Chapter 2
Accounting for Business Combinations

Multiple Choice

1. SFAS 141R requires that all business combinations be accounted for using
   a. the pooling of interests method.
   b. the acquisition method.
   c. either the acquisition or the pooling of interests methods.
   d. neither the acquisition nor the pooling of interests methods.

2. Under the acquisition method, if the fair values of identifiable net assets exceed the value implied by the purchase price 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 any previously recorded goodwill on the seller's books and classify any remainder as an ordinary gain.

3. In a period in which an impairment loss occurs, SFAS No. 142 requires each of the following note disclosures **except**
   a. a description of the facts and circumstances leading to the impairment.
   b. the amount of goodwill by reporting segment.
   c. the method of determining the fair value of the reporting unit.
   d. the amounts of any adjustments made to impairment estimates from earlier periods, if significant.

4. Once a reporting unit is determined to have a fair value below its carrying value, the goodwill impairment loss is computed by comparing the
   a. fair value of the reporting unit and the fair value of the identifiable net assets.
   b. carrying value of the goodwill to its implied fair value.
   c. fair value of the reporting unit to its carrying amount (goodwill included).
   d. carrying value of the reporting unit to the fair value of the identifiable net assets.

5. SFAS 141R requires that the acquirer disclose each of the following for each material business combination **except** the
   a. name and a description of the acquiree acquired.
   b. percentage of voting equity instruments acquired.
   c. fair value of the consideration transferred.
   d. each of the above is a required disclosure

6. In a leveraged buyout, the portion of the net assets of the new corporation provided by the management group is recorded at
   a. appraisal value.
   b. book value.
   c. fair value.
   d. lower of cost or market.

7. When the acquisition price of an acquired firm is less than the fair value of the identifiable net assets, all of the following are recorded at fair value **except**
   a. Assumed liabilities.
   b. Current assets.
   c. Long-lived assets.
   d. Each of the above is recorded at fair value.

8. Under SFAS 141R,
   a. both direct and indirect costs are to be capitalized.
   b. both direct and indirect costs are to be expensed.
   c. direct costs are to be capitalized and indirect costs are to be expensed.
   d. indirect costs are to be capitalized and direct costs are to be expensed.

9. A business combination is accounted for properly as an acquisition. 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?

	Security issue costs	Overhead allocated to the merger
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

10. In a business combination, which of the following costs are assigned to the valuation of the security?

	Professional or consulting fees	Security issue costs
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

11. Parental Company and Sub Company were combined in an acquisition transaction. Parental 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 the cost to Parental. After eliminating previously recorded goodwill, there was still some "negative goodwill." Proper accounting treatment by Parental is to report the amount as
    a. paid-in capital.
    b. a deferred credit, which is amortized.
    c. an ordinary gain.
    d. an extraordinary gain.

12. With an acquisition, direct and indirect expenses are
    a. expensed in the period incurred.
    b. capitalized and amortized over a discretionary period.
    c. considered a part of the total cost of the acquired company.
    d. charged to retained earnings when incurred.

13. In a business combination accounted for as an acquisition, how should the excess of fair value of net assets acquired over the consideration paid be treated?
    a. Amortized as a credit to income over a period not to exceed forty years.
    b. Amortized as a charge to expense over a period not to exceed forty years.
    c. Amortized directly to retained earnings over a period not to exceed forty years.
    d. Recorded as an ordinary gain.

14. 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 an acquisition. 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 that the contingency is expected to be met, the $50,000 fair value of the additional shares to be issued should be treated as a(n)
    a. decrease in noncurrent liabilities of S Company that were assumed by P Company.
    b. decrease in consolidated retained earnings.
    c. increase in consolidated goodwill.
    d. decrease in consolidated other contributed capital.

15. On February 5, Pryor Corporation paid $1,600,000 for all the issued and outstanding common stock of Shaw, Inc., in a transaction properly accounted for as an acquisition. The book values and fair values of Shaw's assets and liabilities on February 5 were as follows

	Book Value	Fair Value
Cash	$ 160,000	$ 160,000
Receivables (net)	180,000	180,000
Inventory	315,000	300,000
Plant and equipment (net)	820,000	920,000
Liabilities	(350,000)	(350,000)
Net assets	$1,125,000	$1,210,000

What is the amount of goodwill resulting from the business combination?
    a. $-0-.
    b. $475,000.
    c. $85,000.
    d. $390,000.

