CHAPTER 1

UNDERSTANDING THE ISSUES

1. (a) Product extension—manufacturer expands product lines in boating industry.
(b) Vertical forward—manufacturer buys distribution outlets
(c) Conglomerate—unrelated businesses
(d) Vertical backward—manufacturer acquires a supplier
(e) Vertical forward—an entertainment company acquires outlets for its products
(f) Market extension—companies providing the same services expand their geographic market

2. By accepting cash in exchange for the net assets of the company, the seller would have to recognize an immediate taxable gain. However, if the seller were to accept common stock of another corporation instead, the seller could construct the transaction as a tax-free reorganization. The seller could then account for the transaction as a tax-free exchange. The seller would not pay taxes until the shares received were sold.

3.

Identifiable assets (fair value) ..	$600,000
Deferred tax liability	
($200,000 × 40%)	(80,000)
Net assets	$520,000
Goodwill	
Price paid	$850,000
Net assets	(520,000)
Goodwill	$330,000

4. (a) The net assets and goodwill will be recorded at their full fair value on the books of the parent on the date of acquisition.
(b) An investment account is recorded at the price paid for the interest.

5. Puncho will record the net assets at their fair value of $800,000 on its books. Also, Puncho will record goodwill of $100,000 ($900,000 – $800,000) resulting from the excess of the price paid over the fair value. Semos will record the removal of its net assets at their book values. Semos will record a gain on the sale of business of $500,000 ($900,000 – $400,000).

6. (a) Value Analysis:

Price paid	$800,000
Fair value of net assets	520,000
Goodwill..................................	$280,000
Current assets (fair value)	$120,000
Land (fair value)	80,000
Building and equipment	
(fair value)	400,000
Customer list (fair value)	20,000
Liabilities (fair value)	(100,000)
Goodwill..................................	280,000
Total	$800,000

(b) Value Analysis:

Price paid	$450,000
Fair value of net assets	520,000
Gain	$ (70,000)
Current assets (fair value)	$120,000
Land (fair value)	80,000
Building and equipment	
(fair value)	400,000
Customer list (fair value)	20,000
Liabilities (fair value)	(100,000)
Gain	(70,000)
Total	$450,000

7. The 2011 financial statements would be revised as they are included in the 2012–2011 comparative statements. The 2012 statements would be based on the new values. The adjustments would be:

(a) The equipment and building will be restated at $180,000 and $550,000 on the comparative 2011 and 2012 balance sheets.
(b) Originally, depreciation on the equipment is $40,000 ($200,000/5) per year. It will be recalculated as $36,000 ($180,000/5) per year. The adjustment for 2011 is for a half year. 2011 depreciation expense and accumulated depreciation will be restated at $18,000 instead of $20,000 for the half year. Depreciation expense for 2012 will be $36,000.

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

(c) Originally, depreciation on the building is $25,000 ($500,000/20) per year. It will be recalculated as $27,500 ($550,000/20) per year. The adjustment for 2011 is for a half year. 2011 depreciation expense and accumulated depreciation will be restated at $13,750 instead of $12,500 for the half year. Depreciation expense for 2012 will be $27,500.

(d) Goodwill is reduced $30,000 on the comparative 2011 and 2012 balance sheets.

8.

Fair value of operating unit	$1,200,000
Book value including goodwill	1,250,000
Goodwill is impaired.	

Fair value of operating unit	$1,200,000
Fair value of net identifiable assets (excluding goodwill)	1,120,000
Recalculated goodwill	$ 80,000
Existing goodwill	200,000
Goodwill impairment loss	$ 120,000

9. (a) An estimated liability should have been recorded on the purchase date. Any difference between that estimate and the $100,000 paid would be recorded as a gain or loss on the liability already recorded.

(b) Even though the issuance is based on performance and suggests additional goodwill, no adjustment is made if additional stock is issued. In this case, the paid-in capital in excess of par account is reduced for the par value of the additional shares to be issued. The fair value of the stock originally issued is being devalued.

The entry would take the following form:

Paid-In Capital in Excess of Par	10,000	
Common Stock ($1 par)		10,000

(c) This agreement is also settled by issuing shares. The price is not changed. The paid-in capital in excess of par account is reduced for the par value of the additional shares to be issued. The fair value of the stock originally issued is being devalued.

The entry would take the following form:

Paid-In Capital in Excess of Par	5,000	
Common Stock ($1 par)		5,000

10. The two major differences are:

(a) Goodwill is $100,000. Under U.S. GAAP it would be impairment tested and possibly reduced in future periods. Under IFRS, it would be amortized over some number of future periods.

(b) Under U.S. GAAP, the stock issue costs would reduce the amount credited to paid in capital. Under IFRS, the issue costs would be expensed in the period incurred.

