Accounting for Corporate Combinations and Associations, 7th edition

Test Bank: Chapter 2

Multiple Choice Questions

1. The general purpose financial statements (GPFS) of a parent entity are prepared from the viewpoint of:
    a) the group
    b) the parent entity
    c) the subsidiary
    d) the non controlling interest

    Answ: A Diff: Easy Page 43

2. A company adopting the replaceable rules included in the Corporations Act announces a dividend to be paid after balance date. The company:
    a) must recognise a liability in its financial statements
    b) must not recognise a liability
    c) has the choice of whether to recognise a liability or not
    d) none of the above

    Answ: B Diff: Easy Page 47

3. A company with a constitution that provides for the declaration of dividends will recognise a liability for dividends payable if:
    a) the dividend is recommended before the balance date but not declared
    b) the dividend is declared before the balance date
    c) the dividend is recommended and declared after the balance date
    d) none of the above

    Answ: B Diff: Moderate Page: 47

4. Consolidation worksheet adjusting journal entries are recorded:
    a) A in the general ledger of the parent entity
    b) B in the general ledger of the subsidiary
    c) C in the consolidation working papers
    d) D none of the above

    Answ: C Diff: Easy Page: 50

5. A parent and its subsidiary adopt different bases for measuring property plant and equipment assets. On consolidation the financial statements must reflect:
    a) the accounting policy of the group
    b) the accounting policy of the subsidiary
    c) either the accounting policy of the parent or the subsidiary
    d) none of the above

    Answ: A Diff: Moderate Page: 52

6. It is important to distinguish between pre and post acquisition equity of a subsidiary to allow:

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a) post acquisition equity to be eliminated on consolidation
b) goodwill or gain on bargain purchase to be calculated
c) avoidance of double counting of pre acquisition equity
d) none of the above

Answ: C Diff: Moderate Page: 53

7. Where a subsidiary has declared but not paid a dividend on a cum div basis on acquisition date, the amount of the dividend must be recorded by the parent company as:
   a) revenue
   b) a reduction in the cost of the investment
   c) a reduction in the amount of goodwill on consolidation
   d) none of the above

   Answ: A Diff: Difficult Page 61

8. Goodwill on acquisition is recorded when:
   a) the cost of the acquisition of the subsidiary is less than the fair value of the subsidiary equity
   b) the cost of the acquisition is more than the fair value of the subsidiary equity
   c) the cost of the acquisition is equal to the fair value of the subsidiary equity
   d) none of the above

   Answ: B Diff: Easy Page: 65

9. During June 20X5, Cassius Ltd acquired all of the share capital of Cicero Ltd in exchange for 1,000,000 shares with a market value of $10 per share, $5,000,000 cash payable on June 30 20X5 plus a further $6,050,000 payable on June 30 20X7. Assume an interest rate of 10%. A consultation fee of $1,000,000 was paid to an independent firm for their assistance in the acquisition. A special department was set up in Cassius Ltd to oversee the acquisition and the estimated costs of this department that were reliably attributable to the acquisition amounted to $300,000. The cost of acquisition was (rounded to nearest $'000):
   a) $21,000,000
   b) $22,350,000
   c) $22,050,000
   d) $21,300,000

   Answ: D Diff: Moderate Page: 65

10. In August 20X6, Caesar Ltd acquired the issued ordinary shares of Alesia Ltd in a one-for-one share exchange. Immediately prior to the acquisition, the shares of Caesar Ltd and Alesia Ltd were being traded on the ASX for $12 and $10 per share respectively. Immediately following the offer to purchase the shares, the shares in Alesia Ltd were being traded at $13 per share. From this information, the cost of acquisition would be recorded at:
    a) $12 per share since this the market assessment of the fair value of the shares issued by Caesar Ltd.
    b) $10 per share since this is the fair value of the shares of Alesia Ltd and thus a reliable measure of the fair value of the shares issued by Caesar Ltd.
    c) $13 per share since the shareholders of Alesia Ltd have a choice between accepting the offer of Caesar Ltd or selling their shares in the market, so that $13 per share is the most objective measure of the fair value of the shares in Caesar Ltd.
    d) None of the above.

    Answ: A Diff: Moderate Page 65

11. During August 20X5, Tiberius Ltd acquired the share capital of Capri Ltd in exchange for 1,000,000 shares in Tiberius Ltd with a fair value of $10 per share. Share issue costs amounted to $400,000. Tiberius Ltd also took over the loan payable by Capri Ltd to Ethereal Finance Ltd of $2,000,000. The cost of the investment is:
    a) $10,000,000
    b) $10,300,000
    c) $12,000,000
    d) None of the above.