16. P Company purchased the net assets of S Company for $225,000. On the date of P's purchase, S Company had no investments in marketable securities and $30,000 (book and fair value) of liabilities. The fair values of S Company's assets, when acquired, were

Current assets	$ 120,000
Noncurrent assets	180,000
Total	$300,000

How should the $45,000 difference between the fair value of the net assets acquired ($270,000) and the consideration paid ($225,000) be accounted for by P Company?
    a. The noncurrent assets should be recorded at $ 135,000.
    b. The $45,000 difference should be credited to retained earnings.
    c. The current assets should be recorded at $102,000, and the noncurrent assets should be recorded at $153,000.
    d. An ordinary gain of $45,000 should be recorded. I would edit as D become B

17. If the value implied by the purchase price of an acquired company exceeds the fair values of identifiable net assets, the excess should be
    a. allocated to reduce any previously recorded goodwill and classify any remainder as an ordinary gain.
    b. allocated to reduce current and long-lived assets.
    c. allocated to reduce long-lived assets.
    d. accounted for as goodwill.

18. 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 agreed to issue additional shares of common stock if the average post combination earnings over the next two years exceeded $500,000. P Company will treat the issuance of the additional shares as a (decrease in)
    a. consolidated retained earnings.
    b. consolidated goodwill.
    c. consolidated paid-in capital.
    d. non-current liabilities of S Company assumed by P Company.

19. The fair value of assets and liabilities of the acquired entity is to be reflected in the financial statements of the combined entity. When the acquisition takes place over a period of time rather than all at once, at what time is the fair value of the assets and liabilities of the acquired entity determined under SFAS 141R?
    a. the date the interest in the acquiree was acquired.
    b. the date the acquirer obtains control of the acquiree
    c. the date of acquisition of the largest portion of the interest in the acquiree.
    d. the date of the financial statements.

20. 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).

21. 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):
    a. loss from a change in accounting principles.
    b. extraordinary loss
    c. loss from continuing operations.
    d. loss from discontinuing operations.

22. P Company acquires all of the voting stock of S Company for $930,000 cash. The book values of S Company's assets are $800,000, but the fair values are $840,000 because land has a fair value above its book value. Goodwill from the combination is computed as:
    a. $130,000.
    b. $90,000.
    c. $40,000.
    d. $0.

23. Under SFAS 141R, what value of the assets and liabilities is reflected in the financial statements on the acquisition date of a business combination?
    a. Carrying value
    b. Fair value
    c. Book value
    d. Average value

Use the following information to answer questions 24 & 25.

North Company issued 24,000 shares of its $20 par value common stock for the net assets of Prairie Company in business combination under which Prairie Company will be merged into North Company. On the date of the combination, North Company common stock had a fair value of $30 per share. Balance sheets for North Company and Prairie Company immediately prior to the combination were as follows:

	North	Prairie
Current Assets	$1,314,000	$192,000
Plant and Equipment (net)	1,725,000	408,000
Total	$3,039,000	$600,000
Liabilities	$ 900,000	$150,000
Common Stock, $20 par value	1,650,000	240,000
Other Contributed Capital	218,000	60,000
Retained Earnings	271,000	150,000
Total	$3,039,000	$600,000

24. If the business combination is treated as an acquisition and Prairie Company's net assets have a fair value of $686,400, North Company's balance sheet immediately after the combination will include goodwill of
    a. $30,600.
    b. $38,400.
    c. $33,600.
    d. $56,400.

25. If the business combination is treated as an acquisition and the fair value of Prairie Company's current assets is $270,000, its plant and equipment is $726,000, and its liabilities are $168,000, North Company's financial statements immediately after the combination will include
    a. Negative goodwill of $108,000.
    b. Plant and equipment of $2,133,000.
    c. Plant and equipment of $2,343,000.
    d. An ordinary gain of $108,000.

