

Chapter 4– Advanced Accounting, 1st edition by Hamlen, Huefner, and Largay

Solutions to Practice Quiz

1. Topic: Goodwill impairment loss: U.S. GAAP
LO 4

Goodwill of \$6,400,000 is recognized on an acquisition. Following U.S. GAAP, the goodwill is allocated to the following reporting segments:

Europe	\$ 3,840,000
Asia	2,560,000

At the end of the year, the following information is available on the segments:

	Fair value	Book value	Fair value of identifiable net assets
Europe	\$35,200,000	\$30,080,000	\$32,360,000
Asia	17,280,000	17,920,000	15,040,000

The goodwill impairment loss for the year, following U.S. GAAP, is:

- a. \$ 320,000
- b. \$ 640,000
- c. \$1,320,000
- d. \$1,640,000

ANS: a

Rationale: Goodwill impairment is possible for the Asia segment only (BV>FV).
Fair value of goodwill = \$17,280,000 – \$15,040,000 = \$2,240,000. Impairment loss = \$2,560,000 – \$2,240,000 = \$320,000

2. Topic: Goodwill impairment loss: IFRS

LO 6

Goodwill of \$6,400,000 is recognized on an acquisition. Following IFRS, the goodwill is allocated to the following cash generating units:

UK	\$ 640,000
Netherlands	3,200,000
China	1,920,000
Japan	640,000

At the end of the year, the following information is available on the units:

	Fair value	Book value	Fair value of identifiable net assets
UK	\$16,000,000	\$ 9,600,000	\$14,080,000
Netherlands	19,200,000	20,480,000	17,200,000
China	9,600,000	10,900,000	8,900,000
Japan	7,680,000	7,040,000	6,200,000

The goodwill impairment loss for the year, following IFRS, is:

- a. \$2,030,000
- b. \$2,420,000
- c. \$2,580,000
- d. \$2,640,000

ANS: c

Rationale: Goodwill impairment is as follows:

Netherlands	\$20,480,000 - \$19,200,000 =	\$1,280,000
China	10,900,000 - 9,600,000 =	<u>1,300,000</u>
Total		\$2,580,000

Use the following information to answer questions 3 – 6 below:

Kroft Foods acquired Codberry Inc. on January 1, 2012, for \$40,000,000, in a stock acquisition. Codberry's acquisition-date assets and liabilities were reported at amounts approximating fair value, except its inventories (FIFO) were overvalued by \$2,000,000, its property and equipment (20-year remaining life, straight-line) was overvalued by \$10,000,000, and it had previously unreported identifiable intangibles (5-year remaining life, straight-line) with a fair value of \$14,000,000. Goodwill from this acquisition was impaired by \$1,000,000 during 2012. Kroft uses the complete equity method to account for the investment on its own books. Below are the December 31, 2012 trial balances of Kroft and Codberry:

	Dr (Cr)	
	Kroft	Codberry
Current assets	\$ 8,000,000	\$ 6,200,000
Property and equipment, net	110,000,000	65,000,000
Investment in Codberry	41,200,000	--
Liabilities	(87,500,000)	(46,200,000)
Capital stock	(39,000,000)	(2,000,000)
Retained earnings, January 1	(16,000,000)	(20,500,000)
Dividends	--	500,000
Sales revenue	(50,000,000)	(20,000,000)
Equity in income of Codberry	(1,700,000)	--
Cost of goods sold	30,000,000	15,000,000
Operating expenses	5,000,000	2,000,000

3. Topic: Consolidation working paper, one year after acquisition
LO 1, 5

Working paper elimination entry (C) is:

