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**Advanced  
Accounting**



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## Chapter 2—Consolidated Statements: Date of Acquisition

### MULTIPLE CHOICE

1.

<u>Account</u>	<u>Investor</u>	<u>Investee</u>
Sales	\$500,000	\$300,000
Cost of Goods Sold	<u>230,000</u>	<u>170,000</u>
Gross Profit	\$270,000	\$130,000
Selling & Admin. Expenses	<u>120,000</u>	<u>100,000</u>
Net Income	<u>\$150,000</u>	<u>\$ 30,000</u>
Dividends paid	50,000	10,000

Assuming Investor owns 70% of Investee. What is the amount that will be recorded as Net Income for the Controlling Interest?

- a. \$164,000
- b. \$171,000
- c. \$178,000
- d. \$180,000

ANS: B                      DIF: M                      OBJ: 2-1

2. Consolidated financial statements are designed to provide:

- a. informative information to all shareholders.
- b. the results of operations, cash flow, and the balance sheet in an understandable and informative manner for creditors.
- c. the results of operations, cash flow, and the balance sheet as if the parent and subsidiary were a single entity.
- d. subsidiary information for the subsidiary shareholders.

ANS: C                      DIF: M                      OBJ: 2-2

3. Consolidated financial statements are appropriate even without a majority ownership if which of the following exists:

- a. the subsidiary has the right to appoint members of the parent company's board of directors.
- b. the parent company has the right to appoint a majority of the members of the subsidiary's board of directors through a large minority voting interest.
- c. the subsidiary owns a large minority voting interest in the parent company.
- d. the parent company has an ability to assume the role of general partner in a limited partnership with the approval of the subsidiary's board of directors.

ANS: B                      DIF: M                      OBJ: 2-3

4. The SEC and FASB has recommended that a parent corporation should consolidate the financial statements of the subsidiary into its financial statements when it exercises control over the subsidiary, even without majority ownership. In which of the following situations would control NOT be evident?

- a. Access to subsidiary assets is available to all shareholders.
- b. Dividend policy is set by the parent.
- c. The subsidiary does not determine compensation for its main employees.
- d. Substantially all cash flows of the subsidiary flow to the controlling shareholders.

ANS: A                      DIF: E                      OBJ: 2-3

5. The goal of the consolidation process is for:
  - a. asset acquisitions and 100% stock acquisitions to result in the same balance sheet.
  - b. goodwill to appear on the balance sheet of the consolidated entity.
  - c. the assets of the noncontrolling interest to be predominately displayed on the balance sheet.
  - d. the investment in the subsidiary to be properly valued on the consolidated balance sheet.

ANS: A                      DIF: E                      OBJ: 2-4

6. A subsidiary was acquired for cash in a business combination on December 31, 20X1. The purchase price exceeded the fair value of identifiable net assets. The acquired company owned equipment with a fair value in excess of the book value as of the date of the combination. A consolidated balance sheet prepared on December 31, 20X1, would
  - a. report the excess of the fair value over the book value of the equipment as part of goodwill.
  - b. report the excess of the fair value over the book value of the equipment as part of the plant and equipment account.
  - c. reduce retained earnings for the excess of the fair value of the equipment over its book value.
  - d. make no adjustment for the excess of the fair value of the equipment over book value. Instead, it is an adjustment to expense over the life of the equipment.

ANS: B                      DIF: D                      OBJ: 2-5

7. Parr Company purchased 100% of the voting common stock of Super Company for \$2,000,000. There are no liabilities. The following book and fair values are available:

	<u>Book Value</u>	<u>Fair Value</u>
Current assets	\$300,000	\$600,000
Land and building	600,000	900,000
Machinery	500,000	600,000
Goodwill	100,000	?

The machinery will appear on the consolidated balance sheet at \_\_\_\_\_.

- a. \$560,000
- b. \$860,000
- c. \$600,000
- d. \$900,000

ANS: C                      DIF: M                      OBJ: 2-5

8. Pagach Company purchased 100% of the voting common stock of Rage Company for \$1,800,000. The following book and fair values are available:

	<u>Book Value</u>	<u>Fair Value</u>
Current assets	\$150,000	\$300,000
Land and building	280,000	280,000
Machinery	400,000	700,000
Bonds payable	(300,000)	(250,000)
Goodwill	150,000	?

The bonds payable will appear on the consolidated balance sheet

- a. at \$300,000 (with no premium or discount shown).
- b. at \$300,000 less a discount of \$50,000.
- c. at \$0; assets are recorded net of liabilities.
- d. at an amount less than \$250,000 since it is a bargain purchase.

ANS: B                      DIF: M                      OBJ: 2-5

9. The investment in a subsidiary should be recorded on the parent's books at the
  - a. underlying book value of the subsidiary's net assets.
  - b. fair value of the subsidiary's net identifiable assets.
  - c. fair value of the consideration given.
  - d. fair value of the consideration given plus an estimated value for goodwill.

