you should provide a list of all journal entries that you record as part of putting together the consolidated financial statements with a clear indication of where the journal entries are posted. They could be posted to Mother Company’s books, or in the Consolidation Worksheets (all entries needed for Son and Daughter Company were completed correctly by their accountants).

Second, you should provide a completed consolidation spreadsheet for Mother Company.

Finally, you should submit a consolidated Balance Sheet, Statement of Retained Earnings, and Income Statement for his company, “Mother Company”, for 2012 (year ended Dec. 31, 2012, or as of Dec. 31, 2012, as appropriate). These financial statements should be for the consolidated company to the extent consolidation is appropriate.

College buddy doesn’t clarify this, but investments to be consolidated should be accounted for on Mother Company’s financial statements using the equity method.

under the full equity method, there are some adjustments necessary for inter-entity transfers of depreciable assets. Any gain on such a transfer would need to be deferred (similar to the deferral of gross profit on inter-entity inventory transfers). The full amount of the gain will charged against “Equity in Investee’s Income” (where “Investee” would normally be replaced by the name of the investee company) as a debit, and the credit side of the entry will be a reduction to the investment account. Each year the investor will get to recognize a portion of this gain equal to the difference between the depreciation that would have been recognized by the selling company and the depreciation that was recognized by the purchasing company. This will be done by debiting the investment account, and crediting “Equity in Investee’s Income”.

Dear Student,

I am the CFO of Mother Corporation. On January 1, 2012 my company made two investments. First, we purchased 19% of Daughter Company for $237,500. Second, we purchased 85% of Son Company for $680,000. We plan on holding both investments for the foreseeable future, though we could sell them if we need the cash. (They have both done very well for us; the daughter company stock was worth $380,000 as of Dec.31, 2012, and we estimate the Son Company stock was worth $1,122,000 as of December 31, 2012!) I know almost nothing about accounting for investments and need your help in putting together my company’s financial statements for the year ended December 31, 2012.

When determining the appropriate price to pay for these investments, we determined the following information.

Daughter Company’s book value on January 1, 2012 was $1,105,000. However, they owned software which we believe was undervalued by $40,000 and which had 10 years of remaining life. In addition, we determined that their equipment was undervalued on their books by $50,000. The equipment had a remaining life of 8 years.

Son’s book value as of January 1, 2012 was $460,000. The remaining 15% of the stock (15,000 shares) was trading at $7.00 per share both before and after our acquisition. In addition, we determined that their building was undervalued by $70,000 and had 7 years of remaining useful life, and that their software was undervalued by $160,000 and had 4 years of remaining useful life.

I have attached a copy of all three companies’ preliminary balance sheets (Dec. 31, 2012), and statements of retained earnings and income statements for the year ended Dec. 31, 2012. I have also attached the footnotes for our (Mother Company’s) financial statements.

As I stated above, I don’t know very much about accounting for investments. Therefore, we have done very little accounting for these two investments. Specifically, we have recorded only the following journal entries:

Dr Investment in Daughter Co. 237,500

Cr Cash 237,500

Dr Investment in Son Co. 680,000

Cr Cash 680,000

(I haven’t even recorded the cash we received as dividends from them yet, because I had no idea what the credit side of that journal entry should be.)

Prof. Hansen tells me that you guys are experts at accounting for investments, and I look forward to seeing the financial statements. I am especially eager to be able to show my boss how much money we made by buying these investments. I get a really big bonus if our return on assets is higher than 12%, and the increased value of these investments should get us there no problem! When I get the big check, I might even invite all you guys over to the house for a big celebration.

