Debit	Credit	Consolidated Totals
		(2,300,000)
		(2,580,000)
		(4,880,000)
		770,000
	(A) 10,000	1,190,000
(A) 220,000		1,920,000
	(A) 1,100,000 (S) 600,000	-0-
(A) 100,000		9,900,000
(A) 190,000		190,000
(A) 500,000		500,000
(A) 100,000		100,000
		14,570,000
		(600,000)
		(4,500,000)
		(100,000)
(S) 220,000		(3,000,000)
(S) 100,000		(1,490,000)
(S) 280,000		(4,880,000)
		(14,570,000)

...tingent performance liability.

...e "Investment in Richmond" account balance on Miller's ...,510,000 fair value of the net identifiable assets received ... the general rule of using the consideration transferred to ...d firm.

...arrangements that can take place to create a business

...al statements mean?

... the purpose of a worksheet?

...n stock of Hudson, Inc., by issuing 50,000 shares of its own ...ight the determination of an acquisition price be difficult?

...lidating assets and liabilities in a business combination

son had to pay $98,000 to lawyers, accountants, and a stock brokerage firm in connection with services rendered during the creation of this business combination. In addition, Harrison paid $56,000 in costs associated with the stock issuance. How will these two costs be recorded under the acquisition method?

Problems

Note: Problems 1–20 relate to the acquisition method of accounting for business combinations. Problems 21 through 25 relate to the purchase method. Problems 26–28 relate to the pooling method.

The Acquisition Method

1. Which of the following is the best theoretical justification for consolidated financial statements?
   a. In form the companies are one entity; in substance they are separate.
   b. In form the companies are separate; in substance they are one entity.
   c. In form and substance the companies are one entity.
   d. In form and substance the companies are separate.
   (AICPA)
2. What is a statutory merger?
   a. A merger approved by the Securities and Exchange Commission.
   b. An acquisition involving the purchase of both stock and assets.
   c. A takeover completed within one year of the initial tender offer.
   d. A business combination in which only one company continues to exist as a legal entity.
3. What is the appropriate accounting treatment for the value assigned to in-process research and development acquired in a business combination?
   a. Expense upon acquisition.
   b. Capitalize as an asset.
   c. Expense if there is no alternative use for the assets used in the research and development and technological feasibility has yet to be reached.
   d. Expense until future economic benefits become certain and then capitalize as an asset.
4. An acquired entity has a long-term operating lease for an office building used for central management. The terms of the lease are very favorable relative to current market rates. However, the lease prohibits subleasing or any other transfer of rights. In its financial statements, the acquiring firm should report the value assigned to the lease contract as
   a. An intangible asset under the contractual-legal criterion.
   b. A part of goodwill.
   c. An intangible asset under the separability criterion.
   d. A building.
5. Williams Company obtains all of the outstanding stock of Jaminson, Inc. In a consolidation prepared immediately after the takeover, at what value will Jaminson's inventory be consolidated?
   a. At Jaminson's historical cost.
   b. A percentage of the acquisition cost paid by Williams.
   c. The inventory will be omitted in the consolidation.
   d. At the acquisition-date fair value.

17. On June 30, 2009, Sampras Company reported the following account balances:

Receivables	$ 80,000	Current liabilities	$ (10,000)
Inventory	70,000	Long-term liabilities	(50,000)
Buildings (net)	75,000	Common stock	(90,000)
Equipment (net)	25,000	Retained earnings	(100,000)
Total assets	$250,000	Total liabilities and equities	$(250,000)

On June 30, 2009, Pelham paid $300,000 cash for all assets and liabilities of Sampras, which will cease to exist as a separate entity. In connection with the acquisition, Pelham paid $10,000 in direct combination costs and agreed to pay $50,000 to the former owners of Sampras contingent on meeting certain revenue goals during 2010. Pelham estimated the present value of its probability adjusted expected payment for the contingency at $15,000.

In determining its offer, Pelham noted the following pertaining to Sampras:

- It holds a building with a fair value $40,000 more than its book value.
- It has developed a customer list appraised at $22,000, although it is not recorded in its financial records.
- It has research and development activity in process with an appraised fair value of $30,000. However, the project has not yet reached technological feasibility and the assets used in the activity have no alternative future use.
- Book values for the receivables, inventory, equipment, and liabilities approximate fair values.

Prepare Pelham's accounting entry to record the combination with Sampras using the

a. Acquisition method.

b. Purchase method.

