Advanced Financial Accounting 2025 Release 1st edition Christensen Solutions Manual

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CHAPTER 1
INTERCORPORATE ACQUISITIONS AND INVESTMENTS IN OTHER ENTITIES

ANSWERS TO QUESTIONS

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

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

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

Q1-4 (a) A **statutory merger** occurs when one company acquires another company and the assets and liabilities of the acquired company are transferred to the acquiring company; the acquired company is liquidated, and only the acquiring company remains. The acquiring company can give cash or other assets in addition to stock.

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

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

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

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

Q1-7 A differential is the total difference at the acquisition date between the sum of (1) the fair value given by the acquiring company, (2) the fair value of any shares already owned by the parent and (3) the acquisition-date fair value of any noncontrolling interest and the book value of the net identifiable assets acquired is referred to as the differential.

Q1-8 The purchase of a company is viewed in the same way as any other purchase of assets. The acquired company is owned by the acquiring company only for the portion of the year subsequent to the combination. Therefore, earnings are accrued only from the date of purchase forward.

Q1-9 None of the retained earnings of the subsidiary should be carried forward under the acquisition method. Thus, consolidated retained earnings immediately following an acquisition is limited to the balance reported by the acquiring company.

Q1-10 Additional paid-in capital reported following a business combination is the amount previously reported on the acquiring company's books plus the excess of the fair value over the par or stated value of any shares issued by the acquiring company in completing the acquisition less any sock issue costs.

Q1-11 When the acquisition method is used, all costs incurred in bringing about the combination are expensed as incurred. None are capitalized. However, costs associated with the issuance of stock are recorded as a reduction of additional paid-in capital.

Q1-12 When the acquiring company issues shares of stock to complete a business combination, the excess of the fair value of the stock issued over its par value is recorded as additional paid-in capital. All costs incurred by the acquiring company in issuing the securities should be treated as a reduction in the additional paid-in capital. Items such as audit fees associated with the registration of the new securities, listing fees, and brokers' commissions should be treated as reductions of additional paid-in capital when stock is issued.

Q1-13 If the fair value of a reporting unit acquired in a business combination exceeds its carrying amount, the goodwill of that reporting unit is considered unimpaired. On the other hand, if the carrying amount of the reporting unit exceeds its fair value, impairment of goodwill is implied. An impairment must be recognized if the carrying amount of the goodwill assigned to the reporting unit is greater than the implied value of the carrying unit's goodwill. The implied value of the reporting unit's goodwill is determined as the excess of the fair value of the reporting unit over the fair value of its net identifiable assets.

Q1-14 A bargain purchase occurs when the fair value of the consideration given in a business combination, along with the fair value of any equity interest in the acquiree already held and the fair value of any noncontrolling interest in the acquiree, is less than the fair value of the acquiree's net identifiable assets.

Q1-15 The acquirer should record the clarification of the acquisition-date fair value of buildings as a reduction to buildings and addition to goodwill.

Q1-16 The acquirer must revalue the equity position to its fair value at the acquisition date and recognize a gain. A total of $250,000 ($25 x 10,000 shares) would be recognized in this case assuming that the $65 per share price is the appropriate fair value for all shares (i.e. there is no control premium for the new shares purchased).

SOLUTIONS TO CASES

C1-1 Assignment of Acquisition Costs

MEMO

To: Vice-President of Finance
Souza Company

From: ___________, CPA

Re: Recording Acquisition Costs of Business Combination

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

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

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

Primary citation

ASC 805

C1-2 Evaluation of Merger

a. AT&T had a vast cable customer base, but felt that TimeWarner's content would greatly enhance the demand for its cable services.

b. AT&T provided TimeWarner shareholders with AT&T stock and an equal value of cash.

c. The cash portion of the merger was funded primarily with debt.

d. This would be a statutory merger since (1) the AT&T name survived through the merger and (2) the acquisition was formalized when AT&T gave both stock and cash.

C1-3 Business Combinations

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

a. One factor that may have prompted the greater use of stock in business combinations in the middle and late 1990s is that many of the earlier combinations that had been effected through the use of debt had unraveled. In many cases, the debt burden was so heavy that the combined companies could not meet debt payments. Thus, this approach to financing mergers had somewhat fallen from favor by the mid-nineties. Further, with the spectacular rise in the stock market after 1994, many companies found that their stock was worth much more than previously. Accordingly, fewer shares were needed to acquire other companies.

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

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

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

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

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

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

C1-4 Determination of Goodwill Impairment

MEMO

TO: Chief Accountant

Plush Corporation

From: ______ _____, CPA

Re: Determining Impairment of Goodwill

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

This means the total amount assigned to goodwill may be divided among a number of reporting units. Goodwill assigned to each reporting unit must be tested for impairment annually and between the annual tests in the event circumstances arise that would lead to a possible decrease in the fair value of the reporting unit below its carrying amount [ASC 350-20-35-30, ASU 2017-04].

