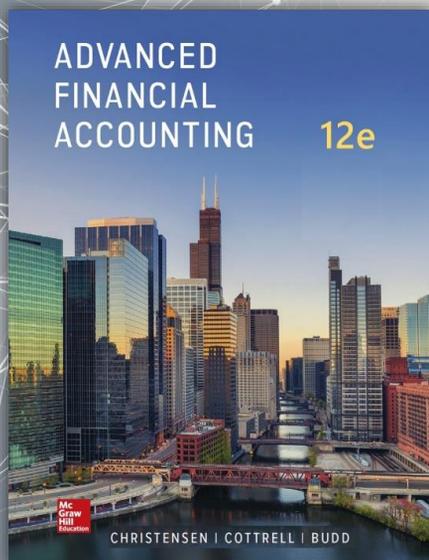




**ACT 460**  
**Advanced Financial Accounting**

**SPRING 2020-2021**



**Intercorporate  
Acquisitions and  
Investments in  
Other Entities**

**Chapter 1**

## Learning Objective 1-1

Understand and explain the reasons for and different methods of business expansion, the types of organizational structures, and the types of acquisitions.



## Enterprise Expansion

- **Reasons for enterprise expansion**
  - Size often allows economies of scale
  - New earning potential
  - Earnings stability through diversification
  - Management rewards for bigger company size
  - Prestige associated with company size

## Business Objectives

- A **subsidiary** is a corporation that is controlled by another corporation, referred to as a **parent company**.
  - Control is usually through majority ownership of its common stock.
- Because a subsidiary is a separate legal entity, the parent's risk associated with the subsidiary's activities is limited.

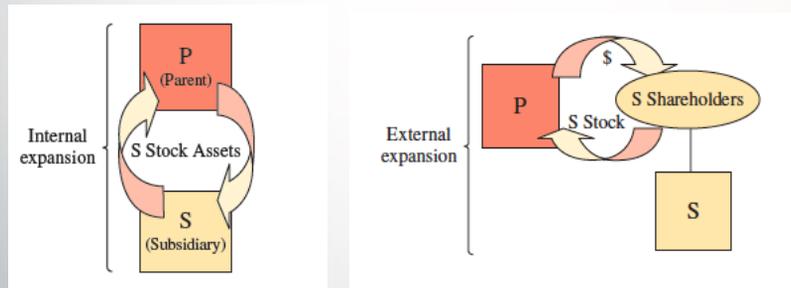
## Ethical Considerations

- **Manipulation of financial reporting**
  - The use of subsidiaries or other entities to borrow money without reporting the debt on their balance sheets
    - Using special entities to manipulate profits
  - Manipulation of accounting for mergers and acquisitions
    - Creative acquisition accounting

# Business Expansion and Forms of Organizational Structure

- **Two Types of Expansion**

- Internal Expansion
- External Expansion



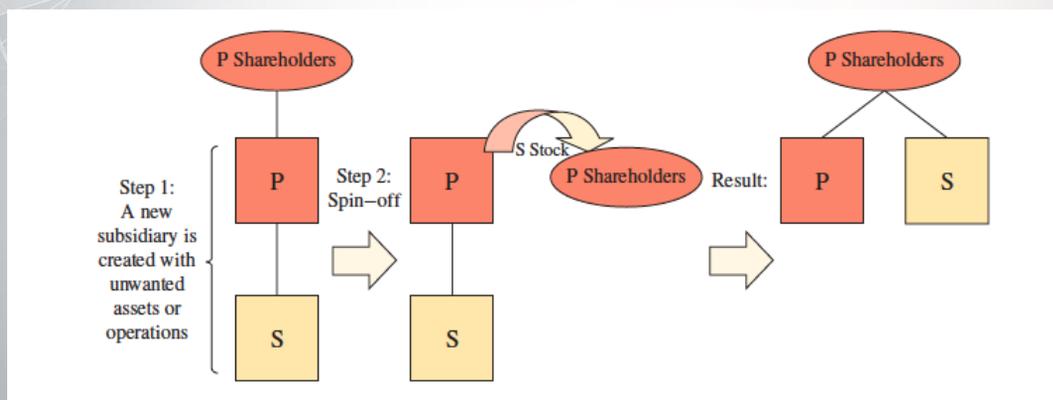
## Internal Expansion: Creating a Business Entity (1 of 2)

- **New entities are created**
  - Subsidiaries
  - Partnerships
  - Joint ventures
  - Special entities
- **Motivating factors:**
  - Helps establish clear lines of control and facilitate the evaluation of operating results
  - Special tax incentives
  - Regulatory reasons
  - Protection from legal liability
  - Disposing of a portion of existing operations

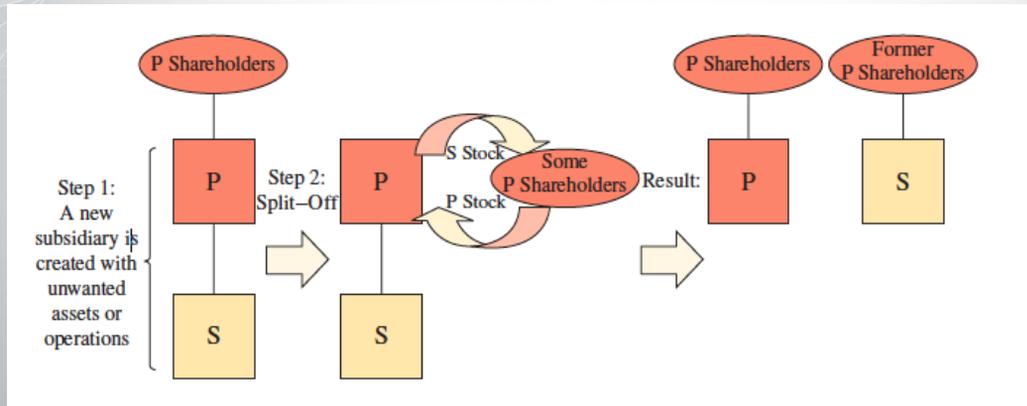
## Internal Expansion: Creating a Business Entity (2 of 2)

- **A spin-off**
  - Occurs when the ownership of a newly created or existing subsidiary is distributed to the parent's stockholders without the stockholders surrendering any of their stock in the parent company
- **A split-off**
  - Occurs when the subsidiary's shares are exchanged for shares of the parent, thereby leading to a reduction in the outstanding shares of the parent company

## Spin-Off



# Split-Off



## External Expansion: Business Combinations

- **Expansion through business combinations**
  - Entry into new product areas or geographic regions by acquiring or combining with other companies
  - A **business combination** occurs when “. . . an acquirer obtains control of one or more businesses”
  - The concept of **control** relates to the ability to direct policies and management

## Control: How?

- **The Usual Way**
  - Owning more than 50% of the subsidiary's outstanding voting stock (50% plus only 1 share will do it)
- **The Unusual Way**
  - Having contractual agreements or financial arrangements that effectively achieve control
    - Informal arrangements
    - Formal agreements
      - Consummation of a written agreement requires recognition on the books of one or more of the companies that are a party to the combination

## Organizational Structure and Financial Reporting (1 of 3)

- **Merger**
  - A business combination in which the acquired business's assets and liabilities are combined with those of the acquiring company
  - Two companies are merged into a single entity



## Organizational Structure and Financial Reporting (2 of 3)

- **Controlling ownership**

- A business combination in which the acquired company remains as a separate legal entity with a majority of its common stock owned by the purchasing company leading to a parent–subsidiary relationship
- Accounting standards normally require consolidated financial statements



## Organizational Structure and Financial Reporting (3 of 3)

- **Noncontrolling ownership**

- The purchase of a less-than-majority interest in another corporation does not usually result in a business combination or a controlling situation

- **Other beneficial interest**

- One company may have a beneficial interest in another entity even without a direct ownership interest
- The beneficial interest may be defined by the agreement establishing the entity or by an operating or financing agreement

## Practice Quiz Question

**A common way to obtain corporate control is**

- a. by purchasing more than 50% of an entity's nonvoting preferred stock.
- b. by bribing the CEO.
- c. by playing a video game about that company.
- d. by purchasing more than 50% of an entity's common stock.
- e. none of the above.

