

Chapter 2– Advanced Accounting, 1st edition by Hamlen, Huefner, and Largay

Solutions to Practice Quiz

1. Topic: Types of combinations
LO 1

Argo Corporation acquires Ballentine Company. Argo records the cost of the acquisition as an asset on its balance sheet for *which one* of the following types of combinations?

- a. Statutory merger
- b. Statutory consolidation
- c. Asset acquisition
- d. Stock acquisition

ANS: d

Rationale: In a stock acquisition, Argo reports the cost as Investment in Ballentine. For all the others, Argo reports each asset and liability acquired, at fair value.

2. Topic: Types of combinations
LO 1

Which one of the following types of business combinations requires the use of a working paper each year to combine the separate accounts of the parent and the subsidiary for presentation in the annual report?

- a. Statutory merger
- b. Statutory consolidation
- c. Stock acquisition
- d. Asset acquisition

ANS: c

Rationale: In a stock acquisition, the parent and subsidiary remain separate legal entities with separate books. To present consolidated financial statements, it is necessary to use a working paper to combine the separate accounts. With the other types of business combinations, the acquirer reports the individual assets and liabilities acquired directly on its books, and no working paper is required.

3. Topic: Measuring and reporting assets and liabilities acquired
LO 2

Tendon Corporation pays \$100,000,000 for Valley Company. Valley's book value is \$2,000,000, and its assets and liabilities are reported at amounts approximating fair value. It has the following unreported intangibles:

	Fair value
In-process research & development	\$ 3,000,000
Assembled workforce	25,000,000
Potential contracts with prospective customers	10,000,000
Brand names	8,000,000

The goodwill reported for this acquisition is:

- a. \$52,000,000
- b. \$77,000,000
- c. \$87,000,000
- d. \$90,000,000

ANS: c

Rationale: IPR&D and brand names are capitalized as intangible assets.
 $\$100,000,000 - \$2,000,000 - \$3,000,000 - \$8,000,000 = \$87,000,000$

4. Topic: Measuring and reporting assets and liabilities acquired
LO 2

An acquired company's balance sheet is as follows (*in thousands*):

	Book value	Market value
	Dr (Cr)	
Current assets	\$ 600	\$ 400
Plant & equipment, net	40,000	30,000
Patents & copyrights	2,000	20,000
Liabilities	(32,000)	(33,000)
Capital stock	(1,000)	
Retained earnings	(9,600)	

The company also has the following previously unreported intangible assets (*in thousands*):

Customer lists	\$ 2,000
Favorable leases	7,000
Technical expertise of employees	10,000

4. *Continued*

If the acquirer pays \$100,000,000 for the company, reported goodwill is:

- a. \$ 63,600,000
- b. \$ 73,600,000
- c. \$ 82,600,000
- d. \$106,600,000

ANS: b

Rationale: The entry to record the acquisition is (*in thousands*):

Current assets	400	
Plant & equipment, net	30,000	
Patents & copyrights	20,000	
Customer lists	2,000	
Favorable leases	7,000	
Goodwill	73,600	
Liabilities		33,000
Consideration paid		100,000

5. Topic: Measurement of consideration paid

LO 3

Eton Corporation acquires Fairfield Company in a stock acquisition.

Consideration paid is as follows:

Cash paid to former shareholders of Fairfield	\$80,000,000
Fair value of \$0.50 par stock issued to former shareholders of Fairfield, 2,000,000 shares	30,000,000
Cash paid for registration fees on stock issued	2,000,000
Cash paid for outside merger consultants	3,500,000

The entry to record the acquisition on Eton's books includes a credit to additional paid-in capital for:

- a. \$30,000,000
- b. \$29,000,000
- c. \$28,000,000
- d. \$27,000,000

ANS: d

Rationale: Registration fees are netted out of additional paid-in capital.