18. SafeData Corporation has the following account balances and respective fair values on June 30:

	Book Values	Fair Values
Receivables	$ 80,000	$ 80,000
Patented technology	100,000	700,000
Customer relationships	-0-	500,000
In-process research and development	-0-	300,000
Liabilities	(400,000)	(400,000)
Common stock	(100,000)	
Additional paid-in capital	(300,000)	
Retained earnings deficit, 1/1	700,000	
Revenues	(300,000)	
Expenses	220,000	

Privacy First, Inc., obtained all of the outstanding shares of SafeData on June 30 by issuing 20,000 shares of common stock having a $1 par value but a $75 fair market value. Privacy First incurred $10,000 in stock issuance costs and paid $75,000 to an investment banking firm for its assistance in arranging the combination. In negotiating the final terms of the deal, Privacy First also agrees to pay $100,000 to SafeData's former owners if it achieves certain revenue goals in the next two years. Privacy First estimates the probability adjusted present value of this contingent performance obligation at $30,000. The transaction is to be accounted for using the acquisition method.

a. What is the fair value of the consideration transferred in this combination?

b. How should the stock issuance costs appear in Privacy First's postcombination financial statements?

c. How should Privacy First account for the fee paid to the investment bank?

d. How does the issuance of these shares affect the stockholders' equity accounts of Privacy First, the parent?

e. How is the fair value of the consideration transferred in the combination allocated among the assets acquired and the liabilities assumed?

f. What is the effect of SafeData's revenues and expenses on consolidated totals? Why?

g. What is the effect of SafeData's Common Stock and Additional Paid-In Capital balances on consolidated totals?

h. If Privacy First's stock had been worth only $50 per share rather than $75, how would the consolidation of SafeData's assets and liabilities have been affected?

19. On January 1, 2009, NewTune Company exchanges 15,000 shares of its common stock for all of the outstanding shares of On-the-Go, Inc. Each of NewTune's shares has a $4 par value and a $50 fair value. The fair value of the stock exchanged in the acquisition was considered equal to On-the-Go's fair value. NewTune also paid $25,000 in stock registration and issuance costs in connection with the merger.

Several of On-the-Go's accounts have fair values that differ from their book values on this date:

	Book Values	Fair Values
Receivables	$ 65,000	$ 63,000
Trademarks	95,000	225,000
Record music catalog	60,000	180,000
In-process research and development	-0-	200,000
Notes payable	(50,000)	(45,000)

Precombination January 1, 2009, book values for the two companies are as follows:

	NewTune	On-the-Go
Cash	$ 60,000	$ 29,000
Receivables	150,000	65,000
Trademarks	400,000	95,000
Record music catalog	840,000	60,000
Equipment (net)	320,000	105,000
Totals	$ 1,770,000	$ 354,000
Accounts payable	$ (110,000)	$ (34,000)
Notes payable	(370,000)	(50,000)
Common stock	(400,000)	(50,000)
Additional paid-in capital	(30,000)	(30,000)
Retained earnings	(860,000)	(190,000)
Totals	$(1,770,000)	$(354,000)

Required:

a. Assume that this combination is a statutory merger so that On-the-Go's accounts will be transferred to the records of NewTune. On-the-Go will be dissolved and will no longer exist as a legal entity. Using the acquisition method, prepare a postcombination balance sheet for NewTune as of the acquisition date.

b. Assume that no dissolution takes place in connection with this combination. Rather, both companies retain their separate legal entities. Using the acquisition method, prepare a worksheet to consolidate the two companies as of the combination date.

c. How do the balance sheet accounts compare across parts (*a*) and (*b*)?

20. On December 31, 2009, Pacifica, Inc., acquired 100 percent of the voting stock of Seguros Company. Pacifica will maintain Seguros as a wholly owned subsidiary with its own legal and accounting identity. The consideration transferred to the owner of Seguros included 50,000 newly issued Pacifica common shares ($20 market value, $5 par value) and an agreement to pay an additional $130,000 cash if Seguros meets certain project completion goals by December 31, 2010. Pacifica estimates a 50 percent probability that Seguros will be successful in meeting these goals and uses a 4 percent discount rate to represent the time value of money.

Immediately prior to the acquisition, the following data for both firms were available:

	Pacifica	Seguros Book Values	Seguros Fair Values
Revenues	$(1,200,000)		
Expenses	875,000		
Net income	$ (325,000)		
Retained earnings, 1/1/09	(950,000)		
Net income	(325,000)		
Dividends paid	90,000		
Retained earnings, 12/31/09	$(1,185,000)		

(*continued*)

	Pacifica	Seguros Book Values	Seguros Fair Values
Cash	110,000	$ 85,000	$ 85,000
Receivables and inventory	750,000	190,000	180,000
Property, plant, and equipment	1,400,000	450,000	600,000
Trademarks	300,000	160,000	200,000
Total assets	$ 2,560,000	$ 885,000	
Liabilities	(500,000)	(180,000)	$(180,000)
Common stock	(400,000)	(200,000)	
Additional paid-in capital	(475,000)	(70,000)	
Retained earnings	(1,185,000)	(435,000)	
Total liabilities and equities	$(2,560,000)	$(885,000)	

In addition, Pacifica assessed a research and development project under way at Seguros to have a fair value of $100,000. Pacifica paid legal and accounting fees of $15,000 in connection with the acquisition and $9,000 in stock issue and registration costs.

