Chapter 1—Business Combinations: New Rules for a Long-Standing Business Practice

MULTIPLE CHOICE

1. An economic advantage of a business combination includes
   a. Utilizing duplicative assets.
   b. Creating separate management teams.
   c. Shared fixed costs.
   d. Horizontally combining levels within the marketing chain.

   ANS: C
   Business combinations may viewed as a way to take advantage of economies of scale by utilizing common facilities and sharing fixed costs.

   DIF: E   OBJ: 1-1

2. One large Midwestern bank’s acquisition of another midwestern bank would be an example of a:
   a. market extension merger.
   b. conglomerate merger.
   c. product extension merger.
   d. horizontal merger.

   ANS: D
   A horizontal merger occurs when two companies offering similar products or services that are likely competitors in the same marketplace merge.

   DIF: M   OBJ: 1-1

3. A large nation-wide bank’s acquisition of a major investment advisory firm would be an example of a:
   a. market extension merger.
   b. conglomerate merger.
   c. product extension merger.
   d. horizontal merger.

   ANS: C
   A product extension merger occurs when the acquiring company is expanding its product offerings in the market place in which it sells.

   DIF: M   OBJ: 1-1

4. A building materials company’s acquisition of a television station would be an example of a:
   a. market extension merger.
   b. conglomerate merger.
   c. product extension merger.
   d. horizontal merger.

   ANS: B
   Because these firms are in unrelated lines of business, this would be a conglomerate merger.

   DIF: M   OBJ: 1-1
5. A tax advantage of business combination can occur when the existing owner of a company sells out and receives:
   a. cash to defer the taxable gain as a "tax-free reorganization."
   b. stock to defer the taxable gain as a "tax-free reorganization."
   c. cash to create a taxable gain.
   d. stock to create a taxable gain.

   ANS: B

   If the owners of a business sell their interests for cash or accept debt instruments, they would have an immediate taxable gain. However, if they accept common stock of another corporation and the transaction is crafted as such, they may account for the transaction as a “tax-free reorganization.” If this is the case, no taxes are paid until they sell the shares received in the transaction.

   DIF: E  OBJ: 1-1

6. A controlling interest in a company implies that the parent company
   a. owns all of the subsidiary's stock.
   b. has acquired a majority of the subsidiary's common stock.
   c. has paid cash for a majority of the subsidiary's stock.
   d. has transferred common stock for a majority of the subsidiary's outstanding bonds and debentures.

   ANS: B

   Typically, a controlling interest is over 50% of the company’s voting stock.

   DIF: E  OBJ: 1-2

7. Some advantages of obtaining control by acquiring a controlling interest in stock include all but:
   a. Negotiations are made directly with the acquiree’s management.
   b. The legal liability of each corporation is limited to its own assets.
   c. The cost may be lower since only a controlling interest in the assets, not the total assets, is acquired.
   d. Tax advantages may result from preservation of the legal entities.

   ANS: A

   If a company was acquiring a controlling interest in stock, the negotiations would be with the target company’s stockholders.

   DIF: M  OBJ: 1-2

8. A(n) ______ occurs when the management of the target company purchases a controlling interest in that company and the company incurs a significant amount of debt as a result.
   a. greenmail
   b. statutory merger
   c. poison pill
   d. leveraged buyout

   ANS: D

   A leveraged buyout is defensive move against an unfriendly takeover where management of the target company purchases a controlling interest in the company. Usually, a significant amount of debt is incurred.

   DIF: E  OBJ: 1-2
9. Acquisition costs such as the fees of accountants and lawyers that were necessary to negotiate and consummate the purchase are
   a. recorded as a deferred asset and amortized over a period not to exceed 15 years
   b. expensed if immaterial but capitalized and amortized if over 2% of the acquisition price
   c. expensed in the period of the purchase
   d. included as part of the price paid for the company purchased

   ANS:  C
   Direct costs of the acquisition, such as professional fees incurred to negotiate and consummate the purchase are expensed in the period of purchase. Costs related to the issuance of securities related to the purchase may be deducted from the value assigned to paid-in capital in excess of par.

   DIF:  M  OBJ:  1-3

10. Which of the following costs of a business combination can be deducted from the value assigned to paid-in capital in excess of par?
    a. Direct and indirect acquisition costs.
    b. Direct acquisition costs.
    c. Direct acquisition costs and stock issue costs if stock is issued as consideration.
    d. Stock issue costs if stock is issued as consideration.

    ANS:  D
    Stock issue costs can be deducted from the value assigned to paid-in capital in excess of par when stock is issued as consideration. All other direct and indirect acquisition costs are expensed.

    DIF:  E  OBJ:  1-3

11. When determining the fair values of assets acquired in an acquisition, the highest level of measurement per GAAP is
    a. adjusted market value based on prices of similar assets.
    b. unadjusted market values in an actively traded market.
    c. based on discounted cash flows.
    d. the entity’s best estimate of an exit or sale value.

    ANS:  B
    FASB provides a hierarchy of values where the highest level measurement possible should be used. The level is as follows:

    Level 1 - Unadjusted quoted market values in an actively traded market.
    Level 2 - Adjusted market value based on prices of similar assets or on observable other inputs such as interest rates.
    Level 3 - Fair value based on unobservable inputs such as the entity’s best estimate of an exit value.

    DIF:  E  OBJ:  1-3

12. Company B acquired the net assets of Company S in exchange for cash. The acquisition price exceeds the fair value of the net assets acquired. How should Company B determine the amounts to be reported for the plant and equipment, and for long-term debt of the acquired Company S?

    Plant and Equipment  Long-Term Debt
    a. Fair value  S's carrying amount
b. Fair value
\[ \text{Fair value} \]
c. S's carrying amount
\[ \text{Fair value} \]
d. S's carrying amount
\[ S's \text{ carrying amount} \]

ANS: B
All assets acquired and liabilities assumed in an acquisition should be recorded at fair value.