ANS: C                      DIF: E                      OBJ: 2-6

10. Which of the following costs of a business combination can be included in the value charged to paid-in-capital in excess of par?
  - a. direct and indirect acquisition costs
  - b. direct acquisition costs
  - c. direct acquisition costs and stock issue costs if stock is issued as consideration
  - d. stock issue costs if stock is issued as consideration

ANS: D                      DIF: M                      OBJ: 2-6

11. When it purchased Sutton, Inc. on January 1, 20X1, Pavin Corporation issued 500,000 shares of its \$5 par voting common stock. On that date the fair value of those shares totaled \$4,200,000. Related to the acquisition, Pavin had payments to the attorneys and accountants of \$200,000, and stock issuance fees of \$100,000. Immediately prior to the purchase, the equity sections of the two firms appeared as follows:

	<u>Pavin</u>	<u>Sutton</u>
Common stock	\$ 4,000,000	\$ 700,000
Paid-in capital in excess of par	7,500,000	900,000
Retained earnings	<u>5,500,000</u>	<u>500,000</u>
Total	<u>\$17,000,000</u>	<u>\$2,100,000</u>

Immediately after the purchase, the consolidated balance sheet should report paid-in capital in excess of par of

- a. \$8,900,000
- b. \$9,100,000
- c. \$9,200,000
- d. \$9,300,000

ANS: C                      DIF: M                      OBJ: 2-6

12. Judd Company issued nonvoting preferred stock with a fair value of \$1,500,000 in exchange for all the outstanding common stock of the Bath Corporation. On the date of the exchange, Bath had tangible net assets with a book value of \$900,000 and a fair value of \$1,400,000. In addition, Judd issued preferred stock valued at \$100,000 to an individual as a finder's fee for arranging the transaction. As a result of these transactions, Judd should report an increase in net assets of \_\_\_\_\_.
  - a. \$900,000
  - b. \$1,400,000
  - c. \$1,500,000
  - d. \$1,600,000

ANS: C                      DIF: M                      OBJ: 2-6

13. In an 80% purchase accounted for as a tax-free exchange, the excess of cost over book value is \$200,000. The equipment's book value for tax purposes is \$100,000 and its fair value is \$150,000. All other identifiable assets and liabilities have fair values equal to their book values. The tax rate is 30%. What is the total deferred tax liability that should be recognized on the consolidated balance sheet on the date of purchase?

- a. \$12,000
- b. \$60,000
- c. \$72,857
- d. \$85,714

ANS: D                      DIF: D                      OBJ: 2-6

14. On June 30, 20X1, Naeder Corporation purchased for cash at \$10 per share all 100,000 shares of the outstanding common stock of the Tedd Company. The total fair value of all identifiable net assets of Tedd was \$1,400,000. The only noncurrent asset is property with a fair value of \$350,000. The consolidated balance sheet of Naeder and its wholly owned subsidiary on June 30, 20X1, should report
- a. a retained earnings balance that is inclusive of a gain of \$400,000.
  - b. goodwill of \$400,000.
  - c. a retained earnings balance that is inclusive of a gain of \$350,000.
  - d. a gain of \$400,000

ANS: A                      DIF: M                      OBJ: 2-6 | 2-7

**Scenario 2-1**

Pinehollow acquired all of the outstanding stock of Stonebriar by issuing 100,000 shares of its \$1 par value stock. The shares have a fair value of \$15 per share. Pinehollow also paid \$25,000 in direct acquisition costs. Prior to the transaction, the companies have the following balance sheets:

<u>Assets</u>	<u>Pinehollow</u>	<u>Stonebriar</u>
Cash	\$ 150,000	\$ 50,000
Accounts receivable	500,000	350,000
Inventory	900,000	600,000
Property, plant, and equipment (net)	<u>1,850,000</u>	<u>900,000</u>
Total assets	<u>\$3,400,000</u>	<u>\$1,900,000</u>
<u>Liabilities and Stockholders' Equity</u>		
Current liabilities	\$ 300,000	\$ 100,000
Bonds payable	1,000,000	600,000
Common stock (\$1 par)	300,000	100,000
Paid-in capital in excess of par	800,000	900,000
Retained earnings	<u>1,000,000</u>	<u>200,000</u>
Total liabilities and equity	<u>\$3,400,000</u>	<u>\$1,900,000</u>

The fair values of Stonebriar's inventory and plant, property and equipment are \$700,000 and \$1,000,000, respectively.

15. Refer to Scenario 2-1. The journal entry to record the purchase of Stonebriar would include a
- a. credit to common stock for \$1,500,000.
  - b. credit to additional paid-in capital for \$1,100,000.
  - c. debit to investment for \$1,500,000.
  - d. debit to investment for \$1,525,000.

ANS: C                      DIF: M                      OBJ: 2-6 | 2-7

16. Refer to Scenario 2-1. Goodwill associated with the purchase of Stonebriar is \_\_\_\_.
- a. \$100,000
  - b. \$125,000
  - c. \$300,000
  - d. \$325,000

ANS: A                      DIF: M                      OBJ: 2-6 | 2-7

17. On April 1, 20X1, Paape Company paid \$950,000 for all the issued and outstanding stock of Simon Corporation. The recorded assets and liabilities of the Simon Corporation on April 1, 20X1, follow:

Cash	\$ 80,000
Inventory	240,000
Property and equipment (net of accumulated depreciation of \$320,000)	480,000
Liabilities	(180,000)

On April 1, 20X1, it was determined that the inventory of Simon had a fair value of \$190,000, and the property and equipment (net) had a fair value of \$560,000. What is the amount of goodwill resulting from the business combination?

- \$0
- \$120,000
- \$300,000
- \$230,000

ANS: C                      DIF: D                      OBJ: 2-7

18. Paro Company purchased 80% of the voting common stock of Sabon Company for \$900,000. There are no liabilities. The following book and fair values are available for Sabon:

	<u>Book Value</u>	<u>Fair Value</u>
Current assets	\$100,000	\$200,000
Land and building	200,000	200,000
Machinery	300,000	600,000
Goodwill	100,000	?

The machinery will appear on the consolidated balance sheet at \_\_\_\_.

