Advanced Accounting 11th Edition Fischer Test Bank

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# Chapter 2—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.

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

   DIF: E OBJ: 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 its investee.

   ANS: A
   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.

   DIF: E OBJ: 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.

   ANS: C
   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.

   DIF: E OBJ: 2-1

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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

ANS: B

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

DIF: D OBJ: 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.

ANS: C
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.

DIF: E OBJ: 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.

ANS: C

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Generally, statements are to be consolidated when a parent firm owns over 50% of the voting stock of another company. The only exceptions is 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.

DIF: M OBJ: 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.

   ANS: B
   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.

   DIF: M OBJ: 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.

   ANS: A
   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.

   DIF: M OBJ: 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 noncontrolling interest will be predominately displayed on the consolidated balance sheet.
   d. The investment in subsidiary account will be displayed on the consolidated balance sheet.

   ANS: A

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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 noncontrolling 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.

DIF: E OBJ: 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.

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

    DIF: M OBJ: 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.

    ANS: A
    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.

    DIF: M OBJ: 2-3

12. A subsidiary was acquired for cash in a business combination on December 31, 20X1. 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, 20X1, 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.

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

    DIF: D OBJ: 2-4

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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

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

DIF: M OBJ: 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.

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

DIF: D OBJ: 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.

ANS: A
The fair values of the subsidiary's net assets would need to be determined in any acquisition.

DIF: E OBJ: 2-5

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16. When it purchased Sutton, Inc. on January 1, 20X1, 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

ANS: B

| | |
|---|---|
| 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.

DIF: D OBJ: 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 |

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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.

ANS: C
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 |

DIF: M OBJ: 2-5

18. When it purchased Sutton, Inc. on January 1, 20X1, 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

ANS: D

| | |
|---|---|
| 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.

DIF: M OBJ: 2-5

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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

ANS: A

| | |
|---|---|
| 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 |

DIF: M OBJ: 2-6

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20. On April 1, 20X1, 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, 20X1, 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, 20X1, 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

ANS: C

| | |
|---|---|
| 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 |

DIF: D OBJ: 2-6

21. On April 1, 20X1, 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, 20X1, 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, 20X1, 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

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ANS: C

| | |
|---|---|
| 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 |

DIF: D OBJ: 2-6

22. On June 30, 20X1, 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, 20X1, 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

ANS: A

| | |
|---|---|
| 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) |

DIF: M OBJ: 2-6

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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

ANS: B

| | 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 |

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| * 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 |

DIF: M OBJ: 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

ANS: A
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.

DIF: M OBJ: 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 |

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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 noncontrolling 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

ANS: A

| | 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 |

DIF: M OBJ: 2-7

26. How is the noncontrolling 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.

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ANS: C
The noncontrolling interest is shown on the consolidated balance sheet in total as a component of shareholders' equity.

DIF: E OBJ: 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

ANS: C

| 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 |

DIF: M OBJ: 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.

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ANS: C

| | 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).

DIF: M OBJ: 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.

ANS: D

| | 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.

DIF: D OBJ: 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.

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

DIF: M OBJ: 2-8

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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.

    ANS: C
    Push down accounting involves adjusting the subsidiary's accounts to reflect the fair value adjustments.

    DIF: M OBJ: 2-9

**PROBLEM**

1. 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.

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ANS:

a.

| | Debit | Credit |
|---|---|---|
| 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 |

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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 |

DIF: M OBJ: 2-3 | 2-4 | 2-5 | 2-6

2. 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.

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ANS:

a.

| | Debit | Credit |
|---|---|---|
| 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 |

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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 |

DIF: D OBJ: 2-3 | 2-4 | 2-5 | 2-6 | 2-8

3. On December 31, 20X1, 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.

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b. Complete the Figure 2-3 worksheet for a consolidated balance sheet as of December 31, 20X1.

**Figure 2-3**

| Account Titles | Trial Balance | | Eliminations and Adjustments | | | |
|---|---|---|---|---|---|---|
| | Priority Company | Sub. Company | Debit | | 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 | | | | |

**(continued)**

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SOUTH-WESTERN
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| Account Titles | NCI | Consolidated Balance Sheet | |
|---|---|---|---|
| | | Debit | 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 | | | |

ANS:

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 |

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**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**

| | Trial Balance | | Eliminations and Adjustments | | | |
|---|---|---|---|---|---|---|
| Account Titles | Priority Company | Sub. Company | Debit | | 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 |

**(continued)**

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| Account Titles | NCI | Consolidated Balance Sheet | |
|---|---|---|---|
| | | Debit | 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.

