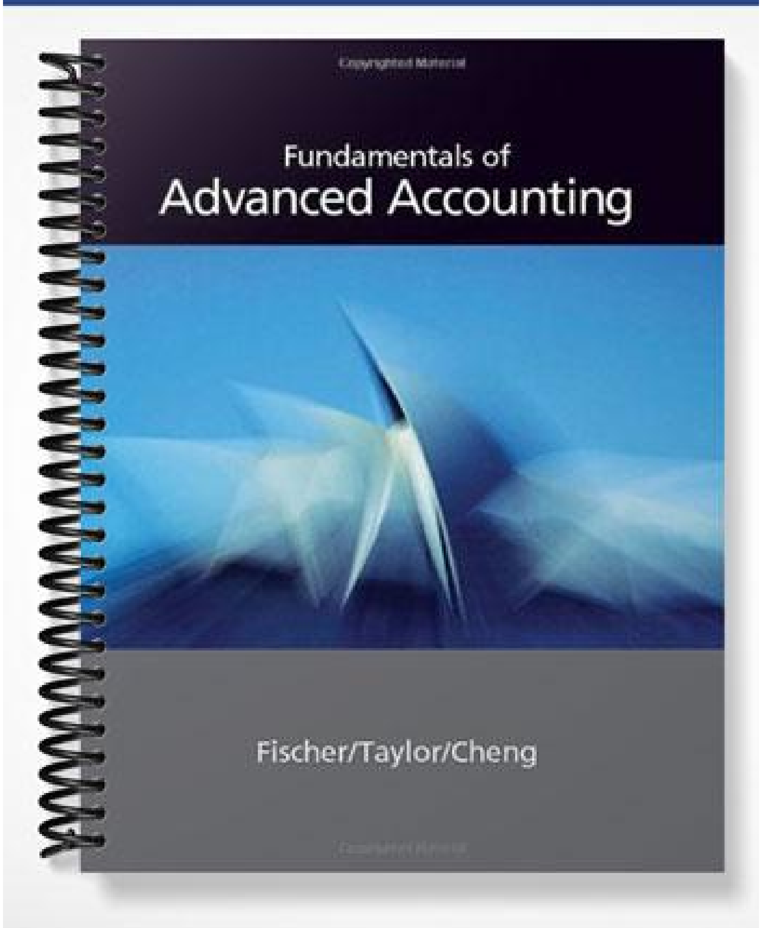
TEST BANK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Fundamentals of
Advanced Accounting
Fischer/Taylor/Cheng

Chapter 2 — Consolidated Statements: Date of Acquisition

MULTIPLE CHOICE

1.

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

Assuming Investor owns 70% of Investee. What is the amount that will be recorded as Net Income for the Controlling Interest?
a. $164,000
b. $171,000
c. $178,000
d. $180,000

ANS: B DIF: M OBJ: 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 manor for creditors.
c. the results of operations, cash flow, and the balance sheet as if there was a single entity.
d. subsidiary information for the subsidiary shareholders.

ANS: B DIF: M OBJ: 2

3. The FASB Exposure Draft assumes consolidation financial statements are appropriate even without a majority of controlling share if which of the following exists:
a. the subsidiary has the right to appoint member's 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: 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: 3

5. The goal of the consolidation process is for:
   a. asset acquisitions and 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: 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: 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:

	Book Value	Fair Value
Current assets......................	$300,000	$600,000
Land and building...................	600,000	900,000
Machinery...........................	500,000	600,000
Goodwill............................	100,000	?

The machinery will appear on the consolidated balance sheet at ________.
a. $560,000
b. $860,000
c. $600,000
d. $900,000

ANS: A DIF: M OBJ: 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:

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

The bonds payable will appear on the consolidated balance sheet
a. at $300,000 (with no premium or discount shown).
b. at $300,000 less a discount of $50,000.
c. at $0; assets are recorded net of liabilities.
d. under a net amount of $250,000 since it is a bargain purchase.