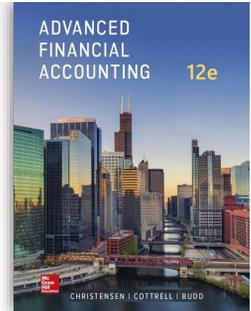
## Practice Quiz Question *Solution*

**A common way to obtain corporate control is**

- a. by purchasing more than 50% of an entity's nonvoting preferred stock.
- b. by bribing the CEO.
- c. by playing a video game about that company.
- d. by purchasing more than 50% of an entity's common stock.**
- e. none of the above.

## Learning Objective 1-2

Understand the development of standards related to acquisition accounting over time.



## The Development and Accounting for Business Combinations (1 of 3)

- In the past, there were two methods of accounting for business combinations:
  - Purchase method
  - Pooling-of-interests method
- Major changes
  - FASB eliminated the pooling-of-interests method
  - FASB issued ASC 805 that replaced the purchase method with the acquisition method, which is now the only acceptable method of accounting for business combinations



## The Development and Accounting for Business Combinations (2 of 3)

- Pooling-of-interests method
  - No longer allowed!
  - The book values of the combining companies were carried forward to the combined company and no revaluations to fair value were made
  - Did not result in write-ups or goodwill that might burden future earnings with additional depreciation or write-offs
  - Managers loved it!



## The Development and Accounting for Business Combinations (3 of 3)

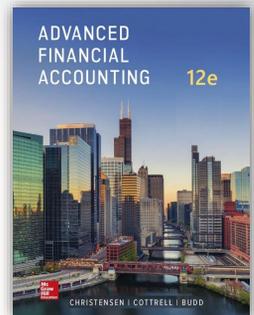
- Acquisition method
  - Consistent with FASB's intention to move accounting in general more toward recognizing fair values
  - The acquirer values the acquired company based on the fair value of the consideration given in the combination and the fair value of any noncontrolling interest not acquired by the acquirer

# Accounting for Business Combinations (IFRS 3)

- Under [IFRS 3](#), business combinations should be accounted for using the **acquisition method** consisting of the following steps (IFRS 3.4-5):
- [Identifying the acquirer.](#)
- [Determining the acquisition date.](#)
- Recognizing and measuring the identifiable [assets acquired](#), the [liabilities](#) assumed and any [non-controlling interest](#) in the acquiree.
- Recognizing and measuring [goodwill](#) or a gain from a [bargain purchase](#).
- Pooling of interest method, fresh start method, or other methods are **not allowed by IFRS 3**. However, they may be used in accounting for business combinations under common control.

## Learning Objective 1-3

Make calculations and prepare journal entries for the creation of a business entity.



## Accounting for Internal Expansion: Creating Business Entities (1 of 4)

- The transferring company creates a subsidiary that it owns and controls.
- The company transfers assets and liabilities to an entity that the company has created and controls and in which it holds majority ownership.
- The company transfers assets and liabilities to the created entity at book value, and the transferring company recognizes an ownership interest in the newly created entity equal to the book value of the net assets transferred.
- If assets are impaired prior to the time of transfer, the transferring company should recognize an impairment loss and transfer the assets to the new entity at the lower fair value.
- Subsidiary records all assets and liabilities received in the transfer at the book values at the time of transfer.

## Accounting for Internal Expansion: Creating Business Entities (2 of 4)

As an illustration of a created entity, assume that Allen Company creates a subsidiary, Blaine Company, and transfers the following assets to Blaine in exchange for all 100,000 shares of Blaine's \$2 par common stock:

<b>Item</b>	<b>Cost</b>	<b>Book Value</b>
Cash		\$70,000
Inventory	\$50,000	50,000
Land	75,000	75,000
Building	100,000	80,000
Equipment	250,000	160,000
		<u>435,000</u>

## Accounting for Internal Expansion: Creating Business Entities (3 of 4)

Allen records the transfer with the following entry:

Investment in Blaine Company Common Stock	435,000	
Accumulated Depreciation, Building	20,000	
Accumulated Depreciation, Equipment	90,000	
Cash		70,000
Inventory		50,000
Land		75,000
Building		100,000
Equipment		250,000

Record the creation of Blaine Company.

## Accounting for Internal Expansion: Creating Business Entities (4 of 4)

Blaine Company records the transfer of assets and the issuance of stock (at the book value of the assets) as follows:

Cash	70,000	
Inventory	50,000	
Land	75,000	
Building	100,000	
Equipment	250,000	
Accumulated Depreciation, Building		20,000
Accumulated Depreciation, Equipment		90,000
Common Stock, \$2 par		200,000
Additional Paid-In Capital		235,000

Record the receipt of assets and the issuance of \$2 par common stock.



Blaine Company  
Balance sheet  
Nov 2, 2020

Assets

Liability & Equity



## Practice Quiz Question

When a parent company creates a subsidiary through internal expansion, the parent's journal entry to transfer assets to the newly created entity will include a debit to

- a. Acquisition Expense.
- b. Cash.
- c. Investment in Subsidiary.
- d. Common Stock.
- e. none of the above.

# EXERCISES

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## E 1-5

### **E1-5** Asset Transfer to Subsidiary [LO 1-3](#)

Pale Company was established on January 1, 20X1. Along with other assets, it immediately purchased land for \$80,000, a building for \$240,000, and equipment for \$90,000. On January 1, 20X5, Pale transferred these assets, cash of \$21,000, and inventory costing \$37,000 to a newly created subsidiary, Sight Company, in exchange for 10,000 shares of Sight's \$6 par value stock. Pale uses straight-line depreciation and useful lives of 40 years and 10 years for the building and equipment, respectively, with no estimated residual values.

#### **Required**

- a. Give the journal entry that Pale recorded when it transferred the assets to Sight.
- b. Give the journal entry that Sight recorded for the receipt of assets and issuance of common stock to Pale.

# Solution

## E1-5 Asset Transfer to Subsidiary

a. Journal entry recorded by Pale Company for transfer of assets to Sight Company:

Investment in Sight Company Common Stock	408,000	
Accumulated Depreciation – Buildings	24,000	
Accumulated Depreciation – Equipment	36,000	
Cash		21,000
Inventory		37,000
Land		80,000
Buildings		240,000
Equipment		90,000

b. Journal entry recorded by Sight Company for receipt of assets from Pale Company:

Cash	21,000	
Inventory	37,000	
Land	80,000	
Buildings	240,000	
Equipment	90,000	
Accumulated Depreciation – Buildings		24,000
Accumulated Depreciation – Equipment		36,000
Common Stock		60,000
Additional Paid-In Capital		348,000

## E1-6

### E1-6 Creation of New Subsidiary LO 1-3

Pester Company transferred the following assets to a newly created subsidiary, Shumby Corporation, in exchange for 40,000 shares of its \$3 par value stock:

	Cost	Book Value
Cash	\$ 40,000	\$ 40,000
Accounts Receivable	75,000	68,000
Inventory	50,000	50,000
Land	35,000	35,000
Buildings	160,000	125,000
Equipment	240,000	180,000

### Required

Page 31

- Give the journal entry in which Pester recorded the transfer of assets to Shumby Corporation.
- Give the journal entry in which Shumby recorded the receipt of assets and issuance of common stock to Pester.