26. On May 1, 2013, the Phil Company paid $1,200,000 for 80% of the outstanding common stock of Sage Corporation in a transaction properly accounted for as an acquisition. The recorded assets and liabilities of Sage Corporation on May 1, 2013, follow:

Cash	$100,000
Inventory	200,000
Property & equipment (Net of accumulated depreciation)	800,000
Liabilities	(160,000)

On May 1, 2013, it was determined that the inventory of Sage had a fair value of $220,000 and the property and equipment (net) has a fair value of $1,200,000. What is the amount of goodwill resulting from the business combination?
a. $0.
b. $112,000.
c. $140,000.
d. $28,000.

Use the following information to answer questions 27 & 28.

Posch Company issued 12,000 shares of its $20 par value common stock for the net assets of Sato Company in a business combination under which Sato Company will be merged into Posch Company. On the date of the combination, Posch Company common stock had a fair value of $30 per share. Balance sheets for Posch Company and Sato Company immediately prior to the combination were as follows:

	Posch	Sato
Current Assets	$ 657,000	$ 96,000
Plant and Equipment (net)	863,000	204,000
Total	$1,520,000	$300,000
Liabilities	$ 450,000	$ 75,000
Common Stock, $20 par value	825,000	120,000
Other Contributed Capital	109,000	30,000
Retained Earnings	136,000	75,000
Total	$1,520,000	$300,000

27. If the business combination is treated as an acquisition and Sato Company's net assets have a fair value of $343,200, Posch Company's balance sheet immediately after the combination will include goodwill of
a. $15,300.
b. $19,200.
c. $16,800.
d. $28,200.

28. If the business combination is treated as an acquisition and the fair value of Sato Company's current assets is $135,000, its plant and equipment is $363,000, and its liabilities are $84,000, Posch Company's financial statements immediately after the combination will include
a. Negative goodwill of $54,000.
b. Plant and equipment of $1,226,000.
c. Plant and equipment of $1,172,000.
d. An extraordinary gain of $54,000.

29. Following its acquisition of the net assets of Burnt Company, PrimroseCompany assigned goodwill of $60,000 to one of the reporting divisions. Information for this division follows:

	Carrying Amount	Fair Value
Cash	$ 20,000	$20,000
Inventory	35,000	40,000
Equipment	125,000	160,000
Goodwill	60,000	
Accounts Payable	30,000	30,000

Based on the preceding information, what amount of goodwill will be reported for this division if its fair value is determined to be $200,000?
a. $0
b. $60,000
c. $30,000
d. $10,000

30. The fair value of net identifiable assets exclusive of goodwill of a reporting unit of X Company is $300,000. On X Company's books, the carrying value of this reporting unit's net assets is $350,000, including $60,000 goodwill. If the fair value of the reporting unit is $335,000, what amount of goodwill impairment will be recognized for this unit?
a. $0
b. $10,000
c. $25,000
d. $35,000

31. The fair value of net identifiable assets of a reporting unit exclusive of goodwill of Y Company is $270,000. The carrying value of the reporting unit's net assets on Y Company's books is $320,000, including $50,000 goodwill. If the reported goodwill impairment for the unit is $10,000, what would be the fair value of the reporting unit?
a. $320,000
b. $310,000
c. $270,000
d. $290,000

32. Porpoise Corporation acquired Sims Company through an exchange of common shares. All of Sims' assets and liabilities were immediately transferred to Porpoise. Porpoise Company's common stock was trading at $20 per share at the time of exchange. The following selected information is also available:

	Porpoise Company	
	Before Acquisition	*After Acquisition*
Par value of shares outstanding	*$200,000*	*$250,000*
Additional Paid in Capital	*350,000*	*550,000*

What number of shares was issued at the time of the exchange?
a. 5,000
b. 17,500
c. 12,500
d. 10,000

Problems

2-1 Balance sheet information for Hope Corporation at January 1, 2013, is summarized as follows:

Current assets	$ 920,000	Liabilities	$ 1,200,000
Plant assets	1,800,000	Capital stock $10 par	800,000
		Retained earnings	720,000
	$2,720,000		$ 2,720,000

Hope's assets and liabilities are fairly valued except for plant assets that are undervalued by $200,000. On January 2, 2013, Robin Corporation issues 80,000 shares of its $10 par value common stock for all of Hope's net assets and Hope is dissolved. Market quotations for the two stocks on this date are:

Robin common:	$28
Hope common:	$19

Robin 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 Robin's investment cost of Hope Corporation.

