# CHAPTER 1

# INTERCORPORATE ACQUISITIONS AND INVESTMENTS IN OTHER ENTITIES

## ANSWERS TO QUESTIONS

**Q1-1** Complex organizational structures often result when companies do business in a complex business environment. New subsidiaries or other entities may be formed for purposes such as extending operations into foreign countries, seeking to protect existing assets from risks associated with entry into new product lines, separating activities that fall under regulatory controls, and reducing taxes by separating certain types of operations.

**Q1-2** The split-off and spin-off result in the same reduction of reported assets and liabilities. Only the stockholders' equity accounts of the company are different. The number of shares outstanding remains unchanged in the case of a spin-off and retained earnings or paid-in capital is reduced. Shares of the parent are exchanged for shares of the subsidiary in a split-off, thereby reducing the outstanding shares of the parent company.

**Q1-3** The management of Enron appears to have used special-purpose entities to avoid reporting debt on its balance sheet and to create fictional transactions that resulted in reported income. It also transferred bad loans and investments to special-purpose entities to avoid recognizing losses in its income statement.

**Q1-4** (a) A **statutory merger** occurs when one company acquires another company and the assets and liabilities of the acquired company are transferred to the acquiring company; the acquired company is liquidated, and only the acquiring company remains.

(b) A **statutory consolidation** occurs when a new company is formed to acquire the assets and liabilities of two combining companies. The combining companies dissolve, and the new company is the only surviving entity.

(c) A **stock acquisition** occurs when one company acquires a majority of the common stock of another company and the acquired company is not liquidated; both companies remain as separate but related corporations.

**Q1-5** A noncontrolling interest exists when the acquiring company gains control but does not own all the shares of the acquired company. The non-controlling interest is made up of the shares not owned by the acquiring company.

**Q1-6** Goodwill is the excess of the sum of (1) the fair value given by the acquiring company, (2) the fair value of any shares already owned by the parent and (3) the acquisition-date fair value of any noncontrolling interest over the acquisition-date fair value of the net identifiable assets acquired in the business combination.

**Q1-7** The level of ownership acquired does not impact the amount of goodwill reported under the acquisition method..

**Q1-8** The total difference at the acquisition date between the sum of (1) the fair value given by the acquiring company, (2) the fair value of any shares already owned by the parent and (3) the acquisition-date fair value of any noncontrolling interest and the book value of the net identifiable assets acquired is referred to as the differential.

**Q1-9** The purchase of a company is viewed in the same way as any other purchase of assets. The acquired company is owned by the acquiring company only for the portion of the year subsequent to the combination. Therefore, earnings are accrued only from the date of purchase forward.

**Q1-10** None of the retained earnings of the subsidiary should be carried forward under the acquisition method. Thus, consolidated retained earnings immediately following an acquisition is limited to the balance reported by the acquiring company.

**Q1-11** Additional paid-in capital reported following a business combination is the amount previously reported on the acquiring company's books plus the excess of the fair value over the par or stated value of any shares issued by the acquiring company in completing the acquisition less any sock issue costs.

**Q1-12** When the acquisition method is used, all costs incurred in bringing about the combination are expensed as incurred. None are capitalized. However, costs associated with the issuance of stock are recorded as a reduction of additional paid-in capital.

**Q1-13** When the acquiring company issues shares of stock to complete a business combination, the excess of the fair value of the stock issued over its par value is recorded as additional paid-in capital. All costs incurred by the acquiring company in issuing the securities should be treated as a reduction in the additional paid-in capital. Items such as audit fees associated with the registration of the new securities, listing fees, and brokers' commissions should be treated as reductions of additional paid-in capital when stock is issued.

**Q1-14** If the fair value of a reporting unit acquired in a business combination exceeds its carrying amount, the goodwill of that reporting unit is considered unimpaired. On the other hand, if the carrying amount of the reporting unit exceeds its fair value, impairment of goodwill is implied. An impairment must be recognized if the carrying amount of the goodwill assigned to the reporting unit is greater than the implied value of the carrying unit's goodwill. The implied value of the reporting unit's goodwill is determined as the excess of the fair value of the reporting unit over the fair value of its net identifiable assets.

**Q1-15** When the fair value of the consideration given in a business combination, along with the fair value of any equity interest in the acquiree already held and the fair value of any noncontrolling interest in the acquiree, is less than the fair value of the acquiree's net identifiable assets, a bargain purchase results.

**Q1-16** The acquirer should record the clarification of the acquisition-date fair value of buildings as a reduction to buildings and addition to goodwill.

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**Q1-17** The acquirer must revalue the equity position to its fair value at the acquisition date and recognize a gain. A total of $250,000 ($25 x 10,000 shares) would be recognized in this case assuming that the $65 per share price is the appropriate fair value for all shares (i.e. there is no control premium for the new shares purchased).

## SOLUTIONS TO CASES

### C1-1 Assignment of Acquisition Costs

MEMO

To: Vice-President of Finance
Troy Company

From: ___________, CPA

Re: Recording Acquisition Costs of Business Combination

Troy Company incurred a variety of costs in acquiring the ownership of Kline Company and transferring the assets and liabilities of Kline to Troy Company. I was asked to review the relevant accounting literature and provide my recommendations as to what was the appropriate treatment of the costs incurred in the acquisition of Kline Company.

Current accounting standards require that acquired companies be valued under **ASC 805** at the fair value of the consideration given in the exchange, plus the fair value of any shares of the acquiree already held by the acquirer, plus the fair value of any noncontrolling interest in the acquiree at the combination date [ASC 805]. All other acquisition-related costs directly traceable to an acquisition should be accounted for as expenses in the period incurred [ASC 805]. The costs incurred in issuing common or preferred stock in a business combination are required to be treated as a reduction of the recorded amount of the securities (which would be a reduction to additonal paid-in capital if the stock has a par value or a reduction to common stock for no par stock).

A total of $720,000 was paid in completing the Kline acquisition. The $200,000 finders' fee and $90,000 legal fees for transferring Kline's assets and liabilities to Troy should be recorded by Kline as acquisition expense in 20X7. The $60,000 payment for stock registration and audit fees should be recorded as a reduction of paid-in capital recorded when the Troy Company shares are issued to acquire the shares of Kline. The only cost potentially at issue is the $370,000 legal fees resulting from the litigation by the shareholders of Kline. If this cost is considered to be a direct acquisition cost, it should be included in acquisition expense. If, on the other hand, it is considered to be related to the issuance of the shares, it should be debited to paid-in capital.

*Primary citation*
ASC 805

### C1-2 Evaluation of Merger

Page numbers refer to the page in the 3M 2005 10-K report.

a. The CUNO acquisition improved 3M's product mix by adding a comprehensive line of filtration products for the separation, clarification and purification of fluids and gases (p. 4).

The CUNO acquisition added 5.1 percent to Industrial sales growth (p.13), and was the primary reason for a 1.0 percent increase in total sales in 2005 (p. 15).

b. The acquisition was funded primarily by debt (p.27): The Company generates significant ongoing cash flow. Net debt decreased significantly in 2004, but increased in 2005, primarily related to the $1.36 billion CUNO acquisition.

c. As of December 31, 2005, the CUNO acquisition increased accounts receivable by $88 million (p. 27).

d. At December 31, 2005, the CUNO acquisition increased inventories by $56 million. Currency translation reduced inventories by $89 million year-on-year (p. 27).

**C1-3 Business Combinations**

It is very difficult to develop a single explanation for any series of events. Merger activity in the United States is impacted by events both within the U.S. economy and those around the world. As a result, there are many potential answers to the questions posed in this case.

a. The most commonly discussed factors associated with the merger activity of the 1990s relate to the increased profitability of businesses. In the past, increases in profitability typically have been associated with increases in sales. The increased profitability of companies in the 1990s, however, more commonly has been associated with decreased costs. Even though sales remained relatively flat, profits increased. Nearly all business entities appear to have gone through one or more downsizing events during the 1990s. Fewer employees now are delivering the same amount of product to customers. Lower inventory levels and reduced investment in production facilities now are needed due to changes in production processes and delivery schedules. Thus, less investment in facilities and fewer employees have resulted in greater profits.

