***Advanced Accounting, 13e, Global Edition* (Beams et al.)**

**Chapter 1 Business Combinations**

1.1 Multiple Choice Questions

1) Which of the following is not a reason for a company to expand through a combination, rather than by building new facilities?

A) A combination might provide cost advantages.

B) A combination might provide fewer operating delays.

C) A combination might provide easier access to intangible assets.

D) A combination might provide an opportunity to invest in a company without having to take responsibility for its financial results.

Answer: D

Objective: LO1.1 Understand the economic motivations underlying business combinations.

Difficulty: Easy

AACSB: Analytical thinking

2) A business merger differs from a business consolidation because

A) a merger dissolves all but one of the prior entities, but a consolidation dissolves all of the prior entities and forms a new corporation.

B) a consolidation dissolves all but one of the prior entities, but a merger dissolves all of the prior entities.

C) a merger is created when two entities join, but a consolidation is created when more than two entities join.

D) a consolidation is created when two entities join, but a merger is created when more than two entities join.

Answer: A

Objective: LO1.2 Learn about alternative forms of business combinations, from both the legal and accounting perspectives.

Difficulty: Easy

AACSB: Analytical thinking

3) Following the accounting concept of a business combination, a business combination occurs when a company acquires an equity interest in another entity and has

A) at least 20% ownership in the entity.

B) more than 50% ownership in the entity.

C) 100% ownership in the entity.

D) control over the entity, irrespective of the percentage owned.

Answer: D

Objective: LO1.2 Learn about alternative forms of business combinations, from both the legal and accounting perspectives.

Difficulty: Easy

AACSB: Analytical thinking

4) Historically, much of the controversy concerning accounting requirements for business combinations involved the \_\_\_\_\_\_\_\_ method.

A) purchase

B) pooling of interests

C) equity

D) acquisition

Answer: B

Objective: LO1.2 Learn about alternative forms of business combinations, from both the legal and accounting perspectives.

Difficulty: Easy

AACSB: Analytical thinking

5) Pitch Co. paid $50,000 in fees to its accountants and lawyers in acquiring Slope Company. Pitch will treat the $50,000 as

A) an expense for the current year.

B) a prior period adjustment to retained earnings.

C) additional cost to investment of Slope on the consolidated balance sheet.

D) a reduction in additional paid-in capital.

Answer: A

Objective: LO1.3 Introduce accounting concepts for business combinations, emphasizing the acquisition method.

Difficulty: Moderate

AACSB: Application of knowledge

6) Picasso Co. issued 5,000 shares of its $1 par common stock, valued at $100,000, to acquire shares of Seurat Company in an all-stock transaction. Picasso paid the investment bankers $35,000 and will treat the investment banker fee as

A) an expense for the current year.

B) a prior period adjustment to Retained Earnings.

C) additional goodwill on the consolidated balance sheet.

D) a reduction to additional paid-in capital.

Answer: D

Objective: LO1.3 Introduce accounting concepts for business combinations, emphasizing the acquisition method.

Difficulty: Moderate

AACSB: Application of knowledge

7) Durer Inc. acquired Sea Corporation in a business combination and Sea Corp. went out of existence. Sea Corp. developed a patent listed as an asset on Sea Corp.'s books at the patent office filing cost. In recording the combination,

A) fair value is not assigned to the patent because the research and development costs have been expensed by Sea Corp.

B) Sea Corp.'s prior expenses to develop the patent are recorded as an asset by Durer at purchase.

C) the patent is recorded as an asset at fair market value.

D) the patent's market value increases goodwill.

Answer: C

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Moderate

AACSB: Analytical thinking

8) In a business combination, which of the following will occur?

A) All identifiable assets and liabilities are recorded at fair value at the date of acquisition.

B) All identifiable assets and liabilities are recorded at book value at the date of acquisition.

C) Goodwill is recorded if the fair value of the net assets acquired exceeds the book value of the net assets acquired.

D) The Sarbanes-Oxley Act requires firms to report material aggregate amounts of goodwill as a separate balance sheet line item.

Answer: A

Objective: LO1.3 Introduce accounting concepts for business combinations, emphasizing the acquisition method.

Difficulty: Moderate

AACSB: Analytical thinking

9) According to ASC 805-30, which one of the following items may not be accounted for as an intangible asset apart from goodwill?

A) A production backlog

B) A valuable employee workforce

C) Noncontractual customer relationships

D) Employment contracts

Answer: B

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Easy

AACSB: Analytical thinking

10) Under the provisions of ASC 805-30, in a business combination, when the investment cost exceeds the total fair value of identifiable net assets acquired, which of the following statements is correct?

A) The excess is first assigned to identifiable net assets according to their fair values; then the rest is assigned to goodwill.

B) The difference is allocated first to reduce proportionately (according to market value) non-current assets, then to non-monetary current assets, and any negative remainder is classified as a deferred credit.

C) The difference is allocated first to reduce proportionately (according to market value) non-current assets, and any negative remainder is classified as an extraordinary gain.