DIF: M
OBJ: 1-4

13. Crystal Co. purchased all of the common stock of Sill Corp. on January 1 of the current year. Five years prior to the acquisition, Sill Corp. had issued 30-year bonds bearing an interest rate of 8%. At the time of the acquisition, the prevailing interest rate for similar bonds was 5%. These bonds should be included in the consolidated balance sheet at
a. face value.
b. at a value higher than Sill’s recorded value due to the change in interest rates.
c. at a value lower than Sill’s recorded value due to the change in interest rates.
d. at Sill’s recorded value.

ANS: B
All assets acquired and liabilities assumed should be recorded at their fair values. A change in interest rates may result in a market value that is different than the recorded value of the bonds. Generally, when interest rates fall, prices on bonds with higher stated interest rates will increase as investors are generally willing to pay more for the higher rate of return.

DIF: D
OBJ: 1-4

14. ACME Co. paid $110,000 for the net assets of Comb Corp. At the time of the acquisition the following information was available related to Comb's balance sheet:

<table>
<thead>
<tr>
<th>Book Value</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets</td>
<td>$50,000</td>
</tr>
<tr>
<td>Building</td>
<td>80,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>40,000</td>
</tr>
<tr>
<td>Liabilities</td>
<td>30,000</td>
</tr>
</tbody>
</table>

What is the amount recorded by ACME for the Building?
a. $110,000
b. $20,000
c. $80,000
d. $100,000

ANS: D
Identifiable assets and liabilities of the acquiree are recorded at fair value.

DIF: E
OBJ: 1-4

15. ABC Co. is acquiring XYZ Inc. XYZ has the following intangible assets:

Patent on a product that is deemed to have no useful life $10,000.
Customer list with an observable fair value of $50,000.
A 5-year operating lease with favorable terms having a discounted present value of $8,000.
Identifiable research and development costs of $100,000.
ABC will record how much for acquired Intangible Assets from the purchase of XYZ Inc?

a. $168,000  
b. $58,000  
c. $158,000  
d. $150,000

ANS: C

### Amounts to be recorded

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Patent</td>
<td>$ -</td>
</tr>
<tr>
<td>Customer list</td>
<td>50,000</td>
</tr>
<tr>
<td>Favorable operating lease</td>
<td>8,000</td>
</tr>
<tr>
<td>Identifiable research and development costs</td>
<td>100,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$158,000</strong></td>
</tr>
</tbody>
</table>

Because the patent is on a product having no useful life, it has no value. It is appropriate to recognize the other intangibles in an acquisition.

DIF: D

OBJ: 1-4

16. Which of the following would not be considered an identifiable intangible asset?
   a. Assembled workforce  
b. Customer lists  
c. Production backlog  
d. Internet domain name

ANS: A

An assembled workforce is specifically stated by FASB as not qualifying as an identifiable intangible asset. Whatever value it has would be included in the value recorded for goodwill.

DIF: E

OBJ: 1-4

17. A contingent liability of an acquiree
   a. refers to future consideration due that is part of the acquisition agreement.  
b. is recorded when it is probable that future events will confirm its existence.  
c. may be recorded beyond the measurement period under certain circumstances.  
d. should be recorded even if the amount cannot be reasonably estimated.

ANS: B

Two criteria must be met for an estimate of a contingent liability to be recorded: 1) information available indicates a liability had been incurred at the acquisition date, and 2) the amount of the liability can be reasonably estimated. Examples of a contingent liability might include pending claims, unfavorable lawsuits or environmental liabilities. Contingent liabilities should not be confused with contingent consideration that is part of the acquisition agreement.

DIF: M

OBJ: 1-4

18. Goodwill results when:
   a. a controlling interest is acquired.  
b. the price of the acquisition exceeds the sum of the fair values of the net identifiable assets acquired.
c. the fair value of net assets acquired exceeds the acquisition price.
d. the price of the acquisition exceeds the book value of an acquired company.

ANS: B

If the acquisition price exceeds the sum of the fair value of the net identifiable assets acquired, the excess price is goodwill.

DIF: E OBJ: 1-4

19. Cozzi Company is being purchased and has the following balance sheet as of the purchase date:

| Current assets | $200,000 | Liabilities | $ 90,000 |
| Fixed assets   | 180,000  | Equity       | 290,000  |
| Total          | $380,000 | Total        | $380,000 |

The price paid for Cozzi's net assets is $500,000. The fixed assets have a fair value of $220,000, and the liabilities have a fair value of $110,000. The amount of goodwill to be recorded in the purchase is:

a. $0
b. $150,000
c. $170,000
d. $190,000

ANS: D

Acquisition price $500,000

Fair value:  Current assets $ 200,000
Fixed assets 220,000
Liabilities (110,000) 310,000

Goodwill $190,000

DIF: M OBJ: 1-4

20. Publics Company acquired the net assets of Citizen Company during 20X5. The purchase price was $800,000. On the date of the transaction, Citizen had no long-term investments in marketable equity securities and $400,000 in liabilities, of which the fair value approximated book value. The fair value of Citizen assets on the acquisition date was as follows:

Current assets $ 800,000
Noncurrent assets 600,000
$1,400,000

How should Publics account for the difference between the fair value of the net assets acquired and the acquisition price of $800,000?

a. Retained earnings should be reduced by $200,000.
b. A $600,000 gain on acquisition of business should be recognized.
c. A $200,000 gain on acquisition of business should be recognized.
d. A deferred credit of $200,000 should be set up and subsequently amortized to future net income over a period not to exceed 40 years.

ANS: C

Fair value of total assets $1,400,000
Fair value of liabilities 400,000
Fair value of net assets 1,000,000
21. ACME Co. paid $110,000 for the net assets of Comb Corp. At the time of the acquisition the following information was available related to Comb's balance sheet:

<table>
<thead>
<tr>
<th></th>
<th>Book Value</th>
<th>Fair Value</th>
</tr>
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<tbody>
<tr>
<td>Current Assets</td>
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<tr>
<td>Building</td>
<td>80,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>40,000</td>
<td>50,000</td>
</tr>
<tr>
<td>Liabilities</td>
<td>30,000</td>
<td>30,000</td>
</tr>
</tbody>
</table>

What is the amount of goodwill or gain related to the acquisition?

