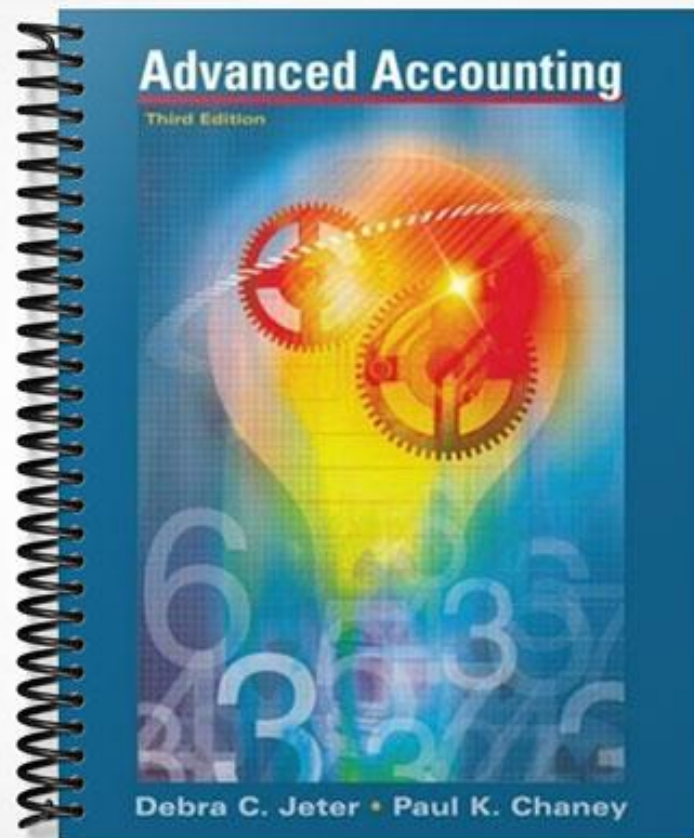


TEST BANK



Chapter 2

Methods of Accounting for Business Combinations

Multiple Choice

1. Assets and liabilities acquired are recorded at their fair values under
 - a. The pooling of interests method.
 - b. The purchase method.
 - c. Both the purchase and the pooling of interests methods.
 - d. Neither the purchase nor the pooling of interests methods.
2. Equity shares issued as consideration are recorded at the book value of the acquired shares under
 - a. The pooling of interests method.
 - b. The purchase method.
 - c. Both the purchase and the pooling of interests methods.
 - d. Neither the purchase nor the pooling of interests methods.
3. Under the purchase method, if the fair values of identifiable net assets exceed the total cost of the acquired company, the excess should be
 - a. accounted for as goodwill.
 - b. allocated to reduce current and long-lived assets.
 - c. allocated to reduce current assets and classify any remainder as an extraordinary gain.
 - d. allocated to reduce long-lived assets and classify any remainder as an extraordinary gain.
4. Which of the following statements is correct?
 - a. The acquired company's retained earnings become a part of the acquiring company's retained earnings under the purchase method.
 - b. The acquired company's retained earnings do not become a part of the acquiring company's retained earnings under the pooling of interests method.
 - c. The acquired company's retained earnings become a part of the acquiring company's retained earnings under both methods.
 - d. None of these.
5. The issuer and combiner companies' earnings are combined for the full year in which the combination occurs under
 - a. the purchase method.
 - b. the pooling of interests method.
 - c. both the purchase and pooling of interests methods.
 - d. neither the purchase nor the pooling of interests methods.
6. Direct costs related to acquisitions are expensed in the year in which incurred under
 - a. the purchase method.
 - b. the pooling of interests method.
 - c. both the purchase and the pooling of interests methods.
 - d. none of these.
7. Under the pooling of interests method, when the par value of the shares issued by the issuing firm is less than the total par value of the combining company's stock, the excess should be
 - a. deducted from the combined other contributed capital.
 - b. deducted from the combined retained earnings.
 - c. added to the combined other contributed capital.
 - d. added to the combined retained earnings.