D) The difference is allocated first to reduce proportionately (according to market value) non-current, depreciable assets to zero, and any negative remainder is classified as a deferred credit.

Answer: A

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Easy

AACSB: Analytical thinking

11) With respect to goodwill, an impairment

A) will be amortized over the remaining useful life.

B) is a two-step process which first compares book value to fair value at the business reporting unit level.

C) is a one-step process considering the entire firm.

D) occurs when asset values are adjusted to fair value in a purchase.

Answer: B

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Easy

AACSB: Analytical thinking

*Use the following information to answer the question(s) below.*

Polka Corporation exchanges 100,000 shares of newly issued $1 par value common stock with a fair market value of $20 per share for all of the outstanding $5 par value common stock of Spot Inc. and Spot is then dissolved. Polka paid the following costs and expenses related to the business combination:

Costs of special shareholders' meeting

to vote on the merger $12,000

Registering and issuing securities 10,000

Accounting and legal fees 18,000

Salaries of Polka's employees assigned

to the implementation of the merger 27,000

Cost of closing duplicate facilities 13,000

12) In the business combination of Polka and Spot

A) the costs of registering and issuing the securities are included as part of the purchase price for Spot.

B) the salaries of Polka's employees assigned to the merger are treated as expenses.

C) all of the costs except those of registering and issuing the securities are included in the purchase price of Spot.

D) only the accounting and legal fees are included in the purchase price of Spot.

Answer: B

Objective: LO1.3 Introduce accounting concepts for business combinations, emphasizing the acquisition method.

Difficulty: Moderate

AACSB: Application of knowledge

13) In the business combination of Polka and Spot,

A) all of the items listed above are treated as expenses.

B) all of the items listed above except the cost of registering and issuing the securities are included in the purchase price.

C) the costs of registering and issuing the securities are deducted from the fair market value of the common stock used to acquire Spot.

D) only the costs of closing duplicate facilities, the salaries of Polka's employees assigned to the merger, and the costs of the shareholders' meeting would be treated as expenses.

Answer: C

Objective: LO1.3 Introduce accounting concepts for business combinations, emphasizing the acquisition method.

Difficulty: Moderate

AACSB: Analytical thinking

14) Which of the following methods does the FASB consider the best indicator of fair values in the evaluation of goodwill impairment?

A) Senior executive's estimates

B) Financial analyst forecasts

C) Fair value

D) The present value of future cash flows discounted at the firm's cost of capital

Answer: C

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Easy

AACSB: Analytical thinking

15) Pepper Company paid $2,500,000 for the net assets of Salt Corporation and Salt was then dissolved. Salt had no liabilities. The fair values of Salt's assets were $3,750,000. Salt's only non-current assets were land and buildings with book values of $100,000 and $520,000, respectively, and fair values of $180,000 and $730,000, respectively. At what value will the buildings be recorded by Pepper?

A) $730,000

B) $520,000

C) $210,000

D) $0

Answer: A

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Moderate

AACSB: Application of knowledge

16) According to ASC 810-10, liabilities assumed in an acquisition will be valued at the \_\_\_\_\_\_\_\_.

A) fair value

B) historical book value

C) current replacement cost

D) present value using market interest rates

Answer: A

Objective: LO1.3 Introduce accounting concepts for business combinations, emphasizing the acquisition method.

Difficulty: Easy

AACSB: Analytical thinking

17) In reference to the FASB disclosure requirements about a business combination in the period in which the combination occurs, which of the following is correct?

A) Firms are not required to disclose the name of the acquired company.

B) Firms are not required to disclose the business purpose for a combination.

C) Firms are required to disclose the nature, terms and fair value of consideration transferred in a business combination.

D) Firms are not required to disclose the details about step acquisitions.

Answer: C

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Easy

AACSB: Analytical thinking

18) Under the current GAAP, Goodwill arising from a business combination is

A) charged to Retained Earnings after the acquisition is completed.

B) amortized over 40 years or its useful life, whichever is longer.

C) amortized over 40 years or its useful life, whichever is shorter.

D) never amortized.

Answer: D

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Easy

AACSB: Analytical thinking

19) In reference to international accounting for goodwill, U.S. companies have complained that past U.S. accounting rules for goodwill placed them at a disadvantage in competing against foreign companies for merger partners. Why?

A) Previous rules required immediate write off of goodwill which resulted in a one-time expense that was not required under international rules.

B) Previous rules required amortization of goodwill which resulted in an ongoing expense that was not required under international rules.

C) Previous rules did not permit the recording of goodwill, thus resulting in a lower asset base than international counterparts would recognize.

D) Previous rules required the immediate write of goodwill to stockholder's equity.

Answer: B

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Moderate

AACSB: Analytical thinking

20) When considering an acquisition, which of the following is NOT a method by which one company may gain control of another company?

A) Purchase of the majority of outstanding voting stock of the acquired company.

B) Purchase of all assets and liabilities of another company.

C) Purchase of all the outstanding voting stock of the acquired company.

D) Purchase of 25% of outstanding voting stock of the acquired company.

