Chapter 02—Consolidated Statements: Date of Acquisition

Multiple Choice

1. An investor receives dividends from its investee and records those dividends as dividend income because:
   a. The investor has a controlling interest in its investee.
   b. The investor has a passive interest in its investee.
   c. The investor has an influential interest in its investee.
   d. The investor has an active interest in its investee.

ANSWER: b

RATIONALE: An investor having a passive interest in its investee (generally resulting from less than 20% ownership) records dividends as dividend income.

DIFFICULTY: E

LEARNING OBJECTIVES: ADAC.FISC.2-1

2. An investor prepares a single set of financial statements which encompasses the financial results for both it and its investee because:
   a. The investor has a controlling interest in its investee.
   b. The investor has a passive interest in its investee.
   c. The investor has an influential interest in its investee.
   d. The investor has an active interest in its investee.

ANSWER: a

RATIONALE: An investor having a controlling interest in its investee (generally resulting from more than 50% ownership) will prepare consolidated financial statements which encompass the financial results of both it and its investee.

DIFFICULTY: E

LEARNING OBJECTIVES: ADAC.FISC.2-1

3. An investor records its share of its investee's income as a separate source of income because:
   a. The investor has a controlling interest in its investee.
   b. The investor has a passive interest in its investee.
   c. The investor has an influential interest in its investee.
   d. The investor has an active interest in its investee.

ANSWER: c

RATIONALE: An investor having an influential interest in its investee (generally resulting from 20% - 50% ownership) records its share of its investee's net income as a separate source of income. This amount also increases the investor's investment in the investee.

DIFFICULTY: E

LEARNING OBJECTIVES: ADAC.FISC.2-1

4.

Account	Investor	Investee
Sales	$500,000	$300,000
Cost of Goods Sold	230,000	170,000
Gross Profit	$270,000	$130,000
Selling & Admin. Expenses	120,000	100,000
Net Income	$150,000	$ 30,000
Dividends paid	50,000	10,000

Assuming Investor owns 70% of Investee. What is the amount that will be recorded as Net Income for the Controlling Interest?

a. $164,000
b. $171,000
c. $178,000
d. $180,000

ANSWER: b

RATIONALE:

Investor net income		$150,000
Investor's portion of Investee income	($30,000 x 70%)	21,000
		$171,000

DIFFICULTY: D

LEARNING OBJECTIVES: ADAC.FISC.2-1

5. Consolidated financial statements are designed to provide:

a. informative information to all shareholders.
b. the results of operations, cash flow, and the balance sheet in an understandable and informative manner for creditors.
c. the results of operations, cash flow, and the balance sheet as if the parent and subsidiary were a single entity.
d. subsidiary information for the subsidiary shareholders.

ANSWER: c

RATIONALE: Consolidated financial statements are designed to provide the results of operations, cash flow and the balance sheet as if the parent and subsidiary were a single entity. Generally, these are more informative for shareholders of the controlling company.

DIFFICULTY: E

LEARNING OBJECTIVES: ADAC.FISC.2-2

6. Which of the following statements about consolidation is **not** true?

a. Consolidation is not required when control is temporary.
b. Consolidation may be appropriate in some circumstances when an investor owns less than 51% of the voting common stock.
c. Consolidation is not required when a subsidiary's operations are not homogeneous with those of its parent.
d. Unprofitable subsidiaries may not be obvious when combined with other entities in consolidation.

ANSWER: c

RATIONALE: Generally, statements are to be consolidated when a parent firm owns over 50% of the voting stock of another company. The only exceptions are when control is temporary or does not rest with the majority owner. There may be instances when a parent firm effectively has control with less than 51% of the voting stock because no other ownership interest exercises significant influence on management. Because many entities may be combined in a consolidation, unprofitable subsidiaries may not be obvious when combined with profitable entities.

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-2

7. Consolidated financial statements are appropriate even without a majority ownership if which of the following exists:

a. the subsidiary has the right to appoint members of the parent company's board of directors.
b. the parent company has the right to appoint a majority of the members of the subsidiary's board of directors because other ownership interests are widely dispersed.

c. the subsidiary owns a large minority voting interest in the parent company.

d. the parent company has an ability to assume the role of general partner in a limited partnership with the approval of the subsidiary's board of directors.

ANSWER: b

RATIONALE: SEC Regulation S-X defines control in terms of power to direct or cause the direction of management and policies of a person, whether through ownership of voting securities, by contract, or otherwise. Thus, control may exist when less than a 51% ownership interest exists but where there is no other large ownership interest that can exert influence on management.

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-2

8. Consolidation might **not** be appropriate even when the majority owner has control if:

a. The subsidiary is in bankruptcy.

b. A manufacturing-based parent has a subsidiary involved in banking activities.

c. The subsidiary is located in a foreign country.

d. The subsidiary has a different fiscal-year end than the parent.

ANSWER: a

RATIONALE: Control is presumed not to rest with the majority owner when the subsidiary is in bankruptcy, in legal reorganization, or when foreign exchange restrictions or foreign government controls cast doubt on the ability of the parent to exercise control over the subsidiary.

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-2

9. Which of the following is true of the consolidation process?

a. Even though the initial accounting for asset acquisitions and 100% stock acquisitions differs, the consolidation process should result in the same balance sheet.

b. Account balances are combined when recording a stock acquisition so the consolidation is automatic.

c. The assets of the non-controlling interest will be predominately displayed on the consolidated balance sheet.

d. The investment in subsidiary account will be displayed on the consolidated balance sheet.

ANSWER: a

RATIONALE: The consolidation process will result in the same balance sheet regardless of whether the acquisition was a stock or asset acquisition. The consolidation process is automatic when an asset acquisition has taken place. The assets of the non-controlling interest are not displayed on the balance sheet, but its share of the equity is included in the equity section of the balance sheet. The consolidation process results in the elimination of the investment in subsidiary account.

DIFFICULTY: E

LEARNING OBJECTIVES: ADAC.FISC.2-3

10. In an asset acquisition:

a. A consolidation must be prepared whenever financial statements are issued.

b. The acquiring company deals only with existing shareholders, not the company itself.

c. The assets and liabilities are recorded by the acquiring company at their book values.

d. Statements for the single combined entity are produced automatically and no consolidation process is needed.

ANSWER: d

RATIONALE: Since account balances are combined in recording an asset acquisition, statements for the single combined reporting entity are produced automatically.

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-3

11. Which of the following is **not** true of the consolidation process for a stock acquisition?

a. Journal entries for the elimination process are made to the parent's or subsidiary's books.
b. The investment account balance on the parent's books will be eliminated.
c. The balance sheets of two companies are combined into a single balance sheet.
d. The shareholder equity accounts of the subsidiary are eliminated.

ANSWER: a

RATIONALE: The consolidation process is separate from the existing accounting records of the companies and requires completion of a worksheet; no entries are made to the parent's or the subsidiary's books.

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-3

12. A subsidiary was acquired for cash in a business combination on December 31, 2016. The purchase price exceeded the fair value of identifiable net assets. The acquired company owned equipment with a fair value in excess of the book value as of the date of the combination. A consolidated balance sheet prepared on December 31, 2016, would

a. report the excess of the fair value over the book value of the equipment as part of goodwill.
b. report the excess of the fair value over the book value of the equipment as part of the plant and equipment account.
c. reduce retained earnings for the excess of the fair value of the equipment over its book value.
d. make no adjustment for the excess of the fair value of the equipment over book value. Instead, it is an adjustment to expense over the life of the equipment.

ANSWER: b

RATIONALE: The consolidated balance sheet includes the subsidiary accounts at full fair value.

DIFFICULTY: D

LEARNING OBJECTIVES: ADAC.FISC.2-4

13. Parr Company purchased 100% of the voting common stock of Super Company for $2,000,000. There are no liabilities. The following book and fair values pertaining to Super Company are available:

	Book Value	Fair Value
Current assets	$300,000	$600,000
Land and building	600,000	900,000
Machinery	500,000	600,000
Goodwill	100,000	?

The amount of machinery that will be included in on the consolidated balance sheet is:

a. $560,000
b. $860,000
c. $600,000
d. $900,000

ANSWER: c

RATIONALE: The consolidated balance sheet includes the subsidiary accounts at full fair value.

