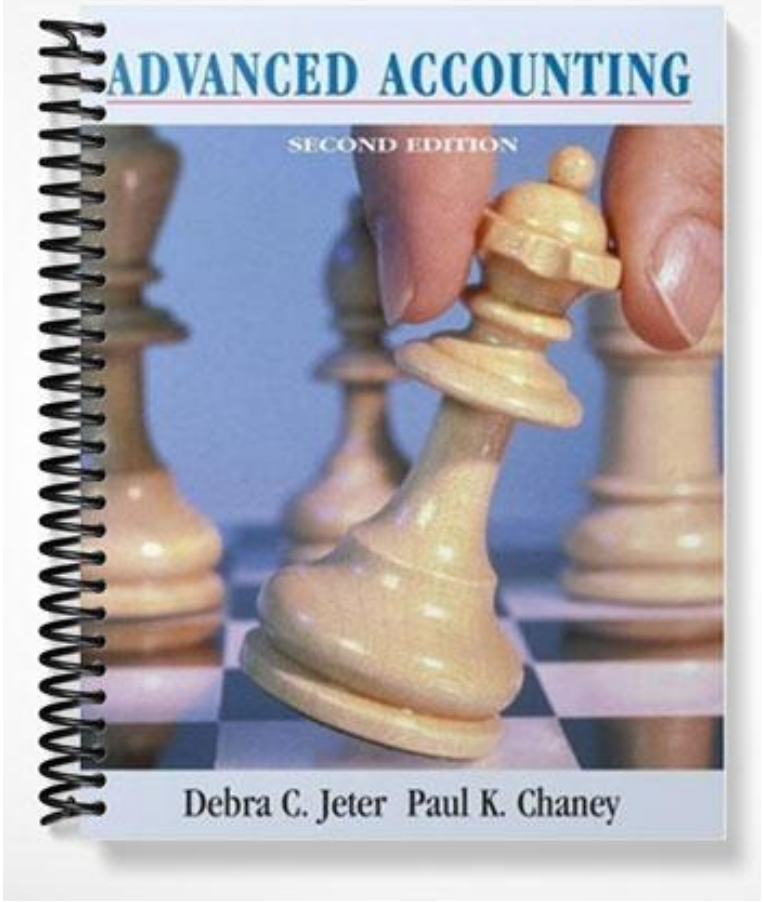
SOLUTIONS MANUAL



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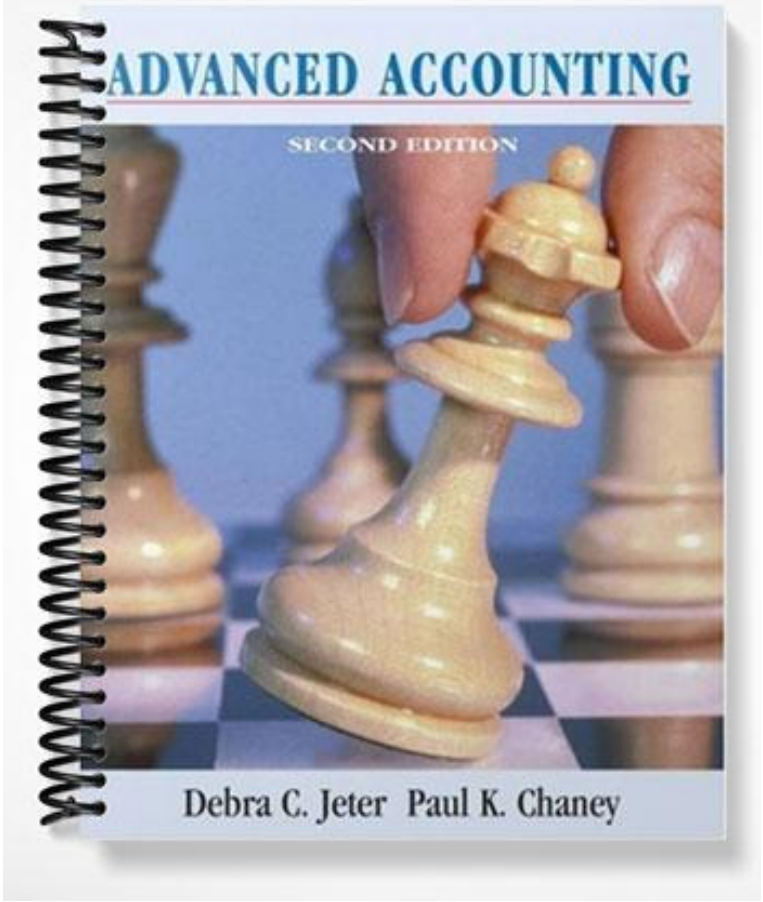

CHAPTER 2

Note: The letter A indicated for a question, exercise, or problem means that the question, exercise, or problem relates to a chapter appendix.

