Classification of securities and why it matters:

Trading: short window
   treat value changes as net income items
Held for Sale: longer window (< 1 year?)
   treat value changes as other comprehensive income
Held to Maturity/Indefinitely
   ignore temporary value changes
   charge permanent impairment to net income

Reclassification/Recovery of value
When reclassifying, treat value changes as of the re-classification date as net income items.

When asset values are permanently impaired, write off to net income.

If asset values recover, and asset is held for sale, treat as OCI. Convert to net income when realized.

!!!If equity investments held for trading or for sale,
treat equity investments as described above. If held indefinitely, then use cost or equity method.!!!
Accounting for Investments with influence: the Sophisticated Equity method (APB 18, Par 19).

Appropriate treatment of investments is a function of size of holding:

Less than 20% & other conditions met:
  Use cost method.
  Record dividend income when declared.
  Do not record share of investee income.

Over 20% & not exempt*:
  Use equity method. This eliminates inter-company transactions and also recognizes investor’s share of investee income as earned.
  Simple or sophisticated?
  Simple: Recognize share of investee loss or gain.
    Reduce investment by dividend.
  Sophisticated: As in Simple Equity method plus adjustment for inter-company transactions and amortization of excess relating to depreciable or wasting assets.
    “one-line consolidation”

Over 50% & not exempt*: control (consolidate).

* exempt = investor does not meet APB 18 criteria for influence or control in spite of exceeding investment threshold.
Steps:

**Preliminaries.**
1. Compute excess.
2. How much is depreciable/wasting assets?
3. Rest is goodwill (non-depreciable).

**Now compute investment income.**
1. Start with investee reported income.
2. **Eliminate** profits on capital assets sold by investee to investor. **Add back** fraction of unrealized profits proportional to depreciation charged during the year.
3. **Eliminate** profits from unsold inter-company goods in investor inventory. **Add back** profits on investor’s beginning inventory.
4. Compute investor share of investee adjusted income.
5. **Eliminate** investor share of unrealized profits on unsold inter-company goods contained in investee inventory. **Add back** investor share of unrealized profits on beginning inventory.
6. Reduce investee income by amount of depreciation/amortization of excess.
7. This is the Investment Income.

**Rest of the accounting as before:**
   Increase investment account by Income. Reduce investment account by dividend.
<table>
<thead>
<tr>
<th>Cost method</th>
<th>Simple Equity Method</th>
<th>Sophisticated Equity Method</th>
</tr>
</thead>
</table>
| **At acquisition date:**  
Dr. Investment in Sub.  
Cr. Cash | **At acquisition date:**  
Dr. Investment in Sub.  
Cr. Cash | **At acquisition date:**  
Dr. Investment in Sub.  
Cr. Cash |
| **At subsidiary year-end**  
No entry | **At subsidiary year-end**  
Dr. Investment in Sub  
Cr. Investment Income  
For our share of sub income | **At subsidiary year-end**  
Dr. Investment in Sub  
Cr. Investment Income  
For our share of sub income  
Dr. Amortization Expense  
Cr. Investment Income  
For amortization of excess |

All intra-co sales & inventory are assumed to have already been eliminated. If not, then we need to eliminate those as well.

**At declaration of dividend**  
Dr. Dividend Receivable  
Cr. Investment Income  
On receipt of dividend  
Dr. Cash  
Cr. Dividend Receivable

**At declaration of dividend**  
1. Do nothing  
2. Dr. Dividend Receivable  
   Cr. Investment Income  
On receipt of dividend  
If you used approach (1) above:  
Dr. Cash  
Cr. Investment in Sub  
If you used approach (2) above:  
Dr. Cash  
Cr. Dividend Receivable

Dividends are handled as in simple equity method.