Companies generally have been reluctant to distribute the increased profits to shareholders through dividends. The result has been a number of companies with substantially increased cash reserves. This, in turn, has led management to look about for other investment alternatives, and cash buyouts have become more frequent in this environment.

In addition to high levels of cash on hand providing an incentive for business combinations, easy financing through debt and equity also provided encouragement for acquisitions. Throughout the nineties, interest rates were very low and borrowing was generally easy. With the enormous stock-price gains of the mid-nineties, companies found that they had a very valuable resource in shares of their stock. Thus, stock acquisitions again came into favor.

b. One factor that may have prompted the greater use of stock in business combinations recently is that many of the earlier combinations that had been effected through the use of debt had unraveled. In many cases, the debt burden was so heavy that the combined companies could not meet debt payments. Thus, this approach to financing mergers had somewhat fallen from favor by the mid-nineties. Further, with the spectacular rise in the stock market after 1994, many companies found that their stock was worth much more than previously. Accordingly, fewer shares were needed to acquire other companies.

c. Two of major factors appear to have had a significant influence on the merger movement in the mid-2000s. First, interest rates were very low during that time, and a great amount of unemployed cash was available worldwide. Many business combinations were effected through significant borrowing. Second, private equity funds pooled money from various institutional investors and wealthy individuals and used much of it to acquire companies.

Many of the acquisitions of this time period involved private equity funds or companies that acquired other companies with the goal of making quick changes and selling the companies for a profit. This differed from prior merger periods where acquiring companies were often looking for long-term acquisitions that would result in synergies.

In late 2008, a mortgage crisis spilled over into the credit markets in general, and money for acquisitions became hard to get. This in turn caused many planned or possible mergers to be canceled. In addition, the economy in general faltered toward the end of 2008 and into 2009.

d. Establishing incentives for corporate mergers is a controversial issue. Many people in our society view mergers as not being in the best interests of society because they are seen as lessening competition and often result in many people losing their jobs. On the other hand, many mergers result in companies that are more efficient and can compete better in a global economy; this in turn may result in more jobs and lower prices. Even if corporate mergers are viewed favorably, however, the question arises as to whether the government, and ultimately the taxpayers, should be subsidizing those mergers through tax incentives. Many would argue that the desirability of individual corporate mergers, along with other types of investment opportunities, should be determined on the basis of the merits of the individual situations rather than through tax incentives.

Perhaps the most obvious incentive is to lower capital gains tax rates. Businesses may be more likely to invest in other companies if they can sell their ownership interests when it is convenient and pay lesser tax rates. Another alternative would include exempting certain types of intercorporate income. Favorable tax status might be given to investment in foreign companies through changes in tax treaties. As an alternative, barriers might be raised to discourage foreign investment in United States, thereby increasing the opportunities for domestic firms to acquire ownership of other companies.

e. In an ideal environment, the accounting and reporting for economic events would be accurate and timely and would not influence the economic decisions being reported. Any change in reporting requirements that would increase or decrease management's ability to "manage" earnings could impact management's willingness to enter new or risky business fields and affect the level of business combinations. Greater flexibility in determining which subsidiaries are to be consolidated, the way in which intercorporate income is calculated, the elimination of profits on intercompany transfers, or the process used in calculating earnings per share could impact such decisions. The processes used in translating foreign investment into United States dollars also may impact management's willingness to invest in domestic versus international alternatives.

## C1-4 Determination of Goodwill Impairment

MEMO

TO: Chief Accountant
Plush Corporation

From: ______ _____, CPA

Re: Determining Impairment of Goodwill

Once goodwill is recorded in a business combination, it must be accounted for in accordance with current accounting literature. Goodwill is carried forward at the original amount without amortization, unless it becomes impaired. The amount determined to be goodwill in a business combination must be assigned to the reporting units of the acquiring entity that are expected to benefit from the synergies of the combination. [ ASC 350-20-35-41]

This means the total amount assigned to goodwill may be divided among a number of reporting units. Goodwill assigned to each reporting unit must be tested for impairment annually and between the annual tests in the event circumstances arise that would lead to a possible decrease in the fair value of the reporting unit below its carrying amount [ ASC 350-20-35-30].

As long as the fair value of the reporting unit is greater than its carrying value, goodwill is not considered to be impaired. If the fair value is less than the carrying value, a second test must be performed. An impairment loss must be reported if the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill. [ASC 350-20-35-11]

At the date of acquisition, Plush Corporation recognized goodwill of $20,000 ($450,000 - $430,000) and assigned it to a single reporting unit. Even though the fair value of the reporting unit increased to $485,000 at December 31, 20X5, Plush Corporation must test for impairment of goodwill if the carrying value of Plush's investment in the reporting unit is above that amount. That would be the case if the carrying value is $500,000. In the second test, the fair value of the reporting unit's net assets, excluding goodwill, is deducted from the fair value of the reporting unit ($485,000) to determine the amount of implied goodwill at that date. If the fair value of the net assets is less than $465,000, the amount of implied goodwill is more than $20,000 and no impairment of goodwill is assumed to have occurred. On the other hand, if the fair value of the net assets is greater than $465,000, the amount of implied goodwill is less than $20,000 and an impairment of goodwill must be recorded.

With the information provided, we do not know if there has been an impairment of the goodwill involved in the purchase of Common Corporation; however, Plush must follow the procedures outlined above in testing for impairment at December 31, 20X5.

*Primary citations*
ASC 350-20-35-11
ASC 350-20-35-30
ASC 350-20-35-41

**C1-5 Risks Associated with Acquisitions**

Google discloses on page 21 of its 2006 Form 10-K that it does not have significant experience acquiring companies. It also notes that most acquisitions the company has already completed have been small companies. The specific risk areas identified include:

- The potential need to implement controls, procedures, and policies appropriate for a public company that were not already in place in the acquired company
- Potential difficulties in integrating the accounting, management information, human resources, and other administrative systems.
- The use of management time on acquisitions-related activities that may temporarily divert attention from operating activities
- Potential difficulty in integrating the employees of an acquired company into the Google organization
- Retaining employees who worked for companies that Google acquires
- Anticipated benefits of acquisitions may not materialize.
- Foreign acquisitions may include additional unique risks including potential difficulties arising from differences in cultures and languages, currencies, and from economic, political, and regulatory risks.

**C1-6 Numbers Game**

a. A company is motivated to keep its stock price high. However, stock price is very sensitive to information about company performance. When the company reports lower earnings than the market anticipated, the stock price often falls significantly. A desire to increase reported earnings to meet the expectations of Wall Street may provide a company with incentives to manipulate earnings to achieve this goal.

b. Levitt discusses 5 specific techniques: (1) "big bath" restructuring charges, (2) creative acquisition accounting, (3) "cookie jar reserves," (4) improper application of the materiality principal, and (5) improper recognition of revenue. Following Levitt's speech, the FASB subsequently dealt with each of these issues. Accounting standards since that time have limited these earnings management techniques.

c. Levitt notes meaningful disclosure to investors about company performance is necessary for investors to trust and feel confident in the information they are using to make investing decisions. Levitt believes this trust is the bedrock of our financial markets and is required for the efficient functioning of U.S. capital markets.

### C1-7 MCI: A Succession of Mergers

The story of MCI WorldCom (later, MCI) is the story of the man who is largely responsible for both the rise and fall of MCI WorldCom. Bernard Ebbers was Chief Executive Officer of MCI until he resigned under pressure from the Board of Directors in April 2002. He put together over five dozen acquisitions in the two decades prior to stepping down. In 1983, he and three friends bought a small phone company which they named LDDS (Long Distance Discount Services); he became CEO of the company in 1985 and guided its growth strategy. In 1989, LDDS combined with Advantage Co., keeping the LDDS name, to provide long-distance service to 11 Southern and Midwestern states. LDDS merged with Advanced Telecommunications Corporation in 1992 in an exchange of stock accounted for as a pooling of interests. In 1993, LDDS merged with Metromedia Communications Corporation and Resurgens Communications Group, with the combined company maintaining the LDDS name and LDDS treated as the surviving company for accounting purposes (although legally Resurgens was the surviving company). In 1994, the company merged with IDB Communications Group in an exchange of stock accounted for as a pooling. In 1995, LDDS purchased for cash the network services operations of Williams Telecommunications Group. Later in 1995, the company changed its name to WorldCom, Inc. In 1996, WorldCom acquired the large Internet services provider UUNET by merging with its parent company, MFS Communications Company, in an exchange of stock. In 1997, WorldCom purchased the Internet and networking divisions of America Online and CompuServe in a three-way stock and asset swap. In 1998, the Company acquired MCI Communications Corporation for approximately $40 billion, and subsequently the name of the company was changed to MCI WorldCom. This merger was accounted for as a purchase. In 1998, the Company also acquired CompuServe for 56 million MCI WorldCom common shares in a business combination accounted for as a purchase. In 1999, MCI WorldCom acquired SkyTel for 23 million MCI WorldCom common shares in a pooling of interests. An attempt to acquire Sprint in 1999, in a deal billed as the biggest in corporate history, was scuttled due to antitrust concerns.