ANSWERS TO QUESTIONS

1. The purchase method treats a combination as the acquisition of one or more companies by another. The pooling of interests method, in contrast, interprets a business combination as the process of two or more groups of stockholders uniting ownership interest by an exchange of equity securities. This method (pooling) is no longer allowed for acquisitions after June 30, 2001. However, accounts resulting from previous acquisitions that used the pooling method will continue to be carried forward under the valuations implied by that method.

   Under the purchase method the identifiable assets acquired and liabilities assumed are recorded at their fair values at the date of acquisition. Any excess of total cost over the sum of these fair values is recorded as goodwill. Under the pooling method fair values of assets and liabilities were ignored, and the assets acquired and liabilities assumed were carried forward to the new or surviving entity at their recorded (book) values.

   Financial statement differences resulted from the use of one method rather than the other. The purchase method normally results in higher asset values. To the extent that these higher values relate to depreciable assets and inventories, future income charges are greater. (Also, bond discounts, under the purchase method, must be amortized to future periods, and in the past goodwill was amortized under the purchase method.) Thus, the use of the pooling method generally resulted in greater future earnings, lower asset values, and greater returns on assets.

2. The par value of the additional shares issued should be debited to other contributed capital and credited to common stock in order to adjust the original entry made. The logic for this treatment is that the total cost of the combination was set as part of the initial combination agreement. The number of shares issued initially was essentially an estimate based on the expected future market price of the stock. Since the market price of the stock at the contingency date was less than the expected price, additional shares must be issued so that the total market value of the shares issued is equal to the agreed upon initial cost.

3. Pro forma financial statements (sometimes referred to as “as if” statements) are financial statements that are prepared to show the effect of planned or contemplated transactions.

4. For purposes of the goodwill impairment test, all goodwill must be assigned to a reporting unit. Goodwill impairment for each reporting unit should be tested in a two-step process. In the first step, the fair value of a reporting unit is compared to its carrying amount (goodwill included) at the date of the periodic review. The fair value of the unit may be based on quoted market prices, prices of comparable businesses, or a present value or other valuation technique. If the fair value at the review date is less than the carrying amount, then the second step is necessary. In the second step, the carrying value of the goodwill is compared to its implied fair value. (The calculation of the implied fair value of goodwill used in the impairment test is similar to the method illustrated throughout this chapter for valuing the goodwill at the date of the combination.)

5. Net income would be the highest under the pooling method (no excess depreciation or goodwill amortization), lowest under the former purchase rules (both excess depreciation and goodwill amortization), and intermediate under the new purchase rules (excess depreciation only). Assets would be higher under the purchase method, either old or new rules. In fact, under the new rules, total assets will remain higher than under the old purchase rules because goodwill, once recorded, is not amortized.

6. The expected increase was due to the elimination of goodwill amortization expense. However, the impairment loss under the new rules was potentially larger than a periodic amortization charge, and this is in fact what materialized within the first year after adoption (a large impairment loss). If there was any initial stock price impact from elimination of goodwill amortization, it was only a short-term or momentum effect. Another issue is how the stock market responds to the goodwill impairment charge. Some users claim that this charge is a non-cash charge and should be disregarded by the market. However, others argue that the charge is an admission that the price paid was too high, and might result in a stock price decline (unless the market had already adjusted for this overpayment prior to the actual writedown).

