

Chapter 1 – Business Combinations: America's Most Popular Business Activity, Bringing an End to the Controversy

MULTIPLE CHOICE

1. An economic advantage of a business combination includes
 - a. Utilizing duplicative assets.
 - b. Creating separate management teams.
 - c. Coordinated marketing campaigns.
 - d. Horizontally combining levels within the marketing chain.

ANS: C DIF: E OBJ: 1

2. A tax advantage of business combination can occur when the existing owner of a company sells out and receives:
 - a. cash to defer the taxable gain as a "tax-free reorganization."
 - b. stock to defer the taxable gain as a "tax-free reorganization."
 - c. cash to create a taxable gain.
 - d. stock to create a taxable gain.

ANS: B DIF: E OBJ: 1

3. A controlling interest in a company implies that the parent company
 - a. owns all of the subsidiary's stock.
 - b. has influence over a majority of the subsidiary's assets.
 - c. has paid cash for a majority of the subsidiary's stock.
 - d. has transferred common stock for a majority of the subsidiary's outstanding bonds and debentures.

ANS: B DIF: M OBJ: 2

4. Which of the following is a potential abuse that may arise when a business combination is accounted for as a pooling of interests?
 - a. Assets of the buyer may be overvalued when the price paid by the investor is allocated among specific assets.
 - b. Earnings of the pooled entity may be increased because of the combination only and not as a result of efficient operations.
 - c. Liabilities may be undervalued when the price paid by the investor is allocated to specific liabilities.
 - d. An undue amount of cost may be assigned to goodwill, thus potentially allowing an understatement of pooled earnings.

ANS: B DIF: M OBJ: 3, Appendix A

5. Company B acquired the assets (net of liabilities) of Company S in exchange for cash. The acquisition price exceeds the fair value of the net assets acquired. How should Company B determine the amounts to be reported for the plant and equipment, and for long-term debt of the acquired Company S?

<u>Plant and Equipment</u>	<u>Long-Term Debt</u>
a. Fair value	S's carrying amount
b. Fair value	Fair value
c. S's carrying amount	Fair value
d. S's carrying amount	S's carrying amount

ANS: B DIF: E OBJ: 4

6. Publics Company acquired the net assets of Citizen Company during 20X5. The purchase price was \$800,000. On the date of the transaction, Citizen had no long-term investments in marketable equity securities and \$400,000 in liabilities. The fair value of Citizen assets on the acquisition date was as follows:

Current assets.....	\$ 800,000
Noncurrent assets.....	<u>600,000</u>
	\$1,400,000
	=====

How should Publics account for the \$200,000 difference between the fair value of the net assets acquired, \$1,000,000, and the cost, \$800,000?

- Retained earnings should be reduced by \$200,000.
- Current assets should be recorded at \$685,000 and noncurrent assets recorded at \$515,000.
- The noncurrent assets should be recorded at \$400,000.
- A deferred credit of \$200,000 should be set up and subsequently amortized to future net income over a period not to exceed 40 years.

ANS: C DIF: M OBJ: 4

7. ABC Co. is acquiring XYZ Inc. XYZ has the following Intangible assets:
- Patent on a product that is deemed to have no useful life \$10,000.
 - Customer List with an observable fair value of \$50,000.
 - A 5-year operating lease with favorable terms with a discounted present value of \$8,000.
 - Identifiable R & D of \$100,000.

ABC will record how much for acquired Intangible Assets from the Purchase of XYZ Inc?

- \$168,000
- \$58,000
- \$158,000
- \$150,000

ANS: B DIF: D OBJ: 4

8. Vibe Company purchased the net assets of Atlantic Company in a business combination accounted for as a purchase. As a result, goodwill was recorded. For tax purposes, this combination was considered to be a tax-free merger. Included in the assets is a building with an appraised value of \$210,000 on the date of the business combination. This asset had a net book value of \$70,000, based on the use of accelerated depreciation for accounting purposes. The building had an adjusted tax basis to Atlantic (and to Vibe as a result of the merger) of \$120,000. Assuming a 36% income tax rate, at what amount should Vibe record this building on its books after the purchase?
- a. \$120,000
 - b. \$134,400
 - c. \$140,000
 - d. \$210,000

ANS: D DIF: M OBJ: 4

9. Goodwill represents the excess cost of an acquisition over the
- a. sum of the fair values assigned to intangible assets less liabilities assumed.
 - b. sum of the fair values assigned to tangible and intangible assets acquired less liabilities assumed.
 - c. sum of the fair values assigned to intangibles acquired less liabilities assumed.
 - d. book value of an acquired company.

ANS: B DIF: M OBJ: 5

10. When purchasing a company occurs, FASB recommends disclosing all of the following EXCEPT:
- a. goodwill related to each reporting segment.
 - b. contingent payment agreements, options, or commitments included in the purchase agreement, including accounting methods to be followed.
 - c. results of operations for the current period if both companies had remained separate.
 - d. amount of in-process R&D purchased and written-off during the period.