- a.
- | | | |
|----------------------------------|-----------|-----------|
| Equity in net income of Codberry | 1,700,000 | |
| Investment in Codberry | | 1,700,000 |
- b.
- | | | |
|----------------------------------|-----------|-----------|
| Equity in net income of Codberry | 1,700,000 | |
| Dividends | | 500,000 |
| Investment in Codberry | | 1,200,000 |
- c.
- | | | |
|----------------------------------|-----------|-----------|
| Dividends | 500,000 | |
| Investment in Codberry | 1,200,000 | |
| Equity in net income of Codberry | | 1,700,000 |
- d.
- | | | |
|----------------------------------|-----------|-----------|
| Investment in Codberry | 1,700,000 | |
| Equity in net income of Codberry | | 1,700,000 |

3. *Continued*

ANS: b

Rationale: Elimination (C) eliminates the equity in net income account and the subsidiary's dividends account, and brings the investment back to its beginning-of-year value. Alternative b. does this correctly.

4. Topic: Consolidation working paper, one year after acquisition
LO 1, 5

Working paper elimination entry (E) is:

a.	Capital stock	2,000,000	
	Retained earnings, January 1	20,500,000	
	Investment in Codberry		22,500,000
b.	Capital stock	2,000,000	
	Investment in Codberry		2,000,000
c.	Capital stock	2,000,000	
	Retained earnings, January 1	36,500,000	
	Investment in Codberry		38,500,000
d.	Investment in Codberry	38,500,000	
	Capital stock		2,000,000
	Retained earnings, January 1		36,500,000

ANS: a

Rationale: Elimination (E) eliminates the subsidiary's beginning equity accounts against the investment account. Alternative a. does this correctly.

5. Topic: Consolidation working paper, one year after acquisition
LO 1, 5

Working paper elimination entry (R) is:

a.	Identifiable intangible assets	14,000,000	
	Property and equipment, net	10,000,000	
	Current assets		2,000,000
	Investment in Codberry		22,000,000
b.	Current assets	2,000,000	
	Property and equipment, net	10,000,000	
	Identifiable intangible assets	14,000,000	
	Goodwill	15,500,000	
	Investment in Codberry		41,500,000
c.	Identifiable intangible assets	14,000,000	
	Goodwill	11,500,000	
	Current assets	2,000,000	
	Property and equipment, net		10,000,000
	Investment in Codberry		17,500,000
d.	Identifiable intangible assets	14,000,000	
	Goodwill	15,500,000	
	Current assets		2,000,000
	Property and equipment, net		10,000,000
	Investment in Codberry		17,500,000

ANS: d

Rationale: Elimination (R) sets up the beginning of year revaluations and eliminates the remainder of the investment account. Alternative d. does this correctly.

6. Topic: Consolidation working paper, one year after acquisition
 LO 1, 3, 5
 Working paper elimination entry (O) is:

a.	Current assets	2,000,000	
	Property and equipment, net	500,000	
	Operating expenses	1,300,000	
	Identifiable intangible assets		2,800,000
	Goodwill		1,000,000
b.	Cost of goods sold	2,000,000	
	Property and equipment, net	500,000	
	Operating expenses	3,300,000	
	Current assets		2,000,000
	Identifiable intangible assets		2,800,000
	Goodwill		1,000,000
c.	Current assets	2,000,000	
	Property and equipment, net	500,000	
	Operating expenses	3,300,000	
	Identifiable intangible assets		2,800,000
	Goodwill		1,000,000
	Cost of goods sold		2,000,000
d.	Property and equipment, net	500,000	
	Operating expenses	3,300,000	
	Identifiable intangible assets		2,800,000
	Goodwill		1,000,000

ANS: c

Rationale: Elimination (O) records the current year write-offs of the revaluations. In the first year, the inventory on hand at the date of acquisition is sold, so all of the inventory revaluation is written off as a reduction in cost of goods sold. The first year write-off of the property and equipment revaluation is $\$10,000,000 / 20 = \$500,000$, a reduction in operating expenses. The write-off of identifiable intangibles is $\$14,000,000 / 5 = \$2,800,000$, an increase in operating expenses. The goodwill impairment loss of $\$1,000,000$ adds to operating expenses. Alternative c. does this correctly.