As long as the fair value of the reporting unit is greater than its carrying value, goodwill is not considered to be impaired. If the fair value is less than the carrying value, an impairment loss must be reported for the amount by which the carrying amount of reporting unit exceeds its fair value. However, the impairment cannot exceed the amount of goodwill originally recognized for that reporting unit [ASC 350-20-35-11, ASU 2017-04]

At the date of acquisition, Plush Corporation recognized goodwill of $20,000 ($450,000 - $430,000) and assigned it to a single reporting unit. Even though the fair value of the reporting unit increased to $485,000 at December 31, 20X5, Plush Corporation must test for impairment of goodwill if the carrying value of Plush's investment in the reporting unit is above that amount. That would be the case if the carrying value were determined to be $500,000. If the carrying value of the reporting unit's net assets exceeds the fair value of the reporting unit's net assets, an impairment is recorded for the amount by which the carrying amount exceeds the fair value (but the impairment is limited to the amount of goodwill reported by that unit). If the carrying amount were $500,000 and the fair value of the reporting unit were $485,000, The impairment would be $15,000 ($500,000 - $485,000). On the other hand, if the fair value were greater than the carrying value, there would be no goodwill impairment. For example, if the carrying value of the reporting unit were determined to be $470,000, there would be no impairment.

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

Primary citations

ASC 350-20-35-11

ASC 350-20-35-30

ASC 350-20-35-41

ASU 2017-04

C1-5 Risks Associated with Acquisitions

Alphabet discloses on pages 9-10 of its 10-K that acquisitions, investments, and divestitures are an important part of its corporate strategy. The company goes on to discuss relevant risks associated with these activities. The specific risk areas identified include:

- The use of management time on acquisitions-related activities may temporarily divert management's time and focus from normal operations.
- After acquiring companies, there is a risk that Alphabet may not successfully develop the business and technologies of the acquired firms.
- It can be difficult to implement controls, procedures, and policies appropriate for a public company that were not already in place in the acquired company.
- Integrating the accounting, management information, human resources, and other administrative systems can be challenging.
- The company sometimes encounters difficulties in transitioning operations, users, and customers into Alphabet's existing platforms.
- Government "red tape" in obtaining necessary approvals can reduce the potential strategic benefits of acquisitions.
- There are many difficulties associated with foreign acquisitions due to differences in culture, language, economics, currencies, politic, and regulation.
- Since corporate cultures can vary significantly, there are potential difficulties in integrating the employees of an acquired company into the Google organization.
- It can be difficult to retain employees who worked for companies that Alphabet acquires.

- There may be legal liabilities for activities of acquired companies.
- Litigation of claims against acquired companies or as a result of acquisitions can be problematic.
- Anticipated benefits of acquisitions may not materialize.
- Acquisitions through equity issuances can result in dilution to existing shareholders. Similarly, the issuance of debt can result in other costs. Impairments, restructuring charges, and other unfavorable results can result.

C1-6 Leveraged Buyouts

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

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

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

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

SOLUTIONS TO EXERCISES

E1-1 Multiple-Choice Questions on Complex Organizations

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

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

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

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

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

   (b) *Incorrect*. This combination results in a parent-subsidiary relationship in which an investment in Spade would be recorded. In the event that goodwill were present in this transaction, it would be reported on the consolidated books and not Poker's books.
   (c) *Incorrect.* In a spin-off, no change to net assets occurs, and consequently no goodwill is recorded.
   (d) *Incorrect.* In a split-off, no change to net assets occurs, and consequently no goodwill is recorded.
4. **b** – In an internal expansion in which the existing company *creates* a new subsidiary, the assets and liabilities are recorded at the carrying values of the original company.

   (a) *Incorrect*. This is not in accordance with GAAP; assets are transferred at the parent's book (carrying) value.
   (c) *Incorrect.* Not in accordance with US GAAP; no gain or loss is permitted because the assets are transferred at the parent's book value.
   (d) *Incorrect.* Not in accordance with US GAAP – Goodwill is not created when a company creates a subsidiary through internal expansion.
5. **d** – This is the proper impairment test required under US GAAP, according to FASB 142/ASC 350.

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

E1-2 Multiple-Choice Questions on Recording Business Combinations

[AICPA Adapted]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

E1-4 Multiple-Choice Questions Involving Account Balances

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

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

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

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

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

4. **b** – $35,000. Since the carrying value of the reporting unit ($330,000) is lower than the fair value of the reporting unit's net assets ($350,000), the goodwill of the reporting unit is not impaired and will remain at its carrying value of $35,000

5. **c** – $15,000. The carrying value of the reporting unit's net assets ($575,000) exceeds the estimated fair value of the reporting unit ($560,000). The goodwill should be impaired by the amount by which the carrying value of the unit's net assets exceeds the estimated fair value of the reporting unit, $15,000 ($575,000 - $560,000).