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

EXERCISES

EXERCISE 1-1

		Debit	Credit
(1)	Current Assets	100,000	
	Land	90,000	
	Building	300,000	
	Equipment	275,000	
	Goodwill	187,000	
	Liabilities		102,000
	Cash		850,000
	Expenses (acquisition costs)	15,000	
	Cash		15,000
(2)	Cash	850,000	
	Liabilities	100,000	
	Accumulated Depreciation—Building	200,000	
	Accumulated Depreciation—Equipment	100,000	
	Current Assets		80,000
	Land		50,000
	Building		450,000
	Equipment		300,000
	Gain on Sale of Business		370,000

Note: Seller does not receive the acquisition costs.

		Debit	Credit
(3)	Investment in Crowley Company	850,000	
	Cash		850,000
	Expenses (acquisition costs)	15,000	
	Cash		15,000

Note: At year-end, Crowley would be consolidated with Barton, as explained in Chapter 2.

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

EXERCISE 1-2

Accounts Receivable	200,000	
Inventory	270,000	
Equipment	40,000	
Brand-Name Copyright	15,000	
Cash		160,000
Current Liabilities		80,000
Mortgage Payable		250,000
Gain on Acquisition*		35,000
Acquisition Expense	25,000	
Cash		25,000

*Total consideration:		
Cash		$160,000
Less fair value of net assets acquired:		
Accounts receivable	$ 200,000	
Inventory	270,000	
Equipment	40,000	
Brand-name copyright	15,000	
Current liabilities	(80,000)	
Mortgage payable	(250,000)	
Value of net identifiable assets acquired		195,000
Excess of total fair value over cost of net assets (gain)		$ (35,000)

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

EXERCISE 1-3

Cash	100,000	
Inventory	250,000	
Equipment	220,000	
Land	180,000	
Buildings	300,000	
Goodwill*	640,000	
Discount on Bonds Payable	140,000	
Current Liabilities		80,000
Bonds Payable		550,000
Common Stock		300,000
Paid-In Capital in Excess of Par		900,000
Acquisition Expense	25,000	
Paid-In Capital in Excess of Par	10,000	
Cash		35,000

*Total consideration:		
Common stock (60,000 shares × $20)		$1,200,000
Less fair value of net assets acquired:		
Cash	$100,000	
Inventory	250,000	
Equipment	220,000	
Land	180,000	
Buildings	300,000	
Current liabilities	(80,000)	
Bonds payable	(410,000)	
Value of net identifiable assets acquired		560,000
Excess of total cost over fair value of net assets (goodwill)		$ 640,000

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

EXERCISE 1-4

Account	Debit	Credit
Accounts Receivable	100,000	
Inventory	210,000	
Equipment for Resale ($200,000 less 10%)	180,000	
Land	200,000	
Building	450,000	
R&D Project	90,000	
Customer List	210,650	
Goodwill*	879,350	
Current Liabilities		80,000
Bonds Payable		200,000
Warranty Liability		40,000
Common Stock		100,000
Paid-In Capital in Excess of Par		1,900,000
Totals	*2,320,000*	*2,320,000*

*Total consideration:

Item		
Common stock (100,000 shares × $20)		$2,000,000
Less fair value of net assets acquired:		
Accounts receivable	$ 100,000	
Inventory	210,000	
Equipment for resale ($200,000 less 10%)	180,000	
Land	200,000	
Building	450,000	
R&D project	90,000	
Customer list ($100,000 payment discounted 3 years at 20%)	210,650*	
Current liabilities	(80,000)	
Bonds payable	(200,000)	
Estimated liability under warranty	(40,000)	
Value of net identifiable assets acquired		1,120,650
Excess of total cost over fair value of net assets (goodwill)		$ 879,350

*This amount is arrived at using table and would be 210,648 using financial calculator or Excel.

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

EXERCISE 1-5

(1)

Estimated Liability for Contingent Consideration	40,000	
Loss on Estimated Contingent Consideration	20,000	
Cash		60,000

2 × (average income of $55,000* – $25,000) less $40,000 liability already recorded.