ANS: C DIF: M OBJ: 5

11. Cozzi Company is being purchased and has the following balance sheet as of the purchase date:

Current assets.....	\$200,000	Liabilities....	\$ 90,000
Fixed assets.....	<u>180,000</u>	Equity.....	<u>290,000</u>
Total.....	<u>\$380,000</u>	Total.....	<u>\$380,000</u>
	=====		=====

The price paid for Cozzi's net assets (the purchaser assumes the liabilities) is \$500,000. The fixed assets have a fair value of \$220,000, and the liabilities have a fair value of \$110,000. The amount of goodwill to be recorded in the purchase is _____.

- a. \$0
- b. \$50,000
- c. \$70,000
- d. \$90,000

ANS: C DIF: M OBJ: 6

12. Separately identified intangible assets are accounted for by amortizing:
- a. exclusively by using impairment testing.
 - b. based upon a pattern that reflects the benefits conveyed by the asset.
 - c. over the useful economic life less residual value using only the straight-line method.
 - d. amortizing over a period not to exceed a maximum of 40 years.

ANS: B DIF: E OBJ: 6

13. Acme Co. is preparing a pro-forma set of financial statements after an acquisition of Coyote Co. The purchase price is less than the fair value of the assets acquired. However, the purchase price is greater than net book value of the acquired company.
- a. Acme's goodwill will decrease over time.
 - b. Acme's amortization of intangible assets will increase over time.
 - c. Depreciation expense will be greater than Coyote Company's expense.
 - d. Coyote's loss on the sale of the assets will create a net loss carryforward.

ANS: C DIF: D OBJ: 6

14. While performing a goodwill impairment test, the company had the following information:

Estimated implied fair value of reporting unit	
(without goodwill)	\$420,000
Existing net book value of reporting unit	
(without goodwill)	\$380,000
Book value of goodwill	\$60,000

Based upon this information the proper conclusion is:

- The existing net book value plus goodwill is in excess of the implied fair value, therefore, no adjustment is required.
- The existing net book value plus goodwill is less than the implied fair value plus goodwill, therefore, no adjustment is required.
- The existing net book value plus goodwill is in excess of the implied fair value, therefore, goodwill needs to be decreased.
- The existing net book value is less than the estimated implied fair value; therefore, goodwill needs to be decreased.

ANS: C

DIF: D

OBJ: 6

15. Balter Inc. acquired Jersey Company on January 1, 20X5. When the purchase occurred Jersey Company had the following information related to fixed assets:

Land	\$ 80,000
Building	200,000
Accumulated Depreciation	(100,000)
Equipment	100,000
Accumulated Depreciation	(50,000)

The building has a 10-year remaining useful life and the equipment has a 5-year remaining useful life. The fair value of the assets on that date were:

Land	\$100,000
Building	130,000
Equipment	75,000

What is the 20X5 depreciation expense Balter will record related to purchasing Jersey Company?

- \$8,000
- \$15,000
- \$28,000
- \$30,000

ANS: C

DIF: M

OBJ: 6

16. In performing the 20X7 impairment test for goodwill, the company had the following 20X6 and 20X7 information is available.

	<u>20X6</u>	<u>20X7</u>
Implied fair value of reporting unit	\$350,000	\$400,000
Net book value of reporting unit (including goodwill)	\$380,000	\$360,000

Based upon this information what are the 20X6 and 20X7 adjustment to goodwill, if any?

- a. 20X6 \$0
20X7 \$40,000 decrease
- b. 20X6 \$30,000 increase
20X7 \$40,000 decrease
- c. 20X6 \$30,000 decrease
20X7 \$40,000 decrease
- d. 20X6 \$30,000 decrease
20X7 \$0

ANS: D DIF: D OBJ: 7

17. Couples Corporation purchases Players Corporation. The fair value of the net assets of Players is \$750,000 and the fair value of priority accounts (including a deduction for depreciation) is \$600,000. Which of the following purchase prices would require using allocation procedures?
- a. \$500,000
 - b. \$600,000
 - c. \$700,000
 - d. \$800,000

ANS: B DIF: D OBJ: 7

18. ACME Co. paid \$110,000 for the net assets of Comb Corp. At the time of the acquisition the following information was available related to Comb's balance sheet:

	<u>Book Value</u>	<u>Fair Value</u>
Current Assets	\$50,000	\$ 50,000
Building	80,000	100,000
Equipment	40,000	50,000
Liabilities	30,000	30,000

What is the amount recorded by ACME for the Building?

- a. \$40,000
- b. \$60,000
- c. \$80,000
- d. \$100,000

ANS: B DIF: D OBJ: 7

19. Which of the following business combination expenses would NOT qualify as a direct acquisition expense for a purchase?
- a. Fees for purchase audit
 - b. Outside legal fees
 - c. Stock issuance fees
 - d. All are direct acquisition expenses.

ANS: C DIF: E OBJ: 8

20. Polk issues common stock to acquire all the assets of the Sam Company on January 1, 20X5. There is a contingent share agreement, which states that if the income of the Sam Division exceeds a certain level during 20X5 and 20X6, additional shares will be issued on January 1, 20X7. The impact of issuing the additional shares is to
- increase the price assigned to fixed assets.
 - have no effect on asset values, but to reassign the amounts assigned to equity accounts.
 - reduce retained earnings.
 - record additional goodwill.