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8. In a leveraged buyout, the portion of the net assets of the new corporation provided by the management group is recorded at
- appraisal value.
 - book value.
 - fair value.
 - lower of cost or market.
9. When the purchase price of an acquired firm is less than the fair value of the identifiable net assets, all of the following are recorded at fair market value except
- Assumed liabilities.
 - Current assets.
 - Long-term investments in marketable securities.
 - Long-lived assets.
10. Which of the following costs are accounted for in the same way under both the purchase and pooling of interests methods?
- Direct costs incurred in a combination.
 - Indirect costs related to acquisitions.
 - Security issuance costs.
 - None of these.
11. A business combination is accounted for properly as a purchase. Which of the following expenses related to effecting the business combination should enter into the determination of net income of the combined corporation for the period in which the expenses are incurred?

	<u>Accounting and consulting fees</u>	<u>Overhead allocated to the merger</u>
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

12. In a business combination, security issuance costs are deducted from the recorded value of the security for a

	<u>Pooling</u>	<u>Purchase</u>
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

13. Par Company and Sub Company were combined in a purchase transaction. Par was able to acquire Sub at a bargain price. The sum of the fair values of identifiable assets acquired less the fair value of liabilities assumed exceeded cost to Par. After revaluing long-lived assets to zero, there was still some "negative goodwill." Proper accounting treatment by Par is to report the amount as
- paid-in capital.
 - a deferred credit, which is amortized.
 - part of current income in the year of combination.
 - an extraordinary gain.

14. Under a pooling of interests, all types of acquisition expenses are
- expensed in the period incurred.
 - capitalized and amortized over a discretionary period.
 - considered a part of the total cost of the acquired company.
 - charged to retained earnings when incurred.
15. In a business combination accounted for as a purchase, how should the excess of fair value of net assets acquired over cost be treated?
- Amortized as a credit to income over a period not to exceed forty years.
 - Amortized as a charge to expense over a period not to exceed forty years.
 - Amortized directly to retained earnings over a period not to exceed forty years.
 - Allocated as a reduction of long-lived other than investments in marketable securities.
16. P Corporation issued 10,000 shares of common stock with a fair value of \$25 per share for all the outstanding common stock of S Company in a business combination properly accounted for as a purchase. The fair value of S Company's net assets on that date was \$220,000. P Company also agreed to issue an additional 2,000 shares of common stock with a fair value of \$50,000 to the former stockholders of S Company as an earnings contingency. Assuming the contingency is met, the \$50,000 fair value of the additional shares issued should be treated as a(n)
- decrease in noncurrent liabilities of S Company that were assumed by P Company.
 - decrease in consolidated retained earnings.
 - increase in consolidated goodwill.
 - decrease in consolidated other contributed capital.
17. On February 5, Seely Corporation paid \$1,500,000 for all the issued and outstanding common stock of Pod, Inc., in a transaction properly accounted for as a purchase. The book values and fair values of Pod's assets and liabilities on February 5 were as follows

	<u>Book Value</u>	<u>Fair Value</u>
Cash	\$ 160,000	\$ 160,000
Receivables (net)	180,000	180,000
Inventory	315,000	300,000
Plant and equipment (net)	820,000	900,000
Liabilities	<u>(350,000)</u>	<u>(350,000)</u>
Net assets	<u>\$1,125,000</u>	<u>\$1,190,000</u>

What is the amount of goodwill resulting from the business combination?

- \$-0-.
- \$375,000.
- \$65,000.
- \$310,000.