*($50,000 + $60,000)/2 = $55,000

(2) Shares issued = $60,000/$5 per share = 12,000 shares
Since the contingency is settled in shares, goodwill is not increased and cash is not changed. The entry to record the 12,000 additional shares issued is as follows:

Paid-In Capital in Excess of Par	12,000	
Common Stock ($1 par)		12,000

(3)

Paid-In Capital in Excess of Par	50,000	
Common Stock ($1 par)		50,000

Deficiency [($6 – $4) × 100,000 shares]	$200,000
Divide by fair value	÷ $4
Added number of shares	50,000

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

EXERCISE 1-6

(1) Adjustments:

Final value of manufacturing plant		$700,000
Provisional value of manufacturing plant		600,000
Total increase		$100,000
Depreciation adjustment:		
Depreciation on final cost ($700,000/10 years)	$70,000	
Depreciation based on provisional cost ($600,000/10 years)	60,000	
Annual increase in depreciation	$10,000	
Adjustment for half year	$5,000	
Journal Entries:		
Plant Assets	100,000	
Goodwill		100,000
Retained Earnings (increase depreciation for half year)	5,000	
Plant Assets (because they are shown net of depreciation)		5,000

(2)

Balance Sheet
December 31, 2011 (revised)

Current assets	$ 300,000	Current liabilities	$ 300,000
Equipment (net)	600,000	Bonds payable	500,000
Plant assets (net)	1,695,000	Common stock ($1 par)	50,000
Goodwill	200,000	Paid-in capital in excess of par	1,300,000
		Retained earnings	645,000
Total assets	$2,795,000	Total liabilities and equity	$2,795,000

Summary Income Statement
For Year Ended December 31, 2011 (revised)

Sales revenue		$800,000
Cost of goods sold		520,000
Gross profit		$280,000
Operating expenses	$150,000	
Depreciation expense	85,000	235,000
Net income		$ 45,000

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

EXERCISE 1-7

Machine = $200,000

Deferred tax liability = $16,800

In this tax-free exchange, depreciation on $56,000 [($200,000 appraised value) – ($144,000* net book value)] of the machine's value is not deductible on future tax returns. The additional tax to be paid as a result of Lewison's inability to deduct the excess value assigned to the machine is $16,800 ($56,000 × 30%).

Goodwill = $800,000 – ($700,000 – $16,800)
= $116,800

*$180,000/10 yrs. × 2 prior years = $36,000 accumulated depreciation
$180,000 – $36,000 = $144,000 net book value

EXERCISE 1-8

Current Assets	100,000	
Equipment	200,000	
Building	270,000	
Deferred Tax Asset	90,000	
Goodwill*	350,000	
Current Liabilities		60,000
Cash		950,000

Price paid		$ 950,000
Less fair value of net assets:		
Current assets	$100,000	
Equipment	200,000	
Building	270,000	
Recorded (current) liabilities	(60,000)	510,000
Excess		$ 440,000
*Tax loss carryforward consideration:		
Deferred tax asset ($300,000 × 30%) = the value of the remaining carryforward		(90,000)
Goodwill		$ 350,000

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

EXERCISE 1-9

(1)

Purchase price	$600,000
Fair value of net assets other than goodwill	400,000
Goodwill	$200,000

The estimated value of the unit exceeds $600,000, confirming goodwill.

(2) (a)

Estimated fair value of business unit	$520,000
Book value of Anton net assets, including goodwill	$500,000

No impairment exists.

(b)

Estimated fair value of business unit	$400,000
Book value of Anton net assets, including goodwill	$450,000

Goodwill is impaired.

Estimated fair value of business units	$400,000
Fair value of net assets, excluding goodwill	340,000
Remeasured amount of goodwill	$ 60,000
Existing goodwill	200,000
Impairment loss	$140,000

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

APPENDIX EXERCISE

EXERCISE 1A-1

(1) Calculation of Earnings in Excess of Normal:

Average operating income:

2011	$ 90,000	
2012	110,000	
2013	120,000	
2014 (subtract $40,000)	100,000	
2015	130,000	
	$550,000 ÷ 5 years =	$110,000
Less normal return on assets at fair value:		
Accounts receivable	$100,000	
Inventory	125,000	
Land	100,000	
Building	300,000	
Equipment	250,000	
Fair value of total assets	$875,000	
Industry normal rate of return	× 12%	
Normal return on assets		105,000
Expected annual earnings in excess of normal		$ 5,000

(a) 5 × $5,000 = $25,000 Goodwill

(b) Capitalize the perpetual yearly earnings at 12%:

$$\text{Goodwill} = \frac{\text{Yearly Excess Earnings}}{\text{Capitalization Rate}}$$

$$= \frac{\$5,000}{0.12}$$

$$= \underline{\$41,667}$$

(c) Present value of a $5,000 annuity capitalized at 16%. The correct present value factor is found in the "present value of an annuity of $1" table, at 16% for 5 periods. This factor multiplied by the $5,000 yearly excess earnings will result in the present value:

3.2743 × $5,000 = $16,372

(2) The goodwill recorded would be $15,000. The journal entry (not required) would be as follows:

Accounts Receivable	100,000	
Inventory	125,000	
Land	100,000	
Building	300,000	
Equipment	250,000	
Goodwill	15,000	
Cash		690,000
Total Liabilities		200,000

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

PROBLEMS

PROBLEM 1-1

Total consideration for Vicker:		
Common stock (30,000 shares × $40)		$1,200,000
Less fair value of net assets acquired:		
Accounts receivable	$ 200,000	
Inventory	190,000	
Land	300,000	
Buildings	450,000	
Current liabilities	(160,000)	
Bonds payable	(90,000)	
Value of net identifiable assets acquired		890,000
Excess of total cost over fair value of net assets (goodwill)		$ 310,000

Bar entry to record the purchase of Vicker:		
Accounts Receivable	200,000	
Inventory	190,000	
Land	300,000	
Buildings	450,000	
Discount on Bonds Payable	10,000	
Goodwill	310,000	
Current Liabilities		160,000
Bonds Payable		100,000
Common Stock (30,000 shares × $10 par)		300,000
Paid-In Capital in Excess of Par		900,000
Dr. = Cr. Check Totals	*1,460,000*	*1,460,000*

Acquisition Expense	5,000	
Cash		5,000

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

Problem 1-1, Concluded

Total consideration for Kendal:		
Common stock (15,000 shares × $40)		$600,000
Less fair value of net assets acquired:		
Accounts receivable	$ 80,000	
Inventory	100,000	
Land	80,000	
Buildings	400,000	
Current liabilities	(55,000)	
Bonds payable	(95,000)	
Value of net identifiable assets acquired		510,000
Excess of total cost over fair value of net assets (goodwill)		$ 90,000

Bar entry to record the purchase of Kendal:

Accounts Receivable	80,000	
Inventory	100,000	
Land	80,000	
Buildings	400,000	
Discount on Bonds Payable	5,000	
Goodwill	90,000	
Current Liabilities		55,000
Bonds Payable		100,000
Common Stock (15,000 shares × $10 par)		150,000
Paid-In Capital in Excess of Par		450,000
Dr. = Cr. Check Totals	*755,000*	*755,000*

Acquisition Expense	4,000	
Cash		4,000

Paid-In Capital in Excess of Par	15,000	
Cash		15,000
To record issue and acquisition costs.		

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

PROBLEM 1-2

(1) Acquisition price $550,000

Total consideration:		
Cash		$550,000
Less fair value of net assets acquired:		
Accounts receivable	$ 79,000	
Inventory	120,000	
Other current assets	55,000	
Equipment	340,000	
Trademark	30,000	
In-process R&D	14,000	
Current liabilities	(145,000)	
Bonds payable	(100,000)	
Value of net identifiable assets acquired		393,000
Excess of total cost over fair value of net assets (goodwill)		$157,000

Journal Entry:		
Accounts Receivable	79,000	
Inventory	120,000	
Other Current Assets	55,000	
Equipment	340,000	
Trademark	30,000	
R&D	14,000	
Goodwill	157,000	
Cash		550,000
Current Liabilities		145,000
Bonds Payable		100,000
Dr. = Cr. Check Totals	*795,000*	*795,000*

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

Problem 1-2, Concluded

(2) Acquisition price $350,000

Total consideration:		
Cash		$350,000
Less fair value of net assets acquired:		
Accounts receivable	$ 79,000	
Inventory	120,000	
Other current assets	55,000	
Equipment	340,000	
Trademark	30,000	
In-process R&D	14,000	
Current liabilities	(145,000)	
Bonds payable	(100,000)	
Value of net identifiable assets acquired		393,000
Excess of fair value of net assets over cost (gain)		$ (43,000)

Journal Entry:		
Accounts Receivable	79,000	
Inventory	120,000	
Other Current Assets	55,000	
Equipment	340,000	
Trademark	30,000	
R&D	14,000	
Gain on Business Acquisition		43,000
Cash		350,000
Current Liabilities		145,000
Bonds Payable		100,000
Dr. = Cr. Check Totals	*638,000*	*638,000*

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

PROBLEM 1-3

(1) $500,000 consideration

Total consideration for Williams:		
Common stock (20,000 shares × $25)		$500,000
Less fair value of net assets acquired:		
Accounts receivable	$ 50,000	
Inventory	250,000	
Land	40,000	
Building	120,000	
Accounts payable	(40,000)	
Value of net identifiable assets acquired		420,000
Excess of total cost over fair value of net assets (goodwill)		$ 80,000

Kiln Corporation journal entries:		
Accounts Receivable	50,000	
Inventory	250,000	
Land	40,000	
Building	120,000	
Goodwill	80,000	
Accounts Payable		40,000
Common Stock		200,000
Paid-In Capital in Excess of Par		300,000
Dr. = Cr. Check Totals	*540,000*	*540,000*