B. Calculate any goodwill from the business combination.

2-2 Maplewood Corporation purchased the net assets of West Corporation on January 2, 2013 for $560,000 and also paid $20,000 in direct acquisition costs. West's balance sheet on January 1, 2013 was as follows:

Accounts receivable-net	$ 180,000	Current liabilities	$ 70,000
Inventory	360,000	Long term debt	160,000
Land	40,000	Common stock ($1 par)	20,000
Building-net	60,000	Paid-in capital	430,000
Equipment-net	80,000	Retained earnings	40,000
Total assets	$ 720,000	Total liab. & equity	$ 720,000

Fair values agree with book values except for inventory, land, and equipment, which have fair values of $400,000, $50,000 and $70,000, respectively. West has patent rights valued at $20,000.

Required:

A. Prepare Maplewood's general journal entry for the cash purchase of West's net assets.

B. Assume Maplewood Corporation purchased the net assets of West Corporation for $500,000 rather than $560,000, prepare the general journal entry.

2-3 Edina Company acquired the assets (except cash) and assumed the liabilities of Burns Company on January 1, 2013, paying $2,600,000 cash. Immediately prior to the acquisition, Burns Company's balance sheet was as follows:

	BOOK VALUE	FAIR VALUE
Accounts receivable (net)	$ 240,000	$ 220,000
Inventory	290,000	320,000
Land	960,000	1,508,000
Buildings (net)	1,020,000	1,392,000
Total	$2,510,000	$3,440,000
Accounts payable	$ 270,000	$ 270,000
Note payable	600,000	600,000
Common stock, $5 par	420,000	
Other contributed capital	640,000	
Retained earnings	580,000	
Total	$2,510,000	

Edina Company agreed to pay Burns Company's former stockholders $200,000 cash in 2014 if post-combination earnings of the combined company reached $1,000,000 during 2013.

Required:

A. Prepare the journal entry necessary for Edina Company to record the acquisition on January 1, 2013. It is expected that the earnings target is likely to be met.

B. Prepare the journal entry necessary for Edina Company in 2014 assuming the earnings contingency was not met.

2-4 Condensed balance sheets for Rich Company and Jordan Company on January 1, 2013 are as follows:

	Rich	Jordan
Current Assets	$ 440,000	$200,000
Plant and Equipment (net)	1,080,000	340,000
Total Assets	$1,520,000	$540,000
Total Liabilities	$ 230,000	$ 80,000
Common Stock, $10 par value	840,000	240,000
Other Contributed Capital	300,000	130,000
Retained Earnings	150,000	90,000
Total Equities	$1,520,000	$540,000

On January 1, 2013 the stockholders of Rich and Jordan agreed to a consolidation whereby a new corporation, Cannon Company, would be formed to consolidate Rich and Jordan. Cannon Company issued 70,000 shares of its $20 par value common stock for the net assets of Rich and Jordan. On the date of consolidation, the fair values of Rich's and Jordan's current assets and liabilities were equal to their book values. The fair value of plant and equipment for each company was: Rich, $1,270,000; Jordan, $360,000.

An investment banking house estimated that the fair value of Cannon Company's common stock was $35 per share. Rich will incur $45,000 of direct acquisition costs and $15,000 in stock issue costs.

Required:
Prepare the journal entries to record the consolidation on the books of Cannon Company assuming that the consolidation is accounted for as an acquisition.

2-5 The stockholders' equities of Penn Corporation and Simon Corporation were as follows on January 1, 2013:

	Penn Corp.	Simon Corp.
Common Stock, $1 par	$1,000,000	$ 600,000
Other Contributed Capital	2,800,000	1,100,000
Retained Earnings	600,000	340,000
Total Stockholders' Equity	$4,400,000	$2,040,000

On January 2, 2013 Penn Corp. issued 100,000 of its shares with a market value of $14 per share in exchange for all of Simon's shares, and Simon Corp. was dissolved. Penn Corp. paid $10,000 to register and issue the new common shares.

Required:
Prepare the stockholders' equity section of Penn Corp. balance sheet after the business combination on January 2, 2013.

