CHAPTER 1

INTERCORPORATE ACQUISITIONS AND INVESTMENTS IN OTHER ENTITIES

ANSWERS TO QUESTIONS

Q1-1 Complex organizational structures often result when companies do business in a complex business environment. New subsidiaries or other entities may be formed for purposes such as extending operations into foreign countries, seeking to protect existing assets from risks associated with entry into new product lines, separating activities that fall under regulatory controls, and reducing taxes by separating certain types of operations.

Q1-2 The split-off and spin-off result in the same reduction of reported assets and liabilities. Only the stockholders' equity accounts of the company are different. The number of shares outstanding remains unchanged in the case of a spin-off and retained earnings or paid-in capital is reduced. Shares of the parent are exchanged for shares of the subsidiary in a split-off, thereby reducing the outstanding shares of the parent company.

Q1-3 The management of Enron appears to have used special-purpose entities to avoid reporting debt on its balance sheet and to create fictional transactions that resulted in reported income. It also transferred bad loans and investments to special-purpose entities to avoid recognizing losses in its income statement.

Q1-4 (a) A **statutory merger** occurs when one company acquires another company and the assets and liabilities of the acquired company are transferred to the acquiring company; the acquired company is liquidated, and only the acquiring company remains.

(b) A **statutory consolidation** occurs when a new company is formed to acquire the assets and liabilities of two combining companies; the combining companies dissolve, and the new company is the only surviving entity.

(c) A **stock acquisition** occurs when one company acquires a majority of the common stock of another company and the acquired company is not liquidated; both companies remain as separate but related corporations.

Q1-5 Assets and liabilities transferred to a new wholly-owned subsidiary normally are transferred at book value. In the event the value of an asset transferred to a newly created entity has been impaired prior to the transfer and its fair value is less than the carrying value on the transferring company's books, the transferring company should recognize an impairment loss and the asset should then be transferred to the entity at the lower value.

Q1-6 The introduction of the concept of beneficial interest expands those situations in which consolidation is required. Existing accounting standards have focused on the presence or absence of equity ownership. Consolidation and equity method reporting have been required when a company holds the required level of common stock of another entity. The beneficial interest approach says that even when a company does not hold stock of another company, consolidation should occur whenever it has a direct or indirect ability to make decisions significantly affecting the results of activities of an entity or will absorb a majority of an entity's expected losses or receive a majority of the entity's expected residual returns.

Q1-7 A noncontrolling interest exists when the acquiring company gains control but does not own all the shares of the acquired company. The non-controlling interest is the shares not owned by the acquiring company.

Q1-8 Under pooling-of-interests accounting the book values of the combining companies were carried forward and no goodwill was recognized. Future earnings were not reduced by additional amortization, depreciation, or write-offs.

Q1-9 Goodwill is the excess of the sum of the fair value given by the acquiring company and the acquisition-date fair value of any noncontrolling interest over the acquisition-date fair value of the net identifiable assets acquired in the business combination.

Q1-10 The level of ownership acquired does not impact the amount of goodwill reported under the acquisition method. Prior to the adoption of the acquisition method the amount reported was determined by the amount paid by the acquiring company to attain ownership of the acquiree.

Q1-11 When less-than-100-percent ownership is acquired, goodwill must be allocated between the acquirer and the noncontrolling interest. This is accomplished by assigning to the acquirer the difference between the acquisition-date fair value of its equity interest in the acquiree and its share of the acquisition-date fair value of the acquiree's net assets. The remaining amount of goodwill is assigned to the noncontrolling interest.
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Q1-12 The total difference at the acquisition date between the fair value of the consideration exchanged and the book value of the net identifiable assets acquired is referred to as the differential.

Q1-13 The purchase of a company is viewed in the same way as any other purchase of assets. The acquired company is owned by the acquiring company only for the portion of the year subsequent to the combination. Therefore, earnings are accrued only from the date of purchase forward.

Q1-14 None of the retained earnings of the subsidiary should be carried forward under the acquisition method. Thus, consolidated retained earnings is limited to the balance reported by the acquiring company.

Q1-15 Additional paid-in capital reported following a business combination is the amount previously reported on the acquiring company's books plus the excess of the fair value over the par or stated value of any shares issued by the acquiring company in completing the acquisition.

Q1-16 When the acquisition method is used, all costs incurred in bringing about the combination are expensed as incurred. None are capitalized. However, costs associated with the issuance of stock are charged to additional paid-in capital.

Q1-17 When the acquiring company issues shares of stock to complete a business combination, the excess of the fair value of the stock issued over its par value is recorded as additional paid-in capital. All costs incurred by the acquiring company in issuing the securities should be treated as a reduction in the additional paid-in capital. Items such as audit fees associated with the registration of securities, listing fees, and brokers' commissions should be treated as reductions of additional paid-in capital when stock is issued. An adjustment to bond premium or bond discount is needed when bonds are used to complete the purchase.

Q1-18 If the fair value of a reporting unit acquired in a business combination exceeds its carrying amount, the goodwill of that reporting unit is considered unimpaired. On the other hand, if the carrying amount of the reporting unit exceeds its fair value, impairment of goodwill is implied. An impairment must be recognized if the carrying amount of the goodwill assigned to the reporting unit is greater than the implied value of the carrying unit's goodwill. The implied value of the reporting unit's goodwill is determined as the excess of the fair value of the reporting unit over the fair value of its net assets excluding goodwill.

Q1-19 When the fair value of the consideration given in a business combination, along with the fair value of any equity interest in the acquiree already held and the fair value of any noncontrolling interest in the acquiree, is less than the fair value of the acquiree's net identifiable assets, a bargain purchase results.

Q1-20* The acquirer should record the clarification of the acquisition-date fair value of buildings as a reduction to buildings and addition to goodwill.
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Q1-21* The acquirer must revalue the equity position to its fair value at the acquisition date and recognize a gain. A total of $250,000 ($25 x 10,000 shares) would be recognized in this case.

Q1-22A The purchase method calls for recording the acquirer's investment in the acquired company at the amount of the total purchase price paid by the acquirer, including associated costs. The difference between this amount and the acquirer's proportionate share of the fair value of the net identifiable assets is reported as goodwill.

Q1-23A Under the pooling method, the book values of the assets, liabilities, and equity of the acquired company are carried forward without adjustment to fair value. No goodwill is recorded because the fair value of the Consideration given is not recognized. Consistent with the idea of the owners of the combining companies continuing as owners of the combined company, the retained earnings of both companies are carried forward.

SOLUTIONS TO CASES

C1-1 Reporting Alternatives and International Harmonization

a. In the past, U.S. companies were required to systematically amortize the amount of goodwill recorded, thereby reducing earnings, while companies in other countries were not required to do so. Thus, reported results subsequent to business combinations were often lower than for foreign acquirers that did not amortize goodwill. The FASB changed accounting for goodwill in 2001 to no longer require amortization. Instead, the FASB now requires goodwill to be tested periodically for impairment and written down if impaired. Also, international accounting standards and U.S. standards have become closer in recent years, and authoritative bodies are working to bring standards even closer.

b. U.S. companies must be concerned about accounting standards in other countries and about international standards (i.e., those issued by the International Accounting Standards Committee). Companies operate in a global economy today. Not only do they buy and sell products and services in other countries, but they may raise capital and have operations located in other countries. Such companies may have to meet foreign reporting requirements, and these requirements may differ from U.S. reporting standards. In recent years, the acceptance of international accounting standards has become widespread, and international standards are even gaining acceptance in the United States. Thus, many U.S. companies, and not just the largest, may find foreign and international reporting standards relevant if they are going to operate globally.