ANS: B DIF: M OBJ: 5

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

ANS: C DIF: E OBJ: 6

10. Which of the following costs of a business combination are 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: 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:

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

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

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

ANS: B DIF: M OBJ: 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: D DIF: M OBJ: 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: 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 reflect
a. an extraordinary gain of $50,000.
b. goodwill of $50,000.
c. an extraordinary gain of $350,000.
d. goodwill of $350,000.

ANS: A DIF: M OBJ: 6, 7

Pinehollow-Stonebriar Scenario

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 have companies has the following balance sheets:

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

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

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15. Refer to the Pinehollow-Stonebriar Scenario. 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. credit to cash for $1,525,000.
d. debit to investment for $1,525,000.

ANS: D DIF: M OBJ: 6, 7

16. Goodwill associated with the purchase of Stonebriar is __________.
    a. $100,000
    b. $125,000
    c. $300,000
    d. $325,000

ANS: B DIF: M OBJ: 6, 7

17. On April 1, 20X1, Paape Company paid $950,000 for all the issued and outstanding stock of Simon Corporation in a transaction properly recorded as a purchase. The recorded assets and liabilities of the Prime 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 Paape had a fair value of $190,000, and the property and equipment (net) had a fair value of $560,000. What is the amount of goodwill resulting from the business combination?
    a. $0
    b. $120,000
    c. $300,000
    d. $230,000

ANS: C DIF: D OBJ: 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:

	Book Value	Fair Value
Current assets.....................	$100,000	$200,000
Land and building..................	200,000	200,000
Machinery..........................	300,000	600,000
Goodwill...........................	100,000	?

Using the parent company concept, the machinery will appear on the consolidated balance sheet at __________.
    a. $600,000
    b. $540,000
    c. $480,000
    d. $300,000

ANS: B DIF: M OBJ: 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.
    a. Goodwill on the books of an acquired company should be disregarded.
    b. Goodwill is recorded prior to recording fixed assets.
    c. Goodwill is not recorded until all assets are stated at full fair value.
    d. Goodwill is treated consistent with other tangible assets.

    ANS: C DIF: M OBJ: 9

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

    ANS: C DIF: M OBJ: 10

PROBLEM

1. The Income Statements of Ruger Inc. and Nina Co. are:

	Ruger	Nina
Sales	$1,000,000	$400,000
Cost of Goods Sold	500,000	150,000
Gross Profit	500,000	250,000
Sales and Administration Expenses	300,000	170,000
Net Income	$ 200,000	$ 80,000
	==========	========
Dividends Paid	$60,000	$20,000

Compute Ruger's Net Income based upon the following ownership of Nina Co.
a. 10%
b. 40%
c. 80%

ANS:

a.

Ruger Net Income from Operations	$200,000
Dividend Revenue (10% x $20,000)	2,000
Net Income	$202,000

b.

Ruger Net Income from Operations	$200,000
Income from Investment (40% x $80,000)	32,000
Net Income	$232,000

c.

Controlling Income Ruger + Nina	$280,000
Noncontrolling Interest (20% x $80,000)	(16,000)
Controlling Interest	$264,000

DIF: E OBJ: 1

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

Assets	
Accounts receivable	$ 200,000
Inventory	450,000
Property and plant (net)	600,000
Goodwill	150,000
Total	$1,400,000

Liabilities and Equity	
Notes payable	$ 600,000
Common stock, $5 par	300,000
Paid-in capital in excess of par	400,000
Retained earnings	100,000
Total	$1,400,000

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

Assume that Redstar Corporation exchanges 45,000 of its $3 par value shares of common stock, when the fair price is $4/share, for 100% of the common stock of Supernova Company. Redstar incurred direct acquisition costs of $5,000 and stock issuance costs of $5,000.

