

*Advanced Accounting, 12e (Beams et al.)*

**Chapter 1 Business Combinations**

1.1 Multiple Choice Questions

1) Which of the following is not a reason for a company to expand through a combination, rather than by building new facilities?

- A) A combination might provide cost advantages.
- B) A combination might provide fewer operating delays.
- C) A combination might provide easier access to intangible assets.
- D) A combination might provide an opportunity to invest in a company without having to take responsibility for its financial results.

Answer: D

Objective: LO1

Difficulty: Easy

2) A business merger differs from a business consolidation because

- A) a merger dissolves all but one of the prior entities, but a consolidation dissolves all of the prior entities and forms a new corporation.
- B) a consolidation dissolves all but one of the prior entities, but a merger dissolves all of the prior entities.
- C) a merger is created when two entities join, but a consolidation is created when more than two entities join.
- D) a consolidation is created when two entities join, but a merger is created when more than two entities join.

Answer: A

Objective: LO2

Difficulty: Easy

3) Following the accounting concept of a business combination, a business combination occurs when a company acquires an equity interest in another entity and has

- A) at least 20% ownership in the entity.
- B) more than 50% ownership in the entity.
- C) 100% ownership in the entity.
- D) control over the entity, irrespective of the percentage owned.

Answer: D

Objective: LO2

Difficulty: Easy

4) Historically, much of the controversy concerning accounting requirements for business combinations involved the \_\_\_\_\_ method.

- A) purchase
- B) pooling of interests
- C) equity
- D) acquisition

Answer: B

Objective: LO2

Difficulty: Easy

5) Pitch Co. paid \$50,000 in fees to its accountants and lawyers in acquiring Slope Company. Pitch will

treat the \$50,000 as

- A) an expense for the current year.
- B) a prior period adjustment to retained earnings.
- C) additional cost to investment of Slope on the consolidated balance sheet.
- D) a reduction in additional paid-in capital.

Answer: A

Objective: LO3, 4

Difficulty: Moderate

6) Picasso Co. issued 5,000 shares of its \$1 par common stock, valued at \$100,000, to acquire shares of Seurat Company in an all-stock transaction. Picasso paid the investment bankers \$35,000 and will treat the investment banker fee as

- A) an expense for the current year.
- B) a prior period adjustment to Retained Earnings.
- C) additional goodwill on the consolidated balance sheet.
- D) a reduction to additional paid-in capital.

Answer: D

Objective: LO3

Difficulty: Moderate

7) Durer Inc. acquired Sea Corporation in a business combination and Sea Corp went out of existence. Sea Corp developed a patent listed as an asset on Sea Corp's books at the patent office filing cost. In recording the combination,

- A) fair value is not assigned to the patent because the research and development costs have been expensed by Sea Corp.
- B) Sea Corp's prior expenses to develop the patent are recorded as an asset by Durer at purchase.
- C) the patent is recorded as an asset at fair market value.
- D) the patent's market value increases goodwill.

Answer: C

Objective: LO4

Difficulty: Moderate

8) In a business combination, which of the following will occur?

- A) All identifiable assets and liabilities are recorded at fair value at the date of acquisition.
- B) All identifiable assets and liabilities are recorded at book value at the date of acquisition.
- C) Goodwill is recorded if the fair value of the net assets acquired exceeds the book value of the net assets acquired.
- D) None of the above is correct.

Answer: A

Objective: LO3

Difficulty: Moderate

9) According to FASB Statement 141R, which one of the following items may not be accounted for as an intangible asset apart from goodwill?

- A) A production backlog
- B) A valuable employee workforce
- C) Noncontractual customer relationships
- D) Employment contracts

Answer: B

Objective: LO4

Difficulty: Easy

10) Under the provisions of FASB Statement No. 141R, in a business combination, when the fair value of identifiable net assets acquired exceeds the investment cost, which of the following statements is correct?

- A) A gain from a bargain purchase is recognized for the amount that the fair value of the identifiable net assets acquired exceeds the acquisition price.
- B) The difference is allocated first to reduce proportionately (according to market value) non-current assets, then to non-monetary current assets, and any negative remainder is classified as a deferred credit.
- C) The difference is allocated first to reduce proportionately (according to market value) non-current assets, and any negative remainder is classified as an extraordinary gain.
- D) The difference is allocated first to reduce proportionately (according to market value) non-current, depreciable assets to zero, and any negative remainder is classified as a deferred credit.

Answer: A

Objective: LO4

Difficulty: Easy

11) With respect to goodwill, an impairment

- A) will be amortized over the remaining useful life.
- B) is a two-step process which first compares book value to fair value at the business reporting unit level.
- C) is a one-step process considering the entire firm.
- D) occurs when asset values are adjusted to fair value in a purchase.

Answer: B

Objective: LO4

Difficulty: Easy

Use the following information to answer the question(s) below.