E1-5 Asset Transfer to Subsidiary

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

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

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

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

E1-6 Creation of New Subsidiary

a. Journal entry recorded by Pester Company for transfer of assets to Shumby Corporation:

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

b. b. Journal entry recorded by Shumby Corporation for receipt of assets from Pester Company:

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

E1-7 Balance Sheet Totals of Parent Company

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

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

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

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

E1-8 Acquisition of Net Assets

Pun Corporation will record the following journal entries:

(1)

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

(2)

Acquisition Expense	4,000	
Cash		4,000

E1-9 Reporting Goodwill

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

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

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

E1-10 Stock Acquisition

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

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

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

E1-11 Balances Reported Following Combination

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

E1-12 Goodwill Recognition

Journal entry to record acquisition of Spur Corporation net assets:

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

<u>Computation of goodwill</u>

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

E1-13 Acquisition Using Debentures

Journal entry to record acquisition of Sorden Company net assets:

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

Computation of goodwill

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

E1-14 Bargain Purchase

Journal entry to record acquisition of Sorden Company net assets:

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

Computation of Bargain Purchase Gain

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

E1-15 Goodwill Impairment

a. Goodwill of $80,000 will be reported. The fair value of the reporting unit ($340,000) is greater than the carrying amount of the reporting unit ($290,000). As a result, no impairment loss will be recorded.

b. An impairment loss of $10,000 ($290,000 - $280,000) will be recognized. Therefore, goodwill of $70,000 will be reported (80,000 – 10,000 impairment loss).

c. An impairment loss of $30,000 ($290,000 - $260,000) will be recognized. Therefore, goodwill of $50,000 will be reported (80,000 – 30,000 impairment loss).

E1-16 Goodwill Impairment

a. No impairment loss will be recognized. The estimated fair value of the reporting unit ($530,000) is greater than the carrying value of the reporting unit's net assets ($500,000).

b. A goodwill impairment of $15,000 will be recognized ($500,000 - $485,000).

c. A goodwill impairment of $50,000 will be recognized ($500,000 - $450,000).

E1-17 Goodwill Assigned to Reporting Units

Goodwill of $146,000 ($50,000 + $48,000 + $8,000 + $40,000) should be reported, computed as follows:

Reporting Unit A: A goodwill impairment of $10,000 should be recognized ($700,000 - $690,000). Thus, goodwill of $50,000 ($60,000 - $10,000 impairment) should be reported on December 31, 20X7..

Reporting Unit B: There is no goodwill impairment because the fair value of the reporting unit exceeds the carrying value. Goodwill of $48,000 should be reported on December 31, 20X7.

Reporting Unit C: A goodwill impairment of $20,000 should be recognized ($380,000 - $370,000). Thus, goodwill of $8,000 ($28,000 - $20,000 impairment) should be reported on December 31, 20X7.

Reporting Unit D: There is no goodwill impairment because the fair value of the reporting unit exceeds the carrying value. Goodwill of $40,000 should be reported.

E1-18 Goodwill Measurement

a. The fair value of the reporting unit ($580,000) is greater than the carrying value of the investment ($550,000). Thus, goodwill is not impaired Goodwill of $150,000 will be reported.

b. The carrying value of the reporting unit ($550,000) exceeds the fair value of the reporting unit ($540,000). Thus, an impairment of goodwill of $10,000 ($550,000 - $540,000) must be recognized. Goodwill of $140,000 will be reported.

c. The carrying value of the reporting unit ($550,000) exceeds the fair value of the reporting unit ($500,000). Thus, an impairment loss of $50,000 ($550,000 - $500,000) must be recognized. Goodwill of $100,000 will be reported.

d. The carrying value of the reporting unit ($550,000) exceeds the fair value of the reporting unit ($460,000). Thus, an impairment loss of $90,000 ($550,000 - $460,000) must be recognized. Goodwill of $60,000 will be reported.

E1-19 Computation of Fair Value

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

E1-20 Computation of Shares Issued and Goodwill

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

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

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

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

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

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

E1-21 Combined Balance Sheet

Pam Corporation and Slest Company
Combined Balance Sheet
January 1, 20X2

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

Computation of goodwill

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

Computation of APIC

Fair value of compensation given ($60 x 8,000 shares)	$480,000
Less par value of shares issued ($8 x 8,000)	(64,000)
Plus existing APIC from Pam's books	140,000
Additional Paid-In Capital	$ 556,000