- \$600,000
- \$540,000
- \$480,000
- \$300,000

ANS: A                      DIF: M                      OBJ: 2-8

19. When a company purchases another company that has existing goodwill and the transaction is accounted for as a stock acquisition, the goodwill should be treated in the following manner.
- Goodwill on the books of an acquired company should be disregarded.
  - Goodwill is recorded prior to recording fixed assets.
  - Goodwill is not recorded until all assets are stated at full fair value.
  - Goodwill is treated consistent with other tangible assets.

ANS: C                      DIF: M                      OBJ: 2-9

20. The SEC requires the use of push-down accounting in some specific situations. Push-down accounting results in:
- goodwill be recorded in the parent company separate accounts.
  - eliminating subsidiary retained earnings and paid-in capital in excess of par.
  - reflecting fair values on the subsidiary's separate accounts.
  - changing the consolidation worksheet procedure because no adjustment is necessary to eliminate the investment in subsidiary account.

ANS: C                      DIF: M                      OBJ: 2-10

## PROBLEM

1. Supernova Company had the following summarized balance sheet on December 31, 20X1:

<u>Assets</u>		
Accounts receivable		\$ 200,000
Inventory		450,000
Property and plant (net)		600,000
Goodwill		<u>150,000</u>
Total		<u>\$1,400,000</u>
<u>Liabilities and Equity</u>		
Notes payable		\$ 600,000
Common stock, \$5 par		300,000
Paid-in capital in excess of par		400,000
Retained earnings		<u>100,000</u>
Total		<u>\$1,400,000</u>

The fair value of the inventory and property and plant is \$600,000 and \$850,000, respectively.

Assume that Redstar Corporation exchanges 75,000 of its \$3 par value shares of common stock, when the fair price is \$20/share, for 100% of the common stock of Supernova Company. Redstar incurred acquisition costs of \$5,000 and stock issuance costs of \$5,000.

Required:

- What journal entry will Redstar Corporation record for the investment in Supernova?
- Prepare a supporting value analysis and determination and distribution of excess schedule
- Prepare Redstar's elimination and adjustment entry for the acquisition of Supernova.

ANS:

a. Investment in Supernova (75,000 × \$20)	1,500,000	
Common Stock \$3 par value		225,000
Paid-in-capital excess of par		1,275,000
Acquisition expense*	10,000	
Cash		10,000

\*alternative treatment: debit Paid-in capital in excess of par for issue costs

b)

### Value Analysis

	Company Implied Fair Value	Parent Price (100%)	NCI Value (0%)
Company fair value	<u>\$1,500,000</u>	<u>\$1,500,000</u>	N/A
Fair value identifiable net assets	<u>1,050,000</u>	<u>1,050,000</u>	
Goodwill	<u>\$ 450,000</u>	<u>\$ 450,000</u>	

Determination & Distribution Schedule

	Company Implied <u>Fair Value</u>	(100%) <u>Parent Price</u>	0% <u>NCI Value</u>
Fair value of subsidiary	<u>\$1,500,000</u>	<u>\$1,500,000</u>	
Less book value:			
C Stk	\$ 300,000		
APIC	400,000		
R/E	<u>100,000</u>		
Total S/E	\$ 800,000	\$ 800,000	
Interest Acquired		<u>100%</u>	
Book value		<u>\$ 800,000</u>	
Excess of fair over book	<u>\$ 700,000</u>	<u>\$ 700,000</u>	
Adjustment of identifiable accounts:			
	<u>Adjustment</u>		
Inventory	\$ 150,000		
Property and equip	250,000		
Goodwill (increase over \$150,000)	<u>300,000</u>		
Total	<u>\$ 700,000</u>		

c. Elimination entries

<b>EL</b> Common Stock \$5 Par – Sub	300,000	
Paid-in capital in excess of par – sub	400,000	
Retained Earnings – sub	100,000	
Investment in Supernova		800,000
<b>D</b> Inventory	150,000	
Property and Plant	250,000	
Goodwill	300,000	
Investment in Supernova		700,000

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

2. On December 31, 20X1, Priority Company purchased 80% of the common stock of Subsidiary Company for \$1,550,000. On this date, Subsidiary had total owners' equity of \$650,000 (common stock \$100,000; other paid-in capital, \$200,000; and retained earnings, \$350,000). Any excess of cost over book value is due to the under or overvaluation of certain assets and liabilities. Assets and liabilities with differences in book and fair values are provided in the following table:

	<u>Book Value</u>	<u>Fair Value</u>
Current Assets	\$500,000	\$800,000
Accounts Receivable	200,000	150,000
Inventory	800,000	800,000
Land	100,000	600,000
Buildings (net)	700,000	900,000
Current Liabilities	800,000	875,000
Long-Term Debt	850,000	930,000

Remaining excess, if any, is due to goodwill.



Required:

- a. Using the information above and on the separate worksheet, prepare a schedule to determine and distribute the excess of cost over book value.
- b. Complete the Figure 2-1 worksheet for a consolidated balance sheet as of December 31, 20X1.

**Figure 2-1**

Account Titles	Trial Balance		Eliminations and Adjustments			
	Priority Company	Sub. Company	Debit		Credit	
Assets:						
Current Assets	425,000	500,000				
Accounts Receivable	530,000	200,000				
Inventory	1,600,000	800,000				
Investment in Sub Co.	1,550,000					
Land	225,000	100,000				
Buildings and Equipment	1,200,000	1,100,000				
Accumulated Depreciation	800,000	(400,000)				
Total	4,730,000	2,300,000				
Liabilities and Equity:						
Current Liabilities	2,100,000	800,000				
Bonds Payable	1,000,000	850,000				
Common Stock – P Co.	900,000					
Addn'l paid-in capt – P Co	670,000					
Retained Earnings – P Co.	60,000					
Common Stock – S Co.		100,000				
Addn'l paid-in capt – S Co		200,000				
Retained Earnings – S Co.		<u>350,000</u>				
NCI						
Total	4,730,000	2,300,000				

(continued)

Account Titles	NCI	Consolidated Balance Sheet	
		Debit	Credit
Assets:			
Current Assets			
Accounts Receivable			
Inventory			
Investment in Sub Co.			

