

TEST BANK
CHAPTER 2
Mergers and Acquisitions

MULTIPLE CHOICE

1. Topic: Acquisition accounting

LO 1

ASC Topic 805 provides standards for reporting acquisition of a *business*. How does the reporting for the acquisition of a business differ from acquisition of a group of assets and liabilities?

- a. In the acquisition of a business, the cost may exceed the fair value of the identifiable net assets acquired.
- b. In the acquisition of a business, contingent consideration is not included in the measurement of total cost.
- c. In the acquisition of a group of assets and liabilities, consulting fees paid to complete the transaction are expensed.
- d. In the acquisition of a group of assets and liabilities, previously unreported identifiable intangible assets are likely to be recognized.

ANS: a

2. Topic: Acquisition accounting

LO 1

ASC Topic 805 provides standards for reporting *business combinations*. Which one of the following is most likely to be considered a business combination?

- a. Formation of a joint venture by two or more existing companies.
- b. Formation of a new subsidiary.
- c. Purchase of a controlling interest in an international company.
- d. Merger of an existing subsidiary with a parent.

ANS: c

3. Topic: Acquisition accounting

LO 1

The requirements of *ASC Topic 805* do *not* apply to:

- a. Acquisitions where control is obtained over one or more businesses
- b. Combinations of two or more companies already under common control
- c. Acquisitions where control is obtained by acquiring the voting stock of the acquired company
- d. Acquisitions of product lines and divisions

ANS: b

4. Topic: Acquisition accounting

LO 1

ASC Topic 805 only applies to an acquisition if:

- a. You are buying all the assets and liabilities of another company.
- b. You are buying a business and obtaining control of that business.
- c. You are a public company buying the assets and liabilities of another public company.
- d. You are buying over 50% of the voting stock of another company.

ANS: b

5. Topic: Acquisition accounting

LO 1

Acquisition accounting only applies to the acquisition of a *business*. What are the three elements of a business, per *ASC Topic 805*?

- a. assets, liabilities, and equity
- b. facilities, workforce, and contracts
- c. input, process, and output
- d. products, services, and workforce

ANS: c

6. Topic: Acquisition accounting

LO 1

Acquisition accounting only applies to the acquisition of a *business*. *ASC Topic 805* identifies an initial condition that immediately determines that the transaction is not an acquisition of a business, without further analysis. What is this condition?

- a. Acquisition of a division within another company.
- b. Acquisition of a single identifiable asset.
- c. Acquisition of only intangible assets.
- d. Acquisition of a single product line.

ANS: b

7. Topic: Valuation of acquired net assets

LO 1

In acquisition accounting, one company is identified as the acquiring company. Which statement below is *most* likely to be true concerning the acquiring company.

- a. It pays cash for the acquisition rather than issuing stock.
- b. Its shareholders sell their stock before the acquisition takes place.
- c. Its shareholders receive a premium over market value in the exchange of shares.
- d. It issues stock to acquire the other company.

ANS: d

8. Topic: Valuation of acquired assets and liabilities

LO 1

Proctor Company acquires the assets and liabilities of Singer Corporation, in a transaction reported as a merger. How are the assets and liabilities of Proctor and Singer reported?

- a. Proctor's assets and liabilities remain at book value, and Singer's assets and liabilities are reported at fair value at the date of acquisition.
- b. Singer's assets and liabilities remain at book value, and Proctor's assets and liabilities are reported at fair value at the date of acquisition.
- c. The assets and liabilities of both Proctor and Singer are reported at fair value at the date of acquisition.
- d. Proctor's assets and liabilities remain at book value, and Singer's assets and liabilities are reported at fair value at the balance sheet date, each time a balance sheet is prepared.

ANS: a

9. Topic: Recognition of acquired assets

LO 1

The following intangibles have been identified for an acquired company. Which one(s) are most likely to be separately capitalized by the acquiring company, per *ASC Topic 805*?

- Developed technology
 - Skilled workforce
 - Brand names
 - Prospective contracts
- a. Developed technology, brand names, and prospective contracts
 - b. Brand names and prospective contracts
 - c. Developed technology and brand names
 - d. Skilled workforce and prospective contracts

ANS: c

10. Topic: Recognition of acquired assets, private companies

LO 1

When a private company acquires another company, GAAP for private companies allows which identifiable intangible assets to be combined with goodwill and not separately capitalized?

- a. Brand names
- b. Technology
- c. Software licenses
- d. Noncompetition agreements

ANS: d

11. Topic: Valuation of acquired assets

LO 1

Company A has unreported identifiable intangible assets that are very valuable, and would like investors to know about them. Which one of the following actions will allow these intangible assets to be reported?

- a. Get a third-party appraisal of the intangible assets.
- b. Reclassify Company A's reported plant and equipment as intangible assets.
- c. Find a company to combine with, and designate Company A as the acquirer.
- d. Find a company to combine with, and designate Company A as the company being acquired.

ANS: d

12. Topic: Intangible assets acquired

LO 1

Which of the following is *least* likely to be reported as an acquired identifiable intangible asset?

- a. In-process research and development
- b. Synergies in developing future products
- c. Production processes
- d. Broadcast rights

ANS: b

13. Topic: Goodwill recognition

LO 1

Which one of the following items is *most* likely to be reported as goodwill?

- a. Skilled workforce
- b. Brand names
- c. Developed technology
- d. In-process research and development

ANS: a

14. Topic: Identifiable intangible assets acquired

LO 1

All of the following are examples of reportable identifiable intangible assets acquired in a business combination, *except*:

- a. Mineral rights
- b. Customer lists
- c. Advertising jingles
- d. Prospective customer contracts

ANS: d

15. Topic: Date of acquisition

LO 1

A company acquires the assets and liabilities of another company. The acquired company's assets and liabilities are reported on the acquiring company's books at fair value *as of what date*?

- a. The day the acquiring company takes control of the acquired company
- b. The day the acquisition is announced to the public
- c. The day the acquiring company obtains the financing necessary for the acquisition
- d. The day the acquiring company completes its research concerning the value of the acquired assets and liabilities

ANS: a

16. Topic: Goodwill calculation

LO 1

Prolean Corporation acquired Setlan Company for \$10,000,000 in cash, paid to Setlan's former owners. The carrying value of Setlan's reported net assets totaled \$2,000,000 at the date of acquisition. Setlan's reported asset and liability values equaled their fair values, except for the following:

	Fair Value	Book Value
Inventory	\$ 15,000	\$40,000
Land	80,000	20,000
Identifiable intangible assets	400,000	0

The identifiable intangible assets meet *ASC Topic 805* requirements for separate capitalization. Goodwill reported for this acquisition is:

- a. \$7,965,000
- b. \$7,515,000
- c. \$7,565,000
- d. \$9,505,000

ANS: c

Cost		\$10,000,000
Fair value of IDNA:		
Book value	\$2,000,000	
Inventory revaluation	(25,000)	
Land revaluation	60,000	
Recognition of ID intangibles	<u>400,000</u>	<u>2,435,000</u>
Goodwill		<u>\$7,565,000</u>

17. Topic: Goodwill calculation

LO 1

X Company acquires all of Y Company's assets and liabilities for \$15,000,000 in cash. The fair values of Y's assets and liabilities approximate their book values, except Y has developed technology valued at \$8,000,000 that is not reported on its balance sheet, and its buildings are overvalued by \$7,000,000. Here is Y's balance sheet just prior to the acquisition:

	<u>Y Company</u>
Current assets	\$ 500,000
Land, buildings, and equipment	<u>9,500,000</u>
Total assets	<u><u>\$10,000,000</u></u>
Liabilities	\$ 6,000,000
Common stock, \$1 par	100,000
Additional paid-in capital	2,915,000
Retained earnings	1,000,000
Treasury stock	(20,000)
Accumulated other comprehensive income	<u>5,000</u>
Total liabilities and equity	<u><u>\$10,000,000</u></u>

How much goodwill is recognized for this acquisition?

- a. \$12,000,000
- b. \$ 4,000,000
- c. \$10,000,000
- d. \$16,000,000

ANS: c

Cost		\$15,000,000
Fair value of IDNA acquired:		
Reported net assets (\$10,000,000 - \$6,000,000 – \$7,000,000)	\$(3,000,000)	
Developed technology	<u>8,000,000</u>	<u>5,000,000</u>
Goodwill		<u><u>\$10,000,000</u></u>

18. Topic: Goodwill**LO 1**

Pringle Corporation acquires Snax Company at an acquisition cost of \$50,000,000. Assets and liabilities of Snax are as follows:

	Book Value	Fair Value
Current assets	\$ 1,500,000	\$ 800,000
Land, buildings, and equipment (net)	16,000,000	7,000,000
Brand names	-0-	8,000,000
Liabilities	12,000,000	11,500,000

Goodwill arising from this acquisition is:

- a. \$45,700,000
- b. \$44,500,000
- c. \$20,500,000
- d. \$22,700,000

ANS: a

$$\$50,000,000 - (\$800,000 + \$7,000,000 + \$8,000,000 - \$11,500,000) = \underline{\underline{\$45,700,000}}$$

19. Topic: Valuation of assets acquired**LO 1**

Pyn Corporation acquires all of Sys Company at an acquisition cost of \$100,000,000 in cash. Fair values of Sys' assets and liabilities are as follows:

	Fair Value
Current assets	\$ 1,000,000
Land, buildings and equipment	8,000,000
Brand names	2,000,000
Customer lists	4,000,000
Skilled workforce	15,000,000
Potentially profitable future projects	10,000,000
Liabilities	6,000,000

Pyn records goodwill of:

- a. \$66,000,000
- b. \$76,000,000
- c. \$81,000,000
- d. \$91,000,000

ANS: d

The entry to record the combination is:

Current assets		1,000,000	
Land, buildings & equipment		8,000,000	
Brand names		2,000,000	
Customer lists		4,000,000	
Goodwill		91,000,000	
	Liabilities		6,000,000
	Cash		100,000,000

20. Topic: Net asset valuation, prior goodwill

LO 1

Kelly Corporation acquires the assets and liabilities of Lawson Company. Below is the balance sheet of Lawson, along with fair values of its assets and liabilities, at the date of acquisition.

	Book value Dr (Cr)	Fair value Dr (Cr)
Current assets	\$ 1,000,000	\$ 500,000
Plant & equipment	60,000,000	30,000,000
Identifiable intangibles	10,000,000	35,000,000
Goodwill	4,000,000	10,000,000
Current liabilities	(2,000,000)	(2,000,000)
Long-term liabilities	(52,000,000)	(52,000,000)
Capital stock	(3,000,000)	
Retained earnings	(18,000,000)	

Kelly pays \$50,000,000 in cash for the assets and liabilities of Lawson. How much goodwill does Kelly record for this acquisition?

- a. \$28,500,000
- b. \$34,500,000
- c. \$38,500,000
- d. \$0

ANS: c

$$\begin{aligned} & \$50,000,000 - (\$500,000 + \$30,000,000 + \$35,000,000 - \$2,000,000 - \$52,000,000) = \\ & \underline{\underline{\$38,500,000}} \end{aligned}$$

21. Topic: Valuation of intangible assets acquired

LO 1

What is the most common way to value acquired intangible assets?

- a. Income method
- b. Market approach
- c. Cost approach
- d. Opportunity cost approach

ANS: a

22. Topic: Valuation of intangible assets acquired

LO 1

Acquired developed technology is expected to generate after-tax operating income of \$50,000 in the first year and grow at a rate of 5% over the next two years. Depreciation expense included in operating expenses is expected to be \$5,000 in the first year, growing at a rate of 3% over the next two years. The value of acquired developed technology is estimated as the present value of operating cash flow over the first three years. The appropriate discount rate is 20%, and cash flows are assumed to occur at year-end for purposes of valuing acquired developed technology.

Which value is *closest* to the amount at which the acquired developed technology should be reported on the acquiring company's balance sheet?