Answer: D

Objective: LO1.2 Learn about alternative forms of business combinations, from both the legal and accounting perspectives.

Difficulty: Moderate

AACSB: Analytical thinking

1.2 Exercises

1) Parrot Incorporated purchased the assets and liabilities of Sparrow Company at the close of business on December 31, 2013. Parrot borrowed $2,000,000 to complete this transaction, in addition to the $640,000 cash that they paid directly. The fair value and book value of Sparrow's recorded assets and liabilities as of the date of acquisition are listed below. In addition, Sparrow had a patent that had a fair value of $50,000.

Book Value Fair Value

Cash $120,000 $120,000

Inventories 220,000 250,000

Other current assets 630,000 600,000

Land 270,000 320,000

Plant assets-net 4,650,000 4,600,000

Total Assets $5,890,000

Accounts payable $1,200,000 $1,200,000

Notes payable 2,100,000 2,100,000

Capital stock, $5 par 700,000

Additional paid-in capital 1,400,000

Retained Earnings 490,000

Total Liabilities & Equities $5,890,000

Required:

1. Prepare Parrot's general journal entry for the acquisition of Sparrow, assuming that Sparrow survives as a separate legal entity.

2. Prepare Parrot's general journal entry for the acquisition of Sparrow, assuming that Sparrow will dissolve as a separate legal entity.

Answer:

1. General journal entry recorded by Parrot for the acquisition of Sparrow (Sparrow survives as a separate legal entity):

Investment in Sparrow 2,640,000

Cash 640,000

Notes Payable 2,000,000

2. General journal entry recorded by Parrot for the acquisition of Sparrow (Sparrow dissolves as a separate legal entity):

Cash 120,000

Inventories 250,000

Other current assets 600,000

Land 320,000

Plant assets 4,600,000

Patent 50,000

Accounts payable 1,200,000

Notes payable 2,100,000

Cash 640,000

Notes Payable 2,000,000

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Moderate

AACSB: Application of knowledge

2) On January 2, 2013 Piron Corporation issued 100,000 new shares of its $5 par value common stock valued at $19 a share for all of Seana Corporation's outstanding common shares. Piron paid $15,000 to register and issue shares. Piron also paid $20,000 for the direct combination costs of the accountants. The fair value and book value of Seana's identifiable assets and liabilities were the same. Summarized balance sheet information for both companies just before the acquisition on January 2, 2013 is as follows:

Piron Seana

Cash $150,000 $120,000

Inventories 320,000 400,000

Other current assets 500,000 500,000

Land 350,000 250,000

Plant assets-net 4,000,000 1,500,000

Total Assets $5,320,000 $2,770,000

Accounts payable $1,000,000 $300,000

Notes payable 1,300,000 660,000

Capital stock, $5 par 2,000,000 500,000

Additional paid-in capital 1,000,000 100,000

Retained Earnings 20,000 1,210,000

Total Liabilities & Equities $5,320,000 $2,770,000

Required:

1. Prepare Piron's general journal entry for the acquisition of Seana, assuming that Seana survives as a separate legal entity.

2. Prepare Piron's general journal entry for the acquisition of Seana, assuming that Seana will dissolve as a separate legal entity.

Answer:

1. General journal entry recorded by Piron for the acquisition of Seana (Seana survives as a separate legal entity):

Investment in Seana 1,900,000

Common stock 500,000

Additional paid-in capital 1,400,000

Investment expense 20,000

Additional paid-in capital 15,000

Cash 35,000

2. General journal entry recorded by Piron for the acquisition of Seana (Seana dissolves as a separate legal entity):

Cash 85,000

Inventories 400,000

Other current assets 500,000

Land 250,000

Plant assets 1,500,000

Goodwill 90,000

Investment expense 20,000

Accounts payable 300,000

Notes payable 660,000

Common stock 500,000

Additional paid-in capital 1,385,000

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Difficult

AACSB: Application of knowledge

3) On December 31, 2013, Pandora Incorporated issued 40,000 shares of its $20 par common stock for all the outstanding shares of the Sophocles Company. In addition, Pandora agreed to pay the owners of Sophocles an additional $200,000 if a specific contract achieved the profit levels that were targeted by the owners of Sophocles in their sale agreement. The fair value of this amount, with an agreed likelihood of occurrence and discounted to present value, is $160,000. In addition, Pandora paid $10,000 in stock issue costs, $40,000 in legal fees, and $48,000 to employees who were dedicated to this acquisition for the last three months of the year. Summarized balance sheet and fair value information for Sophocles immediately prior to the acquisition follows.

Book Value Fair Value

Cash $100,000 $100,000

Accounts Receivable 280,000 250,000

Inventory 520,000 640,000

Buildings and Equipment (net) 750,000 870,000

Trademarks and Tradenames 0 500,000

Total Assets $1,650,000

Accounts Payable $200,000 $190,000

Notes Payable 900,000 900,000

Retained Earnings 550,000

Total Liabilities and Equity $1,650,000

Required:

1. Prepare Pandora's general journal entry for the acquisition of Sophocles assuming that Pandora's stock was trading at $35 at the date of acquisition and Sophocles dissolves as a separate legal entity.