Required:

a. What journal entry will Redstar Corporation record for the investment in Supernova?

b. Prepare a supporting determination and distribution of excess schedule

c. Prepare Redstar's elimination and adjustment entry for the acquisition of Supernova.

ANS:

(100% purchase with Extraordinary Gain)

a. Investment in Supernova (45,000 x $4)+ $5,000	185,000	
Common Stock $3 par value		135,000
Paid-in-capital excess of par		45,000
Cash (direct acquisition costs)		5,000
Paid-in capital excess of par	5,000	
Cash (to investment company)		5,000

b. Determination and Distribution of Excess Schedule

Price paid for investment		$ 185,000	
Less book value of interest purchased:			
Common Stock $5 par	$ 300,000		
Paid-in capital in excess of par	400,000		
Retained Earnings	100,000		
Total Equity	$ 800,000		
Ownership interest	100%	800,000	
Book value exceeds cost		$(615,000)	Debit
		=========	
Adjustments			
Accounts Receivable	-----		
Inventory ($600,000 - $450,000)	150,000		Debit
Property and Plant	(600,000)		Credit
Goodwill	(150,000)		Credit
Extraordinary Gain	(15,000)		Credit
Total Adjustments		$(615,000)	
		=========	

c. Worksheet entry.

Common Stock $5 Par	$300,000	
Paid-in capital in excess of par	400,000	
Retained Earnings	100,000	
Investment		$800,000
(Alternative Credits:		
Investment in Supernova		185,000
Excess		(615,000)
Investment in Supernova	615,000	
Inventory	150,000	
Property and Plant		600,000
Goodwill		150,000
Extraordinary Gain		15,000

(Alternative Debit:
Excess 615,000)

DIF: M OBJ: 2, 3, 4, 5, 6

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

	Book Value	Fair Value
Current Assets.......................	$500,000	$800,000
Accounts Receivable..................	200,000	150,000
Inventory............................	800,000	800,000
Land.................................	100,000	600,000
Buildings (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.

ANS:

a. Determination and Distribution of Excess of Cost over Book Value Schedule:

Price paid for investment in Subsidiary Company.................		$1,550,000
Less Book value of interest acquired:		
Common stock.......................	$100,000	
Other paid-in capital.............	200,000	
Retained earnings	350,000	
Total stockholders' equity.........	$650,000	
Interest acquired..................	80%	520,000
Excess of cost over book value (debit balance)		$1,030,000
		==========
Allocable to:		
Current assets ($300,000 x .80).....		$240,000 Dr.
Accounts Receivable ($50,000 x .80).		40,000 Cr.
Land ($500,000 x .80)...............		400,000 Dr.
Building and Equipment..($200,000 x .80)		160,000 Dr.
Current Liabilities ($75,000 x .80).		60,000 Cr.
Premium on Bonds ($80,000 x .80)....		64,000 Cr.
Goodwill...........................		$394,000 Dr.
		========

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

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: 4, 5, 6, 7, 8

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

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. Use the parent company concept (pro rata fair value approach) in any revaluation of net assets.

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

ANS:

a. Determination and Distribution of Excess of Cost over Book Value Schedule:

Price paid for investment in Subsidiary Company		$280,000
Less book value of interest acquired:		
Common stock	$ 20,000	
Other paid-in capital	80,000	
Retained earnings	150,000	
Total stockholders' equity	$250,000	
Interest acquired	80%	200,000
Excess of cost over book value (debit balance)		$ 80,000
Allocable to:		
Inventory ($5,000 x 80%)		$ 4,000
Land ($20,000 x 80%)		16,000
Building and Equipment ($30,000 x 80%)		24,000
Discount on Bonds ($5,000 x 80%)		4,000
Goodwill		$32,000

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

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: 4, 5, 6, 7, 8

5. On January 1, 20X1, Panther Company purchased 100% of the common stock of Seahawk Company for $1,410,000. On this date, Seahawk had total owners' equity of $1,150,000.