ANSWERS TO EXERCISES

Exercise 2-1

Part A	Receivables	228,000	
	Inventory	396,000	
	Plant and Equipment	540,000	
	Land	660,000	
	Goodwill ($2,154,000- $1,824,000)	330,000	
	Liabilities		594,000
	Cash		1,560,000
Part B	Receivables	228,000	
	Inventory	396,000	
	Plant and Equipment ($540,000 – $108,000) *	432,000	
	Land ($660,000 – $132,000) *	528,000	
	Liabilities		594,000
	Cash		990,000

* The excess of net fair value over cost ($240,000 = $1,944,000 - $120,000 - $594,000 - $990,000) serves to reduce proportionately the fair values assigned to non-current assets (land and plant and equipment). An alternative approach is to compare the total consideration of $1,584,000 ($990,000 cash + $594,000 liabilities assumed) to the fair value of assets of $1,824,000. Thus the excess of the fair value over the total consideration is $240,000.

Proportion Assigned to:

Plant and equipment: $\frac{540}{540+660} = .45$

Land: $\frac{660}{540+660} = .55$

Reduction in Asset Value:

Plant and equipment (.45 × $240,000)	= $108,000
Land (.55 × $240,000)	= 132,000
Total	$240,000

Exercise 2-2	Purchase
Cash	$680,000
Receivables	720,000
Inventories	2,240,000
Plant and Equipment (net) ($3,840,000 + $720,000)	4,560,000
Goodwill	120,000
Total Assets	$8,320,000
Liabilities	1,520,000
Common Stock, $16 par ($3,440,000 + (.50 × $800,000))	3,840,000
Other Contributed Capital ($400,000 + $800,000)	1,200,000
Retained Earnings	1,760,000
Total Equities	$8,320,000

Entries on Petrello Company's books would be:

	Purchase	
Cash	200,000	
Receivables	240,000	
Inventory	240,000	
Plant and Equipment	720,000	
Goodwill *	120,000	
Liabilities		320,000
Common Stock (25,000 × $16)		400,000
Other Contributed Capital ($48 - $16) × 25,000		800,000

* ($48 × 25,000) – [($1,480,000 – ($800,000-$720,000)- $320,000]
= $1,200,000 –[$1,480,000 – 80,000 – 320,000] = $1,200,000 - $1,080,000 = 120,000

Exercise 2-3

Accounts Receivable	231,000	
Inventory	330,000	
Land	550,000	
Buildings and Equipment	1,144,000	
Goodwill	848,000	
Allowance for Uncollectible Accounts ($231,000 - $198,000)		33,000
Current Liabilities		275,000
Bonds Payable		450,000
Premium on Bonds Payable ($495,000 - $450,000)		45,000
Preferred Stock (15,000 × $100)		1,500,000
Common Stock (30,000 × $10)		300,000
Other Contributed Capital ($25 - $10) × 30,000		450,000
Cash		50,000

Cost paid ($1,500,000 + $750,000 + $50,000) =	$2,300,000
Fair value of net assets (198,000 +330,000 + 550,000 + 1,144,000 – 275,000 – 495,000) =	1,452,000
Goodwill =	$848,000

Exercise 2-4

Cash	96,000	
Receivables	55,200	
Inventory	126,000	
Land	198,000	
Plant and Equipment	466,800	
Goodwill*	137,450	
Accounts Payable		44,400
Bonds Payable		480,000
Premium on Bonds Payable**		45,050
Cash		510,000

** Present value of maturity value, 12 periods @4%:	0.6246 × $480,000 =	$299,808
Present value of interest annuity, 12 periods @ 4%:	9.38507 × $24,000 =	225,242
Total present value		525,050
Par value		480,000
Premium on bonds payable		$ 45,050

*Cash paid		$510,000
Less: Book value of net assets acquired ($897,600 – $44,400 - $480,000)		(373,200)
Excess of cash paid over book value		136,800
Increase in inventory to fair value	(15,600)	
Increase in land to fair value	(28,800)	
Increase in bond to fair value	45,050	
Total increase in net assets to fair value		650
Goodwill		$137,450

Exercise 2-5

Part A	Current Assets	960,000	
	Plant and Equipment ($1,440,000 - $24,000)	1,416,000	
	Liabilities		216,000
	Cash		2,160,000
	Cost (amount paid)	$2,160,000	
	Fair value of net assets ($2,400,000 - $216,000)	2,184,000	
	Excess of fair value over cost (reduce plant and equipment)	$24,000	
Part B	Plant and Equipment	24,000	
	Goodwill	336,000	
	Cash		360,000