2. Prepare Pandora's general journal entry for the acquisition of Sophocles assuming that Pandora's stock was trading at $35 at the date of acquisition and Sophocles continues as a separate legal entity.

3. Prepare Pandora's general journal entry for the acquisition of Sophocles assuming that Pandora's stock was trading at $25 at the date of acquisition and Sophocles dissolves as a separate legal entity.

4. Prepare Pandora's general journal entry for the acquisition of Sophocles assuming that Pandora's stock was trading at $25 at the date of acquisition and Sophocles survives as a separate legal entity.

Answer:

1. At $35 per share, assuming Sophocles dissolves as a separate legal entity:

Cash $100,000

Accounts Receivable 250,000

Inventory 640,000

Buildings and Equipment 870,000

Trademarks/Trade names 500,000

Goodwill 290,000

Accounts payable 190,000

Contingent Liability 160,000

Notes payable 900,000

Common stock 800,000

Additional paid-in capital 600,000

Investment expense 40,000

Additional paid-in capital 10,000

Cash 50,000

NOTE: Amount paid to employees dedicated to the acquisition would be routinely expensed through company payroll and have no separate impact on the acquisition entry.

2. At $35 per share, assuming Sophocles continues as a separate legal entity:

Investment in Sophocles 1,560,000

Contingent Liability 160,000

Common stock 800,000

Additional paid-in capital 600,000

Investment expense 40,000

Additional paid-in capital 10,000

Cash 50,000

NOTE: Amount paid to employees dedicated to the acquisition would be routinely expensed through company payroll and have no separate impact on the acquisition entry.

3. At $25 per share, assuming Sophocles dissolves as a separate legal entity:

Cash $100,000

Accounts Receivable 250,000

Inventory 640,000

Buildings and Equipment 870,000

Trademarks/Trade names 500,000

Accounts payable 190,000

Contingent Liability 160,000

Notes payable 900,000

Gain on bargain purchase 110,000

Common stock 800,000

Additional paid-in capital 200,000

Investment expense 40,000

Additional paid-in capital 10,000

Cash 50,000

NOTE: Amount paid to employees dedicated to the acquisition would be routinely expensed through company payroll and have no separate impact on the acquisition entry.

4. At $25 per share, assuming Sophocles continues as a separate legal entity:

Investment in Sophocles 1,160,000

Contingent Liability 160,000

Common stock 800,000

Additional paid-in capital 200,000

Investment expense 40,000

Additional paid-in capital 10,000

Cash 50,000

NOTE: Amount paid to employees dedicated to the acquisition would be routinely expensed through company payroll and have no separate impact on the acquisition entry.

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Difficult

AACSB: Application of knowledge

4) On January 2, 2013 Palta Company issued 80,000 new shares of its $5 par value common stock valued at $12 a share for all of Sudina Corporation's outstanding common shares. Palta paid $5,000 for the direct combination costs of the accountants. Palta paid $18,000 to register and issue shares. The fair value and book value of Sudina's identifiable assets and liabilities were the same. Summarized balance sheet information for both companies just before the acquisition on January 2, 2013 is as follows:

Palta Sudina

Cash $75,000 $60,000

Inventories 160,000 200,000

Other current assets 200,000 250,000

Land 175,000 125,000

Plant assets-net 1,500,000 750,000

Total Assets $2,110,000 $1,385,000

Accounts payable $100,000 $155,000

Notes payable 700,000 330,000

Capital stock, $2 par 600,000 250,000

Additional paid-in capital 450,000 50,000

Retained Earnings 260,000 600,000

Total Liabilities & Equity $2,110,000 $1,385,000

Required:

1. Prepare Palta's general journal entry for the acquisition of Sudina assuming that Sudina survives as a separate legal entity.

2. Prepare Palta's general journal entry for the acquisition of Sudina assuming that Sudina will dissolve as a separate legal entity.

Answer:

1. General journal entry recorded by Palta for the acquisition of Sudina (Sudina survives as a separate legal entity):

Investment in Sudina 960,000

Common stock 400,000

Additional paid-in capital 560,000

Investment expense 5,000

Additional paid-in capital 18,000

Cash 23,000

2. General journal entry recorded by Palta for the acquisition of Sudina (Sudina dissolves as a separate legal entity):

Cash 37,000

Inventories 200,000

Other current assets 250,000

Land 125,000

Plant assets 750,000

Goodwill 60,000

Investment expense 5,000

Accounts payable 155,000

Notes payable 330,000

Common stock 400,000

Additional paid-in capital 542,000

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Moderate

AACSB: Application of knowledge

5) Saveed Corporation purchased the net assets of Penny Inc. on January 2, 2013 for $1,690,000 cash and also paid $15,000 in direct acquisition costs. Penny dissolved as of the date of the acquisition. Penny's balance sheet on January 2, 2013 was as follows:

Accounts receivable-net $190,000 Current liabilities $235,000

Inventory 480,000 Long term debt 650,000

Land 110,000 Common stock ($1 par) 25,000

Building-net 630,000 Paid-in capital 150,000

Equipment-net 240,000 Retained earnings 590,000

Total assets $1,650,000 Total liab. & equity $1,650,000

Fair values agree with book values except for inventory, land, and equipment, which have fair values of $640,000, $140,000 and $230,000, respectively. Penny has customer contracts valued at $20,000.