(2) $385,000 consideration

Total consideration for Williams:		
Cash		$385,000
Less fair value of net assets acquired:		
Accounts receivable	$ 50,000	
Inventory	250,000	
Land	40,000	
Building	120,000	
Accounts payable	(40,000)	
Value of net identifiable assets acquired		420,000
Excess of fair value of net assets over cost (gain)		$ (35,000)

Kiln Corporation journal entries:		
Accounts Receivable	50,000	
Inventory	250,000	
Land	40,000	
Building	120,000	
Gain on Acquisition		35,000
Accounts Payable		40,000
Cash		385,000
Dr. = Cr. Check Totals	*460,000*	*460,000*

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

PROBLEM 1-4

Total consideration for Jack:		
Common stock (18,000 shares × $270)		$4,860,000
Less fair value of net assets acquired:		
Investments	$ 400,500	
Accounts receivable	925,000	
Inventory	1,200,000	
Prepaid insurance	18,000	
Land	70,000	
Machinery and equipment ($1,473,500 × 1.3)	1,915,550	
Current liabilities	(1,475,000)	
Value of net identifiable assets acquired		3,054,050
Excess of total cost over fair value of net assets (goodwill)		$1,805,950

Journal Entry:

Investments	400,500	
Accounts Receivable	925,000	
Inventory	1,200,000	
Prepaid Insurance	18,000	
Land	70,000	
Machinery and Equipment	1,915,550	
Goodwill	1,805,950	
Current Liabilities		1,475,000
Common Stock (18,000 × $10)		180,000
Paid-In Capital in Excess of Par [(18,000 × $270) – $180,000]		4,680,000
Dr. = Cr. Check Totals	*6,335,000*	*6,335,000*

Acquisition Expense	12,000	
Cash		12,000

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

PROBLEM 1-5

Total consideration for Sylvester:		
Cash		$580,000
Less fair value of net assets acquired:		
Notes receivable	$ 24,000	
Accounts receivable	56,000	
Inventory	30,000	
Other current assets	15,000	
Investments	63,000	
Land	55,000	
Building	275,000	
Equipment	426,000	
Patents	20,000	
Trade names	15,000	
Accounts payable	(45,000)	
Payroll and benefit-related liabilities—Current	(12,500)	
Debt maturing in one year	(10,000)	
Long-term debt	(248,000)	
Payroll and benefit-related liabilities—Long-Term	(156,000)	
Value of net identifiable assets acquired		507,500
Excess of total cost over fair value of net assets (goodwill)		$ 72,500

Journal Entry:		
Notes Receivable	24,000	
Accounts Receivable	56,000	
Inventory	30,000	
Other Current Assets	15,000	
Investments	63,000	
Land	55,000	
Building	275,000	
Equipment	426,000	
Patents	20,000	
Trade Names	15,000	
Goodwill	72,500	
Accounts Payable		45,000
Payroll and Benefit-Related Liabilities—Current		12,500
Debt Maturing in One Year		10,000
Long-Term Debt		248,000
Payroll and Benefit-Related Liabilities—Long-Term		156,000
Cash		580,000
Dr. = Cr. Check Totals	*1,051,500*	*1,051,500*

Acquisition Expense	20,000	
Cash		20,000

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

PROBLEM 1-6

(1) Total consideration for Smith:

Cash		$200,000
Stock issued (15,000 shares × $20)		300,000
Contingent liability ($50,000 × 75%)		37,500
Total consideration		$537,500
Less fair value of net assets acquired:		
Notes receivable	$ 33,000	
Inventory	80,000	
Prepaid expenses	15,000	
Investments	55,000	
Land	90,000	
Buildings	170,000	
Equipment	250,000	
Vehicles	25,000	
Franchise	70,000	
Accounts payable	(63,000)	
Taxes payable	(15,000)	
Interest payable	(3,000)	
Bonds payable	(220,000)	
Value of net identifiable assets acquired		487,000
Excess of total cost over fair value of net assets (goodwill)		$ 50,500

Journal Entry:

Notes Receivable	33,000	
Inventory	80,000	
Prepaid Expenses	15,000	
Investments	55,000	
Discount on Bonds Payable	30,000	
Land	90,000	
Buildings	170,000	
Equipment	250,000	
Vehicles	25,000	
Franchise	70,000	
Goodwill	50,500	
Accounts Payable		63,000
Taxes Payable		15,000
Interest Payable		3,000
Bonds Payable		250,000
Cash		200,000
Common Stock (15,000 shares × $2)		30,000
Paid-In Capital in Excess of Par		270,000
Estimated Contingent Liability		37,500
Dr. = Cr. Check Totals	*868,500*	*868,500*