    Answ: A Diff: Moderate Page: 65

12. During August 20X5, Atticus Ltd acquired the share capital of Finch Pty Ltd in exchange for 1,000,000 shares in Atticus Ltd with a fair value of $10 per share. Share issue costs amounted to $400,000 and an amount of $400,000 was paid to consultants. Atticus Ltd also took over the loans payable to the shareholders of Finch Pty Ltd by that company of $2,000,000. The cost of the investment is:
    a) $12,400,000
    b) $ 8,400,000
    c) $12,800,000
    d) None of the above.

    Answ: A Diff: Moderate Page: 65

13. Any goodwill arising on a business combination is required to be tested at least annually for impairment. This requirement arises from the operation of:
    a) AASB116 Property Plant and Equipment
    b) AASB3 Business Combinations
    c) AASB138 Intangible Assets
    d) AASB 136 Impairment

    Answ: D Diff: moderate Page: 73

14. For the year ended June 30 20X6, the following financial statements were prepared for the two companies Arkle Ltd and Red Rum Ltd (amounts in thousands). At that date, the net assets of Red Rum Ltd approximated their fair value.

Balance Sheets as at June 30 20X6

	Arkle Ltd	**Red Rum Ltd**
Assets		
Sundry assets	$10,000	$2,000
Investment in Subsidiary	2,000	
Total assets	$12,000	$2,000
Less liabilities	2,000	500
Net assets	$10,000	$1,500
Shareholders' equity		
Share capital	$ 2,000	$1,000
Retained earnings	8,000	500
Total shareholders' equity	$10,000	$1,500

Income Statements for the Year ended June 30 20X6

	Arkle Ltd	Red Rum Ltd
Sales revenue	$20,000	$2,000
Less cost of goods sold	12,000	1,200
	--------	-------
Gross profit	$ 8,000	$ 800
Less sundry expenses	4,000	100
	--------	-------
Profit from continuing activities before tax	$ 4,000	$ 700
Less income tax expense	1,500	350
	--------	-------
Profit for the year	$ 2,500	$ 350
	=====	====

Statements of Movements in Retained Earnings Year ended June 30 20X6

	Arkle Ltd	Red Rum Ltd
Retained earnings July 1 20X5	$ 6,000	$ 400
Add profit for the year	2,500	350
Less dividend paid	500	250
	--------	-------
Retained earnings June 30 20X6	$ 8,000	$ 500
	=====	====

On July 1 20X5, Arkle Ltd acquired all of the share capital for $2,250,000 cash. Immediately subsequent to acquisition, Red Rum Ltd paid a dividend of $250,000 out of retained earnings at July 1 20X5. The goodwill paid on the investment was:

a) $850,000
b) $750,000
c) $600,000
d) None of the above.

Answ: A Diff: Easy Page 71

15. Assume the same data as in Question 14. Any goodwill element in the cost of acquisition had not been impaired. The consolidated shareholders' equity of Arkle Ltd and its subsidiary at June 30 20X6 is:

a) $10,080,000
b) $10,100,000
c) $10,350,000
d) None of the above.

Answ: C Diff: Moderate Page 71

16. A subsidiary which is identified as a single cash generating unit (CGU) has property plant and equipment assets with a carrying amount of $100,000 and a recoverable amount of $80,000. On acquisition of the subsidiary goodwill of $60,000 was recognised. The amount to be identified as goodwill impairment loss is:

a) $100,000
b) $80,000
c) $20,000
d) $60,000

Answ: C Diff: Moderate Page: 79

17. On July 1 20X5, Helios Ltd acquired all of the share capital of Havers Pty Ltd (100,000 shares) for $10 per share. During the year ended June 30 20X6, Helios Ltd received a dividend from Havers Ltd of $60,000; a dividend which had been declared by the directors of Havers Ltd in the year ended June 30 20X5 and was not subject to ratification by the shareholders of Havers Ltd. During the year ended June 30 20X6, Helios Ltd received an interim dividend of $40,000 from Havers Ltd and the directors of Havers Ltd declared a final dividend of $60,000. At June 30 20X6, The directors estimated that the fair value of the shares in Havers Ltd was only $9 per share at that date, but the estimated fall in value was considered to be only temporary and the carrying amount of the investment had not been impaired.