U.S. companies also sometimes acquire foreign companies, especially if they wish to move into a new geographic area or ensure a supply of raw materials. For the acquiring company to perform its due diligence with respect to a foreign acquisition, it must be familiar with international financial reporting standards.

C1-2 Assignment of Acquisition Costs

NOTE: This memo is written assuming that 20X7 means 2007 prior to the FASB's release of SFAS 141R. Accordingly, 20X9 is assumed to be 2009 *after* SFAS 141R came into effect. If students interpreted the years as generic years, they would assume that both acquisitions took place after the implementation of acquisition accounting required under SFAS 141R and the rules discussed in the last two paragraphs would apply to both acquisitions.

MEMO

To: Vice-President of Finance
Troy Company

From: ______ _____, CPA

Re: Recording Acquisition Costs of Business Combination

Troy Company incurred a variety of costs in acquiring the ownership of Kline Company and transferring the assets and liabilities of Kline to Troy Company. I was asked to review the relevant accounting literature and provide my recommendations as to what was the appropriate treatment of the costs incurred in the acquisition of Kline Company.

The accounting standards applicable to the 20X7 acquisition required that all direct costs of purchasing another company be treated as part of the total cost of the acquired company. The costs incurred in issuing common or preferred stock in a business combination were required to be treated as a reduction of the otherwise determinable fair value of the securities. [**FASB 141**, Par. 24]

A total of $720,000 was paid by Troy in completing its acquisition of Kline. The $200,000 finders' fee and $90,000 legal fees for transferring Kline's assets and liabilities to Troy should have been included in the purchase price of Kline. The $60,000 payment for stock registration and audit fees should have been recorded as a reduction of paid-in capital recorded when the Troy Company shares were issued to acquire the shares of Kline. The only cost potentially at issue is the $370,000 legal fees resulting from the litigation by the shareholders of Kline. If this cost is considered to be a direct cost of acquisition , it should have been included in the costs of acquiring Kline. If, on the other hand, it is considered an indirect or general expense, it should have been charged to expense in 20X7. [**FASB 141**, Par. 24]

While one might argue that the $370,000 was an indirect cost, it resulted directly from the exchange of shares used to complete the business combination and should have been included in the amount assigned to the cost of acquiring ownership of Kline. Of the total costs incurred, $660,000 should have been assigned to the purchase price of Kline and $60,000 recorded as a reduction of paid-in-capital.

You also requested information on how the costs of acquiring Lad Company should be treated under current accounting standards. Since the acquisition of Kline, the FASB has issued **FASB 141R (ASC 805)**, "Business Combinations," issued in December 2007. This standard can be found at the FASB website (www.fasb.org/pdf/fas141r.pdf).

Stock issue costs continue to be treated as previously. Acquired companies are to be valued under **FASB 141R (ASC 805)** at the fair value of the consideration given in the exchange, plus the fair value of any shares of the acquiree already held by the acquirer, plus the fair value of any noncontrolling interest in the acquiree at the date of combination [**FASB 141R**, Par. 34, ASC 805]. All other acquisition-related costs are accounted for expenses in the period incurred [**FASB 141R**, Par. 59, ASC 805].

Primary citation
FASB 141R; ASC 805

C1-3 Evaluation of Merger

Page numbers refer to the page in the 3M 2005 10-K report.

a. The CUNO acquisition improved 3M's product mix by adding a comprehensive line of filtration products for the separation, clarification and purification of fluids and gases (p. 4).

The CUNO acquisition added 5.1 percent to Industrial sales growth (p.13), and was the primary reason for a 1.0 percent increase in total sales in 2005 (p. 15).

b. The acquisition was funded primarily by debt (p.27): The Company generates significant ongoing cash flow. Net debt decreased significantly in 2004, but increased in 2005, primarily related to the $1.36 billion CUNO acquisition.

c. As of December 31, 2005, the CUNO acquisition increased accounts receivable by $88 million (p. 27).

d. At December 31, 2005, the CUNO acquisition increased inventories by $56 million. Currency translation reduced inventories by $89 million year-on-year (p. 27).

C1-4 Business Combinations

It is very difficult to develop a single explanation for any series of events. Merger activity in the United States is impacted by events both within the U.S. economy and those around the world. As a result, there are many potential answers to the questions posed in this case.

a. The most commonly discussed factors associated with the merger activity of the nineties relate to the increased profitability of businesses. In the past, increases in profitability typically have been associated with increases in sales. The increased profitability of companies in the past decade, however, more commonly has been associated with decreased costs. Even though sales remained relatively flat, profits increased. Nearly all business entities appear to have gone through one or more downsizing events during the past decade. Fewer employees now are delivering the same amount of product to customers. Lower inventory levels and reduced investment in production facilities now are needed due to changes in production processes and delivery schedules. Thus, less investment in facilities and fewer employees have resulted in greater profits.

Companies generally have been reluctant to distribute the increased profits to shareholders through dividends. The result has been a number of companies with substantially increased cash reserves. This, in turn, has led management to look about for other investment alternatives, and cash buyouts have become more frequent in this environment.

In addition to high levels of cash on hand providing an incentive for business combinations, easy financing through debt and equity also provided encouragement for acquisitions. Throughout the nineties, interest rates were very low and borrowing was generally easy. With the enormous stock-price gains of the mid-nineties, companies found that they had a very valuable resource in shares of their stock. Thus, stock acquisitions again came into favor.

b. One factor that may have prompted the greater use of stock in business combinations recently is that many of the earlier combinations that had been effected through the use of debt had unraveled. In many cases, the debt burden was so heavy that the combined companies could not meet debt payments. Thus, this approach to financing mergers had somewhat fallen from favor by the mid-nineties. Further, with the spectacular rise in the stock market after 1994, many companies found that their stock was worth much more than previously. Accordingly, fewer shares were needed to acquire other companies.

c. Two of major factors appear to have had a significant influence on the merger movement in the mid-2000s. First, interest rates were very low during that time, and a great amount of unemployed cash was available worldwide. Many business combinations were effected through significant borrowing. Second, private equity funds pooled money from various institutional investors and wealthy individuals and used much of it to acquire companies.

Many of the acquisitions of this time period involved private equity funds or companies that acquired other companies with the goal of making quick changes and selling the companies for a profit. This differed from prior merger periods where acquiring companies were often looking for long-term acquisitions that would result in synergies.

In late 2007, a mortgage crisis spilled over into the credit markets in general, and money for acquisitions became hard to get. This in turn caused many planned or possible mergers to be canceled. In addition, the economy in general faltered toward the end of 2007 and into 2008.

C1-4 (continued)

d. Establishing incentives for corporate mergers is a controversial issue. Many people in our society view mergers as not being in the best interests of society because they are seen as lessening competition and often result in many people losing their jobs. On the other hand, many mergers result in companies that are more efficient and can compete better in a global economy; this in turn may result in more jobs and lower prices. Even if corporate mergers are viewed favorably, however, the question arises as to whether the government, and ultimately the taxpayers, should be subsidizing those mergers through tax incentives. Many would argue that the desirability of individual corporate mergers, along with other types of investment opportunities, should be determined on the basis of the merits of the individual situations rather than through tax incentives.

Perhaps the most obvious incentive is to lower capital gains tax rates. Businesses may be more likely to invest in other companies if they can sell their ownership interests when it is convenient and pay lesser tax rates. Another alternative would include exempting certain types of intercorporate income. Favorable tax status might be given to investment in foreign companies through changes in tax treaties. As an alternative, barriers might be raised to discourage foreign investment in United States, thereby increasing the opportunities for domestic firms to acquire ownership of other companies.

e. In an ideal environment, the accounting and reporting for economic events would be accurate and timely and would not influence the economic decisions being reported. Any change in reporting requirements that would increase or decrease management's ability to "manage" earnings could impact management's willingness to enter new or risky business fields and affect the level of business combinations. Greater flexibility in determining which subsidiaries are to be consolidated, the way in which intercorporate income is calculated, the elimination of profits on intercompany transfers, or the process used in calculating earnings per share could impact such decisions. The processes used in translating foreign investment into United States dollars also may impact management's willingness to invest in domestic versus international alternatives.