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-4

14. Pagach Company purchased 100% of the voting common stock of Rage Company for $1,800,000. The following book and fair values are available:

	Book Value	Fair Value
Current assets	$150,000	$300,000
Land and building	280,000	280,000
Machinery	400,000	700,000
Bonds payable	(300,000)	(250,000)
Goodwill	150,000	?

The bonds payable will appear on the consolidated balance sheet

a. at $300,000 (with no premium or discount shown).
b. at $300,000 less a discount of $50,000.
c. at $0; assets are recorded net of liabilities.
d. at an amount less than $250,000 since it is a bargain purchase.

ANSWER: b
RATIONALE: The consolidated balance sheet includes the subsidiary accounts at full fair value.
DIFFICULTY: D
LEARNING OBJECTIVES: ADAC.FISC.2-4

15. Which of the following is **not** an advantage of the parent issuing shares of stock in exchange for the subsidiary common shares being acquired?

a. It is not necessary to determine the fair values of the subsidiary's net assets.
b. It may allow the subsidiary's shareholders to have a tax free exchange.
c. It avoids the depletion of cash.
d. If the parent is publicly held, the share price is readily determinable.

ANSWER: a
RATIONALE: The fair values of the subsidiary's net assets would need to be determined in any acquisition.
DIFFICULTY: E
LEARNING OBJECTIVES: ADAC.FISC.2-5

16. When it purchased Sutton, Inc. on January 1, 2016, Pavin Corporation issued 500,000 shares of its $5 par voting common stock. On that date the fair value of those shares totaled $4,200,000. Related to the acquisition, Pavin had payments to the attorneys and accountants of $200,000, and stock issuance fees of $100,000. Immediately prior to the purchase, the equity sections of the two firms appeared as follows:

	Pavin	Sutton
Common stock	$ 4,000,000	$ 700,000
Paid-in capital in excess of par	7,500,000	900,000
Retained earnings	5,500,000	500,000
Total	$17,000,000	$2,100,000

Immediately after the purchase, the consolidated balance sheet should report paid-in capital in excess of par of

a. $8,900,000
b. $9,100,000
c. $9,200,000
d. $9,300,000

ANSWER: b

RATIONALE:

Fair value of shares issued	$ 4,200,000
Par value of shares issued (500,000 shares @ $5)	(2,500,000)
	1,700,000
Less stock issuance fees	(100,000)
	1,600,000
Pavin's original paid-in capital in excess of par	7,500,000
Paid-in capital in excess of par per consolidated balance sheet	$9,100,000

Sutton's paid-in capital in excess of par would be eliminated in consolidation.

DIFFICULTY: D

LEARNING OBJECTIVES: ADAC.FISC.2-5

17. Pinehollow acquired all of the outstanding stock of Stonebriar by issuing 100,000 shares of its $1 par value stock. The shares have a fair value of $15 per share. Pinehollow also paid $25,000 in direct acquisition costs. Prior to the transaction, the companies have the following balance sheets:

Assets	Pinehollow	Stonebriar
Cash	$ 150,000	$ 50,000
Accounts receivable	500,000	350,000
Inventory	900,000	600,000
Property, plant, and equipment (net)	1,850,000	900,000
Total assets	$3,400,000	$1,900,000
Liabilities and Stockholders' Equity		
Current liabilities	$ 300,000	$ 100,000
Bonds payable	1,000,000	600,000
Common stock ($1 par)	300,000	100,000
Paid-in capital in excess of par	800,000	900,000
Retained earnings	1,000,000	200,000
Total liabilities and equity	$3,400,000	$1,900,000

The fair values of Stonebriar's inventory and plant, property and equipment are $700,000 and $1,000,000, respectively. The journal entry to record the purchase of Stonebriar would include a

a. credit to common stock for $1,500,000.
b. credit to paid-in capital in excess of par for $1,100,000.
c. debit to investment for $1,500,000.
d. debit to investment for $1,525,000.

ANSWER: c

RATIONALE: The entries to record the acquisition of Stonebriar and issuance of stock would be:

Investment in Stonebriar	$1,500,000	
Common Stock (100,000 shares @ $1)		$ 100,000
Paid-in Capital in Excess of Par		1,400,000
Paid-in Capital in Excess of Par	25,000	
Cash		25,000

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-5

18. When it purchased Sutton, Inc. on January 1, 2016, Pavin Corporation issued 500,000 shares of its $5 par voting

common stock. On that date the fair value of those shares totaled $4,200,000. Related to the acquisition, Pavin had payments to the attorneys and accountants of $200,000, and stock issuance fees of $100,000. Immediately prior to the purchase, the equity sections of the two firms appeared as follows:

	Pavin	Sutton
Common stock	$ 4,000,000	$ 700,000
Paid-in capital in excess of par	7,500,000	900,000
Retained earnings	5,500,000	500,000
Total	$17,000,000	$2,100,000

Immediately after the purchase, the consolidated balance sheet should report retained earnings of:

a. $6,000,000

b. $5,800,000

c. $5,500,000

d. $5,300,000

ANSWER: d

RATIONALE:

Pavin's retained earnings	$5,500,000
Less payments to attorneys and accountants	(200,000)
Retained earnings per consolidated balance sheet	$5,300,000

Sutton's retained earnings would be eliminated in consolidation. The payments to attorneys and accountants would be charged to acquisition expense, which would be closed to retained earnings.

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-5

19. Pinehollow acquired all of the outstanding stock of Stonebriar by issuing 100,000 shares of its $1 par value stock. The shares have a fair value of $15 per share. Pinehollow also paid $25,000 in direct acquisition costs. Prior to the transaction, the companies have the following balance sheets:

Assets	Pinehollow	Stonebriar
Cash	$ 150,000	$ 50,000
Accounts receivable	500,000	350,000
Inventory	900,000	600,000
Property, plant, and equipment (net)	1,850,000	900,000
Total assets	$3,400,000	$1,900,000
Liabilities and Stockholders' Equity		
Current liabilities	$ 300,000	$ 100,000
Bonds payable	1,000,000	600,000
Common stock ($1 par)	300,000	100,000
Paid-in capital in excess of par	800,000	900,000
Retained earnings	1,000,000	200,000
Total liabilities and equity	$3,400,000	$1,900,000

The fair values of Stonebriar's inventory and plant, property and equipment are $700,000 and $1,000,000, respectively. What is the amount of goodwill that will be included in the consolidated balance sheet immediately following the acquisition?

a. $100,000

b. $125,000

c. $300,000

d. $325,000

ANSWER: a

RATIONALE:

Fair value of subsidiary (100,000 shares @ $15)	$1,500,000
Less book value of interest acquired:	
Common stock ($1 par)	100,000
Paid-in capital in excess of par	900,000
Retained earnings	200,000
Total equity	1,200,000
Excess of fair value over book value	$ 300,000
Adjustment of identifiable accounts:	
Inventory ($700,000 fair - $600,000 book value)	$ 100,000
Property, plant and equipment ($1,000,000 fair - $900,000 net book value)	100,000
Goodwill	100,000
Total	$ 300,000

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-6

20. On April 1, 2016, Paape Company paid $950,000 for all the issued and outstanding stock of Simon Corporation. The recorded assets and liabilities of the Simon Corporation on April 1, 2016, follow:

Cash	$ 80,000
Inventory	240,000
Property and equipment (net of accumulated depreciation of $320,000)	480,000
Liabilities	(180,000)

On April 1, 2016, it was determined that the inventory of Simon had a fair value of $190,000, and the property and equipment (net) had a fair value of $560,000. What is the amount of goodwill resulting from the business combination?

a. $0

b. $120,000

c. $300,000

d. $230,000

ANSWER: c

RATIONALE:

Fair value of subsidiary	$950,000
Less book value of interest acquired:	
Cash	80,000
Inventory	240,000
Property, plant and equipment, net	480,000
Liabilities	(180,000)
Total net assets	620,000
Excess of fair value over book value	$330,000
Adjustment of identifiable accounts:	
Inventory ($190,000 fair - $240,000 book value)	$ (50,000)
Property, plant and equipment ($560,000 fair - $480,000 net book value)	80,000
Goodwill	300,000
Total	$330,000

DIFFICULTY: D

Chapter 02—Consolidated Statements: Date of Acquisition

LEARNING OBJECTIVES: ADAC.FISC.2-6

21. On April 1, 2016, Paape Company paid $950,000 for all the issued and outstanding stock of Simon Corporation. The recorded assets and liabilities of the Simon Corporation on April 1, 2016, follow:

Cash	$ 80,000
Inventory	240,000
Property and equipment (net of accumulated depreciation of $320,000)	480,000
Liabilities	(180,000)

On April 1, 2016, it was determined that the inventory of Simon had a fair value of $190,000, and the property and equipment (net) had a fair value of $560,000. The entry to distribute the excess of fair value over book value will include:

a. A debit to inventory of $50,000

b. A credit to the investment in Simon Corporation of $620,000

c. A debit to goodwill of $330,000

d. A credit to the investment in Simon Corporation of $330,000

ANSWER: c

RATIONALE:

Fair value of subsidiary	$950,000
Less book value of interest acquired:	
Cash	80,000
Inventory	240,000
Property, plant and equipment, net	480,000
Liabilities	(180,000)
Total net assets	620,000
Excess of fair value over book value	$330,000
Adjustment of identifiable accounts:	
Inventory ($190,000 fair - $240,000 book value)	$ (50,000)
Property, plant and equipment ($560,000 fair - $480,000 net book value)	80,000
Goodwill	300,000
Total	$330,000

The entry to distribute the excess of fair value over book value will be:

Property, Plant and Equipment	80,000	
Goodwill	300,000	
Inventory		50,000
Investment in Simon Corporation		330,000

DIFFICULTY: D

LEARNING OBJECTIVES: ADAC.FISC.2-6

22. On June 30, 2016, Naeder Corporation purchased for cash at $10 per share all 100,000 shares of the outstanding common stock of the Tedd Company. The total fair value of all identifiable net assets of Tedd was $1,400,000. The only noncurrent asset is property with a fair value of $350,000. The consolidated balance sheet of Naeder and its wholly owned subsidiary on June 30, 2016, should report

a. a retained earnings balance that is inclusive of a gain of $400,000.

b. goodwill of $400,000.

c. a retained earnings balance that is inclusive of a gain of $350,000.

d. a gain of $400,000

ANSWER: a

RATIONALE:	Fair value of consideration (100,000 shares @ $10)	$1,000,000
	Less fair value of identifiable net assets acquired	1,400,000
	Gain on acquisition	$ (400,000)

DIFFICULTY: M
LEARNING OBJECTIVES: ADAC.FISC.2-6

23. Pinehollow acquired 80% of the outstanding stock of Stonebriar by issuing 80,000 shares of its $1 par value stock. The shares have a fair value of $15 per share. Pinehollow also paid $25,000 in direct acquisition costs. Prior to the transaction, the companies have the following balance sheets:

Assets	Pinehollow	Stonebriar
Cash	$ 150,000	$ 50,000
Accounts receivable	500,000	350,000
Inventory	900,000	600,000
Property, plant, and equipment (net)	1,850,000	900,000
Total assets	$3,400,000	$1,900,000
Liabilities and Stockholders' Equity		
Current liabilities	$ 300,000	$ 100,000
Bonds payable	1,000,000	600,000
Common stock ($1 par)	300,000	100,000
Paid-in capital in excess of par	800,000	900,000
Retained earnings	1,000,000	200,000
Total liabilities and equity	$3,400,000	$1,900,000

The fair values of Stonebriar's inventory and plant, property and equipment are $700,000 and $1,000,000, respectively. What is the amount of goodwill that will be included in the consolidated balance sheet immediately following the acquisition?

a. $300,000
b. $100,000
c. $200,000
d. $240,000

ANSWER: b

RATIONALE:

	Company Implied Fair Value	Parent Price	NCI
Fair value of subsidiary *	$1,500,000	$1,200,000	$ 300,000
Less book value of interest acquired:			
Common stock ($1 par)	100,000		
Paid-in capital in excess of par	900,000		
Retained earnings	200,000		
Total equity	1,200,000	1,200,000	1,200,000
Interest acquired		80%	20%
Book value		960,000	240,000
Excess of fair value over book value	$ 300,000	$ 240,000	$ 60,000
Adjustment of identifiable accounts:			
Inventory ($700,000 fair - $600,000 book value)	$ 100,000		
Property, plant and equipment ($1,000,000 fair - $900,000			

net book value)	100,000
Goodwill	100,000
Total	$ 300,000

* Fair value derived as follows:

Fair value of consideration given (80,000 shares @ $15)	$1,200,000
Implied fair value of subsidiary ($1,200,000 / 80%)	$1,500,000
Fair value of NCI ($1,500,000 x 20%)	$ 300,000

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-7

24. Paro Company purchased 80% of the voting common stock of Sabon Company for $900,000. There are no liabilities. The following book and fair values are available for Sabon:

	Book Value	Fair Value
Current assets	$100,000	$200,000
Land and building	200,000	200,000
Machinery	300,000	600,000
Goodwill	100,000	?

The machinery will appear on the consolidated balance sheet at ____.

a. $600,000

b. $540,000

c. $480,000

d. $300,000

ANSWER: a

RATIONALE: The consolidated balance sheet includes the subsidiary accounts at full fair value, even if less than 100% of the subsidiary's common stock is acquired.

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-7

25. Pinehollow acquired 70% of the outstanding stock of Stonebriar by issuing 70,000 shares of its $1 par value stock. The shares have a fair value of $15 per share. Pinehollow also paid $25,000 in direct acquisition costs. Prior to the transaction, the companies have the following balance sheets:

Assets	Pinehollow	Stonebriar
Cash	$ 150,000	$ 50,000
Accounts receivable	500,000	350,000
Inventory	900,000	600,000
Property, plant, and equipment (net)	1,850,000	900,000
Total assets	$3,400,000	$1,900,000
Liabilities and Stockholders' Equity		
Current liabilities	$ 300,000	$ 100,000
Bonds payable	1,000,000	600,000
Common stock ($1 par)	300,000	100,000
Paid-in capital in excess of par	800,000	900,000
Retained earnings	1,000,000	200,000
Total liabilities and equity	$3,400,000	$1,900,000

The fair values of Stonebriar's inventory and plant, property and equipment are $700,000 and $1,000,000, respectively. What is the amount of the non-controlling interest that will be included in the consolidated balance sheet immediately after the acquisition?

a. $450,000
b. $360,000
c. $315,000
d. $420,000

ANSWER: a

RATIONALE:

	Company Implied Fair Value	Parent Price	NCI
Fair value of subsidiary *	$1,500,000	$1,050,000	$ 450,000
Less book value of interest acquired:			
Common stock ($1 par)	100,000		
Paid-in capital in excess of par	900,000		
Retained earnings	200,000		
Total equity	1,200,000	1,200,000	1,200,000
Interest acquired		70%	30%
Book value		840,000	360,000
Excess of fair value over book value	$300,000	$ 210,000	$ 90,000
Adjustment of identifiable accounts:			
Inventory ($700,000 fair - $600,000 book value)	$ 100,000		
Property, plant and equipment ($1,000,000 fair - $900,000 net book value)	100,000		
Goodwill	100,000		
Total	$ 300,000		

* Fair value derived as follows:

Fair value of consideration given (70,000 shares @ $15)	$1,050,000
Implied fair value of subsidiary ($1,050,000 / 70%)	$1,500,000
Fair value of NCI ($1,500,000 x 30%)	$ 450,000

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-7

26. How is the non-controlling interest treated in the consolidated balance sheet?
a. It is included in long-term liabilities.
b. It appears between the liability and equity sections of the balance sheet.
c. It is included in total as a component of shareholders’ equity.
d. It is included in shareholders’ equity and broken down into par, paid-in capital in excess of par and retained earnings.

ANSWER: c

RATIONALE: The non-controlling interest is shown on the consolidated balance sheet in total as a component of shareholders’ equity.