MCI WorldCom's long distance and other businesses experienced major declines in 2000 and profits began to fall. Continued deterioration of operations and cash flows and disclosure of a massive accounting fraud in June 2002, led MCI WorldCom to file for bankruptcy protection in July 2002, in the largest Chapter 11 case in U.S. history at that time.[1] Subsequent discoveries of additional inappropriate accounting activities and restatements of financial statements further blemished the company's reputation. In April 2003, WorldCom filed a plan of reorganization with the SEC and changed the company name from WorldCom to MCI. The company went through a period of retrenchment, and in early 2006 merged with Verizon Communications. Thus, MCI is no longer a separate company but rather is part of Verizon's wireline business.

Criminal charges were filed against Bernard Ebbers and five other former executives of WorldCom in connect with a major fraud investigation. The company also was charged and eventually reached a settlement with the SEC, agreeing to pay $500 million of cash and 10 million shares of common stock of MCI. Bernard Ebbers was tried for an $11 billion accounting fraud and in 2005 was found guilty of all nine counts with which he was charged. He was sentenced to 25 years in prison, with confiscation of nearly all of his assets. Ebbers is currently in the Oakdale Federal Correctional Complex in Louisiana.

[1] Since this time, Lehman Brothers and Washington Mutual have had bigger bankruptcy filings. http://en.wikipedia.org/wiki/Largest_bankruptcies_in_U.S._history#Largest_bankruptcies

### C1-8 Leveraged Buyouts

a. A leveraged buyout (LBO) involves acquiring a company in a transaction or series of planned transactions that include using a very high proportion of debt, often secured by the assets of the target company. Normally, the investors acquire all of the stock or assets of the target company. A management buyout (MBO) occurs when the existing management of a company acquires all or most of the stock or assets of the company. Frequently, the investors in LBOs include management, and thus an LBO may also be an MBO

b. The FASB has not dealt with leveraged buyouts in either current pronouncements or exposure drafts of proposed standards. The Emerging Issues Task Force has addressed limited aspects of accounting for LBOs. In EITF 84-23, “Leveraged Buyout Holding Company Debt,” the Task Force did not reach a consensus. In EITF 88-16, “Basis in Leveraged Buyout Transactions,” the Task Force did provide guidance as to the proper basis that should be recognized for an acquiring company’s interest in a target company acquired through a leveraged buyout.

c. Whether an LBO is a type of business combination is not clear and probably depends on the structure of the buyout. The FASB has not taken a position on whether an LBO is a type of business combination. The EITF indicated that LBOs of the type it was considering are similar to business combinations. Most LBOs are effected by establishing a holding company for the purpose of acquiring the assets or stock of the target company. Such a holding company has no substantive operations. Some would argue that a business combination can occur only if the acquiring company has substantive operations. However, neither the FASB nor EITF has established such a requirement. Thus, the question of whether an LBO is a business combination is unresolved.

d. The primary issue in deciding the proper basis for an interest in a company acquired in an LBO, as determined by EITF 88-16, is whether the transaction has resulted in a change in control of the target company (a new controlling shareholder group has been established). If a change in control has not occurred, the transaction is treated as a recapitalization or restructuring, and a change in basis is not appropriate (the previous basis carries over). If a change in control has occurred, a new basis of accounting may be appropriate.

## SOLUTIONS TO EXERCISES

### E1-1 Multiple-Choice Questions on Complex Organizations

1. **b** – As companies grow in size and respond to their unique business environment, they often develop complex organizational and ownership structures.

   (a) *Incorrect*. The need to avoid legal liability is not a direct result of increased complexity.
   (c) *Incorrect.* Part of the reason the business environment is complex is due to the increased number and type of divisions and product lines in companies.
   (d) *Incorrect.* This statement is false. There has been an impact on organizational structure and management.

2. **d** – A transfer of product to a subsidiary does not constitute a sale for income purposes and as such would not increase profit for the parent.

   (a) *Incorrect*. Shifting risk is a common reason for establishing a subsidiary.
   (b) *Incorrect.* Corporations often establish subsidiaries in other regulatory environments so that the parent company is not explicitly affected by the regulatory control.
   (c) *Incorrect.* Corporations will often establish subsidiaries to take advantage of tax benefits that exist in different regions.

3. **a** – When a merger occurs, all the assets and liabilities are transferred to the purchasing company and any excess of the purchase price over the fair value of the net assets is recorded as goodwill on the purchaser's books.

   (b) *Incorrect*. This combination results in a parent-subsidiary relationship in which an investment in Penn would be recorded. In the event that goodwill were present in this transaction, it would be reported on the consolidated books and not Randolph's books.
   (c) *Incorrect.* In a spin-off, no change to net assets occurs, and consequently no goodwill is recorded.
   (d) *Incorrect.* In a split-off, no change to net assets occurs, and consequently no goodwill is recorded.

4. **b** – In an internal expansion in which the existing company *creates* a new subsidiary, the assets and liabilities are recorded at the carrying values of the original company.

   (a) *Incorrect*. This is not in accordance with GAAP; assets are transferred at the parent's book (carrying) value.
   (c) *Incorrect.* Not in accordance with US GAAP; no gain or loss is permitted because the assets are transferred at the parent's book value.
   (d) *Incorrect.* Not in accordance with US GAAP – Goodwill is not created when a company creates a subsidiary through internal expansion.

5. **d** – This is the proper impairment test required under US GAAP, according to FASB 142/ASC 350.

(a) *Incorrect*. This is not the proper test for impairment under US GAAP.
(b) *Incorrect.* This is not the proper test for impairment under US GAAP.
(c) *Incorrect.* This is not the proper test for impairment under US GAAP.

### E1-2 Multiple-Choice Questions on Recording Business Combinations [AICPA Adapted]

1. **a** – The excess sum of the consideration given over the sum of the fair value of identifiable assets less liabilities equals goodwill.

(b) *Incorrect*. Assets considered only need be identifiable, not just tangible. For example, patents would be identifiable, but not tangible.
(c) *Incorrect.* Assets considered only have to be identifiable. This includes both tangible and intangible identifiable assets.
(d) *Incorrect.* The calculation of goodwill requires a remeasurement of the assets and liabilities at fair value, not book value.

2. **c** – "Costs of issuing equity securities used to acquire the acquire are treated in the same manner as stock issue costs are normally treated, as a reduction in the paid-in capital associated with the securities" A reduction to the paid-in capital account results in a reduction in the fair value of the securities issued.

(a) *Incorrect*. Stock issue costs are not expensed but are charged as a reduction in paid-in capital.
(b) *Incorrect.* Stock issue costs result in a reduction of stockholder's equity, not an increase.
(d) *Incorrect.* Stock issue costs result in a reduction of equity, and are not capitalized. They are not added to goodwill.

3. **d** – When a new company is acquired, the assets and liabilities are recorded at fair value.

(a) *Incorrect*. Historical cost is not always reflective of actual value, thus fair values are used.
(b) *Incorrect.* Book value is often different than fair value, thus fair value is the appropriate basis.
(c) *Incorrect.* This method is also unacceptable. Fair value is the appropriate basis.

4. **d** – This combination would result in a bargain purchase.