C1-5 Determination of Goodwill Impairment

MEMO

TO: Chief Accountant
Plush Corporation

From: ______ _____, CPA

Re: Determining Impairment of Goodwill

Once goodwill is recorded in a business combination, it must be accounted for in accordance with **FASB Statement No. 142**. Goodwill is carried forward at the original amount without amortization, unless it becomes impaired. The amount determined to be goodwill in a business combination must be assigned to the reporting units of the acquiring entity that are expected to benefit from the synergies of the combination. [**FASB 142**, Par. 34; ASC 350-20-35-41]

This means the total amount assigned to goodwill may be divided among a number of reporting units. Goodwill assigned to each reporting unit must be tested for impairment annually and between the annual tests in the event circumstances arise that would lead to a possible decrease in the fair value of the reporting unit below its carrying amount [**FASB 142**, Par. 28; ASC 350-20-35-30].

As long as the fair value of the reporting unit is greater than its carrying value, goodwill is not considered to be impaired. If the fair value is less than the carrying value, a second test must be performed. An impairment loss must be reported if the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill. [**FASB 142**, Par. 20; ASC 350-20-35-11]

At the date of acquisition, Plush Corporation recognized goodwill of $20,000 ($450,000 - $430,000) and assigned it to a single reporting unit. Even though the fair value of the reporting unit increased to $485,000 at December 31, 20X5, Plush Corporation must test for impairment of goodwill if the carrying value of Plush's investment in the reporting unit is above that amount. That would be the case if the carrying value is $500,000. In the second test, the fair value of the reporting unit's net assets, excluding goodwill, is deducted from the fair value of the reporting unit ($485,000) to determine the amount of implied goodwill at that date. If the fair value of the net assets is less than $465,000, the amount of implied goodwill is more than $20,000 and no impairment of goodwill is assumed to have occurred. On the other hand, if the fair value of the net assets is greater than $465,000, the amount of implied goodwill is less than $20,000 and an impairment of goodwill must be recorded.

With the information provided, we do not know if there has been an impairment of the goodwill involved in the purchase of Common Corporation; however, Plush must follow the procedures outlined above in testing for impairment at December 31, 20X5.

Primary citations
FASB 142, Par. 20; ASC 350-20-35-11
FASB 142, Par. 28; ASC 350-20-35-30
FASB 142, Par. 34; ASC 350-20-35-41

C1-6 Risks Associated with Acquisitions

Google discloses on page 21 of its 2006 Form 10-K that it does not have significant experience acquiring companies. It also notes that most acquisitions the company has already completed have been small companies. The specific risk areas identified include:

- The potential need to implement controls, procedures, and policies appropriate for a public company that were not already in place in the acquired company
- Potential difficulties in integrating the accounting, management information, human resources, and other administrative systems.
- The use of management time on acquisitions-related activities that may temporarily divert attention from operating activities
- Potential difficulty in integrating the employees of an acquired company into the Google organization
- Retaining employees who worked for companies that Google acquires
- Anticipated benefits of acquisitions may not materialize.
- Foreign acquisitions may include additional unique risks including potential difficulties arising from differences in cultures and languages, currencies, and from economic, political, and regulatory risks.

C1-7 Numbers Game

a. A company is motivated to keep its stock price high. However, stock price is very sensitive to information about company performance. When the company reports lower earnings than the market anticipated, the stock price often falls significantly. A desire to increase reported earnings to meet the expectations of Wall Street may provide a company with incentives to manipulate earnings to achieve this goal.

b. Levitt discusses 5 specific techniques: (1) "big bath" restructuring charges, (2) creative acquisition accounting, (3) "cookie jar reserves," (4) improper application of the materiality principal, and (5) improper recognition of revenue. Following Levitt's speech, the FASB subsequently dealt with each of these issues. Accounting standards since that time have limited these earnings management techniques.

c. Levitt notes meaningful disclosure to investors about company performance is necessary for investors to trust and feel confident in the information they are using to make investing decisions. Levitt believes this trust is the bedrock of our financial markets and is required for the efficient functioning of U.S. capital markets.

C1-8 MCI: A Succession of Mergers

The story of MCI WorldCom (later, MCI) is the story of the man who is largely responsible for both the rise and fall of MCI WorldCom. Bernard Ebbers was Chief Executive Officer of MCI until he resigned under pressure from the Board of Directors in April 2002. He put together over five dozen acquisitions in the two decades prior to stepping down. In 1983, he and three friends bought a small phone company which they named LDDS (Long Distance Discount Services); he became CEO of the company in 1985 and guided its growth strategy. In 1989, LDDS combined with Advantage Co., keeping the LDDS name, to provide long-distance service to 11 Southern and Midwestern states. LDDS merged with Advanced Telecommunications Corporation in 1992 in an exchange of stock accounted for as a pooling of interests. In 1993, LDDS merged with Metromedia Communications Corporation and Resurgens Communications Group, with the combined company maintaining the LDDS name and LDDS treated as the surviving company for accounting purposes (although legally Resurgens was the surviving company). In 1994, the company merged with IDB Communications Group in an exchange of stock accounted for as a pooling. In 1995, LDDS purchased for cash the network services operations of Williams Telecommunications Group. Later in 1995, the company changed its name to WorldCom, Inc. In 1996, WorldCom acquired the large Internet services provider UUNET by merging with its parent company, MFS Communications Company, in an exchange of stock. In 1997, WorldCom purchased the Internet and networking divisions of America Online and CompuServe in a three-way stock and asset swap. In 1998, the Company acquired MCI Communications Corporation for approximately $40 billion, and subsequently the name of the company was changed to MCI WorldCom. This merger was accounted for as a purchase. In 1998, the Company also acquired CompuServe for 56 million MCI WorldCom common shares in a business combination accounted for as a purchase. In 1999, MCI WorldCom acquired SkyTel for 23 million MCI WorldCom common shares in a pooling of interests. An attempt to acquire Sprint in 1999, in a deal billed as the biggest in corporate history, was scuttled due to antitrust concerns.

MCI WorldCom's long distance and other businesses experienced major declines in 2000 and profits began to fall. Continued deterioration of operations and cash flows and disclosure of a massive accounting fraud in June 2002, led MCI WorldCom to file for bankruptcy protection in July 2002, in the largest Chapter 11 case in U.S. history at that time.[1] Subsequent discoveries of additional inappropriate accounting activities and restatements of financial statements further blemished the company's reputation. In April 2003, WorldCom filed a plan of reorganization with the SEC and changed the company name from WorldCom to MCI. The company went through a period of retrenchment, and in early 2006 merged with Verizon Communications. Thus, MCI is no longer a separate company but rather is part of Verizon's wireline business.

Criminal charges were filed against Bernard Ebbers and five other former executives of WorldCom in connect with a major fraud investigation. The company also was charged and eventually reached a settlement with the SEC, agreeing to pay $500 million of cash and 10 million shares of common stock of MCI. Bernard Ebbers was tried for an $11 billion accounting fraud and in 2005 was found guilty of all nine counts with which he was charged. He was sentenced to 25 years in prison, with confiscation of nearly all of his assets. Ebbers is currently in the Oakdale Federal Correctional Complex in Louisiana.