Exercise 2-6

The amount of the contingency is $750,000 (75,000 shares at $10 per share)

Part A	Other Contributed Capital	750,000	
	Cash		750,000
Part B	Other Contributed Capital	187,500	
	Common Stock		187,500

$\frac{\$750,000}{\$40}$ = 18,750 additional shares @ $10 par value

Exercise 2-7

Current Assets	$3,000
Plant Assets (1)	24,350
Goodwill (2)	23,400
Debt	50,000
Stockholders' Equity (3)	750

(1) $12,000 + [.95 × ($25,000 – $12,000)] = $24,350

(2) Cost of shares	$50,000
Book value of net assets acquired (.95 × $15,000)	14,250
Excess of cost over book value	35,750
Assigned to plant assets [.95 × ($25,000 - $12,000)]	12,350
Assigned to goodwill	$23,400

(3) .05 × $15,000 = 750

Exercise 2-8

1. (c)	Cost (8,000 shares @ $30)	$240,000
	Fair value of net assets acquired	228,800
	Excess of cost over fair value (goodwill)	$ 11,200

2. (c)	Cost (8,000 shares @ $30)	$240,000
	Fair value of net assets acquired	276,000
	Difference between cost and fair value (reduce Plant & Equipment)	$ 36,000
	Price's Cost of Plant and Equipment	$575,000
	Sim's Fair Value of Plant and Equipment	242,000
	Excess of Fair Value over Cost	(36,000)
	Plant and Equipment (balance)	$ 781,000

Exercise 2-9

Current Assets	362,000	
Long-term assets ($1,890,000 + $120,000) + ($98,000 + $5,000)	2,013,000	
Goodwill *	395,000	
Liabilities		119,000
Long-term Debt		491,000
Common Stock (144,000 × $5)		720,000
Other Contributed Capital (144,000 × ($15 - $5))		1,440,000

* (144,000 × $15) – [$362,000 + $2,013,000 – ($119,000 + $491,000)] = $395,000

Total shares issued $\left(\frac{\$700{,}000}{\$5}+\frac{\$20{,}000}{\$5}\right)$ = 144,000

Fair value of stock issued (144,000 × $15) = $2,160,000

Exercise 2-10

Case A

Cost (Purchase Price)	$130,000
Less: Fair Value of Net Assets	120,000
Goodwill	$ 10,000

Case B

Cost (Purchase Price)	$110,000
Less: Fair Value of Net Assets	90,000
Goodwill	$ 20,000

Case C

Cost (Purchase Price)	$15,000
Less: Fair Value of Net Assets	20,000
Adjustment to Fair Value of Long-Lived Assets	($ 5,000)

Exercise 2-10 (Continued)

	Assets			Liabilities
	Goodwill	Current Assets	Long-Lived Assets	
Case A	$10,000	$20,000	$130,000	$30,000
Case B	20,000	30,000	80,000	20,000
Case C	0	20,000	35,000	40,000

Exercise 2-11
Part A.

2004: **Step 1**: Fair value of the reporting unit $400,000

Carrying value of unit:

Carrying value of identifiable net assets	$330,000	
Carrying value of goodwill ($450,000 - $375,000)	75,000	
		405,000
Excess of carrying value over fair value		$ 5,000

The excess of carrying value over fair value means that step 2 is required.

Step 2: Fair value of the reporting unit		$400,000
Fair value of identifiable net assets		340,000
Implied value of goodwill		60,000
Recorded value of goodwill ($450,000 - $375,000)		75,000
Impairment loss		$ 15,000

2005: **Step 1**: Fair value of the reporting unit $400,000

Carrying value of unit:

Carrying value of identifiable net assets	$320,000	
Carrying value of goodwill ($75,000 - $15,000)	60,000	
		380,000
Excess of Fair value over Carrying value		$ 20,000

The excess of fair value over carrying value means that step 2 is **not** required.

2006: **Step 1**: Fair value of the reporting unit $350,000

Carrying value of unit:

Carrying value of identifiable net assets	$300,000	
Carrying value of goodwill ($75,000 - $15,000)	60,000	
		360,000
Excess of carrying value over fair value		$ 10,000

The excess of carrying value over fair value means that step 2 is required.

