

# Problem 4

Achen Company acquired 30% of the stock of Rheinland Minerals Company. Achen acquired this investment for purposes of being able to exert significant influence over the strategic plans and operations of Rheinland. Following are events pertaining to this investment:

- Sept 1        Purchased 150,000 shares of Rheinland for \$17 per share.
- Sept 30        The fair value of Rheinland's stock was \$27 per share, and the company reported June income of \$330,000.
- Oct 15        The fair value of Rheinland's stock was \$32 per share, and the company declared and paid a dividend of \$1.25 per share.
- Oct 31        The fair value of Rheinland's stock was \$28 per share, and the company reported July income of \$270,000.

- a) What method should be used to account for this investment?
- b) Prepare journal entries to account for the activity pertaining to the investment in Rheinland Metals.
- c) If the investment in Rheinland Metals was insufficient to allow Achen to exert significant influence, how would the accounting approach differ?



## Solution

a) The investment should be accounted for via the equity method. The equity method is used for investments where the investor has the ability to exert significant influence over the investee. The presumption is that the ability to exert significant influence occurs at investment levels generally at the 20% and above level (however, this presumption can be overcome and the equity can be used for investments at lower levels, and vice versa). Note that market value adjustments are generally not recorded for investments accounted for under the equity method.

b)

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Date	Accounts	Debit	Credit
1-Sep	Investment in Rheinland	2,550,000	
	Cash		2,550,000
	<i>To record the purchase of 150,000 shares of Rheinland at \$17</i>		
30-Sep	Investment in Rheinland	99,000	
	Investment Income		99,000
	<i>To record share of Rheinland's reported income (30% X \$330,000)</i>		
15-Oct	Cash	187,500	
	Investment in Rheinland		187,500
	<i>To record a \$1.25 per share cash dividend on the investment</i>		
31-Oct	Investment in Rheinland	81,000	
	Investment Income		81,000
	<i>To record share of Rheinland's reported income (30% X \$270,000)</i>		

c) In the absence of significant influence, the investment would initially be recorded at cost. Subsequent adjustments would be made based on changes in market value of the stock. The manner of recognizing these value changes would depend on whether the intent of the investment was "trading" or "available for sale." In either case, the dividends would be recorded as dividend income.