ANS: D DIF: D OBJ: 8

21. In a purchase, the direct acquisition, indirect acquisition and security issuance costs are accounted for as follows:

Direct Acquisition	Indirect Acquisition	Security Issuance
a. Added to price paid	Added to price paid	Added to price paid
b. Added to price paid	Expensed	Deducted from value of security issued
c. Expensed	Expensed	Deducted from value of security issued
d. Expensed	Expensed	Expensed

ANS: B DIF: E OBJ: 9

22. Orbit Inc. purchased Planet Co. in 20X3. At that time an existing patent was not recorded as a separately identified intangible asset. At the end of fiscal year 20X5, the patent is valued at \$15,000, and goodwill has a book value of \$100,000. How should intangible assets be reported at the beginning of fiscal year 20X6?
- Goodwill \$100,000 Patent \$0
 - Goodwill \$115,000 Patent \$0
 - Goodwill \$100,000 Patent \$15,000
 - Goodwill \$85,000 Patent \$15,000

ANS: D DIF: M OBJ: 9

23. Which of the following income factors should not be factored into a calculation of goodwill?
- sales for the period
 - income tax expense
 - extraordinary items
 - cost of goods sold

ANS: C DIF: M OBJ: 10, Appendix A

PROBLEM

1. Internet Corporation is considering the acquisition of Homepage Corporation and has obtained the following audited condensed balance sheet:

Homepage Corporation			
Balance Sheet			
December 31, 20X5			
<u>Assets</u>		<u>Liabilities and Equity</u>	
Current assets....	\$ 40,000	Current Liabilities.....	\$ 60,000
Land.....	20,000	Capital Stock (50,000 shares,	
Buildings (net)...	80,000	\$1 par value).....	50,000
Equipment (net)...	60,000	Other Paid-in Capital.....	20,000
		Retained Earnings.....	70,000
	<u>\$200,000</u>		<u>\$200,000</u>
	=====		=====

Internet also acquired the following fair values for Homepage's assets and liabilities:

Current assets.....	\$ 55,000
Land.....	60,000
Buildings (net).....	90,000
Equipment (net).....	75,000
Current Liabilities.....	(60,000)
	<u>\$220,000</u>
	=====

Internet and Homepage agree on a price of \$280,000 for Homepage's net assets. Prepare the necessary journal entry to record the purchase given the following scenarios:

- Internet pays cash for Homepage Corporation and incurs \$5,000 of direct acquisition costs.
- Internet issues its \$5 par value stock as consideration. The fair value of the stock at the acquisition date is \$50 per share. Additionally, Internet incurs \$5,000 of security issuance costs.

ANS:

a. Current assets.....	\$55,000	
Land.....	60,000	
Buildings.....	90,000	
Equipment.....	75,000	
Goodwill.....	65,000	
Current Liabilities.....		\$ 60,000
Cash.....		285,000
b. Current assets.....	\$55,000	
Land.....	60,000	
Buildings.....	90,000	
Equipment.....	75,000	
Goodwill.....	65,000	
Current Liabilities.....		\$ 60,000
Common Stock.....		28,000
Other Paid-in Capital.....		252,000
Cash.....		5,000

DIF: M

OBJ: 5

2. On January 1, 20X5, Brown Inc. acquired Larson Company's net assets in exchange for Brown's common stock with a par value of \$100,000 and a fair value of \$800,000. Brown also paid \$10,000 in direct acquisition costs and \$15,000 in stock issuance costs.

On this date, Larson's condensed account balances showed the following:

	<u>Book Value</u>	<u>Fair Value</u>
Current Assets	\$ 280,000	\$ 370,000
Plant and Equipment	440,000	480,000
Accumulated Depreciation	(100,000)	
Intangibles - Patents	80,000	120,000
Current Liabilities	(140,000)	(140,000)
Long-Term Debt	(100,000)	(110,000)
Common Stock	(200,000)	
Other Paid-in Capital	(120,000)	
Retained Earnings	(140,000)	

Required:

Record Brown's purchase of Larson Company's net assets on the books of Brown Inc.

ANS:

	<u>Debit</u>	<u>Credit</u>	
Current Assets.....	\$370,000		
Plant and Equipment.....	480,000		
Intangibles - Patents.....	120,000		
Intangibles - Goodwill.....	90,000		
Current Liabilities.....		\$140,000	
Long-term Debt.....	110,000		
Common Stock.....		100,000	Other
Paid-in Capital.....		685,000	
Cash.....		25,000	

To record the acquisition of Larson's net asset.