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| **Mother Company** | | | |
| **Balance Sheet, As of December 31, 2012** | | | |
| Cash |  |  | $ 128,820 |
| Accounts Receivable |  |  | $ 457,148 |
| Inventory |  |  | $ 650,300 |
| Investment in Daughter Company |  |  | $ 237,500 |
| Investment in Son Company |  |  | $ 680,000 |
| Bonds Receivable |  |  | $ 1,250,000 |
| Bond Premium |  |  | $ 48,953 |
| Land and Buildings |  |  | $ 790,000 |
| Patent |  |  | $ 35,000 |
| Equipment |  |  | $ 345,000 |
| Other Assets |  |  | $ 118,600 |
| **Total Assets** |  |  | **$ 4,741,321** |
| Accounts Payable |  |  | $ (273,500) |
| Bonds Payable |  |  | $ (375,000) |
| Premiums on Bonds Payable |  |  | $ (22,000) |
| Other Liabilities |  |  | $ (905,855) |
| Common Stock |  |  | $ (770,000) |
| Additional Paid in Capital |  |  | $ (1,395,000) |
| Retained Earnings, 12/31 |  |  | $ (999,966) |
| **Total Liabilities and Equity** |  |  | **$ (4,741,321)** |

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| **Mother Company** | | | |
| **Statement of Retained Earnings, for the 12 months ending December 31, 2012** | | | |
| Retained Earnings, 1/1/12 |  |  | $ (648,952) |
| Net Income |  |  | $ (393,014) |
| Dividends Paid |  |  | $ 42,000 |
| **Retained Earnings, 12/31/12** |  |  | **$ (999,966)** |

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| **Mother Company** | | | |
| **Income Statement, for the 12 months ending December 31, 2012** | | | |
| Revenues |  |  | $ (3,250,000) |
| Interest Income |  |  | $ (66,513) |
| Gain on Sale of Equipment |  |  | $ (8,000) |
| **Total Revenues** |  |  | **$ (3,324,513)** |
| Cost of Sales |  |  | $ 2,245,900 |
| Interest Expense |  |  | $ 116,900 |
| Amortization Expense |  |  | $ 188,080 |
| Depreciation Expense |  |  | $ 380,619 |
| **Total Expenses** |  |  | **$ 2,931,499** |
| **Net Income** |  |  | **$ (393,014)** |

**Mother Company – Footnotes to the Financial Statements**

**Note 1--Summary of Significant Accounting Policies**

a. ACCOUNTING PRINCIPLES

The financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

b. USE OF ESTIMATES

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

c. REVENUE RECOGNITION

Sales are recognized upon shipment of merchandise. The Company does not provide for allowances or return of goods except for cause. When an allowance or return occurs, it is accounted for as a reduction of sales. Sales allowances or returns are not significant to the operations of the Company.

d. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are carried at cost. Depreciation and amortization for financial accounting purposes are provided by using the straight line method over the estimates useful lives of the assets.

Leases of manufacturing facilities which are in substance financing arrangements have been capitalized, with the corresponding liability included in capitalized lease obligations.

**Note 2—Investment Securities**

In accordance with U.S. GAAP, Mother Company accounts for equity investments through which Company exercises significant influence over but does not control the investee and is not the primary beneficiary of the investee’s activities are accounted for using the equity method. Investments through which we are not able to exercise significant influence over the investee and which do not have readily determinable fair values are accounted for under the cost method.

In accordance with U.S. GAAP, the Company bases the method of accounting for equity investments on the ability to provide significant influence regardless of the percent-ownership.

**Note 3—Dividend Income**

In 2012, Mother Company declared and paid dividends in the amount of $42,000 to shareholders. Additionally, Mother Company received dividends from its investments in Son Company and Daughter Company, on November 1, 2012.

**Note 4—Property, Plant and Equipment**

The following table displays the details of property, plant and equipment, which are stated net of Accumulated Depreciation:



**Note 5— Related Party Transactions**

During 2012, Mother Company participated in transactions with two related parties, Son Company and Daughter Company.

During this fiscal year, Son Company purchased equipment from Mother Company. The equipment was recorded on Son Company’s books for $80,000. Both Mother Company and Son Company use the straight line method of depreciation for machinery and equipment.

Additionally, during 2012, Mother Company sold inventory with a cost of $150,000 to partially owned Daughter Company for $250,000.