On December 31, 20X4, Seahawk Company had reported an operating loss before taxes of $175,000. Assume a tax rate of 35%. Since a carryback of $75,000 was available, a tax refund receivable of $26,250 was recorded and a net-of-tax loss of $148,750 was reported. At the date of purchase, Panther Company has concluded that the balance of the tax benefit of the operating loss will be realized in 20X1 when a consolidated tax return is prepared.

On January 1, 20X1, the excess of cost over book value is due to the tax benefit above, to a $30,000 undervaluation of Bonds Payable, to an undervaluation of land, building and equipment, and to goodwill. The fair value of land is $500,000. The fair value of building and equipment is $750,000. The book value of the land is $400,750. The book value of the building and equipment is $613,000.

Required:

a. Using the information above and on the separate worksheet, complete a schedule for determination and distribution of the excess of cost over book value.

b. Complete the Figure 2-3 worksheet for a consolidated balance sheet as of January 1, 20X1.

ANS:

a. Determination and Distribution of Excess of Cost Over Book Value Schedule:

Price paid for investment in Seahawk Company....................		$1,410,000
Less book value of interest acquired:		
Common stock.......................	$ 200,000	
Other paid-in capital.............	300,000	
Retained earnings..................	650,000	
Total stockholders' equity.........	$1,150,000	
Interest acquired..................	100%	1,150,000
Excess of cost over book value (debit balance)....................		$ 260,000

Allocable to:		
Tax Benefit of Operating Loss Carryforward.....................	$ 26,250	
Land...............................	99,250	Dr.
Building...........................	137,000	Dr.
Premium on bonds payable	(30,000)	Cr.
Goodwill...........................	$ 27,500	Dr.

b. For the worksheet solution, please refer to Answer 2-3.

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.

DIF: D OBJ: 4, 5, 6, 7

6. On January 1, 20X1, Parent Company purchased 80% of the common stock of Subsidiary Company for $248,800. On this date, Subsidiary had total owners' equity of $240,000.

   On December 31, 20X4, Subsidiary Company had reported an operating loss before taxes of $40,000. Assume a tax rate of 30%. Since a carryback of $20,000 was available, a tax refund receivable of $6,000 was recorded and a net-of-tax loss of $34,000 was reported. At the date of purchase, Parent Company has concluded that the balance of the tax benefit of the operating loss will be realized in 20X1 when a consolidated tax return is prepared.

   On January 1, 20X1, the excess of cost over book value is due to the tax benefit above, to a $5,000 undervaluation of Bonds Payable, to an undervaluation of land, building and equipment, and to goodwill. The fair value of land is $40,000. 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. From the information above and on the separate worksheet, complete a schedule for determination and distribution of the excess of cost over book value. Use the parent company concept (pro rata fair value approach) in any revaluation of net assets.

   b. Complete the Figure 2-4 worksheet for a consolidated balance sheet as of January 1, 20X1.

ANS:

a. Determination and Distribution of Excess of Cost Over Book Value Schedule:

Price paid for investment in Subsidiary Company............................		$248,800
Less book value of interest acquired:		
Common stock........................	$ 50,000	
Other paid-in capital...............	70,000	
Retained earnings...................	120,000	
Total stockholders' equity..........	$240,000	
Interest acquired...................	80%	192,000
Excess of cost over book value (debit balance).....................		$ 56,800
		========
Allocable to:		
Tax Benefit of Operating Loss Carryforward ($6,000 x 80%)........		$ 4,800 Dr.
Land ($10,000 x 80%)................		8,000 Dr.
Building ($20,000 x 80%)............		16,000 Dr.
Premium on Bonds Payable ($5,000 x 80%)		(4,000)Cr.
Goodwill		$32,000 Dr.
		=======

b. For the worksheet solution, please refer to Answer 2-4.