DIFFICULTY: E

LEARNING OBJECTIVES: ADAC.FISC.2-7

27. Pinehollow acquired all of the outstanding stock of Stonebriar by issuing 100,000 shares of its $1 par value stock. The shares have a fair value of $15 per share. Pinehollow also paid $25,000 in direct acquisition costs. Prior to the transaction, the companies have the following balance sheets:

Assets	Pinehollow	Stonebriar
Cash	$ 150,000	$ 50,000
Accounts receivable	500,000	350,000
Inventory	900,000	600,000
Property, plant, and equipment (net)	1,850,000	900,000
Total assets	$3,400,000	$1,900,000
Liabilities and Stockholders' Equity		
Current liabilities	$ 300,000	$ 100,000
Bonds payable	1,000,000	600,000
Common stock ($1 par)	300,000	100,000
Paid-in capital in excess of par	800,000	900,000
Retained earnings	1,000,000	200,000
Total liabilities and equity	$3,400,000	$1,900,000

The fair values of Stonebriar's inventory and plant, property and equipment are $700,000 and $1,000,000, respectively. What is the amount of property, plant and equipment that will be included in the consolidated balance sheet immediately after the acquisition?

a. $2,570,000

b. $2,750,000

c. $2,850,000

d. $2,650,000

ANSWER: c

RATIONALE:

Property, plant and equipment:	
Pinehollow (at net book value)	$1,850,000
Stonebriar (at full fair value)	1,000,000
Per consolidated balance sheet	$2,850,000

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-7

28. Pesto Company paid $10 per share to acquire 80% of Sauce Company's 100,000 outstanding shares; however the market price of the remaining shares was $8.50. The fair value of Sauce's net assets at the time of the acquisition was $850,000. In this case, where Pesto paid a premium to achieve control:

a. The total value assigned to the NCI at the date of the acquisition may be less than the NCI percentage of the fair value of the net assets.

b. Goodwill is assigned 80% to Pesto and 20% to the NCI.

c. The NCI share of goodwill would be reduced to zero.

d. Pesto would recognize a gain on the acquisition.

ANSWER: c

RATIONALE:

	Company Implied Fair Value	Parent Price	NCI Value
Company fair value *	$970,000	$800,000	$170,000
Fair value of net assets	850,000	680,000	170,000

Goodwill	$120,000	$120,000	$ 0

* Fair value of parent price is 80,000 shares x $10 per share. This would ordinarily imply a company subsidiary fair value of $1,000,000 ($800,000 / 80%). However, the shares attributable to the NCI have a value of $170,000 (20,000 shares x $8.50).

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-7

29. Pesto Company paid $8 per share to acquire 80% of Sauce Company's 100,000 outstanding shares. The fair value of Sauce's net assets at the time of the acquisition was $850,000. In this case:

a. The total value assigned to the NCI at the date of the acquisition may be less than the NCI percentage of the fair value of the net assets.

b. Goodwill will be recognized by Pesto.

c. Pesto and the NCI would both recognize a gain on the acquisition.

d. Pesto only would recognize a gain on the acquisition.

ANSWER: d

RATIONALE:

	Company Implied Fair Value	Parent Price	NCI Value
Company fair value *	$810,000	$640,000	$170,000
Fair value of net assets	850,000	680,000	170,000
Gain on acquisition	$(40,000)	$(40,000)	$ 0

* Fair value of parent price is 80,000 shares x $8 per share. This would ordinarily imply a company subsidiary fair value of $800,000 ($640,000 / 80%). However, the net assets attributable to the NCI have a fair value of $170,000, and the NCI value cannot be less than this amount.

DIFFICULTY: D

LEARNING OBJECTIVES: ADAC.FISC.2-7

30. When a company purchases another company that has existing goodwill and the transaction is accounted for as a stock acquisition, the goodwill should be treated in the following manner:

a. The goodwill on the books of an acquired company should be written off.

b. Goodwill is recorded prior to recording fixed assets.

c. The fair value of the goodwill is ignored in the calculation of goodwill of the new acquisition.

d. Goodwill is treated in a manner consistent with tangible assets.

ANSWER: c

RATIONALE: If a subsidiary is purchased and it has goodwill on its books, that goodwill is ignored in the value analysis.

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-8

31. The SEC requires the use of push-down accounting in some specific situations. Push-down accounting results in:

a. goodwill be recorded in the parent company separate accounts.

b. eliminating subsidiary retained earnings and paid-in capital in excess of par.

c. reflecting fair values on the subsidiary's separate accounts.

d. changing the consolidation worksheet procedure because no adjustment is necessary to eliminate the investment in subsidiary account.

ANSWER:	c
RATIONALE:	Push down accounting involves adjusting the subsidiary's accounts to reflect the fair value adjustments.
DIFFICULTY:	M
LEARNING OBJECTIVES:	ADAC.FISC.2-9

Subjective Short Answer

32. Supernova Company had the following summarized balance sheet on December 31 of the current year:

Assets	
Accounts receivable	$ 350,000
Inventory	450,000
Property and plant (net)	600,000
Total	$1,400,000

Liabilities and Equity	
Notes payable	$ 600,000
Common stock, $5 par	300,000
Paid-in capital in excess of par	400,000
Retained earnings	100,000
Total	$1,400,000

The fair value of the inventory and property and plant is $600,000 and $850,000, respectively.

Assume that Redstar Corporation exchanges 75,000 of its $3 par value shares of common stock, when the fair price is $20 per share, for 100% of the common stock of Supernova Company. Redstar incurred acquisition costs of $5,000 and stock issuance costs of $5,000.

Required:

a. What journal entries will Redstar Corporation record for the investment in Supernova and issuance of stock?

b. Prepare a supporting value analysis and determination and distribution of excess schedule

c. Prepare Redstar's elimination and adjustment entry for the acquisition of Supernova.

ANSWER:

a.

Investment in Supernova (75,000 × $20)	1,500,000	
Common Stock (75,000 x $3)		225,000
Paid-in Capital in Excess of Par		1,275,000
Acquisition Expense	5,000	
Paid-in Capital in Excess of Par	5,000	
Cash		10,000

b)

Value Analysis

	Company Implied Fair Value	Parent Price (100%)	NCI Value (0%)
Company fair value	$1,500,000	$1,500,000	N/A
Fair value identifiable net assets *	1,200,000	1,200,000	
Goodwill	$ 300,000	$ 300,000	

Determination & Distribution Schedule

	Company Implied Fair Value	(100%) Parent Price	0% NCI Value
Fair value of subsidiary	$1,500,000	$1,500,000	
Less book value:			
Common stock	$ 300,000		
Paid-in capital in excess of par	400,000		
Retained earnings	100,000		
Total equity	$ 800,000	$ 800,000	
Interest Acquired		100%	
Book value		$ 800,000	
Excess of FV over BV	$ 700,000	$ 700,000	

Adjustment of identifiable accounts:

	Adjustment
Inventory ($600,000 - $450,000)	$ 150,000
Property, plant and equipment ($850,000 - $600,000)	250,000
Goodwill	300,000
Total	$ 700,000

* Fair value of net assets:

Accounts receivable	$ 350,000
Inventory	600,000
Property, plant and equipment	850,000
Notes payable	(600,000)
	$1,200,000

c. Elimination entries

EL	Common Stock $5 Par – Sub	300,000	
	Paid-in Capital in Excess of Par – Sub	400,000	
	Retained Earnings – Sub	100,000	
	Investment in Supernova		800,000
D	Inventory	150,000	
	Property and Plant	250,000	
	Goodwill	300,000	
	Investment in Supernova		700,000

DIFFICULTY: M
LEARNING OBJECTIVES: ADAC.FISC.2-3
ADAC.FISC.2-4
ADAC.FISC.2-5
ADAC.FISC.2-6

33. Supernova Company had the following summarized balance sheet on December 31 of the current year:

Assets	
Accounts receivable	$ 200,000
Inventory	450,000
Property and plant (net)	600,000

Goodwill	150,000
Total	$1,400,000

Liabilities and Equity

Notes payable	$ 600,000
Common stock, $5 par	300,000
Paid-in capital in excess of par	400,000
Retained earnings	100,000
Total	$1,400,000

The fair value of the inventory and property and plant is $600,000 and $850,000, respectively.

Assume that Redstar Corporation exchanges 75,000 of its $3 par value shares of common stock, when the fair price is $20 per share, for 100% of the common stock of Supernova Company. Redstar incurred acquisition costs of $5,000 and stock issuance costs of $5,000.

Required:

a. What journal entries will Redstar Corporation record for the investment in Supernova and issuance of stock?

b. Prepare a supporting value analysis and determination and distribution of excess schedule

c. Prepare Redstar's elimination and adjustment entry for the acquisition of Supernova.

ANSWER:

a.