- a. \$ 85,000
- b. \$100,000
- c. \$121,000
- d. \$143,000

ANS: c

	Year 1	Year 2	Year 3
Operating profit	\$50,000	\$52,500	\$55,125
Depreciation expense	<u>5,000</u>	<u>5,150</u>	<u>5,305</u>
Operating cash flow	\$55,000	\$57,650	\$60,430

$$\$55,000/1.2 + \$57,650/(1.2)^2 + \$60,430/(1.2)^3 = \underline{\underline{\$120,839}}$$

23. Topic: Contingent Consideration

LO 2

Peters Corporation acquires all of the voting shares of Stefan Company by issuing 500,000 shares of \$1 par common stock valued at \$10,000,000. Included in the agreement is a contingency guaranteeing the former shareholders of Stefan that Peters' shares will be worth at least \$18 per share after one year. If the shares are worth less, Peters will pay the former shareholders of Stefan enough cash to reimburse them for the decline in value below \$18 per share. Peters estimates that there is a 5% chance that the stock value will be \$16 at the end of one year, and a 95% chance that the stock value will be \$18 per share or higher. A discount rate of 10% is appropriate. Which amount below is closest to the value of the contingent consideration at the date of acquisition?

- a. \$1,000,000
- b. \$ 45,000
- c. \$ 50,000
- d. \$ 865,000

ANS: b

$$[(\$18 - \$16) \times 500,000] \times 0.05 = \$50,000/1.10 = \underline{\underline{\$45,455}}$$

24. Topic: Acquisition cost

LO 2

Poppy Corporation acquires Stevens Company, paying the owners of Stevens 1,000,000 new shares with a par value of \$0.50 per share and a fair value of \$50 per share at the date of acquisition. Poppy also incurs cash registration fees of \$100,000 and consulting fees of \$700,000. Several of Stevens' former owners will stay on as employees, and Poppy agrees to pay them an additional amount if they remain with the company. The present value of this agreement at the date of acquisition is \$400,000. What is Poppy's reported acquisition cost?

- a. \$50,000,000
- b. \$50,700,000
- c. \$50,400,000
- d. \$51,200,000

ANS: a
 $\$50 \times 1,000,000 = \$50,000,000$. Registration fees reduce APIC, consulting fees are expensed, and the contingent payment to employees is compensation for future services.

25. Topic: Acquisition cost and goodwill

LO 1, 2

A company acquires the assets and liabilities of another company. The fair value of the acquired company's identifiable net assets is \$5,000,000. The acquisition transaction includes the following:

- \$5,000,000 in cash paid to the former owners of the acquired company
- 150,000 new shares of stock with a market value \$45/share. Registration fees, paid in cash, were \$1,000,000.
- \$4,000,000 in cash paid to the underwriter for consulting services
- Earnings contingency with an expected present value of \$3,000,000 at the date of acquisition

Goodwill for this acquisition is:

- a. \$11,750,000
- b. \$14,750,000
- c. \$10,750,000
- d. \$ 9,750,000

ANS: d

Acquisition cost = $\$5,000,000 + (150,000 \times \$45) + \$3,000,000 = \$14,750,000$
Goodwill = $\$14,750,000 - \$5,000,000 = \$9,750,000$

26. Topic: Out-of-pocket acquisition costs

LO 1, 2

Prescott acquires all of the stock of Sanders by issuing new stock to the previous shareholders of Sanders. Prescott paid consulting, accounting, and legal fees, and registration fees for the new stock issued by Sanders. What effect will these two items have on the *amount of goodwill* reported on the acquisition?

	<u>Consulting Fees</u>	<u>Registration Fees</u>
a.	No effect	Increase
b.	Increase	Increase
c.	No effect	No effect
d.	Increase	No effect

ANS: c

Consulting, accounting, and legal fees are expensed as incurred, and registration fees reduce APIC. Neither is added to goodwill.

27. Topic: Acquisition cost, contingent payments

LO 2

The expected present value of contingent payments made by an acquiring company to the former owners of the acquired company are part of the acquisition cost

- a. At all times.
- b. When they are compensation for future employee services.
- c. When they are tied to a future company performance goal.
- d. Never.

ANS: c

28. Topic: Acquisition cost, earnout

LO 2

An acquirer includes an earnout, or earnings contingency, in the acquisition price. Additional cash will be paid to the former owners of the acquired company if the acquired company's performance exceeds certain thresholds within the next three years. The payoff, if any, would occur three years after the acquisition.

Which of the following statements is *true*?

- a. The earnout is not reported at the date of acquisition but is reported as an adjustment to the acquisition price if and when paid.
- b. The earnout is reported as a liability on the acquiring company's books at the date of acquisition.
- c. If the discount rate increases, the date-of-acquisition earnout value increases.
- d. The earnout usually reduces reported goodwill at the date of acquisition.

ANS: b

29. Topic: Acquisition cost, earnings contingency

LO 2

ABC Corporation acquires the assets and liabilities of XYZ Company in a merger. If ABC offers the former shareholders of XYZ an earnings contingency, what is the likely result of having this contingency, on ABC's balance sheet at the date of acquisition?

- a. ABC will report less goodwill.
- b. ABC will revalue XYZ's previously reported assets at higher amounts.
- c. ABC will revalue XYZ's previously reported liabilities at higher amounts.
- d. ABC will report a liability for the earnings contingency.

ANS: d

30. Topic: Acquisition cost, registration fees

LO 2

Parish Corporation issues new stock with \$1/share par value to the former shareholders of Sanford Company, in a merger. The registration fees Parish pays to issue the new stock will

- a. Increase goodwill.
- b. Reduce Parish's income.
- c. Increase previously unreported identifiable intangible assets acquired.
- d. Reduce Parish's additional paid-in capital.

ANS: d

31. Topic: Acquisition costs and goodwill

LO 1, 2

Which one of the following items *increases* the amount of goodwill recognized in an acquisition?

- a. Consulting fees paid to Goldman Sachs
- b. Payments offered to employees of the acquired company that are based on their future performance
- c. An earnout added to an acquisition agreement to motivate the acquired company's shareholders to sell
- d. Registration fees the acquiring company pays to issue new stock in an acquisition

ANS: c

32. Topic: Acquisition costs

LO 2

All of the following increase the acquisition cost of the acquired company *except*:

- a. Fair market value of stock issued by the acquiring company to the former shareholders of the acquired company
- b. Fair market value of debt issued by the acquiring company to acquire the voting stock of the acquired company
- c. Payments to the former owners of the acquired company that are contingent on continued employment in the firm
- d. Earnings contingency that is dependent on the future performance of the acquired company

ANS: c

33. Topic: Valuation of acquired net assets, acquisition costs

LO 1, 2

ABC Corporation acquires the assets and liabilities of XYZ Company. Holding everything else constant, which situation will result in ABC reporting *less* goodwill on this acquisition?

- a. XYZ has previously unreported identifiable intangible assets.
- b. The market rate of interest on XYZ's liabilities has declined.
- c. The fair value of XYZ's buildings and equipment is lower than its book value.
- d. ABC includes an earnings contingency in the acquisition cost.

ANS: a

34. Topic: Acquired net assets, acquisition costs

LO 1, 2

Which item affects the reported net income of an acquiring company at the date of acquisition?

- a. An earnout agreement promising future payments to the former owners of the acquired company, dependent on the acquired company's future performance
- b. Fees paid to outside accountants and lawyers
- c. Identifiable intangible assets acquired, that were not previously reported by the acquired company
- d. Goodwill recognized as a result of the acquisition

ANS: b

35. Topic: Acquisition cost, contingent consideration

LO 2

An acquired company's former owners become employees of the acquiring company. At the date of acquisition, an acquiring company promises to make future payments to these former owners, which are terminated when the former owners are no longer employed. At the date of acquisition, the acquiring company:

- a. Does not report these contingent payments
- b. Reports the contingent payments as a liability, at expected present value
- c. Reports the contingent payments as a liability, by summing up the expected future payments
- d. Reports the contingent payments as a credit to equity

ANS: a

36. Topic: Acquisition costs, goodwill

LO 1, 2

An acquiring company pays \$45 million in cash, and issues new no-par stock with a fair value of \$75 million, to the acquired company's former owners, for the assets and liabilities of the acquired company. Registration fees associated with the new stock issuance are \$300,000, paid in cash. Consulting fees for the acquisition are \$1 million, paid in cash. The fair value of the acquired company's identifiable net assets is \$65 million.

The entry or entries the acquiring company makes to record the acquisition have what net effect on its account balances?

- a. Capital stock increases by \$75 million.
- b. Expenses increase by 1.3 million.
- c. Cash decreases by \$46 million.
- d. Goodwill increases by \$55 million.

ANS: d

The acquisition entry is:

Identifiable net assets		65,000,000	
Goodwill		55,000,000	
Merger expenses		1,000,000	
	Cash		46,300,000
	Capital stock		74,700,000

37. Topic: Valuation of assets and liabilities acquired, acquisition costs

LO 1, 2

Pyn Corporation acquires all of Sys Company's assets and liabilities, reported as a merger. Acquisition-related items are as follows:

- \$60 million in cash paid to Sys' former shareholders
- \$25 million fair value of stock issued
- \$1 million consulting fees, paid in cash
- \$4 million in new stock registration fees, paid in cash
- Earnout with an expected present value of \$2 million

Fair values of Sys' assets and liabilities are as follows:

	Fair Value
Current assets	\$ 1,000,000
Land, buildings, and equipment	8,000,000
Brand names	2,000,000
Customer lists	4,000,000
Skilled workforce	15,000,000
Potentially profitable future projects	10,000,000
Liabilities	6,000,000

Pyn records goodwill of:

- \$79,000,000
- \$83,000,000
- \$81,000,000
- \$78,000,000

ANS: d

The entry made to record the acquisition is:

Current assets		1,000,000	
Land, buildings, and equipment		8,000,000	
Brand names		2,000,000	
Customer lists		4,000,000	
Goodwill		78,000,000	
Merger expenses		1,000,000	
	Liabilities		8,000,000
	Cash		65,000,000
	Capital stock		21,000,000

38. Topic: Changes in asset values subsequent to acquisition

LO 3

Sheetz Company is purchased by Pulsar Corporation, at an acquisition cost that is \$25,000,000 greater than the fair value of the identifiable net assets acquired. One of the assets acquired is a building, originally valued at \$15,000,000 at the date of the purchase. Six months after the acquisition, it is discovered that the building was actually worth \$7,000,000 at the date of acquisition.

What entry is made to reflect this new information?

- a. Dr. goodwill; Cr. building for \$8,000,000
- b. Dr. loss on building; Cr. building for \$8,000,000
- c. Dr. retained earnings; Cr. building for \$8,000,000
- d. no entry is made

ANS: a

39. Topic: Changes in asset values subsequent to acquisition

LO 3

Pearson Company acquired Sunview Company at an acquisition cost that was \$20 million greater than the fair value of identifiable net assets acquired. Pearson assigned a fair value of \$1,000,000 to Sunview's land. Ten months later, Pearson obtained information that the land was worth \$4,000,000 at the date of acquisition.

How does Pearson account for this value change?

- a. Gain of \$3,000,000, reported in income
- b. Increase goodwill by \$3,000,000
- c. Loss of \$3,000,000, reported in other comprehensive income
- d. Reduce goodwill by \$3,000,000

ANS: d

40. Topic: Changes in asset values subsequent to acquisition

LO 3

An acquirer made the following entry to report an acquisition:

Tangible assets		4,000	
Customer lists		600	
Goodwill		1,000	
	Liabilities		2,000
	Cash		3,600

Six months after the acquisition, the customer lists are determined to be worthless. How is this information reported if (1) the new information relates to the value of the customer lists as of the date of acquisition, and (2) the new information relates to changes in value since acquisition?

- a. (1) \$600 gain on acquisition in income (2) \$600 decrease in goodwill
- b. (1) \$600 increase in goodwill (2) \$600 loss in income
- c. (1) \$600 loss in income (2) \$600 increase in goodwill
- d. (1) \$600 decrease in cash (2) \$600 loss in income

ANS: b

41. Topic: Subsequent changes in acquired asset values
LO 3

Kelly Corporation acquires all of the assets and liabilities of Lawson Co. at an acquisition cost that is \$50 million above the fair value of identifiable net assets acquired. Three months after the acquisition, land belonging to Lawson at the date of acquisition is discovered. The land has a fair value of \$5,000,000.

The entry to reflect this new information includes:

- a. A credit to goodwill of \$5,000,000
- b. A credit to land of \$5,000,000
- c. A gain of \$5,000,000, reported in income
- d. A loss of \$5,000,000, reported in income

ANS: a

The correcting entry is:

Land		5,000,000	
	Goodwill		5,000,000

42. Topic: Subsequent changes in acquired asset values
LO 3

Kelly Corporation acquires all of the assets and liabilities of Lawson Co. at an acquisition cost that is \$50 million above the fair value of identifiable net assets acquired. Three months after the acquisition, it is determined that because of a downturn in the economy after the acquisition, acquired brand names with indefinite lives are worth \$5,000,000 less than originally estimated.