DIF: M OBJ: 3, 11, 12, Appendix B

3. The Chan Corporation purchased the net assets (existing liabilities were assumed) of the Don Company for \$900,000 cash. The balance sheet for the Don Company on the date of acquisition showed the following:

Assets

Current assets.....	\$ 100,000
Equipment.....	300,000
Accumulated depreciation.....	(100,000)
Plant.....	600,000
Accumulated depreciation.....	(250,000)
Total.....	<u>\$ 650,000</u>
	=====

Liabilities and Equity

Bonds payable, 8%.....	\$ 200,000
Common stock, \$1 par.....	100,000
Paid-in capital in excess of par.....	200,000
Retained earnings.....	150,000
Total.....	<u>\$ 650,000</u>
	=====

Required:

The equipment has a fair value of \$300,000, and the plant assets have a fair value of \$500,000. Assume that the Chan Corporation has an effective tax rate of 40%. Prepare the entry to record the purchase of the Don Company for each of the following separate cases with specific added information:

- The sale is a nontaxable exchange to the seller that limits the buyer to depreciation and amortization on only book value for tax purposes.
- The bonds have a current fair value of \$190,000. The transaction is a nontaxable exchange.
- There are \$100,000 of prior-year losses that can be used to claim a tax refund. The transaction is a nontaxable exchange.
- There are \$150,000 of past losses that can be carried forward to future years to offset taxes that will be due. The transaction is a nontaxable exchange.

ANS:

a. Current Assets.....	\$100,000	
Equipment.....	300,000	
Plant.....	500,000	
Goodwill (\$300,000 x .6).....	500,000	
Deferred Tax Liability*.....		\$300,000
Bonds Payable.....		200,000
Cash.....		900,000
* .4 x (\$800,000 Fair Value - \$550,000 Book Value of fixed assets) + .4 x \$500,000 Goodwill		

b. Current Assets.....	\$100,000	
Equipment.....	300,000	
Plant.....	500,000	
Goodwill.....	190,000	
Bonds Payable.....		\$190,000
Cash.....		900,000

c. Current Assets.....	\$100,000	
Equipment.....	300,000	
Plant	500,000	
Tax Refund Receivable.....	40,000	
Goodwill.....	160,000	
Bonds Payable.....		\$200,000
Cash.....		900,000

d. Current Assets.....	\$100,000	
Equipment.....	300,000	
Plant.....	500,000	
Deferred Tax Expense (\$150,000 x .4) ..	60,000	
Goodwill (\$240,000 ÷ .6).....	400,000	
Bonds Payable.....		\$200,000
Cash.....		900,000

Deferred Tax Liability
 $(\$250,000 \times .4) + (\$400,000 \times .4) \dots$ 260,000

DIF: D OBJ: 8

4. On January 1, 20X5, Zepp and Nottle Companies had condensed balance sheets as shown below:

	Zepp Company	Nottle Company
Current Assets.....	\$1,000,000	\$ 600,000
Plant and Equipment.....	1,500,000	800,000
	<u>\$2,500,000</u>	<u>\$1,400,000</u>
	=====	=====
Current Liabilities.....	\$ 200,000	\$ 100,000
Long-Term Debt.....	300,000	300,000
Common Stock, \$10 par.....	1,400,000	400,000
Paid-in Capital in Excess of Par.....	0	100,000
Retained Earnings.....	<u>600,000</u>	<u>500,000</u>
	<u>\$2,500,000</u>	<u>\$1,400,000</u>
	=====	=====

Required:

Record the acquisition of Nottle's net assets, the issuance of the stock and/or payment of cash, and payment of the related costs. Assume that Zepp issued 30,000 shares of new common stock with a fair value of \$25 per share and paid \$500,000 cash for all of the net assets of Nottle. Direct acquisition costs of \$50,000 and stock issuance costs of \$20,000 were paid-in cash. The combination is accounted for as a purchase. Current assets had a fair value of \$650,000, plant and equipment had a fair value of \$900,000, and long-term debt had a fair value of \$330,000.

ANS:

Current Assets.....	\$650,000	
Plant and Equipment.....	900,000	
Goodwill.....	180,000	
Current Liabilities.....		\$100,000
Long-Term Debt.....		330,000
Common Stock.....		300,000
Paid-in Capital in Excess of Par (1)		430,000
Cash (2).....		570,000

(1) $30,000 \times (\$25 - 10) = \$20,000$

(2) $\$500,000 + 70,000 = \$570,000$

DIF: M OBJ: 5

5. On January 1, 20X1, Honey Bee Corporation purchased the net assets of Green Hornet Company for \$1,500,000. On this date, a condensed balance sheet for Green Hornet showed:

	Book Value	Fair Value
Current Assets.....	\$ 500,000	\$800,000
Long-Term Investments in Securities.	200,000	150,000
Land.....	100,000	600,000
Buildings (net).....	700,000	900,000
	<u>\$1,500,000</u>	
	=====	
Current Liabilities.....	\$ 300,000	\$300,000
Long-Term Debt.....	550,000	600,000
Common Stock (no-par).....	300,000	
Retained Earnings.....	350,000	
	<u>\$1,500,000</u>	
	=====	

Required:

Record the entry on Honey Bee's books for the acquisition of Green Hornet's net assets. Prepare supporting schedules as necessary.