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[1] Since this time, Lehman Brothers and Washington Mutual have had bigger bankruptcy filings.
http://en.wikipedia.org/wiki/Largest_bankruptcies_in_U.S._history#Largest_bankruptcies

C1-9 Leveraged Buyouts

a. A leveraged buyout (LBO) involves acquiring a company in a transaction or series of planned transactions that include using a very high proportion of debt, often secured by the assets of the target company. Normally, the investors acquire all of the stock or assets of the target company. A management buyout (MBO) occurs when the existing management of a company acquires all or most of the stock or assets of the company. Frequently, the investors in LBOs include management, and thus an LBO may also be an MBO

b. The FASB has not dealt with leveraged buyouts in either current pronouncements or exposure drafts of proposed standards. The Emerging Issues Task Force has addressed limited aspects of accounting for LBOs. In EITF 84-23, "Leveraged Buyout Holding Company Debt," the Task Force did not reach a consensus. In EITF 88-16, "Basis in Leveraged Buyout Transactions," the Task Force did provide guidance as to the proper basis that should be recognized for an acquiring company's interest in a target company acquired through a leveraged buyout.

c. Whether an LBO is a type of business combination is not clear and probably depends on the structure of the buyout. The FASB has not taken a position on whether an LBO is a type of business combination. The EITF indicated that LBOs of the type it was considering are similar to business combinations. Most LBOs are effected by establishing a holding company for the purpose of acquiring the assets or stock of the target company. Such a holding company has no substantive operations. Some would argue that a business combination can occur only if the acquiring company has substantive operations. However, neither the FASB nor EITF has established such a requirement. Thus, the question of whether an LBO is a business combination is unresolved.

d. The primary issue in deciding the proper basis for an interest in a company acquired in an LBO, as determined by EITF 88-16, is whether the transaction has resulted in a change in control of the target company (a new controlling shareholder group has been established). If a change in control has not occurred, the transaction is treated as a recapitalization or restructuring, and a change in basis is not appropriate (the previous basis carries over). If a change in control has occurred, a new basis of accounting may be appropriate.

C1-10 Curtiss-Wright and Goodwill

a. Curtiss-Wright Corporation acquired seven businesses in 2001 and six businesses in 2002, with all of the acquisitions accounted for as purchases. Goodwill increased from $47,204,000 on January 1, 2001, to $83,585,000 at December 31, 2001, an increase of $36,381,000 or 77.1 percent. Goodwill of $181,101,000 was reported at December 31, 2002, an increase of $97,516,000 or 116.7 percent for the year. Goodwill represented 22.3 percent ($181,101,000/$812,924,000) of total assets at December 31, 2002. This amount represents a substantially higher proportion of total assets than is found in most manufacturing-related companies. Note that the company accounted for all of its acquisitions using the purchase method, one of the two acceptable methods of accounting for business combinations during that time, and the method that resulted in the recognition of goodwill.

b. Curtis-Wright acquired assets having a total fair value of $42.4 million (and assumed liabilities of $7.4 million) through business combinations in 2006. Goodwill increased in 2006 by $22.9 million ($411.1 - $388.2), for an increase of about 6 percent. The amount of goodwill at December 31, 2006, represents about 26 percent of total assets.

c. Curtis-Wright recognized no goodwill impairment losses for 2005 or 2006. At the end of 2006, Curtis-Wright changed its date for testing goodwill impairment from July 31 to October 31. This was done to better coincide with the company's normal schedule for developing strategic plans and forecasts. This change had no effect on the financial statements for 2006 and prior years.

d. The management of Curtiss-Wright undoubtedly prefers the current treatment of goodwill. Curtiss-Wright has a large amount of goodwill in comparison with most companies, and amortizing that goodwill would have a negative impact on earnings. Given that Curtiss-Wright has had no goodwill impairment losses in recent years under the current treatment of goodwill, earnings has not been burdened by the company's substantial goodwill. However, if the company's market position were to deteriorate or a sustained general economic downturn were to occur, the company could incur significant goodwill impairment losses. Despite the economic crisis of 2008, Curtis-Wright had not recognized any goodwill impairment losses as of their 2009 annual report.

C1-11 Sears and Kmart: The Joining Together of Two of America's Oldest Retailers

a. Kmart declared Chapter 11 bankruptcy on January 22, 2002. The company reorganized and emerged from bankruptcy on May 6, 2003.

b. The business combination was a stock acquisition in the form of a consolidation. That is, a new corporation was formed to acquire the two combining companies, Kmart and Sears, Roebuck. After the combination, the parent company, Sears Holdings Corporation, held all of the stock of Sears, Roebuck and Co. and Kmart Holding Corporation.

c. Kmart was designated as the acquiring company. This determination was made on the basis of relative share ownership subsequent to the combination, makeup of the combined company's board of directors, makeup of senior management, and perhaps other factors. Given that Kmart was considered to be the acquirer, the historical balances of its accounts became those of the parent company, Sears Holdings.

SOLUTIONS TO EXERCISES

E1-1 Multiple-Choice Questions on Complex Organizations

1. b

2. d

3. a

4. b

5. d

E1-2 Multiple-Choice Questions on Recording Business Combinations [AICPA Adapted]

1. a

2. c

3. d

4. d

5. c

E1-3 Multiple-Choice Questions on Reported Balances [AICPA Adapted]

1. d

2. d

3. c

4. c

E1-4 Multiple-Choice Questions Involving Account Balances

1. c

2. c

3. b

4. b

5. b

E1-5 Asset Transfer to Subsidiary

a. Journal entry recorded by Pale Company for transfer of assets to Bright Company:

Investment in Bright Company Common Stock	408,000	
Accumulated Depreciation – Buildings	24,000	
Accumulated Depreciation – Equipment	36,000	
Cash		21,000
Inventory		37,000
Land		80,000
Buildings		240,000
Equipment		90,000

b. Journal entry recorded by Bright Company for receipt of assets from Pale Company:

Cash	21,000	
Inventory	37,000	
Land	80,000	
Buildings	240,000	
Equipment	90,000	
Accumulated Depreciation – Buildings		24,000
Accumulated Depreciation – Equipment		36,000
Common Stock		60,000
Additional Paid-In Capital		348,000

E1-6 Creation of New Subsidiary

a. Journal entry recorded by Lester Company for transfer of assets to Mumby Corporation:

Investment in Mumby Corporation Common Stock	498,000	
Allowance for Uncollectible Accounts Receivable	7,000	
Accumulated Depreciation – Buildings	35,000	
Accumulated Depreciation – Equipment	60,000	
Cash		40,000
Accounts Receivable		75,000
Inventory		50,000
Land		35,000
Buildings		160,000
Equipment		240,000

b. Journal entry recorded by Mumby Corporation for receipt of assets from Lester Company:

Cash	40,000	
Accounts Receivable	75,000	
Inventory	50,000	
Land	35,000	
Buildings	160,000	
Equipment	240,000	
Allowance for Uncollectible Accounts Receivable		7,000
Accumulated Depreciation – Buildings		35,000
Accumulated Depreciation – Equipment		60,000
Common Stock		120,000
Additional Paid-In Capital		378,000

E1-7 Balance Sheet Totals of Parent Company

a. Journal entry recorded by Foster Corporation for transfer of assets and accounts payable to Kline Company:

Investment in Kline Company Common Stock	66,000	
Accumulated Depreciation	28,000	
Accounts Payable	22,000	
Cash		15,000
Accounts Receivable		24,000
Inventory		9,000
Land		3,000
Depreciable Assets		65,000

b. Journal entry recorded by Kline Company for receipt of assets and accounts payable from Foster Corporation:

Cash	15,000	
Accounts Receivable	24,000	
Inventory	9,000	
Land	3,000	
Depreciable Assets	65,000	
Accumulated Depreciation		28,000
Accounts Payable		22,000
Common Stock		48,000
Additional Paid-In Capital		18,000

E1-8 Creation of Partnership

a. Journal entry recorded by Glover Corporation for transfer of assets to G&R Partnership:

Investment in G&R Partnership	450,000	
Accumulated Depreciation – Buildings	60,000	
Accumulated Depreciation – Equipment	40,000	
Cash		10,000
Accounts Receivable		19,000
Inventory		35,000
Land		16,000
Buildings		260,000
Equipment		210,000

b. Journal entry recorded by Renfro Company for the transfer of cash to G&R Partnership:

Investment in G&R Partnership	50,000	
Cash		50,000

c. Journal entry recorded by G&R Partnership for receipt of assets from Glover Corporation and Renfro Company:

Cash	60,000	
Accounts Receivable	19,000	
Inventory	35,000	
Land	16,000	
Buildings	260,000	
Equipment	210,000	
Accumulated Depreciation – Buildings		60,000
Accumulated Depreciation – Equipment		40,000
Capital, Glover Corporation		450,000
Capital, Renfro Company		50,000

E1-9 Acquisition of Net Assets

Sun Corporation will record the following journal entries:

(1)

Assets	71,000	
Goodwill	9,000	
Liabilities		20,000
Cash		60,000

(2)

Merger Expense	4,000	
Cash		4,000

E1-10 Reporting Goodwill

a. Goodwill: $120,000 = $310,000 - $190,000
Investment: $310,000

b. Goodwill: $6,000 = $196,000 - $190,000
Investment: $196,000

c. Goodwill: $0; no goodwill is recorded when the purchase price is below the fair value of the net identifiable assets.
Investment: $190,000; recorded at the fair value of the net identifiable assets.

E1-11 Stock Acquisition

Journal entry to record the purchase of Tippy Inc., shares:

Investment in Tippy Inc., Common Stock	986,000	
Common Stock		425,000
Additional Paid-In Capital		561,000

$986,000 = $58 x 17,000 shares
$425,000 = $25 x 17,000 shares
$561,000 = ($58 - $25) x 17,000 shares

E1-12 Balances Reported Following Combination

a.	Stock Outstanding: $200,000 + ($10 x 8,000 shares)	$280,000
b.	Cash and Receivables: $150,000 + $40,000	190,000
c.	Land: $100,000 + $85,000	185,000
d.	Buildings and Equipment (net): $300,000 + $230,000	530,000
e.	Goodwill: ($50 x 8,000) - $355,000	45,000
f.	Additional Paid-In Capital: $20,000 + [($50 - $10) x 8,000]	340,000
g.	Retained Earnings	330,000

E1-13 Goodwill Recognition

Journal entry to record acquisition of Spur Corporation net assets:

Cash and Receivables	40,000	
Inventory	150,000	
Land	30,000	
Plant and Equipment	350,000	
Patent	130,000	
Goodwill	55,000	
Accounts Payable		85,000
Cash		670,000

Computation of goodwill

Fair value of consideration given		$670,000
Fair value of assets acquired	$700,000	
Fair value of liabilities assumed	(85,000)	
Fair value of net assets acquired		615,000
Goodwill		$ 55,000

E1-14 Acquisition Using Debentures

Journal entry to record acquisition of Sorden Company net assets:

Cash and Receivables	50,000	
Inventory	200,000	
Land	100,000	
Plant and Equipment	300,000	
Discount on Bonds Payable	17,000	
Goodwill	8,000	
Accounts Payable		50,000
Bonds Payable		625,000

Computation of goodwill

Fair value of consideration given		$608,000
Fair value of assets acquired	$650,000	
Fair value of liabilities assumed	(50,000)	
Fair value of net assets acquired		600,000
Goodwill		$ 8,000

E1-15 Bargain Purchase

Journal entry to record acquisition of Sorden Company net assets:

Cash and Receivables	50,000	
Inventory	200,000	
Land	100,000	
Plant and Equipment	300,000	
Discount on Bonds Payable	16,000	
Accounts Payable		50,000
Bonds Payable		580,000
Gain on Bargain Purchase of Subsidiary		36,000

The gain represents the excess of the $600,000 fair value of the net assets acquired ($650,000 - $50,000) over the $564,000 paid to purchase ownership.

E1-16 Impairment of Goodwill

a. Goodwill of $80,000 will be reported. The fair value of the reporting unit ($340,000) is greater than the carrying amount of the investment ($290,000) and the goodwill does not need to be tested for impairment.

b. Goodwill of $35,000 will be reported (fair value of reporting unit of $280,000 - fair value of net assets of $245,000). An impairment loss of $45,000 ($80,000 - $35,000) will be recognized.

c. Goodwill of $15,000 will be reported (fair value of reporting unit of $260,000 - fair value of net assets of $245,000). An impairment loss of $65,000 ($80,000 - $15,000) will be recognized.

E1-17 Assignment of Goodwill

a. No impairment loss will be recognized. The fair value of the reporting unit ($530,000) is greater than the carrying value of the investment ($500,000) and goodwill does not need to be tested for impairment.

b. An impairment of goodwill of $15,000 will be recognized. The implied value of goodwill is $45,000 ($485,000 - $440,000), which represents a $15,000 decrease from the original $60,000.

c. An impairment of goodwill of $50,000 will be recognized. The implied value of goodwill is $10,000 ($450,000 - $440,000), which represents a $50,000 decrease from the original $60,000.

E1-18 Goodwill Assigned to Reporting Units

Goodwill of $158,000 ($60,000 + $48,000 + $0 + $50,000) should be reported, computed as follows:

Reporting Unit A: Goodwill of $60,000 should be reported. The implied value of goodwill is $90,000 ($690,000 - $600,000) and the carrying amount of goodwill is $60,000.

Reporting Unit B: Goodwill of $48,000 should be reported. The fair value of the reporting unit ($335,000) is greater than the carrying value of the investment ($330,000).

Reporting Unit C: No goodwill should be reported. The fair value of the net assets ($400,000) exceeds the fair value of the reporting unit ($370,000).

Reporting Unit D: Goodwill of $50,000 should be reported. The fair value of the reporting unit ($585,000) is greater than the carrying value of the investment ($520,000).

E1-19 Goodwill Measurement

a. Goodwill of $150,000 will be reported. The fair value of the reporting unit ($580,000) is greater than the carrying value of the investment ($550,000) and goodwill does not need to be tested for impairment.

b. Goodwill of $50,000 will be reported. The implied value of goodwill is $50,000 (fair value of reporting unit of $540,000 - fair value of net assets of $490,000). Thus, an impairment of goodwill of $100,000 ($150,000 - $50,000) must be recognized.

c. Goodwill of $10,000 will be reported. The implied value of goodwill is $10,000 (fair value of reporting unit of $500,000 - fair value of net assets of $490,000). Thus, an impairment loss of $140,000 ($150,000 - $10,000) must be recognized.

d. No goodwill will be reported. The fair value of the net assets ($490,000) exceeds the fair value of the reporting unit ($460,000). Thus, the implied value of goodwill is $0 and an impairment loss of $150,000 ($150,000 - $0) must be recognized.