The entry to reflect this new information includes:

- a. A credit to goodwill of \$5,000,000
- b. A debit to identifiable intangibles of \$5,000,000
- c. A gain of \$5,000,000, reported in income
- d. A loss of \$5,000,000, reported in income

ANS: d

The correcting entry is:

Impairment loss (income)		5,000,000	
	Identifiable intangibles		5,000,000

43. Topic: Subsequent changes in acquisition valuations

LO 3

The estimated value of assets acquired and liabilities assumed change subsequent to the acquisition. When should a company record the change as a correction of the initial acquisition entry?

- a. The change takes place within one year of the acquisition.
- b. The change is normally reported in income.
- c. The change is normally reported as an adjustment to other comprehensive income.
- d. The change reflects value as of the date of acquisition.

ANS: d

44. Topic: Subsequent value changes, acquired assets

LO 3

Portland Company paid \$100,000,000 in cash for Seattle Company's assets and liabilities, recording goodwill of \$75,000,000. As part of the acquisition, previously unreported brand names were capitalized at a value of \$4,000,000. Three months later, Seattle's brand names are determined to have been worthless as of the date of acquisition. The entry to record this information includes:

- a. A debit to loss of \$4,000,000, reported in income
- b. A debit to brand names of \$4,000,000
- c. A debit to goodwill of \$4,000,000
- d. A debit to retained earnings of \$4,000,000

ANS: c

The correcting entry, within the measurement period, is:

Goodwill		4,000,000	
	Brand names		4,000,000

45. Topic: Subsequent value changes, bargain gain

LO 3, 4

Portland Company paid \$20,000,000 in cash for Seattle Company's assets and liabilities, recording a bargain gain of \$1,500,000. As part of the acquisition, previously unreported brand names were capitalized at a value of \$4,000,000. Three months later, Seattle's brand names are determined to have been worthless as of the date of acquisition. The entry to record this information includes:

- a. A debit to loss of \$2,500,000, reported in income
- b. A debit to brand names of \$4,000,000
- c. A debit to goodwill of \$2,500,000
- d. A debit to retained earnings of \$2,500,000

ANS: c

The correcting entry, within the measurement period, is:

Bargain gain (income)		1,500,000	
Goodwill		2,500,000	
	Brand names		4,000,000

46. Topic: Subsequent value changes, bargain gain

LO 3, 4, 5

Portland Company paid \$20,000,000 in cash for Seattle Company's assets and liabilities, recording a bargain gain of \$1,500,000. Three months later, it is determined that Seattle's acquisition-date liabilities, related to pending lawsuits, were actually \$3,000,000 lower as of the date of acquisition. The entry to record this information includes:

- a. A credit to gain on acquisition of \$3,000,000
- b. A credit to liabilities of \$3,000,000
- c. A debit to goodwill of \$3,000,000
- d. A credit to goodwill of \$3,000,000

ANS: a

The correcting entry, within the measurement period, is:

Liabilities		3,000,000	
	Bargain gain (income)		3,000,000

47. Topic: Subsequent value changes, earnings contingency

LO 2, 3

Pecan acquires Southern in an acquisition reported as a merger. The acquisition results in \$50 million in goodwill. The acquisition cost includes an earnings contingency, valued at \$1 million at the date of acquisition. Within the measurement period, additional information on Southern's expected future performance at the date of acquisition reveals that the earnout actually had a fair value of \$200,000 at the date of acquisition.

The entry to record the new information includes a credit of \$800,000 to:

- a. Intangible assets
- b. Goodwill
- c. Gain on acquisition
- d. Earnings contingency liability

ANS: b

The entry to correct the date of acquisition value of the earnout is:

Earnings contingency liability		800,000	
	Goodwill		800,000

48. Topic: Earnings contingency, subsequent value changes

LO 2, 3

Pecan acquires Southern in an acquisition reported as a merger. The acquisition results in \$50 million in goodwill. The acquisition cost includes an earnings contingency, valued at \$1 million at the date of acquisition. Within the next year, increases in the demand for Southern's products subsequent to acquisition require that the earnout be revalued to \$1,800,000. The entry to record the new information includes a debit of \$800,000 to:

- a. Intangible assets
- b. Goodwill
- c. Loss on contingency
- d. Earnings contingency liability

ANS: c

The change in earnout value is due to subsequent events and is therefore not a correction of the initial acquisition entry. The entry to record the revaluation is:

Loss on contingency (income)		800,000	
	Earnings contingency liability		800,000

49. Topic: Subsequent value changes

LO 3

ABC Corporation acquires all of the assets and liabilities of XYZ Company, at a price that is significantly higher than the fair value of the identifiable net assets acquired. Four months after the acquisition, a fire destroys some of XYZ's property.

How does ABC report this?

- a. ABC will report less goodwill from the acquisition.
- b. ABC will report more goodwill from the acquisition.
- c. ABC will not report this event.
- d. ABC will report a loss on property in income.

ANS: d

The value change is due to subsequent events, so the decline in property value is an impairment loss.

50. Topic: Subsequent value changes

LO 3

Pacific Company acquired Starz Company for \$100 million and recognized \$70 million in goodwill. Within a year after the acquisition, due to improvement in the economy Starz' land is worth \$15 million more than the amount estimated at the date of acquisition.

How is this information reported?

- a. Gain on acquisition of \$15 million
- b. Gain on land of \$15 million
- c. Reduction in goodwill of \$15 million
- d. Not reported

ANS: d

The value change is due to subsequent events and is therefore reported using normal accounting. Increases in the value of land are not reported.

51. Topic: Subsequent value changes

LO 3, 5

Pacific Company acquired Starz Company for \$100 million and recognized \$70 million in goodwill. When it recorded the acquisition, Pacific recognized an additional liability not already reported on Starz' balance sheet, for a pending lawsuit against Starz, and estimated its value at \$12 million. Three months after the date of acquisition, Pacific determined that the present value of the lawsuit liability was really \$2 million, because of events occurring subsequent to the date of acquisition.

How is this information reported?

- a. Loss on acquisition of \$10 million
- b. Gain on lawsuit of \$10 million
- c. Reduction in goodwill of \$10 million
- d. Not reported

ANS: b

This is a subsequent event so normal accounting applies. Changes in the value of contingent liabilities affect income.

52. Topic: Subsequent value changes

LO 3

Atold Corporation reports goodwill of \$40 million on acquisition of Benholm Company. Subsequently, Atold learns that one of Benholm's buildings has increased in value by \$4 million. How is this reported, if the information is discovered (1) within the measurement period, and (2) after the measurement period is over?

- | | (1) Within the measurement period | (2) After the measurement period |
|----|--|---|
| a. | Decrease in goodwill | Gain on income statement |
| b. | Increase in goodwill | Not reported |
| c. | Decrease in goodwill | Not reported |
| d. | Increase in goodwill | Gain on income statement |

ANS: c

53. Topic: Subsequent value changes

LO 3

Atold Corporation reports goodwill of \$40 million on acquisition of Benholm Company. One month later, Atold learns that Benholm's portfolio of AFS debt investments is worth \$3 million more than estimated at the date of acquisition. How is this reported, if the information is (1) a better estimate of the portfolio's value at the date of acquisition (within the measurement period), or (2) is due to events occurring subsequent to the acquisition (after the measurement period).

	(1) Within the measurement period	(2) After the measurement period
a.	Decrease in goodwill	Gain in OCI
b.	Decrease in goodwill	Not reported
c.	Gain in OCI	Not reported
d.	Not reported	Gain in OCI

ANS: a
Within the measurement period, the correction of the original acquisition entry increases investments and reduces goodwill. After the measurement period, changes in the value of AFS debt investments are reported normally, in OCI.

54. Topic: Bargain purchase

LO 4

Pluto Corporation purchased Saturn Corporation's assets and liabilities for \$4,500,000 in cash. Saturn's reported assets and liabilities have the following fair values at the date of acquisition:

	Fair Value Dr (Cr)
Cash, receivables	\$ 5,000,000
Inventory	7,000,000
Land and buildings	30,000,000
Liabilities	(40,000,000)

Saturn also has brand names, with a fair value of \$4,000,000, that are not reported on its balance sheet. The gain on acquisition is:

- a. \$3,000,000
- b. \$1,500,000
- c. \$-0-
- d. \$5,500,000

ANS: b

Cost		\$4,500,000
Fair value of identifiable net assets:		
Cash, receivables	\$ 5,000,000	
Inventory	7,000,000	
Land and buildings	30,000,000	
Brand names	4,000,000	
Liabilities	(40,000,000)	6,000,000
Gain		<u>\$ (1,500,000)</u>

55. Topic: Bargain purchase

LO 4

Titan Company pays \$2,000,000 in cash to acquire Victory Company's assets and liabilities. Book and fair values of Victory's assets and liabilities appear below.

	Book Value	Fair Value
Current assets	\$ 300,000	\$ 200,000
HTM investments	100,000	120,000
Buildings, net	1,200,000	1,000,000
Equipment, net	2,000,000	500,000
Identifiable intangible assets	0	1,000,000
Liabilities	500,000	520,000

What is the gain on acquisition?

- a. \$820,000
- b. \$-0-
- c. \$280,000
- d. \$300,000

ANS: d

Cost		\$2,000,000
Fair value of net assets acquired:		
Current assets	\$ 200,000	
HTM investments	120,000	
Buildings	1,000,000	
Equipment	500,000	
Identifiable intangible assets	1,000,000	
Liabilities	<u>(520,000)</u>	<u>2,300,000</u>
Gain on acquisition		<u>\$ (300,000)</u>

56. Topic: Bargain gain

LO 4

Packard Company acquires the assets and liabilities of Sutton Company, with an acquisition cost that is less than the fair value of its identifiable net assets. The difference between acquisition cost and the fair value of identifiable net assets acquired

- a. Increases net income on the income statement
- b. Increases other comprehensive income
- c. Reduces noncurrent assets acquired
- d. Reduces goodwill

ANS: a

57. Topic: Bargain gain, contingent consideration

LO 2, 4

A company acquires the assets and liabilities of another company, paying the former owners cash plus an earnings contingency. A gain on acquisition is reported in income if:

- a. The cash paid is less than the book value of the net assets acquired.
- b. The cash paid plus the present value of the earnings contingency is less than the fair value of the identifiable net assets acquired.
- c. The cash paid plus the present value of the earnings contingency is less than the fair value of the tangible net assets acquired.
- d. The cash paid is less than the fair value of identifiable net assets acquired.

ANS: b

58. Topic: Bargain gain

LO 4

An acquiring company may be motivated to report a larger bargain gain to improve its bottom line. All of the following manipulations could be used to overstate the gain, except which one?

- a. Understate the present value of an earnings contingency.
- b. Understate the discount rate used to measure the fair value of acquired liabilities.
- c. Understate the value of previously unreported intangible assets acquired.
- d. Understate the value of acquired contingent liabilities such as pending lawsuits.

ANS: d

59. Topic: Bargain gain

LO 4

Which of the following actions *reduces* the likelihood of reporting a bargain gain on an acquisition?

- a. Pick a higher discount rate to value the earnings contingency.
- b. If stock is issued, pick an acquisition date when the market value of the stock is higher.
- c. Make cash payments to former owners conditional on continued employment in the company.
- d. If stock is issued, classify fewer cash outlays as registration fees.

ANS: b

Only actions that *increase* total acquisition cost *reduce* bargain gains.

60. Topic: Bargain gain

LO 4

Which of the following actions *reduces* the likelihood of reporting a bargain gain on an acquisition?

- a. Identify additional previously unreported acquired identifiable intangible assets.
- b. Use a lower discount rate to measure the present value of expected cash flows from previously unreported acquired favorable leases.
- c. Identify additional previously unreported acquired contingent liabilities.
- d. Classify acquired equity investments as investments with significant influence rather than investments with no significant influence.

ANS: c

Only actions that *reduce* the fair value of acquired identifiable net assets *reduce* bargain gains.

61. Topic: Acquired deferred taxes

LO 5

In a nontaxable acquisition, assets acquired were reported on the acquired company's books at \$1,000, but they are reported on the acquiring company's books at a fair value of \$8,000. The acquiring company's tax rate is 25% and the assets have a 5-year life.