Required:

Prepare Saveed's general journal entry for the cash purchase of Penny's net assets.

Answer: General journal entry for the purchase of Penny's net assets:

Accounts receivable 190,000

Inventory 640,000

Land 140,000

Building 630,000

Equipment 230,000

Customer contracts 20,000

Goodwill 725,000

Investment expense 15,000

Current liabilities 235,000

Long-term debt 650,000

Cash 1,705,000

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Moderate

AACSB: Application of knowledge

6) Bigga Corporation purchased the net assets of Petit, Inc. on January 2, 2013 for $380,000 cash and also paid $15,000 in direct acquisition costs. Petit, Inc. was dissolved on the date of the acquisition. Petit's balance sheet on January 2, 2013 was as follows:

Accounts receivable-net $90,000 Current liabilities $75,000

Inventory 220,000 Long term debt 80,000

Land 30,000 Common stock ($1 par) 10,000

Building-net 20,000 Addtl. paid-in capital 215,000

Equipment-net 40,000 Retained earnings 20,000

Total assets $400,000 Total liab. & equity $400,000

Fair values agree with book values except for inventory, land, and equipment, which have fair values of $260,000, $35,000 and $35,000, respectively. Petit has patent rights with a fair value of $20,000.

Required:

Prepare Bigga's general journal entry for the cash purchase of Petit's net assets.

Answer: General journal entry for the purchase of Petit's net assets:

Accounts receivable 90,000

Inventory 260,000

Land 35,000

Building 20,000

Equipment 35,000

Patent 20,000

Goodwill 75,000

Investment expense 15,000

Current liabilities 75,000

Long-term debt 80,000

Cash 395,000

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Moderate

AACSB: Application of knowledge

7) The balance sheets of Palisade Company and Salisbury Corporation were as follows on December 31, 2013:

|  |  |  |
| --- | --- | --- |
|  | Palisade | Salisbury |
| Current Assets | $260,000 | $120,000 |
| Equipment-net | 440,000 | 480,000 |
| Buildings-net | 600,000 | 200,000 |
| Land | 100,000 | 200,000 |
| Total Assets | $1,400,000 | $1,000,000 |
| Current Liabilities | 100,000 | 120,000 |
| Common Stock, $5 par | 1,000,000 | 400,000 |
| Additional paid-in Capital | 100,000 | 280,000 |
| Retained Earnings | 200,000 | 200,000 |
| Total Liabilities and Stockholders' equity | $1,400,000 | $1,000,000 |

On January 1, 2014 Palisade issued 30,000 of its shares with a market value of $40 per share in exchange for all of Salisbury's shares, and Salisbury was dissolved. Palisade paid $20,000 to register and issue the new common shares. It cost Palisade $50,000 in direct combination costs. Book values equal market values except that Salisbury's land is worth $250,000.

Required:

Prepare a Palisade balance sheet after the business combination on January 1, 2014.

Answer: The balance sheet for Palisade Corporation subsequent to its acquisition of Salisbury Corporation on January 1, 2014 will appear as follows:

|  |  |  |
| --- | --- | --- |
| Current Assets | $310,000 |  |
| Equipment-net | 920,000 |  |
| Buildings-net | 800,000 |  |
| Land | 350,000 |  |
| Goodwill | 270,000 |  |
| Total Assets | $2,650,000 |  |
| Current Liabilities | 220,000 |  |
| Common Stock, $5 par | 1,150,000 |  |
| Additional paid-in Capital | 1,130,000 |  |
| Retained Earnings | 150,000 |  |
| Total Liabilities and Stockholders' equity | $2,650,000 |  |

Note that Current Assets of $310,000 results from the two companies contributing $260,000 and $120,000, less the cash paid out during the acquisition process of $70,000. Retained Earnings of the parent is reduced for the Investment Expense incurred in the process of $50,000.

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Moderate

AACSB: Application of knowledge

8) On January 2, 2013, Pilates Inc. paid $900,000 for all of the outstanding common stock of Spinning Company, and dissolved Spinning Company. The carrying values for Spinning Company's assets and liabilities are recorded below.

Cash $200,000

Accounts Receivable 220,000

Copyrights (purchased) 400,000

Goodwill 120,000

Liabilities (180,000)

Net assets $760,000

On January 2, 2013, Spinning anticipated collecting $185,000 of the recorded Accounts Receivable. Pilates entered into the acquisition because Spinning had Copyrights that Pilates wished to own, and also unrecorded patents with a fair value of $100,000.

Required:

Calculate the amount of goodwill that will be reported on Pilate's balance sheet as of the date of acquisition.