ANS:

Current Assets.....	\$800,000	
Long-Term Investments in Securities.....	150,000	
Land.....	580,000	
Building.....	870,000	
Current Liabilities.....		\$ 300,000
Long-Term Debt.....		600,000
Cash.....		1,500,000

Remaining amount assignable to Land and Building:

	Fair Value	Percent of Total Fair Value	Total Cost Assignable	Assigned Value
Land.....	\$ 600,000	40%	\$1,450,000	\$ 580,000
Building...	900,000	60%	1,450,000	870,000
Total.....	<u>\$1,500,000</u>			<u>\$1,450,000</u>

DIF: M

OBJ: 7

6. Poplar Corp. acquires the net assets of Sapling Company, which has the following balance sheet:

Accounts Receivable	\$ 50,000
Inventory	80,000
Equipment, Net	50,000
Land & Building, Net	<u>120,000</u>
Total Assets	\$300,000
	=====

Bonds Payable	\$ 90,000
Common Stock	100,000
Retained Earnings	<u>110,000</u>
Total Liabilities and	
Stockholders' Equity	\$300,000
	=====

Fair values on the date of acquisition:

Inventory	\$100,000
Equipment	30,000
Land & Building	180,000
Customer List	30,000
Bonds Payable	100,000

Direct acquisition costs: \$10,000

If Poplar paid \$300,000 what journal entries would be recorded by both Poplar Corp. and Sapling Company?

ANS:

Poplar Corp:

Accounts Receivable	\$ 50,000	
Inventory	100,000	
Equipment	30,000	
Land & Building	180,000	
Customer List	30,000	
Goodwill	20,000	
	Bonds Payable	\$ 90,000
	Premium on Bonds Payable	10,000
	Cash (for direct acquisition costs)	10,000
	Cash	300,000

Price paid		
(including direct acquisition costs)		\$310,000
Fair value of current assets		
less liabilities	\$ 50,000	
Fair value of recorded fixed assets	<u>210,000</u>	<u>260,000</u>
Excess attributable to Intangible Assets		\$ 50,000
Fair value of Customer List		<u>30,000</u>
Goodwill		\$ 20,000
		=====

Sapling Company:

Cash	\$300,000	
Bonds Payable	90,000	
Accounts Receivable		\$ 50,000
Inventory		80,000
Equipment		50,000
Land & Building		120,000
Gain on Sale of Business	90,000	

Cash Received:	\$300,000
Net Asset value sold	<u>210,000</u>
Gain	<u>\$ 90,000</u>
	=====

DIF: M OBJ: 6

7. Diamond acquired Heart's net assets. At the time of the acquisition Heart's Balance sheet was as follows:

Accounts Receivable	\$130,000
Inventory	70,000
Equipment, Net	50,000
Building, Net	250,000
Land & Building, Net	<u>100,000</u>
Total Assets	\$600,000
	=====

Bonds Payable	\$100,000
Common Stock	50,000
Retained Earnings	<u>450,000</u>
Total Liabilities and	
Stockholders' Equity	\$600,000
	=====

Fair values on the date of acquisition:

Inventory	\$100,000
Equipment	30,000
Building	350,000
Land	120,000
Brand name copyright	50,000
Bonds payable	120,000

Direct acquisition costs: \$5,000

Required:

Record the entry for the purchase of the net assets of Heart by Diamond at the following Cash prices:

- a. \$700,000
- b. \$300,000
- c. \$100,000

ANS:

a.

Accounts Receivable	\$130,000	
Inventory	100,000	
Equipment	30,000	
Building	350,000	
Land	120,000	
Brand Name	50,000	
Goodwill	45,000	
	Bonds Payable	\$100,000
	Premium on Bonds Payable	20,000
	Cash	705,000

Price paid		
(including direct acquisition costs)		\$705,000
Fair value of current assets		
less liabilities	\$110,000	
Fair Value of recorded fixed assets	<u>500,000</u>	<u>610,000</u>
Excess attributable to Intangible Assets		\$ 95,000
Fair value of Customer List		<u>50,000</u>
Goodwill		<u>\$ 45,000</u>
		=====

b.

Accounts Receivable	\$130,000	
Inventory	100,000	
Equipment	11,700	
Building	136,500	
Land	46,800	
	Bonds Payable	\$100,000
	Premium on Bonds Payable	20,000
	Cash	305,000

Price paid		
(including direct acquisition costs)		\$305,000
Fair value of current assets		
less liabilities	<u>110,000</u>	
Attributable to long-lived assets	<u>\$195,000</u>	
		=====

c.

Accounts Receivable	\$130,000	
Inventory	100,000	
	Extraordinary Gain	\$ 5,000
	Bonds Payable	100,000
	Premium on Bonds Payable	20,000
	Cash	105,000

Price paid		
(including direct acquisition costs)		\$105,000
Fair value of current assets		
less liabilities	<u>110,000</u>	
Deferred credit on purchase	<u>\$ (5,000)</u>	
		=====

DIF: M OBJ: 5, 7

8. Marquette Instruments Company acquired all the assets and assumed all the liabilities of the Nelson Company on July 1, 20X1. The fiscal year for both Marquette and Nelson ends on December 31. On the date of acquisition, Nelson Company had the following trial balance:

Accounts receivable.....	\$ 60,000	
Inventory.....	70,000	
Machinery.....	300,000	
Accumulated depreciation, machinery.....		\$100,000
Notes payable.....		80,000
Sales.....		210,000
Cost of goods sold.....	120,000	
Operating expenses.....	70,000	
Depreciation expense	15,000	
Common stock, \$1 par.....		10,000
Paid-in capital in excess of par.....		70,000
Retained earnings.....		165,000
Totals.....	\$635,000	\$635,000
	=====	=====

Marquette issued 10,000 of its \$5 par value shares for the outstanding shares of the Nelson Company and paid \$10,000 in direct acquisition costs. The fair value of its shares was \$40 per share. On the acquisition date, the inventory had a fair value of \$80,000 (sold by December 31), and the machinery had a fair value of \$400,000 with an estimated 8-year remaining life. Any value associated with intangible assets arising from the business combination are associated with a patent that will be amortized over 10 years.