At the date of acquisition, the acquiring company reports an acquired deferred tax liability of:

- a. \$7,000
- b. \$4,000
- c. \$ 350
- d. \$1,750

ANS: d

$(\$8,000 - \$1,000) \times 25\% = \$2,250$

62. Topic: Acquired deferred taxes

LO 5

An acquirer reports a deferred tax *asset* as one of the assets acquired in a business combination when:

- a. The acquisition is taxable.
- b. The book value of acquired assets is greater than fair value.
- c. The book value of acquired assets is less than fair value.
- d. The acquiree's tax rate is lower than the acquirer's tax rate.

ANS: b

63. Topic: Acquired deferred taxes

LO 5

Potash Company acquires Spokane Corporation's assets and liabilities, in a nontaxable acquisition. The tax basis of Spokane's buildings is \$50 million, with an average remaining life of 25 years, straight-line. The fair value of the buildings at the date of acquisition is \$30 million. Assume the tax rate is 20%.

Based on this information, because of the difference between reporting Spokane's buildings on the books versus tax return, *each year* for the next 25 years Potash will:

- a. Credit deferred tax asset \$4,000,000
- b. Debit deferred tax asset \$160,000
- c. Debit deferred tax liability \$4,000,000
- d. Credit deferred tax asset \$160,000

ANS: d

The total deferred tax asset acquired = (\$50 million – \$30 million) x 20% = \$4 million. Each year the deferred tax asset declines by \$4 million/25 = \$160,000.

64. Topic: Acquired deferred taxes

LO 5

Peer Company acquires Spear Corporation's assets and liabilities, in a nontaxable acquisition. The tax basis of Spear's identifiable intangible assets is \$1 million, with an average remaining life of 5 years, straight-line. The fair value of the identifiable intangible assets at the date of acquisition is \$26 million. Assume the tax rate is 25%.

Based on this information, because of the difference between reporting Spear's plant assets on the books versus tax return, *each year* for the next 5 years Peer will:

- a. Credit deferred tax liabilities \$6.25 million
- b. Debit deferred tax liabilities \$1.25 million
- c. Debit deferred tax assets \$1.25 million
- d. Credit deferred tax assets \$6.25 million

ANS: b

The total deferred tax liability acquired = (\$26 million – \$1 million) x 25% = \$6.25 million. Each year the deferred tax liability declines by \$6.25 million/5 = \$1.25 million.

65. Topic: Acquired deferred taxes

LO 5

An acquired company's tax basis of identifiable net assets acquired is lower than the fair value of identifiable net assets acquired. The acquisition is nontaxable. Which statement below is *true*?

- a. The acquiring company reports an acquired deferred tax asset.
- b. In future years, because of the difference in tax basis and fair value of acquired identifiable net assets, reported tax expense will be less than taxes paid.
- c. No deferred tax assets or liabilities are acquired.
- d. In future years, taxable income will be lower than earnings before tax reported on the books.

ANS: b

66. Topic: Acquired deferred taxes

LO 5

Cognitive Company acquires the assets and liabilities of Tableau in a nontaxable acquisition. The carrying value of Tableau's equipment is greater than its fair value. This tax situation will have what effect on Cognitive's acquisition entry?

- a. Goodwill is lower.
- b. Goodwill is higher.
- c. Acquired equipment is recorded at a lower amount.
- d. There is no effect on the acquisition entry.

ANS: a

A deferred tax asset is recorded so the fair value of identifiable net assets acquired is higher.

67. Topic: Acquired deferred taxes

LO 5

Century Company acquires the assets and liabilities of Horizon Company in a nontaxable acquisition. The acquisition results in recognition of a deferred tax liability. Which of the following is a possible explanation for this deferred tax liability?

- a. The acquisition was a bargain purchase.
- b. Horizon had previously unreported liabilities.
- c. The book value of Horizon's buildings was less than their market value.
- d. The acquisition's cost equaled Horizon's book value.

ANS: c

68. Topic: Acquired deferred taxes

LO 5

Century Company acquires the assets and liabilities of Horizon Company in a nontaxable acquisition. The acquisition results in recognition of a deferred tax asset. Which of the following is a possible explanation for this deferred tax liability?

- a. The acquisition resulted in goodwill.
- b. Horizon had previously unreported limited-life assets.
- c. The book value of Horizon's buildings was greater than their market value.
- d. The acquisition's cost equaled Horizon's book value.

ANS: c

69. Topic: Step acquisition

LO 5

Pivot Corporation owns 80% of the voting stock of Speegee Company. It then acquires the remaining 20% of Speegee's voting stock. Which statement is *true* concerning reporting for the acquisition of the remaining 20%, if the acquisition is reported as a merger?

- a. The assets and liabilities of Speegee are revalued to fair value.
- b. If the acquisition cost is greater than the fair value of identifiable assets acquired, goodwill is recognized.
- c. If the carrying value of the purchased noncontrolling interest is greater than its acquisition cost, a gain is recognized in income.
- d. If the carrying value of the purchased noncontrolling interest is less than its acquisition cost, equity declines.

ANS: d

70. Topic: Step acquisition

LO 5

Asena Corporation owns 30% of the voting stock of Tapestry Company, and reports it as an equity method investment. It then pays cash to acquire the remaining 70% of Tapestry's voting stock. Which statement is *false* concerning reporting for the acquisition of the remaining 70%, if the acquisition is reported as a merger?

- a. If the total acquisition cost is greater than the fair value of identifiable assets acquired, goodwill is recognized.
- b. The equity method investment is written off as a reduction in additional paid-in capital.
- c. The assets and liabilities of Tapestry are revalued to fair value.
- d. The assets and liabilities of Tapestry will now appear on Asena's books.

ANS: b

71. Topic: Step acquisition

LO 5

Nebulus Corporation owns 70% of the voting stock of Suite Company. It reports the 30% interest in the equity section of its balance sheet at \$32,000,000, and all of Suite's assets and liabilities are reported on Nebulus' balance. Nebulus acquires the remaining 30% interest for \$45,000,000 in cash. At that time, the fair value of Suite's identifiable net assets was \$125,000,000. As part of the acquisition entry, Nebulus records

- a. A gain on acquisition of \$13,000,000, in income.
- b. A \$45,000,000 net reduction in shareholders' equity.
- c. A \$32,000,000 net reduction in shareholders' equity.
- d. A gain on acquisition of \$45,000,000, in income.

ANS: b

The acquisition entry is:

Noncontrolling interest (equity)		32,000,000	
APIC (or other equity account)		13,000,000	
	Cash		45,000,000

72. Topic: Step acquisition**LO 5**

Nebulus Corporation owns 30% of the voting stock of Suite Company. It reports the 30% interest as an equity method investment, with a current carrying value of \$32,000,000 and a market value of \$45,000,000. Nebulus acquires the remaining 70% interest for \$120,000,000 in cash. At that time, the fair value of Suite's identifiable net assets was \$125,000,000, and Suite's book value was \$45,000,000. As part of the acquisition entry, Nebulus records

- a. A gain of \$13,000,000, in income.
- b. Goodwill of 27,000,000.
- c. Goodwill of \$107,000,000.
- d. A gain of \$5,000,000, in income.

ANS: a

The combined acquisition entry is:

Identifiable net assets		125,000,000	
Goodwill		40,000,000	
	Cash		120,000,000
	Investment in Suite		32,000,000
	Gain (income)		13,000,000

73. Topic: Acquired in-process research and development**LO 5**

Average Company acquired all of the assets and liabilities of Best Company. Best Company has research and development projects in process, which have not yet been completed. How does Average Company report Best's in-process research and development?

- a. As a limited life intangible asset, at fair value
- b. As an indefinite life intangible asset, at fair value
- c. As part of goodwill
- d. It is not reported

ANS: b

74. Topic: Acquired in-process research and development**LO 5**

Plaza Corporation acquires all of the assets and liabilities of Spiceland Company. How are Spiceland's research and development costs of ongoing projects reported on Plaza's books at the date of acquisition?

- a. Included as part of goodwill
- b. Identifiable asset, at fair value
- c. Operating expense, at fair value
- d. Loss on acquisition, at Spiceland's cost

ANS: b

75. Topic: Acquired in-process research and development

LO 5

If an acquired company has in-process R&D projects, the value of the R&D is reported as an acquired intangible asset:

- a. Only if it already appears on the acquired company's balance sheet
- b. Only if it has an alternative future use
- c. If the probability of success is greater than 50%
- d. At fair value

ANS: d

76. Topic: IFRS vs U.S. GAAP for business combinations

LO 5

Which statement is *true* concerning U.S. GAAP versus IFRS reporting for business combinations?

- a. U.S. GAAP requires recognition of an earnout as part of initial acquisition cost, while IFRS requires an earnout to be recorded only when it is paid.
- b. U.S. GAAP expenses consulting costs while IFRS includes these costs as part of goodwill.
- c. U. S. GAAP and IFRS both require capitalization of in-process R&D as an identifiable intangible asset.
- d. U.S. GAAP and IFRS both require all asset and liability valuation corrections to be reported in income.

ANS: c

77. Preacquisition contingency

LO 5

An acquirer discovers that a competitor has filed a patent infringement lawsuit against the company it is acquiring. This lawsuit is not currently recognized on the acquiree's books. How should the acquirer report the lawsuit at the date it makes the acquisition?

- a. Don't report it until it is settled.
- b. Report it as a liability if it is a probable liability and its value can be reasonably estimated.
- c. Report it as a liability if it is a contractual or separable obligation.
- d. Report it as a liability if it is more likely than not that they will lose the lawsuit.

ANS: b

78. Preacquisition contingency

LO 5

An acquirer pays cash for the assets and liabilities of another company. Which of the following is *most likely* to be reported by the acquirer as one of the liabilities acquired from the other company?

- a. Contingent consideration (earnout) included as part of the acquisition
- b. Warranty liability not previously reported by the acquiree
- c. Unreported unsettled lawsuit against the acquiree
- d. Promised payments to former owners of the acquiree, not related to future employment

ANS: b

79. Topic: Valuation of assets acquired and liabilities assumed, IPR&D, preacquisition contingencies LO 1, 5

Pawan Corporation acquires all of Sesa Company at an acquisition cost of \$80,000,000 in cash. Sesa's reported assets and liabilities are as follows:

	Book Value Dr (Cr)	Fair Value Dr (Cr)
Current assets	\$ 5,000,000	\$ 7,000,000
Land, buildings, and equipment (net)	60,000,000	40,000,000
Liabilities	(40,000,000)	(39,000,000)

Pawan determines that Sesa has the following identifiable intangible assets, not reported on its balance sheet:

	Fair Value
Favorable leaseholds	\$ 4,000,000
In-process research & development	3,000,000
Advertising contracts	5,000,000

Pawan also discovers that Sesa has not properly recorded the expected liability from a settled lawsuit, currently estimated at \$6,000,000.

Pawan records goodwill of:

- a. \$69,000,000
- b. \$60,000,000
- c. \$66,000,000
- d. \$54,000,000

ANS: c

The entry to record the combination is:

Current assets		7,000,000	
Land, buildings & equipment		40,000,000	
Identifiable intangibles		12,000,000	
Goodwill		66,000,000	
	Liabilities		45,000,000
	Cash		80,000,000

80. Topic: Preacquisition contingency, change in estimate

LO 3, 5

Relic Corporation acquires the assets and liabilities of Vware Company and reports goodwill of \$40 million. At the time of the acquisition, Vware was a defendant in a customer's lawsuit, but it was expected that Vware would win, so the lawsuit was not recorded. Within a year of the acquisition, the lawyers persuade both parties to settle out of court for \$8,000,000. How is this payment most likely to be reported? Credit cash, and debit:

- a. Retained earnings (balance sheet)
- b. Other comprehensive income (statement of comprehensive income)
- c. Loss (income statement)
- d. Lawsuit liability (balance sheet)

ANS: c

PROBLEMS

1. Topic: Acquisition accounting LO 1

A company purchases assets from another company for \$10,000,000 in cash. The fair value of the tangible assets is \$7,000,000.

Required

Prepare the journal entry to record the acquisition on the books of the acquirer, assuming

- The acquisition qualifies for acquisition accounting.
- The acquisition does not qualify for acquisition accounting.

ANS:

a.

Tangible assets		7,000,000	
Goodwill		3,000,000	
	Cash		10,000,000

b.