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18. P Company purchased the net assets of S Company for \$150,000. On the date of P's purchase, S Company had no investments in marketable securities and \$20,000 (book and fair value) of liabilities. The fair values of S Company's assets, when acquired, were

Current assets	\$ 80,000
Noncurrent assets	<u>120,000</u>
Total	\$200,000

- How should the \$30,000 difference between the fair value of the net assets acquired (\$180,000) and the cost (\$150,000) be accounted for by P Company?
- a. The noncurrent assets should be recorded at \$ 90,000.
- b. The \$30,000 difference should be credited to retained earnings.
- c. The current assets should be recorded at \$68,000, and the noncurrent assets should be recorded at \$102,000.
- d. A deferred credit of \$30,000 should be set up and amortized to income over a period not to exceed forty years.
19. A business combination occurs when a company acquires an equity interest in another entity and has:
- a. 100% ownership in the entity.
- b. more than 50% ownership in the entity.
- c. at least 20% ownership in the entity.
- d. control over the entity, regardless of the percentage owned.
20. P Co. issued 5,000 shares of its common stock, valued at \$200,000, to the former shareholders of S Company two years after S Company was acquired in an all-stock transaction. The additional shares were issued because P Company guaranteed the minimum value of the shares that were issued to S Company on the date of acquisition. P Company will treat the additional shares as a(n)
- a. decrease in consolidated retained earnings.
- b. increase in consolidated goodwill.
- c. decrease in consolidated other contributed capital.
- d. decrease in non-current liabilities of S Company assumed by P Company
21. In a business combination in which the total fair value of the identifiable assets acquired over liabilities assumed is greater than the cost, the excess fair value is:
- a. classified as an extraordinary gain.
- b. allocated first to reduce proportionately non-current assets, except long-term marketable securities, and any remaining excess over cost is classified as an extraordinary gain.
- c. allocated first to reduce proportionately non-current assets then to non-monetary current assets, and any remaining excess over cost is classified as a deferred credit.
- d. allocated first to reduce proportionately non-current, depreciable assets to zero, and any remaining excess over cost is classified as a deferred credit.
22. The first step in determining goodwill impairment involves comparing the
- a. implied value of a reporting unit to its carrying amount (goodwill excluded).
- b. fair value of a reporting unit to its carrying amount (goodwill excluded).
- c. implied value of a reporting unit to its carrying amount (goodwill included).
- d. fair value of a reporting unit to its carrying amount (goodwill included).

23. If an impairment loss is recorded on previously recognized goodwill due to the transitional goodwill impairment test, the loss should be treated as a(n):
- loss from a change in accounting principles.
 - extraordinary loss
 - loss from continuing operations.
 - loss from discontinuing operations.
24. P Company acquires all of the voting stock of S Company for \$700,000 cash. The book values of S Company's assets are \$600,000, but the fair values are \$630,000 because land has a fair value above its book value. Goodwill from the combination is computed as:
- \$100,000.
 - \$70,000.
 - \$30,000.
 - \$0.
25. P Company paid \$1,000,000 for the net assets of S Company and S Company was dissolved. The fair values of S Company's net assets were \$1,250,000. S Company's only non-current assets were land and building with fair values of \$80,000 and \$320,000 respectively. At what value will the building be recorded by P Company?
- \$320,000.
 - \$200,000.
 - \$120,000.
 - \$0.

From the Jeter 2e Study Guide:

26. What is a bargain purchase?
- When P's cost is far above the fair value of S's net assets acquired
 - When P cannot determine a fair value of its stock issued in the acquisition
 - When P purchases S for less than the fair market value of the net assets acquired
 - When P increases the value of the long-lived assets to reflect its excess cost
27. What is the current technique for the disposition of goodwill acquired in a business combination?
- Amortized over some period not to exceed 40 years
 - Amortized over some period not to exceed 20 years
 - Expensed in the year of combination
 - Capitalized at original value unless impairment occurs

Problems

- 2-1 Balance sheet information for Steve Corporation at January 1, 2004, is summarized as follows:

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

Steve's assets and liabilities are fairly valued except for plant assets that are undervalued by \$50,000. On January 2, 2004, Paul Corporation issues 20,000 shares of its \$10 par value common