E1-22 Recording a Business Combination

Acquisition Expense	54,000	
Deferred Stock Issue Costs	29,000	
Cash		83,000

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

Computation of goodwill

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

Computation of additional paid-in capital

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

E1-23 Reporting Income

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

* 100,000 = 200,000 shares x ½ year

SOLUTIONS TO PROBLEMS

P1-24 Assets and Accounts Payable Transferred to Subsidiary

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

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

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

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

P1-25 Creation of New Subsidiary

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

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

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

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

P1-26 Incomplete Data on Creation of Subsidiary

a. The book value of assets transferred was $152,000 ($3,000 + $16,000 + $27,000 + $9,000 + $70,000 + $60,000 - $21,000 - $12,000).
b. Plumb Company would report its investment in Stew Company equal to the book value of net assets transferred of $138,000 ($152,000 - $14,000).
c. 8,000 shares ($40,000/$5).
d. Total assets declined by $14,000 (book value of assets transferred of $152,000 - investment in Stew Company of $138,000).
e. No effect. The shares outstanding reported by Plumb Company are not affected by the creation of Stew Company.

P1-27 Acquisition in Multiple Steps

Peal Corporation will record the following entries:

(1)

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

(2)

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

P1-28 Journal Entries to Record a Business Combination

Journal entries to record acquisition of SKK net assets:

(1)

Acquisition Expense	14,000	
Cash		14,000

Record payment of legal fees.

(2)

Deferred Stock Issue Costs	28,000	
Cash		28,000

Record costs of issuing stock.

(3)

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

Record purchase of SKK Corporation.

Computation of goodwill

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

Computation of additional paid-in capital

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

P1-29 Recording Business Combinations

Acquisition Expense	38,000	
Deferred Stock Issue Costs	22,000	
Cash		60,000

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

Computation of goodwill

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

Computation of additional paid-in capital

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

P1-30 Business Combination with Goodwill

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

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

b. Balance sheet immediately following acquisition:

Pancor Corporation and Sink Company
Combined Balance Sheet
February 1, 20X3

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

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

Investment in Sink Company Common Stock	178,000	
Cash		178,000

Computation of goodwill

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

P1-31 Bargain Purchase

Journal entries to record acquisition of Sark Corporation net assets:

Acquisition Expense	5,000	
Cash		5,000

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

Computation of gain

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

P1-32 Computation of Account Balances

a.

Acquisition price of reporting unit ($7.60 x 100,000)	$760,000
Fair value of net assets at acquisition ($810,000 - $190,000)	(620,000)
Goodwill at acquisition	$140,000

b. Maximum carrying value of reporting unit's assets:

Carrying value of assets at year-end	$ X
Less: Carrying value of liabilities at year-end (given)	(70,000)
Carrying value of net assets at year-end	$ X - $70,000
Less: Fair value of the reporting unit's net assets	$ (930,000)
	$0

X - $70,00 = $930,000

Maximum carrying value of assets X = $1,000,000

P1-33 Goodwill Assigned to Multiple Reporting Units

a. A goodwill impairment of $95,000 ($20,000 + $50,000 + $25,000) must be reported in the current period for Prover Company:

Computation of goodwill impairment:

Reporting unit A

Carrying value of reporting unit	$420,000

Less: Fair value of reporting unit	(400,000)
Goodwill impairment at year-end	$ 20,000

Reporting unit B

Carrying value of reporting unit	$500,000
Less: Fair value of reporting unit	(440,000)
Goodwill impairment at year-end	$ 60,000*

* Limited to the amount of goodwill on the reporting unit's books ($50,000).

Reporting unit C

Carrying value of reporting unit	$290,000
Less: Fair value of reporting unit	(265,000)
Goodwill impairment at year-end	$ 25,000

b. Goodwill to be reported by Prover Company:

	Reporting Unit		
	A	B	C
Carrying value of goodwill	$70,000	$50,000)*	$40,000
Less: Impairment	(20,000)	(50,000)*	(25,000)
Goodwill to be reported at year-end	50,000	0)*	15,000

* Limited to the amount of goodwill on the reporting unit's books.

Total goodwill to be reported at year-end:	
Reporting unit A	$ 50,000
Reporting unit B	0
Reporting unit C	15,000
Total goodwill to be reported	$65,000

P1-34 Journal Entries

Journal entries to record acquisition of Steel net assets:

(1)

Acquisition Expense	19,000	
Cash		19,000

Record finder's fee and transfer costs.

(2)

Deferred Stock Issue Costs	9,000	
Cash		9,000

Record audit fees and stock registration fees.

(3)

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

Record merger with Steel Company.

Computation of goodwill

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

Computation of additional paid-in capital

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

P1-35 Purchase at More than Book Value

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

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

b. Balance sheet immediately following acquisition:

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

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

Computation of goodwill

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

P1-36 Business Combination

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

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

Computation of fair value of net assets acquired

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

Computation of goodwill

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

P1-37 Combined Balance Sheet

a. Balance sheet:

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

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

Computation of goodwill

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

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

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

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

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

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

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

P1-38 Incomplete Data Problem

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

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

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

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

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

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

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

P1-39 Incomplete Data Following Purchase

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

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

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

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

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

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

g. $306,000 = ($15,000 + $30,000 + $110,000 + $293,000) –

($22,000 + $120,000)

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

P1-40 Comprehensive Business Combination Problem

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

Acquisition Expense	135,000	
Cash		135,000

Deferred Stock Issue Costs	42,000	
Cash		42,000

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

Computation of goodwill

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

P1-40 (continued)

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

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

Record sale of assets and liabilities.