Tangible assets		10,000,000	
	Cash		10,000,000

2. Topic: Acquisition LO 2

Cally Company owns current assets with a market value of \$5,000,000 and plant and equipment with a market value of \$40,000,000. It has liabilities valued at \$35,000,000. It also has unreported brand names valued at \$3,000,000. Breaker Corporation buys Cally's assets and liabilities for \$50,000,000 in cash.

Required

Prepare the journal entry Breaker makes to record the acquisition.

ANS:

Current assets		5,000,000	
Plant and equipment		40,000,000	
Brand names		3,000,000	
Goodwill		37,000,000	
	Liabilities		35,000,000
	Cash		50,000,000

3. **Topic: Valuation of assets acquired and liabilities assumed**

LO 1

Bestvalue Airlines' June 1, 2020 balance sheet is as follows (*in thousands*):

Assets		Liabilities & Equity	
Cash	\$ 1,400	Current liabilities	\$ 3,200
Receivables	650	Long-term debt	5,000
Investments	1,000	Common stock, \$0.01 par	1
Maintenance supplies	150	Additional paid-in capital	5,500
Flight equipment (net of \$2,000 accumulated depreciation)	8,500	Retained earnings (deficit)	(2,300)
International routes	700	Accumulated other comprehensive income	1,999
		Treasury stock	(1,000)
Total assets	<u>\$12,400</u>	Total liabilities & equity	<u>\$12,400</u>

Safeway Airlines acquired Bestvalue on June 1, 2020, in an acquisition reported as a merger. Bestvalue's cash, receivables, investments, and current liabilities were reported at fair value. Its maintenance supplies had a fair value of \$200,000, flight equipment had a fair value of \$10 million, and international routes were worth \$400,000. Long-term debt had a fair value of \$5.1 million. Bestvalue also had an unrecorded intangible, representing leases with favorable terms, worth \$600,000, which meets ASC 805 criteria for separate capitalization. Safeway paid \$12 million in cash for Bestvalue.

Required

Present Safeway's journal entry to record the acquisition. Express all dollar amounts in thousands.

ANS:

(*in thousands*)

Cash		1,400	
Receivables		650	
Investments		1,000	
Maintenance supplies		200	
Flight equipment		10,000	
International routes		400	
Leases		600	
Goodwill		6,050	
	Current liabilities		3,200
	Long-term debt		5,100
	Cash		12,000

4. **Topic: Valuation of assets acquired and liabilities assumed**

LO 1

Sully Company's January 1, 2020 balance sheet is as follows:

Assets		Liabilities & Equity	
Cash, receivables	\$ 3,000,000	Current liabilities	\$ 2,000,000
Inventories	4,000,000	Long-term liabilities	6,500,000
Equity method investments	1,000,000	Capital stock	2,000,000
Land, buildings & equipment	5,500,000	Retained earnings	3,500,000
		Accumulated other comprehensive loss	(400,000)
		Treasury stock	(100,000)
Total assets	\$13,500,000	Total liabilities & equity	\$13,500,000

On January 1, 2020, Pronto Corporation acquired Sully's assets and liabilities for \$50 million in cash. Sully's cash and receivables, and current liabilities were reported at values approximating fair value. However, its inventories were overvalued by \$2,000,000, and its equity method investments were undervalued by \$3,000,000. Its land, buildings & equipment were overvalued by \$2,500,000, and its long-term liabilities were undervalued by \$500,000. The accountants identified the following possible intangible assets attributed to Sully but not currently recorded on its balance sheet:

	Fair Value
Skilled workforce	\$7,000,000
Favorable leases	5,000,000
Developed technology	2,000,000
Prospective customer contracts	1,500,000
Synergies on future projects	3,000,000

Required

Prepare Prance's journal entry to record the acquisition.

ANS:

Cash, receivables		3,000,000	
Inventories		2,000,000	
Equity method investments		4,000,000	
Land, buildings & equipment		3,000,000	
Favorable leases		5,000,000	
Developed technology		2,000,000	
Goodwill		40,000,000	
	Current liabilities		2,000,000
	Long-term liabilities		7,000,000
	Cash		50,000,000

5. Topic: Valuation of identifiable intangible assets

LO 1

Parsons Corporation acquires all of the assets and liabilities of Sonata Company at the beginning of 2019, in an acquisition reported as a merger. Developed technology, not reported on Sonata's balance sheet, is appropriately reported as an acquired identifiable intangible asset. Parsons uses the income approach to value this intangible asset, at the present value of forecasted operating cash flow, net of taxes, capital charges and additional capital expenditures, for the next four years. The following information is collected as part of the valuation process:

- Projected 2019 operating income derived from the developed technology is \$4 million before tax. This amount is expected to grow at a rate of 6% yearly.
- Depreciation and amortization expense included in operating income is \$1 million. This amount is expected to be constant during 2019-2022.
- The tax rate for 2019-2022 is 25%.
- Additional capital expenditures related to the developed technology are forecasted to be \$500,000 in 2019, growing at a rate of 2% yearly.
- The capital charge on contributory assets is estimated at \$200,000. This amount is expected to be constant during 2019-2022.
- The appropriate risk-adjusted discount rate is 20%.

Required

Calculate the value of the developed technology, reported by Parsons as an acquired identifiable intangible asset. Round answers to the nearest dollar and assume cash flows occur at year-end.

ANS:

	2019	2020	2021	2022
Operating income	\$4,000,000	\$4,240,000	\$4,494,400	\$4,764,064
Less income tax expense	<u>(1,000,000)</u>	<u>(1,060,000)</u>	<u>(1,123,600)</u>	<u>(1,191,016)</u>
After-tax operating income	3,000,000	3,180,000	3,370,800	3,573,048
Plus depreciation expense	1,000,000	1,000,000	1,000,000	1,000,000
Less capital expenditures	(500,000)	(510,000)	(520,200)	(530,604)
Less contributory assets capital charge	<u>(200,000)</u>	<u>(200,000)</u>	<u>(200,000)</u>	<u>(200,000)</u>
Net cash flow	\$3,300,000	\$3,470,000	\$3,650,600	\$3,842,444

$$\$3,300,000/1.2 + \$3,470,000/(1.2)^2 + \$3,650,600/(1.2)^3 + \$3,842,444/(1.2)^4 = \underline{\underline{\$9,125,368}}$$

6. Topic: Recognition of acquired intangibles, goodwill

LO 1

ABC Services provides web services to professional service organizations. ABC acquires XYZ Consulting to broaden its service offerings, at a cost of \$40,000,000. The book value of XYZ's recorded net assets (all tangibles) is \$300,000, and their fair value is \$2,000,000. XYZ also possesses the following unreported intangibles, with fair values as listed:

	Fair Value
Registered company name	\$10,000,000
Customer contracts	2,000,000
Long-time customer relationships	4,200,000
Lease agreements	2,500,000
Internet domain names	6,000,000
Skilled workforce	8,000,000

Required

Prepare a schedule to calculate the goodwill recognized for this acquisition.

ANS:

Identifiable intangibles arising from contractual or other legal rights, or separable intangibles, are capitalized by the acquirer. The registered name, customer contracts, lease agreements and internet domain names meet these requirements.

Acquisition cost		\$40,000,000
Fair value of identifiable net assets acquired:		
Tangible net assets	\$ 2,000,000	
Company name	10,000,000	
Customer contracts	2,000,000	
Lease agreements	2,500,000	
Internet domain names	<u>6,000,000</u>	<u>22,500,000</u>
Goodwill		<u>\$17,500,000</u>

Use the following information to answer Questions 7 and 8.

Parrott Corporation acquires the assets and liabilities of Swann Company. The fair values of Swann's reported assets and liabilities are estimated to be as follows at the date of acquisition.

	Fair Value Dr (Cr)
Current assets	\$ 400
Plant & equipment, net	1,500
Liabilities	(1,200)

Parrott determines that Swann has not recorded the following intangible assets on its books:

	Fair Value
Completed technology	\$ 600
Favorable leases	100
Synergies on future projects	250
Assembled workforce	800

These intangibles may or may not all meet the standards for capitalization as identifiable intangible assets. Each of the following questions is independent.

**7. Topic: Valuation of assets acquired and liabilities assumed
LO 1**

Parrott pays \$6,000 in cash to buy all of Swann's assets and liabilities.

Required

- How much in acquired previously unreported identifiable intangibles will Parrott report?
- What is the fair value of identifiable net assets acquired?
- How much goodwill does Parrott report?

ANS:

- $\$600 + \$100 = \underline{\$700}$
- $\$400 + \$1,500 + \$700 - \$1,200 = \underline{\$1,400}$
- $\$6,000 - \$1,400 = \underline{\$4,600}$

8. Topic: Assets acquired and liabilities assumed, measurement of acquisition cost

LO 1, 2

Parrott issues 1,000 shares of \$0.50 par stock to buy Swann's assets and liabilities. Parrott's stock has a market value of \$8/share. Parrott pays \$200 in registration fees to issue the stock, and the fees are paid in cash.

Required

- a. What is Parrott's credit to common stock (par)?
- b. What is Parrott's credit to APIC?
- c. What is acquisition cost?
- d. How much goodwill does Parrott report?

ANS:

- a. $1,000 \times \$0.50 = \underline{\$500}$
- b. $(1,000 \times \$8) - \$500 - \$200 = \underline{\$7,300}$
- c. $(1,000 \times \$8) = \underline{\$8,000}$, or $\$500 + \$7,300 + \$200 = \underline{\$8,000}$
- d. $\$8,000 - \$1,400 = \underline{\$6,600}$

9. **Topic: Assets acquired and liabilities assumed, measurement of acquisition cost**

LO 1,2

Powell Corporation paid \$15 million in cash to acquire the assets and liabilities of Sloan Company. Powell also agreed to make an additional cash payment in the future, with an expected present value of \$600,000, if certain performance targets are met. Powell paid legal and consulting fees of \$300,000 in cash in connection with the merger. A comparison of book and fair values of Sloan's reported assets and liabilities follows:

<i>(in thousands)</i>	Book Value	Fair Value
Current assets.....	\$ 600	\$ 450
Property and equipment, net.....	5,000	2,000
Patents and trademarks.....	200	1,800
Current liabilities.....	(400)	(400)
Long-term debt.....	<u>(3,000)</u>	<u>(3,200)</u>
Net assets.....	<u>\$2,400</u>	<u>\$ 650</u>

Sloan also has previously unreported developed technology, valued at \$1.2 million, meeting ASC *Topic 805* criteria for capitalization.

Required

- What is the acquisition cost for this transaction?
- Prepare the journal entry or entries made by Powell to record the business combination as a merger.

ANS:

- $\$15,000,000 + \$600,000 = \underline{\$15,600,000}$

b.

Current assets	450,000	
Property and equipment	2,000,000	
Patents and trademarks	1,800,000	
Identifiable intangible: developed technology	1,200,000	
Goodwill	13,750,000	
Merger expenses (income)	300,000	
Current liabilities		400,000
Long-term debt		3,200,000
Cash		15,300,000
Earnout liability		600,000

Use the following information to answer Questions 10, 11 and 12. Each question is independent.

Arnprior Corporation acquires all of the assets and liabilities of Bracebridge Company. The fair values of Bracebridge's reported assets and liabilities are estimated to be as follows at the date of acquisition:

	Fair Value
Tangible assets	\$ 1,650
Liabilities	(1,450)

Arnprior determines that Bracebridge has not recorded the following intangible assets on its books:

	Fair Value
Customer lists	\$300
Brand names	140
Skilled workforce	400

Note: The above intangibles may or may not all meet the standards for capitalization as identifiable intangible assets.

10. Topic: Valuation of assets acquired and liabilities assumed

LO 1

Arnprior pays \$4,000 in cash to buy Bracebridge.

Required

- How much in previously unreported intangibles will Arnprior report?
- What is the fair value of identifiable net assets acquired?
- How much goodwill does Arnprior report?

ANS:

- $\$300 + \$140 = \underline{\$440}$
- $\$1,650 + \$440 - \$1,450 = \underline{\$640}$
- $\$4,000 - \$640 = \underline{\$3,360}$

11. Topic: Measurement of acquisition cost

LO 2

Arnprior pays \$2,000 in cash and 1,000 shares of \$1 par stock to buy Bracebridge's outstanding stock. Arnprior's stock has a market value of \$5/share. Arnprior pays \$50 in registration fees to issue the stock, and \$200 in consulting fees. All fees are paid in cash.

Required

Prepare the journal entry to record the acquisition on Arnprior's books. Arnprior treats the acquisition as a *stock acquisition*.