Polka Corporation exchanges 100,000 shares of newly issued \$1 par value common stock with a fair market value of \$20 per share for all of the outstanding \$5 par value common stock of Spot Inc. and Spot is then dissolved. Polka paid the following costs and expenses related to the business combination:

Costs of special shareholders' meeting	
to vote on the merger	\$12,000
Registering and issuing securities	10,000
Accounting and legal fees	18,000
Salaries of Polka's employees assigned	
to the implementation of the merger	27,000
Cost of closing duplicate facilities	13,000

12) In the business combination of Polka and Spot

- A) the costs of registering and issuing the securities are included as part of the purchase price for Spot.
- B) the salaries of Polka's employees assigned to the merger are treated as expenses.
- C) all of the costs except those of registering and issuing the securities are included in the purchase price of Spot.
- D) only the accounting and legal fees are included in the purchase price of Spot.

Answer: B

Objective: LO3

Difficulty: Moderate

13) In the business combination of Polka and Spot,

- A) all of the items listed above are treated as expenses.
- B) all of the items listed above except the cost of registering and issuing the securities are included in the purchase price.
- C) the costs of registering and issuing the securities are deducted from the fair market value of the common stock used to acquire Spot.
- D) only the costs of closing duplicate facilities, the salaries of Polka's employees assigned to the merger, and the costs of the shareholders' meeting would be treated as expenses.

Answer: C

Objective: LO3

Difficulty: Moderate

14) Which of the following methods does the FASB consider the best indicator of fair values in the evaluation of goodwill impairment?

- A) Senior executive's estimates
- B) Financial analyst forecasts
- C) Market value
- D) The present value of future cash flows discounted at the firm's cost of capital

Answer: C

Objective: LO4

Difficulty: Easy

15) Pepper Company paid \$2,500,000 for the net assets of Salt Corporation and Salt was then dissolved. Salt had no liabilities. The fair values of Salt's assets were \$3,750,000. Salt's only non-current assets were land and buildings with book values of \$100,000 and \$520,000, respectively, and fair values of \$180,000 and \$730,000, respectively. At what value will the buildings be recorded by Pepper?

- A) \$730,000
- B) \$520,000
- C) \$210,000
- D) \$0

Answer: A

Objective: LO4

Difficulty: Moderate

16) According to FASB Statement No. 141, liabilities assumed in an acquisition will be valued at the \_\_\_\_\_.

- A) reasonably estimated fair value
- B) historical book value
- C) current replacement cost
- D) present value using market interest rates

Answer: A

Objective: LO3

Difficulty: Easy

17) In reference to the FASB disclosure requirements about a business combination in the period in which the combination occurs, which of the following is correct?

- A) Firms are not required to disclose the name of the acquired company.
- B) Firms are not required to disclose the business purpose for a combination.
- C) Firms are required to disclose the nature, terms and fair value of consideration transferred in a business combination.
- D) All of the above are correct.

Answer: C

Objective: LO4

Difficulty: Easy

18) Under the current GAAP, Goodwill arising from a business combination is

- A) charged to Retained Earnings after the acquisition is completed.
- B) amortized over 40 years or its useful life, whichever is longer.
- C) amortized over 40 years or its useful life, whichever is shorter.
- D) never amortized.

Answer: D

Objective: LO4

Difficulty: Easy

download full file at <http://testbankinstant.com>

19) In reference to international accounting for goodwill, U.S. companies have complained that past U.S. accounting rules for goodwill placed them at a disadvantage in competing against foreign companies for merger partners. Why?

- A) Previous rules required immediate write off of goodwill which resulted in a one-time expense that was not required under international rules.
- B) Previous rules required amortization of goodwill which resulted in an ongoing expense that was not required under international rules.
- C) Previous rules did not permit the recording of goodwill, thus resulting in a lower asset base than international counterparts would recognize.
- D) All of the above are correct.

Answer: B

Objective: LO4

Difficulty: Moderate

20) When considering an acquisition, which of the following is NOT a method by which one company may gain control of another company?

- A) Purchase of the majority of outstanding voting stock of the acquired company.
- B) Purchase of all assets and liabilities of another company.
- C) Purchase the assets, but not necessarily the liabilities, of another company previously in bankruptcy.
- D) All of the above methods result in a company gaining control over another company.

Answer: D

Objective: LO2

Difficulty: Moderate

download full file at <http://testbankinstant.com>

## 1.2 Exercises

1) Parrot Incorporated purchased the assets and liabilities of Sparrow Company at the close of business on December 31, 2013. Parrot borrowed \$2,000,000 to complete this transaction, in addition to the \$640,000 cash that they paid directly. The fair value and book value of Sparrow's recorded assets and liabilities as of the date of acquisition are listed below. In addition, Sparrow had a patent that had a fair value of \$50,000.