# Solution

## E1-6 Creation of New Subsidiary

a. Journal entry recorded by Pester Company for transfer of assets to Shumby Corporation:

Investment in Shumby Corporation Common Stock	498,000	
Allowance for Uncollectible Accounts Receivable	7,000	
Accumulated Depreciation – Buildings	35,000	
Accumulated Depreciation – Equipment	60,000	
Cash		40,000
Accounts Receivable		75,000
Inventory		50,000
Land		35,000
Buildings		160,000
Equipment		240,000

b. Journal entry recorded by Shumby Corporation for receipt of assets from Pester Company:

Cash	40,000	
Accounts Receivable	75,000	
Inventory	50,000	
Land	35,000	
Buildings	160,000	
Equipment	240,000	
Allowance for Uncollectible Accounts Receivable		7,000
Accumulated Depreciation – Buildings		35,000
Accumulated Depreciation – Equipment		60,000
Common Stock		120,000
Additional Paid-In Capital		378,000

## E1-7 Balance Sheet Totals of Parent Company [LO 1-2](#), [1-3](#)

Phoster Corporation established Skine Company as a wholly owned subsidiary. Phoster reported the following balance sheet amounts immediately before and after it transferred assets and accounts payable to Skine Company in exchange for 4,000 shares of \$12 par value common stock:

	Amount Reported			
	Before Transfer		After Transfer	
Cash		\$ 40,000		\$ 25,000
Accounts Receivable		65,000		41,000
Inventory		30,000		21,000
Investment in Skine Company				66,000
Land		15,000		12,000
Depreciable Assets	\$180,000		\$115,000	
Accumulated Depreciation		<u>75,000</u>	<u>47,000</u>	<u>68,000</u>
Total Assets		<u>\$255,000</u>		<u>\$233,000</u>
Accounts Payable		\$ 40,000		\$ 18,000
Bonds Payable		80,000		80,000
Common Stock		60,000		60,000
Retained Earnings		<u>75,000</u>		<u>75,000</u>
Total Liabilities & Equities		<u>\$255,000</u>		<u>\$233,000</u>

### Required

- Give the journal entry that Phoster recorded when it transferred its assets and accounts payable to Skine.
- Give the journal entry that Skine recorded upon receipt of the assets and accounts payable from Phoster.

# Solution

## E1-7 Balance Sheet Totals of Parent Company

- a. Journal entry recorded by Phoster Corporation for transfer of assets and accounts payable to Skine Company:

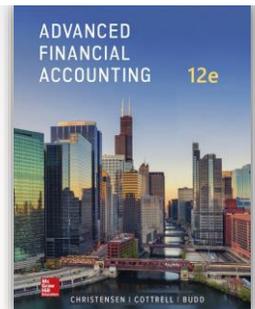
Investment in Skine Company Common Stock	66,000	
Accumulated Depreciation	28,000	
Accounts Payable	22,000	
Cash		15,000
Accounts Receivable		24,000
Inventory		9,000
Land		3,000
Depreciable Assets		65,000

- b. Journal entry recorded by Skine Company for receipt of assets and accounts payable from Phoster Corporation:

Cash	15,000	
Accounts Receivable	24,000	
Inventory	9,000	
Land	3,000	
Depreciable Assets	65,000	
Accumulated Depreciation		28,000
Accounts Payable		22,000
Common Stock		48,000
Additional Paid-In Capital		18,000

## Learning Objective 1-4

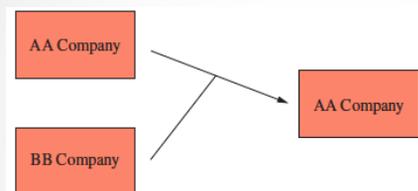
Understand and explain the differences between different forms of business combinations.



# Accounting for External Expansion: Business Combinations

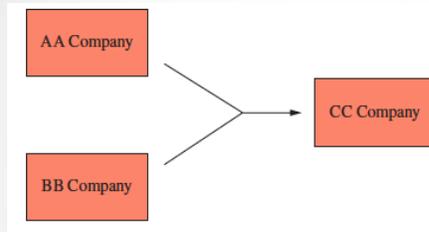
- There are three primary legal forms of business combinations:
  - Statutory merger
  - Statutory consolidation
  - Stock acquisition

## Statutory Merger



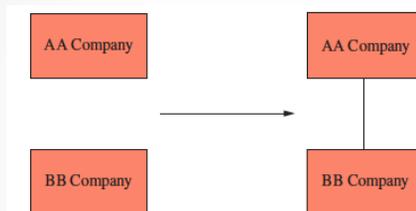
- The acquired company's assets and liabilities are transferred to the acquiring company, and the acquired company is dissolved, or liquidated.
- The operations of the previously separate companies are carried on in a single legal entity following the merger.
- *Result:* one legal entity survives

## Statutory Consolidation



- Both combining companies are dissolved and the assets and liabilities of both companies are transferred to a newly created corporation.
- *Result:* one “new” legal entity survives
- In many situations, however, the resulting corporation is new in form only, and in substance it actually is one of the combining companies reincorporated with a new name.

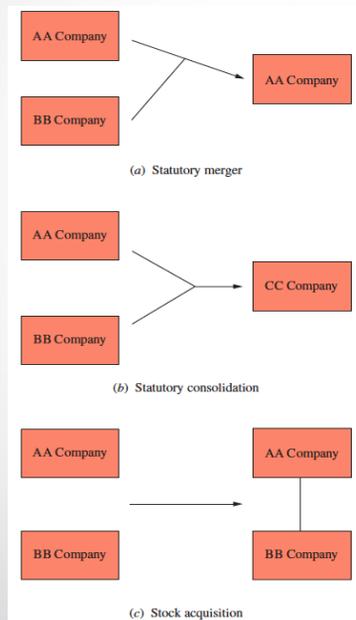
## Stock Acquisition



- One company acquires the voting shares of another company and the two companies continue to operate as separate, but related, legal entities.
- The acquiring company accounts for its ownership interest in the other company as an investment.
- The relationship that is created is referred to as a **parent–subsidiary relationship**.
- For general-purpose financial reporting, a parent company and its subsidiaries present consolidated financial statements.

# Legal Forms of Business Combinations

Figure 1-1



## Methods of Effecting Business Combinations

- **Acquisition of assets**
  - Sometimes one company acquires another company's assets through direct negotiations with its management
  - Statutory merger
  - Statutory consolidation
- **Acquisition of stock**
  - A majority of the outstanding voting shares usually is required unless other factors lead to the acquirer gaining control
  - **Noncontrolling interest:** the total of the shares of an acquired company not held by the controlling shareholder

# Valuation of Business Entities

- **Value of individual assets and liabilities**
  - Value usually determined by appraisal
- **Value of potential earnings**
  - “Going-concern value” based on:
    - A multiple of current earnings
    - Present value of the anticipated future net cash flows generated by the company
- **Valuation of consideration exchanged**
  - Cash: little difficulty
  - Securities: unless traded in the market, estimates of their value must be made

# Acquiring Assets vs. Stock

- **Major Decision Factors**
  - Legal considerations—Buyer must be extremely careful NOT to assume responsibility for (and thus “inherit”) the target company’s
    - Unrecorded liabilities
    - Contingent liabilities (lawsuits)
  - Tax considerations—Often requires major negotiations involving resolution of
    - Seller’s tax desires
    - Buyer’s tax desires
  - Ease of consummation—acquiring common stock is simple compared with acquiring assets

## Acquiring Assets

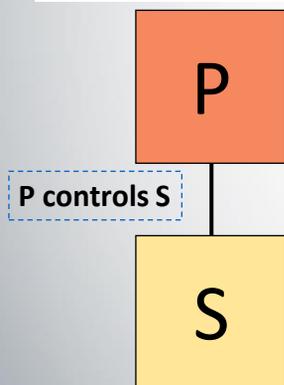
- **Major Advantages of Acquiring Assets**
  - Will not inherit a target's contingent liabilities (excluding environmental)
  - Will not inherit a target's unwanted labor union
- **Major Disadvantages of Acquiring Assets**
  - Transfer of titles on real estate and other assets can be time-consuming
  - Transfer of contracts may not be possible

