Chapter 3– Advanced Accounting, 1st edition by Hamlen, Huefner, and Largay

Solutions to Practice Quiz

1. Topic: Criteria for consolidation
LO 1
Park Corporation invests in Sunder Company. Under U.S. GAAP, Park should consolidate the financial records of Sunder in which one of the following circumstances?

   a. Park invests in a majority of the debt securities of Sunder
   b. Sunder is not a variable interest entity, but Park is the primary beneficiary
   c. Park invests in a majority of the voting stock of Sunder
   d. Sunder supplies the majority of Park's merchandise needs

   ANS: c
   Rationale: U.S. GAAP requires consolidation of majority owned investments in voting equity securities.

2. Topic: Motivations for off-balance-sheet financing
LO 2
Plummer Company pays $100 million in cash to acquire all of the stock of Stratton Company. The balance sheets of Plummer and Stratton just after the acquisition are as follows:

(in millions)	**Plummer**	**Stratton**
Current assets	$ 200	$ 5
Noncurrent assets	2,000	300
Investment in S	100	--
	$2,300	$305
Liabilities	$ 100	$303
Equity	2,200	2
Total	$2,300	$305

   Stratton's assets and liabilities are reported at amounts that approximate fair value at the date of acquisition, and there are no unreported net assets.

   What is Plummer's debt to total assets ratio if it consolidates Stratton? Round to the nearest percent.

   a. 4%
   b. 15%
   c. 16%
   d. 19%

2. *Continued*

ANS: b

Rationale: The consolidated balance sheet is:

(in millions)	
Current assets	$ 205
Noncurrent assets	2,300
Goodwill	98
	$2,603
Liabilities	$ 403
Equity	2,200
Total	$2,603

Consolidated debt to total assets is $403 / $2,603 = 15%

3. Topic: Consolidation of non-equity investments

LO 4

According to U.S. GAAP, criteria for classification of an organization as a variable interest entity include all of the following *except*:

a. The voting rights of some investors are not proportional to their obligations to absorb the organization's expected losses
b. Substantially all of the organization's activities are conducted on behalf of an entity with no voting rights
c. The organization's equity investment is not sufficient to absorb the risks to creditors, without additional subordinated support
d. There is a greater than 50% probability that the company will report a negative retained earnings balance

ANS: d

Rationale: Items a, b and c are stated in Codification paragraph 810-10-15-14, as criteria for an entity to be subject to the guidance of the variable interest entities subsections of the Codification.

4. Topic: Consolidation working paper
LO 5
Pell Company acquires all of Solo Company's voting stock for $75,000,000 in cash. Solo's balance sheet at the date of acquisition is as follows:

	Book value Dr(Cr)	**Fair value Dr(Cr)**
Current assets	$ 5,000,000	$ 4,000,000
Land, buildings and equipment (net)	125,000,000	150,000,000
Liabilities	(80,000,000)	(78,000,000)
Capital stock	(4,000,000)	
Retained earnings	(46,000,000)	

In addition, Solo has unrecorded identifiable intangible assets, meeting the criteria for capitalization, with an estimated fair value of $60,000,000.

In elimination entry (E) on the consolidation working paper at the date of acquisition, the credit to Investment in Solo is:

a. $46,000,000
b. $75,000,000
c. $50,000,000
d. $76,000,000

ANS: c
Rationale: Elimination (E) is:

Capital stock	4,000,000	
Retained earnings	46,000,000	
Investment in Solo		50,000,000

5. Topic: Consolidation working paper
LO 5
Pell Company acquires all of Solo Company's voting stock for $95,000,000 in cash. Solo's balance sheet at the date of acquisition is as follows:

	Book value Dr(Cr)	**Fair value Dr(Cr)**
Current assets	$ 5,000,000	$ 4,000,000
Plant assets	125,000,000	129,000,000
Liabilities	(81,000,000)	(78,000,000)
Capital stock	(4,000,000)	
Retained earnings	(45,000,000)	

In addition, Solo has unrecorded identifiable intangible assets, meeting the criteria for capitalization, with an estimated fair value of $10,000,000.

Elimination entry (R) on the consolidation working paper at the date of acquisition is:

a.

Plant assets	4,000,000	
Intangible assets	10,000,000	
Liabilities	3,000,000	
Goodwill	30,000,000	
Current assets		1,000,000
Investment in Solo		46,000,000

b.

Current assets	1,000,000	
Plant assets	4,000,000	
Intangible assets	10,000,000	
Goodwill	34,000,000	
Liabilities		3,000,000
Investment in Solo		46,000,000

c.

Current assets	4,000,000	
Plant assets	129,000,000	
Intangible assets	10,000,000	
Goodwill	30,000,000	
Liabilities		78,000,000
Investment in Solo		95,000,000

d.

Plant assets	4,000,000	
Intangible assets	10,000,000	
Goodwill	30,000,000	
Current assets		1,000,000
Liabilities		3,000,000
Investment in Solo		40,000,000

5. *Continued*

ANS: a
Rationale: Elimination (R) revalues Solo's identifiable assets and liabilities to fair value, and eliminates the excess of acquisition cost over book value ($95,000,000 - $49,000,000) from the investment account. Alternative a. does this correctly.

6. Topic: Consolidation working paper
LO 5
Pringle Company purchased all of the shares of Spoth Company for $10,000,000. At the date of acquisition, fair values of Spoth's current assets totaled $300,000, fair values of Spoth's plant assets totaled $3,800,000, and fair values of Spoth's liabilities were the same as reported values. There are no previously unreported intangible assets. The balance sheets of Pringle and Spoth immediately following the acquisition appear below.