- a. Goodwill of $70,000
- b. Goodwill of $30,000
- c. A gain of $30,000
- d. A gain of $70,000

ANS: D

Acquisition price $110,000
Fair value of net assets acquired:
Current assets $50,000
Building 110,000
Equipment 50,000
Liabilities (30,000) 180,000
Gain on acquisition of business $(70,000)

DIF: M OBJ: 1-4

22. Jones company acquired Jackson Company for $2,000,000 cash. At that time, the fair value of recorded assets and liabilities was $1,500,000 and $250,000, respectively. Jackson also had unrecorded copyrights valued at $150,000 and its direct costs related to the acquisition were $50,000. What was the amount of the goodwill related to the acquisition?

- a. $600,000
- b. $650,000
- c. $550,000
- d. $700,000

ANS: A

Acquisition price $2,000,000
Fair value: Assets $1,500,000
   Copyrights 150,000
   Liabilities (250,000) 1,400,000
Goodwill $600,000

Direct costs related to the acquisition are expensed in the period the acquisition is made.
DIF: M OBJ: 1-4
23. Jones company acquired Jackson Company for $2,000,000 cash. At that time, the fair value of
recorded assets and liabilities was $1,500,000 and $250,000, respectively. Jackson also had
in-process research and development projects valued at $150,000 and its pension plan’s projected
benefit obligation exceeded the plan assets by $50,000. What was the amount of the goodwill related
to the acquisition?
a. $750,000  
b. $50,000  
c. $250,000  
d. $650,000
ANS: D
Acquisition price $2,000,000
Fair value: Assets $1,500,000
   Research and development 150,000
   Excess pension liability (50,000)
   Liabilities (250,000) 1,350,000
Goodwill $650,000
DIF: D OBJ: 1-4

24. Orbit Inc. purchased Planet Co. on January 1, 20X3. At that time an existing patent having a 5-year
life was not recorded as a separately identified intangible asset. At the end of fiscal year 20X4, it is
determined the patent is valued at $20,000, and goodwill has a book value of $100,000. How should
intangible assets be reported at the beginning of fiscal year 20X5?
a. Goodwill $100,000 Patent $0  
b. Goodwill $100,000 Patent $20,000  
c. Goodwill $80,000 Patent $20,000  
d. Goodwill $80,000 Patent $16,000
ANS: A
In no case may the measurement period exceed a year; therefore, goodwill will remain at its $100,000
book value, and the patent will not be recorded.
DIF: D OBJ: 1-4

25. Orbit Inc. purchased Planet Co. on January 1, 20X3. At that time an existing patent having a 5-year
estimated life was assigned a provisional value of $10,000 and goodwill was assigned a value of
$100,000. By the end of fiscal year 20X3, better information was available that indicated the fair value
of the patent was $20,000. How should intangible assets be reported at the beginning of fiscal year
20X4?
a. Goodwill $100,000 Patent $10,000  
b. Goodwill $90,000 Patent $16,000  
c. Goodwill $84,000 Patent $16,000  
d. Goodwill $90,000 Patent $20,000
ANS: B
Patent:
   New estimate $20,000
   Provisional value $10,000
   Adjustment needed $10,000
   Provisional goodwill $100,000
   Adjusted goodwill $90,000

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from the U.S. Edition. May not be scanned, copied, duplicated, or posted to a publicly accessible website, in whole or in part.
Amortization of the patent in 20X3 based on the new estimate should be $20,000 / 5 = $4,000, so the book value of the patent at December 31, 20X3 would be $16,000 ($20,000 - $4,000)

DIF: D OBJ: 1-4

26. Balter Inc. acquired Jersey Company on January 1, 20X5. When the purchase occurred Jersey Company had the following information related to fixed assets:

<table>
<thead>
<tr>
<th>Asset</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>$80,000</td>
</tr>
<tr>
<td>Building</td>
<td>200,000</td>
</tr>
<tr>
<td>Accumulated Depreciation</td>
<td>(100,000)</td>
</tr>
<tr>
<td>Equipment</td>
<td>100,000</td>
</tr>
<tr>
<td>Accumulated Depreciation</td>
<td>(50,000)</td>
</tr>
</tbody>
</table>

The building has a 10-year remaining useful life and the equipment has a 5-year remaining useful life. The fair value of the assets on that date were:

<table>
<thead>
<tr>
<th>Asset</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>$100,000</td>
</tr>
<tr>
<td>Building</td>
<td>130,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>75,000</td>
</tr>
</tbody>
</table>

What is the 20X5 depreciation expense Balter will record related to purchasing Jersey Company?

a. $8,000
b. $15,000
c. $28,000
d. $30,000

ANS: C

Building Fair value - $130,000 / 10 years $13,000
Equipment Fair value - $ 75,000 / 5 years 15,000 $28,000

DIF: M OBJ: 1-4

27. Polk issues common stock to acquire all the assets of the Sam Company on January 1, 20X5. There is a contingent share agreement, which states that if the income of the Sam Division exceeds a certain level during 20X5 and 20X6, additional shares will be issued on January 1, 20X7. The impact of issuing the additional shares is to

a. increase the price assigned to fixed assets.
b. have no effect on asset values, but to reassign the amounts assigned to equity accounts.
c. reduce retained earnings.
d. record additional goodwill.

ANS: B

An agreement to issue added stock upon the occurrence of a future event is considered to be a change in the estimate of the value of shares issued. The only entry made is at the date of the added stock issue to reassign the original consideration assigned to the stock to a greater number of shares. This typically results in an entry to increase the Common Stock account and decrease Paid-in Capital in Excess of Par.