## Acquiring Common Stock

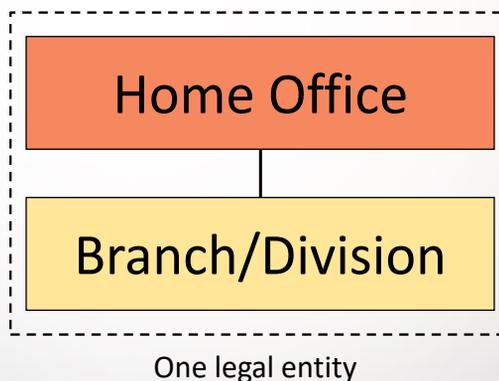
- **Advantages of Acquiring Common Stock**
  - Easy transfer
  - May inherit nontransferable contracts
- **Disadvantages of Acquiring Common Stock**
  - May inherit contingent liabilities or unwanted labor union connection
  - May acquire unwanted facilities/units
  - Will likely be hard to access target's cash

# Organizational Forms—What Acquired?

**Common Stock**—Results in a parent–subsidiary relationship

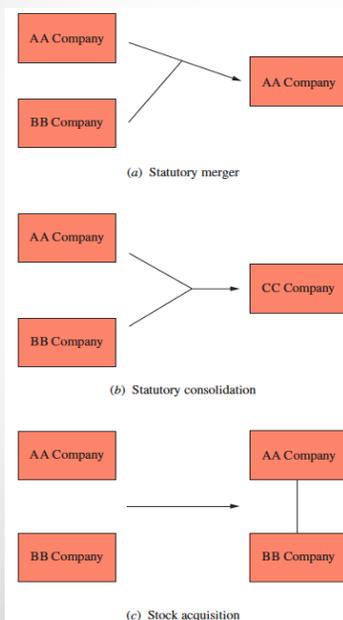


**Target's Assets**—Results in a home office–branch/division relationship



# Legal Forms of Business Combinations

Figure 1-1



# Forms of Business Combination— Details (Option #1)

- **Option #1: Statutory Merger**

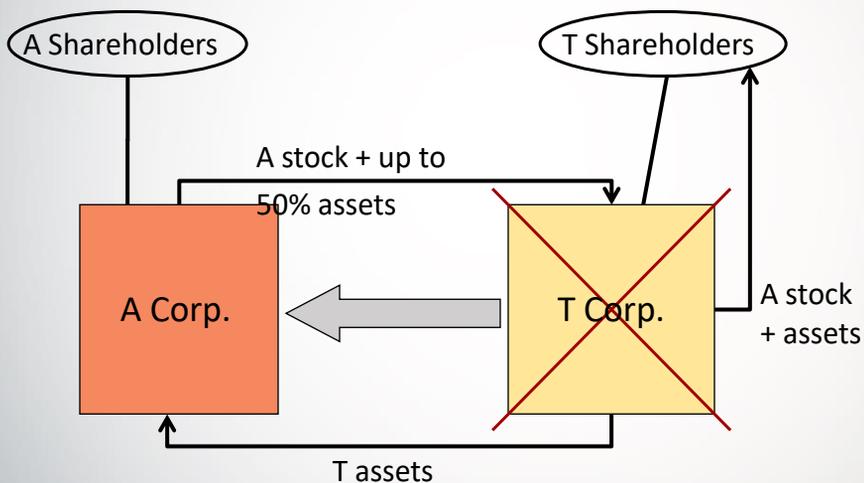
- **Friendly Merger:**

- One entity transfers assets to another in exchange for stock and/or cash
- It liquidates pursuant to state laws

- **Hostile Takeover:**

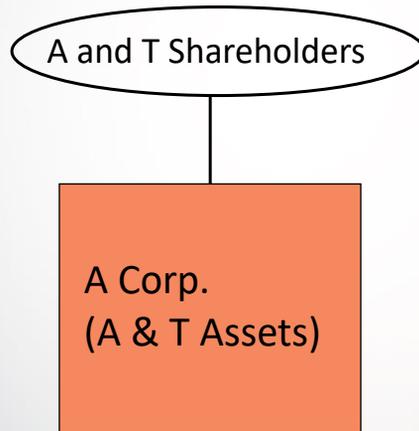
- One company buys the stock of another, creating a temporary parent–subsidiary relationship
- The *parent* then liquidates the *subsidiary* into the *parent* pursuant to state laws
- The result: one legal entity survives

## Statutory Merger: *Peaceful Merger*

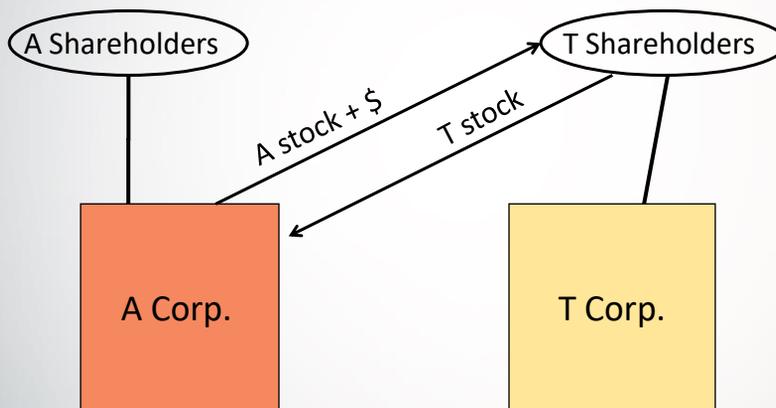


- ♦ Need shareholder approval from both corporations.

## Statutory Merger: *The Result*

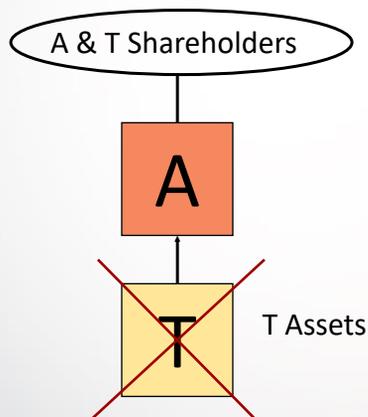


## Statutory Merger: Hostile Takeover (1 of 2)

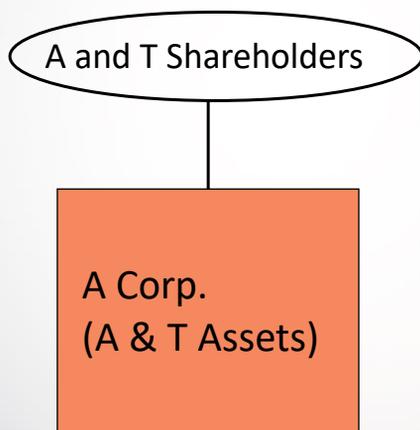


## Statutory Merger: Hostile Takeover (2 of 2)

- A takes all of T's assets and liquidates the corporate shell



## Statutory Merger: *The (Same) Result*

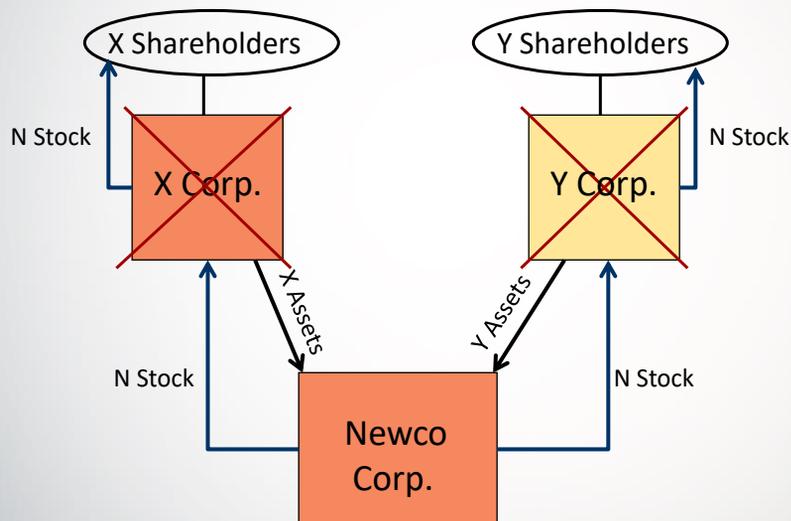


## Forms of Business Combination— Details (Option #2)

- **Option #2: Statutory Consolidation**

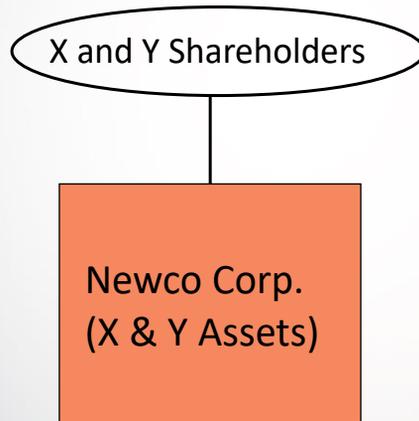
- New corporation (Newco) is created
- Newco issues stock to **both** combining companies in exchange for their stock
- Each combining company becomes a **temporary subsidiary** of Newco
- Both subs are **liquidated** into Newco and become **divisions**
- **Result: One legal entity** survives