	<u>Book Value</u>	<u>Fair Value</u>
Cash	\$120,000	\$120,000
Inventories	220,000	250,000
Other current assets	630,000	600,000
Land	270,000	320,000
Plant assets-net	<u>4,650,000</u>	<u>4,600,000</u>
Total Assets	<u>\$5,890,000</u>	<u>                    </u>
Accounts payable	\$1,200,000	\$1,200,000
Notes payable	2,100,000	2,100,000
Capital stock, \$5 par	700,000	
Additional paid-in capital	1,400,000	
Retained Earnings	<u>490,000</u>	<u>                    </u>
Total Liabilities & Equities	<u>\$5,890,000</u>	<u>                    </u>

### Required:

1. Prepare Parrot's general journal entry for the acquisition of Sparrow, assuming that Sparrow survives as a separate legal entity.
2. Prepare Parrot's general journal entry for the acquisition of Sparrow, assuming that Sparrow will dissolve as a separate legal entity.

Answer:

1. General journal entry recorded by Parrot for the acquisition of Sparrow (Sparrow survives as a separate legal entity):

Investment in Sparrow	2,640,000	
Cash		640,000
Notes Payable		2,000,000

2. General journal entry recorded by Parrot for the acquisition of Sparrow (Sparrow dissolves as a separate legal entity):

Cash	120,000	
Inventories	250,000	
Other current assets	600,000	
Land	320,000	
Plant assets	4,600,000	
Patent	50,000	
Accounts payable		1,200,000
Notes payable		2,100,000
Cash		640,000
Notes Payable		2,000,000

Objective: LO4

Difficulty: Moderate



2) On January 2, 2013 Piron Corporation issued 100,000 new shares of its \$5 par value common stock valued at \$19 a share for all of Seana Corporation's outstanding common shares. Piron paid \$15,000 to register and issue shares. Piron also paid \$20,000 for the direct combination costs of the accountants. The fair value and book value of Seana's identifiable assets and liabilities were the same. Summarized balance sheet information for both companies just before the acquisition on January 2, 2013 is as follows:

	<u>Piron</u>	<u>Seana</u>
Cash	\$150,000	\$120,000
Inventories	320,000	400,000
Other current assets	500,000	500,000
Land	350,000	250,000
Plant assets-net	<u>4,000,000</u>	<u>1,500,000</u>
Total Assets	<u>\$5,320,000</u>	<u>\$2,770,000</u>
Accounts payable	\$1,000,000	\$300,000
Notes payable	1,300,000	660,000
Capital stock, \$5 par	2,000,000	500,000
Additional paid-in capital	1,000,000	100,000
Retained Earnings	<u>20,000</u>	<u>1,210,000</u>
Total Liabilities & Equities	<u>\$5,320,000</u>	<u>\$2,770,000</u>

Required:

1. Prepare Piron's general journal entry for the acquisition of Seana, assuming that Seana survives as a separate legal entity.
  
2. Prepare Piron's general journal entry for the acquisition of Seana, assuming that Seana will dissolve as a separate legal entity.

download full file at <http://testbankinstant.com>

Answer:

1. General journal entry recorded by Piron for the acquisition of Seana (Seana survives as a separate legal entity):

Investment in Seana	1,900,000	
Common stock		500,000
Additional paid-in capital		1,400,000
Investment expense	20,000	
Additional paid-in capital	15,000	
Cash		35,000

2. General journal entry recorded by Piron for the acquisition of Seana (Seana dissolves as a separate legal entity):

Cash	85,000	
Inventories	400,000	
Other current assets	500,000	
Land	250,000	
Plant assets	1,500,000	
Goodwill	90,000	
Investment expense	20,000	
Accounts payable		300,000
Notes payable		660,000
Common stock		500,000
Additional paid-in capital		1,385,000

Objective: LO4

Difficulty: Difficult

3) At December 31, 2013, Pandora Incorporated issued 40,000 shares of its \$20 par common stock for all the outstanding shares of the Sophocles Company. In addition, Pandora agreed to pay the owners of Sophocles an additional \$200,000 if a specific contract achieved the profit levels that were targeted by the owners of Sophocles in their sale agreement. The fair value of this amount, with an agreed likelihood of occurrence and discounted to present value, is \$160,000. In addition, Pandora paid \$10,000 in stock issue costs, \$40,000 in legal fees, and \$48,000 to employees who were dedicated to this acquisition for the last three months of the year. Summarized balance sheet and fair value information for Sophocles immediately prior to the acquisition follows.