Exercise 2-11 (Continued)

Step 2: Fair value of the reporting unit		$350,000
Fair value of identifiable net assets		325,000
Implied value of goodwill		25,000
Recorded value of goodwill	($75,000 - $15,000)	60,000
Impairment loss		$ 35,000

Part B.

2004:	Impairment loss—goodwill	15,000	
	Goodwill		15,000
2005:	No entry		
2006:	Impairment loss—goodwill	35,000	
	Goodwill		35,000

Part C.

SFAS No. 142 specifies the presentation of goodwill in the balance sheet and income statement (if impairment occurs) as follows:

- The aggregate amount of goodwill should be a separate line item in the balance sheet.
- The aggregate amount of losses from goodwill impairment should be shown as a separate line item in the operating section of the income statement unless some of the impairment is associated with a discontinued operation (in which case it is shown net-of-tax in the discontinued operation section).

Part D.

In a period in which an impairment loss occurs, *SFAS No. 142* mandates the following disclosures in the notes:

(1) A description of the facts and circumstances leading to the impairment;
(2) The amount of the impairment loss and the method of determining the fair value of the reporting unit;
(3) The nature and amounts of any adjustments made to impairment estimates from earlier periods, if significant.

Exercise 2-12

1.

Current Assets	125,000	
Plant Assets (net)	400,000	
Goodwill *	175,000	
Liabilities		100,000
Cash		600,000

* $600,000 – [($125,000 + $400,000) - $100,000] = 175,000

2. Amortization for first year $175,000/20 = $8,750
   Same for second year

Exercise 2-12 (Continued)

Carrying Value at January 1, 2002 = $175,000 – ($8,750 x 2) = $157,500

3. Fair value of the reporting unit $550,000
Carrying value of unit (including goodwill) 600,000
Excess of carrying value over fair value $ 50,000
The excess of carrying value over fair value means that step 2 is required.

Step 2: Fair value of the reporting unit	$550,000
Fair value of identifiable net assets	450,000
Implied value of goodwill	100,000
Recorded carrying value of goodwill	157,500
Impairment loss	$ 57,500

- The loss from goodwill impairment should be shown as a separate line item in the operating section of the income statement.

4. 1.) Income before extraordinary items and net income for all periods presented adjusted to exclude expenses from the amortization of goodwill.
2.) A reconciliation of the adjusted net income to the reported net income; and
3.) Similarly adjusted earnings per share amounts.

Exercise 2-13

a. Fair Value of Identifiable Net Assets

Book values $500,000 – $100,000 =	$400,000
Write up of Inventory and Equipment:	
($20,000 + $30,000)=	50,000
Purchase price above which goodwill would result	$ 450,000

b. Below $450,000 equipment would be written down.
c. Equipment would be written down to zero before recording an extraordinary gain:

$450,000 Fair Value of Identifiable Net Assets - $410,000 write-down of equipment = $40,000

Cash and Inventory, as well as Liabilities, would be recorded at fair values totaling ($140,000 - $100,000) or $40,000. At a purchase price of $40,000, equipment would be recorded at zero and there would be no extraordinary gain. At any purchase price lower than $40,000, an extraordinary gain would result.

d. Anything below $450,000 is technically considered a bargain.
e. Goodwill would be $50,000 at a purchase price of $500,000 or ($450,000 + $50,000).

Exercise 2-14

	Pooling	Purchase(old)	Purchase (new)
Revenues	$300,000	$300,000	$300,000
Expenses	(120,000)	(120,000)	(120,000)
Income before depreciation and amortization	180,000	180,000	180,000
Depreciation – equipment	(6,000)	(12,000)	(12,000)
Depreciation - building	(5,000)	(12,500)	(12,500)
Amortization of goodwill		(1,000)	-0-
Income before taxes	$ 169,000	$ 154,500	$155,500

Depreciation and amortization expense

Equipment	$60,000/10 yr = $6,000	$120,000/10 yrs = $12,000
Building	$100,000/20 yrs = $5,000	$250,000/20 yrs = $12,500
Goodwill*		($40,000)/40=$1,000 only under old rules