The following operating results were reported by the two resulting divisions:

	Marquette <u>January 1-December 31</u>	Nelson <u>July 1-December 31</u>
Sales.....	\$450,000	\$300,000
Cost of goods sold.....	230,000	160,000
Operating expenses.....	120,000	80,000
Depreciation expense.....	40,000	15,000

The results for Nelson are based on book values and do not consider adjustments resulting from the business combination.

Required:

Prepare an income statement for the Marquette Instruments Company.

ANS:

Purchase (includes Nelson for only last 6 months)		
Sales.....		\$750,000
Less:		
Cost of goods sold		
(Increase Nelson \$10,000).....	\$400,000	
Operating expenses.....	200,000	
Depreciation expense (\$25,000 for Nelson		
for half year).....	67,500*	
Patent amortization (\$10,000 ÷ 10 years		
for half year).....	<u>500</u>	<u>668,000</u>
Net income.....		<u>\$ 82,000</u>
		=====
*\$40,000 + \$15,000 + (\$200,000 increase ÷ 8 x 1/2 yr.) = \$67,500		

Allocation of purchase price:	
Total price (10,000 shares x \$40 + \$10,000).....	\$410,000
Less inventory.....	(80,000)
Plus liabilities.....	<u>80,000</u>
Available for fixed assets.....	\$410,000
Fair value of machinery.....	<u>400,000</u>
Patent.....	<u>\$ 10,000</u>
	=====

DIF: M OBJ: 6

9. On January 1, July 1, and December 31, 20X5, a condensed trial balance for Nelson Company showed the following debits and (credits):

	<u>01/01/X5</u>	<u>06/30/X5</u>	<u>12/31/X5</u>
Current Assets.....	\$ 200,000	\$ 260,000	\$ 340,000
Plant and Equipment (net).....	500,000	510,000	510,000
Current Liabilities.....	(50,000)	(70,000)	(60,000)
Long-Term Debt.....	(100,000)	(100,000)	(100,000)
Common Stock.....	(150,000)	(150,000)	(150,000)
Other Paid-in Capital.....	(100,000)	(100,000)	(100,000)
Retained Earnings, January 1.....	(300,000)	(300,000)	(300,000)
Dividends Declared			10,000
Revenues.....		(400,000)	(900,000)
Expenses.....		350,000	750,000

Nelson Company's books were NOT closed on June 30, 20X5.

For all of 20X5, Systems' revenues and expenses were \$1,500,000 and \$1,200,000, respectively.

Required:

Assume that, on July 1, 20X5, Systems Corporation purchased the net assets of Nelson Company for \$750,000 in cash. On this date, the fair values for certain net assets were:

Current Assets.....	\$280,000
Plant and Equipment.....	600,000

On July 1, 20X1, the Plant and Equipment had a remaining life of 10 years.

- (1) Record the entry on Systems' books for the July 1, 20X5 purchase of Nelson.
- (2) Compute the amount of net income which will be reported for 20X5.

ANS:

1.

	<u>Debit</u>	<u>Credit</u>
Current Assets.....	\$280,000	
Plant and Equipment....	600,000	
Goodwill.....	40,000	
Current Liabilities..		\$ 70,000
Long-Term Debt.....		100,000
Cash		750,000

2. Net income for 20X5:

	<u>Symantic</u>	<u>Norton</u>	<u>Total</u>
Revenues.....	\$1,500,000 +	\$500,000	= \$2,000,000
Expenses.....	1,200,000 +	400,000	= <u>1,600,000</u>
Income before extra expenses		\$ 400,000	
Depreciation of Plant and Equipment			<u>4,500</u>
Net Income for 20X1.....			\$ 395,500 =====

The extra depreciation on Plant and Equipment would be:
 $\$90,000 \div 10 \text{ years} \times 1/2 = \$4,500$

DIF: D

OBJ:

10. Mans Company is about to purchase the net assets of Eagle Incorporated, which has the following balance sheet:

<u>Assets</u>		
Accounts receivable.....		\$ 60,000
Inventory.....		100,000
Equipment	\$ 90,000	
Accumulated depreciation	<u>(50,000)</u>	40,000
Land and buildings.....	\$ 300,000	
Accumulated depreciation.....	<u>(100,000)</u>	200,000
Goodwill.....		<u>60,000</u>
Total assets.....		\$460,000
		=====
<u>Liabilities and Stockholders' Equity</u>		
Bonds payable.....		\$ 80,000
Common stock, \$10 par.....		200,000
Paid-in capital in excess of par.....		100,000
Retained earnings.....		<u>80,000</u>
Total liabilities and equity.....		\$460,000
		=====

Mans has secured the following fair values of Eagle's accounts:

Inventory.....	\$130,000
Equipment.....	60,000
Land and buildings.....	260,000
Bonds payable.....	60,000

Direct acquisition costs were \$20,000.