Answer: Goodwill is calculated as follows:

Purchase price $900,000

Fair value of net assets:

Cash $200,000

Accounts Receivable 185,000

Copyrights 400,000

Patents 100,000

Liabilities (180,000)

Total (705,000)

Purchase price in excess of

fair value of net assets: $195,000

Pilates would report $195,000 for Goodwill as a result of the acquisition.

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Moderate

AACSB: Application of knowledge

9) On January 2, 2013, Pilates Inc. paid $700,000 for all of the outstanding common stock of Spinning Company, and dissolved Spinning Company. The carrying values for Spinning Company's assets and liabilities are recorded below.

Cash $200,000

Accounts Receivable 220,000

Copyrights (purchased) 400,000

Goodwill 120,000

Liabilities (180,000)

Net assets $760,000

On January 2, 2013, Spinning anticipated collecting $185,000 of the recorded Accounts Receivable. Pilates entered into the acquisition because Spinning had Copyrights that Pilates wished to own, and also unrecorded patents with a fair value of $100,000.

Required:

Calculate the amount of goodwill that will be recorded on Pilate's balance sheet as of the date of acquisition. Then record the journal entry Pilates would record on their books to record the acquisition.

Answer: Goodwill is calculated as follows:

Purchase price $700,000

Fair value of net assets:

Cash $200,000

Accounts Receivable 185,000

Copyrights 400,000

Patents 100,000

Liabilities (180,000)

Total (705,000)

Fair value of net assets in

excess of Purchase price: $(5,000)

Because Pilates paid less than the fair value of the net assets, they are considered to have made a bargain purchase, and would thus record a Gain on Bargain Purchase in the amount of $5,000 at the time of acquisition.

The following journal entry would be prepared:

Cash 200,000

Accounts receivable 185,000

Copyrights 400,000

Patents 100,000

Liabilities 180,000

Bargain purchase gain 5,000

Cash 700,000

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Moderate

AACSB: Application of knowledge

10) Pali Corporation exchanges 200,000 shares of newly issued $10 par value common stock with a fair market value of $40 per share for all the outstanding $5 par value common stock of Shingle Incorporated, which continues on as a legal entity. Fair value approximated book value for all assets and liabilities of Shingle. Pali paid the following costs and expenses related to the business combination:

Registering and issuing securities 19,000

Accounting and legal fees 150,000

Salaries of Pali's employees whose

time was dedicated to the merger 86,000

Cost of closing duplicate facilities 223,000

Required: Prepare the journal entries relating to the above acquisition and payments incurred by Pali, assuming all costs were paid in cash.

Answer:

Investment in Shingle 8,000,000

Common Stock 2,000,000

Additional Paid in Capital 6,000,000

Additional Paid in Capital 19,000

Cash 19,000

Investment Expense (fees) 150,000

Cash 150,000

Salary expense 86,000

Cash 86,000

Plant closure expense 223,000

Cash 223,000

Objective: LO1.3 Introduce accounting concepts for business combinations, emphasizing the acquisition method.

Difficulty: Moderate

AACSB: Application of knowledge

11) Samantha's Sporting Goods had net assets consisting of the following:

Book Value Fair Value

Cash $150,000 $150,000

Inventory 820,000 960,000

Building and Fixtures 330,000 310,000

Liabilities (90,000) (88,000)

Pedic Incorporated purchased Samantha's Sporting Goods, and immediately dissolved Samantha's as a separate legal entity.

Requirement 1: If Samantha's was purchased for $1,000,000 cash, prepare the entry recorded by Pedic.

Requirement 2: If Samantha's was purchased for $1,500,000 cash, prepare the entry recorded by Pedic.

Answer:

Requirement 1:

Cash\* 150,000

Inventory 960,000

Building and Fixtures 310,000

Liabilities 88,000

Gain on Bargain Purchase 332,000

Cash\* 1,000,000

\*Cash entries may be recorded net on single line entry.

Requirement 2:

Cash\* 150,000

Inventory 960,000

Building and Fixtures 310,000

Goodwill 168,000

Liabilities 88,000

Cash\* 1,500,000

\*Cash entries may be recorded net on single line entry.

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Moderate

AACSB: Application of knowledge

12) On January 2, 2013 Carolina Clothing issued 100,000 new shares of its $5 par value common stock valued at $19 a share for all of Dakota Dressing Company's outstanding common shares in an acquisition. Carolina paid $15,000 for registering and issuing securities and $10,000 for other direct costs of the business combination. The fair value and book value of Dakota's identifiable assets and liabilities were the same. Assume Dakota Company is dissolved on the date of the acquisition. Summarized balance sheet information for both companies just before the acquisition on January 2, 2013 is as follows:

Carolina Dakota

Cash $150,000 $120,000

Inventories 320,000 400,000

Other current assets 500,000 500,000

Land 350,000 250,000

Plant assets-net 4,000,000 1,500,000

Total Assets $5,320,000 $2,770,000

Accounts payable $1,000,000 $300,000

Notes payable 1,300,000 660,000

Capital stock, $5 par 2,000,000 500,000

Additional paid-in capital 1,000,000 100,000

Retained Earnings 20,000 1,210,000

Total Liabilities & Equities $5,320,000 $2,770,000

Required:

Prepare a balance sheet for Carolina Clothing immediately after the business combination.