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: D OBJ: 4, 5, 6, 7, 8

7. 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 schedule for determination and distribution of the excess of cost over book value.

b. Complete the Figure 2-5 worksheet for a consolidated balance sheet as of January 1, 20X1.

ANS:

a. Determination and Distribution of Excess of Cost Over Book Value Schedule:

Price paid for investment in Subsidiary Company...........................		$280,000
Less Book value of interest acquired:		
Common stock......................	$ 50,000	
Other paid-in capital.............	70,000	
Retained earnings.................	120,000	
Total	$240,000	
Less interest acquired............	100%	240,000
Excess of cost over book value (debit balance).....................		$ 40,000
		========

Allocable to:	
Inventory.........................	$15,000 Dr.
Discount on bonds payable..........	5,000 Dr.
Remainder to other long-lived assets:	$20,000
Land..............................	16,000 Dr.
Building..........................	4,000 Dr.
Goodwill..........................	$ 0
	=======

Asset	100% of Fair Value	Fraction of Fair Value	Total Assigned Value*	Allocated Assigned Value	Book Value	100% Increase (Decrease)
Land	$ 50,000	1/5	$230,000	$ 46,000	$ 30,000	$16,000
Building	200,000	4/5	230,000	184,000	180,000	4,000
	$250,000			$230,000	$210,000	$20,000
	========			========	========	=======

* Book value of Land ($30,000) and Building ($180,000) plus $20,000 remaining excess of cost over book value.

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

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.

DIF: M OBJ: 4, 5, 6, 7

8. 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.

   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. From the information above and on the separate worksheet, complete a schedule for determination and distribution of the excess of cost over book value. Use the parent company concept (pro rata fair value approach) in any revaluation of net assets.

   b. Complete the Figure 2-6 worksheet for a consolidated balance sheet as of January 1, 20X1.

ANS:

a. Determination and Distribution of Excess of Cost Over Book Value Schedule:

Price paid for investment in Subsidiary Company...........................		$252,000
Less book value of interest acquired:		
Common Stock.......................	$ 50,000	
Other Paid-in Capital..............	70,000	
Retained Earnings..................	120,000	
Total	$240,000	
Less Interest acquired.............	90%	216,000
Excess of cost over book value (debit balance)....................		$ 36,000

Allocable to:	
Inventory ($15,000 x 90%)...........	$13,500 Dr.
Discount on bonds payable ($5,000 x 90%).....................	4,500 Dr.
Remainder to other long-lived assets:	$18,000
Land...............................	14,400 Dr.
Building...........................	3,600 Dr.
Goodwill...........................	$ 0

Alternative 1

Asset	100% of Fair Value	Fraction of Fair Value	Total Assigned Value*	Allocated Assigned Value	100% of Book Value
Land........	$ 50,000	1/5	$230,000	$ 46,000	$ 30,000
Building....	200,000	4/5	230,000	184,000	180,000
	$250,000			$230,000	$210,000

Alternative 1 continued

Asset	100% Increase (Decrease)	90% Increase (Decrease)
Land........	$16,000	$14,400
Building....	4,000	3,600
	$20,000	$18,000

* If remaining allocable cost on a 90% purchase is $18,000, it would be $20,000 on a 100% purchase. Book value of $210,000 must be increased by $20,000 to get total allocable cost. Increase of decrease for 100% purchase must then be multiplied by 90% to derive correct writeup.

Alternative 2

Asset	90% of Fair Value	Fraction of Fair Value	Total Assigned Value**	Allocated Assigned Value	90% of Book Value	90% Increase (Decrease)
Land	$ 45,000	1/5	$207,000	$ 41,400	$ 27,000	$14,400
Building	180,000	4/5	207,000	165,600	162,000	3,600
	$225,000			$207,000	$189,000	$18,000
	========			========	========	=======

** The remaining allocable cost on a 90% purchase is $18,000. The book value of the controlling interest in land and building is $189,000 (90% of $210,000). This book value of $189,000 must be increased by $18,000 to get the total assigned value.

b. For the worksheet solution, please refer to Answer 2-6.