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stock for all of Steve's net assets and Steve is dissolved. Market quotations for the two stocks on this date are:

Paul common: \$28.00

Steve common: \$19.50

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

Finder's fee	\$10,000
Costs of registering and issuing stock	5,000
Legal and accounting fees	6,000

Required:

A. Calculate Paul's investment cost of Steve Corporation.

B. Calculate any goodwill from the business combination.

- 2-2 Peterson Corporation purchased the net assets of Sanderson Corporation on January 2, 2004 for \$280,000 and also paid \$10,000 in direct acquisition costs. Sanderson's balance sheet on January 1, 2004 was as follows:

Accounts receivable-net	\$ 90,000	Current liabilities	\$ 35,000
Inventory	180,000	Long term debt	80,000
Land	20,000	Common stock (\$1 par)	10,000
Building-net	30,000	Paid-in capital	215,000
Equipment-net	<u>40,000</u>	Retained earnings	<u>20,000</u>
Total assets	<u>\$ 360,000</u>	Total liab. & equity	<u>\$ 360,000</u>

Fair values agree with book values except for inventory, land, and equipment, that have fair values of \$200,000, \$25,000 and \$35,000, respectively. Sanderson has patent rights valued at \$10,000.

Required:

A. Prepare Peterson's general journal entry for the cash purchase of Sanderson's net assets.

B. Assume Peterson Corporation purchased the net assets of Sanderson Corporation for \$160,000 rather than \$280,000, prepare the general journal entry.

- 2-3 Pate Company acquired the assets (except cash) and assumed the liabilities of Sand Company on January 1, 2004, paying \$1,200,000 cash. Immediately prior to the acquisition, Sand Company's balance sheet was as follows:

	<u>BOOK VALUE</u>	<u>FAIR VALUE</u>
Accounts receivable (net)	\$ 120,000	\$ 110,000
Inventory	145,000	160,000
Land	480,000	754,000
Buildings (net)	<u>510,000</u>	<u>696,000</u>
Total	<u>\$1,255,000</u>	<u>\$1,720,000</u>
Accounts payable	\$ 135,000	\$ 135,000
Note payable	300,000	300,000
Common stock, \$5 par	210,000	

Other contributed capital	320,000
Retained earnings	<u>290,000</u>
Total	<u>\$1,255,000</u>

Pate Company agreed to pay Sand Company's former stockholders \$100,000 cash if post-combination earnings of the combined company reached \$500,000 during 2004.

Required:

- A. Prepare the journal entry necessary for Pate Company to record the acquisition on January 1, 2004.
- B. Prepare the journal entry necessary for Pate Company to settle the earnings contingency, assuming the contingent payment was \$70,000 instead of \$100,000.

- 2-4 Condensed balance sheets for Poole Company and Simon Company on January 1, 2004 are as follows:

	Poole	Simon
Current Assets	\$ 290,000	\$135,000
Plant and Equipment (net)	<u>720,000</u>	<u>225,000</u>
Total Assets	<u>\$1,010,000</u>	<u>\$360,000</u>
 Total Liabilities	 \$ 150,000	 \$ 55,000
Common Stock, \$10 par value	560,000	160,000
Other Contributed Capital	200,000	85,000
Retained Earnings	<u>100,000</u>	<u>60,000</u>
Total Equities	<u>\$1,010,000</u>	<u>\$360,000</u>

On January 1, 2004 the stockholders of Poole and Simon agreed to a consolidation whereby a new corporation, Lawson Company, would be formed to consolidate Poole and Simon. Lawson Company issued 50,000 shares of its \$20 par value common stock for the net assets of Poole and Simon. On the date of consolidation, the fair values of Poole's and Simon's current assets and liabilities were equal to their book values. The fair value of plant and equipment for each company was: Poole, \$850,000; Simon, \$240,000.