* Cost $445,000
Fair value of net assets 405,000 = ($ 435,000 – $ 30,000)
Goodwill $ 40,000

Exercise 2-15A

Cash	20,000	
Accounts Receivable	112,000	
Inventory	134,000	
Land	55,000	
Plant Assets	463,000	
Discount on Bonds Payable	20,000	
Goodwill*	127,200	
Allowance for Uncollectible Accounts		10,000
Accounts Payable		54,000
Bonds Payable		200,000
Deferred Income Tax Liability		67,200
Common Stock		100,000
Additional Paid in Capital ($6 -$1) × 100,000		500,000

Cost of acquisition	$600,000
Book value of net assets acquired ($80,000 + $132,000 + $160,000)	372,000
Difference between cost and book value	228,000
Allocated to:	
Increase inventory, land, and plant assets to fair value ($52,000 + $25,000 + $71,000)	(148,000)
Decrease bonds payable to fair value	(20,000)
Establish deferred income tax liability ($168,000 × 40%)	67,200
Balance assigned to goodwill	$ 127,200

* If the goodwill is "grossed up," then the goodwill would be recorded at: $127,200/(1- t) = $127,200/.60 = $212,000. In addition, if the goodwill is grossed up, then an additional deferred tax liability should be recorded on the amount of goodwill ($212,000 x .40) or additional deferred tax liability of $84,800. Thus the entry would appear as follows:

Cash	20,000	
Accounts Receivable	112,000	
Inventory	134,000	
Land	55,000	
Plant Assets	463,000	
Discount on Bonds Payable	20,000	
Goodwill	212,000	
Allowance for Uncollectible Accounts		10,000
Accounts Payable		54,000
Bonds Payable		200,000
Deferred Income Tax Liability ($67,200 + $84,800)		152,000
Common Stock		100,000
Additional Paid in Capital		500,000

ANSWERS TO PROBLEMS

Problem 2-1

Current Assets ($180,000 + $85,000)	265,000	
Plant and Equipment ($530,000 + $150,000)	680,000	
Goodwill*	235,000	
Liabilities ($95,000 +$35,000)		130,000
Common Stock (30,000 shares @ $20/share)		600,000
Other Contributed Capital (30,000 × ($35 – $20))		450,000
Goodwill	20,000	
Cash		20,000
Other Contributed Capital	6,000	
Cash		6,000
To record the direct acquisition costs and stock issue costs		

* Goodwill = Excess of Consideration of $1,180,000 (stock valued at $1,050,000 plus debt assumed of $130,000) over Fair Value of Identifiable Assets of $945,000 (current assets of $265,000 plus PPE of $680,000); Goodwill increased in next entry by $20,000 to reflect direct acquisition costs.

Problem 2-2

Acme Company
Balance Sheet
October 1, 2004
(000)

Assets (except goodwill) ($3,900 + $9,000 + $1,300)		$14,200
Goodwill (1)		1,160
Total Assets		$15,360
Liabilities ($2,030 + $2,200 + $260)		$4,490
Common Stock (180 × $20) + $2,000		5,600
Other Contributed Capital (180 × ($50 – $20))		5,400
Retained Earnings		(130)
Total Liabilities and Equity		$15,360

(1)	Cost (180 × $50)		$9,000
	Fair value of net assets acquired:		
	Fair value of assets of Baltic and Colt	$10,300	
	Less liabilities assumed	2,460	7,840
	Goodwill		$1,160

Problem 2-3

Present value of maturity value, 20 periods @ 6%:	0.3118 × $600,000 =	$187,080
Present value of interest annuity, 20 periods @ 6%:	11.46992 × $30,000 =	344,098
Total Present value		531,178
Par value		600,000
Discount on bonds payable		$68,822

Cash	114,000	
Accounts Receivable	135,000	
Inventory	310,000	
Land ($315,000 - $63,002)	251,998	
Buildings ($54,900 - $10,980)	43,920	
Equipment ($39,450 - $7890)	31,560	
Bond Discount ($40,000 + $68,822)	108,822	
Current Liabilities		95,300
Bonds Payable ($300,000 + $600,000)		900,000