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

Problem 1-6, Concluded

(2) Revised estimate of contingent payment ($50,000 × 90%)	$45,000	
Original estimate ($50,000 × 75%)	37,500	
Net increase	$ 7,500	
Journal Entry:		
Loss on Estimated Contingent Liability	7,500	
Estimated Contingent Liability		7,500

PROBLEM 1-7

Total consideration for Heinrich:		
Cash		$150,000
Less fair value of net assets acquired:		
Accounts receivable	$ 90,000	
Inventory	30,000	
Other current assets	8,000	
Equipment	80,000	
Vehicles	50,000	
Mailing list	10,000	
Accounts payable	(56,000)	
Accrued liabilities	(14,000)	
Notes payable	(30,000)	
Value of net identifiable assets acquired		168,000
Excess of fair value of net assets over price paid (gain)		$ (18,000)

Journal Entry:		
Accounts Receivable	90,000	
Inventory	30,000	
Other Current Assets	8,000	
Equipment	80,000	
Vehicles	50,000	
Mailing List	10,000	
Accounts Payable		56,000
Accrued Liabilities		14,000
Notes Payable		30,000
Gain on Acquisition of Business		18,000
Cash		150,000
Dr. = Cr. Check Totals	*268,000*	*268,000*

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

PROBLEM 1-8

(1) Total consideration for Yount:

Cash		$730,000
Less fair value of net assets acquired:		
Cash equivalents	$ 100,000	
Accounts receivable	120,000	
Inventory	70,000	
Depreciable fixed assets	400,000	
Current liabilities	(30,000)	
Long-term liabilities	(165,000)	
Value of net identifiable assets acquired		495,000
Excess of total cost over fair value of net assets (goodwill)		$235,000

Acquisition entry:

Cash Equivalents	100,000	
Accounts Receivable	120,000	
Inventory	70,000	
Depreciable Fixed Assets	400,000	
Goodwill	235,000	
Current Liabilities		30,000
Long-Term Liabilities		165,000
Cash		730,000
Dr. = Cr. Check Totals	*925,000*	*925,000*

Acquisition Expense	20,000	
Cash		20,000

(2) Pro Forma Income:

	Combined Income
Sales	$ 200,000
Less:	
Cost of goods sold ($120,000 + $20,000 additional for inventory valuation)	(140,000)
Other expenses	(25,000)
Depreciation (1/20 of $400,000 market value)	(20,000
Net income	$ 15,000

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

PROBLEM 1-9

Part A

Total consideration for Iris:		
Common stock (10,000 shares × $27)		$270,000
Less fair value of net assets acquired:		
Accounts receivable	$ 15,000	
Inventory	40,000	
Prepaid expenses	12,000	
Investments	33,000	
Land	40,000	
Building	85,000	
Equipment	50,000	
Patent	12,000	
Copyright	26,000	
Accounts payable	(22,000)	
Interest payable	(2,000)	
Notes payable	(40,000)	
Value of net identifiable assets acquired		249,000
Excess of total cost over fair value of net assets (goodwill)		$ 21,000

Journal Entry:		
Accounts Receivable	15,000	
Inventory	40,000	
Prepaid Expenses	12,000	
Investments	33,000	
Land	40,000	
Building	85,000	
Equipment	50,000	
Patent	12,000	
Copyright	26,000	
Goodwill	21,000	
Accounts Payable		22,000
Interest Payable		2,000
Notes Payable		40,000
Common Stock (10,000 shares × $5 par)		50,000
Paid-In Capital in Excess of Par ($270,000 – $50,000)		220,000
Dr. = Cr. Check Totals	*334,000*	*334,000*
Acquisition Expense	10,000	
Cash		10,000

Part B

Summary disclosure:

Sales revenue	$475,000
Net income	$28,920

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

Problem 1-9, Concluded

Worksheet for
Pro Forma Income Statement
For the Year Ending December 31, 2012
(Tax rate expressed as 0.4 for 40%)

Income Statement Accounts	Garman International	Iris Company		Adjustments Debit		Adjustments Credit	Pro Forma Combined Income Statement	
Sales Revenue	(350,000)	(125,000)						(475,000)
Cost of Goods Sold	147,000	55,000	(3)	2,000				204,000
Gross Profit	(203,000)	(70,000)						(271,000)
Selling Expenses	100,000	20,000					120,000	
Administrative Expenses	50,000	30,000					80,000	
Acquisition Expense			(4)	10,000			10,000	
Depreciation Expense—Garman	12,500						12,500	
Depreciation Expense—Iris		8,600	(1)	400			9,000	
Amortization Expense—Garman	1,000						1,000	
Amortization Expense—Iris		3,900			(2)	100	3,800	
Total Operating Expenses	163,500	62,500						236,300
Operating Income	(39,500)	(7,500)						(34,700)
Nonoperating Revenues and Expenses:								
Interest Expense		3,000					3,000	
Investment Income	(12,000)	(4,500)					(16,500)	
Total Nonoperating Revenues and Expenses								(13,500)
Income Before Taxes	(51,500)	(9,000)		12,400		100		(48,200)
Provision for Income Taxes (40%)	20,600	3,600						19,280
Net Income	(30,900)	(5,400)						(28,920)