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

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

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

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

*Alternative approaches exist.

CHAPTER 1

INTERCORPORATE ACQUISITIONS AND INVESTMENTS IN OTHER ENTITIES

IMPORTANT NOTE TO INSTRUCTORS

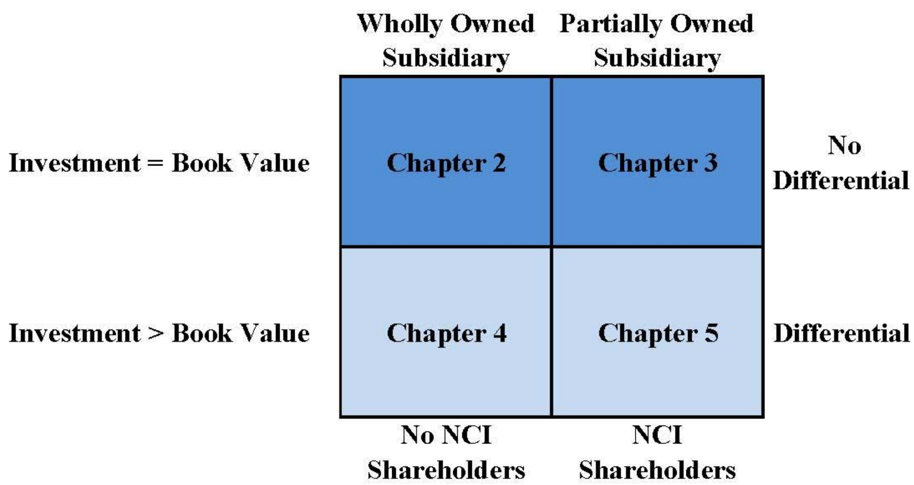
The 2025 release of Advanced Financial Accounting continues the approach to consolidation which was used in the 13th edition. While we encourage instructors to read through the description of all changes in the 2025 release provided in the preface to the book, we summarize this consolidation approach here since it is the fundamental organizational structure for several chapters in the text. As this approach is developed in chapters 2 through 5, we believe it offers students an intuitive foundation for developing consolidated financial statements. We summarize the two main features in our approach to consolidation in the 2025 release here:

✓ A Building-Block Approach to Consolidation—Virtually all advanced financial accounting classes cover consolidation topics. While this topic is perhaps the most important to instructors, students frequently struggle to gain a firm grasp of consolidation principles. This release provides students with a learning friendly framework to consolidations by introducing consolidation concepts and procedures gradually. This is accomplished by a building-block approach, which introduces consolidations earlier than some texts by beginning the consolidation discussion in chapters 2 and 3. The building-block approach can be summarized as follows:

- ***Chapter 2*** begins with the most basic consolidation situation: the consolidation of a wholly owned subsidiary that is either created or purchased at an amount equal to the book value of net assets. Thus, students practice basic consolidation procedures without having to worry about the complications associated with a differential or with noncontrolling shareholders.
- ***Chapter 3*** introduces the notion of partial ownership of a subsidiary that is created or acquired at an amount equal to the book value of net assets. In this way students are exposed to the nuances associated with the existence of noncontrolling shareholders, but without the details associated with a differential.
- ***Chapter 4*** exposes students to the intricacies of consolidation when the subsidiary is acquired for an amount that exceeds the book value of net assets. In order to isolate the new concepts and procedures that accompany the consolidation of a subsidiary with a differential, this chapter focuses on wholly owned subsidiaries.
- ***Chapter 5*** finally brings students full circle to the point where they are ready to tackle more realistic situations where the parent company purchases a controlling interest in a subsidiary (but less than 100 percent ownership) and the acquisition price exceeds the book value of net assets. Thus, students learn how to

simultaneously handle all of the details associated with a differential and with noncontrolling shareholders.

The overall coverage of the consolidation process by chapter is illustrated below.



✓ Organization of Consolidation Entries—Consistent with the building block approach to consolidation, this release facilitates the elimination of the investment in a subsidiary in two steps: (1) first the book value portion of the investment and income from the subsidiary are eliminated and (2) then the differential portion of the investment and income from the subsidiary are eliminated with separate entries. This approach facilitates the building-block approach in chapters 2-5. This release also uses frequent illustrations to help students visualize the steps in the consolidation process.