Computation of Excess of Net Assets Received Over Cost

Cost (Purchase Price) ($531,178 plus liabilities assumed of $95,300 and $260,000)	$886,478
Less: Total fair value of assets received	$968,350
Excess of fair value of net assets over cost	($ 81,872)

Allocation of Excess of Net Assets Received to the Reduction of Noncurrent Assets

Fair value of noncurrent assets:

Land	$315,000
Buildings	54,900
Equipment ($123,700 - $84,250)	39,450
Total	$ 409,350

Allocation of Excess of $81,872

To Land	$\frac{\$315{,}000}{\$409{,}350} \times \$81{,}872 =$	$63,002
To Buildings	$\frac{\$54{,}900}{\$409{,}350} \times \$81{,}872 =$	10,980
To Equipment	$\frac{\$39{,}450}{\$409{,}350} \times \$81{,}872 =$	7,890
		$ 81,872

Problem 2-4

Part A January 1, 2004

Accounts Receivables	72,000	
Inventory	99,000	
Land ($162,000 - $14,580) *	147,420	
Buildings ($450,000 - $40,500) *	409,500	
Equipment ($288,000 - $25,920) *	262,080	
Allowance for uncollectible accounts		7,000
Accounts Payable		83,000
Note Payable		180,000
Cash		720,000

Computation of Excess of Net Assets Received Over Cost

Total fair value of net assets acquired ($1,064,000 - $263,000)	$801,000
Cash paid	720,000
Excess of fair value of net assets over cost	$ 81,000

* Allocation of Excess of $81,000

To Land	$\frac{\$162}{\$900} \times \$81{,}000 = .18 \times \$81{,}000 =$	$14,580
To Buildings	$\frac{\$450}{\$900} \times \$81{,}000 = .50 \times \$81{,}000 =$	40,500
To Equipment	$\frac{\$288}{\$900} \times \$81{,}000 = .32 \times \$81{,}000 =$	25,920
		$ 81,000

Part B January 2, 2006

Additional cash payment increases the cost of the acquisition. The cash increases the assets to their fair values, any excess is goodwill.

Land	14,580	
Buildings	40,500	
Equipment	25,920	
Goodwill ($135,000 - $81,000)	54,000	
Cash		135,000

Part C January 2, 2006 (increase assets proportionally to their fair values)

Land (.18 × 80,000)	14,400	
Buildings (.50 × 80,000)	40,000	
Equipment (.32 × 80,000)	25,600	
Cash		80,000

Problem 2-5

Part A

Investment in Park Company (5% of book value)	2,000	
Common Stock		2,000
Cash	90,000	
Notes Payable		90,000
Investment in Park Company	80,000	
Cash		80,000
Current Assets	12,000	
Plant Assets (1)	68,250	
Goodwill (2)	8,750	
Liabilities		7,000
Investment in Park		82,000

(1) $35,000 + .95 × ($70,000 – $35,000) =	$68,250	
(2) Cost of shares	$80,000	
Book value of net assets (.95 × $40,000) =	38,000	
Difference between cost and book value	$ 42,000	
Allocated to:		
Plant assets (.95 × ($70,000 – $35,000)) =	33,250	
Goodwill	$ 8,750	

Part B

Step Company
Balance Sheet
January 1, 2003

Current Assets ($12,000 + $10,000)	$22,000
Plant Assets ($35,000 + $33,250)	68,250
Goodwill	8,750
Total Assets	$ 99,000
Liabilities	$7,000
Note Payable	90,000
Common Stock	2,000
Total Liabilities and Equity	$ 99,000

Problem 2-6

Pepper Company
Pro Forma Balance Sheet
Giving Effect to Proposed Issue of Common Stock and Note Payable for
All of the Common Stock of Salt Company under Purchase Accounting
December 31, 2003

	Audited Balance Sheet	Adjustments	Pro Forma Balance Sheet
Cash	$180,000	405,000	$585,000
Receivables	230,000	(60,000)	287,000
		117,000	
Inventories	231,400	134,000	365,400
Plant Assets	1,236,500	905,000 (1)	2,141,500
Goodwill		181,500	181,500
Total Assets	$1,877,900		$3,560,400
Accounts Payable, 8%	$255,900	(60,000)	$375,900
		180,000	
Notes Payable	0	300,000	300,000
Mortgage Payable	180,000	152,500	332,500
Common Stock, $20 par	900,000	600,000	1,500,000
Additional Paid-in Capital	270,000	510,000 (2)	780,000
Retained Earnings	272,000		272,000
Total Liabilities and Equity	$1,877,900		$3,560,400