DIF: M OBJ: 2-4 | 2-5 | 2-6 | 2-7

4. On December 31, 20X1, 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.

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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.

ANS:
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 | |

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| | | |
|---|---|---|
| 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* |

DIF: M OBJ: 2-4 | 2-5 | 2-6 | 2-7

5. On January 1, 20X1, 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, 20X1, 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, 20X1.

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**Figure 2-5**

| Account Titles | Trial Balance | | Eliminations and Adjustments | | | |
|---|---|---|---|---|---|---|
| | 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 | | | | |

**(continued)**

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| Account Titles | NCI | 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 | | | |

ANS:
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) |

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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.

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**Answer 2-5**

| Account Titles | Trial Balance: Parent Company | Trial Balance: Sub. Company | Eliminations and Adjustments: Debit | | Eliminations and Adjustments: 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 Co. | | 50,000 | (EL) | 50,000 | | |
| Paidn-in Cap. in Exc. – S | | 70,000 | (EL) | 70,000 | | |
| Retained Earnings – S Co. | | 120,000 | (EL) | 120,000 | | |
| NCI | | | | | | |
| Total | 979,000 | 405,000 | | 300,000 | | 300,000 |

**(continued)**

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| Account Titles | NCI | 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

DIF: M OBJ: 2-4 | 2-5 | 2-6 | 2-7

6. On January 1, 20X1, 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, 20X1, 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.

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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, 20X1.

ANS:
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

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| | | |
|---|---|---|
| **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* |

DIF: D OBJ: 2-4 | 2-5 | 2-6 | 2-7

7. 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 |
| Noncontrolling 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.?

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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?

ANS:

| | | | |
|---|---|---|---|
| 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.

DIF: D OBJ: 2-4 | 2-5 | 2-6

8. 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, 20X1?

(1) Inventory __________
(2) Property and plant __________
(3) Goodwill __________

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(4) Noncontrolling interest __________

b. Prepare a valuation schedule

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

ANS:

| | | | |
|---|---|---|---|
| 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) | Noncontrolling 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 | |

DIF: M OBJ: 2-4| 2-6 | 2-8

9. 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 |

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| 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 noncontrolling interest column.

**Figure 2-9**
Fortuna Co. and Subsidiary Acappella Co.
Partial Worksheet for Consolidated Financial Statements
January 2, 20X4

| | 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) |
| | | |
| | | |
| | | |

**(continued)**

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Fortuna Co. and Subsidiary Acappella Co.
Partial Worksheet for Consolidated Financial Statements
January 2, 20X4

| Account Titles | Eliminations and Adjustments | | | | NCI |
|---|---|---|---|---|---|
| | Debit | | Credit | | |
| 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 | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |

ANS:
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.

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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: | | | |
| Comm 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 | | DR |
| Goodwill | (2 | CR |
| Gain on acquisition | | CR |
| Total | 5 | |

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, 20X4

| | 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) |
| | | |
| | | |
| | | |

**(continued)**

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Fortuna Co. and Subsidiary Acappella Co.
Partial Worksheet for Consolidated Financial Statements
January 2, 20X4

| Account Titles | Eliminations and Adjustments | | | | NCI |
|---|---|---|---|---|---|
| | Debit | | Credit | | |
| 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.

DIF: D OBJ: 2-4 | 2-6 | 2-7 | 2-8

10. Mans Company is about to purchase the net assets of Eagle Incorporated, 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 |

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| 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

ANS:
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 acquistion price is equal to the fair value of the net assets acquired, excluding goodwill.

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b.

| | Debit | Credit |
|---|---|---|
| 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.

| | Debit | Credit |
|---|---|---|
| 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 |

DIF: M OBJ: 2-8

**ESSAY**

1. 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?

ANS:
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 interest 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.

DIF: M OBJ: 2-2

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2.
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?

ANS:
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.

DIF: M OBJ: 2-9

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