Eliminations and Adjustments:

(EL) Eliminate 90% 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: D OBJ: 4, 5, 6, 7, 8

9.

	Pepper Co.	Salt Inc.	Consolidated Financial Statements
Cash	$ 26,000	$ 20,000	$ 46,000
Accounts Receivable, net	20,000	30,000	50,000
Inventory	125,000	110,000	270,000
Land	30,000	80,000	124,000
Building and Equipment	320,000	160,000	459,000
Investment in Subsidiary	279,000	-	-
Goodwill	-	-	41,000
Total Assets	$800,000	$400,000	$990,000
	========	========	========
Accounts Payable	$ 40,000	$ 40,000	$ 80,000
Other Liabilities	70,000	60,000	130,000
Common Stock	400,000	200,000	400,000
Retained Earnings	290,000	100,000	290,000
Noncontrolling Interest	-	-	90,000
Total Liabilities & Stockholders' Equity	$800,000	$400,000	$990,000
	========	========	========

Answer the following based upon the above financial statements:

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

ANS:

a. Investment in Subsidiary $279,000

b. Noncontrolling Interest / Subsidiary Equity $\frac{90{,}000}{200{,}000 + 100{,}000} = 30\%$

100% - 30% = 70%

c. Consolidated Inventory		$270,000
Pepper Co. Inventory	$125,000	
Salt Inc. Inventory	110,000	
Total Inventory Book Value	$235,000	
Adjustment	$ 35,000	
Ownership %	70%	= 50,000

d. The Building and Equipment's book value was overvalued relative to the fair value.
$320,000 + $160,000 = $480,000 > $459,000. ($21,000/70% = $30,000)

DIF: D OBJ: 4, 5, 6

10. On January 1, 20X1, Parent Company acquired 80% of the common stock of Subsidiary Company by issuing Parent common stock with a fair value of $250,800. On this date, Subsidiary had total owners' equity of $240,000.

    Even though the combination must be accounted for as a purchase, it is a tax-free combination for Federal income tax purposes. The corporate tax rate is 30%.

    On January 1, 20X1, the excess of cost over book value is due to an undervaluation of land, building, and goodwill. The fair value of land is $40,000. The fair value of building is $200,000. The book value of the land is $30,000. The book value of the building is $180,000.

    Required:

    a. From the information above and on the separate worksheet, complete a schedule for determination and distribution of the excess of cost over book value. Use the parent company concept (prorata fair value approach) in any writeup of net assets.

    b. Complete the Figure 2-7 worksheet for a consolidated balance sheet as of January 1, 20X1.

ANS:

a. Determination and Distribution of Excess of Cost Over Book Value Schedule:

Price paid for investment in Subsidiary Company............................		$250,800
Less book value of interest acquired:		
Common Stock........................	$ 50,000	
Other Paid-in Capital...............	70,000	
Retained Earnings...................	120,000	
Total	$240,000	
Less Interest acquired..............	80%	192,000
Excess of cost over book value (debit balance).....................		$ 58,800
		========

Land ($10,000 x 80%)................	$ 8,000 Dr.
Deferred Tax Liability ($8,000 x 30%).	(2,400) Cr.
Building ($20,000 x 80%).............	16,000 Dr.
Deferred Tax Liability ($16,000 x 30%)	(4,800) Cr.
Goodwill (Net of deferred tax liability)	$42,000 Dr.

To be distributed	
Goodwill ($42,000 ÷ 70%)............	$ 60,000 Dr.
Deferred Tax Liability.. 30% x $60,000)	(18,000) Cr.
Net of tax value of Goodwill.........	$ 42,000
	========

b. For the worksheet solution, please refer to Answer 2-7.