(a) *Incorrect*. Deferred credits do not arise as a result of fair value of identifiable assets exceeding fair value of the consideration.
(b) *Incorrect.* The fair value is not reduced, and deferred credits do not arise in this situation.
(c) *Incorrect.* The fair value is not reduced, and deferred credits do not arise in this situation.

5. **c** – $875,000 – $800,000 = $75,000. Total consideration given – FV of net assets = Goodwill

**E1-3 Multiple-Choice Questions on Reported Balances [AICPA Adapted]**

1. **d** – $2,900,000. New APIC Balance = existing APIC on Poe's books + APIC from new stock issuance. (200,000*($18-$10) + $1,300,000 = $2,900,000)

2. **d** – $600,000. The total balance in the investment account is equal to the total consideration given in the combination. (10,000 *$60 per share = $600,000)

3. **c** – $150,000. Goodwill = Consideration given – FV of net assets acquired. FV of Net Assets: $80,000 + $190,000 + $560,000 - $180,000 = $650,000. (800,000 – 650,000 = 150,000)

4. **c** – $4,000,000. The increase in net assets is solely attributable to the FV of the consideration given, the nonvoting preferred stock.

   (a) *Incorrect*. This answer only reflects the book value of Master's net assets.
   (b) *Incorrect.* This answer only reflects the fair value of Master's net assets.
   (d) *Incorrect.* The additional stock related to the finder's fee is not capitalized, but rather expensed.

**E1-4 Multiple-Choice Questions Involving Account Balances**

1. **c** – When the parent creates the subsidiary, the equipment is transferred at cost with the accompanying accumulated depreciation (which in effect is the book value). ($100,000/10 = $10,000 per year * 4 = $40,000.)

   (a) *Incorrect*. When a subsidiary is created internally, the assets are transferred as they were on the parent's books (carrying value). Fair value is not considered.
   (b) *Incorrect.* This is the proper carrying value of the asset, but it should be recorded at cost with the accompanying accumulated depreciation.
   (d) *Incorrect.* When a subsidiary is created internally, the assets are transferred as they were on the parent's books (carrying value).

2. **c** – The assets are transferred at the carrying value on the parent's books, and thus no change in reported net assets occurs.

   (a) *Incorrect*. No change occurs.
   (b) *Incorrect.* No change occurs.
   (d) *Incorrect.* No change occurs.

3. **b** – APIC = $140,000 (BV) – 7,000 * $8 = $84,000.

4. **b** – $35,000. The implied valued of goodwill is $45,000 ($395,000 - $350,000). Because goodwill is not adjusted upward, the goodwill remains at the carrying value of $35,000

5. **b** – $30,000. The implied value of goodwill is $60,000 ($560,000 - $500,000). Because the implied goodwill is less than the recorded goodwill, an impairment of $30,000 results ($90,000 - $60,000).

## E1-5 Asset Transfer to Subsidiary

a. Journal entry recorded by Pale Company for transfer of assets to Bright Company:

| | | |
|---|---|---|
| Investment in Bright Company Common Stock | 408,000 | |
| Accumulated Depreciation – Buildings | 24,000 | |
| Accumulated Depreciation – Equipment | 36,000 | |
| Cash | | 21,000 |
| Inventory | | 37,000 |
| Land | | 80,000 |
| Buildings | | 240,000 |
| Equipment | | 90,000 |

b. Journal entry recorded by Bright Company for receipt of assets from Pale Company:

| | | |
|---|---|---|
| Cash | 21,000 | |
| Inventory | 37,000 | |
| Land | 80,000 | |
| Buildings | 240,000 | |
| Equipment | 90,000 | |
| Accumulated Depreciation – Buildings | | 24,000 |
| Accumulated Depreciation – Equipment | | 36,000 |
| Common Stock | | 60,000 |
| Additional Paid-In Capital | | 348,000 |

**E1-6 Creation of New Subsidiary**

a. Journal entry recorded by Lester Company for transfer of assets to Mumby Corporation:

| | | |
|---|---|---|
| Investment in Mumby Corporation Common Stock | 498,000 | |
| Allowance for Uncollectible Accounts Receivable | 7,000 | |
| Accumulated Depreciation – Buildings | 35,000 | |
| Accumulated Depreciation – Equipment | 60,000 | |
| Cash | | 40,000 |
| Accounts Receivable | | 75,000 |
| Inventory | | 50,000 |
| Land | | 35,000 |
| Buildings | | 160,000 |
| Equipment | | 240,000 |

b. Journal entry recorded by Mumby Corporation for receipt of assets from Lester Company:

| | | |
|---|---|---|
| Cash | 40,000 | |
| Accounts Receivable | 75,000 | |
| Inventory | 50,000 | |
| Land | 35,000 | |
| Buildings | 160,000 | |
| Equipment | 240,000 | |
| Allowance for Uncollectible Accounts Receivable | | 7,000 |
| Accumulated Depreciation – Buildings | | 35,000 |
| Accumulated Depreciation – Equipment | | 60,000 |
| Common Stock | | 120,000 |
| Additional Paid-In Capital | | 378,000 |

**E1-7 Balance Sheet Totals of Parent Company**

a. Journal entry recorded by Foster Corporation for transfer of assets and accounts payable to Kline Company:

| | | |
|---|---|---|
| Investment in Kline Company Common Stock | 66,000 | |
| Accumulated Depreciation | 28,000 | |
| Accounts Payable | 22,000 | |
| Cash | | 15,000 |
| Accounts Receivable | | 24,000 |
| Inventory | | 9,000 |
| Land | | 3,000 |
| Depreciable Assets | | 65,000 |

b. Journal entry recorded by Kline Company for receipt of assets and accounts payable from Foster Corporation:

| | | |
|---|---|---|
| Cash | 15,000 | |
| Accounts Receivable | 24,000 | |
| Inventory | 9,000 | |
| Land | 3,000 | |
| Depreciable Assets | 65,000 | |
| Accumulated Depreciation | | 28,000 |
| Accounts Payable | | 22,000 |
| Common Stock | | 48,000 |
| Additional Paid-In Capital | | 18,000 |

**E1-8 Acquisition of Net Assets**

Sun Corporation will record the following journal entries:

(1)

| | | |
|---|---|---|
| Assets | 71,000 | |
| Goodwill | 9,000 | |
| Liabilities | | 20,000 |
| Cash | | 60,000 |

(2)

| | | |
|---|---|---|
| Merger Expense | 4,000 | |
| Cash | | 4,000 |

**E1-9 Reporting Goodwill**

a. Goodwill: $120,000 = $310,000 - $190,000
Investment: $310,000

b. Goodwill: $6,000 = $196,000 - $190,000
Investment: $196,000

c. Goodwill: $0; no goodwill is recorded when the purchase price is below the fair value of the net identifiable assets.
Investment: $190,000; recorded at the fair value of the net identifiable assets.

**E1-10 Stock Acquisition**

Journal entry to record the purchase of Tippy Inc., shares:

| | | |
|---|---|---|
| Investment in Tippy Inc., Common Stock | 986,000 | |
| Common Stock | | 425,000 |
| Additional Paid-In Capital | | 561,000 |

$986,000 = $58 x 17,000 shares
$425,000 = $25 x 17,000 shares
$561,000 = ($58 - $25) x 17,000 shares

## E1-11 Balances Reported Following Combination

| | | |
|---|---|---|
| a. | Stock Outstanding: $200,000 + ($10 x 8,000 shares) | $280,000 |
| b. | Cash and Receivables: $150,000 + $40,000 | 190,000 |
| c. | Land: $100,000 + $85,000 | 185,000 |
| d. | Buildings and Equipment (net): $300,000 + $230,000 | 530,000 |
| e. | Goodwill: ($50 x 8,000) - $355,000 | 45,000 |
| f. | Additional Paid-In Capital: $20,000 + [($50 - $10) x 8,000] | 340,000 |
| g. | Retained Earnings | 330,000 |

## E1-12 Goodwill Recognition

Journal entry to record acquisition of Spur Corporation net assets:

| | | |
|---|---|---|
| Cash and Receivables | 40,000 | |
| Inventory | 150,000 | |
| Land | 30,000 | |
| Plant and Equipment | 350,000 | |
| Patent | 130,000 | |
| Goodwill | 55,000 | |
| Accounts Payable | | 85,000 |
| Cash | | 670,000 |

