash	4200
Dividend Revenue	4200

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At December 31, 2017, Republic's equity security portfolio has the cost and fair Value.

Investments	Cost	Fair Value	Unrealized Gain (Loss)
<b>Ali's Industries, Inc.</b>	\$259700	\$275000	\$ 15300
<b>Campbell Soup Co.</b>	317500	304000	(13500)
<b>Baghdad Co.</b>	141350	104000	(37350)
Total of portfolio	\$718550	\$683000	(35550)

Previous fair value

Fair value adjustment—Cr. \$(35550)

**December 31, 2017**

Unrealized Holding Gain or Loss—Income	35550
Fair Value Adjustment	35550

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On January 23, 2018, Republic sold all of its Ali's Industries, Inc. common stock receiving net proceeds of \$287220.

Net proceeds from sale	\$287220
Cost of Ali's shares	259700
Gain on sale of stock	\$ 27520

January 23, 2018

Cash	287220
Equity Investments	259700
Gain on Sale of Investments	27520

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### **Holdings Between 20% and 50% (Equity Method):**

Under the equity method, the investor and the investee acknowledge a substantive economic relationship. The company originally records the investment at the cost of the shares acquired but subsequently adjusts the amount each period for changes in the investee's net assets. The equity method recognizes that investee's earnings increase investee's net assets, and that investee's losses and dividends decrease these net assets.

To illustrate the equity method and compare it with the fair value method, assume that Maxi Company purchases a 20 percent interest in Mini Company. To apply the fair value method in this example, assume that Maxi does not have the ability to exercise significant influence. Where this example applies the equity method, assume that the 20 percent interest permits Maxi to exercise significant influence. Illustration 17-17 shows the entries.

#### **Fair Value Method**

#### **Equity Method**

**On January 2, 2017, Maxi Company acquired 48,000 shares (20% of Mini Company common stock) at a cost of \$10 a share.**

Equity Investments	480000	Equity Investments	480000
Cash	480000	Cash	480000

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**For the year 2017, Mini Company reported net income of \$200,000; Maxi Company's share is 20%, or \$40,000.**

No entry	Equity Investments	40000
	Investment Income	40000

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**At December 31, 2017, the 48,000 shares of Mini Company have a fair value (market price) of \$12 a share, or \$576,000.**

Fair Value Adjustment	96000	No entry
Unrealized Holding Gain or Loss—Income	96000	

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**On January 28, 2018, Mini Company announced and paid a cash dividend of \$100,000; Maxi Company received 20%, or \$20,000.**

Cash	20000	Cash	20000
Dividend Revenue	20000	Equity Investments	20000

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**For the year 2018, Mini reported a net loss of \$50,000; Maxi Company's share is 20%, or \$10,000.**

No entry	Investment Loss	10000
	Equity Investments	10000

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**At December 31, 2018, the Mini Company 48,000 shares have a fair value (market price) of \$11 a share, or \$528,000.**

Unrealized Holding Gain	48000	
or Loss—Income		
Fair Value Adjustment	48000	No entry

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