Investment in Supernova (75,000 × $20)	1,500,000	
Common Stock (75,000 x $3)		225,000
Paid-in Capital in Excess of Par		1,275,000
Acquisition Expense	5,000	
Paid-in Capital in Excess of Par	5,000	
Cash		10,000

b)

Value Analysis

	Company Implied Fair Value	Parent Price (100%)	NCI Value (0%)
Company fair value	$1,500,000	$1,500,000	N/A
Fair value identifiable net assets *	1,050,000	1,050,000	
Goodwill	$ 450,000	$ 450,000	

Determination & Distribution Schedule

	Company Implied Fair Value	(100%) Parent Price	0% NCI Value
Fair value of subsidiary	$1,500,000	$1,500,000	
Less book value:			
Common stock	$ 300,000		
Paid-in capital in excess of par	400,000		
Retained earnings	100,000		
Total equity	$ 800,000	$ 800,000	
Interest Acquired		100%	
Book value		$ 800,000	

Excess of FV over BV	$ 700,000	$ 700,000
Adjustment of identifiable accounts:		
	Adjustment	
Inventory ($600,000 - $450,000)	$ 150,000	
Property, plant and equipment ($850,000 - $600,000)	250,000	
Goodwill (increase over $150,000)	300,000	
Total	$ 700,000	

* Fair value of net assets:

Accounts receivable	$ 200,000
Inventory	600,000
Property, plant and equipment	850,000
Notes payable	(600,000)
	$1,050,000

c. Elimination entries

EL	Common Stock $5 Par – Sub	300,000	
	Paid-in Capital in Excess of Par – Sub	400,000	
	Retained Earnings – Sub	100,000	
	Investment in Supernova		800,000
D	Inventory	150,000	
	Property and Plant	250,000	
	Goodwill	300,000	
	Investment in Supernova		700,000

DIFFICULTY: D

LEARNING OBJECTIVES: ADAC.FISC.2-3
ADAC.FISC.2-4
ADAC.FISC.2-5
ADAC.FISC.2-6
ADAC.FISC.2-8

34. On December 31, 2016, Priority Company purchased 80% of the common stock of Subsidiary Company for $1,550,000. On this date, Subsidiary had total owners' equity of $650,000 (common stock $100,000; other paid-in capital, $200,000; and retained earnings, $350,000). Any excess of cost over book value is due to the under or overvaluation of certain assets and liabilities. Assets and liabilities with differences in book and fair values are provided in the following table:

	Book Value	Fair Value
Current assets	$500,000	$800,000
Accounts receivable	200,000	150,000
Inventory	800,000	800,000
Land	100,000	600,000
Buildings and equipment, net	700,000	900,000
Current liabilities	800,000	875,000
Bonds payable	850,000	930,000

Remaining excess, if any, is due to goodwill.

Required:

a. Using the information above and on the separate worksheet, prepare a schedule to determine and distribute the excess of cost over book value.

b. Complete the Figure 2-3 worksheet for a consolidated balance sheet as of December 31, 2016.

Figure 2-3

Account Titles	Trial Balance: Priority Company	Trial Balance: Sub. Company	Eliminations and Adjustments: Debit		Eliminations and Adjustments: Credit	
Assets:						
Current Assets	425,000	500,000				
Accounts Receivable	530,000	200,000				
Inventory	1,600,000	800,000				
Investment in Sub Co.	1,550,000					
Land	225,000	100,000				
Buildings and Equipment	400,000	700,000				
Total	4,730,000	2,300,000				
Liabilities and Equity:						
Current Liabilities	2,100,000	800,000				
Bonds Payable	1,000,000	850,000				
Common Stock – P Co.	900,000					
Paid-in Cap. in Excess – P Co.	670,000					
Retained Earnings – P Co.	60,000					
Common Stock – S Co.		100,000				
Paid-in Cap. in Excess – S Co.		200,000				
Retained Earnings – S Co.		350,000				
NCI						
Total	4,730,000	2,300,000				

Account Titles	NCI	Consolidated Balance Sheet: Debit	Consolidated Balance Sheet: Credit
Assets:			
Current Assets			

Accounts Receivable			
Inventory			
Investment in Sub Co.			
Land			
Buildings and Equipment			
Total			
Liabilities and Equity:			
Current Liabilities			
Bonds Payable			
Common Stock – P Co.			
Paid-in Cap. in Excess – P Co.			
Retained Earnings – P Co.			
Common Stock – S Co.			
Paid-in Cap. in Excess – S Co			
Retained Earnings – S Co.			
NCI			
Total			

ANSWER: a. Determination and Distribution Schedule:

	Company Implied Fair Value	Parent Price	NCI Value
Fair value of subsidiary	$1,937,500	$1,550,000	$387,500
Less book value:			
Common stock	$ 100,000		
Paid-in capital in excess of par	200,000		
Retained earnings	350,000		
Total equity	$ 650,000	$ 650,000	$650,000
Interest Acquired		80%	20%
Book value		$ 520,000	$130,000
Excess of FV over BV	$1,287,500	$1,030,000	$257,500
Adjust identifiable accounts:			
Current assets	$ 300,000		
Accounts receivable	(50,000)		
Land	500,000		
Buildings and equipment (net)	200,000		
Current liabilities	(75,000)		
Premium on bonds payable	(80,000)		

Goodwill	492,500
Total	$1,287,500

b. For the worksheet solution, please refer to Answer 2-3.

Answer 2-3

Account Titles	Trial Balance: Priority Company	Trial Balance: Sub. Company	Eliminations and Adjustments: Debit		Eliminations and Adjustments: Credit	
Assets:						
Current Assets	425,000	500,000	(D)	300,000		
Accounts Receivable	530,000	200,000			(D)	50,000
Inventory	1,600,000	800,000				
Investment in Sub. Co.	1,550,000				(EL)	520,000
					(D)	1,030,000
Land	225,000	100,000	(D)	500,000		
Buildings and Equipment	400,000	700,000	(D)	200,000		
Goodwill			(D)	492,500		
Total	4,730,000	2,300,000				
Liabilities and Equity:						
Current Liabilities	2,100,000	800,000			(D)	75,000
Bonds Payable	1,000,000	850,000				
Premium on Bonds Pay					(D)	80,000
Common Stock – P Co.	900,000					
Paid-in Cap. in Exc. – P Co.	670,000					
Ret. Earnings – P Co.	60,000					
Common Stock – S Co.		100,000	(EL)	80,000		
Paid-in Cap. in Exc. – S Co.		200,000	(EL)	160,000		
Ret. Earnings – S Co.		350,000	(EL)	280,000	(D)	257,500
NCI						
Total	4,730,000	2,300,000		2,012,500		2,012,500

Account Titles	NCI	Consolidated Balance Sheet: Debit	Consolidated Balance Sheet: Credit
Assets:			

Current Assets		1,225,000	
Accounts Receivable		680,000	
Inventory		2,400,000	
Investment in Sub. Co.		- -	
Land		825,000	
Buildings and Equipment		1,300,000	
Goodwill		492,500	
Liabilities and Equity:			
Current Liabilities			2,975,000
Bonds Payable			1,850,000
Premium on Bonds Pay			80,000
Common Stock – P Co.			900,000
Paid-in Cap. in Exc. – P Co.			670,000
Ret. Earnings – P Co.			60,000
Common Stock – S Co.	20,000		
Paid-in Cap. in Exc. – S Co.	40,000		
Ret. Earnings – S Co.	327,500		
NCI	387,500		387,500
Total		6,922,500	6,922,500

Eliminations and Adjustments:

(EL) Eliminate 80% of the subsidiary's equity accounts against the investment in subsidiary account.

(D) Allocate the excess of cost over book value to net assets as required by the determination and distribution of excess schedule.

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-4
ADAC.FISC.2-5
ADAC.FISC.2-6
ADAC.FISC.2-7

35. On December 31, 2016, Parent Company purchased 80% of the common stock of Subsidiary Company for $280,000. On this date, Subsidiary had total owners' equity of $250,000 (common stock $20,000; other paid-in capital, $80,000; and retained earnings, $150,000). Any excess of cost over book value is due to the under or overvaluation of certain assets and liabilities. Inventory is undervalued $5,000. Land is undervalued $20,000. Buildings and equipment have a fair value which exceeds book value by $30,000. Bonds payable are overvalued $5,000. The remaining excess, if any, is due to goodwill.