E1-20 Computation of Fair Value

Amount paid		$517,000
Book value of assets	$624,000	
Book value of liabilities	(356,000)	
Book value of net assets	$268,000	
Adjustment for research and development costs	(40,000)	
Adjusted book value	$228,000	
Fair value of patent rights	120,000	
Goodwill recorded	93,000	(441,000)
Fair value increment of buildings and equipment		$ 76,000
Book value of buildings and equipment		341,000
Fair value of buildings and equipment		$417,000

E1-21 Computation of Shares Issued and Goodwill

a. 15,600 shares were issued, computed as follows:

Par value of shares outstanding following merger		$327,600
Paid-in capital following merger		650,800
Total par value and paid-in capital		$978,400
Par value of shares outstanding before merger	$218,400	
Paid-in capital before merger	370,000	
		(588,400)
Increase in par value and paid-in capital		$390,000
Divide by price per share		÷ $25
Number of shares issued		15,600

b. The par value is $7, computed as follows:

Increase in par value of shares outstanding ($327,600 - $218,400)	$109,200
Divide by number of shares issued	÷ 15,600
Par value	$ 7.00

c. Goodwill of $34,000 was recorded, computed as follows:

Increase in par value and paid-in capital	$390,000
Fair value of net assets ($476,000 - $120,000)	(356,000)
Goodwill	$ 34,000

E1-22 Combined Balance Sheet

Adam Corporation and Best Company
Combined Balance Sheet
January 1, 20X2

Cash and Receivables	$ 240,000	Accounts Payable	$ 125,000
Inventory	460,000	Notes Payable	235,000
Buildings and Equipment	840,000	Common Stock	244,000
Less: Accumulated Depreciation	(250,000)	Additional Paid-In Capital	556,000
Goodwill	75,000	Retained Earnings	205,000
	$1,365,000		$1,365,000

Computation of goodwill

Fair value of compensation given	$480,000
Fair value of net identifiable assets ($490,000 - $85,000)	(405,000)
Goodwill	$ 75,000

E1-23 Recording a Business Combination

Merger Expense	54,000	
Deferred Stock Issue Costs	29,000	
Cash		83,000

Cash	70,000	
Accounts Receivable	110,000	
Inventory	200,000	
Land	100,000	
Buildings and Equipment	350,000	
Goodwill (1)	30,000	
Accounts Payable		195,000
Bonds Payable		100,000
Bond Premium		5,000
Common Stock		320,000
Additional Paid-In Capital (2)		211,000
Deferred Stock Issue Costs		29,000

Computation of goodwill

Fair value of consideration given (40,000 x $14)		$560,000
Fair value of assets acquired	$830,000	
Fair value of liabilities assumed	(300,000)	
Fair value of net assets acquired		(530,000)
Goodwill		$ 30,000

Computation of additional paid-in capital

Number of shares issued	40,000
Issue price in excess of par value ($14 - $8)	x $6
Total	$240,000
Less: Deferred stock issue costs	(29,000)
Increase in additional paid-in capital	$211,000

E1-24 Reporting Income

20X2: Net income = $6,028,000 [$2,500,000 + $3,528,000]
Earnings per share = $5.48 [$6,028,000 / (1,000,000 + 100,000*)]

20X1: Net income = $4,460,000 [previously reported]
Earnings per share = $4.46 [$4,460,000 / 1,000,000]

* 100,000 = 200,000 shares x ½ year

SOLUTIONS TO PROBLEMS

P1-25 Assets and Accounts Payable Transferred to Subsidiary

a. Journal entry recorded by Tab Corporation for its transfer of assets and accounts payable to Collon Company:

Investment in Collon Company Common Stock	320,000	
Accounts Payable	45,000	
Accumulated Depreciation – Buildings	40,000	
Accumulated Depreciation – Equipment	10,000	
Cash		25,000
Inventory		70,000
Land		60,000
Buildings		170,000
Equipment		90,000

b. Journal entry recorded by Collon Company for receipt of assets and accounts payable from Tab Corporation:

Cash	25,000	
Inventory	70,000	
Land	60,000	
Buildings	170,000	
Equipment	90,000	
Accounts Payable		45,000
Accumulated Depreciation – Buildings		40,000
Accumulated Depreciation – Equipment		10,000
Common Stock		180,000
Additional Paid-In Capital		140,000

P1-26 Creation of New Subsidiary

a. Journal entry recorded by Eagle Corporation for transfer of assets and accounts payable to Sand Corporation:

Investment in Sand Corporation Common Stock	400,000	
Allowance for Uncollectible Accounts Receivable	5,000	
Accumulated Depreciation	40,000	
Accounts Payable	10,000	
Cash		30,000
Accounts Receivable		45,000
Inventory		60,000
Land		20,000
Buildings and Equipment		300,000

b. Journal entry recorded by Sand Corporation for receipt of assets and accounts payable from Eagle Corporation:

Cash	30,000	
Accounts Receivable	45,000	
Inventory	60,000	
Land	20,000	
Buildings and Equipment	300,000	
Allowance for Uncollectible Accounts Receivable		5,000
Accumulated Depreciation		40,000
Accounts Payable		10,000
Common Stock		50,000
Additional Paid-In Capital		350,000

P1-27 Incomplete Data on Creation of Subsidiary

a. The book value of assets transferred was $152,000 ($3,000 + $16,000 + $27,000 + $9,000 + $70,000 + $60,000 - $21,000 - $12,000).

b. Thumb Company would report its investment in New Company equal to the book value of net assets transferred of $138,000 ($152,000 - $14,000).

c. 8,000 shares ($40,000/$5).

d. Total assets declined by $14,000 (book value of assets transferred of $152,000 - investment in New Company of $138,000).

e. No effect. The shares outstanding reported by Thumb Company are not affected by the creation of New Company.

P1-28 Establishing a Partnership

a. Journal entry recorded by K&D partnership for receipt of assets and accounts payable:

Cash	210,000	
Inventory	30,000	
Land	70,000	
Buildings	200,000	
Equipment	120,000	
Accumulated Depreciation – Buildings		50,000
Accumulated Depreciation – Equipment		30,000
Accounts Payable		50,000
Capital, Krantz Company		300,000
Capital, Dull Corporation		200,000

b. Journal entry recorded by Krantz Company for transfer of assets and accounts payable to K&D Partnership:

Investment in K&D Partnership	300,000	
Accumulated Depreciation – Buildings	50,000	
Accumulated Depreciation – Equipment	30,000	
Accounts Payable	50,000	
Cash		10,000
Inventory		30,000
Land		70,000
Buildings		200,000
Equipment		120,000

Journal entry recorded by Dull Corporation for cash transferred to K&D Partnership:

Investment in K&D Partnership	200,000	
Cash		200,000

P1-29 Balance Sheet Data for Companies Establishing a Partnership

a. Journal entry recorded by Good Corporation for assets transferred to G&W Partnership:

Investment in G&W Partnership	150,000	
Accumulated Depreciation – Buildings	30,000	
Accumulated Depreciation – Equipment	20,000	
Cash		21,000
Inventory		4,000
Land		15,000
Buildings		100,000
Equipment		60,000

b. Journal entry recorded by Nevall Company for assets transferred to G&W Partnership:

Investment in G&W Partnership	50,000	
Accumulated Depreciation – Equipment	14,000	
Cash		3,000
Inventory		25,000
Equipment		36,000

c. Journal entry recorded by G&W Partnership for assets received from Good Corporation and Nevall Company:

Cash	24,000	
Inventory	29,000	
Land	15,000	
Buildings	100,000	
Equipment	96,000	
Accumulated Depreciation – Buildings		30,000
Accumulated Depreciation – Equipment		34,000
Capital, Good Corporation		150,000
Capital, Nevall Company		50,000

P1-30 Acquisition in Multiple Steps

Deal Corporation will record the following entries:

(1)

Investment in Mead Company Stock	85,000	
Common Stock - $10 Par Value		40,000
Additional Paid-In Capital		45,000

(2)

Merger Expense	3,500	
Additional Paid-In Capital	2,000	
Cash		5,500

(3)

Investment in Mead Company Stock	6,000	
Gain on Increase in Value of Mead Company Stock		6,000

P1-31 Journal Entries to Record a Business Combination

Journal entries to record acquisition of TKK net assets:

(1)

Merger Expense	14,000	
Cash		14,000

Record payment of legal fees.