An investment banking house estimated that the fair value of Lawson Company's common stock was \$35 per share. Poole will incur \$30,000 of direct acquisition costs and \$10,000 in stock issue costs.

Required:

Prepare the journal entries to record the consolidation on the books of Lawson Company assuming that:

- A. The consolidation is accounted for as a purchase.
- B. The consolidation is accounted for as a pooling of interests.

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2-5 The stockholders' equities of P Corporation and S Corporation were as follows on January 1, 2004:

	<u>P Corp.</u>	<u>S Corp.</u>
Common Stock, \$1 par	\$2,000,000	\$ 600,000
Other Contributed Capital	5,500,000	1,100,000
Retained Earnings	<u>1,300,000</u>	<u>340,000</u>
Total Stockholders' equity	\$8,800,000	\$2,040,000

On January 2, 2004 P Corp. issued 200,000 of its shares with a market value of \$14 per share in exchange for all of S's shares, and S Corp. was dissolved. P Corp. paid \$20,000 to register and issue the new common shares.

Required:

- A. Prepare the stockholders' equity section of P Corp. balance after the business combination on January 2, 2004.

2-6 The managers of Petty Company own 5,000 of its 50,000 outstanding common shares. Swann Company is formed by the managers of Petty Company to take over Petty Company in a leveraged buyout. The managers contribute their shares in Petty Company and Swann Company then borrows \$225,000 to purchase the remaining 45,000 shares of Petty Company for \$200,000; the remaining \$25,000 is used for working capital. Petty Company is then merged into Swann Company effective January 1, 2004. Data relevant to Petty Company immediately prior to the leveraged buyout follow:

	<u>Book Value</u>	<u>Fair Value</u>
Current Assets	\$ 30,000	\$ 30,000
Plant Assets	85,000	175,000
Liabilities	<u>(15,000)</u>	<u>(15,000)</u>
Stockholders' Equity	<u>\$100,000</u>	<u>\$190,000</u>

Required:

- A. Prepare journal entries on Swann Company's books to reflect the effects of the leveraged buyout.
- B. Determine the balance of each of the following immediately after the merger:
1. Current Assets
 2. Plant Assets
 3. Note Payable
 4. Common Stock

ANSWER KEY*Multiple Choice*

- | | | |
|------|-------|-------|
| 1. b | 10. b | 19. d |
| 2. a | 11. c | 20. c |
| 3. d | 12. c | 21. b |
| 4. d | 13. d | 22. c |
| 5. b | 14. a | 23. a |
| 6. b | 15. d | 24. b |
| 7. c | 16. c | 25. c |
| 8. b | 17. d | 26. c |
| 9. d | 18. a | 27. d |

Problems

2-1	A. FMV of shares issued by Paul (20,000sh x \$28.00) =	\$560,000
	Finder's fees	10,000
	Legal and accounting fees	<u>6,000</u>
	Total investment cost	<u>\$576,000</u>

B. Investment cost from Part A	\$576,000
Less: Fair value of Steve's net assets (\$680,000 + \$50,000 - \$300,000)	<u>430,000</u>
Goodwill from investment	<u>\$146,000</u>

2-2	A. Accounts Receivable	90,000	
	Inventory	200,000	
	Land	25,000	
	Building	30,000	
	Equipment	35,000	
	Patent	10,000	
	Goodwill	15,000	
	Current Liabilities		35,000
	Long-term Debt		80,000
	Cash		290,000

B. Accounts Receivable	90,000	
Inventory	200,000	
Current Liabilities		35,000
Long-term Debt		80,000
Cash		170,000
Extraordinary Gain		5,000

2-3	A. Accounts Receivable	120,000	
	Inventory	160,000	
	Land (\$754,000 - \$44,200)	709,800	
	Buildings (\$696,000 - \$40,800)	655,200	
	Allowance for Uncollectible Accounts		10,000