Required:

a. Prepare a value analysis schedule for this business combination.

b. Prepare the determination and distribution schedule for this business combination

c. Prepare the necessary elimination entries in general journal form.

ANSWER: a) Value analysis schedule

	Company Implied Fair Value	Parent Price	NCI Value
Company fair value	$ 350,000	$ 280,000	$ 70,000
Fair value identifiable net assets	310,000	248,000	62,000
Goodwill	$ 40,000	$ 32,000	$ 8,000

b) Determination and distribution schedule:

	Company Implied Fair Value	Parent Price	NCI Value
Fair value of subsidiary	$ 350,000	$ 280,000	$ 70,000
Less book value:			
Common stock	$ 20,000		
Paid-in capital in excess of par	80,000		
Retained earnings	150,000		
Total Equity	$ 250,000	$ 250,000	$250,000
Interest Acquired		80%	20%
Book value		$ 200,000	$ 50,000
Excess of FV over BV	$ 100,000	$ 80,000	$ 20,000
Adjust identifiable accounts:			
Inventory	$ 5,000		
Land	20,000		
Buildings & equipment	30,000		
Discount on bonds payable	5,000		
Goodwill	40,000		
Total	$ 100,000		

c) Elimination entries:

ELIMINATION ENTRY 'EL'		
Common Stock - Sub	16,000	
Paid-in Capital in Excess - Sub	64,000	
Retained Earnings - Sub	120,000	
Investment in Subsidiary		200,000
	200,000	*200,000*
ELIMINATION ENTRY 'D'		
Inventory	$ 5,000	
Land	20,000	
Buildings & Equipment	30,000	
Discount on Bonds Payable	5,000	
Goodwill	40,000	
Investment in Sub		80,000
Retained Earnings-Sub (NCI)		20,000
	100,000	*100,000*

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-4
ADAC.FISC.2-5
ADAC.FISC.2-6
ADAC.FISC.2-7

36. On January 1, 2016, Parent Company purchased 100% of the common stock of Subsidiary Company for $280,000. On this date, Subsidiary had total owners' equity of $240,000.

On January 1, 2016, the excess of cost over book value is due to a $15,000 undervaluation of inventory, to a $5,000 overvaluation of Bonds Payable, and to an undervaluation of land, building and equipment. The fair value of land is $50,000. The fair value of building and equipment is $200,000. The book value of the land is $30,000. The book value of the building and equipment is $180,000.

Required:

a. Using the information above and on the separate worksheet, complete a value analysis schedule

b. Complete schedule for determination and distribution of the excess of cost over book value.

c. Complete the Figure 2-5 worksheet for a consolidated balance sheet as of January 1, 2016.

Figure 2-5

	Trial Balance Trial Balance		Eliminations and Adjustments			
Account Titles	Parent Company	Sub. Company	Debit		Credit	
Assets:						
Inventory	50,000	30,000				
Other Current Assets	239,000	165,000				
Investment in Subsidiary	280,000					
Land	120,000	30,000				
Buildings	350,000	230,000				
Accumulated Depreciation	(100,000)	(50,000)				
Other Intangibles	40,000					
Total	979,000	405,000				
Liabilities and Equity:						
Current Liabilities	191,000	65,000				
Bonds Payable		100,000				
Common Stock – P Co.	100,000					
Paid-in Cap. in Exc. - P Co.	150,000					
Retained Earnings – P Co.	538,000					
Common Stock – S Co.		50,000				
Paid-in Cap. in Exc. - S Co.		70,000				
Retained Earnings – S Co.		120,000				
NCI						

Total	979,000	405,000					

Account Titles	NCI	Consolidated Consolidated Balance Sheet Debit	Credit
Assets:			
Inventory			
Other Current Assets			
Investment in Subsidiary			
Land			
Buildings			
Accumulated Depreciation			
Other Intangibles			
Total			
Liabilities and Equity:			
Current Liabilities			
Bonds Payable			
Common Stock – P Co.			
Paid-in Cap. in Exc. - P Co.			
Retained Earnings – P Co.			
Common Stock – S Co.			
Paid-in Cap. in Exc. - S Co.			
Retained Earnings – S Co.			
NCI			
Total			

ANSWER: a. Value analysis schedule:

	Company Implied Fair Value	Parent Price
Company fair value	$280,000	$280,000
Fair value identifiable net assets	300,000	300,000
Gain on acquisition	$(20,000)	$(20,000)

b. Determination and Distribution Schedule:

	Company Implied Fair Value	Parent Price

Fair value of subsidiary	$ 280,000	$ 280,000
Less book value:		
Common stock	$ 50,000	
Paid-in capital in excess of par	70,000	
Retained earnings	120,000	
Total equity	$ 240,000	$ 240,000
Interest Acquired		100%
Book value		$ 240,000
Excess of fair over book value	$ 40,000	$ 40,000

Adjust identifiable accounts:	
Inventory	$ 15,000
Land	20,000
Buildings and equipment	20,000
Discount on bonds payable	5,000
Gain on acquisition	(20,000)
Total	$ 40,000

c. For the worksheet solution, please refer to Answer 2-5.

Answer 2-5

	Trial Balance Trial Balance		Eliminations and Adjustments			
Account Titles	Parent Company	Sub. Company	Debit		Credit	
Assets:						
Inventory	50,000	30,000	(D)	15,000		
Other Current Assets	239,000	165,000				
Investment in Subsidiary	280,000				(EL)	240,000
					(D)	40,000
Land	120,000	30,000	(D)	20,000		
Buildings	350,000	230,000	(D)	20,000		
Accumulated Depreciation	(100,000)	(50,000)				
Other Intangibles	40,000					
Goodwill						
Total	979,000	405,000				
Liabilities and Equity:						
Current Liabilities	191,000	65,000				
Bonds Payable		100,000				
Discount on Bonds Payable			(D)	5,000		
Common Stock – P Co.	100,000					
Paid-in Cap. in Exc. – P Co.	150,000					
Retained Earnings – P Co.	538,000				(D)	20,000
Common Stock – S		50,000	(EL)	50,000		

Co.					
Paid-in Cap. in Exc. – S Co.		70,000	(EL) 70,000		
Retained Earnings – S Co.		120,000	(EL) 120,000		
NCI					
Total	979,000	405,000	300,000	300,000

Account Titles	NCI	Consolidated Consolidated Balance Sheet Debit	Credit
Assets:			
Inventory		95,000	
Other Current Assets		404,000	
Investment in Subsidiary		- -	
Land		170,000	
Buildings		600,000	
Accumulated Depreciation			150,000
Other Intangibles		40,000	
Goodwill			
Total			
Liabilities and Equity:			
Current Liabilities			256,000
Bonds Payable			100,000
Discount on Bonds Payable		5,000	
Common Stock – P Co.			100,000
Paid-in Cap. in Exc. – P Co.			150,000
Retained Earnings – P Co.			558,000
Common Stock – S Co.	0		
Paid-in Cap. in Exc. – S Co.	0		
Retained Earnings – S Co.	0		
NCI	0		0
Total		1,314,000	1,314,000

Eliminations and Adjustments:

(EL) Eliminate 100% of the subsidiary's equity accounts against the investment in subsidiary account.

(D) Allocate the excess of cost over book value to net assets as required by the determination and distribution of excess schedule; gain on acquisition closed to parent’s Retained Earnings account

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-4

ADAC.FISC.2-5
ADAC.FISC.2-6
ADAC.FISC.2-7

37. On January 1, 2016, Parent Company purchased 90% of the common stock of Subsidiary Company for $252,000. On this date, Subsidiary had total owners' equity of $240,000 consisting of $50,000 in common stock, $70,000 additional paid-in capital, and $120,000 in retained earnings.

On January 1, 2016, the excess of cost over book value is due to a $15,000 undervaluation of inventory, to a $5,000 overvaluation of Bonds Payable, and to an undervaluation of land, building and equipment. The fair value of land is $50,000. The fair value of building and equipment is $200,000. The book value of the land is $30,000. The book value of the building and equipment is $180,000.

Required:

a. Complete the valuation analysis schedule for this combination.

b. Complete the determination and distribution schedule for this combination.

c. Prepare, in general journal form, the elimination entries required to prepare a consolidated balance sheet for Parent and Subsidiary on January 1, 2016.