### Statutory Consolidation: *The Process*



- ♦ Need shareholder approval from both corporations

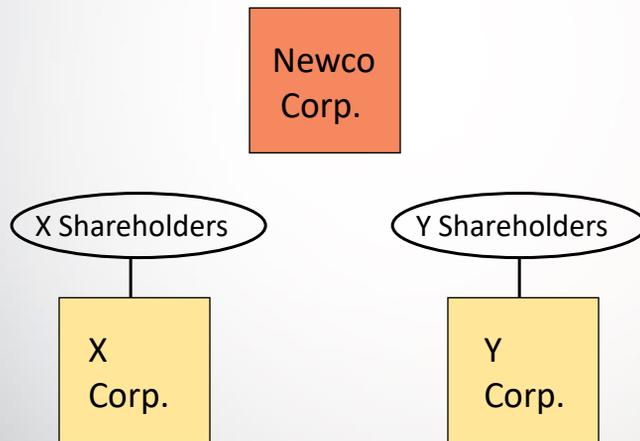
## Statutory Consolidation: *The Result*



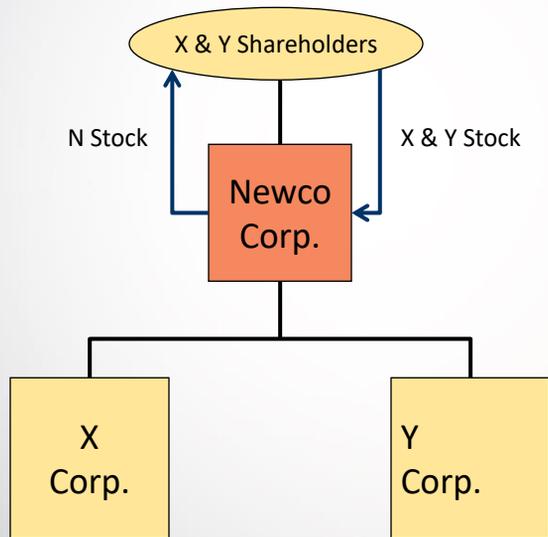
## Forms of Business Combination— Details (Option #3)

- **Option #3: HOLDING COMPANY:**
  - Similar to a statutory consolidation except that the two subsidiaries are NOT liquidated into newly formed parent corporation.
  - Instead, the new company issues its stock to the shareholders of the two existing corporations in exchange for their stock in the two new subsidiary corporations.

## Holding Company: *The Starting Point*



## Holding Company: *The Result*



## Practice Quiz Question #5

A way to force out a target company's dissenting shareholders is to use

- a. acquisition accounting.
- b. pooling-of-interests accounting.
- c. a statutory merger.
- d. a statutory consolidation.
- e. none of the above.

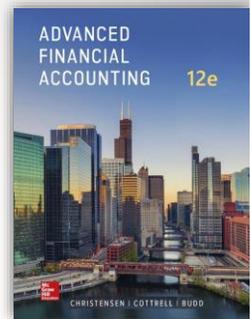
## Practice Quiz Question *Solution*

A way to force out a target company's dissenting shareholders is to use

- a. acquisition accounting.
- b. pooling-of-interests accounting.
- c. a statutory merger.**
- d. a statutory consolidation.
- e. none of the above.

## Learning Objective 1-5

Make calculations and business combination journal entries in the presence of a differential, goodwill, or a bargain purchase element.



## Acquisition Accounting

- The acquirer recognizes all assets acquired and liabilities assumed in a business combination and measures them at their acquisition-date fair values.
  - If less than 100% of the acquiree is acquired, the noncontrolling interest also is measured at its acquisition-date fair value.
  - If the acquiring company already had an ownership interest in the acquiree, that investment is also measured at its acquisition-date fair value.



## Fair Value Measurements

- The acquirer must value at fair value:
  1. The consideration it exchanges in a business combination,
  2. Each of the individual assets and liabilities acquired,
  3. Any noncontrolling interest in the acquiree, and
  4. Any interest already held in the acquiree.
- The value of the consideration given in the exchange is usually the best measure of the value received and, therefore, reflects the value of the acquirer's interest in the acquiree.



## Applying the Acquisition Method

- The full acquisition-date fair values of the individual assets acquired, both tangible and intangible, and liabilities assumed in a business combination are recognized by the consolidated entity.
- This is true regardless of the percentage ownership acquired by the controlling entity.
- All costs of bringing about and consummating a business combination are charged to an acquisition expense as incurred.

# Goodwill

- Goodwill as it relates to business combinations consists of all those intangible factors that allow a business to earn above-average profits.
- Under the acquisition method, an acquirer measures and recognizes goodwill from a business combination based on the difference between the total fair value of the acquired company and the fair value of its net identifiable assets.
- The fair value of the consideration given is compared with the acquisition-date fair value of the acquiree's net identifiable assets, and any excess is *goodwill*.

## Example 1: Goodwill (1 of 5)

- ◆ Assume that Albert Company acquires all of the net assets of Zanfor Company for \$400,000 when the fair value of Zanfor's net identifiable assets is \$380,000.
- ◆ The fair value of all Zanfor's assets and liabilities is equal to Zanfor's book value except for land where the fair value is \$100,000 greater than the book value.

(in thousands)	Book Value
Assets	400
Liabilities	120
Net Assets	280

## Example 1: Goodwill (2 of 5)

- ◆ Assume that Albert Company acquires all of the net assets of Zanfor Company for \$400,000 when the fair value of Zanfor's net identifiable assets is \$380,000.
- ◆ The fair value of all Zanfor's assets and liabilities is equal to Zanfor's book value except for land where the fair value is \$100,000 greater than the book value.

(in thousands)	Book Value	Fair Value
Assets	400	500
Liabilities	120	120
Net Assets	280	380

Net identifiable assets = 380

## Example 1: Goodwill (3 of 5)

- ◆ Assume that Albert Company acquires all of the net assets of Zanfor Company for \$400,000 when the fair value of Zanfor's net identifiable assets is \$380,000.
- ◆ The fair value of all Zanfor's assets and liabilities is equal to Zanfor's book value except for land where the fair value is \$100,000 greater than the book value.

(in thousands)	Book Value	Fair Value
Assets	400	500
Liabilities	120	120
Net Assets	280	380
Acquisition Price		400

Net identifiable assets = 380

$$\begin{aligned} \text{Acquisition price} &= \$400 \\ \text{FV of net identifiable assets} &= \$380 \\ \text{BV of Net identifiable assets} &= \$280 \\ \text{Differential} &= \text{Acquisition price} - \text{BV} \\ &= 400 - 280 = 120 \\ \text{Goodwill} &= \text{Acquisition price} - \text{FV} \\ &= 400 - 380 = 20 \\ \text{Excess value} &= \text{FV} - \text{BV} \\ &= 380 - 280 = 100 \end{aligned}$$

Assets	500
Goodwill	20
Liabilities	120
Cash	400

## Example 1: Goodwill (4 of 5)

- Assume that Albert Company acquires all of the net assets of Zanfor Company for \$400,000 when the fair value of Zanfor's net identifiable assets is \$380,000.
- The fair value of all Zanfor's assets and liabilities is equal to Zanfor's book value except for land where the fair value is \$100,000 greater than the book value.