Answer: Carolina Clothing

Balance Sheet

January 2, 2013

Assets: Liabilities:

Cash $245,000 Accounts payable $1,300,000

Inventory 720,000 Notes payable 1,960,000

Other current assets 1,000,000 Total liabilities 3,260,000

Total current assets 1,965,000

Land 600,000 Equity:

Plant assets-net 5,500,000 Common stock ($5 par) 2,500,000

Goodwill 90,000 Additional paid-in

Total Long-term Assets 6,190,000 capital 2,385,000

Retained earnings 10,000

Total equity 4,895,000

Total assets $8,155,000 Total liab. & equity $8,155,000

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Difficult

AACSB: Application of knowledge

13) Balance sheet information for Sphinx Company at January 1, 2013, is summarized as follows:

Current assets $230,000 Liabilities $300,000

Plant assets 450,000 Capital stock $10 par 200,000

\_\_\_\_\_\_\_\_ Retained earnings 180,000

$680,000 $680,000

Sphinx's assets and liabilities are fairly valued except for plant assets that are undervalued by $50,000. On January 2, 2013, Pyramid Corporation issues 20,000 shares of its $10 par value common stock for all of Sphinx's net assets and Sphinx is dissolved. Market quotations for the two stocks on this date are:

Pyramid common: $28.00

Sphinx common: $19.50

Pyramid pays the following fees and costs in connection with the combination:

Finder's fee $10,000

Legal and accounting fees 6,000

Required:

1. Calculate Pyramid's investment cost of Sphinx Corporation.

2. Calculate any goodwill from the business combination.

Answer:

Requirement 1

FMV of shares issued by Pyramid: 20,000 × $28.00= $560,000

Requirement 2

Investment cost from above: $560,000

Less: Fair value of Sphinx's net assets ($680,000 of

total assets plus $50,000 of undervalued plant assets

minus $300,000 of debt) 430,000

Equals: Goodwill from investment in Sphinx $ 130,000

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Moderate

AACSB: Application of knowledge

14) On December 31, 2013, Peris Company acquired Shanta Company's outstanding stock by paying $400,000 cash and issuing 10,000 shares of its own $30 par value common stock, when the market price was $32 per share. Peris paid legal and accounting fees amounting to $35,000 in addition to stock issuance costs of $8,000. Shanta is dissolved on the date of the acquisition. Balance sheet information for Peris and Shanta immediately preceding the acquisition is shown below, including fair values for Shanta's assets and liabilities.

Peris Shanta Shanta

Book Value Book Value Fair Value

Cash $490,000 $140,000 $140,000

Accounts Receivable 560,000 280,000 280,000

Inventory 520,000 200,000 260,000

Land 460,000 150,000 140,000

Plant Assets — Net 980,000 325,000 355,000

Construction Permits 380,000 170,000 190,000

Accounts Payable (460,000) (140,000) (140,000)

Other accrued expenses (160,000) (45,000) (45,000)

Notes Payable (800,000) (460,000) (460,000)

Common Stock ($30 par) (960,000)

Common Stock ($20 par) (200,000)

Additional P.I.C (192,000) (80,000)

Retained Earnings (818,000) (340,000)

Required: Determine the consolidated balances which Peris would present on their consolidated balance sheet for the following accounts.

Cash

Inventory

Construction Permits

Goodwill

Notes Payable

Common Stock

Additional Paid in Capital

Retained Earnings

Answer: Cash = $490,000 + $140,000 - $400,000 - $35,000 - $8,000 = $187,000

Inventory = $520,000 + $260,000 = $780,000

Construction Permits = $380,000 + $190,000 = $570,000

Goodwill = $720,000 (Paid $400,000 + $320,000) - $720,000 (Fair Value of Net Assets) = 0

Notes Payable = $800,000 + $460,000 = $1,260,000

Common Stock = $960,000 + $300,000 (10,000 shares issued × $30 par) = $1,260,000

Additional Paid in Capital = $192,000 + $20,000 (10,000 shares issued × $2 excess over par per share) - $8,000 (cost of issuance) = $204,000

Retained Earnings = $818,000 - $35,000 (investment expense) = $783,000

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Difficult

AACSB: Application of knowledge

15) On June 30, 2013, Stampol Company ceased operations and all of their assets and liabilities were purchased by Postoli Incorporated. Postoli paid $40,000 in cash to the owner of Stampol, and signed a five-year note payable to the owners of Stampol in the amount of $200,000. Their closing balance sheets as of June 30, 2013 are shown below. In the purchase agreement, both parties noted that Inventory was undervalued on the books by $10,000, and Pistoli would also take possession of a customer list with a fair value of $18,000. Pistoli paid all legal costs of the acquisition, which amounted to $7,000.