Required:

Record the entry for the purchase of the net assets of Eagle by Mans at the following cash prices:

- a. \$450,000
- b. \$310,000
- c. \$80,000

ANS:

a. Accounts Receivable.....	\$ 60,000	
Inventory.....	130,000	
Equipment.....	60,000	
Land and Buildings.....	260,000	
Discount on Bonds Payable.....	20,000	
Goodwill*.....	20,000	
Bonds Payable.....		\$ 80,000
Cash.....		470,000

* Price paid	
(including direct acquisition costs)...	\$470,000
Fair value of current assets	
less liabilities.....	<u>130,000</u>
Attributable to long-lived assets.....	\$340,000
Fair value of long-lived assets.....	<u>320,000</u>
Excess attributable to goodwill.....	\$ 20,000
	=====

b. Accounts Receivable.....	\$ 60,000	
Inventory.....	130,000	
Equipment*.....	37,500	
Land and Buildings*.....	162,500	
Discount on Bonds Payable.....	20,000	
Bonds Payable.....		\$ 80,000
Cash.....		330,000

* Price paid	
(including direct acquisition costs)...	\$330,000
Fair value of current assets	
less liabilities.....	<u>130,000</u>
Attributable to long-lived assets.....	\$200,000
	=====

<u>Asset</u>	<u>Fair Value</u>	<u>Percent of Fair</u>	<u>Value Available</u>	<u>Assigned Value</u>
Equipment.....	\$ 60,000	18.75	\$200,000	\$ 37,500
Land and buildings.....	260,000	81.25	200,000	162,500
Total.....	<u>\$320,000</u>	<u>100.00</u>		<u>\$200,000</u>
	=====			=====

C.		
Accounts Receivable.....	\$ 60,000	
Inventory.....	130,000	
Discount on Bonds Payable.....	20,000	
Extraordinary Gain.....		\$ 30,000
Bonds Payable.....		80,000
Cash.....		100,000

* Price paid	
(including direct acquisition costs)...	\$100,000
Fair value of current assets	
less liabilities.....	<u>130,000</u>
Extraordinary Gain.....	\$ (30,000)
	=====

DIF: M OBJ: 5, 7

11. The Blue Reef Company purchased the net assets of the Pink Coral Company on January 1, 20X1, and made the following entry to record the purchase:

Current Assets.....	100,000	
Equipment.....	150,000	
Land	50,000	
Buildings.....	300,000	
Goodwill	100,000	
Liabilities.....		80,000
Common Stock, \$1 Par.....		100,000
Paid-in Capital in Excess of Par.....		520,000

Required:

Make the required entry on January 1, 20X3, for each of the two following independent contingency agreements:

- a. An additional cash payment would be made on January 1, 20X3 equal to four times the amount by which average annual earnings of the Pink Coral Division exceed \$80,000 per year 20X1 and 20X2. Net income was \$112,000 in 20X1 and \$140,000 in 20X2.
- b. Additional shares would be issued on January 1, 20X3 to compensate for any fall in the value of Blue Reef common stock below \$16 per share. The settlement would be to cure the deficiency by issuing added shares based on their fair value on January 1, 20X3. The fair price of the shares on January 1, 20X3 was \$10.

ANS:

a. Goodwill.....	184,000	
Cash.....		184,000
4 x (average income of \$126,000 - \$80,000)		
b. Paid-in Capital in Excess of Par.....	600,000	
Common Stock, \$1 par.....		60,000
Paid-in Capital in Excess of Par.....		540,000
Deficiency, \$6 x 100,000 shares.....	\$600,000	
Divide by \$10 fair value.....		<u>10</u>
Added number of shares.....		\$ 60,000

DIF: M OBJ: 8

12. The balance sheet information for Nickel Company is to be used in both parts (a) and (b), each of which is an independent case. On January 1, 20X1, a business combination occurred between Dime Co. and Nickel Co. On this date, a condensed balance sheet for Nickel showed:

	<u>Book Value</u>
Current Assets.....	\$ 500,000
Plant and Equipment (net).....	900,000
Intangibles - Patent.....	150,000
	<u>\$1,550,000</u>
	=====
Current Liabilities.....	\$ 75,000
Long-Term Debt.....	225,000
Common Stock.....	400,000
Paid-in Capital in Excess of Par.....	300,000
Retained Earning.....	550,000
	<u>\$1,550,000</u>
	=====

Required:

- a. Assume the combination was an asset acquisition in which Dime purchased all of the net assets of Nickel for \$1,725,000 cash. Nickel's current assets were undervalued \$70,000; plant and equipment were undervalued \$150,000; the patent was undervalued \$80,000; and long-term debt was overvalued \$45,000.

Record the entry or entries on Dime's books to carry out the acquisition of the net assets of Nickel.