(1) Adjust depreciation as follows:

New amounts:	
Building	$4,000
Equipment	5,000
Total new	$9,000
Recorded	8,600
Adjustment	$ 400

(2) Adjust amortization as follows:

New amounts:	
Patent	$1,200
Copyright	2,600
Total new	$3,800
Recorded	3,900
Adjustment	$ (100)

(3) Increase cost of goods sold to reflect fair value of beginning inventory.

(4) Expense acquisition costs.

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

PROBLEM 1-10

Current Assets	100,000	
Assets Under Operating Leases (fair)	580,000	
Net Investment in Direct Financing Leases*	710,605	
Leased Equipment Under Capital Lease (fair)	60,000	
Buildings (fair)	400,000	
Land (fair)	100,000	
Research & Development (fair)	200,000	
Goodwill‡	382,678	
Current Liabilities		150,000
Obligation Under Capital Lease of Equipment**		33,283
Estimated Liabilities Under Lawsuit (estimate)		50,000
Cash		2,300,000

*Recorded net investment in direct financing leases		$730,000
Less adjustment for $50,000 per year lease:		
Present value of payments of $50,000 per year for 5 years at 8%: $50,000 × 3.9927	$ 199,635	
Present value of payments of $50,000 per year for 5 years at 12%: $50,000 × 3.6048	(180,240)***	19,395
		$710,605

**Present value of 5 payments of $9,233 at 12%: $9,233 × 3.6048 = $33,283

***PV amounts are based on tables at the end of text. The use of a financial calculator or Excel ....will result in a minor (under $2) difference.

‡Cash	$2,300,000
Value assigned to identifiable net assets	1,917,322
Goodwill	$ 382,678

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

PROBLEM 1-11

Current Assets	150,000	
Equipment ($150,000 increase)	350,000	
Land and Buildings	250,000	
Deferred Tax Asset	54,000	
Goodwill*	91,000	
Bonds Payable		200,000
Deferred Tax Liability		45,000
Common Stock ($10 par)		100,000
Paid-In Capital in Excess of Par ($650,000 – $100,000 par)		550,000
Dr. = Cr. Check Totals	*895,000*	*895,000*
*Price paid (10,000 shares × $65 fair value)		$650,000
Fair value of net assets:		
Current assets	$ 150,000	
Equipment	350,000	
Deferred tax liability [30% × ($350,000 – $200,000)] from deferred increase in equipment value	(45,000)	
Land and buildings	250,000	
Bonds payable	(200,000)	
Deferred tax asset (30% × $180,000) from carryover losses	54,000	559,000
Excess attributable to goodwill (net of deferred tax liability)		$ 91,000

Acquisition Expense	10,000	
Cash		10,000

Paid-In Capital in Excess of Par	3,000	
Cash		3,000

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

PROBLEM 1-12

(1)

Reported Income for 2011
Combined Income Statement
For the Period Ending December 31, 2011

Sales revenue		$620,000
Cost of goods sold		223,000
Gross profit		$397,000
Selling expense	$140,000	
Administrative expenses	172,500	
Depreciation expense	20,550	
Amortization expense	10,600	343,650
Income from operations		$ 53,350
Other income and expenses		9,000
Income before taxes		$ 62,350
Provision for income taxes		18,705
Net income		$ 43,645

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

Problem 1-12, Continued

Name of Acquiring Company: Faber Enterprises
Name of Acquired Company: Ann's Tool Company
Income Statement
For the Year Ending December 31, 2011
(Tax rate expressed as 0.3 for 30%)

