*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:

July 1	Initial cost	$50,000
Nov 1	Dividends received	(2,000)
Dec 31	Recognize 20% of Sid'd net income for ½ year	(2,500)
Dec 31	Ending Balance	$50,500

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
Received in excess of earnings

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