Ohio Energy Company: Accounting for Joint Ventures: Problem Handouts

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Phase 1

Your client, the Ohio Energy Company, is in negotiations with two neighboring utilities, Kentucky Gas and Electric and Indiana Power and Light. The three companies desire to form a new company, Wardwell Solutions, Inc., which would be an energy consulting firm providing services to large companies on minimizing energy costs. Ohio Energy Company has some internally developed technology that is crucial to the business of Wardwell Solutions. For that reason, Ohio Energy would contribute substantially less cash in forming Wardwell Solutions than the other two partners. Each of the three forming companies would have a one-third interest in Wardwell Solutions once it has been formed.

Question:

1. Provide a report to your client explaining the accounting and reporting for its ownership in Wardwell Solutions, Inc.

Image courtesy of Westfalia Separator, Inc.

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Phase 2

The deal has been struck. At the beginning of 2002, the three partners formed Wardwell Solutions, Inc. The investment made is summarized in the table below:

Investing Firm	**Intellectual Capital**	**Monetary Capital**
Ohio Energy Company	$1,000,000	$1,000,000
Kentucky Gas and Electric	$0	$2,000,000
Indiana Power and Light	$0	$2,000,000

Ohio Energy's proprietary technology was developed internally by the firm. Therefore it is not recorded on the books. Management believes that the value of Ohio Energy's proprietary technology will last five years. During its first year of operations, Wardwell Solutions, Inc. reported net income of $300,000.

Questions:

1. What entry should Ohio Energy Company make to record the investment in Wardwell Solutions, Inc.?
2. What entry should Ohio Energy Company make at year-end?
3. What amount will be shown on Ohio Energy Company's balance sheet for its investment in Wardwell Solutions, Inc.?
4. What amount will be shown on the balance sheets of the other partners of the joint venture?

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Phase 3

In the beginning of 2003, the three partners confer about their joint venture. They agree that Wardwell Solutions will grow much faster if there is an infusion of new capital. None of the three partners desires to invest more money at this time. They therefore agree to seek another investor in the enterprise. Ohio Energy Company is curious about the accounting implications if another investor is brought into the equation.

Question:

1. Prepare a report for your client to explain the accounting and reporting implications when a new investor joins the joint venture.

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Phase 4

When the three partners consult with their bank, they find a venture capital firm, Kobalt, Krafty & Robbin, which is willing to invest $5,000,000 in return for 40% ownership in the joint venture. After they consider the offer, the three partners agree to Kobalt, Krafty & Robbin's terms. The three partners would retain an equal interest in the remaining equity of Wardwell Solutions, Inc. During the second year of operations, Wardwell Solutions, Inc. reports net income of $1,000,000.

Question:

1. What entry should Ohio Energy Company make to reflect the infusion of capital?
2. What entry will Ohio Energy Company make at year-end with respect to its investment in the joint venture?
3. What amount will Ohio Energy Company report on its balance sheet for its investment?

Provide a reconciliation to prove your current difference between the inside basis and the outside basis is correct.

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PBL Worksheet: Pertinent, Known Information

Group: __________________ Date: ____________________

What do we know?	How will what we know help us solve this problem?

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PBL Worksheet: Additional Information Required

Group: __________________ Date: ____________________

What do we need to know?	How will what we need to know help us solve this problem?

What have we learned?	