DIF: M OBJ: 1-4
28. Jones company acquired Jackson Company for $2,000,000 cash. At that time, the fair value of recorded assets and liabilities was $1,500,000 and $250,000, respectively. If Jackson meets specified sales targets, Jones is required to pay an additional $200,000 in cash per the acquisition agreement. Jones estimates the probability of this to be 50%. The direct costs related to the acquisition were $50,000. What was the amount of the goodwill related to the acquisition?

a. $900,000  
b. $950,000  
c. $850,000  
d. $750,000

ANS: C

Acquisition price: Cash at closing $2,000,000  
Contingent consideration $100,000

Fair value: Assets $1,500,000  
Liabilities (250,000)  
Goodwill $850,000

Direct costs related to the acquisition are expensed in the period the acquisition is made.

DIF: M  
OBJ: 1-4

29. ACME Co. paid $110,000 for the net assets of Comb Corp. At the time of the acquisition the following information was available related to Comb's balance sheet:

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<td>80,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>40,000</td>
</tr>
<tr>
<td>Liabilities</td>
<td>30,000</td>
</tr>
</tbody>
</table>

What is the amount of gain or loss on disposal of business should Comb Corp. recognize?

a. Gain of $60,000  
b. Gain of $60,000  
c. Loss of $30,000  
d. Loss of $60,000

ANS: C

Acquisition price $110,000

Book values of net assets acquired:

| Current assets | $ 50,000 |
| Building | 80,000 |
| Equipment | 40,000 |
| Liabilities (30,000) | 140,000 |
| Loss on sale of business | $(30,000) |

DIF: M  
OBJ: 1-4
30. Vibe Company purchased the net assets of Atlantic Company in a business combination accounted for as a purchase. As a result, goodwill was recorded. For tax purposes, this combination was considered to be a tax-free merger. Included in the assets is a building with an appraised value of $210,000 on the date of the business combination. This asset had a net book value of $70,000. The building had an adjusted tax basis to Atlantic (and to Vibe as a result of the merger) of $120,000. Assuming a 40% income tax rate, at what amount should Vibe record this building on its books after the purchase?

<table>
<thead>
<tr>
<th>Building</th>
<th>Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. $174,000</td>
<td>$ 0</td>
</tr>
<tr>
<td>b. $140,000</td>
<td>$36,000</td>
</tr>
<tr>
<td>c. $210,000</td>
<td>$90,000</td>
</tr>
<tr>
<td>d. $210,000</td>
<td>$36,000</td>
</tr>
</tbody>
</table>

ANS: D

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of building</td>
<td>$210,000</td>
</tr>
<tr>
<td>Tax basis of building</td>
<td>$120,000</td>
</tr>
<tr>
<td>Excess not deductible</td>
<td>$90,000</td>
</tr>
<tr>
<td>Tax rate</td>
<td>x 40%</td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td>$ 36,000</td>
</tr>
</tbody>
</table>

DIF: M OBJ: 1-5

31. When an acquisition of another company occurs, FASB requires disclosing all of the following except:
   a. amounts recorded for each major class of assets and liabilities.
   b. information concerning contingent consideration including a description of the arrangements and the range of outcomes.
   c. results of operations for the current period if both companies had remained separate.
   d. A qualitative description of factors that make up the goodwill recognized.

ANS: C

FASB requires revenue and earnings of the acquiree since the acquisition date and proforma revenue and earnings had the acquisition occurred at the start of the accounting period, but does not require results of operations for the current period if both companies had remained separate.

DIF: M OBJ: 1-6

32. While performing a goodwill impairment test, the company had the following information:

| Estimated implied fair value of reporting unit | $420,000 |
| Fair value of net assets on date of measurement (without goodwill) | $400,000 |
| Existing net book value of reporting unit (without goodwill) | $380,000 |
| Book value of goodwill | $ 60,000 |

Based upon this information the proper conclusion is:
   a. The company should recognize a goodwill impairment loss of $20,000.
   b. Goodwill is not impaired.
   c. The company should recognize a goodwill impairment loss of $40,000.
   d. The company should recognize a goodwill impairment loss of $60,000.

ANS: C

Impairment Test:
Estimated implied fair value of the reporting unit | $420,000
Existing book values, including goodwill 440,000

Impairment is indicated since the book value of the unit exceeds the fair value.

Impairment Loss Calculation:
Estimated implied fair value of the reporting unit $420,000
Less: Fair value of net assets 400,000
Implied fair value of goodwill 20,000
Existing recorded goodwill 60,000
Estimated impairment loss $ 40,000

DIF: M OBJ: 1-7

33. In performing the impairment test for goodwill, the company had the following 20X6 and 20X7 information available.

<table>
<thead>
<tr>
<th></th>
<th>20X6</th>
<th>20X7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of the reporting unit</td>
<td>$350,000</td>
<td>$400,000</td>
</tr>
<tr>
<td>Net book value (including $50,000 goodwill)</td>
<td>$360,000</td>
<td>$380,000</td>
</tr>
</tbody>
</table>

Assume that the carrying value of the identifiable assets are a reasonable approximation of their fair values. Based upon this information what are the 20X6 and 20X7 adjustment to goodwill, if any?

a. no adjustment  $20,000 decrease
b. $10,000 increase  $20,000 decrease
c. $10,000 decrease  $20,000 decrease
d. $10,000 decrease no adjustment

ANS: D

Impairment Test 20X6:
Estimated implied fair value of the reporting unit $350,000
Existing book values, including goodwill 360,000

Impairment is indicated since the book value of the unit exceeds the fair value.

Impairment Loss Calculation:
Estimated implied fair value of the reporting unit $350,000
Less: Fair value of net assets (360,000 - 50,000) 310,000
Implied fair value of goodwill 40,000
Existing recorded goodwill 50,000
Estimated impairment loss $ 10,000

Impairment Test 20X7:
Estimated implied fair value of the reporting unit $400,000
Existing book values, including goodwill 380,000

No impairment is indicated in 20X7.

DIF: M OBJ: 1-7
34. Which of the following income factors should not be considered in expected future income when estimating the value of goodwill?
   a. sales for the period
   b. income tax expense
   c. extraordinary items
   d. cost of goods sold

ANS: C

Because a forecast of future income may start by projecting recent years’ incomes into the future, it is important to factor out “one-time” occurrences such as extraordinary items that will not likely recur in the near future.