ANS:

Investment in Bracebridge		7,000	
Merger expenses		200	
	Cash		2,250
	Common stock (par)		1,000
	Additional paid-in capital		3,950

12. Topic: Assets acquired and liabilities assumed, measurement of acquisition cost, subsequent changes in estimates

LO 1, 2, 3

Arnprior pays \$4,000 in cash to buy Bracebridge. Arnprior also agrees to pay Bracebridge's former owners an additional amount if Bracebridge's EBITDA exceeds a certain target amount over the next three years. Arnprior values this promise at a present value of \$175. Arnprior pays consulting fees of \$80 in cash to Goldman Sachs in connection with this acquisition.

Required

- a. Prepare the journal entry or entries Arnprior makes to record the acquisition as a *merger*.
- b. Three months after the acquisition, Arnprior determines that the date-of-acquisition fair value of Bracebridge's tangible assets was really \$1,050. Prepare the journal entry Arnprior makes to record this information.

ANS:

a.

Tangible assets		1,650	
Identifiable intangible assets		440	
Goodwill		3,535	
Merger expenses		80	
	Liabilities		1,450
	Cash		4,080
	Earnout liability		175

b.

Goodwill		600	
	Tangible assets		600

13. Topic: Earnings contingency**LO 2**

At the beginning of 2020, Pentron Corporation is in negotiations to acquire all of the stock of Santel Company. Pentron agrees to pay the former shareholders of Santel an additional cash amount at the end of 2022 (three years after the acquisition) that depends on the total reported earnings before interest, taxes, depreciation and amortization (EBITDA) for Santel during 2020-2022. Pentron will pay \$2 for each dollar of total EBITDA above \$10,000,000 that Santel reports. Here are Pentron's expectations for Santel's total reported EBITDA for 2020-2022.

Total EBITDA	Probability
\$ 4,000,000	0.25
\$ 8,000,000	0.10
\$ 12,000,000	0.20
\$ 16,000,000	0.30
\$ 18,000,000	0.15

The appropriate discount rate for this earnout is 20%.

Required

Calculate the amount of the earnout that Pentron should report as part of its cost of acquiring Santel.

ANS:

$(\$12,000,000 - \$10,000,000) \times 0.20 \times \2	\$ 800,000
$(\$16,000,000 - \$10,000,000) \times 0.30 \times \2	3,600,000
$(\$18,000,000 - \$10,000,000) \times 0.15 \times \2	<u>2,400,000</u>
	\$ 6,800,000
$\$6,800,000 / (1.20)^3$	<u>\$ 3,935,185</u>

14. Topic: Earnings Contingency**LO 2**

To induce the owners of Splunk Company to sell to Patterson Corporation, an earnout was included in the acquisition agreement. Patterson agrees to pay the former owners of Splunk \$2.00 for every dollar of total EBITDA earned over \$20 million in the next four years. The payment would be made at the end of four years. Expected total EBITDA in the next four years is as follows:

Total EBITDA earned	Probability
\$ 5,000,000	0.40
20,000,000	0.30
25,000,000	0.20
40,000,000	0.10

Required

What is the expected present value of the earnout at the date of acquisition, assuming a discount rate of 20%? Round your answer to the nearest dollar.

ANS:

$(\$25,000,000 - \$20,000,000) \times \$2 \times 0.20$	\$2,000,000
$(\$40,000,000 - \$20,000,000) \times \$2 \times 0.10$	<u>4,000,000</u>
	\$6,000,000
$\$6,000,000 / (1.2)^4$	<u>\$2,893,519*</u>

**Answers may vary due to rounding.*

15. Topic: Valuation of assets acquired and liabilities assumed, acquisition cost

LO 1, 2

Dr. Pepper Snapple Group (DPSG) acquired the assets and liabilities of Turquoise Water Inc. on September 30, 2020, in a merger. The acquisition involves the following payments:

Cash paid to Turquoise Water shareholders	\$85,000,000
Cash paid to Morgan Stanley for consulting services	12,000,000
New stock issued, 100,000 shares, \$0.50 par, fair value at acquisition	5,000,000
Stock registration fees, paid in cash	600,000
Earnings contingency, to be paid in three years, present value	2,000,000

Turquoise Water's balance sheet just prior to the acquisition appears below. Fair value information on Turquoise Water's assets and liabilities is also provided.

Turquoise Water, Inc.		
	Book Value	Fair Value
Assets		
Current assets	\$ 1,000,000	\$ 800,000
Plant and equipment, net	41,000,000	10,000,000
Patents and trademarks	<u>3,400,000</u>	20,000,000
Total assets	<u>\$ 45,400,000</u>	
Liabilities & Equity		
Current liabilities	\$ 400,000	400,000
Long-term liabilities	40,000,000	41,000,000
Common stock, par value	500,000	
Additional paid-in capital	8,500,000	
Retained earnings	(2,000,000)	
Accumulated OCI	(1,400,000)	
Treasury stock	<u>(600,000)</u>	
Total liabilities & equity	<u>\$ 45,400,000</u>	

In addition to the assets reported on Turquoise Water's balance sheet, the following previously unreported intangible assets are identified:

	Fair Value
Bottlers' franchise rights	\$ 10,400,000
Skilled workforce	15,000,000
Non-competition agreements	4,000,000
Expected expansion into new product lines	5,000,000
Order backlogs	2,000,000

Required

- Prepare the journal entry DPSG makes to record this acquisition as a merger.
- Now assume DPSG acquires all of the stock of Turquoise Water. Prepare the journal entry DPSG makes to record this acquisition as a stock acquisition.

ANS:

a.

Current assets		800,000	
Plant and equipment		10,000,000	
Patents and trademarks		20,000,000	
Bottlers' franchise rights		10,400,000	
Non-competition agreements		4,000,000	
Order backlogs		2,000,000	
Merger expenses		12,000,000	
Goodwill		86,200,000	
	Current liabilities		400,000
	Long-term liabilities		41,000,000
	Cash		97,600,000
	Common stock, par		50,000
	Additional paid-in capital		4,350,000
	Earnout liability		2,000,000

b.

Investment in Turquoise Water		92,000,000	
Merger expenses		12,000,000	
	Cash		97,600,000
	Common stock, par		50,000
	Additional paid-in capital		4,350,000
	Earnout liability		2,000,000

16. Topic: Valuation of assets acquired and liabilities assumed, acquisition cost**LO 1, 2**

IBM acquired all of DemandTec's assets and liabilities. DemandTec's assets and liabilities at the date of acquisition are as follows:

	Book Value Dr (Cr)	Fair Value Dr (Cr)
Cash & receivables	\$ 2,000,000	\$ 1,500,000
Inventories	10,000,000	6,000,000
Plant & equipment, net	30,000,000	19,000,000
Loans payable	(35,000,000)	(34,000,000)

IBM identifies the following intangibles that exist at the acquisition date but are not currently reported on DemandTec's books. Not all of these may qualify as separately reported identifiable intangible assets, per *ASC Topic 805*.

	Fair Value
Brand name	\$ 12,000,000
Potential contracts with prospective customers	2,000,000
Order backlogs	5,000,000
Technically skilled workforce	25,000,000

The acquisition terms are as follows:

- \$4,000,000 in cash paid to the former owners of DemandTec.
- 200,000 new shares of IBM common stock, par value \$0.50 and market value \$130/share. Registration fees, paid in cash, were \$500,000.
- \$1,000,000 in cash paid to Credit Suisse for consulting services.
- Earnings contingency with an expected present value of \$6,000,000 at the date of acquisition.

Required

Prepare the journal entry to record this acquisition on IBM's books.

ANS:

Cash & receivables		1,500,000	
Inventories		6,000,000	
Plant & equipment		19,000,000	
Brand name		12,000,000	
Order backlogs		5,000,000	
Goodwill		26,500,000	
Merger expenses		1,000,000	
	Loans payable		34,000,000
	Earnings contingency liability		6,000,000
	Cash		5,500,000
	Common stock		100,000
	APIC		25,400,000

Use the following information to answer questions 17 – 19 below.

Drover Corporation acquired all of Exeter Company's assets and liabilities in an all-cash acquisition. Drover recorded the transaction as follows:

Current assets		500,000	
Plant assets		20,000,000	
Identifiable intangibles		4,500,000	
Goodwill		15,000,000	
	Liabilities		17,000,000
	Cash		23,000,000

17. Topic: Changes in estimated valuations

LO 3

Subsequent to the acquisition, Drover obtains information that one of the recorded identifiable intangibles has a fair value that is \$1,000,000 *lower* than the amount at which it was recorded.

Required

Prepare the journal entry needed to record this information, if the change in value occurs:

- During the measurement period.
- Outside of the measurement period.

ANS:

a.

Goodwill		1,000,000	
	Identifiable intangibles		1,000,000

b.

Loss (income)		1,000,000	
	Identifiable intangibles		1,000,000

18. Topic: Changes in estimated valuations

LO 3

Subsequent to the acquisition, Drover obtains information that one of the recorded identifiable intangibles has a fair value that is \$1,000,000 *higher* than the amount at which it was recorded.

Required

Prepare the journal entry needed to record this information, if the change in value occurs:

- During the measurement period.
- Outside of the measurement period.

ANS:

a.

Identifiable intangibles		1,000,000	
	Goodwill		1,000,000

- No entry; writeups of intangibles are not recorded using normal accounting

19. Topic: Changes in estimated valuations, bargain purchase

LO 3, 4

Subsequent to the acquisition, Drover obtains information that the plant assets have a fair value that is \$16,000,000 *higher* than the amount at which it was recorded.

Required

Prepare the journal entry needed to record this information, if the change in value occurs:

- a. During the measurement period.
- b. Outside of the measurement period.

ANS:

a.

Plant assets		16,000,000	
	Goodwill		15,000,000
	Bargain gain (income)		1,000,000

- b. No entry; writeups of plant assets are not recorded using normal accounting

20. Topic: Subsequent value changes

LO 3

Plattsburgh Company acquired all of Sedona Corporation's assets and liabilities for \$40 million in cash. At the date of acquisition, Sedona's identifiable net assets had a fair value of \$10 million.

Required

For each of the following value changes occurring six months subsequent to the acquisition, prepare the journal entry, if any, to record the revaluation. Treat each change independently.

- a. It was determined that brand names valued at \$1 million at the date of acquisition, and capitalized per *ASC Topic 805* requirements, actually had a value of \$5 million at the date of acquisition.
- b. A downturn in the economy subsequent to the acquisition resulted in a \$2 million decline in the value of acquired developed technology, capitalized at the date of acquisition per *ASC Topic 805* requirements.
- c. Land valued at \$6 million at the date of acquisition increased in value to \$8 million due to an increased demand for real estate in the last six months.
- d. The acquisition included an earnout provision, valued at \$3 million at the date of acquisition. Due to an upturn in demand for Sedona's products in the last six months, the expected present value of the earnout is now \$5 million.
- e. The acquisition included an earnout provision, valued at \$3 million at the date of acquisition. New information is obtained about Sedona's expected future performance as of the date of acquisition, increasing its expected present value to \$4 million at the date of acquisition.
- f. It is determined that Sedona's acquisition-date liabilities omitted a pending lawsuit valued at \$1.5 million.
- g. Sedona's acquired liabilities, reported by Plattsburgh, include a pending lawsuit with a date-of-acquisition estimated value of \$10 million. Because of events occurring subsequent to the acquisition, it is determined that the lawsuit's value has declined to \$2 million.
- h. Sedona's acquired assets include AFS debt investments with a date-of-acquisition value of \$2 million. These investments increase in value to \$2.5 million due to a decline in market interest rates subsequent to acquisition.
- i. Sedona's acquired assets include AFS debt investments with a date-of-acquisition value of \$2 million. It is determined that some AFS debt investments were omitted from the inventory of acquired investments. The value of these omitted investments was \$1.5 million.

ANS:

a.

Brand names (intangible asset)		4,000,000	
	Goodwill		4,000,000

b.

Impairment loss (income)		2,000,000	
	Developed technology (intangible asset)		2,000,000

c. Not reported

d.

Loss on earnout (income)		2,000,000	
	Earnings contingency liability		2,000,000

e.

Goodwill		1,000,000	
	Earnings contingency liability		1,000,000

f.

Goodwill		1,500,000	
	Lawsuit liability		1,500,000

g.

Lawsuit liability		8,000,000	
	Gain on lawsuit (income)		8,000,000

h.