Land			
Buildings and Equipment			
Accumulated Depreciation			
Total			
Liabilities and Equity:			
Current Liabilities			
Bonds Payable			
Common Stock – P Co.			
Addn'l paid-in capt – P Co			
Retained Earnings – P Co.			
Common Stock – S Co.			
Addn'l paid-in capt – S Co			
Retained Earnings – S Co.			
NCI			
Total			

ANS:

a. Determination and Distribution Schedule:

	Company Implied Fair Value	Parent Price	NCI Value
Fair value of subsidiary	<u>\$ 1,937,500</u>	<u>\$ 1,550,000</u>	<u>\$387,500</u>
Less book value:			
C Stk	\$ 100,000		
APIC	200,000		
R/E	<u>350,000</u>		
Total S/E	\$ 650,000	\$ 650,000	\$650,000
Interest Acquired		80%	20%
Book value		\$ 520,000	\$130,000
Excess of fair over book	<u>\$ 1,287,500</u>	<u>\$ 1,030,000</u>	<u>\$257,500</u>

**Adjust identifiable accounts:**

Current assets	\$ 300,000
Accounts Receivable	(50,000)
Land	500,000
Buildings (net)	200,000
Current liabilities	(75,000)
Long-term debt	(80,000)
Goodwill	<u>492,500</u>
Total	<u>\$ 1,287,500</u>

b. For the worksheet solution, please refer to Answer 2-1.

**Answer 2-1**

Account Titles	Trial Balance		Eliminations and Adjustments	
	Priority Company	Sub. Company		
			Debit	Credit
<b>Assets:</b>				
Current Assets	425,000	500,000	(D) 300,000	
Accounts Receivable	530,000	200,000		(D) 50,000
Inventory	1,600,000	800,000		
Investment in Sub. Co.	1,550,000			(EL) 520,000 (D) 1,030,000
Land	225,000	100,000	(D) 500,000	
Buildings and Equipment	1,200,000	1,100,000	(D) 200,000	
Accumulated Depreciation	(800,000)	(400,000)		
Goodwill			(D) 492,500	
<b>Total</b>	<b>4,730,000</b>	<b>2,300,000</b>		
<b>Liabilities and Equity:</b>				
Current Liabilities	2,100,000	800,000		(D) 75,000
Bonds Payable	1,000,000	850,000		
Premium on Bonds Pay				(D) 80,000
Common Stock – P Co.	900,000			
Addn'l paid-in capt – P Co	670,000			
Ret. Earnings – P Co.	60,000			
Common Stock – S Co.		100,000	(EL) 80,000	
Addn'l paid-in capt – S Co		200,000	(EL) 160,000	
Ret. Earnings – S Co.		350,000	(EL) 280,000	(D) 257,500
NCI				
<b>Total</b>	<b>4,730,000</b>	<b>2,300,000</b>	<b>2,012,500</b>	<b>2,012,500</b>

(continued)

Account Titles	NCI	Consolidated Balance Sheet	
		Debit	Credit
<b>Assets:</b>			
Current Assets		1,225,000	
Accounts Receivable		680,000	
Inventory		2,400,000	
Investment in Sub. Co.		--	
Land		825,000	
Buildings and Equipment		2,500,000	
Accumulated Depreciation			1,200,000
Goodwill		492,500	
<b>Liabilities and Equity:</b>			
Current Liabilities			2,975,000

Bonds Payable			1,850,000
Premium on Bonds Pay			80,000
Common Stock – P Co.			900,000
Addn'l paid-in capt – P Co			670,000
Ret. Earnings – P Co.			60,000
Common Stock – S Co.	20,000		
Addn'l paid-in capt – S Co	40,000		
Ret. Earnings – S Co.	237,500		
NCI	387,500		387,500
Total		8,122,500	8,122,500

Eliminations and Adjustments:

- (EL) Eliminate 80% of the subsidiary's equity accounts against the investment in subsidiary account.
- (D) Allocate the excess of cost over book value to net assets as required by the determination and distribution of excess schedule.

DIF: M                      OBJ: 2-4 | 2-5 | 2-6 | 2-7 | 2-8

3. On December 31, 20X1, Parent Company purchased 80% of the common stock of Subsidiary Company for \$280,000. On this date, Subsidiary had total owners' equity of \$250,000 (common stock \$20,000; other paid-in capital, \$80,000; and retained earnings, \$150,000). Any excess of cost over book value is due to the under or overvaluation of certain assets and liabilities. Inventory is undervalued \$5,000. Land is undervalued \$20,000. Buildings and equipment have a fair value which exceeds book value by \$30,000. Bonds payable are overvalued \$5,000. The remaining excess, if any, is due to goodwill.

Required:

- Prepare a value analysis schedule for this business combination.
- Prepare the determination and distribution schedule for this business combination
- Prepare the necessary elimination entries in general journal form.

