CHAPTER 1

INTERCORPORATE ACQUISITIONS AND INVESTMENTS IN OTHER ENTITIES

IMPORTANT NOTE TO INSTRUCTORS

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

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

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

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

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

	Wholly Owned Subsidiary	**Partially Owned Subsidiary**	
Investment = Book Value	**Chapter 2**	**Chapter 3**	**No Differential**
Investment > Book Value	**Chapter 4**	**Chapter 5**	**Differential**
	No NCI Shareholders	**NCI Shareholders**	

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

OVERVIEW OF CHAPTER 1

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

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

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

LEARNING OBJECTIVES

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

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

SYNOPSIS OF CHAPTER 1

Intercorporate Acquisitions and Investments in Other Entities

T-Mobile's Merger with Sprint
A Brief Introduction

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

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

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

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

The Development of Accounting for Business Combinations

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

Accounting for Internal Expansion: Creating Business Entities

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

Accounting for External Expansion: Business Combinations

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

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

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

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

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

TEACHING IDEAS

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

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

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

DESCRIPTIONS OF CASES, EXERCISES, AND PROBLEMS

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

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

E1-8 12 min. LO 1-2, LO 1-5 M	**Acquisition of Net Assets** Students are required to show the journal entries that the parent must make at time of acquisition.
E1-9 20 min. LO 1-5 M	**Reporting Goodwill** Students must calculate goodwill to be reported under different acquisition prices.
E1-10 10 min. LO 1-5 E	**Stock Acquisition** Students must show the journal entry that the acquiring company must record when it issues stock for acquiring a subsidiary.
E1-11 20 min. LO 1-5 M	**Balances Reported Following Combination** Students must calculate seven balances for balance sheet accounts immediately following a business combination.
E1-12 15 min. LO 1-5 E	**Goodwill Recognition** Students must show the journal entry to be made by the acquiring company in recording a business combination involving goodwill.
E1-13 15 min. LO 1-5 M	**Acquisition Using Debentures** Students must show the journal entry to be made by the acquiring company in recording a business combination executed using debentures.
E1-14 15 min. LO 1-5 M	**Bargain Purchase** Students must show the journal entry to be made by the acquiring company in recording a business combination involving gain on a bargain purchase.
E1-15 20 min. LO 1-5 M	**Goodwill Impairment** Students must calculate goodwill and potential impairment of goodwill given three different fair value amounts.
E1-16 15 min. LO 1-5	**Goodwill Impairment** Students must calculate goodwill and potential impairment of goodwill given three different fair value amounts.

M	
E1-17 20 min. LO 1-5 M	**Goodwill Assigned to Reporting Units** Students must calculate reported goodwill for a company, based on information for four different reporting units.
E1-18 15 min. LO 1-5 E	**Goodwill Measurement** Students must calculate goodwill and potential impairment of goodwill given four different fair value amounts.
E1-19 20 min. LO 1-5 M	**Computation of Fair Value** Students must calculate the fair value of buildings and equipment, given the cost of acquisition, the fair value of other assets and liabilities, and the book value of the building and equipment.
E1-20 20 min. LO 1-5 M	**Computation of Shares Issued and Goodwill** Students must determine the number of shares issued, the par value of the acquiring company's stock, and any goodwill arising from the business combination.
E1-21 15 min. LO 1-5 M, Ws	**Combined Balance Sheet** Students must prepare a balance sheet of the combined company immediately following the acquisition.
E1-22 20 min. LO 1-5 M	**Recording a Business Combination** Students must show the journal entries made by the acquiring company given financial statement information for both companies and market value of the acquiring company's common stock.
E1-23 15 min. LO 1-5 M	**Reporting Income** Students must compute net income and earnings-per-share reported in comparative income statement for two years.
P1-24 10 min. LO 1-3 E	**Assets and Accounts Payable Transferred to Subsidiary** Students must show journal entries recorded for transfer of assets and liabilities to the newly established subsidiary.
P1-25 10 min. LO 1-3	**Creation of New Subsidiary** Students must show journal entries made for the transfer of assets and liabilities to a newly created entity.

E	
P1-26 25 min. LO 1-3 M	**Incomplete Data on Creation of Subsidiary** Students must calculate book value, reported amounts, reported shares, impact on balance sheet amounts.
P1-27 20 min. LO 1-5 M	**Acquisition in Multiple Steps** Students must prepare journal entries for the completion of the acquisition of additional shares of a previously owned company.
P1-28 15 min. LO 1-5 M	**Journal Entries to Record a Business Combination** Students must show the journal entries made to record a business combination in which the acquiring company issues shares of common stock.
P1-29 15 min. LO 1-5 M	**Recording Business Combinations** Students must show the journal entries made to record a business combination in which the acquiring company issues shares of common stock.
P1-30 30 min. LO 1-5 E	**Business Combination with Goodwill** Students must show the journal entry to be recorded by the acquiring company and the balance sheet following the business combination.
P1-31 15 min. LO 1-5 M	**Bargain Purchase** Students must show the journal entry to be made by the acquiring company in recording a business combination involving gain on a bargain purchase.
P1-32 15 min. LO 1-5 M	**Computation of Account Balances** Calculation of liability balance and fair value is required with simultaneous consideration of potential goodwill impairment.
P1-33 25 min. LO 1-5 H	**Goodwill Assigned to Multiple Reporting Units** Calculation of goodwill and potential goodwill impairment for multiple reporting units in a company are required.
P1-34	**Journal Entries**

15 min. LO 1-5 M	Students must show journal entries recorded by the acquiring company for a business combination. Costs of combination must be considered.
P1-35 30 min. LO 1-5 M	**Purchase at More than Book Value** Students must show journal entries to record a business combination and prepare a balance sheet immediately after the business combination.
P1-36 25 min. LO 1-5 M	**Business Combination** Journal entries recorded by the acquiring company to record the business combination. Several account balances must be adjusted.
P1-37 30 min. LO 1-5 H	**Combined Balance Sheet** The balance sheet following the business combination is required. Stockholders' equity balances are required assuming three different levels of stock are issued by the acquiring company in completing the business combination.
P1-38 30 min. LO 1-5 M	**Incomplete Data** Balance sheet information for two separate entities and for the combined entity immediately after a business combination is given. Students must calculate the number of shares issued, market value of shares, fair value of inventory held by the acquired company, acquired company's net assets, goodwill arising from the combination, retained earnings balance after combination, and depreciation expense for the first year on the acquired company's depreciable assets.
P1-39 30 min. LO 1-5 M	**Incomplete Data Following Purchase** Balance sheet information for two separate entities and for the combined entity immediately after a business combination is given. Students must calculate the number and price of shares issued, the amount of cash paid as stock issuance costs, market value of shares issued on date of combination, cash paid for stock issue costs, market value of shares issued, the fair value of inventory and net assets, and the amount of goodwill to be reported.
P1-40 40 min. LO 1-5 M	**Comprehensive Business Combination** Students are given a comprehensive set of financial statements with book values and fair values. They are required to prepare all journal entries on the acquiring company's books related to the business combination. Next, they are asked to present the entries that would have been entered on the acquired company's books.

Difficulty Level Abbreviations:

E = Easy
M = Medium
H = Hard

OTHER RESOURCES

Chapter 1
Business Combination Illustration

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

Balance Sheet Data
of Individual Companies

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

COMPUTATION OF GOODWILL

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