(2)

Deferred Stock Issue Costs	28,000	
Cash		28,000

Record costs of issuing stock.

(3)

Cash and Receivables	28,000	
Inventory	122,000	
Buildings and Equipment	470,000	
Goodwill	12,000	
Accounts Payable		41,000
Notes Payable		63,000
Common Stock		96,000
Additional Paid-In Capital		404,000
Deferred Stock Issue Costs		28,000

Record purchase of TKK Corporation.

Computation of goodwill

Fair value of consideration given (24,000 x $22)	$528,000
Fair value of net assets acquired ($620,000 - $104,000)	(516,000)
Goodwill	$ 12,000

Computation of additional paid-in capital

Number of shares issued	24,000
Issue price in excess of par value ($22 - $4)	x $18
Total	$432,000
Less: Deferred stock issue costs	(28,000)
Increase in additional paid-in capital	$404,000

P1-32 Recording Business Combinations

Merger Expense	38,000	
Deferred Stock Issue Costs	22,000	
Cash		60,000

Cash and Equivalents	41,000	
Accounts Receivable	73,000	
Inventory	144,000	
Land	200,000	
Buildings	1,500,000	
Equipment	300,000	
Goodwill	127,000	
Accounts Payable		35,000
Short-Term Notes Payable		50,000
Bonds Payable		500,000
Common Stock $2 Par		900,000
Additional Paid-In Capital		878,000
Deferred Stock Issue Costs		22,000

Computation of goodwill

Fair value of consideration given (450,000 x $4)	$1,800,000
Fair value of net assets acquired ($41,000 + $73,000 + $144,000 + $200,000 + $1,500,000 + $300,000 - $35,000 - $50,000 - $500,000)	(1,673,000)
Goodwill	$ 127,000

Computation of additional paid-in capital

Number of shares issued	450,000
Issue price in excess of par value ($4 - $2)	x $2
Total	$900,000
Less: Deferred stock issue costs	(22,000)
Increase in additional paid-in capital	$878,000

P1-33 Business Combination with Goodwill

a. Journal entry to record acquisition of Zink Company net assets:

Cash	20,000	
Accounts Receivable	35,000	
Inventory	50,000	
Patents	60,000	
Buildings and Equipment	150,000	
Goodwill	38,000	
Accounts Payable		55,000
Notes Payable		120,000
Cash		178,000

b. Balance sheet immediately following acquisition:

Anchor Corporation and Zink Company
Combined Balance Sheet
February 1, 20X3

Cash	$ 82,000	Accounts Payable	$140,000
Accounts Receivable	175,000	Notes Payable	270,000
Inventory	220,000	Common Stock	200,000
Patents	140,000	Additional Paid-In	
Buildings and Equipment	530,000	Capital	160,000
Less: Accumulated		Retained Earnings	225,000
Depreciation	(190,000)		
Goodwill	38,000		
	$995,000		$995,000

c. Journal entry to record acquisition of Zink Company stock:

Investment in Zink Company Common Stock	178,000	
Cash		178,000

Computation of goodwill

Fair value of consideration given	$178,000
Fair value of net assets acquired	
($20,000 + $35,000 + $50,000 + $60,000	
+ $150,000 - $55,000 -$120,000)	(140,000)
Goodwill	$ 38,000

P1-34 Bargain Purchase

Journal entries to record acquisition of Lark Corporation net assets:

Merger Expense	5,000	
Cash		5,000

Cash and Receivables	50,000	
Inventory	150,000	
Buildings and Equipment (net)	300,000	
Patent	200,000	
Accounts Payable		30,000
Cash		625,000
Gain on Bargain Purchase of Lark Corporation		45,000

Computation of gain

Fair value of consideration given	$625,000
Fair value of net assets acquired ($700,000 - $30,000)	(670,000)
Gain on bargain purchase	$ 45,000

P1-35 Computation of Account Balances

a. Liabilities reported by the Aspro Division at year-end:

Fair value of reporting unit at year-end		$930,000
Acquisition price of reporting unit ($7.60 x 100,000)	$760,000	
Fair value of net assets at acquisition ($810,000 - $190,000)	(620,000)	
Goodwill at acquisition	$140,000	
Impairment in current year	(30,000)	
Goodwill at year-end		(110,000)
Fair value of net assets at year-end		$820,000

Fair value of assets at year-end	$950,000
Fair value of net assets at year-end	(820,000)
Fair value of liabilities at year-end	$130,000

b. Required fair value of reporting unit:

Fair value of assets at year-end	$ 950,000
Fair value of liabilities at year-end (given)	(70,000)
Fair value of net assets at year-end	$ 880,000
Original goodwill balance	140,000
Required fair value of reporting unit to avoid recognition of impairment of goodwill	$1,020,000

P1-36 Goodwill Assigned to Multiple Reporting Units

a. Goodwill to be reported by Rover Company:

	Reporting Unit A	Reporting Unit B	Reporting Unit C
Carrying value of goodwill	$70,000	$80,000	$40,000
Implied goodwill at year-end	90,000	50,000	75,000
Goodwill to be reported at year-end	70,000	50,000	40,000

Total goodwill to be reported at year-end:	
Reporting unit A	$ 70,000
Reporting unit B	50,000
Reporting unit C	40,000
Total goodwill to be reported	$160,000

Computation of implied goodwill

Reporting unit A		
Fair value of reporting unit		$400,000
Fair value of identifiable assets	$350,000	
Fair value of accounts payable	(40,000)	
Fair value of net assets		(310,000)
Implied goodwill at year-end		$ 90,000
Reporting unit B		
Fair value of reporting unit		$440,000
Fair value of identifiable assets	$450,000	
Fair value of accounts payable	(60,000)	
Fair value of net assets		(390,000)
Implied goodwill at year-end		$ 50,000
Reporting unit C		
Fair value of reporting unit		$265,000
Fair value of identifiable assets	$200,000	
Fair value of accounts payable	(10,000)	
Fair value of net assets		(190,000)
Implied goodwill at year-end		$ 75,000

b. Goodwill impairment of $30,000 ($80,000 - $50,000) must be reported in the current period for reporting unit B.

P1-37 Journal Entries

Journal entries to record acquisition of Light Steel net assets:

(1)

Merger Expense	19,000	
Cash		19,000

Record finder's fee and transfer costs.

(2)

Deferred Stock Issue Costs	9,000	
Cash		9,000

Record audit fees and stock registration fees.

(3)

Cash	60,000	
Accounts Receivable	100,000	
Inventory	115,000	
Land	70,000	
Buildings and Equipment	350,000	
Bond Discount	20,000	
Goodwill	95,000	
Accounts Payable		10,000
Bonds Payable		200,000
Common Stock		120,000
Additional Paid-In Capital		471,000
Deferred Stock Issue Costs		9,000

Record merger with Light Steel Company.