	<u>Book Value</u>	<u>Fair Value</u>
Cash	\$100,000	\$100,000
Accounts Receivable	280,000	250,000
Inventory	520,000	640,000
Buildings and Equipment (net)	750,000	870,000
Trademarks and Tradenames	0	500,000
Total Assets	<u>\$1,650,000</u>	
Accounts Payable	\$200,000	\$190,000
Notes Payable	900,000	900,000
Retained Earnings	550,000	
Total Liabilities and Equity	<u>\$1,650,000</u>	

Required:

1. Prepare Pandora's general journal entry for the acquisition of Sophocles assuming that Pandora's stock was trading at \$35 at the date of acquisition and Sophocles dissolves as a separate legal entity.
2. Prepare Pandora's general journal entry for the acquisition of Sophocles assuming that Pandora's stock was trading at \$35 at the date of acquisition and Sophocles continues as a separate legal entity.
3. Prepare Pandora's general journal entry for the acquisition of Sophocles assuming that Pandora's stock was trading at \$25 at the date of acquisition and Sophocles dissolves as a separate legal entity.
4. Prepare Pandora's general journal entry for the acquisition of Sophocles assuming that Pandora's stock was trading at \$25 at the date of acquisition and Sophocles survives as a separate legal entity.

Answer:

1. At \$35 per share, assuming Sophocles dissolves as a separate legal entity:

Cash	\$100,000	
Accounts Receivable	250,000	
Inventory	640,000	
Buildings and Equipment	870,000	
Trademarks/Trade names	500,000	
Goodwill	290,000	
Accounts payable		190,000
Contingent Liability		160,000
Notes payable		900,000
Common stock		800,000
Additional paid-in capital		600,000
Investment expense	40,000	
Additional paid-in capital	10,000	
Cash		50,000

NOTE: Amount paid to employees dedicated to the acquisition would be routinely expensed through company payroll and have no separate impact on the acquisition entry.

2. At \$35 per share, assuming Sophocles continues as a separate legal entity:

Investment in Sophocles	1,560,000	
Contingent Liability		160,000
Common stock		800,000
Additional paid-in capital		600,000
Investment expense	40,000	
Additional paid-in capital	10,000	
Cash		50,000

NOTE: Amount paid to employees dedicated to the acquisition would be routinely expensed through company payroll and have no separate impact on the acquisition entry.

3. At \$25 per share, assuming Sophocles dissolves as a separate legal entity:

Cash	\$100,000	
Accounts Receivable	250,000	
Inventory	640,000	
Buildings and Equipment	870,000	
Trademarks/Trade names	500,000	
Accounts payable		190,000
Contingent Liability		160,000
Notes payable		900,000
Gain on bargain purchase		110,000
Common stock		800,000
Additional paid-in capital		200,000
Investment expense	40,000	
Additional paid-in capital	10,000	
Cash		50,000

NOTE: Amount paid to employees dedicated to the acquisition would be routinely expensed through company payroll and have no separate impact on the acquisition entry.

4. At \$25 per share, assuming Sophocles continues as a separate legal entity:

Investment in Sophocles	1,160,000	
Contingent Liability		160,000
Common stock		800,000
Additional paid-in capital		200,000
Investment expense	40,000	
Additional paid-in capital	10,000	
Cash		50,000

NOTE: Amount paid to employees dedicated to the acquisition would be routinely expensed through company payroll and have no separate impact on the acquisition entry.

Objective: LO4

Difficulty: Difficult

4) On January 2, 2013 Palta Company issued 80,000 new shares of its \$5 par value common stock valued at \$12 a share for all of Sudina Corporation's outstanding common shares. Palta paid \$5,000 for the direct combination costs of the accountants. Palta paid \$18,000 to register and issue shares. The fair value and book value of Sudina's identifiable assets and liabilities were the same. Summarized balance sheet information for both companies just before the acquisition on January 2, 2013 is as follows:

	<u>Palta</u>	<u>Sudina</u>
Cash	\$75,000	\$60,000
Inventories	160,000	200,000
Other current assets	200,000	250,000
Land	175,000	125,000
Plant assets-net	<u>1,500,000</u>	<u>750,000</u>
Total Assets	<u>\$2,110,000</u>	<u>\$1,385,000</u>
Accounts payable	\$100,000	\$155,000
Notes payable	700,000	330,000
Capital stock, \$2 par	600,000	250,000
Additional paid-in capital	450,000	50,000
Retained Earnings	<u>260,000</u>	<u>600,000</u>
Total Liabilities & Equity	<u>\$2,110,000</u>	<u>\$1,385,000</u>

Required:

1. Prepare Palta's general journal entry for the acquisition of Sudina assuming that Sudina survives as a separate legal entity.
2. Prepare Palta's general journal entry for the acquisition of Sudina assuming that Sudina will dissolve as a separate legal entity.