\$30,000,000 fair value – \$2,000,000 registration fees – \$1,000,000 par value = \$27,000,000

6. Topic: Measurement of consideration paid
LO 3

Halifax Corporation acquires Nova Company in a statutory merger.
Consideration paid is as follows:

Cash paid to former shareholders of Nova	\$20,000,000
Fair value of stock issued to Nova's former shareholders	90,000,000
Cash paid for registration fees on stock issued	2,000,000
Cash paid for outside merger consultants	3,500,000
Expected present value of earnout agreement	200,000

The fair value of Nova's identifiable net assets acquired is \$50,000,000. How much goodwill is reported for this acquisition?

- a. \$63,700,000
- b. \$63,500,000
- c. \$60,000,000
- d. \$60,200,000

ANS: d

Rationale: The acquisition entry is as follows:

Identifiable net assets	50,000,000	
Merger expenses	3,500,000	
Goodwill	60,200,000	
Cash		25,500,000
Capital stock		88,000,000
Earnout liability		200,000

7. Topic: Subsequent changes in acquisition values

LO 3

Villa Corporation reports goodwill of \$10 million on acquisition of Webster Company. Six months after the acquisition, Villa learns that at the date of acquisition, Webster owed \$1,000,000 to a private lender. This debt was overlooked in the original acquisition entry. How is this new information reported in the consolidated financial statements?

- a. Decrease in goodwill of \$1 million
- b. Increase in goodwill of \$1 million
- c. Loss of \$1 million on the consolidated income statement
- d. Gain of \$1 million on the consolidated income statement

ANS: b

Rationale: This is a correction of the original acquisition entry, since it relates to facts in existence at the date of acquisition, and it is within the one year constraint. The correction is:

Goodwill	1,000,000	
Liability		1,000,000

8. Topic: Bargain purchase

LO 4

Petra Corporation purchased all of the outstanding shares of Stuckey Corporation for \$25,000,000. Stuckey's assets and liabilities at the date of acquisition are as follows:

	Fair value	Book value
	Dr (Cr)	
Current assets	\$ 6,500,000	\$ 8,000,000
Plant assets	60,000,000	90,000,000
Current liabilities	(4,000,000)	(4,000,000)
Noncurrent liabilities	(67,000,000)	(69,000,000)

Stuckey has previously unreported intangibles, meeting the criteria for capitalization, with a fair value of 35,000,000. The gain on acquisition is:

- a. \$ 1,500,000
- b. \$40,500,000
- c. \$ 2,000,000
- d. \$ 5,500,000

8. *Continued*

ANS: d

Cost		\$ 25,000,000
Fair value of identifiable net assets:		
Current assets	\$ 6,500,000	
Plant assets	60,000,000	
Intangibles	35,000,000	
Current liabilities	(4,000,000)	
Noncurrent liabilities	<u>(67,000,000)</u>	<u>30,500,000</u>
Gain		<u>\$ 5,500,000</u>

9. Topic: In-process research and development

LO 5

An acquired company has the following balance sheet (*in thousands*):

	Book value	Market value
	Dr (Cr)	
Current assets	\$ 300	\$ 500
Plant & equipment, net	20,000	15,000
Liabilities	(16,000)	(16,000)
Capital stock	(500)	
Retained earnings	(3,800)	

In addition, the company has previously unrecorded in-process research & development valued at \$22,000,000. If the acquirer's acquisition cost is \$50,000,000, reported goodwill is:

- \$28,500,000
- \$50,500,000
- \$66,500,000
- \$44,500,000

ANS: a

Rationale: The entry to record the acquisition is (*in thousands*):

Current assets	500	
Plant & equipment, net	15,000	
IPR&D	22,000	
Goodwill	28,500	
Liabilities		16,000
Consideration paid		50,000

10. Topic: Preacquisition contingency

LO 5

An acquired company has an unsettled lawsuit, in which it is the defendant. The expected present value of the obligation is \$5,000,000, and the lawsuit meets the requirements for recognition at acquisition date. No changes in the reported value are made until the lawsuit is settled, 18 months after acquisition, for \$3,000,000. In the year of settlement, the effect of the settlement is to report the \$2,000,000 change in the value of the lawsuit as:

- a. A decrease in goodwill
- b. A gain
- c. An increase in goodwill
- d. A loss

ANS: b

Rationale: The reduction in the liability occurs outside of the measurement period, and results in a gain, reported in income.