2-6 The managers of Savage Company own 10,000 of its 100,000 outstanding common shares. Swann Company is formed by the managers of Savage Company to take over Savage Company in a leveraged buyout. The managers contribute their shares in Savage Company and Swann Company then borrows $675,000 to purchase the remaining 90,000 shares of Savage Company for $600,000; the remaining $75,000 is used for working capital. Savage Company is then merged into Swann Company effective January 1, 2013. Data relevant to Savage Company immediately prior to the leveraged buyout follow:

	Book Value	Fair Value
Current Assets	$ 90,000	$ 90,000
Plant Assets	255,000	525,000
Liabilities	(45,000)	(45,000)
Stockholders' Equity	$300,000	$570,000

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

2-7 On January 1, 2010, Brighton Company acquired the net assets of Dakota Company for $1,580,000 cash. The fair value of Dakota's identifiable net assets was $1,310,000 on his date. Brighton Company decided to measure goodwill impairment using the present value of future cash flows to estimate the fair value of the reporting unit (Dakota). The information for these subsequent years is as follows:

Year	*Present value of Future Cash Flows*	*Carrying value of Dakota's Identifiable Net Assets**	*Fair Value Dakota's Identifiable Net Assets*
2013	$1,400,000	$1,160,000	$1,190,000
2014	$1,400,000	$1,120,000	$1,210,000

* Identifiable net assets do not include goodwill.

Required:

A: For each year determine the amount of goodwill impairment, if any.

B: Prepare the journal entries needed each year to record the goodwill impairment (if any) on Brighton's books.

2-8 The following balance sheets were reported on January 1, 2013, for Wood Company and Rose Company:

	Wood	Rose
Cash	$ 150,000	$ 30,000
Inventory	450,000	150,000
Equipment (net)	1,320,000	570,000
Total	$1,920,000	$750,000
Total liabilities	$ 450,000	$150,000
Common stock, $20 par value	600,000	300,000
Other contributed capital	375,000	105,000
Retained earnings	495,000	195,000
Total	$1,920,000	$750,000

Required:

Appraisals reveal that the inventory has a fair value $180,000, and the equipment has a current value of $615,000. The book value and fair value of liabilities are the same. Assuming that Wood Company wishes to acquire Rose for cash in an asset acquisition, determine the following cutoff amounts:

A. The purchase price above which Wood would record goodwill.
B. The purchase price at which Wood would record a $50,000 gain.
C. The purchase price below which Wood would obtain a "bargain."
D. The purchase price at which Wood would record $75,000 of goodwill.

Short Answer

1. SFAS No. 142 requires that goodwill impairment be tested annually for each reporting unit. Discuss the necessary steps of the goodwill impairment test.

2. Briefly describe the different treatment under SFAS 141 vs. SFAS 141R for the following issues:
   - Business definition
   - Acquisition costs
   - In-process R&D
   - Contingent consideration

Short Answer Questions from the Textbook

1. When contingent consideration in an acquisition is based on security prices, how should this contingency be reflected on the acquisition date? If the estimate changes during the measurement period, how is this handled? If the estimate changes after the end of the measurement period, how is this adjustment handled? Why?

2. What are pro forma financial statements? What is their purpose?

3. How would a company determine whether goodwill has been impaired?

4. AOL announced that because of an accounting change (FASB Statements Nos. 141R [ASC 805] and142 [ASC 350]), earnings would be increasing over the next 25 years by $5.9 billion a year. What change(s) required by FASB (in SFAS Nos. 141Rand 142) resulted in an increase in AOL's in-comeincome? Would you expect this increase in earnings to have a positive impact on AOL's stock price? Why or why not?

Business Ethics Question from Textbook
There have been several recent cases of a CEO or CFO resigning or being ousted for misrepresenting academic credentials. For instance, during February 2006,the CEO of RadioShack resigned by 'mutual agreement' for inflating his educational background. During 2002, Veritas Software Corporation's CFO resigned after claiming to have an MBA from Stanford University. On the other hand, Bausch & Lomb Inc.'s board refused the CEO's offer to resign following a questionable claim to have an MBA.
Suppose you have been retained by the board of a company where the CEO has 'overstated' credentials. This company has a code of ethics and conduct which states that the employee should always do "the right thing."(a) What is the board of directors' responsibility in such matters?(b) What arguments would you make to ask the CEO to resign? What damage might be caused if the decision is made to retain the current CEO?