Change in Cash

Cash from stock issue ($37 × 30,000)	$1,110,000
Less: Cash paid for acquisition	(800,000)
Plus: Cash acquired in acquisition	95,000
Total change in cash	$ 405,000

Goodwill:

Cost of acquisition	$1,100,000
Net assets acquired $340,000 + $179,500 + $184,000)	703,500
Excess cost over net assets acquired	$396,500
Assigned to plant assets	215,000
Goodwill	$ 181,500

(1) $690,000 + $215,000 (2) ($37 - $20) × 30,000

Problem 2-7

Ping Company
Pro Forma Income Statement for the Year 2004
Assuming a Merger of Ping Company and Spalding Company

Sales (1)		$6,345,972
Cost of goods sold:		
Fixed Costs (2)	$962,157	
Variable Costs (3)	2,464,095	3,426,252
Gross Margin		2,919,720
Selling Expenses (4)	$785,910	
Other Expenses (5)	319,310	1,105,220
Net Income		$1,814,500

$$\frac{\$1{,}814{,}500 - (\$952{,}640 + \$499{,}900)}{0.20} = \frac{\$361{,}960}{0.20} = \$1{,}809{,}800$$

Since $1,809,800 is greater than $1,800,000 Ping should buy Spalding.

(1) $3,510,100 + $2,365,800 = $5,875,900 × 1.2 × .9 = $6,345,972

(2) ($1,752,360 × .35) + ($1,423,800 × .35 × .70) = $962,157

(3) $1,752,360 × .70 × $\frac{\$5{,}875{,}900 \times 1.2}{\$3{,}510{,}100}$ = $2,464,095

(4) ($632,500 + $292,100) × .85 = $785,910

(5) $172,600 × 1.85 = $319,310

Problem 2-8A

Part A	Receivables	125,000	
	Inventory	195,000	
	Land	120,000	
	Plant Assets	567,000	
	Patents	200,000	
	Deferred Tax Asset (60,000 x 35%)	21,000	
	Goodwill*	154,775	
	Current Liabilities		89,500
	Bonds Payable		300,000
	Premium on Bonds Payable		60,000
	Deferred Tax Liability		93,275
	Common Stock (30,000 × $2)		60,000
	Other Contributed Capital (30,000 × $26)		780,000

Cost of acquisition (30,000 × $28)	$840,000
Book value of net assets acquired ($120,000 + $164,000 + $267,000)	551,000
Difference between cost and book value	289,000
Allocated to:	
Increase inventory, land, plant assets, and patents to fair value	(266,500)
Deferred income tax liability (35% × $266,500)	93,275
Increase bonds payable to fair value	60,000
Deferred income tax asset (35% × $60,000)	(21,000)
Balance assigned to goodwill	$154,775

* If the goodwill is grossed up, then it will be recorded at: $154,775/(1-t) or $154,775/.65 = $238,115. In this case, additional deferred tax liability on the goodwill will be: $238,115 x .35 = $83,340.

The entry would then appear as follows:

Receivables	125,000	
Inventory	195,000	
Land	120,000	
Plant Assets	567,000	
Patents	200,000	
Deferred Tax Asset ($60,000 x 35%)	21,000	
Goodwill	238,115	
Current Liabilities		89,500
Bonds Payable		300,000
Premium on Bonds Payable		60,000
Deferred Tax Liability ($93,275 + $83,340)		176,615
Common Stock (30,000 × $2)		60,000
Other Contributed Capital (30,000 × $26)		780,000

Part B

Income Tax Expense (Balancing amount)	148,006	
Deferred Tax Liability ($51,125 × 35%)*	17,894	
Deferred Tax Asset ($6,000 × 35%)		2,100
Income Tax Payable ($468,000 × 35%)		163,800

*

Inventory:	$28,000
Plant Assets, $\frac{\$100{,}000}{10}$	10,000
Patents, - $\frac{\$105{,}000}{8}$	13,125
Total	$51,125