OVERVIEW OF CHAPTER 1

Chapter 1 provides students with an understanding of the legal forms of business combinations and the financial statement effects of the accounting procedures used in recording a business combination. It also discusses the proliferation of complex organizational structures and regulatory as well as ethical considerations. This chapter fully illustrates accounting for business combinations on the date of acquisition, using the acquisition method, both for business combinations effected through an acquisition of net assets and by an acquisition of common shares.

The discussions contain specific illustrations of the valuation of tangible and intangible assets and liabilities held by the acquired company on the date of acquisition. Chapter 1 also illustrates the measurement and reporting of goodwill and the treatment of a bargain purchase and discusses the impairment of goodwill. It also explains the treatment of costs associated with completing a merger and the associated disclosure requirements.

The Additional Considerations portion of the chapter discusses factors adding to uncertainty in business combinations; in-process research and development; and noncontrolling equity held prior to combination.

LEARNING OBJECTIVES

When students finish studying this chapter, they should be able to:

LO 1-1 Understand and explain the reasons for and different methods of business expansion, the types of organizational structures, and the types of acquisitions.
LO 1-2 Understand the development of standards related to acquisition accounting over time.
LO 1-3 Make calculations and prepare journal entries for the creation of a business entity.
LO 1-4 Understand and explain the differences between different forms of business combinations.
LO 1-5 Make calculations and business combination journal entries in the presence of a differential, goodwill, or a bargain purchase element.
LO 1-6 Understand additional considerations associated with business combinations.

SYNOPSIS OF CHAPTER 1

Intercorporate Acquisitions and Investments in Other Entities

T-Mobile's Merger with Sprint
A Brief Introduction

LO 1-1 Understand and explain the reasons for and different methods of business expansion, the types of organizational structures, and the types of acquisitions.

An Introduction to Complex Business Structures
Enterprise Expansion
Business Objectives
Frequency of Business Combinations
Ethical Considerations

Business Expansion and Forms of Organizational Structure

Internal Expansion: Creating a Business Entity
External Expansion: Business Combinations
Organizational Structure and Financial Reporting

LO 1-2 Understand the development of standards related to acquisition accounting over time.

The Development of Accounting for Business Combinations

LO 1-3 Make calculations and prepare journal entries for the creation of a business entity.

Accounting for Internal Expansion: Creating Business Entities

LO 1-4 Understand and explain the differences between different forms of business combinations.

Accounting for External Expansion: Business Combinations

Legal Forms of Business Combinations
Methods of Effecting Business Combinations
Valuation of Business Entities

LO 1-5 Make calculations and business combination journal entries in the presence of a differential, goodwill, or a bargain purchase element.

Acquisition Accounting
Fair Value Measurements
Applying the Acquisition Method
Goodwill
Combination Effected through the Acquisition of Net Assets
Combination Effected through Acquisition of Stock
Financial Reporting Subsequent to a Business Combination

LO 1-6 Understand additional considerations associated with business combinations.

Additional Considerations in Accounting for Business Combinations
Uncertainty in Business Combinations
In-Process Research and Development
Noncontrolling Equity Held Prior to Combination

TEACHING IDEAS

1. Students could be asked to prepare a "Company Mergers & Acquisitions History." Each student (or group) is assigned a company from the *Fortune 500* list that appears annually in the April issue of *Fortune*. This could be reproduced and students could be assigned a company based on their seating order in the class. Alternatively, the instructor may have the list and then students may select a number between 1 and 100 at random and the instructor will tell them the name of "their" company. The students then must obtain the M&A activity of that company for the last 10 years from *Moody's Industrial Manual* or some similar source. *Moody's* presents this information at the beginning of each company's profile information. The students should determine the number and magnitude of the business combinations and investments for their company and prepare a historical timeline showing the business combinations and any other information they can obtain on selected (or all) combinations. Several activities during the semester or quarter can be based on the student's company selection made at this time.

2. Students can be required to conduct a key word search online and asked to provide examples and brief descriptions of several different types of merger activities.

3. Students could access the *Wall Street Journal* online article database and search for an article on a recent business combination. The students could be asked to provide a brief oral or written summary of the article.

DESCRIPTIONS OF CASES, EXERCISES, AND PROBLEMS

C1-1 35 min. LO 1-2, LO 1-5 M	**Assignment of Acquisition Costs** Students must research the current authoritative accounting standards as well as any FASB proposals regarding the treatment of acquisition costs and report their findings.
C1-2 15 min. LO 1-1, LO 1-3 M	**Evaluation of Merger** Students are asked to explain the funding of an acquisition as well as the impact on receivables and inventory.
C1-3 15 min. LO 1-4 M	**Business Combinations** Students must identify and evaluate tax incentives and other economic factors associated with the frequency of business combinations since the 1960s.
C1-4 25 min. LO 1-5 E	**Determination of Goodwill Impairment** Students must research the authoritative literature regarding impairment testing of goodwill. Students must report their findings and explain the type of tests used to determine whether goodwill has been impaired and provide some examples that would indicate possible goodwill impairment.
C1-5 25 min. LO 1-1 E	**Risks Associated with Acquisitions** Students must discuss the risks that Alphabet, Inc. (parent company of Google) sees inherent in potential acquisitions after researching the information provided by the company to investors about its motivation for acquiring companies and the possible risks associated with such acquisitions.
C1-6 25 min. LO 1-4 M	**Leveraged Buyouts** Students must explain a leveraged buyout and contrast it with a management buyout. They must identify authoritative pronouncements and the major issue involved in determining proper basis for an interest in an LBO acquired company.