ANS:

- a) Value analysis schedule

	Company Implied <u>Fair Value</u>	<u>Parent Price</u>	<u>NCI Value</u>
Company fair value	\$ 350,000	\$ 280,000	\$ 70,000
Fair value identifiable net assets	<u>310,000</u>	<u>248,000</u>	<u>62,000</u>
Goodwill	<u>\$ 40,000</u>	<u>\$ 32,000</u>	<u>\$ 8,000</u>

b) Determination and distribution schedule:

	Company Implied <u>Fair Value</u>	<u>Parent Price</u>	<u>NCI Value</u>
Fair value of subsidiary	\$ 350,000	\$ 280,000	\$ 70,000
Less book value:			
C Stk	\$ 20,000		
APIC	80,000		
R/E	<u>150,000</u>		
Total S/E	\$ 250,000	\$ 250,000	\$250,000
Interest Acquired		<u>80%</u>	<u>20%</u>
Book value		<u>\$ 200,000</u>	<u>\$ 50,000</u>
Excess of fair over book	<u>\$ 100,000</u>	<u>\$ 80,000</u>	<u>\$ 20,000</u>
Adjust identifiable accounts:			
Inventory	\$ 5,000		
Land	20,000		
Bldgs & Equip	30,000		
Bond Pay Discount	5,000		
Goodwill	<u>40,000</u>		
Total	<u>\$ 100,000</u>		

c) Elimination entries:

**ELIMINATION ENTRY 'EL'**

C Stk-Sub	16,000		
APIC-Sub	64,000		
R/E-Sub	120,000		
Investment in Sub		200,000	
	<i>200,000</i>	<i>200,000</i>	

**ELIMINATION ENTRY 'D'**

Inventory	\$ 5,000		
Land	20,000		
Bldgs & Equip	30,000		
Bond Pay Discount	5,000		
Goodwill	40,000		
Investment in Sub		80,000	
R/E-Sub (NCI)		20,000	
	<i>100,000</i>	<i>100,000</i>	

DIF: M                      OBJ: 2-4 | 2-5 | 2-6 | 2-7 | 2-8

4. On January 1, 20X1, Parent Company purchased 100% of the common stock of Subsidiary Company for \$280,000. On this date, Subsidiary had total owners' equity of \$240,000.

On January 1, 20X1, the excess of cost over book value is due to a \$15,000 undervaluation of inventory, to a \$5,000 overvaluation of Bonds Payable, and to an undervaluation of land, building and equipment. The fair value of land is \$50,000. The fair value of building and equipment is \$200,000. The book value of the land is \$30,000. The book value of the building and equipment is \$180,000.

Required:

- a. Using the information above and on the separate worksheet, complete a value analysis schedule

- b. Complete schedule for determination and distribution of the excess of cost over book value.
- c. Complete the Figure 2-5 worksheet for a consolidated balance sheet as of January 1, 20X1.

**Figure 2-5**

Account Titles	Trial Balance		Eliminations and Adjustments	
	Parent Company	Sub. Company	Debit	Credit
Assets:				
Inventory	50,000	30,000		
Other Current Assets	239,000	165,000		
Investment in Subsidiary	280,000			
Land	120,000	30,000		
Buildings	350,000	230,000		
Accumulated Depreciation	(100,000)	(50,000)		
Other Intangibles	40,000			
Total	979,000	405,000		
Liabilities and Equity:				
Current Liabilities	191,000	65,000		
Bonds Payable		100,000		
Common Stock – P Co.	100,000			
Addn'l Pd-In Capt – P Co.	150,000			
Retained Earnings – P Co.	538,000			
Common Stock – S Co.		50,000		
Addn'l Pd-In Capt – S Co.		70,000		
Retained Earnings – S Co.		120,000		
NCI				
Total	979,000	405,000		

(continued)

Account Titles	NCI	Consolidated Balance Sheet	
		Debit	Credit
Assets:			
Inventory			
Other Current Assets			
Investment in Subsidiary			
Land			
Buildings			
Accumulated Depreciation			
Other Intangibles			
Total			
Liabilities and Equity:			
Current Liabilities			

Bonds Payable			
Common Stock – P Co.			
Addn'l Pd-In Capt – P Co.			
Retained Earnings – P Co.			
Common Stock – S Co.			
Addn'l Pd-In Capt – S Co.			
Retained Earnings – S Co.			
NCI			
<b>Total</b>			

ANS:

a. Value analysis schedule:

	Company Implied <u>Fair Value</u>	<u>Parent Price</u>
Company fair value	\$ 280,000	\$ 280,000
Fair value identifiable net assets	<u>300,000</u>	<u>300,000</u>
Gain on acquisition	<u>\$ (20,000)</u>	<u>\$ (20,000)</u>

b. Determination and Distribution Schedule:

	Company Implied <u>Fair Value</u>	<u>Parent Price</u>
Fair value of subsidiary	<u>\$ 280,000</u>	<u>\$ 280,000</u>
Less book value:		
C Stk	\$ 50,000	
APIC	70,000	
R/E	<u>120,000</u>	
Total S/E	\$ 240,000	\$ 240,000
Interest Acquired		<u>100%</u>
Book value		\$ 240,000
Excess of fair over book	<u>\$ 40,000</u>	<u>\$ 40,000</u>
Adjust identifiable accounts:		
Inventory	\$ 15,000	
Land	20,000	
Bldgs & Equip	20,000	
Bond Pay Discount	5,000	
Gain on acquisition	<u>(20,000)</u>	
Total	<u>\$ 40,000</u>	

c. For the worksheet solution, please refer to Answer 2-5.