AFS investments		500,000	
	Gain on AFS investments (OCI)		500,000

i.

AFS investments		1,500,000	
	Goodwill		1,500,000

21. Topic: Earnings contingency and subsequent revaluation

LO 2, 3

Patterson Corporation acquired Sles Company, with the entire consideration in the form of an earnout. Patterson Corporation agreed to pay the former owners of Sles Company three times total operating income earned over the next three years. The payment, if any, would be made at the end of three years. Patterson originally reported the earnout at \$350 million.

Required

- a. Assume Patterson used a discount rate of 20% to record the earnout at the date of acquisition. What did Patterson expect total operating income over the next three years to be? Round your answer to the nearest million.
- b. What factors determined the discount rate used in Part a.?
- c. Patterson estimated the fair value of Sles' identifiable net assets to be \$150 million at the date of acquisition. How did the existence of the earnout affect the entry Patterson made to record the acquisition?
- d. During the first year, the value of the earnout increased to \$375 million due to the passage of time. How did Patterson record this increase in value?

ANS:

- a. Let E = Expected operating income
$$\$350 = 3E/(1.2)^3$$
$$E = \$201.6 \text{ million}$$
- b. The discount rate should be the risk-free rate adjusted for the uncertainty connected with the payout. Factors include the current prime rate and variability in expected future performance, which is a function of the predicted risk associated with economic variables impacting the company's ability to perform.
- c. Without the earnout, no consideration was paid and Patterson would have reported a bargain gain of \$150 million. Since the earnout was valued at \$350 million, Patterson reported goodwill of \$200 million (= \$350 – \$150 million).
- d. The passage of time is a subsequent event. The entry is as follows (*in millions*):

Loss (income)		25	
	Earnout liability		25

22. Topic: Income effects of measurement period adjustments**LO 3**

On November 30, 2019, Pronto Corporation acquired all of the assets and liabilities of Slipup Company. The acquisition generated goodwill of \$30,000,000. At the date of acquisition, Slipup's equipment had an estimated fair value of \$14,000,000, and a 5-year life, straight-line. On June 30, 2020, new information reveals that the equipment's fair value was \$35,000,000 at the date of acquisition. Pronto's accounting year ends on December 31.

Required

Prepare the journal entry or entries to record the change in valuation of Slipup's equipment on March 1, 2020, assuming the valuation change is within the measurement period, and depreciation has already been recorded through June 30.

ANS:

Equipment, net		18,550,000	
Depreciation expense		2,450,000	
	Goodwill		21,000,000

To correct the valuation of acquired equipment and related depreciation.

The adjustment, net of depreciation, to the equipment account = $(\$35,000,000 - \$14,000,000) \times (53/60) = \$18,550,000$. Alternatively, the correction to depreciation expense = $[(\$35,000,000 - \$14,000,000)/5] \times (7/12) = \$937,500$. Although one month of the depreciation expense adjustment is related to 2019, it is recognized as part of 2020 depreciation.

23. Topic: Income effects of measurement period adjustments**LO 3**

On September 30, 2020, Pepper Corporation acquired all of the assets and liabilities of Salt Company. The acquisition generated goodwill of \$50,000,000. At the date of acquisition, identifiable intangibles related to developed technology were reported at a value of \$13,800,000, and subsequently amortized using an estimated life of 3 years, straight-line. On March 31, 2021, new information reveals that the technology's fair value was \$3,000,000 at the date of acquisition. Pepper's accounting year ends on December 31 of each year.

Required

Prepare the journal entry or entries to record the change in valuation of the developed technology on March 31, 2021, assuming the valuation change is within the measurement period, and

- Amortization on the identifiable intangible has already been recorded through March 31, 2021.
- Amortization on the identifiable intangible has not yet been recorded for the first quarter of 2021.

ANS:

a.

Goodwill		10,800,000	
	Identifiable intangibles		9,000,000
	Amortization expense		1,800,000

To correct the valuation of acquired technology and related amortization.

The adjustment, net of amortization, to the intangibles account = $(\$3,000,000 - \$13,800,000) \times (30/36) = \$9,000,000$. Alternatively, the correction to amortization expense = $[(\$3,000,000 - \$13,800,000)/3] \times (6/12) = \$1,800,000$. Although three months of the amortization expense adjustment is related to 2020, it is recognized as an adjustment to 2021 amortization.

b.

The solution below splits the entries into two parts to clarify the reasoning.

Goodwill		10,800,000	
	Identifiable intangibles		9,900,000
	Amortization expense		900,000

To correct the valuation of acquired technology and related amortization as of the end of 2020.

Now the identifiable intangibles balance is corrected as of the start of 2021, and the first quarter's amortization expense is recorded normally:

Amortization expense		250,000	
	Identifiable intangibles		250,000

To record amortization expense for the first quarter of 2021. $\$250,000 = (\$3,000,000/3) \times 3/12$.

The entries may be handled in different ways. However, in both a. and b., the total amortization expense recorded in 2021 must be \$(650,000), and the intangibles balance at March 31, 2021 is \$2,500,000 $(= \$3,000,000 - (\$3,000,000/3 \times \frac{1}{2}))$. The amounts already recorded differ between scenarios a. and b. and therefore the corrections are different.

24. Topic: Bargain gain

LO 4

Plains Company pays \$15,000,000 in cash to acquire the assets and liabilities of Southwest Corporation. Southwest's balance sheet at the date of acquisition, including fair values of reported assets and liabilities, appears below. In addition, Southwest has previously unreported technology valued at \$2,000,000.

Southwest Corporation		
	Book Value	Fair Value
Assets		
Current assets	\$ 5,000,000	\$ 3,000,000
Plant & equipment, net	<u>20,000,000</u>	30,000,000
Total assets	<u>\$ 25,000,000</u>	
Liabilities & Equity		
Liabilities	\$ 22,000,000	21,000,000
Capital stock	4,000,000	
Retained earnings	(950,000)	
AOCI	<u>(50,000)</u>	
Total liabilities & equity	<u>\$ 25,000,000</u>	

Required

Prepare Plains' journal entry to record its acquisition of Southwest.

ANS:

Current assets		3,000,000	
Plant & equipment		30,000,000	
Identifiable intangibles		2,000,000	
	Liabilities		21,000,000
	Cash		15,000,000
	Gain on purchase (income)		1,000,000

25. Topic: Valuation of assets acquired and liabilities assumed, acquisition cost, bargain gain
LO 1, 2, 4

Delight Candy acquires all of the assets and liabilities of Orbit Brands. Delight incurs the following costs for the acquisition:

- 5,000,000 shares of new Delight common stock, par value \$0.10/share, market value \$6/share, issued to the former shareholders of Orbit
- Registration fees connected with issuing the new shares, \$200,000, paid in cash
- \$1,000,000 in cash paid to retire the outstanding Orbit stock
- Consulting fees paid to Goldman Sachs, in cash: \$1,100,000

The balance sheet of Orbit *immediately prior to* the acquisition is as follows:

Orbit Brands		
	Book Value	Fair Value
Assets		
Current assets	\$ 8,400,000	\$ 6,000,000
Plant & equipment, net	40,000,000	30,000,000
Trademarks	<u>1,000,000</u>	5,000,000
Total assets	<u>\$ 49,400,000</u>	
Liabilities & Equity		
Current liabilities	\$ 400,000	400,000
Long-term liabilities	45,000,000	44,000,000
Capital stock	4,000,000	
Retained earnings	2,000,000	
Accumulated other comprehensive income	1,000,000	
Treasury stock	<u>(3,000,000)</u>	
Total liabilities & equity	<u>\$ 49,400,000</u>	

In addition to the assets and liabilities already reported, Orbit has the following previously unrecorded intangible assets that meet the requirements for capitalization:

Intangible Asset	Fair Value
Brand names	\$ 8,000,000
Secret formulas	20,000,000

Required

- Prepare the journal entry or entries to record the acquisition on Delight's books.
- Assume the same information as above, but Orbit has an additional previously unreported intangible that meets the requirements for capitalization: a noncompetition agreement with a fair value of \$10,000,000. All fair value calculations have been double checked for accuracy and found to be correct. Make the journal entry or entries to record the acquisition on Delight's books.

ANS:

a.

Current assets		6,000,000	
Plant & equipment		30,000,000	
Trademarks		5,000,000	
Brand names		8,000,000	
Secret formulas		20,000,000	
Goodwill		6,400,000	
Merger expenses		1,100,000	
	Current liabilities		400,000
	Long-term liabilities		44,000,000
	Cash		2,300,000
	Common stock		500,000
	APIC		29,300,000

b.

Current assets		6,000,000	
Plant & equipment		30,000,000	
Trademarks		5,000,000	
Brand names		8,000,000	
Secret formulas		20,000,000	
Noncompetition agreement		10,000,000	
Merger expenses		1,100,000	
	Current liabilities		400,000
	Long-term liabilities		44,000,000
	Cash		2,300,000
	Common stock		500,000
	APIC		29,300,000
	Gain on acquisition (income)		3,600,000

26. Topic: Valuation of assets and liabilities, acquisition cost, bargain purchase

LO 1, 2, 4

Schenk Corporation's balance sheet *immediately prior* to its acquisition by Piaget Company is as follows:

Schenk Corporation		
	Book Value	Fair Value
Assets		
Current assets	\$ 3,000,000	\$ 2,500,000
Plant & equipment, net	<u>24,000,000</u>	15,000,000
Total assets	<u>\$ 27,000,000</u>	
Liabilities & Equity		
Liabilities	\$ 23,220,000	23,020,000
Common stock	60,000	
Additional paid-in capital	3,400,000	
Retained earnings	400,000	
AOCI	<u>(80,000)</u>	
Total liabilities & equity	<u>\$ 27,000,000</u>	

In addition to the assets already reported by Schenk, previously unreported identifiable intangible assets valued at \$12,000,000 are identified as owned by Schenk Corporation. These assets are appropriately recorded by Piaget as assets.

Piaget Company issues 200,000 shares of new \$1 par common stock with a market value of \$80/share to acquire Schenk's assets and liabilities. Stock registration fees are \$350,000 and costs for the services of outside accountants and lawyers are \$400,000, both paid in cash.

Required

- Prepare Piaget's entry to record the acquisition.
- Now assume Piaget Company issues 50,000 shares of \$1 par common stock with a market value of \$80/share to acquire Schenk's assets and liabilities. Registration fees for the stock issue are \$150,000 and out of pocket costs for the services of outside accountants and lawyers are \$200,000, both paid in cash. The terms of the merger include an earnings contingency. Piaget Company estimates the expected present value of the payout on the earnings contingency to be \$300,000. Prepare Piaget's entry to record the acquisition.

ANS:

a.

Current assets		2,500,000	
Plant & equipment		15,000,000	
Identifiable intangibles		12,000,000	
Goodwill		9,520,000	
Merger expenses		400,000	
	Liabilities		23,020,000
	Common stock		200,000
	APIC		15,450,000
	Cash		750,000

b.

Current assets		2,500,000	
Plant & equipment		15,000,000	
Identifiable intangibles		12,000,000	
Merger expenses		200,000	
	Liabilities		23,020,000
	Earnings contingency liability		300,000
	Common stock		50,000
	APIC		3,800,000
	Cash		350,000
	Gain on purchase (income)		2,180,000

27. Topic: Step acquisition

LO 5

Plunk Corporation currently holds a 75 percent interest in Spelt Industries and reports the noncontrolling interest in Spelt at \$3,500,000 in the equity section of its balance sheet. Plunk pays \$4,000,000 in cash to acquire the remaining 25 percent interest in Spelt.

Required

Prepare Plunk's journal entry to record acquisition of the noncontrolling interest in Spelt.

ANS:

Noncontrolling interest (equity)		3,500,000	
Shareholders' equity (APIC)		500,000	
	Cash		4,000,000

28. Topic: Step acquisition**LO 5**

Paxata Corporation holds a 35 percent interest in SCP Company's stock, reported at \$8,000,000 using the equity method. The fair value of the investment is \$12,000,000. It acquires the remaining 65 percent of SCP's stock for \$25,000,000 in cash. At that date, STP's tangible assets have a fair value of \$5,000,000, its identifiable intangible assets have a fair value of \$16,000,000, and its liabilities have a fair value of \$12,000,000. The acquisition is accounted for as a merger.

Required

Prepare Paxata's journal entry to record acquisition of the remaining interest in SCP.