Accounts Payable	135,000
Note Payable	300,000
Cash	1,200,000

Cost of acquisition	\$1,200,000
Fair value of net assets acquired	
(\$1,720,000 - \$435,000)	<u>1,285,000</u>
Excess of fair value over cost	<u>\$ 85,000</u>

Allocation of excess of fair value over cost:

Land	$754,000/1,450,000 = 52\% \times \$85,000 =$	\$44,200
Buildings	$696,000/1,450,000 = 48\% \times 85,000 =$	<u>40,800</u>
		<u>\$85,000</u>

B. Land	(52% × \$70,000)	36,400	
Buildings	(48% × \$70,000)	33,600	
Cash			70,000

2-4	A. Current Assets (\$290 + \$135)	425,000	
	Plant and Equipment (\$850 + \$240)	1,090,000	
	Goodwill	440,000	
	Liabilities (\$150 + \$55)		205,000
	Common Stock		
	(50,000 shares @ \$20/share)		1,000,000
	Other Contributed Capital		
	(50,000 × (\$35-\$20))		750,000

Goodwill	30,000	
Cash		30,000
Other Contributed Capital	10,000	
Cash		10,000

B. Current Assets (\$290 + \$135)	425,000	
Plant and Equipment (\$720 + \$225)	945,000	
Liabilities (\$150 + \$55)		205,000
Common Stock		
(50,000 shares @ \$20/share)		1,000,000
Other Contributed Capital		
(\$200 + \$85 - \$280)		5,000
Retained Earnings (\$100 + \$60)		160,000
Miscellaneous Expense	40,000	
Cash		40,000

2-5	A. Stockholders' Equity:		
	Common Stock, \$1 par	\$2,200,000	
	Other Contributed Capital	8,080,000	[\$5,500,000 + (200,000 X \$13) - \$20,000]
	Retained Earnings	<u>1,300,000</u>	
	Total stockholders' Equity	<u>\$11,580,000</u>	

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2-6

Part A

Investment in Petty Company (\$100,000 X .10)	10,000	
Common Stock		10,000
Cash	225,000	
Note Payable		225,000
Investment in Petty Company	200,000	
Cash		200,000
Current Assets	30,000	
Plant Assets (1)	166,000	
Goodwill (2)	29,000	
Liabilities		15,000
Investment in Petty		210,000

(1) $\$85,000 + [.90 \times (\$175,000 - \$85,000)] = \$166,000$

(2) Cost of shares	\$200,000
Book value of net assets (.90 x \$100,000) =	<u>90,000</u>
Difference between cost and book value	\$110,000
Allocated to:	
Plant assets (.90 x (\$175,000 - \$85,000)) =	<u>81,000</u>
Goodwill	<u>29,000</u>

Part B

1. Current Assets (\$30,000 + \$25,000)	55,000
2. Plant Assets (\$85,000 + \$81,000)	166,000
3. Note Payable	225,000
4. Common Stock	10,000

2-7

A. Seville's net assets at fair value:

Cash	\$ 30,000
Receivables	14,000
Inventory	23,000
Plant & Equip	<u>95,000</u>
Total assets	\$162,000
Liabilities	<u>10,000</u>
Fair value of S's net assets	<u>\$152,000</u>

Proust's stock issued:

Seville's stock = \$75,000/\$10 par value = 7,500 shares

Proust issues $7,500/2 = 3,750$ new shares x \$50 market price = \$187,500

Goodwill:

Proust's cost	\$187,500
Fair value of S's assets	<u>152,000</u>
Goodwill	<u>\$ 35,500</u>

B.

To record Proust's purchase of Seville		
Cash	30,000	
Receivables	14,000	
Inventory	23,000	
Plant and equipment	95,000	
Goodwill	35,500	
Liabilities		10,000
Common stock [3,750 x \$10 par]		37,500
Other contributed capital [3,750 x \$40]		150,000