(in thousands)	Book Value	Fair Value
Assets	400	500
Liabilities	120	120
Net Assets	280	380
Acquisition Price		400
Goodwill		20

Net identifiable assets = 380

## Example 1: Goodwill (5 of 5)

Goodwill only exists if purchase price exceeds the fair value that can be assigned to IDENTIFIABLE assets.

(in thousands)	Book Value	Fair Value
Assets	400	500
Liabilities	120	120
Net Assets	280	380
Acquisition Price		400
Goodwill		20

Acquisition Price:

- Goodwill = 20,000
- Identifiable Excess = 100,000
- Book value = 280,000

Net identifiable assets = 380

New investment recorded by parent

## Example: Controlling Interest Acquisition

- ◆ If, instead of an acquisition of assets, Albert acquires 75% of the common stock of Zanfor for \$300,000, and the fair value of the noncontrolling interest is \$100,000, goodwill is computed as follows:

Fair value of consideration given by Albert	\$300,000
+ Fair value of noncontrolling interest	<u>100,000</u>
Total fair value of Zanfor Company	\$400,000
- Fair value of net identifiable assets acquired	<u>(380,000)</u>
Goodwill	<u><u>\$20,000</u></u>

- ◆ Note that the total amount of goodwill is not affected by whether 100% of the acquiree or less than that is acquired.

## The Acquisition Method: Items Included in the Acquirer's Cost

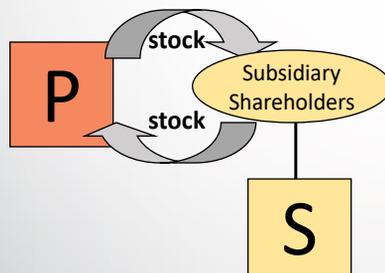
- **Category #1:** The fair value of the consideration given
- **Category #2:** Certain out-of-pocket direct costs
  - In the past, these were included in acquisition
  - Now expense!
- **Category #3:** Contingent consideration
  - Paid subsequent to the acquisition date

## Acquirer's Cost: Category 1 (1 of 2)

- **Types of Consideration:** practically any type
  - Cash
  - Common stock
  - Preferred stock
  - Notes receivable or bonds
  - Used trucks

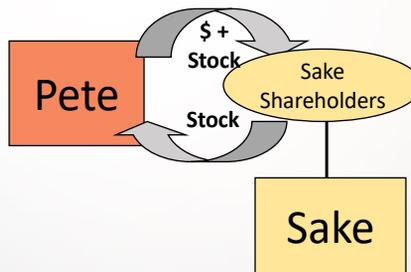
## Acquirer's Cost: Category 1 (2 of 2)

- **General Rule**
  - Use the FMV of the consideration *given*
- **Exception**
  - Use the FMV of the property *received* . . . if it is more readily determinable



## Group Exercise 1: Basic Acquisition (1 of 2)

Pete Inc. acquired 100% of the outstanding common stock of Sake Inc. for \$2,500,000 cash and 20,000 shares of its own common stock (\$1 par value), which was trading at \$50 per share at the acquisition date.

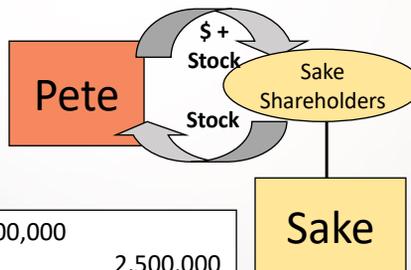


Required: Prepare the journal entry to record the acquisition.

## Group Exercise 1: Basic Acquisition (2 of 2)

Pete Inc. acquired 100% of the outstanding common stock of Sake Inc. for \$2,500,000 cash and 20,000 shares of its own common stock (\$1 par value), which was trading at \$50 per share at the acquisition date.

Acquisition Cost:	
Cash	\$2,500,000
Stock	<u>1,000,000</u>
Total	\$3,500,000



Investment in Sake	3,500,000	
Cash		2,500,000
Common Stock		20,000
Additional Paid-in Cap.		980,000

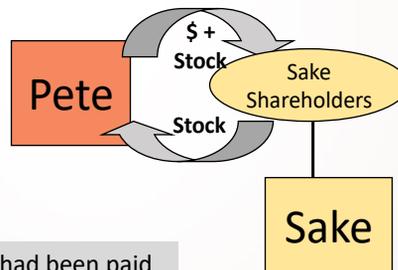
## Acquirer's Cost: Category 2

- In the past, costs traceable to the acquisition were capitalized:
  - Legal fees—the acquisition agreement
  - Purchase investigation fees
  - Finder's fees
  - Travel costs
  - Professional consulting fees
- ASC 805 requires that they be expensed in the acquisition period.
- Do not expense direct costs of issuing stock
  - Charge to Additional Paid-In Capital

## Group Exercise 2: Recording Direct Costs

Assume the same information provided in Exercise 1. In addition, assume that Pete incurred the following direct costs:

Legal fees (acquisition)	\$ 52,000
Accounting fees (acquisition)	27,000
Travel expenses	11,000
Legal fees (stock issuance)	31,000
Accounting fees (stock issue)	14,000
SEC filing fees	<u>9,000</u>
<b>Total</b>	<b>\$144,000</b>



Prior to the consummation date, \$117,000 had been paid and charged to a deferred charges account pending consummation of the acquisition. The remaining \$27,000 has *not* been paid or accrued.

Required: Prepare the journal entry to record the direct costs.

## Group Exercise 2: *Solution*

	<u>Charge To</u>	
	<u>Acquisition Expense</u>	<u>Additional Paid-in Capital</u>
Legal fees (acquisition)	\$ 52,000	
Accounting fees (acquisition)	27,000	
Travel expenses	11,000	
Legal fees (stock issuance)		\$ 31,000
Accounting fees (stock issue)		14,000
SEC Filing fees		<u>9,000</u>
Totals	<u>\$ 90,000</u>	<u>\$ 54,000</u>

Acquisition Expense	90,000	
Additional Paid-in Capital	54,000	
Deferred Charges		117,000
Accrued Liabilities		27,000

## Acquirer's Cost: Category 3

- Contingent Consideration
  - **Contingent payments depending on some unresolved future event**
    - Example: agree to issue additional shares in 6 months if shares given lose value
  - Record at fair value as of the acquisition date.
  - Mark to market each subsequent period until the contingent event is resolved

## Combination Effected through the Acquisition of Net Assets (1 of 6)

- Assume that Point Corporation acquires all of the assets and assumes all of the liabilities of Sharp Company in a statutory merger by issuing 10,000 shares of \$10 par common stock to Sub.
- The shares issued have a total market value of \$610,000.
- Point incurs legal and appraisal fees of \$40,000 in connection with the combination.
- Point incurs stock issue costs of \$25,000 in connection with the combination.