ANS:

Investment in SCP (equity method investment)		4,000,000	
	Gain on equity method investment (income)		4,000,000

To revalue the equity method investment to fair value.

Tangible assets		5,000,000	
Identifiable intangible assets		16,000,000	
Goodwill		28,000,000	
	Liabilities		12,000,000
	Cash		25,000,000
	Investment in SCP		12,000,000

To record acquisition of the remaining interest in SCP.

29. Topic: Acquired deferred taxes

LO 5

Peabody Company acquires all of the assets and liabilities of Shea Company in a nontaxable acquisition at the beginning of 2021, reporting the acquisition as a merger. The tax basis of Shea's plant assets was \$10 million. Their date-of-acquisition fair values totaled \$14 million. The plant assets have an average remaining life, as of the date of acquisition, of 25 years. During 2021, Peabody reports income before depreciation on Shea's plant assets of \$4 million. Assume a tax rate of 30%.

Required

- a. At what value does Peabody report acquired deferred taxes at the date of acquisition? Is this an asset or liability? Explain.
- b. Prepare Peabody's journal entry to record income taxes for 2021. Report taxes owed as taxes payable.

ANS:

- a. $(\$14,000,000 - \$10,000,000) \times 30\% = \underline{\$1,200,000}$

This amount is reported as an acquired deferred tax liability. Peabody will only be able to deduct depreciation based on the lower \$10 million value, but it will report depreciation expense based on the higher \$14 million value. Therefore, it will pay more taxes than it reports as tax expense, due to the lower deductible depreciation, and the difference is a liability at the date of acquisition.

- b. Tax expense = $[\$4,000,000 - (\$14,000,000/25)] \times 30\% = \$1,032,000$
Taxes payable = $[\$4,000,000 - (\$10,000,000/25)] \times 30\% = \$1,080,000$

2021 entry:

Tax expense		1,032,000	
Deferred tax liabilities		48,000	
	Taxes payable		1,080,000

30. Topic: Acquired deferred taxes

LO 5

PNC Corporation acquires all of the assets and liabilities of SPN Company in a nontaxable acquisition at the beginning of 2020, reporting the acquisition as a merger. The tax basis of SPN's buildings and equipment was \$35 million. Their date-of-acquisition fair values totaled \$15 million. The buildings and equipment have an average remaining life, as of the date of acquisition, of 20 years. During 2020, PNC reports income before depreciation on SPN's buildings and equipment of \$4 million. Assume a tax rate of 25%.

Required

- a. At what value does PNC report acquired deferred taxes at the date of acquisition? Is this an asset or liability? Explain.
- b. Prepare PNC's journal entry to record income taxes for 2020. Report taxes owed as taxes payable.

ANS:

- a. $(\$35,000,000 - \$15,000,000) \times 25\% = \underline{\$5,000,000}$.
This amount is reported as an acquired deferred tax asset. PNC will be able to deduct depreciation based on the higher \$35 million value, but it will report depreciation expense based on the lower \$15 million value. Therefore, it can look forward to paying less in taxes than it reports as tax expense, due to the higher deductible depreciation, and the difference is an asset at the date of acquisition.
- b. Tax expense = $[\$4,000,000 - (\$15,000,000/20)] \times 25\% = \$812,500$
Taxes payable = $[\$4,000,000 - (\$35,000,000/20)] \times 25\% = \$562,500$

2018 entry:

Tax expense		812,500	
	Taxes payable		562,500
	Deferred tax assets		250,000

31. Topic: Assets acquired and liabilities assumed, measurement of acquisition cost, preacquisition contingencies, deferred taxes
LO 1, 2, 5

Date-of-acquisition information on Fizzy Beverage's assets and liabilities appears below:

	Book Value	Fair Value
Current assets	\$ 2,000	\$ 1,500
Property, plant, and equipment, net	14,000	5,000
Total assets	<u>\$ 16,000</u>	
Liabilities	\$ 9,000	9,500
Capital stock	1,500	
Retained earnings	6,800	
Accumulated other comprehensive loss	(500)	
Treasury stock	<u>(800)</u>	
Total liabilities and equity	<u>\$ 16,000</u>	

Cola King Company acquires the assets and liabilities of Fizzy Beverage, paying the following amounts:

Cash consideration to the former owners	\$50,000
Fair value of new no-par common stock issued	60,000
Registration fees on new stock issued, paid in cash	1,000
Accounting, consulting, and attorney services, paid in cash	4,000

Fizzy has the following previously unreported intangible assets meeting the criteria for separate recognition as identifiable intangible assets.

Favorable lease agreements	\$ 5,000
Developed technology	40,000

The following liabilities previously unreported by Fizzy meet the criteria for separate recognition as acquired liabilities.

Deferred tax liabilities	\$ 4,000
Warranty liabilities	8,000

Required

Cola King records the assets and liabilities of Fizzy directly on its books. Prepare the journal entry or entries Cola King made to record the acquisition.

ANS:

Current assets		1,500	
Property, plant, and equipment		5,000	
Identifiable intangible assets		45,000	
Goodwill		80,000	
Merger expenses		4,000	
	Liabilities		21,500
	Cash		55,000
	Capital stock		59,000

32. Topic: Assets acquired and liabilities assumed, measurement of acquisition cost, subsequent value changes, in-process R&D

LO 1, 2, 3, 5

Date-of-acquisition information on an acquired company's reported assets and liabilities appears below:

	Book Value	Fair Value
Current assets	\$ 3,000	\$ 1,500
Property, plant, and equipment, net	<u>10,000</u>	5,000
Total assets	<u>\$ 13,000</u>	
Liabilities	\$ 8,000	7,600
Capital stock	1,000	
Retained earnings	<u>4,000</u>	
Total liabilities and equity	<u>\$ 13,000</u>	

The following amounts were paid by the acquiring company:

Cash consideration to the former owners	\$35,000
Fair value of 1,000,000 shares of new no-par common stock issued	70,000
Registration fees on new stock issued, paid in cash	2,000
Accounting, consulting, and attorney services, paid in cash	5,000
Fair value of earnings contingency	500

The acquired company has the following previously unreported intangible assets. Not all of them meet the criteria for separate recognition as assets.

Favorable lease agreements	\$ 3,000
Developed technology	18,000
Future product improvements	4,000
Optimization of product and service delivery	15,000
In-process research and development projects	22,000

Required

The acquiring company records the assets and liabilities of the acquired company directly on its books. Prepare the journal entry the acquiring company made to record the acquisition.

ANS:

Current assets		1,500	
Property, plant and equipment		5,000	
Favorable lease agreements		3,000	
Developed technology		18,000	
In-process R&D		22,000	
Goodwill		63,600	
Merger expenses		5,000	
	Liabilities		7,600
	Cash		42,000
	Capital stock		68,000
	Earnout liability		500

33. Topic: Valuation of assets acquired and liabilities assumed, acquisition cost, subsequent value changes, preacquisition contingency, in-process R&D
LO 1, 2, 3, 5

Serano Corporation's trial balance is as follows:

	Serano Dr (Cr)
Cash and receivables	\$ 200
Inventories	600
Property, plant, and equipment, net	7,500
Liabilities	(7,600)
Capital stock	(720)
Retained earnings	20

An analysis of Serano's assets and liabilities reveals that its inventories are overvalued by \$100 and its property, plant and equipment is overvalued by \$3,000. In addition, the following items are not currently reported on Serano's balance sheet:

- Customer contracts, valued at \$30
- In-process research and development, valued at \$200
- Expected future warranty liabilities with a present value of \$15

On January 2, 2020, Pago issues new stock with a market value of \$700 to acquire the assets and liabilities of Serano. Stock registration fees are \$50, paid in cash. Consulting, accounting, and legal fees connected with the merger are \$100, paid in cash. In addition, Pago enters into an earnings contingency agreement, whereby Pago will pay the former shareholders of Serano an additional amount if Serano's performance meets certain minimum levels. The present value of the contingency is estimated at \$25.

Required

- Prepare the journal entry or entries Pago makes to record the acquisition.
- Now assume that during March, 2020, new information comes in regarding the value of Serano's property, plant and equipment at the date of acquisition. It is determined that the property was actually worth \$800 less than previously estimated. Make the entry to record this new information.

ANS:

a.

Cash and receivables		200	
Inventories		500	
Property, plant & equipment		4,500	
Identifiable intangibles		230	
Goodwill		2,910	
Merger expenses		100	
	Liabilities		7,615
	Cash		150
	Earnings contingency liability		25
	Capital stock		650

b.

Goodwill		800	
	Property, plant & equipment		800

34. Topic: Valuation of assets acquired and liabilities assumed, acquisition cost, in-process R&D, deferred taxes

LO 1, 2, 5

International Auto (IA) acquires Genuine Parts, Inc. (GP). The acquisition involves the following payments:

Cash paid to GP	\$ 5,000
Cash paid to consultants and lawyers	1,200
New stock issued, 1,000 shares, \$2 par	36,000
Stock registration fees, paid in cash	900

Here is GP's balance sheet at the date of acquisition. Fair value information on GP's assets and liabilities is also provided.

Genuine Parts, Inc.		
	Book value	Fair value
Assets		
Current assets	\$ 1,000	\$ 1,200
Fixed assets, net	27,000	20,000
Trademarks	<u>3,400</u>	6,000
Total assets	<u>\$31,400</u>	
Liabilities & Equity		
Current liabilities	\$ 400	400
Long-term liabilities	26,000	25,000
Common stock, par value	500	
Additional paid-in capital	8,500	
Retained earnings	(3,400)	
Treasury stock	<u>(600)</u>	
Total liabilities & equity	<u>\$31,400</u>	

In addition to the assets reported on GP's balance sheet, the following previously unreported intangible assets are identified.

	Fair Value
Licensing agreements	\$ 900
Order backlogs	4,000
In-process R&D	1,500

The acquisition also results in a deferred tax asset valued at \$1,000.

Required

IA acquires all of the assets and liabilities of GP. Prepare the journal entry or entries IA makes to record this acquisition.

ANS:

Current assets		1,200	
Fixed assets		20,000	
Identifiable intangibles		12,400	
Deferred tax assets		1,000	
Goodwill		31,800	
Merger expenses		1,200	
	Current liabilities		400
	Long-term liabilities		25,000
	Cash		7,100
	Common stock		2,000
	APIC		33,100

35. Topic: Valuation of assets acquired and liabilities assumed, acquisition cost, in-process R&D, preacquisition contingency, deferred taxes

LO 1, 2, 5

Bed & Bath buys all of Costless Company's assets and liabilities. Costless' balance sheet at the date of acquisition, including fair value information on its reported assets and liabilities, is as follows:

	Book Value Dr (Cr)	Fair Value Dr (Cr)
Assets		
Cash, receivables	\$ 1,000,000	\$ 950,000
Inventories	5,000,000	4,000,000
Property and equipment	<u>60,000,000</u>	45,000,000
Total assets	\$ 66,000,000	
Liabilities & Equity		
Accounts and notes payable	\$ 30,000,000	29,000,000
Common stock	500,000	
Additional paid-in capital	15,000,000	
Retained earnings	<u>20,500,000</u>	
Total liabilities and equity	\$ 66,000,000	

Assets and liabilities attributed to Costless, not currently reported on its books are:

	Fair value
Favorable leaseholds	\$ 3,000,000
Brand names	9,500,000
In-process R&D	1,000,000
Warranty liabilities	1,800,000

In addition, a deferred tax liability of \$2,000,000 is recognized as part of the acquisition.

The acquisition terms are as follows:

- Bed & Bath paid Costless' shareholders a total of \$25,000,000 in cash.
- Bed & Bath issued a total of 2,000,000 new shares of its common stock to Costless' shareholders. Bed & Bath's shares have a par value of \$1/share and a total fair value of \$92,000,000. Bed & Bath paid \$900,000 in cash for registration fees to issue the shares.
- Bed & Bath paid \$1,000,000 to Goldman Sachs for merger advisement, all paid in cash.

Required

Prepare the journal entry to record this acquisition on Bed & Bath's books.

ANS:

Cash, receivables		950,000	
Inventories		4,000,000	
Property and equipment		45,000,000	
Identifiable intangibles		13,500,000	
Merger expenses		1,000,000	
Goodwill		86,350,000	
	Accounts and notes payable		29,000,000
	Warranty liabilities		1,800,000
	Deferred tax liabilities		2,000,000
	Cash		26,900,000
	Common stock		2,000,000
	APIC		89,100,000