ANSWER:

a. Value analysis schedule

	Company Implied Fair Value	Parent Price	NCI Value
Company fair value	$ 282,000**	$ 252,000	$ 30,000*
Fair value identifiable net assets	300,000	270,000	30,000
Gain on acquisition	$ (18,000)	$ (18,000)	$ ———

*Cannot be less than the NCI share of the fair value of net assets
**Sum of parent price + minimum allowable for NCI value

b. Determination and distribution schedule

	Company Implied Fair Value	Parent Price	NCI Value
Fair value of subsidiary	$ 282,000	$ 252,000	$ 30,000
Less book value:			
Common stock	$ 50,000		
Paid-in capital in excess of par	70,000		
Retained earnings	120,000		
Total Equity	$ 240,000	$ 240,000	$240,000
Interest Acquired		90%	10%
Book value		$ 216,000	$ 24,000
Excess of fair over book value	$ 42,000	$ 36,000	$ 6,000
Adjust identifiable accounts:			
Inventory	$ 15,000		
Land	20,000		
Buildings and equipment	20,000		
Discount on bonds payable	5,000		
Gain on acquisition	(18,000)		

Total	$ 42,000	

c. Elimination entries

ELIMINATION ENTRY 'EL'		
Common Stock-Sub	45,000	
Paid-in Capital in Exc. -Sub	63,000	
Retained Earnings-Sub	108,000	
Investment in Subsidiary		216,000
	216,000	*216,000*
ELIMINATION ENTRY 'D'		
Inventory	$ 15,000	
Land	20,000	
Buildings & Equipment	20,000	
Discount on Bonds Payable	5,000	
Gain on Acquisition		18,000
Investment in Subsidiary		36,000
Retained Earnings-Sub (NCI)		6,000
	60,000	*60,000*

DIFFICULTY: D

LEARNING OBJECTIVES: ADAC.FISC.2-4
ADAC.FISC.2-5
ADAC.FISC.2-6
ADAC.FISC.2-7

38. The following consolidated financial statement was prepared immediately following the acquisition of Salt, Inc. by Pepper Co.

	Individual Balance Sheets		Consolidated Financial
	Pepper Co.	Salt Inc.	Statements
Cash	$ 26,000	$ 20,000	$ 46,000
Accounts Receivable, net	20,000	30,000	50,000
Inventory	125,000	110,000	270,000
Land	30,000	80,000	124,000
Building and Equipment	320,000	160,000	459,000
Investment in Subsidiary	279,000	-	-
Goodwill	-	-	41,000
Total Assets	$800,000	$400,000	$990,000
Accounts Payable	$ 40,000	$ 40,000	$ 80,000
Other Liabilities	70,000	60,000	130,000
Common Stock	400,000	200,000	400,000
Retained Earnings	290,000	100,000	290,000
Non-controlling Interest	-	-	90,000
Total Liabilities & Stockholders' Equity	$800,000	$400,000	$990,000

Answer the following based upon the above financial statements:

a. How much did Pepper Co. pay to acquire Salt Inc.?
b. What was the fair value of Salt's Inventory at the time of acquisition?
c. Was the book value of Salt's Building and Equipment overvalued or undervalued relative to the Building and Equipment's fair value at the time of acquisition?

ANSWER:

a. Investment in subsidiary $279,000

b.

Consolidated inventory	$270,000	
Pepper Co. inventory	125,000	
Fair value attributable to Salt		$145,000

c.

Consolidated buildings and equipment	$459,000	
Pepper Co. buildings and equipment	320,000	
Fair value attributable to Salt		$139,000

c. The Building and Equipment's book value was overvalued $21,000 relative to the fair value.
The book value was $160,000 vs. $139,000 fair value.

DIFFICULTY: D

LEARNING OBJECTIVES: ADAC.FISC.2-4
ADAC.FISC.2-5
ADAC.FISC.2-6

39. Supernova Company had the following summarized balance sheet on December 31, 20X1:

Assets	
Accounts receivable	$ 200,000
Inventory	450,000
Property and plant (net)	600,000
Goodwill	150,000
Total	$1,400,000
Liabilities and Equity	
Notes payable	$ 600,000
Common stock, $5 par	300,000
Paid-in capital in excess of par	400,000
Retained earnings	100,000
Total	$1,400,000

The fair value of the inventory and property and plant is $600,000 and $850,000, respectively.

Required:

a. Assume that Redstar Corporation purchases 100% of the common stock of Supernova Company for $1,800,000. What value will be assigned to the following accounts of the Supernova Company when preparing a consolidated balance sheet on December 31, 2016?

(1) Inventory __________
(2) Property and plant __________
(3) Goodwill __________
(4) Non-controlling interest __________

b. Prepare a valuation schedule

c. Prepare a supporting determination and distribution of excess schedule.

ANSWER:

a.

(1)	Inventory	$600,000	($450,000 BV + $150,000)
(2)	Property and plant	$850,000	($600,000 BV + $250,000)
(3)	Goodwill	$750,000	
(4)	Non-controlling interest	0	No NCI – 100% acquisition

b. Valuation schedule

	Company Implied Fair Value	Parent Price
Company fair value	$ 1,800,000	$ 1,800,000
Fair value identifiable net assets	1,050,000	1,050,000
Goodwill	$ 750,000	$ 750,000

c.

	Company Implied Fair Value	Parent Price
Fair value of subsidiary	$ 1,800,000	$ 1,800,000
Less book value:		
Common Stock	$300,000	
Paid-in capital in excess of par	400,000	
Retained earnings	100,000	
Total Equity	$ 800,000	$ 800,000
Interest Acquired		100%
Book value		800,000
Excess of fair over book value	$ 1,000,000	$ 1,000,000

Adjust identifiable accounts:	
Inventory	$ 150,000
Property & plant (net)	250,000
Goodwill (increase from $150,000)	600,000
Total	$ 1,000,000

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-4
ADAC.FISC.2-6
ADAC.FISC.2-8

40. Fortuna Company issued 70,000 shares of $1 par stock, with a fair value of $20 per share, for 80% of the outstanding shares of Acappella Company. The firms had the following separate balance sheets *prior* to the acquisition:

Assets	Fortuna	Acappella
Current assets	$2,100,000	$ 960,000
Property, plant, and equipment (net)	4,600,000	1,300,000
Goodwill	-	240,000
Total assets	$6,700,000	$2,500,000
Liabilities and Stockholders' Equity		
Liabilities	$3,000,000	$ 800,000
Common stock ($1 par)	800,000	
Common stock ($5 par)		200,000
Paid-in capital in excess of par	2,200,000	300,000
Retained earnings	700,000	1,200,000
Total liabilities and equity	$6,700,000	$2,500,000

Book values equal fair values for the assets and liabilities of Acappella Company, except for the property, plant, and equipment, which has a fair value of $1,600,000.

Required:

a. Prepare a value analysis schedule

b. Prepare a determination and distribution of excess schedule.

c. Provide all eliminations on the partial balance sheet worksheet provided in Figure 2-9 and complete the non-controlling interest column.

Figure 2-9
Fortuna Co. and Subsidiary Acappella Co.
Partial Worksheet for Consolidated Financial Statements
January 2, 2016

	Balance Sheet	
Account Titles	Fortuna	Acappella
Current Assets	2,100,000	960,000
Property, Plant, and		
Equipment	4,600,000	1,300,000
Investment in Acappella	1,400,000	
Goodwill		240,000
Liabilities	(3,000,000)	(800,000)
Common Stock – Fortuna	(870,000)	
Paid-in Capital in Excess		
of Par – Fortuna	(3,530,000)	
Retained Earnings – Fortuna	(700,000)	
Common Stock – Acappella		(200,000)
Paid-in Capital in Excess		
of Par – Acappella		(300,000)
Retained Earnings – Acappella		(1,200,000)

Fortuna Co. and Subsidiary Acappella Co.
Partial Worksheet for Consolidated Financial Statements
January 2, 2016

	Eliminations and Adjustments				
Account Titles	Debit		Credit		NCI
Current Assets					
Property, Plant, and					
Equipment					

Investment in Acappella					
Goodwill					
Liabilities					
Common Stock – Fortuna					
Paid-in Capital in Excess					
of Par – Fortuna					
Retained Earnings – Fortuna					
Common Stock – Acappella					
Paid-in Capital in Excess					
of Par – Acappella					
Retained Earnings – Acappella					

ANSWER:

a. Value analysis schedule:

	Company Implied Fair Value	Parent Price	NCI Value
Company fair value	$ 1,752,000	$1,400,000	$ 352,000*
Fair value identifiable net assets	1,760,000	1,408,000	352,000
Gain on acquisition	$ (8,000)	(8,000)	$ -

*Cannot be less than NCI share of identifiable net assets; company fair value is sum of parent price and NCI value.

b. Determination and distribution of excess schedule:

	Company Implied Fair Value		Parent Price	NCI Value
Fair value subsidiary	$1,752,000		$1,400,000	$352,000
Less book value:				
Common Stock	200,000			
APIC	300,000			
Ret Earn	1,200,000			
Total S/E	1,700,000		1,700,000	1,700,000
Interest acquired			80%	20%
Book value			1,360,000	340,000
Excess of fair over book	52,000		40,000	12,000
Adjust identifiable accounts:				
Plant and equipment	300,000	DR		
Goodwill	(240,000)	CR		
Gain on acquisition	(8,000)	CR		
Total	52,000			

c. For the worksheet solution, please refer to Answer 2-9.