**Answer 2-5**

Account Titles	Trial Balance		Eliminations and Adjustments			
	Parent Company	Sub. Company	Debit		Credit	
	Assets:					
Inventory	50,000	30,000	(D)	15,000		
Other Current Assets	239,000	165,000				
Investment in Subsidiary	280,000				(EL)	240,000
					(D)	40,000
Land	120,000	30,000	(D)	20,000		
Buildings	350,000	230,000	(D)	20,000		
Accumulated Depreciation	(100,000)	(50,000)				
Other Intangibles	40,000					
Goodwill						
Total	979,000	405,000				
Liabilities and Equity:						
Current Liabilities	191,000	65,000				
Bonds Payable		100,000				
Discount on Bonds			(D)	5,000		
Common Stock – P Co.	100,000					
Addn'l Pd-In Capt – P Co.	150,000					
Retained Earnings – P Co.	538,000				(D)	20,000
Common Stock – S Co.		50,000	(EL)	50,000		
Addn'l Pd-In Capt – S Co.		70,000	(EL)	70,000		
Retained Earnings – S Co.		120,000	(EL)	120,000		
NCI						
Total	979,000	405,000		300,000		300,000

(continued)

Account Titles	NCI	Consolidated Balance Sheet	
		Debit	Credit
Assets:			
Inventory		95,000	
Other Current Assets		404,000	
Investment in Subsidiary		- -	
Land		170,000	
Buildings		600,000	
Accumulated Depreciation			150,000
Other Intangibles		40,000	
Goodwill			
Total			
Liabilities and Equity:			
Current Liabilities			256,000
Bonds Payable			100,000
Discount on Bonds		5,000	



Common Stock – P Co.			100,000
Addn'l Pd-In Capt – P Co.			150,000
Retained Earnings – P Co.			558,000
Common Stock – S Co.	0		
Addn'l Pd-In Capt – S Co.	0		
Retained Earnings – S Co.	0		
NCI	0		0
Total		1,314,000	1,314,000

Eliminations and Adjustments:

- (EL) Eliminate 100% of the subsidiary's equity accounts against the investment in subsidiary account.
- (D) Allocate the excess of cost over book value to net assets as required by the determination and distribution of excess schedule; gain on acquisition closed to parent's Retained Earnings account

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

5. On January 1, 20X1, Parent Company purchased 90% of the common stock of Subsidiary Company for \$252,000. On this date, Subsidiary had total owners' equity of \$240,000 consisting of \$50,000 in common stock, \$70,000 additional paid-in capital, and \$120,000 in retained earnings.

On January 1, 20X1, the excess of cost over book value is due to a \$15,000 undervaluation of inventory, to a \$5,000 overvaluation of Bonds Payable, and to an undervaluation of land, building and equipment. The fair value of land is \$50,000. The fair value of building and equipment is \$200,000. The book value of the land is \$30,000. The book value of the building and equipment is \$180,000.

Required:

- a. Complete the valuation analysis schedule for this combination.
- b. Complete the determination and distribution schedule for this combination.
- c. Prepare, in general journal form, the elimination entries required to prepare a consolidated balance sheet for Parent and Subsidiary on January 1, 20X1.

ANS:

- a. Value analysis schedule

	Company Implied <u>Fair Value</u>	<u>Parent Price</u>	<u>NCI Value</u>
Company fair value	\$ 282,000**	\$ 252,000	\$ 30,000*
Fair value identifiable net assets	<u>300,000</u>	<u>270,000</u>	<u>30,000</u>
Gain on acquisition	<u>\$ (18,000)</u>	<u>\$ (18,000)</u>	<u>\$ –</u>

\*Cannot be less than the NCI share of the fair value of net assets

\*\*Sum of parent price + minimum allowable for NCI value

b. Determination and distribution schedule

	Company Implied <u>Fair Value</u>	<u>Parent Price</u>	<u>NCI Value</u>
Fair value of subsidiary	\$ 282,000	\$ 252,000	\$ 30,000
Less book value:			
C Stk	\$ 50,000		
APIC	70,000		
R/E	<u>120,000</u>		
Total S/E	\$ 240,000	\$ 240,000	\$240,000
Interest Acquired		<u>90%</u>	<u>10%</u>
Book value		<u>\$ 216,000</u>	<u>\$ 24,000</u>
Excess of fair over book	<u>\$ 42,000</u>	<u>\$ 36,000</u>	<u>\$ 6,000</u>
Adjust identifiable accounts:			
Inventory	\$ 15,000		
Land	20,000		
Bldgs & Equip	20,000		
Bond Pay Discount	5,000		
Gain on acquisition	<u>(18,000)</u>		
Total	<u>\$ 42,000</u>		

c. Elimination entries

**ELIMINATION ENTRY 'EL'**

C Stk-Sub	45,000		
APIC-Sub	63,000		
R/E-Sub	108,000		
Investment in Sub		216,000	
	<u>216,000</u>	<u>216,000</u>	

**ELIMINATION ENTRY 'D'**

Inventory	\$ 15,000		
Land	20,000		
Bldgs & Equip	20,000		
Bond Pay Discount	5,000		
Gain on acquisition		18,000	
Investment in Sub		36,000	
R/E-Sub (NCI)		6,000	
	<u>60,000</u>	<u>60,000</u>	

DIF: D                      OBJ: 2-4 | 2-5 | 2-6 | 2-7 | 2-8

6.