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: D OBJ: 4, 5, 6, 7, 8

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

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

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

Required:

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

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

b. 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. Determination and Distribution of Excess Schedule:

Price paid.............................		$1,800,000
Equity of Supernova:		
Common stock, $5 par..................	$300,000	
Paid-in capital in excess of par......	400,000	
Retained earnings.....................	100,000	
Total equity........................	$800,000	
Interest purchased....................	100%	800,000
Excess cost over book value............		1,000,000
Increase inventory.....................		150,000
Available for fixed assets............		$ 850,000
Add existing goodwill..................		150,000
Adjusted available for fixed assets.....		$1,000,000
Increase property and plant............		250,000
Goodwill (total).....................		$ 750,000

DIF: M OBJ: 6, 7, 9

12. Saturn Company had the following summarized balance sheet on December 31, 20X1:

Assets	
Accounts receivable..................................	$ 180,000
Inventory..	500,000
Property and plant (net).............................	600,000
Goodwill...	120,000
Total..	$1,400,000

Liabilities and Equity	
Notes payable..	$ 600,000
Common stock, $5 par.................................	300,000
Paid-in capital in excess of par.....................	400,000
Retained earnings....................................	100,000
Total..	$1,400,000

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

Required:

a. Assume that Return Corporation purchases 80% of the common stock of Saturn Company for $600,000. What value will be assigned to the following accounts of the Saturn 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 supporting determination and distribution of excess schedule.

ANS:

a.

(1)	Inventory	$580,000	$500,000 BV + $80,000
(2)	Property and plant	$576,000	$600,000 BV - $24,000
(3)	Goodwill	$ 24,000	$120,000 BV - $96,000
(4)	Noncontrolling interest	$160,000	20% of $800,000 equity

b. Determination and Distribution of Excess Schedule:

Price paid............................		$ 600,000
Equity of Saturn:		
Common stock, $5 par.................	$300,000	
Paid-in capital in excess of par......	400,000	
Retained earnings....................	100,000	
Total equity.......................	$800,000	
Interest purchased...................	80%	640,000
Excess cost over book value............		$ (40,000)
Increase inventory, 80% x $100,000......		80,000
Available for fixed assets............		$(120,000)
Add existing goodwill, 80% x $120,000...		96,000
Adjusted available for fixed assets...		$ (24,000)
Decrease property and plant............		$ 24,000

DIF: M OBJ: 6, 7, 8, 9

13. Pluto purchased 100% of the common stock of the Saturn Company for $325,000 when Saturn had the following balance sheet:

Assets	
Current assets	$ 50,000
Inventory	60,000
Property and plant	300,000
Accumulated depreciation	(110,000)
Total	$ 300,000

Liabilities and Equity	
Current liabilities	$ 50,000
Common stock, $5 par	100,000
Pain-in capital in excess of par	50,000
Retained earnings	100,000
Total	$300,000

The fair value of the plant is $250,000.

The purchase is a tax free exchange as to the seller; thus, the purchaser will be able to depreciate only the book value of the assets purchased. The applicable tax rate is 30%.

Required:

a. At what amount will the following accounts be listed on the consolidated balance sheet prepared on the date of purchase?

(1) Inventory _________
(2) Property and plant _________
(3) Deferred tax liability _________
(4) Goodwill _________

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

ANS:

a. (1) Inventory $ 60,000
(2) Property and plant $250,000
(3) Deferred tax liability $(32,143)
(4) Goodwill $ 47,143

b. Determination and Distribution of Excess Schedule:

Price paid............................		$325,000
Equity of Supernova:		
Common stock, $5 par..................	$100,000	
Paid-in capital in excess of par......	50,000	
Retained earnings.....................	100,000	
Total equity........................	$250,000	
Interest purchased....................	100%	250,000
Excess cost over book value............		$ 75,000
Increase property and plant............	$ 50,000	
Deferred tax liability (.3 x $50,000)...	(15,000)	35,000
Goodwill (net).......................		$ 40,000