Answer:

1. General journal entry recorded by Palta for the acquisition of Sudina (Sudina survives as a separate legal entity):

Investment in Sudina	960,000	
Common stock		400,000
Additional paid-in capital		560,000
Investment expense	5,000	
Additional paid-in capital	18,000	
Cash		23,000

2. General journal entry recorded by Palta for the acquisition of Sudina (Sudina dissolves as a separate legal entity):

Cash	37,000	
Inventories	200,000	
Other current assets	250,000	
Land	125,000	
Plant assets	750,000	
Goodwill	60,000	
Investment expense	5,000	
Accounts payable		155,000
Notes payable		330,000
Common stock		400,000
Additional paid-in capital		542,000

Objective: LO4

Difficulty: Moderate

5) Saveed Corporation purchased the net assets of Penny Inc. on January 2, 2013 for \$1,690,000 cash and also paid \$15,000 in direct acquisition costs. Penny dissolved as of the date of the acquisition. Penny's balance sheet on January 2, 2013 was as follows:

Accounts receivable-net	\$190,000	Current liabilities	\$235,000
Inventory	480,000	Long term debt	650,000
Land	10,000	Common stock (\$1 par)	25,000
Building-net	630,000	Paid-in capital	150,000
Equipment-net	<u>240,000</u>	Retained earnings	<u>590,000</u>
Total assets	<u>\$1,650,000</u>	Total liab. & equity	<u>\$1,650,000</u>

Fair values agree with book values except for inventory, land, and equipment, which have fair values of \$640,000, \$140,000 and \$230,000, respectively. Penny has customer contracts valued at \$20,000.

Required:

Prepare Saveed's general journal entry for the cash purchase of Penny's net assets.

Answer: General journal entry for the purchase of Penny's net assets:

Accounts receivable	190,000	
Inventory	640,000	
Land	140,000	
Building	630,000	
Equipment	230,000	
Customer contracts	20,000	
Goodwill	725,000	
Investment expense	15,000	
Current liabilities		235,000
Long-term debt		650,000
Cash		1,705,000

Objective: LO4

Difficulty: Moderate



6) Bigga Corporation purchased the net assets of Petit, Inc. on January 2, 2013 for \$380,000 cash and also paid \$15,000 in direct acquisition costs. Petit, Inc. was dissolved on the date of the acquisition. Petit's balance sheet on January 2, 2013 was as follows:

Accounts receivable-net	\$90,000	Current liabilities	\$75,000
Inventory	220,000	Long term debt	80,000
Land	30,000	Common stock (\$1 par)	10,000
Building-net	20,000	Addtl. paid-in capital	215,000
Equipment-net	<u>40,000</u>	Retained earnings	<u>20,000</u>
Total assets	<u>\$400,000</u>	Total liab. & equity	<u>\$400,000</u>

Fair values agree with book values except for inventory, land, and equipment, which have fair values of \$260,000, \$35,000 and \$35,000, respectively. Petit has patent rights with a fair value of \$20,000.

Required:

Prepare Bigga's general journal entry for the cash purchase of Petit's net assets.

Answer: General journal entry for the purchase of Petit's net assets:

Accounts receivable	90,000	
Inventory	260,000	
Land	35,000	
Building	20,000	
Equipment	35,000	
Patent	20,000	
Goodwill	75,000	
Investment expense	15,000	
Current liabilities		75,000
Long-term debt		80,000
Cash		395,000

Objective: LO4

Difficulty: Moderate

7) The balance sheets of Palisade Company and Salisbury Corporation were as follows on December 31, 2013:

	Palisade	Salisbury
Current Assets	\$260,000	\$120,000
Equipment-net	440,000	480,000
Buildings-net	600,000	200,000
Land	100,000	200,000
Total Assets	<u>\$1,400,000</u>	<u>\$1,000,000</u>
Current Liabilities	100,000	120,000
Common Stock, \$5 par	1,000,000	400,000
Additional paid-in Capital	100,000	280,000
Retained Earnings	<u>200,000</u>	<u>200,000</u>
Total Liabilities and Stockholders' equity	<u>\$1,400,000</u>	<u>\$1,000,000</u>

On January 1, 2014 Palisade issued 30,000 of its shares with a market value of \$40 per share in exchange for all of Salisbury's shares, and Salisbury was dissolved. Palisade paid \$20,000 to register and issue the new common shares. It cost Palisade \$50,000 in direct combination costs. Book values equal market values except that Salisbury's land is worth \$250,000.

Required:

Prepare a Palisade balance sheet after the business combination on January 1, 2014.

Answer: The balance sheet for Palisade Corporation subsequent to its acquisition of Salisbury Corporation on January 1, 2014 will appear as follows:

Current Assets	\$310,000
Equipment-net	920,000
Buildings-net	800,000
Land	350,000
Goodwill	<u>270,000</u>
Total Assets	<u>\$2,650,000</u>
Current Liabilities	220,000
Common Stock, \$5 par	1,150,000
Additional paid-in Capital	1,130,000
Retained Earnings	<u>150,000</u>
Total Liabilities and Stockholders' equity	<u>\$2,650,000</u>

Note that Current Assets of \$310,000 results from the two companies contributing \$260,000 and \$120,000, less the cash paid out during the acquisition process of \$70,000. Retained Earnings of the parent is reduced for the Investment Expense incurred in the process of \$50,000.