**Mother Company – Board of Directors**

*Joshua Kramer, Chief Executive Officer and Chairman of the Board*

Joshua Kramer has served as our Chief Executive Officer since October 2005 and our Chairman of the Board since inception. Mr. Kramer currently serves as a member of the board of directors of Daughter Company. Mr. Kramer holds an MBA degree from Stanford University and a B.A. from James Madison University.

*Emily McHale, Chief Executive Officer and Chairman of the Board, AdUSA, Inc.*

Emily McHale has served as one of our directors since March 2006. In late 2007, Ms. McHale founded AdUSA, Inc. where she is now Executive Chairman of the Board. Previously, Ms. McHale served on the board of MarketMe, Inc. from January 2001 until May 2005. Ms. McHale holds a B.S. in Marketing from Washington and Lee University.

*Kyle Marry, Investor*

Kyle Marry has served as one of our directors since July 2008. Mr. Marry was previously on the board of Playtime, Inc. from June 2000 until March 2004. From 1978 until his retirement in 1999, Mr. Marry served in management roles at Accounting for You, Inc. where he became worldwide managing partner of market development and a member of the firm’s executive committee. Mr. Marry holds an MBA degree from Harvard as well as a B.S. in Accounting from Boston College. He is currently serving on the board of Daughter Company as well as Father Company.

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| **Daughter Company** | | | |
| **Balance Sheet, As of December 31, 2012** | | | |
| Cash |  |  | $ 251,000 |
| Accounts Receivable |  |  | $ 501,000 |
| Inventory |  |  | $ 634,000 |
| Land and Buildings |  |  | $ 186,000 |
| Patent |  |  | $ 25,000 |
| Equipment |  |  | $ 199,000 |
| Other Assets |  |  | $ 137,000 |
| **Total Assets** |  |  | **$ 1,933,000** |
| Accounts Payable |  |  | $ (385,000) |
| Bonds Payable |  |  | $ (140,000) |
| Premiums on Bonds Payable |  |  | $ (5,350) |
| Other Liabilities |  |  | $ (243,000) |
| Common Stock |  |  | $ (380,000) |
| Additional Paid in Capital |  |  | $ (100,000) |
| Retained Earnings, 12/31 |  |  | $ (679,650) |
| **Total Liabilities and Equity** |  |  | **$ (1,933,000)** |

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| **Daughter Company** | | | |
| **Statement of Retained Earnings, for the 12 months ending December 31, 2012** | | | |
| Retained Earnings, 1/1/12 |  |  | $ (625,000) |
| Net Income |  |  | $ (94,650) |
| Dividends Paid |  |  | $ 40,000 |
| **Retained Earnings, 12/31/12** |  |  | **$ (679,650)** |

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| **Daughter Company** | | | |
| **Income Statement, for the 12 months ending December 31, 2012** | | | |
| Revenues |  |  | $ (850,000) |
| Interest Income |  |  | $ (60,000) |
| **Total Revenues** |  |  | **$ (910,000)** |
| Cost of Sales |  |  | $ 745,000 |
| Interest Expense |  |  | $ 20,000 |
| Amortization Expense |  |  | $ 25,000 |
| Depreciation Expense |  |  | $ 25,350 |
| **Total Expenses** |  |  | **$ 815,350** |
| **Net Income** |  |  | **$ (94,650)** |

**Daughter Company – Board of Directors**

*Pete Duckett, Chief Executive Officer and Chairman of the Board*

Pete Duckett has served as our Chief Executive Officer since April 2010 and our has been a member of our Board since its inception in March 2000. Mr. Duckett also currently serves on the board for ToysRUs, Inc. Previously, Mr. Duckett served as the Chief Financial Officer for Mother Company, until he relocated to Denver, Colorado for Daughter Company. Mr. Duckett has both an MBA and B.S. from Duke University.