E1-1 20 min. LO 1-1, LO 1-3, LO 1-5 M	**Multiple-Choice Questions on Complex Organizations** A set of five multiple-choice questions test students' understanding of complex business organizations.
E1-2 20 min. LO1-2, LO 1-5 E	**Multiple-Choice Questions on Recording Business Combinations [AICPA Adapted]** A set of five multiple-choice questions test students' basic understanding of recording business combinations.
E1-3 13 min. LO 1-2, LO 1-5 M	**Multiple-Choice Questions on Reported Balances [AICPA Adapted]** Four multiple-choice questions cover the computation of stockholders' equity and asset balances for the combined entity following a business combination.
E1-4 13 min. LO 1-2, LO 1-5 M	**Multiple-Choice Questions Involving Account Balances** Five multiple-choice questions cover the computation of account balances and related journal entries after a business combination.
E1-5 20 min. LO 1-3 E	**Asset Transfer to Subsidiary** Students are asked to show the journal entries made by the parent and subsidiary for the transfer of assets to the subsidiary.
E1-6 15 min. LO 1-3 E	**Creation of New Subsidiary** Students are asked to show the journal entries made by the parent and the subsidiary for the transfer of assets to the subsidiary.
E1-7 15 min. LO 1-2, LO 1-3 E	**Balance Sheet Totals of Parent Company** Journal entries are required for transfer of assets and accounts payable between a parent company and its newly created subsidiary. Both the parent and subsidiary journal entries must be made.

E1-8 12 min. LO 1-2, LO 1-5 M	**Acquisition of Net Assets** Students are required to show the journal entries that the parent must make at time of acquisition.
E1-9 20 min. LO 1-5 M	**Reporting Goodwill** Students must calculate goodwill to be reported under different acquisition prices.
E1-10 10 min. LO 1-5 E	**Stock Acquisition** Students must show the journal entry that the acquiring company must record when it issues stock for acquiring a subsidiary.
E1-11 20 min. LO 1-5 M	**Balances Reported Following Combination** Students must calculate seven balances for balance sheet accounts immediately following a business combination.
E1-12 15 min. LO 1-5 E	**Goodwill Recognition** Students must show the journal entry to be made by the acquiring company in recording a business combination involving goodwill.
E1-13 15 min. LO 1-5 M	**Acquisition Using Debentures** Students must show the journal entry to be made by the acquiring company in recording a business combination executed using debentures.
E1-14 15 min. LO 1-5 M	**Bargain Purchase** Students must show the journal entry to be made by the acquiring company in recording a business combination involving gain on a bargain purchase.
E1-15 20 min. LO 1-5 M	**Goodwill Impairment** Students must calculate goodwill and potential impairment of goodwill given three different fair value amounts.

E1-16 15 min. LO 1-5 M	**Goodwill Impairment** Students must calculate goodwill and potential impairment of goodwill given three different fair value amounts.
E1-17 20 min. LO 1-5 M	**Goodwill Assigned to Reporting Units** Students must calculate reported goodwill for a company, based on information for four different reporting units.
E1-18 15 min. LO 1-5 E	**Goodwill Measurement** Students must calculate goodwill and potential impairment of goodwill given four different fair value amounts.
E1-19 20 min. LO 1-5 M	**Computation of Fair Value** Students must calculate the fair value of buildings and equipment, given the cost of acquisition, the fair value of other assets and liabilities, and the book value of the building and equipment.
E1-20 20 min. LO 1-5 M	**Computation of Shares Issued and Goodwill** Students must determine the number of shares issued, the par value of the acquiring company's stock, and any goodwill arising from the business combination.
E1-21 15 min. LO 1-5 M, Ws	**Combined Balance Sheet** Students must prepare a balance sheet of the combined company immediately following the acquisition.
E1-22 20 min. LO 1-5 M	**Recording a Business Combination** Students must show the journal entries made by the acquiring company given financial statement information for both companies and market value of the acquiring company's common stock.
E1-23 15 min. LO 1-5 M	**Reporting Income** Students must compute net income and earnings-per-share reported in comparative income statement for two years.
P1-24 10 min. LO 1-3 E	**Assets and Accounts Payable Transferred to Subsidiary** Students must show journal entries recorded for transfer of assets and liabilities to the newly established subsidiary.