Objective: LO4

Difficulty: Moderate

download full file at <http://testbankinstant.com>

8) On January 2, 2013, Pilates Inc. paid \$900,000 for all of the outstanding common stock of Spinning Company, and dissolved Spinning Company. The carrying values for Spinning Company's assets and liabilities are recorded below.

Cash	\$200,000
Accounts Receivable	220,000
Copyrights (purchased)	400,000
Goodwill	120,000
Liabilities	<u>(180,000)</u>
Net assets	<u>\$760,000</u>

On January 2, 3, Spinning anticipated collecting \$185,000 of the recorded Accounts Receivable. Pilates entered into the acquisition because Spinning had Copyrights that Pilates wished to own, and also unrecorded patents with a fair value of \$100,000.

Required:

Calculate the amount of goodwill that will be recorded on Pilate's balance sheet as of the date of acquisition.

Answer:

Goodwill is calculated as follows:

Purchase price		\$900,000
Fair value of net assets:		
Cash	\$200,000	
Accounts Receivable	185,000	
Copyrights	400,000	
Patents	100,000	
Liabilities	<u>(180,000)</u>	
Total		<u>(705,000)</u>
Purchase price in excess of fair value of net assets:		<u>\$195,000</u>

Pilates would record \$195,000 for Goodwill as a result of the acquisition.

Objective: LO4

Difficulty: Moderate

download full file at <http://testbankinstant.com>

9) On January 2, 2013, Pilates Inc. paid \$700,000 for all of the outstanding common stock of Spinning Company, and dissolved Spinning Company. The carrying values for Spinning Company's assets and liabilities are recorded below.

Cash	\$200,000
Accounts Receivable	220,000
Copyrights (purchased)	400,000
Goodwill	120,000
Liabilities	<u>(180,000)</u>
Net assets	<u>\$760,000</u>

On January 2, 2013, Spinning anticipated collecting \$185,000 of the recorded Accounts Receivable. Pilates entered into the acquisition because Spinning had Copyrights that Pilates wished to own, and also unrecorded patents with a fair value of \$100,000.

Required:

Calculate the amount of goodwill that will be recorded on Pilate's balance sheet as of the date of acquisition. Then record the journal entry Pilates would record on their books to record the acquisition.

Answer: Goodwill is calculated as follows:

Purchase price		\$700,000
Fair value of net assets:		
Cash	\$200,000	
Accounts Receivable	185,000	
Copyrights	400,000	
Patents	100,000	
Liabilities	<u>(180,000)</u>	
Total		<u>(705,000)</u>
Fair value of net assets in excess of Purchase price:		\$(5,000)

Because Pilates paid less than the fair value of the net assets, they are considered to have made a bargain purchase, and would thus record a Gain on Bargain Purchase in the amount of \$5,000 at the time of acquisition.

The following journal entry would be prepared:

Cash	200,000	
Accounts receivable	185,000	
Copyrights	400,000	
Patents	100,000	
Liabilities		180,000
Bargain purchase gain		5,000
Cash		700,000

Objective: LO4

Difficulty: Moderate

download full file at <http://testbankinstant.com>

10) Pali Corporation exchanges 200,000 shares of newly issued \$10 par value common stock with a fair market value of \$40 per share for all the outstanding \$5 par value common stock of Shingle Incorporated, which continues on as a legal entity. Fair value approximated book value for all assets and liabilities of Shingle. Pali paid the following costs and expenses related to the business combination:

Registering and issuing securities	19,000
Accounting and legal fees	150,000
Salaries of Pali's employees whose time was dedicated to the merger	86,000
Cost of closing duplicate facilities	223,000

Required: Prepare the journal entries relating to the above acquisition and payments incurred by Pali, assuming all costs were paid in cash.

Answer:

Investment in Shingle	8,000,000	
Common Stock		2,000,000
Additional Paid in Capital		6,000,000
Additional Paid in Capital	19,000	
Cash		19,000
Investment Expense (fees)	150,000	
Cash		150,000
Salary expense	86,000	
Cash		86,000
Plant closure expense	223,000	
Cash		223,000

Objective: LO3

Difficulty: Moderate

download full file at <http://testbankinstant.com>

11) Samantha's Sporting Goods had net assets consisting of the following:

	<u>Book Value</u>	<u>Fair Value</u>
Cash	150,000	150,000
Inventory	820,000	960,000
Building and Fixtures	330,000	310,000
Liabilities	(90,000)	(88,000)

Pedic Incorporated purchased Samantha's Sporting Goods, and immediately dissolved Samantha's as a separate legal entity.

Requirement 1: If Samantha's was purchased for \$1,000,000 cash, prepare the entry recorded by Pedic.

Requirement 2: If Samantha's was purchased for \$1,500,000 cash, prepare the entry recorded by Pedic.

Answer:

Requirement 1:

Cash*	150,000	
Inventory	960,000	
Building and Fixtures	310,000	
Liabilities		88,000
Gain on Bargain Purchase		332,000
Cash*		1,000,000

\*Cash entries may be recorded net on single line entry.

