EX1-Company A purchased 30% of the ordinary shares that have voting rights of Company A for an amount of 1000,000 $. As a result of this ownership, A had a significant influence on the financial and operational decisions of Company (E). - The income statement of Company (E) for year end 2022 showed a net profit of $ 800000.

On May 1,2023 companyE distributed the amount of $100000 of the net profit.

**Required**- Apply Equity method for those transactions

**Solution**

Because that company A exercises a significant influence ( see definition),so A must apply the Equity method :

**Journal entries**

1-On initial recognition A must enter the following in the journal at the date of the acquisition of E shares :

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Debit(000)** | | **Credit(000)** |
| **Investments in Associates**  **Bank** | **1000** | **1000** | |

2-**On December 31,2022, A recognise its profit share as** :

|  |  |  |
| --- | --- | --- |
|  | **Debit(000)** | **Credit(000)** |
| **Investments in Associates**  **Income from investments in associates**  **8000000×30%** | 2400 | 2400 |

3-**Profit Distribution on may1,2023**

|  |  |  |
| --- | --- | --- |
|  | **Debit(000)** | **Credit(000)** |
| **Bank**  **Investments in Associates**  **100000×30%** | 30 | 30 |

**EX2**- On 05/01/2013 - Company A purchased 40% of Company S, the purchase cost was 3,700,000 DZD. Payment was made by check. The fair value of Company S's assets and liabilities before the purchase was as follows:

Total assets 9,000,000 DZD

Liabilities 800,000 DZD

Assets include machinery with a historical cost of 1,200,000 DZD depreciated over 20 years, cars with a cost of 320,000 DZD depreciated over four years. The assets were purchased when the company was established on 02/01/2011.

If you know that on 12/31/2013:

- Company S realize a profit of 750,000 DZD

- There was a decrease in goodwill of 45,000 DZD

And on 3/1/2014 - Company S distributed 50% of the profit realized in 2013

**Required**: Record the necessary transactions in the journal, and show the adjustments to the investment account in Company S in the books of Company A.

**Solution:**

Calculation of the fair value of net assets purchased

= [9,000,000 – 800,000 ]\* 40% = 3,280,000

Calculate goodwill = Purchase cost – Fair value of net assets purchased

= 3,700,000 – 3,280,000 = 420,000

Record the purchase entries in the journal of Company A:

|  |  |  |
| --- | --- | --- |
|  | **Debit(000)** | **Credit(000)** |
| **Investments in the company**  **Cash** | 3700 | 3700 |

**Adjustments made on 12/31/2013**

The balance of the investment account in the company S is **3,700,000**

Add: A's share of S's profits) 750,000 \* 40%) 300,000

Subtract: Decrease in goodwill (45,000)

Depreciation of machinery (1,200,000 / 20) \* 40% (24,000)

Depreciation of the car (320,000 / 4) \* 40% (32,000)

The balance of the investment account in the company S **3,899,000**

on 12/31/2013

Recording Company A's share of Company S's profits

|  |  |  |
| --- | --- | --- |
|  | **Debit(000)** | **Credit(000)** |
| **Investments in Associates(s)**  **Income from investments in associates(s)** | 300 | 300 |

Recording Company A's share of Company S's expenses

|  |  |  |
| --- | --- | --- |
|  | **Debit(000)** | **Credit(000)** |
| **Investmemts expenses**  **Investments in Associates(s)** | 101ⁱ | 101 |

ⁱ **45000+24000+32000**

Record receipt of part of the profits

|  |  |  |
| --- | --- | --- |
|  | **Debit(000)** | **Credit(000)** |
| **Bank**  **Investments in Associates**  **300000×50 %** | 150 | 150 |