under equity method, Pal recognizes $2,500 in income and reports the investment in Sid at $50,500 at December 31.

Summary of Pal’s equity under equity method:

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 1</td>
<td>Initial cost</td>
<td>$50,000</td>
</tr>
<tr>
<td>Nov 1</td>
<td>Dividends received</td>
<td>(2,000)</td>
</tr>
<tr>
<td>Dec 31</td>
<td>Recognize 20% of Sid’s net income for ½ year</td>
<td>(2,500)</td>
</tr>
<tr>
<td>Dec 31</td>
<td>Ending Balance</td>
<td>$50,500</td>
</tr>
</tbody>
</table>

An exception arises when dividends received exceed the investor’s share of earnings after the investment has been acquired → return capital or liquidating dividends

Example:
Sid’s net income for the year had been $15,000, Pal’s share would have been $1,500 ($15,000 x 1/2 year x 20%). The $2,000 dividend received exceeds the $1,500 equity in Sid’s income, so the $500 excess would be considered as return of capital and credited to Investment in Sid account. Assume Pal records the $2,000 cash on Nov 1 as dividend income, a year-to-year entry to adjust dividend income and investment account needed.

```
Dividend incomme (-R, -SE)  500
Investment in Sid (-A)      500
To adjust dividend income and investment account for dividends
```

This entry reduces dividend income to Pal’s $1,500 share of income earned after July 1 and reduces the investment in Sid to $49,500, the new fair value/cost basis for investment. If after liquidating dividend, the stock had fair value of $60,000 at December 31, then the entry to increase the investment to its fair value is required:

```
Allowance to adjust AFS securities to MV  10,500
Unrealized gains on AFS securities*  10,500
```

*included in other comprehensive income