Postoli Stampol

Cash $150,000 $17,000

Inventory 260,000 120,000

Other current assets 420,000 60,000

Land 60,000 0

Plant assets-net 590,000 190,000

Total Assets $1,480,000 $387,000

Accounts payable $440,000 $127,000

Notes payable 160,000 80,000

Capital stock, $5 par 20,000 50,000

Additional paid-in capital 60,000 0

Retained Earnings 800,000 130,000

Total Liabilities & Equities $1,480,000 $387,000

Required:

1. Prepare the journal entry Postoli would record at the date of acquisition.

2. Prepare the journal entry Stampol would record at the date of acquisition.

Answer: Postoli's journal entry:

Inventory 130,000

Other Current Assets 60,000

Plant Assets — net 190,000

Customer List 18,000

Goodwill 32,000

Cash\* 23,000

Accounts Payable 127,000

Notes Payable\*\* 280,000

Investment Expense 7,000

Cash 7,000

\*Cash payment of $40,000 is shown net of the $17,000 received in the acquisition.

\*\*Notes Payable signed for $200,000 is shown in addition to the $80,000 purchased in the acquisition.

Stampol's journal entry:

Accounts Payable $127,000

Notes Payable 80,000

Capital Stock 50,000

Retained Earnings 130,000

Cash $17,000

Inventory 120,000

Other Current Assets 60,000

Plant assets — net 190,000

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Moderate

AACSB: Application of knowledge

16) Pony acquired Spur Corporation's assets and liabilities for $500,000 cash on December 31, 2013. Spur dissolved on the date of the acquisition. Spur's balance sheet and related fair values are shown as of that date, below.

Book Value Fair Value

Cash $20,000 $20,000

Accounts Receivable 40,000 38,000

Land 45,000 50,000

Plant and Equipment — net 460,000 410,000

Franchise Agreement 0 160,000

Total Assets $565,000

Accounts Payable $70,000 $70,000

Other Liabilities 120,000 110,000

Common Stock 180,000

Additional Paid in Capital 40,000

Retained Earnings 155,000

Total Liabilities and Equity $565,000

Required: Prepare the journal entry recorded by Pony as a result of this transaction.

Answer: Accounts Receivable 38,000

Land 50,000

Plant and Equipment — net 410,000

Franchise agreement 160,000

Goodwill 2,000

Accounts Payable 70,000

Other Liabilities 110,000

Cash\* 480,000

\*Cash payment is shown net of cash received in acquisition.

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Moderate

AACSB: Application of knowledge

1.3 True/False

1) It is frequently more expensive for a firm to obtain needed facilities through combination than through development.

Answer: FALSE

Explanation: It is frequently less expensive

Objective: LO1.1 Understand the economic motivations underlying business combinations.

Difficulty: Easy

AACSB: Analytical thinking

2) The U.S. Department of Justice and the Federal Trade Commission have primary responsibility for enforcing federal antitrust laws.

Answer: TRUE

Objective: LO1.1 Understand the economic motivations underlying business combinations.

Difficulty: Easy

AACSB: Analytical thinking

3) A merger occurs when one corporation takes over all the operations of another business entity, and that entity is dissolved.

Answer: TRUE

Objective: LO1.2 Learn about alternative forms of business combinations, from both the legal and accounting perspectives.

Difficulty: Moderate

AACSB: Analytical thinking

4) In August 1999, the Financial Accounting Standards Board issued a report supporting its proposed decision to eliminate the pooling of interests method to account for business combinations.

Answer: TRUE

Objective: LO1.2 Learn about alternative forms of business combinations, from both the legal and accounting perspectives.

Difficulty: Moderate

AACSB: Analytical thinking

5) Under the acquisition method a combination is recorded using the fair-value principle.

Answer: TRUE

Objective: LO1.3 Introduce accounting concepts for business combinations, emphasizing the acquisition method.

Difficulty: Moderate

AACSB: Analytical thinking

6) The first step in recording an acquisition is to determine the fair values of all identifiable tangible and intangible assets acquired and actual value of liabilities assumed in the combination.

Answer: FALSE

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Difficult

AACSB: Analytical thinking

7) Firms should conduct an impairment test for goodwill at least quarterly.

Answer: FALSE

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Moderate

AACSB: Analytical thinking

8) The GAAP defines the accounting concept of a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses.

Answer: TRUE

Objective: LO1.2 Learn about alternative forms of business combinations, from both the legal and accounting perspectives.

Difficulty: Easy

AACSB: Analytical thinking

9) For intangibles to be recognizable they must meet both a separability criterion and a contractual-legal criterion.

Answer: FALSE

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Difficult

AACSB: Analytical thinking

10) In an acquisition, if the fair value of identifiable assets acquired over liabilities assumed exceed the cost of the acquired company the gain is recognized as an extraordinary gain by the acquiror.

Answer: FALSE

Objective: LO1.4 See how firms record fair values of assets and liabilities in an acquisition.

Difficulty: Difficult

AACSB: Analytical thinking