Figure 2-9

Fortuna Co. and Subsidiary Acappella Co.

Partial Worksheet for Consolidated Financial Statements

January 2, 2016

	Balance Sheet	
Account Titles	Fortuna	Acappella
Current Assets	2,100,000	960,000
Property, Plant, and		
Equipment	4,600,000	1,300,000
Investment in Acappella	1,400,000	
Goodwill		240,000
Liabilities	(3,000,000)	(800,000)
Common Stock – Fortuna	(870,000)	
Paid-in Capital in Excess		
of Par – Fortuna	(3,530,000)	
Retained Earnings – Fortuna	(700,000)	
Common Stock – Acappella		(200,000)
Paid-in Capital in Excess		
of Par – Acappella		(300,000)
Retained Earnings – Acappella		(1,200,000)

Fortuna Co. and Subsidiary Acappella Co.
Partial Worksheet for Consolidated Financial Statements
January 2, 2016

	Eliminations and Adjustments				
Account Titles	Debit		Credit		NCI
Current Assets					
Property, Plant, and					
Equipment	(D)	300,000			
Investment in Acappella			(EL)	1,360,000	
			(D)	40,000	
Goodwill			(D)	240,000	
Liabilities					
Common Stock – Fortuna					
Paid-in Capital in Excess					
of Par – Fortuna					
Retained Earnings – Fortuna			(D)	8,000	
Common Stock – Acappella	(EL)	160,000			(40,000)
Paid-in Capital in Excess					
of Par – Acappella	(EL)	240,000			(60,000)

Retained Earnings – Acappella	(EL)	960,000	(D)	12,000	(252,000)
					352,000

Eliminations and Adjustments:

(EL) Eliminate 80% of subsidiary equity against the investment account.
(D) Distribute excess according to the determination and distribution of excess schedule.

DIFFICULTY: D
LEARNING OBJECTIVES: ADAC.FISC.2-4
ADAC.FISC.2-6
ADAC.FISC.2-7
ADAC.FISC.2-8

41. Mans Company is about to purchase the net assets of Eagle Inc., which has the following balance sheet:

Assets		
Accounts receivable		$ 60,000
Inventory		100,000
Equipment	$ 90,000	
Accumulated depreciation	(50,000)	40,000
Land and buildings	$300,000	
Accumulated depreciation	(100,000)	200,000
Goodwill		60,000
Total assets		$460,000
Liabilities and Stockholders' Equity		
Bonds payable		$ 80,000
Common stock, $10 par		200,000
Paid-in capital in excess of par		100,000
Retained earnings		80,000
Total liabilities and equity		$460,000

Mans has secured the following fair values of Eagle's accounts:

Inventory	$130,000
Equipment	60,000
Land and buildings	260,000
Bonds payable	60,000

Acquisition costs were $20,000.

Required:

Record the entry for the purchase of the net assets of Eagle by Mans at the following cash prices:

a. $450,000

b. $310,000

c. $480,000

ANSWER: NOTE: In all scenarios, the pre-existing goodwill on Mans' balance sheet is disregarded when measuring the goodwill inherent in Eagle's purchase transaction.

Fair value of acquired net assets:	
Accounts receivable	$ 60,000
Inventory	130,000
Equipment	60,000
Land and buildings	260,000
Bonds payable	(60,000)
	$450,000

a.	Accounts Receivable	60,000	
	Inventory	130,000	
	Equipment	60,000	
	Land and Buildings	260,000	
	Discount on Bonds Payable	20,000	
	Acquisition Expenses	20,000	
	Bonds Payable		80,000
	Cash (includes acquisition costs)		470,000

There is no goodwill since the acquisition price is equal to the fair value of the net assets acquired, excluding goodwill.

b.	Accounts Receivable	60,000	
	Inventory	130,000	
	Equipment	60,000	
	Land and Buildings	260,000	
	Discount on Bonds Payable	20,000	
	Acquisition Expenses	20,000	
	Gain on Acquisition of Business ($310,000 - $450,000)		140,000
	Bonds Payable		80,000
	Cash (includes acquisition costs)		330,000

c.	Accounts Receivable	60,000	
	Inventory	130,000	
	Equipment	60,000	
	Land and Buildings	260,000	
	Discount on Bonds Payable	20,000	
	Acquisition Expenses	20,000	
	Goodwill ($480,000 - $450,000)	30,000	
	Bonds Payable		80,000
	Cash (includes acquisition costs)		500,000

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-8

42. Exercise

Assume that Organic Food, Inc. issued 10,000 shares of its $5 par value common stock for 100% of the outstanding shares of JMJ Meats Company. The fair value of a share of the Organic stock is $15. Organic Food, Inc. also paid $12,000 in accounting and legal fees to complete the purchase. Make the necessary entry that Organic Food, Inc. would make to record the purchase including the entry to record the costs of the acquisition.

ANSWER: Investment in JMJ Meats Company (10,000 shares issued x $15 fair value)…..150,000
Common Stock ($5 par value) (10,000 shares x $5

par)……………………………………50,000
Paid-In Capital in Excess of Par ($150,000 - $50,000)………………………………………100,000

Acquisition Expense (closed to Retained Earnings since only balance sheets are being examined)……………………………………………………………………………………12,000

Cash………12,000

DIFFICULTY: MED

LEARNING OBJECTIVES: ADAC.FISC.2-5

43. When there is a consolidation with a noncontrolling interest, the following is true with respect to what can happen with less than a 100% ownership interest consolidation EXCEPT FOR:

a. Subsidiary accounts are adjusted to partial fair value based on the controlling interest percentage.
b. The entire amount of every subsidiary nominal account is merged with the nominal accounts of the parent to calculate consolidated income.
c. The parent's investment account is eliminated against only its ownership percentage of the underlying subsidiary equity accounts.
d. All of the above are true

ANSWER: Subsidiary accounts are adjusted to partial fair value based on the controlling interest percentage.

DIFFICULTY: E

LEARNING OBJECTIVES: ADAC.FISC.2-7

Essay

44. Discuss the conditions under which the SEC would assume a presumption of control. Additionally, under what circumstances might consolidation be required even though the parent does not control the subsidiary?
When would it not be appropriate to consolidate when more than 50% of the voting stock is held?

ANSWER: SEC Regulation S-X defines control in terms of power to direct or cause the direction of management and policies of a person, whether through the ownership of voting securities, by contract or otherwise. Thus, control has been said to exist when less than 51% ownership exists, but there are no other large ownership interests that can exert influence on management.

The exception to consolidating when control exists is if control is only temporary or does not exist with the majority owner. This could occur when the subsidiary is in bankruptcy, in legal organization, or when foreign exchange restrictions or foreign government controls cast doubt on the ability of the parent to exercise control over the subsidiary.

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-2

45. A parent company purchases an 80% interest in a subsidiary at a price high enough to revalue all assets and allow for goodwill on the interest purchased. If "push down accounting" were used in conjunction with the "economic entity concept," what unique procedures would be used?

ANSWER: All assets including goodwill would be adjusted to full fair value. The method differs in that the asset adjustments would be made directly on the books of the subsidiary rather than on the consolidated worksheet.

DIFFICULTY: M

LEARNING OBJECTIVES: ADAC.FISC.2-7