*Kyle Marry, Investor*

Kyle Marry has served as one of our directors since November 2012. Mr. Marry was previously on the board of Playtime, Inc. from June 2000 until March 2004. From 1978 until his retirement in 1999, Mr. Marry served in management roles at Accounting for You, Inc. where he became worldwide managing partner of market development and a member of the firm’s executive committee. Mr. Marry holds an MBA degree from Harvard as well as a B.S. in Accounting from Boston College. He is currently serving on the board of Mother Company as well as Father Company.

*Joshua Kramer, Chief Executive Officer and Chairman of the Board, Mother Company*

Joshua Kramer has served on our board since January 2012. Mr. Kramer currently serves as CEO and Chairman of the Board for Mother Company. Mr. Kramer holds an MBA degree from Stanford University and a B.A. from James Madison University.

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| **Son Company** | | | |
| **Balance Sheet, As of December 31, 2012** | | | |
| Cash |  |  | $ 166,285 |
| Accounts Receivable |  |  | $ 585,000 |
| Inventory |  |  | $ 822,500 |
| Land and Buildings |  |  | $ 279,300 |
| Software |  |  | $ 310,200 |
| Equipment |  |  | $ 326,000 |
| Other Assets |  |  | $ 287,600 |
| **Total Assets** |  |  | **$ 2,776,885** |
| Accounts Payable |  |  | $ (646,000) |
| Bonds Payable |  |  | $ (1,100,000) |
| Discounts on Bonds Payable |  |  | $ 89,750 |
| Other Liabilities |  |  | $ (290,125) |
| Common Stock |  |  | $ (245,000) |
| Additional Paid in Capital |  |  | $ (70,000) |
| Retained Earnings, 12/31 |  |  | $ (515,510) |
| **Total Liabilities and Equity** |  |  | **$ (2,776,885)** |

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| **Son Company** | | | |
| **Statement of Retained Earnings, for the 12 months ending December 31, 2012** | | | |
| Retained Earnings, 1/1/12 |  |  | $ (145,000) |
| Net Income |  |  | $ (465,510) |
| Dividends Paid |  |  | $ 95,000 |
| **Retained Earnings, 12/31/12** |  |  | **$ (515,510)** |

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| **Son Company** | | | |
| **Income Statement, for the 12 months ending December 31, 2012** | | | |
| Revenues |  |  | $ (2,825,000) |
| Interest Income |  |  | $ (64,700) |
| **Total Revenues** |  |  | **$ (2,889,700)** |
| Cost of Sales |  |  | $ 1,988,020 |
| Interest Expense |  |  | $ 100,250 |
| Amortization Expense |  |  | $ 90,000 |
| Depreciation Expense |  |  | $ 245,920 |
| **Total Expenses** |  |  | **$ 2,424,190** |
| **Net Income** |  |  | **$ (465,510)** |

**Son Company – Board of Directors**

*Katie Yourk, Chief Executive Officer and Chairman of the Board*

Katie Yourk has served as our Chief Executive Officer since March 2000 and our Chairman of the Board since inception in June 2000. Ms. Yourk has previously served on the board for Capital Toys, Inc. from June 1996 until November 1999. Additionally, Ms. Yourk currently serves on the board for Massey, Inc. Ms. Yourk holds an MBA from Rollins College and a B.S. in Business Administration from the University of Central Florida.

*Joann Chapman, Managing Director, Lake Mary*

Joann Chapman has served as one of our directors since December 2006. Ms. Chapman previously served as a member of the board for Kaplana, Inc and serves currently as the Managing Director at Lake Mary, a private equity firm, where she has served since February 2004. Ms. Chapman holds a B.A. from the University of Florida.

*Collin Kisell, Managing Director, Cassel Equity Group*

Collin Kisell has served on our board since June 2000. Mr. Kisell founded and served as the Chief Executive Officer of Kidz Play, Inc. in early 1991. He was the acting CEO until his relocation to Cassel Equity Group in March 1999. Currently, Mr. Kisell also serves on the board of Cassel Equity Group as the Managing Director. Mr. Kisell holds a B.S. in Business Administration from Stanford University.