Income Statement Accounts	Faber Enterprises	6 Mo. Ann's Tool Co.	Adjustments Debit	Adjustments Credit	Combined Income Statement	
Sales Revenue	(550,000)	(70,000)				(620,000)
Cost of Goods Sold	200,000	25,000		(1) 2,000		223,000
Gross Profit	(350,000)	(45,000)				(397,000)
Selling Expenses	125,000	15,000			140,000	
Administrative Expenses	150,000	22,500			172,500	
Depreciation Expense—Faber	13,800				13,800	
Depreciation Expense—Ann's Tool		3,750	(2) 3,000		6,750	
Amortization Expense—Faber	5,600				5,600	
Amortization Expense—Ann's Tool		1,000	(3) 4,000		5,000	
Total Operating Expenses	294,400	42,250				343,650
Operating Income	(55,600)	(2,750)				(53,350)
Nonoperating Revenues and Expenses:						
Interest Expense		2,000			2,000	
Interest Income	(7,000)				(7,000)	
Dividend Income	(4,000)				(4,000)	
Total Nonoperating Revenues and Expenses						(9,000)
Income Before Taxes	(66,600)	(750)	7,000	2,000		(62,350)
Provision for Income Taxes (30%)	19,980	225				18,705
Net Income	(46,620)	(525)				(43,645)

(1) Reduce (sold) inventory to fair value.

(2) New depreciation:

Building, 1/2($125,000/25 years)	2,500
Equipment, ½($56,000/8 years)	3,500
Trucks, ½($3,000/2 years)	750
Total new depreciation	6,750
Recorded depreciation	3,750
Adjustment	3,000

(3) New amortization:

Patent, (1/2($18,000/6 years)	1,500
Computer software, ½($10,000/2years)	2,500
Copyright, ½($20,000/10 years)	1,000
Total new amortization	5,000
Recorded amortization	1,000
Adjustment	4,000

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

Problem 1-12, Concluded

(2) Pro forma disclosure for 2011 as if acquisition occurred at the start of the year:

Sales revenue ($550,000 + $140,000)	$ 690,000
Net income	$ 39,270
Calculation of net income:	
Reported net incomes before tax ($66,600 + $1,500)	$ 68,100
Inventory adjustment	2,000
Old Ann depreciation and amortization ($7,500 + $2,000)	9,500
New Ann amortization and depreciation	(23,500)*
Adjusted income before tax	$ 56,100
Tax provision (30%)	(16,830)
Net income	$ 39,270

*($2,500 + $3,500 + $750 + $1,500 + $2,500 + $1,000) = $11,750 × 2 = $23,500

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

PROBLEM 1-13

(1) Total consideration for Walsh:

Common stock (20,000 shares × $60)		$1,200,000
Less fair value of net assets acquired:		
Cash	$ 30,000	
Accounts receivable	60,000	
Investment in marketable securities	150,000	
Land	450,000	
Buildings	450,000	
Equipment	600,000	
Accounts payable	(120,000)	
Income tax payable	(190,000)	
Value of net identifiable assets acquired		1,430,000
Excess of fair value of net assets over cost (gain)		$ (230,000)

Journal Entry:

Cash	30,000	
Accounts Receivable	60,000	
Investment in Marketable Securities	150,000	
Land	450,000	
Buildings	450,000	
Equipment	600,000	
Accounts Payable		120,000
Income Tax Payable		190,000
Gain on Acquisition		230,000
Common Stock ($2 × 20,000 shares)		40,000
Paid-In Capital in Excess of Par ($1,200,000 – $40,000)		1,160,000
Dr. = Cr. Check Totals	*1,740,000*	*1,740,000*

(2) Entry to record contingent consideration:

Paid-In Capital in Excess of Par	1,740	
Common Stock (870 shares × $2)		1,740

Amount of consideration = deficiency in price × shares:
$2.50 × 20,000 shares = $50,000

Number of new shares needed: $\frac{\$50,000}{\$57.50 \text{ per share}}$ = 870 shares

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.

APPENDIX PROBLEM

PROBLEM 1A-1

(1) Bonds:

Present value of interest payments for 5 years at 8%,	
$27,000 × 3.9927	$107,803
Present value of principal due in 5 years at 8%,	
$300,000 × 0.6806	204,180*
Present value of bonds	$311,983

Goodwill:

Expected return	
($120,000 + $140,000 + $150,000 + $160,000 + $180,000) ÷ 5	$150,000
Normal return on assets	
($150,000 + $200,000 + $100,000 + $600,000) × 10%	105,000
Profit in excess of normal return	$ 45,000
Present value of excess of normal return for 5 years at 16%,	
$45,000 × 3.2743	$147,344

*PV amounts are based on tables at the end of text. The use of a financial calculator or Excel will result in a minor (under $2) difference.

(2)

Cash and Receivables	150,000	
Inventory	200,000	
Land	100,000	
Building	600,000	
Goodwill	147,344	
Current Liabilities		120,000
9% Bonds Payable		300,000
Premium on Bonds Payable		11,983
Cash		765,361

© 2012 Cengage Learning. All Rights Reserved. This edition is intended for use outside of the U.S. only, with content that may be different from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.