## Combination Effected through the Acquisition of Net Assets (2 of 6)

- The book values and fair values of Sharp's individual assets and liabilities on the date of combination are as follows:

**Figure 1-2**

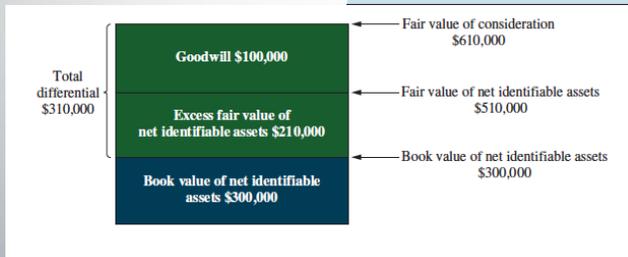
<b>Assets, Liabilities &amp; Equities</b>	<b>Book Value</b>	<b>Fair Value</b>
Cash & Receivables	\$45,000	\$ 45,000
Inventory	65,000	75,000
Land	40,000	70,000
Buildings & Equipment	400,000	350,000
Accumulated Depreciation	(150,000)	
Patent		80,000
<b>Total Assets</b>	<u>\$400,000</u>	<u>\$620,000</u>
Current Liabilities	\$100,000	110,000
Common Stock (\$5 par)	100,000	
Additional Paid-In Capital	50,000	
Retained Earnings	150,000	
<b>Total Liabilities &amp; Equities</b>	<u>\$400,000</u>	
<b>Fair Value of Net Assets</b>		<u>\$510,000</u>

# Combination Effected through the Acquisition of Net Assets (3 of 6)

The *differential* is the total difference at acquisition date between the fair value of the consideration exchanged and the book value of the net identifiable assets acquired.

Figure 1-2

Assets, Liabilities & Equities	Book Value	Fair Value
Cash & Receivables	\$45,000	\$ 45,000
Inventory	65,000	75,000
Land	40,000	70,000
Buildings & Equipment	400,000	350,000
Accumulated Depreciation	(150,000)	
Patent		80,000
<b>Total Assets</b>	<b><u>\$400,000</u></b>	<b><u>\$620,000</u></b>
Current Liabilities	\$100,000	110,000
Common Stock (\$5 par)	100,000	
Additional Paid-In Capital	50,000	
Retained Earnings	150,000	
<b>Total Liabilities &amp; Equities</b>	<b><u>\$400,000</u></b>	
<b>Fair Value of Net Assets</b>		<b><u>\$510,000</u></b>



# Combination Effected through the Acquisition of Net Assets (4 of 6)

- The \$40,000 of acquisition costs incurred by Point in carrying out the acquisition are expensed as incurred:

Acquisition Expense	40,000
Cash	40,000

Record costs related to acquisition of Sharp Company.

## Combination Effected through the Acquisition of Net Assets (5 of 6)

- ◆ Portions of the \$25,000 of stock issue costs related to the shares issued to acquire Sharp may be incurred at various times.
- ◆ To facilitate accumulating these amounts before recording the combination, Point may record them in a separate temporary “suspense” account as incurred:

Deferred Stock Issue Costs	25,000	
Cash		25,000

Record costs related to issuance of common stock.

- ◆ The stock issue costs are treated as a reduction in the proceeds received from the issuance of the stock.
- ◆ Thus, these costs are transferred from the temporary account to Additional Paid-In Capital as a reduction.

## Combination Effected through the Acquisition of Net Assets (6 of 6)

- ◆ On the date of combination, Point records the acquisition of Sharp with the following entry:

Cash and Receivables	45,000	
Inventory	75,000	
Land	70,000	
Buildings and Equipment	350,000	
Patent	80,000	
Goodwill	100,000	
Current Liabilities		110,000
Common Stock		100,000
Additional Paid-In Capital		485,000
Deferred Stock Issue Costs		25,000

Record acquisition of Sharp Company.

- ◆ This entry records all of Sharp’s individual assets and liabilities, both tangible and intangible, on Point’s books at their fair values on the date of combination.
- ◆ The \$100,000 difference between the fair value of the shares given by Point (\$610,000) and the fair value of Sharp’s net assets is recorded as goodwill.
- ◆ The stock issue costs are transferred from the temporary account to Additional Paid-In Capital as a reduction
  - Point records the \$610,000 of stock issued at its value minus the stock issue costs, or \$585,000 (\$100,000 of this amount is recorded in the Common Stock account and the remainder in Additional Paid-In Capital).

## Entries Recorded by Acquired Company (1 of 2)

- ◆ On the date of the combination, Sharp records the following entry to recognize receipt of the Point shares and the transfer of all individual assets and liabilities to Point:

Investment in Point Stock	610,000	
Current Liabilities	100,000	
Accumulated Depreciation	150,000	
Cash and Receivables		45,000
Inventory		65,000
Land		40,000
Buildings and Equipment		400,000
Gain on Sale of Net Assets		310,000

Record transfer of assets to Point Corporation.

## Entries Recorded by Acquired Company (2 of 2)

- ◆ The distribution of Point shares to Sharp shareholders and the liquidation of Sharp are recorded on Sharp's books with the following entry:

Common Stock	100,000	
Additional Paid-In Capital	50,000	
Retained Earnings	150,000	
Gain on Sale of Net Assets	310,000	
Investment in Point Stock		610,000

Record distribution of Point Corporation stock.

## Subsequent Accounting for Goodwill by Acquirer

- Goodwill impairment losses are recognized in income from continuing operations or are included in gain/loss from discontinued operations, if related.
- Goodwill must be tested for impairment at least annually, at the same time each year.
- When goodwill arises in a business combination, it must be assigned to individual reporting units.
- To test for impairment, the fair value of the reporting unit is compared with its carrying amount.
- A goodwill impairment is measured as the amount by which the carrying value exceeds the fair value.

## Bargain Purchase

- Occasionally, the fair value of the consideration given in a business combination, along with the fair value of any equity interest in the acquiree already held and the fair value of any noncontrolling interest in the acquiree, may be less than the fair value of the acquiree's net identifiable assets, resulting in a ***bargain purchase***.
- When a bargain purchase occurs, the acquirer must take steps to ensure that all acquisition-date valuations are appropriate.
- If they are, the acquirer recognizes a gain at the date of acquisition for the excess of the amount of the net identifiable assets acquired and liabilities assumed as valued under ASC 805, usually at fair value, over the sum of the fair value of the consideration given in the exchange, the fair value of any equity interest in the acquiree held by the acquirer at the date of acquisition, and the fair value of any noncontrolling interest.

## Example 1: Bargain Purchase

- Using the data from the last example, assume that Point company is able to acquire Sharp for \$500,000 cash even though the fair value of Sharp's net identifiable assets is estimated to be \$510,000.
- Point would recognize a \$10,000 gain.
- Point would record the following entry:

Cash and Receivables	45,000	
Inventory	75,000	
Land	70,000	
Buildings and Equipment	350,000	
Patent	80,000	
Cash		500,000
Current Liabilities		110,000
Gain on Bargain Purchase of Sharp Company		10,000

Record acquisition of Sharp Company.

## Goodwill vs. Bargain Purchase Element

• <b>FMV Given &gt; FMV of Net Assets</b>	→	<b>Goodwill</b>
(Acquisition price)		
400	200	
• <b>FMV Given &lt; FMV of Net Assets</b>	→	<b>Bargain Purchase Element</b>
170	200	
• <b>FMV Given = FMV of Net Assets</b>	→	<b>Neither GW nor BPE</b>

# Goodwill: How to calculate it?

- **Goodwill is calculated as the residual amount**
  - First, estimate the FMV of identifiable net assets
    - Includes both tangible AND intangible assets
  - Second, subtract the total FMV of all identifiable net assets from the total FMV given by owners
  - The residual is deemed to be goodwill

$$\text{GW} = \text{Total FMV Given} - \text{FMV of Identifiable Net Assets}$$

## Example 2: Goodwill (1 of 2)

Assume Bigco Corp. pays **\$170,000** for Littleco Inc. and that the estimated fair market values of assets, liabilities, and equity accounts are as follows:

Accounts Receivable	\$ 100,000	Liabilities	\$200,000
Inventory	100,000		
LT Marketable sec.	60,000	Retained Earnings	100,000
PP&E	<u>140,000</u>	Common Stock	<u>100,000</u>
Total Assets	\$ 400,000	Total Liab/Equity	\$ 400,000

$$\begin{aligned} \text{FV Net Assets} &= \text{FV Total Assets} - \text{FV Total Liabilities} \\ \text{FV Net Assets} &= \$400,000 - \$200,000 = \$200,000 \end{aligned}$$

$$\begin{aligned} \text{Bargain purchase element} \\ &= \text{Acquisition price} - \text{FMV Net Assets} \\ &= \$170,000 - \$200,000 = \$(30,000) \end{aligned}$$