	<u>Individual Balance Sheets</u>		<u>Consolidated Financial Statements</u>
	<u>Pepper Co.</u>	<u>Salt Inc.</u>	
Cash	\$ 26,000	\$ 20,000	\$ 46,000
Accounts Receivable, net	20,000	30,000	50,000
Inventory	125,000	110,000	270,000
Land	30,000	80,000	124,000
Building and Equipment	320,000	160,000	459,000
Investment in Subsidiary	279,000	-	-
Goodwill	<u>-</u>	<u>-</u>	<u>41,000</u>
Total Assets	<u>\$800,000</u>	<u>\$400,000</u>	<u>\$990,000</u>

Accounts Payable	\$ 40,000	\$ 40,000	\$ 80,000
Other Liabilities	70,000	60,000	130,000
Common Stock	400,000	200,000	400,000
Retained Earnings	290,000	100,000	290,000
Noncontrolling Interest	_____	_____	<u>90,000</u>
Total Liabilities & Stockholders' Equity	<u>\$800,000</u>	<u>\$400,000</u>	<u>\$990,000</u>

Answer the following based upon the above financial statements:

- How much did Pepper Co. pay to acquire Salt Inc.?
- What was the fair value of Salt's Inventory at the time of acquisition?
- Was the book value of Salt's Building and Equipment overvalued or undervalued relative to the Building and Equipment's fair value at the time of acquisition?

ANS:

- Investment in Subsidiary \$279,000
  
- |                            |                |           |
|----------------------------|----------------|-----------|
| Consolidated Inventory     | \$270,000      |           |
| Pepper Co. Inventory       | <u>125,000</u> |           |
| Value attributable to Salt |                | \$145,000 |
  
- The Building and Equipment's book value was overvalued relative to the fair value.  
 $\$320,000 + \$160,000 = \$480,000$ ; consolidated buildings carried at \$459,000  
Salt's B&E overvalued by \$21,000

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

7. Supernova Company had the following summarized balance sheet on December 31, 20X1:

<u>Assets</u>		
Accounts receivable		\$ 200,000
Inventory		450,000
Property and plant (net)		600,000
Goodwill		<u>150,000</u>
Total		<u>\$1,400,000</u>
<u>Liabilities and Equity</u>		
Notes payable		\$ 600,000
Common stock, \$5 par		300,000
Paid-in capital in excess of par		400,000
Retained earnings		<u>100,000</u>
Total		<u>\$1,400,000</u>

The fair value of the inventory and property and plant is \$600,000 and \$850,000, respectively.

Required:

- a. Assume that Redstar Corporation purchases 100% of the common stock of Supernova Company for \$1,800,000. What value will be assigned to the following accounts of the Supernova Company when preparing a consolidated balance sheet on December 31, 20X1?

(1) Inventory	_____
(2) Property and plant	_____
(3) Goodwill	_____
(4) Noncontrolling interest	_____

- b. Prepare a valuation schedule

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

ANS:

a. (1) Inventory	\$600,000	(\$450,000 BV + \$150,000)
(2) Property and plant	\$850,000	(\$600,000 BV + \$250,000)
(3) Goodwill	\$750,000	
(4) Noncontrolling interest	0	No NCI

- b. Valuation schedule

	Company Implied <u>Fair Value</u>	<u>Parent Price</u>
Company fair value	\$ 1,800,000	\$ 1,800,000
Fair value identifiable net assets	<u>1,050,000</u>	<u>1,050,000</u>
Goodwill	<u>\$ 750,000</u>	<u>\$ 750,000</u>

- c.

	Company Implied <u>Fair Value</u>	<u>Parent Price</u>
Fair value of subsidiary	<u>\$ 1,800,000</u>	<u>\$ 1,800,000</u>
Less book value:		
C Stk	\$ 300,000	
APIC	400,000	
R/E	<u>100,000</u>	
Total S/E	<u>\$ 800,000</u>	\$ 800,000
Interest Acquired		<u>100%</u>
Book value		<u>800,000</u>
Excess of fair over book	<u>\$ 1,000,000</u>	<u>\$ 1,000,000</u>

Adjust identifiable accounts:

Inventory	\$ 150,000
Property & plant (net)	250,000
Goodwill (increase from \$150,000)	<u>600,000</u>
Total	<u>\$ 1,000,000</u>

DIF: M

OBJ: 2-6 | 2-7 | 2-9

8. Fortuna Company issued 70,000 shares of \$1 par stock, with a fair value of \$20 per share, for 80% of the outstanding shares of Acappella Company. The firms had the following separate balance sheets *prior* to the acquisition:

<u>Assets</u>	<u>Fortuna</u>	<u>Acappella</u>
Current assets	\$2,100,000	\$ 960,000
Property, plant, and equipment (net)	4,600,000	1,300,000
Goodwill		<u>240,000</u>
Total assets	<u>\$6,700,000</u>	<u>\$2,500,000</u>
 <u>Liabilities and Stockholders' Equity</u>		
Liabilities	\$3,000,000	\$ 800,000
Common stock (\$1 par)	800,000	
Common stock (\$5 par)		200,000
Paid-in capital in excess of par	2,200,000	300,000
Retained earnings	<u>700,000</u>	<u>1,200,000</u>
Total liabilities and equity	<u>\$6,700,000</u>	<u>\$2,500,000</u>

Book values equal fair values for the assets and liabilities of Acappella Company, except for the property, plant, and equipment, which has a fair value of \$1,600,000.

Required:

- Prepare a value analysis schedule
- Prepare a determination and distribution of excess schedule.
- Provide all eliminations on the partial balance sheet worksheet provided in Figure 2-8 and complete the noncontrolling interest column.

**Figure 2-8**

Fortuna Co. and Subsidiary Acappella Co.