Using the acquisition method, prepare the following:

a. Pacifica's entries to account for the consideration transferred to the former owners of Seguros, the direct combination costs, and the stock issue and registration costs. (Use a 0.961538 present value factor where applicable.)

b. A postacquisition column of accounts for Pacifica.

c. A worksheet to produce a consolidated balance sheet as of December 31, 2009.

Purchase Method

21. Bakel Corporation has the following December 31 account balances:

Receivables	$ 80,000
Inventory	200,000
Land	600,000
Building	500,000
Liabilities	(400,000)
Common stock	(100,000)
Additional paid-in capital	(100,000)
Retained earnings, 1/1	(700,000)
Revenues	(300,000)
Expenses	220,000

Several of Bakel's accounts have fair values that differ from book value: land—$400,000; building—$600,000; inventory—$280,000; and liabilities—$330,000. Homewood, Inc., obtains all of Bakel's outstanding shares by issuing 20,000 shares of common stock having a $5 par value but a $55 fair value. Stock issuance costs amount to $10,000.

a. What is the purchase price in this combination?

b. What is the book value of Bakel's net assets on the date of the takeover?

c. How are the stock issuance costs handled?

d. How does the issuance of these shares affect the stockholders' equity accounts of Homewood, the parent?

e. What allocations are made of Homewood's purchase price to specific accounts and to goodwill?

f. If Bakel had in-process research and development assets (with no alternative future uses) valued at $60,000, how would the allocations in part (*e*) change? Where is acquired in-process research and development typically reported on consolidated financial statements?

g. How do Bakel's revenues and expenses affect consolidated totals? Why?

h. How do Bakel's common stock and additional paid-in capital balances affect consolidated totals?

i. In financial statements prepared immediately following the takeover, what impact will this acquisition have on the various consolidated totals?

j. If Homewood's stock had been worth only $40 per share rather than $55, how would the consolidation of Bakel's assets and liabilities have been affected?

22. Winston has the following account balances as of February 1.

Inventory	$ 600,000
Land	500,000
Buildings (net) (valued at $1,000,000)	900,000
Common stock ($10 par value)	(800,000)
Retained earnings 1/1	(1,100,000)
Revenues	(600,000)
Expenses	500,000

Arlington pays $1.4 million cash and issues 10,000 shares of its $30 par value common stock (valued at $80 per share) for all of Winston's outstanding stock. Stock issuance costs amount to $30,000. Prior to recording these newly issued shares, Arlington reports a Common Stock account of $900,000 and Additional Paid-In Capital of $500,000. For each of the following accounts, determine what balance would be included in a February 1 consolidation.

a. Goodwill.

b. Expenses.

c. Retained Earnings, 1/1.

d. Buildings.

23. Use the same information as presented in question (22) but assume that Arlington pays cash of $2.3 million. No stock is issued. An additional $40,000 is paid in direct combination costs. For each of the following accounts, determine what balance would be included in a February 1 consolidation.

a. Goodwill.

b. Expenses.

c. Retained Earnings, 1/1.

d. Buildings.

24. Use the same information as presented in question (22) but assume that Arlington pays $2,020,000 in cash. An additional $20,000 is paid in direct combination costs. For each of the following accounts, determine what balance will be included in a February 1 consolidation.

a. Inventory.

b. Goodwill.

c. Expenses.

d. Buildings.

e. Land.

25. Merrill acquires 100 percent of the outstanding voting shares of Harriss Company on January 1, 2008. To obtain these shares, Merrill pays $200,000 in cash and issues 10,000 shares of its own $10 par value common stock. On this date, Merrill's stock has a fair value of $18 per share. Merrill also pays $10,000 to a local investment company for arranging the acquisition. Merrill paid an additional $6,000 in stock issuance costs.

The book values for both Merrill and Harriss as of January 1, 2008, follow. The fair value of each of Harriss's accounts is also included. In addition, Harriss holds a fully amortized patent that still retains a $30,000 value.

	Merrill, Inc.	Harriss Company	
	Book Values	Book Values	Fair Values
Cash	$ 300,000	$ 40,000	$ 40,000
Receivables	160,000	90,000	80,000
Inventory	220,000	130,000	130,000
Land	100,000	60,000	60,000
Buildings (net)	400,000	110,000	140,000
Equipment (net)	120,000	50,000	50,000
Accounts payable	(160,000)	(30,000)	(30,000)
Long-term liabilities	(380,000)	(170,000)	(150,000)
Common stock	(400,000)	(40,000)	
Retained earnings	(360,000)	(240,000)	