Computation of goodwill

| | | |
|---|---|---|
| Fair value of consideration given | | $670,000 |
| Fair value of assets acquired | $700,000 | |
| Fair value of liabilities assumed | (85,000) | |
| Fair value of net assets acquired | | 615,000 |
| Goodwill | | $ 55,000 |

**E1-13 Acquisition Using Debentures**

Journal entry to record acquisition of Sorden Company net assets:

| | | |
|---|---|---|
| Cash and Receivables | 50,000 | |
| Inventory | 200,000 | |
| Land | 100,000 | |
| Plant and Equipment | 300,000 | |
| Discount on Bonds Payable | 17,000 | |
| Goodwill | 8,000 | |
| Accounts Payable | | 50,000 |
| Bonds Payable | | 625,000 |

Computation of goodwill

| | | |
|---|---|---|
| Fair value of consideration given | | $608,000 |
| Fair value of assets acquired | $650,000 | |
| Fair value of liabilities assumed | (50,000) | |
| Fair value of net assets acquired | | 600,000 |
| Goodwill | | $ 8,000 |

**E1-14 Bargain Purchase**

Journal entry to record acquisition of Sorden Company net assets:

| | | |
|---|---|---|
| Cash and Receivables | 50,000 | |
| Inventory | 200,000 | |
| Land | 100,000 | |
| Plant and Equipment | 300,000 | |
| Discount on Bonds Payable | 16,000 | |
| Accounts Payable | | 50,000 |
| Bonds Payable | | 580,000 |
| Gain on Bargain Purchase of Subsidiary | | 36,000 |

Computation of Bargain Purchase Gain

| | | |
|---|---|---|
| Fair value of consideration given | | $564,000 |
| Fair value of assets acquired | $650,000 | |
| Fair value of liabilities assumed | (50,000) | |
| Fair value of net assets acquired | | 600,000 |
| Bargain Purchase Gain | | $ 36,000 |

**E1-15 Impairment of Goodwill**

a. Goodwill of $80,000 will be reported. The fair value of the reporting unit ($340,000) is greater than the carrying amount of the investment ($290,000) and the goodwill does not need to be tested for impairment. As a result, no loss will be recorded.

b. Goodwill of $35,000 will be reported (fair value of reporting unit of $280,000 - fair value of net assets of $245,000). An impairment loss of $45,000 ($80,000 - $35,000) will be recognized.

c. Goodwill of $15,000 will be reported (fair value of reporting unit of $260,000 - fair value of net assets of $245,000). An impairment loss of $65,000 ($80,000 - $15,000) will be recognized.

**E1-16 Assignment of Goodwill**

a. No impairment loss will be recognized. The fair value of the reporting unit ($530,000) is greater than the carrying value of the investment ($500,000) and goodwill does not need to be tested for impairment.

b. An impairment of goodwill of $15,000 will be recognized. The implied value of goodwill is $45,000 ($485,000 - $440,000), which represents a $15,000 decrease from the original $60,000.

c. An impairment of goodwill of $50,000 will be recognized. The implied value of goodwill is $10,000 ($450,000 - $440,000), which represents a $50,000 decrease from the original $60,000.

**E1-17 Goodwill Assigned to Reporting Units**

Goodwill of $158,000 ($60,000 + $48,000 + $0 + $50,000) should be reported, computed as follows:

Reporting Unit A: Goodwill of $60,000 should be reported. The implied value of goodwill is $90,000 ($690,000 - $600,000) and the carrying amount of goodwill is $60,000.

Reporting Unit B: Goodwill of $48,000 should be reported. The fair value of the reporting unit ($335,000) is greater than the carrying value of the investment ($330,000).

Reporting Unit C: No goodwill should be reported. The fair value of the net assets ($400,000) exceeds the fair value of the reporting unit ($370,000).

Reporting Unit D: Goodwill of $50,000 should be reported. The fair value of the reporting unit ($585,000) is greater than the carrying value of the investment ($520,000).

**E1-18 Goodwill Measurement**

a. Goodwill of $150,000 will be reported. The fair value of the reporting unit ($580,000) is greater than the carrying value of the investment ($550,000) and goodwill does not need to be tested for impairment. No loss will be recorded.

b. Goodwill of $50,000 will be reported. The implied value of goodwill is $50,000 (fair value of reporting unit of $540,000 - fair value of net assets of $490,000). Thus, an impairment of goodwill of $100,000 ($150,000 - $50,000) must be recognized.

c. Goodwill of $10,000 will be reported. The implied value of goodwill is $10,000 (fair value of reporting unit of $500,000 - fair value of net assets of $490,000). Thus, an impairment loss of $140,000 ($150,000 - $10,000) must be recognized.

d. No goodwill will be reported. The fair value of the net assets ($490,000) exceeds the fair value of the reporting unit ($460,000). Thus, the implied value of goodwill is $0 and an impairment loss of $150,000 ($150,000 - $0) must be recognized.

**E1-19 Computation of Fair Value**

| | | |
|---|---|---|
| Amount paid | | $517,000 |
| Book value of assets | $624,000 | |
| Book value of liabilities | (356,000) | |
| Book value of net assets | $268,000 | |
| Adjustment for research and development costs | (40,000) | |
| Adjusted book value | $228,000 | |
| Fair value of patent rights | 120,000 | |
| Goodwill recorded | 93,000 | (441,000) |
| Fair value increment of buildings and equipment | | $ 76,000 |
| Book value of buildings and equipment | | 341,000 |
| Fair value of buildings and equipment | | $417,000 |

## E1-20 Computation of Shares Issued and Goodwill

a. 15,600 shares were issued, computed as follows:

| | | |
|---|---|---|
| Par value of shares outstanding following merger | | $327,600 |
| Paid-in capital following merger | | 650,800 |
| Total par value and paid-in capital | | $978,400 |
| Par value of shares outstanding before merger | $218,400 | |
| Paid-in capital before merger | 370,000 | |
| | | (588,400) |
| Increase in par value and paid-in capital | | $390,000 |
| Divide by price per share | | ÷ $25 |
| Number of shares issued | | 15,600 |

b. The par value is $7, computed as follows:

| | |
|---|---|
| Increase in par value of shares outstanding ($327,600 - $218,400) | |
| Divide by number of shares issued | $109,200 |
| Par value | ÷ 15,600 |
| | $ 7.00 |

c. Goodwill of $34,000 was recorded, computed as follows:

| | |
|---|---|
| Increase in par value and paid-in capital | $390,000 |
| Fair value of net assets ($476,000 - $120,000) | (356,000) |
| Goodwill | $ 34,000 |

## E1-21 Combined Balance Sheet

Adam Corporation and Best Company
Combined Balance Sheet
January 1, 20X2

| | | | |
|---|---|---|---|
| Cash and Receivables | $ 240,000 | Accounts Payable | $ 125,000 |
| Inventory | 460,000 | Notes Payable | 235,000 |
| Buildings and Equipment | 840,000 | Common Stock | 244,000 |
| Less: Accumulated Depreciation | (250,000) | Additional Paid-In Capital | 556,000 |
| Goodwill | 75,000 | Retained Earnings | 205,000 |
| | $1,365,000 | | $1,365,000 |

Computation of goodwill

| | |
|---|---|
| Fair value of compensation given | $480,000 |
| Fair value of net identifiable assets ($490,000 - $85,000) | (405,000) |
| Goodwill | $ 75,000 |

Computation of APIC

| | |
|---|---|
| Fair value of compensation given | $480,000 |
| Plus APIC from Adam's books | $120,000 |
| Less par value of shares issued | (64,000) |
| Goodwill | $ 556,000 |

## E1-22 Recording a Business Combination

| | | |
|---|---|---|
| Merger Expense | 54,000 | |
| Deferred Stock Issue Costs | 29,000 | |
| Cash | | 83,000 |

| | | |
|---|---|---|
| Cash | 70,000 | |
| Accounts Receivable | 110,000 | |
| Inventory | 200,000 | |
| Land | 100,000 | |
| Buildings and Equipment | 350,000 | |
| Goodwill (1) | 30,000 | |
| Accounts Payable | | 195,000 |
| Bonds Payable | | 100,000 |
| Bond Premium | | 5,000 |
| Common Stock | | 320,000 |
| Additional Paid-In Capital (2) | | 211,000 |
| Deferred Stock Issue Costs | | 29,000 |