Partial Worksheet for Consolidated Financial Statements

January 2, 20X4

Account Titles	Balance Sheet	
	Fortuna	Acappella
Current Assets	2,100,000	960,000
Property, Plant, and Equipment	4,600,000	1,300,000
Investment in Acappella	1,400,000	
Goodwill		240,000
Liabilities	(3,000,000)	(800,000)
Common Stock – Fortuna	(870,000)	
Paid-in Capital in Excess of Par – Fortuna	(3,530,000)	
Ret Earnings – Fortuna	(700,000)	
Common Stock – Paid-in Capital in Excess of Par – Acappella		(200,000)
		(300,000)

Ret Earn – Acappella		(1,200,000)

(continued)

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

Account Titles	Eliminations and Adjustments		NCI
	Debit	Credit	
Current Assets			
Property, Plant, and Equipment			
Investment in Acappella			
Goodwill			
Liabilities			
Common Stock – Fortuna			
Paid-in Capital in Excess of Par – Fortuna			
Ret Earnings – Fortuna			
Common Stock – Paid-in Capital in Excess of Par – Acappella			
Ret Earn – Acappella			

ANS:

a. Value analysis schedule:

	<u>Company Implied</u>		
	<u>Fair Value</u>	<u>Parent Price</u>	<u>NCI Value</u>
Company fair value	\$ 1,752,000	\$1,400,000	\$ 352,000*
Fair value identifiable net assets	<u>1,760,000</u>	<u>1,408,000</u>	<u>352,000</u>
Gain	<u>\$ (8,000)</u>	<u>(8,000)</u>	<u>\$ -</u>

\*Cannot be less than NCI share of identifiable net assets; company fair value is sum of parent price and NCI value.

b. Determination and distribution of excess schedule:

	Company Implied Fair Value	Parent Price	NCI Value
Fair value subsidiary	<u>\$1,752,000</u>	<u>\$1,400,000</u>	<u>\$352,000</u>
Less book value:			
Comm Stock	200,000		
APIC	300,000		
Ret Earn	<u>1,200,000</u>		
Total S/E	1,700,000	1,700,000	1,700,000
Interest acquired		<u>80%</u>	<u>20%</u>
Book value		<u>1,360,000</u>	<u>340,000</u>
Excess of fair over book	<u>52,000</u>	<u>40,000</u>	<u>12,000</u>

Adjust identifiable accounts:

Plant and equipment	300,000	DR
Goodwill	(240,000)	CR
Gain on acquisition	<u>(8,000)</u>	CR
Total	<u>52,000</u>	

c. For the worksheet solution, please refer to Answer 2-8.

**Figure 2-8**  
Fortuna Co. and Subsidiary Acappella Co.  
Partial Worksheet for Consolidated Financial Statements  
January 2, 20X4

Account Titles	Balance Sheet	
	Fortuna	Acappella
Current Assets	2,100,000	960,000
Property, Plant, and Equipment	4,600,000	1,300,000
Investment in Acappella	1,400,000	
Goodwill		240,000
Liabilities	(3,000,000)	(800,000)
Common Stock – Fortuna	(870,000)	
Paid-in Capital in Excess of Par – Fortuna	(3,530,000)	
Ret Earnings – Fortuna	(700,000)	
Common Stock – Acappella		(200,000)
Paid-in Capital in Excess of Par – Acappella		(300,000)
Ret Earn – Acappella		(1,200,000)

(continued)

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

Account Titles	Eliminations and Adjustments		NCI
	Debit	Credit	
Current Assets			
Property, Plant, and Equipment	(D) 300,000		
Investment in Acappella		(EL) 1,360,000	
		(D) 40,000	
Goodwill		(D) 240,000	
Liabilities			
Common Stock – Fortuna			
Paid-in Capital in Excess of Par – Fortuna			
Ret. Earnings – Fortuna		(D) 8,000	
Common Stock – Acappella	(EL) 160,000		(40,000)
Paid-in Capital in Excess of Par – Acappella	(EL) 240,000		(60,000)
Ret. Earnings – Acappella	(EL) 960,000	(D) 12,000	<u>(252,000)</u>
			352,000

Eliminations and Adjustments:

(EL) Eliminate 80% of subsidiary equity against the investment account.

(D) Distribute excess according to the determination and distribution of excess schedule.

DIF: M                      OBJ: 2-4 | 2-6 | 2-7 | 2-8 | 2-9

**ESSAY**

1. Discuss the conditions under which the FASB would assume a presumption of control. Additionally, under what circumstances might the FASB require consolidation even though the parent does not control the subsidiary?

ANS:

The FASB presumes that control exists if one company owns over 50% of the voting interest in another company or has an unconditional right to appoint a majority of the members of another company's controlling body. Additionally, in the absence of evidence to the contrary, one or more of the following conditions would lead to a presumption of control:

1. Ownership of a large noncontrolling interest where no other party has a significant interest.
2. Ownership of securities or unconditional rights in the company that can be converted into securities that would cause a controlling interest to exist.
3. The acquiring company has the unconditional right to dissolve the entity whose interest was acquired and assume control of the assets.
4. A relationship with another entity that assures control through provisions in a charter, bylaws, or trust agreement.



5. A legal obligation created with the controlled entity that requires substantially all cash flows and other economic benefits to flow to the controlling entity.
6. A sole general partner in a limited partnership where no other party may dissolve the partnership or remove the general partner.

DIF: M                      OBJ: 2-3

2. A parent company purchases an 80% interest in a subsidiary at a price high enough to revalue all assets and allow for goodwill on the interest purchased. If "push down accounting" were used in conjunction with the "economic entity concept," what unique procedures would be used?

ANS:

All assets including goodwill would be adjusted to full fair value. The method differs in that the asset adjustments would be made directly on the books of the subsidiary rather than on the consolidated worksheet.

DIF: D                      OBJ: 2-8 | 2-10