DIF: M  OBJ: 1-8 | Appendix A

PROBLEM

1. Internet Corporation is considering the acquisition of Homepage Corporation and has obtained the following audited condensed balance sheet:

   Homepage Corporation
   Balance Sheet
   December 31, 20X5

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities and Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
<td>$ 40,000</td>
</tr>
<tr>
<td>Land</td>
<td>20,000</td>
</tr>
<tr>
<td>Buildings (net)</td>
<td>80,000</td>
</tr>
<tr>
<td>Equipment (net)</td>
<td>60,000</td>
</tr>
<tr>
<td></td>
<td>$200,000</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>$ 60,000</td>
</tr>
<tr>
<td>Capital Stock (50,000 shares, $1 par value)</td>
<td>50,000</td>
</tr>
<tr>
<td>Other Paid-in Capital</td>
<td>20,000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>70,000</td>
</tr>
<tr>
<td></td>
<td>$200,000</td>
</tr>
</tbody>
</table>

Internet also acquired the following fair values for Homepage's assets and liabilities:

<table>
<thead>
<tr>
<th>Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
</tr>
<tr>
<td>Land</td>
</tr>
<tr>
<td>Buildings (net)</td>
</tr>
<tr>
<td>Equipment (net)</td>
</tr>
<tr>
<td>Current Liabilities</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

Internet and Homepage agree on a price of $280,000 for Homepage's net assets. Prepare the necessary journal entry to record the purchase given the following scenarios:

a. Internet pays cash for Homepage Corporation and incurs $5,000 of acquisition costs.

b. Internet issues its $5 par value stock as consideration. The fair value of the stock at the acquisition date is $50 per share. Additionally, Internet incurs $5,000 of security issuance costs.
ANS:

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Current assets</td>
<td>55,000</td>
</tr>
<tr>
<td>Land</td>
<td>60,000</td>
</tr>
<tr>
<td>Buildings</td>
<td>90,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>75,000</td>
</tr>
<tr>
<td>Goodwill ($280,000 - $220,000)</td>
<td>60,000</td>
</tr>
<tr>
<td>Acquisition expense</td>
<td>5,000</td>
</tr>
<tr>
<td>Current liabilities</td>
<td>60,000</td>
</tr>
<tr>
<td>Cash</td>
<td>285,000</td>
</tr>
</tbody>
</table>

b. Current assets | 55,000 |
| Land | 60,000 |
| Buildings | 90,000 |
| Equipment | 75,000 |
| Goodwill | 60,000 |
| Current liabilities | 60,000 |
| Common stock | 28,000 |
| Paid-in capital in excess of par | 252,000 |

Paid-in capital in excess of par * | 5,000 |
Cash | 5,000 |

*Alternatively, this amount could be charged to Acquisition Expense.

DIF: M OBJ: 1-3 | 1-4

2. On January 1, 20X5, Brown Inc. acquired Larson Company's net assets in exchange for Brown's common stock with a par value of $100,000 and a fair value of $800,000. Brown also paid $10,000 in direct acquisition costs and $15,000 in stock issuance costs.

On this date, Larson's condensed account balances showed the following:

<table>
<thead>
<tr>
<th>Book Value</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets</td>
<td>$280,000</td>
</tr>
<tr>
<td>Plant and Equipment</td>
<td>440,000</td>
</tr>
<tr>
<td>Accumulated Depreciation</td>
<td>(100,000)</td>
</tr>
<tr>
<td>Intangibles – Patents</td>
<td>80,000</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>(140,000)</td>
</tr>
<tr>
<td>Long-Term Debt</td>
<td>(100,000)</td>
</tr>
<tr>
<td>Common Stock</td>
<td>(200,000)</td>
</tr>
<tr>
<td>Other Paid-in Capital</td>
<td>(120,000)</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>(140,000)</td>
</tr>
</tbody>
</table>

Required:

Record Brown's purchase of Larson Company's net assets.
ANS:
Acquisition price $800,000
Fair value of acquired net assets:
Current assets $370,000
Plant and equipment 480,000
Intangibles - patents 120,000
Current liabilities (140,000)
Long-term debt (110,000) 720,000
Goodwill $ 80,000

Debit Credit
Current Assets $370,000
Plant and Equipment 480,000
Intangibles – Patents 120,000
Intangibles – Goodwill 80,000
Current Liabilities $140,000
Long-term Debt 110,000
Common Stock 100,000
Paid-in Capital in Excess of Par 700,000

Acquisition expenses*
Cash 25,000

*alternative treatment: debit Paid-In Capital in Excess of Par for issue costs

DIF: M OBJ: 1-3 | 1-4

3. On January 1, 20X5, Zebb and Nottle Companies had condensed balance sheets as shown below:

<table>
<thead>
<tr>
<th></th>
<th>Zebb Company</th>
<th>Nottle Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets</td>
<td>$1,000,000</td>
<td>$ 600,000</td>
</tr>
<tr>
<td>Plant and Equipment</td>
<td>1,500,000</td>
<td>800,000</td>
</tr>
<tr>
<td></td>
<td><strong>$2,500,000</strong></td>
<td><strong>$1,400,000</strong></td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>$ 200,000</td>
<td>$ 100,000</td>
</tr>
<tr>
<td>Long-Term Debt</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td>Common Stock, $10 par</td>
<td>1,400,000</td>
<td>400,000</td>
</tr>
<tr>
<td>Paid-in Capital in Excess of Par</td>
<td>0</td>
<td>100,000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>600,000</td>
<td>500,000</td>
</tr>
<tr>
<td></td>
<td><strong>$2,500,000</strong></td>
<td><strong>$1,400,000</strong></td>
</tr>
</tbody>
</table>

Required:

Record the acquisition of Nottle's net assets, the issuance of the stock and/or payment of cash, and
payment of the related costs. Assume that Zebb issued 30,000 shares of new common stock with a fair
value of $25 per share and paid $500,000 cash for all of the net assets of Nottle. Acquisition costs of
$50,000 and stock issuance costs of $20,000 were paid in cash. Current assets had a fair value of
$650,000, plant and equipment had a fair value of $900,000, and long-term debt had a fair value of
$330,000.
ANS:
Current Assets
Plant and Equipment 650,000
Goodwill** 130,000
Acquisition Expenses* 70,000

Current Liabilities 100,000
Long-Term Debt 330,000
Common Stock 300,000
Paid-in Capital in Excess of Par 450,000
Cash ($500,000 + 70,000) 570,000

*alternative treatment: debit Paid-in Capital in Excess of Par for issue costs

** Calculation of goodwill
Acquisition price:
Cash $500,000
Common stock issued (30,000 shares x $25) $750,000
$1,250,000

Fair value of acquired net assets:
Current assets $650,000
Plant and equipment 900,000
Current liabilities (100,000)
Long-term debt (330,000) 1,120,000
Goodwill $130,000

DIF: M OBJ: 1-4

4. On January 1, 20X1, Honey Bee Corporation purchased the net assets of Green Hornet Company for $1,500,000. On this date, a condensed balance sheet for Green Hornet showed:

<table>
<thead>
<tr>
<th></th>
<th>Book Value</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets</td>
<td>$500,000</td>
<td>$800,000</td>
</tr>
<tr>
<td>Long-Term Investments in Securities</td>
<td>200,000</td>
<td>150,000</td>
</tr>
<tr>
<td>Land</td>
<td>100,000</td>
<td>600,000</td>
</tr>
<tr>
<td>Buildings (net)</td>
<td>700,000</td>
<td>900,000</td>
</tr>
<tr>
<td></td>
<td>$1,500,000</td>
<td></td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>$300,000</td>
<td>$300,000</td>
</tr>
<tr>
<td>Long-Term Debt</td>
<td>550,000</td>
<td>600,000</td>
</tr>
<tr>
<td>Common Stock (no-par)</td>
<td>300,000</td>
<td></td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>350,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$1,500,000</td>
<td></td>
</tr>
</tbody>
</table>

Required:

Record the entry on Honey Bee's books for the acquisition of Green Hornet's net assets.
ANS:
Acquisition price $1,500,000
Fair value of acquired net assets:
Current assets $800,000
Long-term investments in securities 150,000
Land 600,000
Buildings 900,000
Current liabilities (300,000)
Long-term debt (600,000) 1,550,000
Gain on acquisition of business $50,000

Current Assets 800,000
Long-Term Investments in Securities 150,000
Land 600,000
Building 900,000

Current Liabilities 300,000
Long-Term Debt 600,000
Gain on Acquisition of Business 50,000
Cash 1,500,000

DIF:  M  OBJ:  1-4

5. Diamond acquired Heart's net assets. At the time of the acquisition Heart's Balance sheet was as follows:

Accounts Receivable $130,000
Inventory 70,000
Equipment, Net 50,000
Building, Net 250,000
Land 100,000
Total Assets $600,000

Bonds Payable $100,000
Common Stock 50,000
Retained Earnings 450,000
Total Liabilities and Stockholders' Equity $600,000

Fair values on the date of acquisition:

Inventory $100,000
Equipment 30,000
Building 350,000
Land 120,000
Brand Name 50,000
Bonds payable 120,000

Acquisition costs: $5,000
Required:

Record the entry for the purchase of the net assets of Heart by Diamond at the following cash prices:

a. $700,000
b. $300,000

ANS:
Fair value of acquired net assets:

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>$130,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>100,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>30,000</td>
</tr>
<tr>
<td>Buildings</td>
<td>350,000</td>
</tr>
<tr>
<td>Land</td>
<td>120,000</td>
</tr>
<tr>
<td>Brand name</td>
<td>50,000</td>
</tr>
<tr>
<td>Bonds payable</td>
<td>(120,000)</td>
</tr>
<tr>
<td>Total</td>
<td>$660,000</td>
</tr>
</tbody>
</table>

a. Accounts Receivable 130,000
Inventory 100,000
Equipment 30,000
Buildings 350,000
Land 120,000
Brand Name 50,000
Goodwill ($700,000 - $660,000) 40,000
Acquisition Expenses 5,000

Bonds Payable 100,000
Premium on Bonds Payable 20,000
Cash ($700,000 + $5,000) 705,000

b. Accounts Receivable 130,000
Inventory 100,000
Equipment 30,000
Buildings 350,000
Land 120,000
Brand Name 50,000
Acquisition Expenses 5,000

Bonds Payable 100,000
Premium on Bonds Payable 20,000
Gain on Acquisition of Business ($300,000 - $660,000) 360,000
Cash ($300,000 + $5,000) 305,000

DIF: M OBJ: 1-4
6. On January 1, July 1, and December 31, 20X5, a condensed trial balance for Nelson Company showed the following debits and (credits):

<table>
<thead>
<tr>
<th></th>
<th>01/01/X5</th>
<th>07/01/X5</th>
<th>12/31/X5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets</td>
<td>$200,000</td>
<td>$260,000</td>
<td>$340,000</td>
</tr>
<tr>
<td>Plant and Equipment</td>
<td>500,000</td>
<td>510,000</td>
<td>510,000</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>(50,000)</td>
<td>(70,000)</td>
<td>(60,000)</td>
</tr>
<tr>
<td>Long-Term Debt</td>
<td>(100,000)</td>
<td>(100,000)</td>
<td>(100,000)</td>
</tr>
<tr>
<td>Common Stock</td>
<td>(150,000)</td>
<td>(150,000)</td>
<td>(150,000)</td>
</tr>
<tr>
<td>Other Paid-in Capital</td>
<td>(100,000)</td>
<td>(100,000)</td>
<td>(100,000)</td>
</tr>
<tr>
<td>Retained Earnings, January 1</td>
<td>(300,000)</td>
<td>(300,000)</td>
<td>(300,000)</td>
</tr>
<tr>
<td>Dividends Declared</td>
<td></td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td>Revenues</td>
<td></td>
<td>(400,000)</td>
<td>(900,000)</td>
</tr>
<tr>
<td>Expenses</td>
<td></td>
<td>350,000</td>
<td>750,000</td>
</tr>
</tbody>
</table>

Assume that, on July 1, 20X5, Systems Corporation purchased the net assets of Nelson Company for $750,000 in cash. On this date, the fair values for certain net assets were:

Current Assets $280,000
Plant and Equipment (remaining life of 10 years) $600,000

Nelson Company's books were NOT closed on June 30, 20X5.