    At the date of acquisition, July 1 20X5, the shareholders' equity of Havers Ltd was (amounts in thousands):

Shareholders' equity	
Share capital	$200
Retained earnings	400

Total shareholders' equity	$600
	===

    At the date of acquisition, the carrying amounts of the net assets of Havers Ltd approximated fair value. If a consolidated balance sheet were to be prepared for Helios Ltd and its subsidiaries at the date of acquisition, the consolidation adjustment to eliminate the investment in the subsidiary would be:

a)	Share Capital	$200,000	
	Retained Earnings	400,000	
	Goodwill	400,000	
	Investment in Subsidiary		$1,000,000
b)	Share Capital	$200,000	
	Retained Earnings	400,000	
	Dividend Payable	60,000	
	Goodwill	340,000	
	Investment in Subsidiary		$1,000,000
c)	Share Capital	$200,000	
	Retained Earnings	340,000	
	Dividend Payable	60,000	
	Goodwill	340,000	
	Investment in Subsidiary		$ 940,000
d)	None of the above		

    Answ: B Diff: Moderate Page 81

18. Assume the same data as in Question 17. In preparing the consolidated financial statements in the year ended June 30 20X6, the consolidation adjustment to eliminate the investment in the subsidiary would be:

a)	Share Capital	$200,000	
	Retained Earnings	340,000	
	Goodwill	400,000	
	Investment in Subsidiary		$940,000

b)	Share Capital	$200,000	
	Retained Earnings	400,000	
	Dividend Payable		$ 60,000
	Goodwill	400,000	
	Investment in Subsidiary		$940,000

c)	Share Capital	$200,000	
	Retained Earnings	400,000	
	Goodwill	340,000	
	Investment in Subsidiary		$940,000

d) None of the above

Answ: C Diff: Easy Page 81

19. Under current accounting standards a dividend declared by a subsidiary from pre-acquisition equity will be recognised by the parent company as:
    a) revenue
    b) a reduction in the investment in subsidiary asset
    c) not recognised
    d) none of the above

Answ: A Diff: Moderate Page: 88

20. When a dividend declared by a subsidiary results in an adjustment for impairment of the parent company investment in subsidiary asset, the following consolidation worksheet adjustment is required:
    a) DR Impairment loss Investment in Subsidiary
       CR Accum. Impairment Loss
    b) DR Accum Impairment Loss
       CR Impairment Loss Investment in Subsidiary
    c) DR Impairment Loss Investment in Subsidiary
       CR Investment in Subsidiary
    d) none of the above

Answ: B Diff: Difficult Page 92

21. On July 1 20X5, Helios Ltd acquired all of the share capital of Havers Pty Ltd (100,000 shares) for $10 per share. Immediately subsequent to acquisition, the directors of Havers Ltd declared and paid a dividend of $60,000 from the retained earnings at June 30 20X5. During the year ended June 30 20X6, Helios Ltd received an interim dividend of $40,000 from Havers Ltd and the directors of Havers Ltd declared a final dividend of $60,000. At the date of acquisition, July 1 20X5, the shareholders' equity of Havers Ltd was (amounts in thousands):

Shareholders' equity	
Share capital	$200
Retained earnings	400

Total shareholders' equity	$600
	===

At the date of acquisition, the carrying amounts of the net assets of Havers Ltd approximated fair value. If a consolidated balance sheet were to be prepared for Helios Ltd and its subsidiaries at the date of acquisition, the consolidation adjustment to eliminate the investment in the subsidiary would be:

a)	Share Capital	$200,000

	Retained Earnings	400,000	
	Goodwill	400,000	
	Investment in Subsidiary		$1,000,000
b)	Share Capital	$200,000	
	Retained Earnings	400,000	
	Dividend Payable	60,000	
	Goodwill	340,000	
	Investment in Subsidiary		$1,000,000
c)	Share Capital	$200,000	
	Retained Earnings	340,000	
	Dividend Payable	60,000	
	Goodwill	340,000	
	Investment in Subsidiary		$ 940,000

d) None of the above

Answ: A Diff: Easy Page 81

True/ False Questions

1. The purpose of consolidated financial statements is to provide information to shareholders of the parent company

Answ: F Diff: Moderate Page 43

2. The declaration date of a dividend determines whether it will be recorded as a liability in the financial statements

Answ: T Diff: Easy Page: 45

3. Totals and subtotals in a consolidation worksheet are derived by adding/subtracting down the group column.

Answ: T Diff: Easy Page 49

4. All consolidation adjusting entries must be repeated in subsequent accounting periods

Answ: F Diff: Moderate Page: 50

5. Where a subsidiary's financial reporting period ends on a different date to that of the parent company the subsidiary must prepare additional financial statements