- b. Assume that, in the combination, Dime acquired Nickel's net assets by issuance of new Dime common stock with a par value of \$200,000 and a fair value of \$1,750,000. In addition, Dime incurred stock issuance costs of \$30,000. For financial accounting purposes, the combination is to be accounted for as a purchase. For tax purposes, the combination is tax-free to the shareholders of Nickel Company. Assume a tax rate of 32%. Current assets of Nickel are undervalued by \$70,000. The fair value of Nickel's plant and equipment was \$1,050,000. The intangible is a patent with a fair value equal to book value.

Record the entry or entries on Dime's books to carry out the acquisition of the net assets of Nickel. Provide supporting calculations.

ANS:

a. Current Assets.....	\$ 570,000	
Plant and Equipment.....	1,050,000	
Intangibles - Patents.....	230,000	
Intangibles - Goodwill.....	130,000*	
Current Liabilities.....		\$ 75,000
Long-Term Debt.....		180,000
Cash.....		1,725,000

*Goodwill = \$1,725,000 price - \$1,595,000 sum of net asset fair value.

b. Price paid..... \$1,750,000

Current assets.....	\$ 570,000	
Deferred tax liability.....	(22,400)	
32% x (\$570,000 - 500,000)		
Plant and equipment.....	1,050,000	
Deferred tax liability.....	(48,000)	
32% x (\$1,050,000 - 900,000)		
Intangibles - Patents.....	150,000	
Current liabilities.....	(75,000)	
Long-term debt.....	(225,000)	
Net-of-tax value of goodwill.....		<u>1,399,600</u>
		\$ 350,400
		=====

Goodwill recorded as follows:

Goodwill (\$350,400 ÷ 68%).....	\$515,294
Deferred tax liability	
(32% x \$515,294).....	<u>164,894</u>
Net-of-tax value of goodwill	\$350,400
	=====

Current Assets.....	\$ 570,000	
Plant and Equipment.....	1,050,000	
Intangibles - Patents.....	150,000	
Intangibles - Goodwill.....	515,294	
Deferred Taxes Liability.....		\$ 235,294*
Current Liabilities.....		75,000
Long-Term Debt.....		225,000
Common Stock.....		200,000
Paid-in Capital in Excess of Par.....		1,520,000**
Cash.....		30,000

* \$22,400 + 48,000 + 164,894 = \$235,294

** \$1,750,000 fair - \$200,000 par - \$30,000 issuance costs

DIF: D

OBJ: 8

ESSAY

1. Goodwill is an intangible asset. There are a variety of recommendations about how intangible assets should be included in the financial statements. Discuss the recommendations for proper disclosure of goodwill. Include a comparison with disclosure of other intangible assets.

ANS:

Goodwill arises when a company is purchased and the value assigned to identifiable assets, including intangible assets, is in excess of the price paid. As such goodwill represents the value of intangible assets that could not be valued individually.

During a purchase some intangible assets such as patents, customer lists, brand names, and favorable lease agreements may exist but have not been recorded. The fair value of these intangible assets should be determined and recorded separate from the value of goodwill associated with the purchase.

Intangible assets other than goodwill will be amortized over their economic lives. The amortization method should reflect the pattern of benefits conveyed by the asset, so that a straight-line method is to be used unless another systematic method is appropriate.

Intangible assets may be reported individually, in groups, or in the aggregate on the balance sheet after fixed assets and are displayed net of cumulative amortization. Details for current and cumulative amortization, along with significant residual values, are shown in the footnotes to the balance sheet.

Goodwill is subject to impairment procedures. These concerns must be addressed related to goodwill:

1. Goodwill must be allocated to reporting units if the purchased company contains more than one reporting unit.
2. A reporting unit valuation plan must be established within one year of a purchase. This will be used as the measurement process in future periods.
3. Impairment testing is normally done on an annual basis.
4. The procedure for determining impairment must be established.
5. The procedure for determining the amount of the impairment loss, which is also the decrease in the goodwill amount recorded, must be established.

Goodwill is considered impaired when the implied fair value of reporting unit is less than the carrying value of the reporting unit's net assets. Once goodwill is written down, it cannot be adjusted to a higher amount.

Changes to goodwill must be disclosed. The disclosure would include the amount of goodwill acquired, the goodwill impairment losses, and the goodwill written off as part of a disposal of a reporting unit.

DIF: D

OBJ: 4, 5, 6, 9

2. While acquisitions are often friendly, there are numerous occasions when a party does not want to be acquired. Discuss possible defensive strategies that firms can implement to fend off a hostile takeover attempt.

ANS:

GREENMAIL: A strategy in which the target company pays a premium price to purchase treasury shares. The shares purchased are owned by the hostile acquirer or shareholders who might sell to the hostile acquirer.

WHITE KNIGHT: A strategy in which the target company locates a different company to take it over, a company that is more likely to keep current management and employees in place.

SELLING THE CROWN JEWELS: A strategy in which the target company sells off vital assets in order to make the company less attractive to prospective acquirers.

POISON PILL: A strategy in which the target company issues stock rights to existing shareholders at a price far below fair value. The rights are only exercisable if an acquirer makes a bid for the target company. The resulting new shares make the acquisition more expensive.

LEVERAGED BUYOUT: A strategy in which the management of the target company attempts to purchase a controlling interest in the target company, in order to continue control of the company.

DIF: M

OBJ: 2