For all of 20X5, Systems' revenues and expenses were $1,500,000 and $1,200,000, respectively.

Required:
1. Record the entry on Systems' books for the July 1, 20X5 purchase of Nelson.

**ANS:**

1. **Debit**  | **Credit**
   - Current Assets  | 280,000
   - Plant and Equipment  | 600,000
   - Goodwill * | 40,000
   - Current Liabilities  | 70,000
   - Long-Term Debt  | 100,000
   - Cash | 750,000

* Goodwill is calculated as follows:

**Acquisition price** $750,000

**Fair value of acquired net assets:**

- Current assets $280,000
- Plant and equipment 600,000
- Current liabilities (70,000)
- Long-term debt (100,000) 710,000
- Goodwill $ 40,000

**DIF: D  OBJ: 1-4**
7. On January 1, 20X3 the fair values of Pink Coral’s net assets were as follows:

<table>
<thead>
<tr>
<th>Asset</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets</td>
<td>$100,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>$150,000</td>
</tr>
<tr>
<td>Land</td>
<td>$50,000</td>
</tr>
<tr>
<td>Buildings</td>
<td>$300,000</td>
</tr>
<tr>
<td>Liabilities</td>
<td>$80,000</td>
</tr>
</tbody>
</table>

On January 1, 20X3, Blue Reef Company purchased the net assets of the Pink Coral Company by issuing 100,000 shares of its $1 par value stock when the fair value of the stock was $6.20. It was further agreed that Blue Reef would pay an additional amount on January 1, 20X5, if the average income during the 2-year period of 20X3-20X4 exceeded $80,000 per year. The expected value of this consideration was calculated as $184,000; the measurement period is one year. Blue Reef paid $15,000 in professional fees to negotiate the purchase and construct the acquisition agreement and $10,000 in stock issuance costs.

Required: Prepare Blue Reef’s entries:

a) on January 1, 20X3 to record the acquisition
b) on August 1, 20X3 to revise the contingent consideration to $170,000
c) on January 1, 20X5 to settle the contingent consideration clause of the agreement for $175,000

ANS:

a. Current Assets 100,000
   Equipment 150,000
   Land 50,000
   Buildings 300,000
   Goodwill * 284,000
   Liabilities 80,000
   Estimated Liability for Contingent Consideration 184,000
   Common stock, $1 Par ($1 x 100,000 shares) 100,000
   Paid-in Capital in Excess of Par ($620,000 - $100,000) 520,000
   Acquisition Expense 15,000
   Paid-in Capital in Excess of Par ** 10,000
   Cash 25,000

** Alternatively, this amount could be charged to acquisition expense.

* Goodwill is calculated as follows:

Acquisition price:
Fair value of common stock issued ($6.20 x 100,000 shares) $620,000
Contingent consideration 184,000
804,000

Fair value of acquired net assets:
Current assets $100,000
Equipment 150,000
Land 50,000
Buildings 300,000
Liabilities (80,000) 520,000
Goodwill $284,000

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b. Estimated Liability for Contingent Consideration
   Goodwill
   
   The adjustment is made to goodwill since this entry was made within the measurement period.

c. Estimated Liability for Contingent Consideration
   Loss on Estimated Contingent Consideration
   Cash

   DIF: M OBJ: 1-4

8. The Blue Reef Company purchased the net assets of the Pink Coral Company on January 1, 20X1, and made the following entry to record the purchase:

   Current Assets
   Equipment
   Land
   Buildings
   Goodwill
   Liabilities
   Common Stock, $1 Par
   Paid-in Capital in Excess of Par

   Required:

   Make the required entry on January 1, 20X3, assuming that additional shares would be issued on that date to compensate for any fall in the value of Blue Reef common stock below $16 per share. The settlement would be to cure the deficiency by issuing added shares based on their fair value on January 1, 20X3. The fair price of the shares on January 1, 20X3 was $10.

   ANS:
   
   Paid-in Capital in Excess of Par
   Common Stock, $1 par

   Deficiency: ($16 - $10) × 100,000 shares issued to acquire
   Divide by $10 fair value
   Added number of shares to issue

   DIF: D OBJ: 1-3 | 1-4

9. Poplar Corp. acquires the net assets of Sapling Company, which has the following balance sheet:

   Accounts Receivable $ 50,000
   Inventory 80,000
   Equipment, Net 50,000
   Land & Building, Net 120,000
   Total Assets $300,000
Bonds Payable $ 90,000
Common Stock 100,000
Retained Earnings 110,000
Total Liabilities and Stockholders' Equity $300,000

Fair values on the date of acquisition:

Accounts receivable $ 50,000
Inventory 100,000
Equipment 30,000
Land and building 180,000
Customer list 30,000
Bonds payable 100,000

Acquisition costs: $ 10,000

If Poplar paid $300,000 what journal entries would be recorded by both Poplar Corp. and Sapling Company?