Computation of goodwill

| | | |
|---|---|---|
| Fair value of consideration given (40,000 x $14) | | $560,000 |
| Fair value of assets acquired | $830,000 | |
| Fair value of liabilities assumed | (300,000) | |
| Fair value of net assets acquired | | (530,000) |
| Goodwill | | $ 30,000 |

Computation of additional paid-in capital

| | |
|---|---|
| Number of shares issued | 40,000 |
| Issue price in excess of par value ($14 - $8) | x $6 |
| Total | $240,000 |
| Less: Deferred stock issue costs | (29,000) |
| Increase in additional paid-in capital | $211,000 |

## E1-23 Reporting Income

| | | | |
|---|---|---|---|
| 20X2: | Net income | = | $6,028,000 [$2,500,000 + $3,528,000] |
| | Earnings per share | = | $5.48 [$6,028,000 / (1,000,000 + 100,000*)] |
| 20X1: | Net income | = | $4,460,000 [previously reported] |
| | Earnings per share | = | $4.46 [$4,460,000 / 1,000,000] |

* 100,000 = 200,000 shares x ½ year

## SOLUTIONS TO PROBLEMS

### P1-24 Assets and Accounts Payable Transferred to Subsidiary

a. Journal entry recorded by Tab Corporation for its transfer of assets and accounts payable to Collon Company:

| | | |
|---|---|---|
| Investment in Collon Company Common Stock | 320,000 | |
| Accounts Payable | 45,000 | |
| Accumulated Depreciation – Buildings | 40,000 | |
| Accumulated Depreciation – Equipment | 10,000 | |
| Cash | | 25,000 |
| Inventory | | 70,000 |
| Land | | 60,000 |
| Buildings | | 170,000 |
| Equipment | | 90,000 |

b. Journal entry recorded by Collon Company for receipt of assets and accounts payable from Tab Corporation:

| | | |
|---|---|---|
| Cash | 25,000 | |
| Inventory | 70,000 | |
| Land | 60,000 | |
| Buildings | 170,000 | |
| Equipment | 90,000 | |
| Accounts Payable | | 45,000 |
| Accumulated Depreciation – Buildings | | 40,000 |
| Accumulated Depreciation – Equipment | | 10,000 |
| Common Stock | | 180,000 |
| Additional Paid-In Capital | | 140,000 |

**P1-25 Creation of New Subsidiary**

a. Journal entry recorded by Eagle Corporation for transfer of assets and accounts payable to Sand Corporation:

| | | |
|---|---|---|
| Investment in Sand Corporation Common Stock | 400,000 | |
| Allowance for Uncollectible Accounts Receivable | 5,000 | |
| Accumulated Depreciation | 40,000 | |
| Accounts Payable | 10,000 | |
| Cash | | 30,000 |
| Accounts Receivable | | 45,000 |
| Inventory | | 60,000 |
| Land | | 20,000 |
| Buildings and Equipment | | 300,000 |

b. Journal entry recorded by Sand Corporation for receipt of assets and accounts payable from Eagle Corporation:

| | | |
|---|---|---|
| Cash | 30,000 | |
| Accounts Receivable | 45,000 | |
| Inventory | 60,000 | |
| Land | 20,000 | |
| Buildings and Equipment | 300,000 | |
| Allowance for Uncollectible Accounts Receivable | | 5,000 |
| Accumulated Depreciation | | 40,000 |
| Accounts Payable | | 10,000 |
| Common Stock | | 50,000 |
| Additional Paid-In Capital | | 350,000 |

**P1-26 Incomplete Data on Creation of Subsidiary**

a. The book value of assets transferred was $152,000 ($3,000 + $16,000 + $27,000 + $9,000 + $70,000 + $60,000 - $21,000 - $12,000).

b. Thumb Company would report its investment in New Company equal to the book value of net assets transferred of $138,000 ($152,000 - $14,000).

c. 8,000 shares ($40,000/$5).

d. Total assets declined by $14,000 (book value of assets transferred of $152,000 - investment in New Company of $138,000).

e. No effect. The shares outstanding reported by Thumb Company are not affected by the creation of New Company.

**P1-27 Acquisition in Multiple Steps**

Deal Corporation will record the following entries:

(1)

| | | |
|---|---|---|
| Investment in Mead Company Stock | 85,000 | |
| Common Stock - $10 Par Value | | 40,000 |
| Additional Paid-In Capital | | 45,000 |

(2)

| | | |
|---|---|---|
| Merger Expense | 3,500 | |
| Additional Paid-In Capital | 2,000 | |
| Cash | | 5,500 |

(3)

| | | |
|---|---|---|
| Investment in Mead Company Stock | 6,000 | |
| Gain on Increase in Value of Mead Company Stock | | 6,000 |

Calculation of Gain:

| | | |
|---|---|---|
| Fair value on date of full acquisition: | | $100,000 |
| Fair value of consideration given: | ($85,000) | |
| Prior investment amount: | ($9,000) | |
| Gain on Increase in Value: | | $6,000 |

**P1-28 Journal Entries to Record a Business Combination**

Journal entries to record acquisition of TKK net assets:

(1)

| | | |
|---|---|---|
| Merger Expense | 14,000 | |
| Cash | | 14,000 |

Record payment of legal fees.

(2)

| | | |
|---|---|---|
| Deferred Stock Issue Costs | 28,000 | |
| Cash | | 28,000 |

Record costs of issuing stock.

(3)

| | | |
|---|---|---|
| Cash and Receivables | 28,000 | |
| Inventory | 122,000 | |
| Buildings and Equipment | 470,000 | |
| Goodwill | 12,000 | |
| Accounts Payable | | 41,000 |
| Notes Payable | | 63,000 |
| Common Stock | | 96,000 |
| Additional Paid-In Capital | | 404,000 |
| Deferred Stock Issue Costs | | 28,000 |

Record purchase of TKK Corporation.

Computation of goodwill

| | |
|---|---|
| Fair value of consideration given (24,000 x $22) | $528,000 |
| Fair value of net assets acquired ($620,000 - $104,000) | (516,000) |
| Goodwill | $ 12,000 |

Computation of additional paid-in capital

| | |
|---|---|
| Number of shares issued | 24,000 |
| Issue price in excess of par value ($22 - $4) | x $18 |
| Total | $432,000 |
| Less: Deferred stock issue costs | (28,000) |
| Increase in additional paid-in capital | $404,000 |

**P1-29 Recording Business Combinations**

| | | |
|---|---|---|
| Merger Expense | 38,000 | |
| Deferred Stock Issue Costs | 22,000 | |
| Cash | | 60,000 |

| | | |
|---|---|---|
| Cash and Equivalents | 41,000 | |
| Accounts Receivable | 73,000 | |
| Inventory | 144,000 | |
| Land | 200,000 | |
| Buildings | 1,500,000 | |
| Equipment | 300,000 | |
| Goodwill | 127,000 | |
| Accounts Payable | | 35,000 |
| Short-Term Notes Payable | | 50,000 |
| Bonds Payable | | 500,000 |
| Common Stock $2 Par | | 900,000 |
| Additional Paid-In Capital | | 878,000 |
| Deferred Stock Issue Costs | | 22,000 |

Computation of goodwill

| | |
|---|---|
| Fair value of consideration given (450,000 x $4) | $1,800,000 |
| Fair value of net assets acquired ($41,000 + $73,000 + $144,000 + $200,000 + $1,500,000 + $300,000 - $35,000 - $50,000 - $500,000) | (1,673,000) |
| Goodwill | $ 127,000 |

Computation of additional paid-in capital

| | |
|---|---|
| Number of shares issued | 450,000 |
| Issue price in excess of par value ($4 - $2) | x $2 |
| Total | $900,000 |
| Less: Deferred stock issue costs | (22,000) |
| Increase in additional paid-in capital | $878,000 |