P1-25 10 min. LO 1-3 E	**Creation of New Subsidiary** Students must show journal entries made for the transfer of assets and liabilities to a newly created entity.
P1-26 25 min. LO 1-3 M	**Incomplete Data on Creation of Subsidiary** Students must calculate book value, reported amounts, reported shares, impact on balance sheet amounts.
P1-27 20 min. LO 1-5 M	**Acquisition in Multiple Steps** Students must prepare journal entries for the completion of the acquisition of additional shares of a previously owned company.
P1-28 15 min. LO 1-5 M	**Journal Entries to Record a Business Combination** Students must show the journal entries made to record a business combination in which the acquiring company issues shares of common stock.
P1-29 15 min. LO 1-5 M	**Recording Business Combinations** Students must show the journal entries made to record a business combination in which the acquiring company issues shares of common stock.
P1-30 30 min. LO 1-5 E	**Business Combination with Goodwill** Students must show the journal entry to be recorded by the acquiring company and the balance sheet following the business combination.
P1-31 15 min. LO 1-5 M	**Bargain Purchase** Students must show the journal entry to be made by the acquiring company in recording a business combination involving gain on a bargain purchase.
P1-32 15 min. LO 1-5 M	**Computation of Account Balances** Calculation of liability balance and fair value is required with simultaneous consideration of potential goodwill impairment.

P1-33 25 min. LO 1-5 H	**Goodwill Assigned to Multiple Reporting Units** Calculation of goodwill and potential goodwill impairment for multiple reporting units in a company are required.
P1-34 15 min. LO 1-5 M	**Journal Entries** Students must show journal entries recorded by the acquiring company for a business combination. Costs of combination must be considered.
P1-35 30 min. LO 1-5 M	**Purchase at More than Book Value** Students must show journal entries to record a business combination and prepare a balance sheet immediately after the business combination.
P1-36 25 min. LO 1-5 M	**Business Combination** Journal entries recorded by the acquiring company to record the business combination. Several account balances must be adjusted.
P1-37 30 min. LO 1-5 H	**Combined Balance Sheet** The balance sheet following the business combination is required. Stockholders' equity balances are required assuming three different levels of stock are issued by the acquiring company in completing the business combination.
P1-38 30 min. LO 1-5 M	**Incomplete Data** Balance sheet information for two separate entities and for the combined entity immediately after a business combination is given. Students must calculate the number of shares issued, market value of shares, fair value of inventory held by the acquired company, acquired company’s net assets, goodwill arising from the combination, retained earnings balance after combination, and depreciation expense for the first year on the acquired company’s depreciable assets.
P1-39 30 min. LO 1-5 M	**Incomplete Data Following Purchase** Balance sheet information for two separate entities and for the combined entity immediately after a business combination is given. Students must calculate the number and price of shares issued, the amount of cash paid as stock issuance costs, market value of shares issued on date of combination, cash paid for stock issue costs, market value of shares issued, the fair value of inventory and net assets, and the amount of goodwill to be reported.
P1-40 40 min. LO 1-5 M	**Comprehensive Business Combination**

	Students are given a comprehensive set of financial statements with book values and fair values. They are required to prepare all journal entries on the acquiring company's books related to the business combination. Next, they are asked to present the entries that would have been entered on the acquired company's books.

Difficulty Level Abbreviations:

E = Easy
M = Medium
H = Hard

OTHER RESOURCES

Chapter 1
Business Combination Illustration

On January 1, 20X9, Aggressive Co. acquired all the common shares of Docile Corp. by issuing common shares. Aggressive Co. issued shares with a par value of $15,000 and a market value of $90,000 in completing the acquisition.

Balance Sheet Data
of Individual Companies

	Aggressive Co.		Docile Corp.		Combined
	Book Value	Fair Value	Book Value	Fair Value	Combined Value
Cash	$50,000	$50,000	$20,000	$20,000	$70,000
Inventory	50,000	70,000	40,000	50,000	100,000
Building & Equipment(net)	300,000	350,000	60,000	80,000	380,000
Goodwill					12,000
TOTAL ASSETS	$400,000		$120,000		$562,000
Current Liabilities	$25,000	$25,000	$40,000	$40,000	$65,000
Bonds Payable	75,000	76,500	30,000	32,000	107,000
Capital Stock	200,000		20,000		215,000
Additional Paid-In Capital	30,000		10,000		105,000
Retained Earnings	70,000		20,000		70,000
TOTAL LIABILITIES AND S.E	$400,000		$120,000		$562,000

COMPUTATION OF GOODWILL

Fair Value of Shares issued by Aggressive Co.		$90,000
Fair Value of Docile Corp. Assets	$150,000	
Fair Value of Docile Corp. Liabilities	(72,000)	
Fair Value of Docile Corp. Net Assets		(78,000)
Goodwill		$12,000