	Pringle Co.	**Spoth Co.**
	Dr (Cr)	
Current assets	$ 1,500,000	$ 200,000
Plant assets	7,000,000	3,000,000
Investment in S Co.	10,000,000	--
Intangible assets	5,000,000	--
Liabilities	(16,000,000)	(2,400,000)
Common stock	(200,000)	(100,000)
Additional paid-in capital	(2,000,000)	(400,000)
Retained earnings	(4,600,000)	(150,000)
Treasury stock	300,000	20,000
Accumulated other comprehensive income	(1,000,000)	(170,000)

In elimination entry (E) on the consolidation working paper at the date of acquisition, the credit to Investment in Spoth is:

a. $820,000
b. $970,000
c. $840,000
d. $800,000

ANS: d
Rationale: Elimination (E) is:

Common stock	100,000	
Additional paid-in capital	400,000	
Retained earnings	150,000	
Accumulated other comprehensive income	170,000	
Treasury stock		20,000
Investment in Solo		800,000

7. Topic: Consolidation working paper
LO 5
Pringle Company purchased all of the shares of Spoth Company for $10,000,000. At the date of acquisition, fair values of Spoth's current assets totaled $300,000, fair values of Spoth's plant assets totaled $3,800,000, and fair values of Spoth's liabilities were the same as reported values. There are no previously unreported intangible assets. The balance sheets of Pringle and Spoth immediately following the acquisition appear below.

	Pringle Co.	Spoth Co.
	Dr (Cr)	
Current assets	$ 1,500,000	$ 200,000
Plant assets	7,000,000	3,000,000
Investment in S Co.	10,000,000	--
Intangible assets	5,000,000	--
Liabilities	(16,000,000)	(2,400,000)
Common stock	(200,000)	(100,000)
Additional paid-in capital	(2,000,000)	(400,000)
Retained earnings	(4,600,000)	(150,000)
Treasury stock	300,000	20,000
Accumulated other comprehensive income	(1,000,000)	(170,000)

In elimination entry (R) on the consolidation working paper at the date of acquisition, the debit to Goodwill is:

a. $8,400,000
b. $8,300,000
c. $6,000,000
d. $9,200,000

ANS: b
Rationale: Total excess of acquisition cost over book value = $10,000,000 – $800,000 = $9,200,000, which is the credit to Investment in Solo in elimination (R).

Elimination (R) is:

Current assets	100,000	
Plant assets	800,000	
Goodwill	8,300,000	
Investment in Solo		9,200,000

8. Topic: Consolidation working paper and bargain purchase
LO 5
Petra Corporation purchased all of the outstanding shares of Stuckey Corporation for $24,000,000. Stuckey's balance sheet at the date of acquisition is as follows:

	Book value	Fair value
	Dr (Cr)	
Current assets	$ 8,000,000	$ 6,500,000
Plant assets	90,000,000	60,000,000
Current liabilities	(4,000,000)	(4,000,000)
Noncurrent liabilities	(69,000,000)	(67,000,000)
Capital stock	(2,000,000)	
Retained earnings	(23,000,000)	

Stuckey has previously unreported intangibles, meeting the criteria for capitalization, with a fair value of 35,000,000. Elimination entry (R) on the consolidation working paper, is:

a.

Noncurrent liabilities	2,000,000	
Intangible assets	35,000,000	
Current assets		1,500,000
Plant assets		30,000,000
Gain on acquisition		5,500,000

b.

Noncurrent liabilities	2,000,000	
Intangible assets	35,000,000	
Current assets		1,500,000
Plant assets		30,000,000
Investment in Stuckey		2,000,000
Gain on acquisition		3,500,000

c.

Noncurrent liabilities	2,000,000	
Intangible assets	35,000,000	
Investment in Stuckey	1,000,000	
Current assets		1,500,000
Plant assets		30,000,000
Gain on acquisition		6,500,000

d.

Intangible assets	35,000,000	
Investment in Stuckey	1,000,000	
Current assets		1,500,000
Plant assets		30,000,000
Noncurrent liabilities		2,000,000
Gain on acquisition		2,500,000

8. *Continued*

ANS: c
Rationale: Elimination (E) removes Stuckey's equity accounts, crediting the investment by $25,000,000. Elimination (R) eliminates the remainder of the investment with a debit of $1,000,000, and revalues the identifiable net assets from book to fair value. The gain on investment is the price paid less the fair value of the identifiable net assets acquired, or $24,000,000 – ($6,500,000 + $60,000,000 + $35,000,000 – $4,000,000 – $67,000,000) = $6,500,000.

9. Topic: IFRS vs. U.S. GAAP, consolidation policy
LO 6
Which statement is *false* concerning IFRS and U.S. GAAP consolidation policy?

a. More investments are likely to be consolidated following IFRS standards than following U.S. GAAP.
b. More investments are likely to be consolidated following U.S. GAAP than following IFRS.
c. Both U.S. GAAP and IFRS use the concept of control to determine whether an entity should be consolidated.
d. It is very rare to see consolidation of a minority equity investment under U.S. GAAP.

ANS: b
Rationale: U.S. GAAP and IFRS both require consolidation of investments where the investor has control. However, U.S. GAAP defines control as majority stock ownership, while IFRS has a more flexible interpretation of control, allowing minority-owned investments to be consolidated.

10. Topic: IFRS vs. U.S. GAAP, consolidation policy
LO 6
Which statement is *true* concerning IFRS for consolidation of non-equity investments?

a. A company should consolidate a non-equity investment if it meets the criteria as a variable interest entity.
b. A company should never consolidate a non-equity investment.
c. A company should consolidate a non-equity investment if it owns a majority of its voting stock.
d. A company should consolidate a non-equity investment if it has control of the entity.

ANS: d
Rationale: IFRS uses the same concept of control for consolidation of all investments, including equity and non-equity investments.