ANSWER KEY

Multiple Choice

1. b	10. c	19. b	28. b
2. d	11. c	20. d	29. d
3. b	12. a	21. a	30. c
4. b	13. d	22. b	31. b
5. d	14. c	23. b	32. c
6. b	15. d	24. c	
7. d	16. dsee note on p3	25. d	
8. b	17. d	26. c	
9. c	18. c	27. c	

Problems

2-1	A.	FMV of shares issued by Robin (80,000 sh × $28) =		$2,240,000
	B.	Investment cost from Part A		$2,240,000
		Less: Fair value of Hope's net assets ($2,720,000+$200,000–$1,200,000)		1,720,000
		Goodwill from investment		$ 520,000
2-2	A.	Accounts Receivable	180,000	
		Inventory	400,000	
		Land	50,000	
		Building	60,000	
		Equipment	70,000	
		Patent	20,000	
		Goodwill	10,000	
		Acquisition Expense	20,000	
		Current Liabilities		70,000
		Long-term Debt		160,000
		Cash		580,000
	B.	Acquisition Expense	20,000	
		Accounts Receivable	180,000	
		Inventory	400,000	
		Land	50,000	
		Building	60,000	
		Equipment	70,000	
		Patent	20,000	
		Current Liabilities		70,000
		Long-term Debt		160,000
		Cash		520,000
		Gain on Acquisition		50,000

2-3 A.

Accounts Receivable	240,000	
Inventory	320,000	
Land	1,508,000	
Buildings	1,392,000	
Goodwill	30,000	
Allowance for Uncollectible Accounts		20,000
Accounts Payable		270,000
Note Payable		600,000
Cash		2,600,000
Goodwill	200,000	
Liability for Contingent Consideration		200,000

Cost of acquisition	$2,600,000
Fair value of net assets acquired ($3,440,000 – $870,000)	2,570,000
Goodwill	$ 30,000

B.

Liability for Contingent Consideration	200,000	
Income from Change in Estimate		200,000

2-4

Current Assets ($440,000 + $200,000)	640,000	
Plant and Equipment ($1,270,000 + $360,000)	1,630,000	
Goodwill	490,000	
Liabilities ($230,000 + $80,000)		310,000
Common Stock (70,000 shares @ $20/share)		1,400,000
Other Contributed Capital (70,000 × ($35 – $20))		1,050,000
Acquisition Expense	45,000	
Cash		45,000
Other Contributed Capital	15,000	
Cash		15,000

2-5

Stockholders' Equity:

Common Stock, $1 par	$1,100,000	
Other Contributed Capital	4,090,000	[$2,800,000 + (100,000 × $13) – $10,000]
Retained Earnings	600,000	
Total stockholders' Equity	$ 5,790,000	

2-6 A

Investment in Savage Company ($300,000 × .10)	30,000	
Common Stock		30,000
Cash	675,000	
Note Payable		675,000
Investment in Savage Company	600,000	
Cash		600,000
Current Assets	90,000	
Plant Assets (1)	498,000	
Goodwill (2)	87,000	
Liabilities		45,000
Investment in Savage		630,000

(1) $255,000 + [.90 × ($525,000 – $255,000)] = $498,000

(2) Cost of shares	$600,000
Book value of net assets (.90 × $300,000) =	270,000
Difference between cost and book value	$330,000
Allocated to:	
Plant assets (.90 × ($525,000 – $255,000)) =	243,000
Goodwill	87,000

B

1. Current Assets ($90,000 + $75,000)	165,000
2. Plant Assets ($255,000 + $243,000)	498,000
3. Note Payable	675,000
4. Common Stock	30,000

2-7 A.

2013:	**Step 1:** Fair value of the reporting unit		$1,400,000
	Carrying value of unit:		
	Carrying value of identifiable net assets	$1,160,000	
	Carrying value of goodwill ($1,580,000 – $1,310,000)	270,000	
			1,430,000
	Excess of carrying value over fair value		$30,000

The excess of carrying value over fair value means that step 2 is required.