Answ: T Diff: Easy Page: 51

6. In a consolidation it would be double counting to record the net assets of a subsidiary and the parent company's investment in subsidiary asset

Answ: T Diff: Easy Page: 53

7. The investment date and the acquisition date of a subsidiary will always be the same.

Answ: F Diff: Easy Page: 56

8. Post acquisition changes in the composition of pre acquisition equity can be ignored for the purposes of consolidation adjustments

Answ: F Diff: Moderate Page: 56

9. Dividends payable by a subsidiary on an ex-dividend basis will be ignored for the purposes of consolidation

Answ: T Diff: Difficult Page: 62

10. Goodwill is not an identifiable intangible asset because it is not separable.

Answ: T Diff: Moderate Page: 64

11. In a business combination share issue costs are not included as part of the cost of acquisition.

Answ: T Diff: Easy Page: 66

12. Changes in fair value of contingent consideration in a business combination will affect the calculation of goodwill/gain on bargain purchase

Answ: F Diff: Moderate Page: 70

13. A gain on bargain purchase will be recognised in the financial statements of the acquiring company in a business combination relating to the acquisition of a controlling interest in a company.

Answ: F Diff: Easy Page: 74

14. There is no limit to the amount of impairment loss write down of the assets of a cash generating unit (CGU)

Answ: F Diff: Moderate Page: 78

15. The investment elimination entry to eliminate the investment in subsidiary asset is a ‘standing consolidation worksheet adjustment’ and will not alter from year to year.

Answ: T Diff: Easy Page: 84

16. A dividend paid by a subsidiary out of pre-acquisition profits will always result in the parent company’s investment in subsidiary asset being impaired.

Answ: F Diff: Difficult Page: 92

Theory Questions

1. Discuss the changes in the accounting rules for recognition of liabilities for dividends payable after 1 January 2005.

   Answ:

   Recognition of liability for dividend payable:

   - Since 2005 Accounting Standard AASB110 Events after Reporting Date prevents the recognition of a liability for dividends payable unless the dividend is 'declared' by the reporting date

   - 'declared' means authorised and no longer at discretion of the entity

   Diff: Moderate Page: 46

2. Explain the consequences of distinguishing between pre and post acquisition equity of a subsidiary in the consolidation process.

   Answ:

   Pre and post acquisition equity:

   - pre acquisition equity is equity of subsidiary at acquisition date

   - pre acquisition equity is eliminated on consolidation to avoid double counting of net assets of subsidiary at acquisition date

   - post acquisition equity of a subsidiary are profits and reserve changes after acquisition

   - post acquisition equity forms part of the group equity reported in consolidated financial statements

   - goodwill is measured as the difference between the cost of the investment and the pre acquisition equity acquired

   - the dividing line between pre and post acquisition equity is the acquisition date.

   Diff: Difficult Page 52/55

3. Explain why the existence of goodwill enables an entity to generate higher future cash flows or profits than would otherwise occur.

   Answ:

   Goodwill:

- Goodwill represents future economic benefits arising from unidentified assets acquired in a business combination
- The future economic benefits include such things as customer base, employees, and superior manufacturing processes which make the parent willing to pay more than the value of the identified assets and liabilities
  Diff: Moderate Page: 64

4. Outline the regulatory basis for the requirement to measure goodwill at cost less accumulated impairment losses.

   Answ:

   Measurement of goodwill:

   - under current accounting standards goodwill is not required to be amortised

   - This situation arises from the interaction of a number of accounting standards

   AASB116 excludes goodwill from the requirement to depreciate as the standard only covers tangible assets

   AASB 3 does not cover accounting for goodwill subsequent to initial recognition

   AASB136 requires goodwill to be tested annually for impairment

   Diff: Moderate Page: 73

5. Explain why dividends paid by subsidiaries out of pre-acquisition profits will result in impairment of the parent company's investment in subsidiary asset.

   Answ:

   Dividends paid by subsidiaries:

   - Where a subsidiary pays a dividend it must be treated as revenue (previously dividends paid out of pre acquisition profits were treated as a reduction in the cost of the investment)
   - AASB136 now requires the investment in subsidiary to be tested for impairment when a dividend is paid and it is expected to result in impairment
   - Recording an impairment loss resulting from a payment of a dividend out of pre acquisition profits will have the same effect as the previous treatment of such dividends as a reduction in the cost of the investment
     Diff: Difficult Page: 92

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