Computation of goodwill

Fair value of consideration given (12,000 x $50)	$600,000
Fair value of net assets acquired ($695,000 - $10,000 - $180,000)	(505,000)
Goodwill	$ 95,000

Computation of additional paid-in capital

Number of shares issued	12,000
Issue price in excess of par value ($50 - $10)	x $40
Total	$480,000
Less: Deferred stock issue costs	(9,000)
Increase in additional paid-in capital	$471,000

P1-38 Purchase at More than Book Value

a. Journal entry to record acquisition of Stafford Industries net assets:

Cash	30,000	
Accounts Receivable	60,000	
Inventory	160,000	
Land	30,000	
Buildings and Equipment	350,000	
Bond Discount	5,000	
Goodwill	125,000	
Accounts Payable		10,000
Bonds Payable		150,000
Common Stock		80,000
Additional Paid-In Capital		520,000

b. Balance sheet immediately following acquisition:

Ramrod Manufacturing and Stafford Industries
Combined Balance Sheet
January 1, 20X2

Cash	$ 100,000	Accounts Payable		$ 60,000
Accounts Receivable	160,000	Bonds Payable	$450,000	
Inventory	360,000	Less: Discount	(5,000)	445,000
Land	80,000	Common Stock		280,000
Buildings and Equipment	950,000	Additional		
Less: Accumulated		Paid-In Capital		560,000
Depreciation	(250,000)	Retained Earnings		180,000
Goodwill	125,000			
	$1,525,000			$1,525,000

Computation of goodwill

Fair value of consideration given (4,000 x $150)	$600,000
Fair value of net assets acquired ($630,000 - $10,000 - $145,000)	(475,000)
Goodwill	$125,000

P1-39 Business Combination

Journal entry to record acquisition of Toot-Toot Tuba net assets:

Cash	300	
Accounts Receivable	17,000	
Inventory	35,000	
Plant and Equipment	500,000	
Other Assets	25,800	
Goodwill	86,500	
Allowance for Uncollectibles		1,400
Accounts Payable		8,200
Notes Payable		10,000
Mortgage Payable		50,000
Bonds Payable		100,000
Capital Stock ($10 par)		90,000
Premium on Capital Stock		405,000

Computation of fair value of net assets acquired

Cash	$300
Accounts Receivable	17,000
Allowance for Uncollectible Accounts	(1,400)
Inventory	35,000
Plant and Equipment	500,000
Other Assets	25,800
Accounts Payable	(8,200)
Notes Payable	(10,000)
Mortgage Payable	(50,000)
Bonds Payable	(100,000)
Fair value of net assets acquired	$408,500

Computation of goodwill

Fair value of consideration given (9,000 x $55)	$495,000
Fair value of net assets acquired	(408,500)
Goodwill	$86,500

P1-40 Combined Balance Sheet

a. Balance sheet:

Bilge Pumpworks and Seaworthy Rope Company
Combined Balance Sheet
January 1, 20X3

Cash and Receivables	$110,000	Current Liabilities	$ 100,000
Inventory	142,000	Capital Stock	214,000
Land	115,000	Capital in Excess	
Plant and Equipment	540,000	of Par Value	216,000
Less: Accumulated		Retained Earnings	240,000
Depreciation	(150,000)		
Goodwill	13,000		
	$770,000		$ 770,000

Computation of goodwill

Fair value of consideration given (700 x $300)	$210,000
Fair value of net assets acquired ($217,000 – $20,000)	(197,000)
Goodwill	$13,000

b. (1) Stockholders' equity with 1,100 shares issued:

Capital Stock [$200,000 + ($20 x 1,100 shares)]	$ 222,000
Capital in Excess of Par Value [$20,000 + ($300 - $20) x 1,100 shares]	328,000
Retained Earnings	240,000
	$ 790,000

(2) Stockholders' equity with 1,800 shares issued:

Capital Stock [$200,000 + ($20 x 1,800 shares)]	$ 236,000
Capital in Excess of Par Value [$20,000 + ($300 - $20) x 1,800 shares]	524,000
Retained Earnings	240,000
	$1,000,000

(3) Stockholders' equity with 3,000 shares issued:

Capital Stock [$200,000 + ($20 x 3,000 shares)]	$ 260,000
Capital in Excess of Par Value [$20,000 + ($300 - $20) x 3,000 shares]	860,000
Retained Earnings	240,000
	$1,360,000

P1-41 Incomplete Data Problem

a. 5,200 = ($126,000 - $100,000)/$5

b. $208,000 = ($126,000 + $247,000) - ($100,000 + $65,000)

c. $46,000 = $96,000 - $50,000

d. $130,000 = ($50,000 + $88,000 + $96,000 + $430,000 - $46,000 - $220,000 - $6,000) - ($40,000 + $60,000 + $50,000 + $300,000 - $32,000 - $150,000 - $6,000)

e. $78,000 = $208,000 - $130,000

f. $97,000 (as reported by End Corporation)

g. $13,000 = ($430,000 - $300,000)/10 years

P1-42 Incomplete Data Following Purchase

a. 14,000 = $70,000/$5

b. $8.00 = ($70,000 + $42,000)/14,000

c. 7,000 = ($117,000 - $96,000)/$3

d. $24,000 = $65,000 + $15,000 - $56,000

e. $364,000 = ($117,000 + $553,000 + $24,000) – ($96,000 + $234,000)

f. $110,000 = $320,000 - $210,000

g. $306,000 = ($15,000 + $30,000 + $110,000 + $293,000) - ($22,000 + $120,000)

h. $58,000 = $364,000 - $306,000

P1-43 Comprehensive Business Combination Problem

a. Journal entries on the books of Bigtime Industries to record the combination:

Merger Expense	135,000	
Cash		135,000

Deferred Stock Issue Costs	42,000	
Cash		42,000

Cash	28,000	
Accounts Receivable	251,500	
Inventory	395,000	
Long-Term Investments	175,000	
Land	100,000	
Rolling Stock	63,000	
Plant and Equipment	2,500,000	
Patents	500,000	
Special Licenses	100,000	
Discount on Equipment Trust Notes	5,000	
Discount on Debentures	50,000	
Goodwill	109,700	
Current Payables		137,200
Mortgages Payable		500,000
Premium on Mortgages Payable		20,000
Equipment Trust Notes		100,000
Debentures Payable		1,000,000
Common Stock		180,000
Additional Paid-In Capital — Common		2,298,000
Deferred Stock Issue Costs		42,000

Computation of goodwill

Value of stock issued ($14 x 180,000)		$2,520,000
Fair value of assets acquired	$4,112,500	
Fair value of liabilities assumed	(1,702,200)	
Fair value of net identifiable assets		(2,410,300)
Goodwill		$ 109,700

P1-43 (continued)

b. Journal entries on the books of HCC to record the combination:

Investment in Bigtime Industries Stock	2,520,000	
Allowance for Bad Debts	6,500	
Accumulated Depreciation	614,000	
Current Payables	137,200	
Mortgages Payable	500,000	
Equipment Trust Notes	100,000	
Debentures Payable	1,000,000	
Discount on Debentures Payable		40,000
Cash		28,000
Accounts Receivable		258,000
Inventory		381,000
Long-Term Investments		150,000
Land		55,000
Rolling Stock		130,000
Plant and Equipment		2,425,000
Patents		125,000
Special Licenses		95,800
Gain on Sale of Assets and Liabilities		1,189,900

Record sale of assets and liabilities.

Common Stock	7,500	
Additional Paid-In Capital — Common Stock	4,500	
Treasury Stock		12,000

Record retirement of Treasury Stock:*
$7,500 = $5 x 1,500 shares
$4,500 = $12,000 - $7,500

Common Stock	592,500	
Additional Paid-In Capital — Common	495,500	
Additional Paid-In Capital — Retirement of Preferred	22,000	
Retained Earnings	1,410,000	
Investment in Bigtime Industries Stock		2,520,000

Record retirement of HCC stock and distribution of Integrated Industries stock:
$592,500 = $600,000 - $7,500
$495,500 = $500,000 - $4,500
1,410,000 = $220,100 + $1,189,900

*Alternative approaches exist.