**P1-30 Business Combination with Goodwill**

a. Journal entry to record acquisition of Zink Company net assets:

| | | |
|---|---|---|
| Cash | 20,000 | |
| Accounts Receivable | 35,000 | |
| Inventory | 50,000 | |
| Patents | 60,000 | |
| Buildings and Equipment | 150,000 | |
| Goodwill | 38,000 | |
| Accounts Payable | | 55,000 |
| Notes Payable | | 120,000 |
| Cash | | 178,000 |

b. Balance sheet immediately following acquisition:

Anchor Corporation and Zink Company
Combined Balance Sheet
February 1, 20X3

| | | | |
|---|---|---|---|
| Cash | $ 82,000 | Accounts Payable | $140,000 |
| Accounts Receivable | 175,000 | Notes Payable | 270,000 |
| Inventory | 220,000 | Common Stock | 200,000 |
| Patents | 140,000 | Additional Paid-In | |
| Buildings and Equipment | 530,000 | Capital | 160,000 |
| Less: Accumulated | | Retained Earnings | 225,000 |
| Depreciation | (190,000) | | |
| Goodwill | 38,000 | | |
| | $995,000 | | $995,000 |

c. Journal entry to record acquisition of Zink Company stock:

| | | |
|---|---|---|
| Investment in Zink Company Common Stock | 178,000 | |
| Cash | | 178,000 |

Computation of goodwill

| | |
|---|---|
| Fair value of consideration given | $178,000 |
| Fair value of net assets acquired ($20,000 + $35,000 + $50,000 + $60,000 + $150,000 - $55,000 -$120,000) | (140,000) |
| Goodwill | $ 38,000 |

**P1-31 Bargain Purchase**

Journal entries to record acquisition of Lark Corporation net assets:

| | | |
|---|---|---|
| Merger Expense | 5,000 | |
| Cash | | 5,000 |

| | | |
|---|---|---|
| Cash and Receivables | 50,000 | |
| Inventory | 150,000 | |
| Buildings and Equipment (net) | 300,000 | |
| Patent | 200,000 | |
| Accounts Payable | | 30,000 |
| Cash | | 625,000 |
| Gain on Bargain Purchase of Lark Corporation | | 45,000 |

Computation of gain

| | |
|---|---|
| Fair value of consideration given | $625,000 |
| Fair value of net assets acquired ($700,000 - $30,000) | (670,000) |
| Gain on bargain purchase | $ 45,000 |

**P1-32 Computation of Account Balances**

a. Liabilities reported by the Aspro Division at year-end:

| | | |
|---|---|---|
| Fair value of reporting unit at year-end | | $930,000 |
| Acquisition price of reporting unit ($7.60 x 100,000) | $760,000 | |
| Fair value of net assets at acquisition ($810,000 - $190,000) | (620,000) | |
| Goodwill at acquisition | $140,000 | |
| Impairment in current year | (30,000) | |
| Goodwill at year-end | | (110,000) |
| Fair value of net assets at year-end | | $820,000 |

| | |
|---|---|
| Fair value of assets at year-end | $950,000 |
| Fair value of net assets at year-end | (820,000) |
| Fair value of liabilities at year-end | $130,000 |

b. Required fair value of reporting unit:

| | |
|---|---|
| Fair value of assets at year-end | $ 950,000 |
| Fair value of liabilities at year-end (given) | (70,000) |
| Fair value of net assets at year-end | $ 880,000 |
| Original goodwill balance | 140,000 |
| Required fair value of reporting unit to avoid recognition of impairment of goodwill | $1,020,000 |

## P1-33 Goodwill Assigned to Multiple Reporting Units

a. Goodwill to be reported by Rover Company:

| | Reporting Unit | | |
|---|---|---|---|
| | A | B | C |
| Carrying value of goodwill | $70,000 | $80,000 | $40,000 |
| Implied goodwill at year-end | 90,000 | 50,000 | 75,000 |
| Goodwill to be reported at year-end | 70,000 | 50,000 | 40,000 |

| | |
|---|---|
| Total goodwill to be reported at year-end: | |
| Reporting unit A | $ 70,000 |
| Reporting unit B | 50,000 |
| Reporting unit C | 40,000 |
| Total goodwill to be reported | $160,000 |

| | | |
|---|---|---|
| Computation of implied goodwill | | |
| Reporting unit A | | |
| Fair value of reporting unit | | $400,000 |
| Fair value of identifiable assets | $350,000 | |
| Fair value of accounts payable | (40,000) | |
| Fair value of net assets | | (310,000) |
| Implied goodwill at year-end | | $ 90,000 |
| | | |
| Reporting unit B | | |
| Fair value of reporting unit | | $440,000 |
| Fair value of identifiable assets | $450,000 | |
| Fair value of accounts payable | (60,000) | |
| Fair value of net assets | | (390,000) |
| Implied goodwill at year-end | | $ 50,000 |
| | | |
| Reporting unit C | | |
| Fair value of reporting unit | | $265,000 |
| Fair value of identifiable assets | $200,000 | |
| Fair value of accounts payable | (10,000) | |
| Fair value of net assets | | (190,000) |
| Implied goodwill at year-end | | $ 75,000 |

b. Goodwill impairment of $30,000 ($80,000 - $50,000) must be reported in the current period for reporting unit B.

## P1-34 Journal Entries

Journal entries to record acquisition of Light Steel net assets:

(1)

| | | |
|---|---|---|
| Merger Expense | 19,000 | |
| Cash | | 19,000 |

Record finder's fee and transfer costs.

(2)

| | | |
|---|---|---|
| Deferred Stock Issue Costs | 9,000 | |
| Cash | | 9,000 |

Record audit fees and stock registration fees.

(3)

| | | |
|---|---|---|
| Cash | 60,000 | |
| Accounts Receivable | 100,000 | |
| Inventory | 115,000 | |
| Land | 70,000 | |
| Buildings and Equipment | 350,000 | |
| Bond Discount | 20,000 | |
| Goodwill | 95,000 | |
| Accounts Payable | | 10,000 |
| Bonds Payable | | 200,000 |
| Common Stock | | 120,000 |
| Additional Paid-In Capital | | 471,000 |
| Deferred Stock Issue Costs | | 9,000 |

Record merger with Light Steel Company.

Computation of goodwill

| | |
|---|---|
| Fair value of consideration given (12,000 x $50) | $600,000 |
| Fair value of net assets acquired ($695,000 - $10,000 - $180,000) | (505,000) |
| Goodwill | $ 95,000 |

Computation of additional paid-in capital

| | |
|---|---|
| Number of shares issued | 12,000 |
| Issue price in excess of par value ($50 - $10) | x $40 |
| Total | $480,000 |
| Less: Deferred stock issue costs | (9,000) |
| Increase in additional paid-in capital | $471,000 |

**P1-35 Purchase at More than Book Value**

a. Journal entry to record acquisition of Stafford Industries net assets:

| | | |
|---|---|---|
| Cash | 30,000 | |
| Accounts Receivable | 60,000 | |
| Inventory | 160,000 | |
| Land | 30,000 | |
| Buildings and Equipment | 350,000 | |
| Bond Discount | 5,000 | |
| Goodwill | 125,000 | |
| Accounts Payable | | 10,000 |
| Bonds Payable | | 150,000 |
| Common Stock | | 80,000 |
| Additional Paid-In Capital | | 520,000 |

b. Balance sheet immediately following acquisition:

Ramrod Manufacturing and Stafford Industries
Combined Balance Sheet
January 1, 20X2

| | | | | |
|---|---|---|---|---|
| Cash | $ 100,000 | Accounts Payable | | $ 60,000 |
| Accounts Receivable | 160,000 | Bonds Payable | $450,000 | |
| Inventory | 360,000 | Less: Discount | (5,000) | 445,000 |
| Land | 80,000 | Common Stock | | 280,000 |
| Buildings and Equipment | 950,000 | Additional | | |
| Less: Accumulated | | Paid-In Capital | | 560,000 |
| Depreciation | (250,000) | Retained Earnings | | 180,000 |
| Goodwill | 125,000 | | | |
| | $1,525,000 | | | $1,525,000 |