Requirement 2:

Cash*	150,000	
Inventory	960,000	
Building and Fixtures	310,000	
Goodwill	168,000	
Liabilities		88,000
Cash*		1,500,000

\*Cash entries may be recorded net on single line entry.

Objective: LO4

Difficulty: Moderate

12) On January 2, 2013 Carolina Clothing issued 100,000 new shares of its \$5 par value common stock valued at \$19 a share for all of Dakota Dressing Company's outstanding common shares in an acquisition. Carolina paid \$15,000 for registering and issuing securities and \$10,000 for other direct costs of the business combination. The fair value and book value of Dakota's identifiable assets and liabilities were the same. Assume Dakota Company is dissolved on the date of the acquisition. Summarized balance sheet information for both companies just before the acquisition on January 2, 2013 is as follows:

	<u>Carolina</u>	<u>Dakota</u>
Cash	\$150,000	\$120,000
Inventories	320,000	400,000
Other current assets	500,000	500,000
Land	350,000	250,000
Plant assets-net	<u>4,000,000</u>	<u>1,500,000</u>
Total Assets	<u>\$5,320,000</u>	<u>\$2,770,000</u>
Accounts payable	\$1,000,000	\$300,000
Notes payable	1,300,000	660,000
Capital stock, \$5 par	2,000,000	500,000
Additional paid-in capital	1,000,000	100,000
Retained Earnings	<u>20,000</u>	<u>1,210,000</u>
Total Liabilities & Equities	<u>\$5,320,000</u>	<u>\$2,770,000</u>

Required:

Prepare a balance sheet for Carolina Clothing immediately after the business combination.

Answer:

Carolina Clothing  
Balance Sheet  
January 2, 2013

Assets:		Liabilities:	
Cash	\$245,000	Accounts payable	\$1,300,000
Inventory	720,000	Notes payable	<u>1,960,000</u>
Other current assets	<u>1,000,000</u>	Total liabilities	<u>3,260,000</u>
Total current assets	<u>1,965,000</u>		
		Equity:	
Land	600,000	Common stock (\$5 par)	2,500,000
Plant assets-net	5,500,000	Additional paid-in	
Goodwill	<u>90,000</u>	capital	2,385,000
Total Long-term Assets	<u>6,190,000</u>	Retained earnings	<u>10,000</u>
		Total equity	<u>4,895,000</u>
Total assets	<u>\$8,155,000</u>	Total liab.& equity	<u>\$8,155,000</u>

Objective: LO4

Difficulty: Difficult

13) Balance sheet information for Sphinx Company at January 1, 2013, is summarized as follows:

Current assets	\$230,000	Liabilities	\$300,000
Plant assets	450,000	Capital stock \$10 par	200,000
		Retained earnings	180,000
	<u>\$680,000</u>		<u>\$680,000</u>

Sphinx's assets and liabilities are fairly valued except for plant assets that are undervalued by \$50,000. On January 2, 2013, Pyramid Corporation issues 20,000 shares of its \$10 par value common stock for all of Sphinx's net assets and Sphinx is dissolved. Market quotations for the two stocks on this date are:

Pyramid common:	\$28.00
Sphinx common:	\$19.50

Pyramid pays the following fees and costs in connection with the combination:

Finder's fee	\$10,000
Legal and accounting fees	6,000

Required:

1. Calculate Pyramid's investment cost of Sphinx Corporation.
2. Calculate any goodwill from the business combination.

Answer:

Requirement 1

FMV of shares issued by Pyramid:  $20,000 \times \$28.00 =$  \$560,000

Requirement 2

Investment cost from above: \$560,000

Less: Fair value of Sphinx's net assets (\$680,000 of total assets plus \$50,000 of undervalued plant assets minus \$300,000 of debt) 430,000

Equals: Goodwill from investment in Sphinx \$ 130,000

Objective: LO4

Difficulty: Moderate



14) On December 31, 2013, Peris Company acquired Shanta Company's outstanding stock by paying \$400,000 cash and issuing 10,000 shares of its own \$30 par value common stock, when the market price was \$32 per share. Peris paid legal and accounting fees amounting to \$35,000 in addition to stock issuance costs of \$8,000. Shanta is dissolved on the date of the acquisition. Balance sheet information for Peris and Shanta immediately preceding the acquisition is shown below, including fair values for Shanta's assets and liabilities.

	Peris <u>Book Value</u>	Shanta <u>Book Value</u>	Shanta <u>Fair Value</u>
Cash	490,000	\$140,000	\$140,000
Accounts Receivable	560,000	280,000	280,000
Inventory	520,000	200,000	260,000
Land	460,000	150,000	140,000
Plant Assets — Net	980,000	325,000	355,000
Construction Permits	380,000	170,000	190,000
Accounts Payable	(460,000)	(140,000)	(140,000)
Other accrued expenses	(160,000)	(45,000)	(45,000)
Notes Payable	(800,000)	(460,000)	(460,000)
Common Stock (\$30 par)	(960,000)		
Common Stock (\$20 par)		(200,000)	
Additional P.I.C	(192,000)	(80,000)	
Retained Earnings	(818,000)	(340,000)	

Required: Determine the consolidated balances which Peris would present on their consolidated balance sheet for the following accounts.