ANS:

**Poplar Corp:**

Accounts Receivable 50,000
Inventory 100,000
Equipment 30,000
Land & Building 180,000
Customer List 30,000
Goodwill ($300,000 - $290,000) 10,000
Acquisition Expenses 10,000

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds Payable</td>
<td>90,000</td>
</tr>
<tr>
<td>Premium on Bonds Payable</td>
<td>10,000</td>
</tr>
<tr>
<td>Cash ($300,000 + $10,000)</td>
<td>310,000</td>
</tr>
</tbody>
</table>

**Fair value of acquired net assets:**

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>$ 50,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>100,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>30,000</td>
</tr>
<tr>
<td>Land and building</td>
<td>180,000</td>
</tr>
<tr>
<td>Customer list</td>
<td>30,000</td>
</tr>
<tr>
<td>Liabilities (100,000)</td>
<td>$290,000</td>
</tr>
</tbody>
</table>
Sapling Company:

Cash 300,000
Bonds Payable 90,000
Accounts Receivable 50,000
Inventory 80,000
Equipment 50,000
Land and Building 120,000
Gain on Sale of Business ($300,000 - $100,000 - $110,000) 90,000

$110,000

DIF: M OBJ: 1-4

10. The Chan Corporation purchased the net assets (existing liabilities were assumed) of the Don Company for $900,000 cash. The balance sheet for the Don Company on the date of acquisition showed the following:

Assets
Current assets $100,000
Equipment 300,000
Accumulated depreciation (100,000)
Plant 600,000
Accumulated depreciation (250,000)
Total $650,000

Liabilities and Equity
Bonds payable, 8% $200,000
Common stock, $1 par 100,000
Paid-in capital in excess of par 200,000
Retained earnings 150,000
Total $650,000

Required:

The equipment has a fair value of $300,000, and the plant assets have a fair value of $500,000. Assume that the Chan Corporation has an effective tax rate of 40%. Prepare the entry to record the purchase of the Don Company for each of the following separate cases with specific added information:

a. The sale is a nontaxable exchange to the seller that limits the buyer to depreciation and amortization on only book value for tax purposes.

b. The bonds have a current fair value of $190,000. The transaction is a taxable exchange.

c. There are $100,000 of prior-year losses that can be used to claim a tax refund. The transaction is a taxable exchange.

d. There are $150,000 of past losses that can be carried forward to future years to offset taxes that will be due. The transaction is a taxable exchange.
ANS:

<table>
<thead>
<tr>
<th>Current Assets</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment</td>
<td>300,000</td>
<td></td>
</tr>
<tr>
<td>Plant</td>
<td>500,000</td>
<td></td>
</tr>
<tr>
<td>Goodwill</td>
<td>300,000</td>
<td></td>
</tr>
<tr>
<td>Deferred Tax Liability*</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td>Bonds Payable</td>
<td>200,000</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>900,000</td>
<td></td>
</tr>
</tbody>
</table>

* 40% \times ($800,000 Fair Value – $550,000 Book Value of fixed assets)

b. Current Assets 100,000
   Equipment 300,000
   Plant 500,000
   Goodwill 190,000
   Bonds Payable 190,000
   Cash 900,000

c. Current Assets 100,000
   Equipment 300,000
   Plant 500,000
   Tax Refund Receivable ($100,000 \times 40\%) 40,000
   Goodwill 160,000
   Bonds Payable 200,000
   Cash 900,000

d. Current Assets 100,000
   Equipment 300,000
   Plant 500,000
   Deferred Tax Asset ($150,000 \times 40\%) 60,000
   Goodwill 140,000
   Bonds Payable 200,000
   Cash 900,000

DIF: D OBJ: 1-8

ESSAY

1. While acquisitions are often friendly, there are numerous occasions when a party does not want to be acquired. Discuss possible defensive strategies that firms can implement to fend off a hostile takeover attempt.

ANS:

GREENMAIL: A strategy is which the target company pays a premium price to purchase treasury shares. The shares purchased are owned by the hostile acquirer or shareholders who might sell to the hostile acquirer.
WHITE KNIGHT: A strategy in which the target company locates a different company to take it over, a company that is more likely to keep current management and employees in place.

SELLING THE CROWN JEWELS: A strategy in which the target company sells off vital assets in order to make the company less attractive to prospective acquirers.

POISON PILL: A strategy in which the target company issues stock rights to existing shareholders at a price far below fair value. The rights are only exercisable if an acquirer makes a bid for the target company. The resulting new shares make the acquisition more expensive.

LEVERAGED BUYOUT: A strategy in which the management of the target company attempts to purchase a controlling interest in the target company, in order to continue control of the company.

DIF: M OBJ: 1-2

2. Goodwill is an intangible asset. There are a variety of recommendations about how intangible assets should be included in the financial statements. Discuss the recommendations for proper disclosure of goodwill. Include a comparison with disclosure of other intangible assets.

ANS: Goodwill arises when a company is purchased and the value assigned to identifiable assets, including intangible assets, is in excess of the price paid. As such goodwill represents the value of intangible assets that could not be valued individually.

During a purchase some intangible assets such as patents, customer lists, brand names, and favorable lease agreements may exist but have not been recorded. The fair value of these intangible assets should be determined and recorded separate from the value of goodwill associated with the purchase.

Intangible assets other than goodwill will be amortized over their economic lives. The amortization method should reflect the pattern of benefits conveyed by the asset, so that a straight-line method is to be used unless another systematic method is appropriate.

Intangible assets may be reported individually, in groups, or in the aggregate on the balance sheet after fixed assets and are displayed net of cumulative amortization. Details for current and cumulative amortization, along with significant residual values, are shown in the footnotes to the balance sheet.

Goodwill is subject to impairment procedures. These concerns must be addressed related to goodwill:

1. Goodwill must be allocated to reporting units if the purchased company contains more than one reporting unit.
2. A reporting unit valuation plan must be established within one year of a purchase. This will be used as the measurement process in future periods.
3. Impairment testing is normally done on an annual basis.
4. The procedure for determining impairment must be established.
5. The procedure for determining the amount of the impairment loss, which is also the decrease in the goodwill amount recorded, must be established.
Goodwill is considered impaired when the implied fair value of reporting unit is less than the carrying value of the reporting unit's net assets. Once goodwill is written down, it cannot be adjusted to a higher amount.

Changes to goodwill must be disclosed. The disclosure would include the amount of goodwill acquired, the goodwill impairment losses, and the goodwill written off as part of a disposal of a reporting unit.

DIF: D OBJ: 1-4 | 1-6 | 1-7