	Step 2: Fair value of the reporting unit	$1,400,000
	Fair value of identifiable net assets	1,190,000
	Implied value of goodwill	210,000
	Recorded value of goodwill ($1,580,000 – $1,310,000)	270,000
	Impairment loss	$60,000

2014:	**Step 1:** Fair value of the reporting unit		$1,400,000
	Carrying value of unit:		
	Carrying value of identifiable net assets	$1,120,000	
	Carrying value of goodwill ($270,000 – $40,000)	230,000	
			1,350,000

	Excess of Fair value over Carrying value		$ 50,000

The excess of fair value over carrying value means that step 2 is **not** required.

B.

2013:	Impairment Loss—Goodwill	60,000	
	Goodwill		60,000
2014:	No entry		

2-8 a. Fair Value of Identifiable Net Assets

Book values $750,000 – $150,000 =	$600,000
Write up of Inventory and Equipment:	
($30,000 + $45,000) =	75,000
Purchase price above which goodwill would result	$675,000

b. Any existing goodwill would be eliminated before recording a gain:
$675,000 Fair Value of Identifiable Net Assets – $50,000 Gain = $625,000.

c. Anything below $675,000 is technicially considered a bargain.

d. Goodwill would be $75,000 at a purchase price of $750,000 or ($675,000 + $75,000).

Short Answer

1. In the first step of the goodwill impairment test, the fair value of the reporting unit is compared to its carrying amount. If the fair value is less than the carrying amount, then the carrying value of the goodwill is compared to its implied fair value. A loss is recognized when the carrying value of goodwill is higher than its fair value.

2.

Issue	SFAS No. 141	SFAS No. 141R
Business definition	A business is defined as a self-sustaining integrated set of activities and assets conducted and managed for the purpose of providing a return to investors. The definition would exclude early-stage development entities.	A business or a group of assets no longer must be self-sustaining. The business or group of assets must be capable of generating a revenue stream. This definition would include early-stage development entities.
Acquisition costs	Capitalize the costs.	Expense as incurred.
In-process R&D	Included as part of purchase price, but then immediately expensed.	Included as part of purchase price, treated as an asset.
Contingent consideration	Record when determinable and reflect subsequent changes in the purchase price.	Record at fair value on the acquisition date with subsequent changes recorded on the income statement.

Short Answer Questions from the Textbook Solutions

1. At the acquisition date, the information available (and through the end of the measurement period) is used to estimate the expected total consideration at fair value. If the subsequent stock issue valuation differs from this assessment, the *Exposure Draft (SFAS 1204-001)* expected to replace *FASB Statement No. 141R* specifies that equity should not be adjusted. The reason is that the valuation was determined at the date of the exchange, and thus the impact on the firm's equity was measured at that point based on the best information available then.

2. Pro forma financial statements (sometimes referred to as "as if" statements) are financial statements that are prepared to show the effect of planned or contemplated transactions.

3. For purposes of the goodwill impairment test, all goodwill must be assigned to a reporting unit. Goodwill impairment for each reporting unit should be tested in a two-step process. In the first step, the fair value of a reporting unit is compared to its carrying amount (goodwill included) at the date of the periodic review. The fair value of the unit may be based on quoted market prices, prices of comparable businesses, or a present value or other valuation technique. If the fair value at the review date is less than the carrying amount, then the second step is necessary. In the second step, the carrying value of the goodwill is compared to its implied fair value. (The calculation of the implied fair value of goodwill used in the impairment test is similar to the method illustrated throughout this chapter for valuing the goodwill at the date of the combination.)

4. The expected increase was due to the elimination of goodwill amortization expense. However, the impairment loss under the new rules was potentially larger than a periodic amortization charge, and this is in fact what materialized within the first year after adoption (a large impairment loss). If there was any initial stock price impact from elimination of goodwill amortization, it was only a short-term or momentum effect. Another issue is how the stock market responds to the goodwill impairment charge. Some users claim that this charge is a non-cash charge and should be disregarded by the market. However, others argue that the charge is an admission that the price paid was too high, and might result in a stock price decline (unless the market had already adjusted for this overpayment prior to the actual write down).

ANSWERS TO BUSINESS ETHICS CASE

a and b. The board has responsibility to investigate anything that might suggest malfeasance or inappropriate conduct. Such incidents suggest broader problems with integrity, honesty, and judgment. In other words, can you trust any reports from the CEO that lied on his resume? If the CEO is not fired, what kind of message does this send to other employees? Employees will feel that top executives are not subject to the same standards of ethical conduct as they are.