Cash

Inventory

Construction Permits

Goodwill

Notes Payable

Common Stock

Additional Paid in Capital

Retained Earnings

Answer: Cash = \$490,000 + \$140,000 - \$400,000 - \$35,000 - \$8,000 = \$187,000

Inventory = \$520,000 + \$260,000 = \$780,000

Construction Permits = \$380,000 + \$190,000 = \$570,000

Goodwill = \$720,000 (Paid \$400,000 + \$320,000) - \$720,000 (Fair Value of Net Assets) = 0

Notes Payable = \$800,000 + \$460,000 = \$1,260,000

Common Stock = \$960,000 + \$300,000 (10,000 shares issued × \$30 par) = \$1,260,000

Additional Paid in Capital = \$192,000 + \$20,000 (10,000 shares issued × \$2 excess over par per share) - \$8,000 (cost of issuance) = \$204,000

Retained Earnings = \$818,000 - \$35,000 (investment expense) = \$783,000

Objective: LO4

Difficulty: Difficult

15) On June 30, 2013, Stampol Company ceased operations and all of their assets and liabilities were purchased by Postoli Incorporated. Postoli paid \$40,000 in cash to the owner of Stampol, and signed a five-year note payable to the owners of Stampol in the amount of \$200,000. Their closing balance sheets as of June 30, 2013 are shown below. In the purchase agreement, both parties noted that Inventory was undervalued on the books by \$10,000, and Pistoli would also take possession of a customer list with a fair value of \$18,000. Pistoli paid all legal costs of the acquisition, which amounted to \$7,000.

	<u>Postoli</u>	<u>Stampol</u>
Cash	\$150,000	\$17,000
Inventory	260,000	120,000
Other current assets	420,000	60,000
Land	60,000	0
Plant assets-net	<u>590,000</u>	<u>190,000</u>
Total Assets	<u>\$1,480,000</u>	<u>\$387,000</u>
Accounts payable	\$440,000	\$127,000
Notes payable	160,000	80,000
Capital stock, \$5 par	20,000	50,000
Additional paid-in capital	60,000	0
Retained Earnings	<u>800,000</u>	<u>130,000</u>
Total Liabilities & Equities	<u>\$1,480,000</u>	<u>\$387,000</u>

Required:

1. Prepare the journal entry Postoli would record at the date of acquisition.
2. Prepare the journal entry Stampol would record at the date of acquisition.

Answer:

Postoli's journal entry:

Inventory	130,000	
Other Current Assets	60,000	
Plant Assets — net	190,000	
Customer List	18,000	
Goodwill	32,000	
Cash*		23,000
Accounts Payable		127,000
Notes Payable**		280,000
Investment Expense	7,000	
Cash		7,000

\*Cash payment of \$40,000 is shown net of the \$17,000 received in the acquisition.

\*\*Notes Payable signed for \$200,000 is shown in addition to the \$80,000 purchased in the acquisition.

Stampol's journal entry:

Accounts Payable	\$127,000	
Notes Payable	80,000	
Capital Stock	50,000	
Retained Earnings	130,000	
Cash		\$17,000
Inventory		120,000
Other Current Assets		60,000
Plant assets — net		190,000

Objective: LO4

Difficulty: Moderate

download full file at <http://testbankinstant.com>

16) Pony acquired Spur Corporation's assets and liabilities for \$500,000 cash on December 31, 2013. Spur dissolved on the date of the acquisition. Spur's balance sheet and related fair values are shown as of that date, below.

	<u>Book Value</u>	<u>Fair Value</u>
Cash	\$20,000	\$20,000
Accounts Receivable	40,000	38,000
Land	45,000	50,000
Plant and Equipment — net	460,000	410,000
Franchise Agreement	<u>0</u>	160,000
Total Assets	<u>\$565,000</u>	
Accounts Payable	\$70,000	\$70,000
Other Liabilities	120,000	110,000
Common Stock	180,000	
Additional Paid in Capital	40,000	
Retained Earnings	<u>155,000</u>	
Total Liabilities and Equity	<u>\$565,000</u>	

Required: Prepare the journal entry recorded by Pony as a result of this transaction.

Answer:

Accounts Receivable	38,000	
Land	50,000	
Plant and Equipment — net	410,000	
Franchise agreement	160,000	
Goodwill	2,000	
Accounts Payable		70,000
Other Liabilities		110,000
Cash*		480,000

\*Cash payment is shown net of cash received in acquisition.

Objective: LO4

Difficulty: Moderate