7. Topic: Impairment testing, identifiable intangibles, U.S. GAAP
LO 4

A parent acquired a subsidiary on June 30, 2010, the accounting year-end for both companies. The following previously unreported intangible assets were recognized in acquisition (*in millions*):

	Fair value	Useful life
Customer lists	\$ 60	3 years
Favorable leaseholds	200	5 years

No impairment losses were reported in fiscal 2011. It is now June 30, 2012. You have the following information regarding these intangibles:

	Customer lists	Favorable leaseholds
Total expected future undiscounted cash flows	\$ 23	\$100
Total expected future discounted cash flows	18	70

The intangibles impairment loss for fiscal 2012, following U.S. GAAP, is:

- \$ 50
- \$ 52
- \$ 92
- \$172

ANS: a

Rationale:

Book values at June 30, 2012:

Customer lists: $\$60 - [2 \times (\$60/3)] = \$20$

Favorable leaseholds: $\$200 - [2 \times (\$200/5)] = \$120$

Customer lists are not impaired ($\$20 < \23)

Favorable leaseholds are impaired ($\$120 > \100); the loss is $\$120 - \$70 = \$50$

8. Topic: Impairment testing, identifiable intangibles, IFRS
LO 6
Use the same information as in question 7. The intangibles impairment loss for fiscal 2012, following IFRS, is:

- a. \$ 50
- b. \$ 52
- c. \$ 92
- d. \$172

ANS: b

Rationale:

Book values at June 30, 2012:

Customer lists: $\$60 - [2 \times (\$60/3)] = \$20$

Favorable leaseholds: $\$200 - [2 \times (\$200/5)] = \$120$

Customer lists impairment: $\$20 - \$18 = \$2$

Favorable leaseholds impairment: $\$120 - \$70 = \$50$

Total impairment loss = $\$2 + \$50 = \$52$

9. Topic: Equity method and consolidated balances
LO 2

Which statement is *false* concerning a comparison of a parent's books and the consolidated financial statements of the parent and its subsidiary, when the parent uses the complete equity method to report its investment in its subsidiary?

- a. The parent's net income equals consolidated net income.
- b. The parent's retained earnings equals consolidated retained earnings.
- c. The parent's total assets are lower than consolidated total assets.
- d. The parent's dividends for the year are lower than consolidated dividends.

ANS: d

Rationale: In consolidation, the subsidiary's dividends are eliminated. So the parent's dividends equal consolidated dividends.

10. Topic: Reporting revaluations in subsequent years
LO 1, 3, 5

A subsidiary is acquired on July 1, 2008. Its assets and liabilities are revalued in acquisition as follows:

	Fair value less book value	Life
Inventories	\$ 5,000,000	LIFO
Intangibles	2,500,000	2 years
Bonds payable	(10,000,000)	5 years

Assume straight-line write-offs for the intangibles and bonds payable revaluations. It is now June 30, 2012, four years since acquisition. Consolidation working paper elimination O for 2012 is:

a.	Cost of goods sold	5,000,000	
	Amortization expense	1,250,000	
	Interest expense	2,000,000	
	Inventories		5,000,000
	Intangibles		1,250,000
	Bonds payable		2,000,000
b.	Amortization expense	1,250,000	
	Bonds payable	2,000,000	
	Intangibles		1,250,000
	Interest expense		2,000,000
c.	Interest expense	2,000,000	
	Bonds payable		2,000,000
d.	Bonds payable	2,000,000	
	Interest expense		2,000,000

ANS: c

Rationale: Using LIFO, the inventory at the date of acquisition is still on hand, so it is not written off. The intangibles revaluations have been completely written off. The bonds payable revaluation is still being written off; the amount is $\$10,000,000 / 5 = \$2,000,000$, and since its fair value is less than its book value, the write-off increases interest expense.