Distributed:

Goodwill ($40,000 ÷ .7)	$ 57,143
Deferred tax ($57,143 x .3)	(17,143)
	$ 40,000

DIF: D OBJ: 6, 7

14. Fortuna Company issued 51,500 shares of $1 par stock, with a fair value of $21 per share, for 80% of the outstanding shares of Acappella Company. The firms had the following separate balance sheets prior to the acquisition:

Assets	Fortuna	Acappella
Current assets............................	$2,100,000	$ 960,000
Property, plant, and equipment (net)........	4,600,000	1,300,000
Goodwill..................................		240,000
Total assets..............................	$6,700,000	$2,500,000

Liabilities and Stockholders' Equity		
Liabilities...............................	$3,000,000	$ 800,000
Common stock ($1 par).....................	800,000	
Common stock ($5 par).....................		200,000
Paid-in capital in excess of par..........	2,200,000	300,000
Retained earnings.........................	700,000	1,200,000
Total liabilities and equity..............	$6,700,000	$2,500,000

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

Required:

a. Prepare a determination and distribution of excess schedule.

b. Provide all eliminations on the partial balance sheet worksheet provided in Figure 2-8 and complete the noncontrolling interest column.

ANS:

a. Determination and Distribution of Excess Schedule:

Price paid (51,500 shares x $21 fair value)		$1,081,500
Less interest acquired:		
Common stock ($10 par)................	$ 200,000	
Paid-in capital in excess of par......	300,000	
Retained earnings.....................	1,200,000	
Total stockholders' equity..........	$1,700,000	
Interest acquired..................	80%	1,360,000
Excess book value over cost............		$ 278,500
Less needed previously recorded goodwill (80% x $240,000).....................		192,000
Left to decrease property, plant, and equipment		$ 86,500
		==========

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

Eliminations and Adjustments:

(1) Eliminate 80% of subsidiary equity against the investment account.
(2) Distribute excess according to the determination and distribution of excess schedule.

DIF: M OBJ: 4, 6, 7, 8, 9

ESSAY

1. Historically the SEC and the FASB have considered majority ownership to define control as a necessary condition prior to preparing consolidating financial statements. Now, both of these organizations are considering a change in the definition of control.

   Discuss the historical perspective on consolidation and now under what situations control would be considered appropriate without majority ownership. In your response describe the function of consolidated financial statements.

ANS:

Consolidated financial statements are designed to present the results of operations, cash flow and the balance sheet of the parent and its subsidiaries as if they were a single company. Historically, ownership in excess of 50% was considered necessary for control. Prior to FAS 94 non-homogeneous subsidiaries were not consolidated. Under FAS 94 the only exceptions for consolidation relate to control being necessary, or it does not rest with the majority owner.

Currently, FASB would presume control to exist, without majority ownership, if any of the following situations exist:

* The parent company has the right to appoint the majority of members to the board of directors.
* The parent can elect the majority of members to the board of directors with a large minority (less than 50%) voting interest.
* The parent company is the only general partner in a limited partnership and no other partner group may dissolve the partnership or remove the general partner.

The parent has the unilateral ability to assume the role of general partner in a limited partnership.

DIF: M OBJ: 2, 3

2. 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: 3

3. 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 that are not normally used for such an 80% purchase?

ANS:

All assets including goodwill would be adjusted 100%, rather than 80%, of the way to fair value. This would mean that the noncontrolling interest would be increased for 20% of the total write-ups through the noncontrolling interest in retained earnings. The method would also be unique in that the asset adjustments would be made directly on the books of the subsidiary rather than on the consolidated worksheet.

DIF: D OBJ: 8, 10

[[Insert FIGURE 2-1 from Excel Spreadsheet]]

[[Insert ANSWER 2-1 from Excel spreadsheet]]

[[Insert FIGURE 2-2 from Excel spreadsheet]]

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