Computation of goodwill

| | |
|---|---|
| Fair value of consideration given (4,000 x $150) | $600,000 |
| Fair value of net assets acquired ($630,000 - $10,000 - $145,000) | (475,000) |
| Goodwill | $125,000 |

**P1-36 Business Combination**

Journal entry to record acquisition of Toot-Toot Tuba net assets:

| | | |
|---|---|---|
| Cash | 300 | |
| Accounts Receivable | 17,000 | |
| Inventory | 35,000 | |
| Plant and Equipment | 500,000 | |
| Other Assets | 25,800 | |
| Goodwill | 86,500 | |
| Allowance for Uncollectibles | | 1,400 |
| Accounts Payable | | 8,200 |
| Notes Payable | | 10,000 |
| Mortgage Payable | | 50,000 |
| Bonds Payable | | 100,000 |
| Capital Stock ($10 par) | | 90,000 |
| Premium on Capital Stock | | 405,000 |

Computation of fair value of net assets acquired

| | |
|---|---|
| Cash | $300 |
| Accounts Receivable | 17,000 |
| Allowance for Uncollectible Accounts | (1,400) |
| Inventory | 35,000 |
| Plant and Equipment | 500,000 |
| Other Assets | 25,800 |
| Accounts Payable | (8,200) |
| Notes Payable | (10,000) |
| Mortgage Payable | (50,000) |
| Bonds Payable | (100,000) |
| Fair value of net assets acquired | $408,500 |

Computation of goodwill

| | |
|---|---|
| Fair value of consideration given (9,000 x $55) | $495,000 |
| Fair value of net assets acquired | (408,500) |
| Goodwill | $86,500 |

## P1-37 Combined Balance Sheet

a. Balance sheet:

Bilge Pumpworks and Seaworthy Rope Company
Combined Balance Sheet
January 1, 20X3

| | | | |
|---|---|---|---|
| Cash and Receivables | $110,000 | Current Liabilities | $ 100,000 |
| Inventory | 142,000 | Capital Stock | 214,000 |
| Land | 115,000 | Capital in Excess | |
| Plant and Equipment | 540,000 | of Par Value | 216,000 |
| Less: Accumulated | | Retained Earnings | 240,000 |
| Depreciation | (150,000) | | |
| Goodwill | 13,000 | | |
| | $770,000 | | $ 770,000 |

Computation of goodwill

| | |
|---|---|
| Fair value of consideration given (700 x $300) | $210,000 |
| Fair value of net assets acquired ($217,000 – $20,000) | (197,000) |
| Goodwill | $13,000 |

b. (1) Stockholders' equity with 1,100 shares issued:

| | |
|---|---|
| Capital Stock [$200,000 + ($20 x 1,100 shares)] | $ 222,000 |
| Capital in Excess of Par Value [$20,000 + ($300 - $20) x 1,100 shares] | 328,000 |
| Retained Earnings | 240,000 |
| | $ 790,000 |

(2) Stockholders' equity with 1,800 shares issued:

| | |
|---|---|
| Capital Stock [$200,000 + ($20 x 1,800 shares)] | $ 236,000 |
| Capital in Excess of Par Value [$20,000 + ($300 - $20) x 1,800 shares] | 524,000 |
| Retained Earnings | 240,000 |
| | $1,000,000 |

(3) Stockholders' equity with 3,000 shares issued:

| | |
|---|---|
| Capital Stock [$200,000 + ($20 x 3,000 shares)] | $ 260,000 |
| Capital in Excess of Par Value [$20,000 + ($300 - $20) x 3,000 shares] | 860,000 |
| Retained Earnings | 240,000 |
| | $1,360,000 |

**P1-38 Incomplete Data Problem**

a. 5,200 = ($126,000 - $100,000)/$5

b. $208,000 = ($126,000 + $247,000) - ($100,000 + $65,000)

c. $46,000 = $96,000 - $50,000

d. $130,000 = ($50,000 + $88,000 + $96,000 + $430,000 - $46,000 - $220,000 - $6,000) - ($40,000 + $60,000 + $50,000 + $300,000 - $32,000 - $150,000 - $6,000)

e. $78,000 = $208,000 - $130,000

f. $97,000 (as reported by End Corporation)

g. $13,000 = ($430,000 - $300,000)/10 years

**P1-39 Incomplete Data Following Purchase**

a. 14,000 = $70,000/$5

b. $8.00 = ($70,000 + $42,000)/14,000

c. 7,000 = ($117,000 - $96,000)/$3

d. $24,000 = $65,000 + $15,000 - $56,000

e. $364,000 = ($117,000 + $553,000 + $24,000) – ($96,000 + $234,000)

f. $110,000 = $320,000 - $210,000

g. $306,000 = ($15,000 + $30,000 + $110,000 + $293,000) - ($22,000 + $120,000)

h. $58,000 = $364,000 - $306,000

**P1-40 Comprehensive Business Combination Problem**

a. Journal entries on the books of Bigtime Industries to record the combination:

| | | |
|---|---|---|
| Merger Expense | 135,000 | |
| Cash | | 135,000 |

| | | |
|---|---|---|
| Deferred Stock Issue Costs | 42,000 | |
| Cash | | 42,000 |

| | | |
|---|---|---|
| Cash | 28,000 | |
| Accounts Receivable | 251,500 | |
| Inventory | 395,000 | |
| Long-Term Investments | 175,000 | |
| Land | 100,000 | |
| Rolling Stock | 63,000 | |
| Plant and Equipment | 2,500,000 | |
| Patents | 500,000 | |
| Special Licenses | 100,000 | |
| Discount on Equipment Trust Notes | 5,000 | |
| Discount on Debentures | 50,000 | |
| Goodwill | 109,700 | |
| Current Payables | | 137,200 |
| Mortgages Payable | | 500,000 |
| Premium on Mortgages Payable | | 20,000 |
| Equipment Trust Notes | | 100,000 |
| Debentures Payable | | 1,000,000 |
| Common Stock | | 180,000 |
| Additional Paid-In Capital — Common | | 2,298,000 |
| Deferred Stock Issue Costs | | 42,000 |

Computation of goodwill

| | | |
|---|---|---|
| Value of stock issued ($14 x 180,000) | | $2,520,000 |
| Fair value of assets acquired | $4,112,500 | |
| Fair value of liabilities assumed | (1,702,200) | |
| Fair value of net identifiable assets | | (2,410,300) |
| Goodwill | | $ 109,700 |

**P1-40** (continued)

b. Journal entries on the books of HCC to record the combination:

| | | |
|---|---|---|
| Investment in Bigtime Industries Stock | 2,520,000 | |
| Allowance for Bad Debts | 6,500 | |
| Accumulated Depreciation | 614,000 | |
| Current Payables | 137,200 | |
| Mortgages Payable | 500,000 | |
| Equipment Trust Notes | 100,000 | |
| Debentures Payable | 1,000,000 | |
| Discount on Debentures Payable | | 40,000 |
| Cash | | 28,000 |
| Accounts Receivable | | 258,000 |
| Inventory | | 381,000 |
| Long-Term Investments | | 150,000 |
| Land | | 55,000 |
| Rolling Stock | | 130,000 |
| Plant and Equipment | | 2,425,000 |
| Patents | | 125,000 |
| Special Licenses | | 95,800 |
| Gain on Sale of Assets and Liabilities | | 1,189,900 |

Record sale of assets and liabilities.

| | | |
|---|---|---|
| Common Stock | 7,500 | |
| Additional Paid-In Capital — Common Stock | 4,500 | |
| Treasury Stock | | 12,000 |

Record retirement of Treasury Stock:*
$7,500 = $5 x 1,500 shares
$4,500 = $12,000 - $7,500

| | | |
|---|---|---|
| Common Stock | 592,500 | |
| Additional Paid-In Capital — Common | 495,500 | |
| Additional Paid-In Capital — Retirement of Preferred | 22,000 | |
| Retained Earnings | 1,410,000 | |
| Investment in Bigtime Industries Stock | | 2,520,000 |

Record retirement of HCC stock and distribution of Integrated Industries stock:
$592,500 = $600,000 - $7,500
$495,500 = $500,000 - $4,500
1,410,000 = $220,100 + $1,189,900

*Alternative approaches exist.