Accounts Receivable	\$ 100,000	
Inventory	100,000	
Marketable Securities	60,000	
PP&E	140,000	
Cash		\$ 170,000
Liabilities		200,000
Gain on bargain purchase		30,000

## Example 2: Goodwill (2 of 2)

### Journal Entry:

Accounts Receivable	\$ 100,000	
Inventory	100,000	
Marketable Securities	60,000	
PP&E	140,000	
Goodwill	200,000	
Cash		\$ 400,000
Liabilities		200,000

## Goodwill: What to Do With It?

### • Goodwill

- Must capitalize as an asset
- Cannot amortize to earnings
- Must periodically (at least annually) assess for impairment
- If impaired, must write it down—charge to earnings

# Bargain Purchase Element: What to Do With It?

- **Bargain Purchase Element**

- Still record assets and liabilities assumed at their fair values
- The amount by which consideration given exceeds the fair value of net assets is a gain to the acquirer

## Example 2: Bargain Purchase (1 of 2)

Assume Bigco Corp. pays \$150,000 for Littleco Inc. and that the estimated fair market values of assets, liabilities, and equity accounts are as follows:

Accounts Receivable	\$ 100,000	Liabilities	\$ 200,000
Inventory	100,000		
LT Marketable sec.	60,000	Retained Earnings	100,000
PP&E	<u>140,000</u>	Common Stock	<u>100,000</u>
Total Assets	\$ 400,000	Total Liab/Equity	\$ 400,000

Net Assets = Total Assets – Total Liabilities

Net Assets = \$400,000 – \$200,000 = \$200,000

Gain = Acquisition price – Net Assets

= \$150,000 – \$200,000 = \$(50,000)

## Example 2: Bargain Purchase (2 of 2)

### Journal Entry:

Accounts Receivable	\$ 100,000	
Inventory	100,000	
Marketable Securities	60,000	
PP&E	140,000	
Gain		\$ 50,000
Cash		150,000
Liabilities		200,000

## Acquisition of Intangibles

- **ASC 805**
  - An intangible asset should be recognized separately from goodwill only if its benefits can be separately identified.
  - Finite intangible assets should be amortized over their useful life with no arbitrary cap (i.e., no 40-year limit).
  - Some intangible assets (such as goodwill) may have an indefinite or infinite life. They should not be amortized, but tested for impairment at least annually.

# Intangible Assets

- More are recognized under ASC 805
- Record at fair value but only if either of the following two criteria are met:
  1. Intangible arises from a **legal** or **contractual** right
  2. Intangible does **not** arise from a legal or contractual right but is **separable**

# Separately Recognized Intangibles

- ASC 805 specifies that the following should be recognized separately from goodwill:
  - Marketing-related intangibles
    - Trademarks and internet domains
  - Customer-related intangibles
    - Customer lists, order backlogs, etc.
  - Artistic-related intangibles
    - Normally items protected by copyrights
  - Contract-based intangibles
    - Licenses, franchises, broadcast rights
  - Technology-based intangible assets
    - Both patented and unpatented technologies

## Key:

Purpose is to get companies to recognize intangibles separately from goodwill.

## Group Exercise 3: Acquisition of Intangibles

On January 1, 20X9, Buyer Company acquired 100% ownership of Target Company's assets for \$9,400 cash and assumed its liabilities.

	Current Assets	\$2,400	}	<b>3,900 Total Assets</b>
	Property, Plant, and Equipment	1,500		
	Current Liabilities	500	}	<b>1,600 Total Liabilities</b>
	Long-term Debt	1,100		
<b>Separately Identifiable:</b>				<b>2,300 Net Assets</b>

In addition, Target Company had the following intangible items on the acquisition date (not included in Target's balance sheet):

- 1,400** a. Trademarks (not recognized on Target's books) because they were internally developed. The trademarks have a value of \$1,400. The useful life of these trademarks is indefinite.
  - 1,000** b. Ongoing research projects that have an estimated value of \$1,000.
  - 1,500** c. Internally developed computer software with a value of \$1,500. This software has a useful life of three years.
  - 800** d. Internally developed patents with a value of \$800. The patents have a useful life of seven years.
  - 200** e. Other separately identifiable intangibles with a value of \$200. These assets have an average useful life of five years.
- 4,900**

**REQUIRED: Make Buyer's journal entry to record the acquisition of Target.**

## Group Exercise 3: Solution

Purchase Price	–	Net Assets	–	Separately Identified Int.	=	G.W.
\$9,400		\$2,300		\$4,900		\$2,200

Current Assets	2,400	
Property, Plant, and Equipment	1,500	
Trademarks	1,400	
In-Process Research and Development	1,000	
Computer Software	1,500	
Patents	800	
Other Intangible Assets	200	
Goodwill	2,200	
Current Liabilities		500
Long-Term Debt		1,100
Cash		9,400

# Comprehensive Example: Acquisition Method

## Entries Recorded by Acquiring Company

Merger Expense	40,000	
Cash		40,000

Record costs related to acquisition of Sharp Company.

Deferred Stock Issue Costs	25,000	
Cash		25,000

Record costs related to issuance of common stock.

On the date of combination, Point records the acquisition of Sharp with the following entry:

Cash and Receivables	45,000	
Inventory	75,000	
Land	70,000	
Buildings and Equipment	350,000	
Patent	80,000	
Goodwill	100,000	
Current Liabilities		110,000
Common Stock		100,000
Additional Paid-In Capital		485,000
Deferred Stock Issue Costs		25,000

Record acquisition of Sharp Company.

## Entries Recorded by Acquired Company

Investment in Point Stock	610,000	
Current Liabilities	100,000	
Accumulated Depreciation	150,000	
Cash and Receivables		45,000
Inventory		65,000
Land		40,000
Buildings and Equipment		400,000
Gain on Sale of Net Assets		310,000

Record transfer of assets to Point Corporation.

Common Stock	100,000	
Additional Paid-In Capital	50,000	
Retained Earnings	150,000	
Gain on Sale of Net Assets	310,000	
Investment in Point Stock		610,000

Record distribution of Point Corporation stock.

## E1-8 Acquisition of Net Assets [LO 1-2](#) , [1-5](#)

Pun Corporation concluded the fair value of Slender Company was \$60,000 and paid that amount to acquire its net assets. Slender reported assets with a book value of \$55,000 and fair value of \$71,000 and liabilities with a book value and fair value of \$20,000 on the date of combination. Pun also paid \$4,000 to a search firm for finder's fees related to the acquisition.

### Required

Give the journal entries to be made by Pun to record its investment in Slender and its payment of the finder's fees.

### E1-8 Acquisition of Net Assets

Pun Corporation will record the following journal entries:

(1)	Assets	71,000	
	Goodwill	9,000	
	Liabilities		20,000
	Cash		60,000
(2)	Merger Expense	4,000	
	Cash		4,000

$$\begin{aligned}
 \text{Goodwill} &= 60,000 - (71,000 - 20,000) \\
 &= 60,000 - 51,000 \\
 &= 9,000
 \end{aligned}$$

**E1-9 Reporting Goodwill** [LO 1-5](#)

Samper Company reported the book value of its net assets at \$160,000 when Public Corporation acquired 100 percent of its voting stock for cash. The fair value of Samper's net assets was determined to be \$190,000 on that date.

**Required**

Determine the amount of goodwill to be reported in consolidated financial statements presented immediately following the combination and the amount at which Public will record its investment in Samper if the amount paid by Public is

- \$310,000.
- \$196,000.
- \$150,000.

**E1-9 Reporting Goodwill**

- Goodwill: \$120,000 = \$310,000 - \$190,000  
Investment: \$310,000
- Goodwill: \$6,000 = \$196,000 - \$190,000  
Investment: \$196,000
- Goodwill: \$0; no goodwill is recorded when the purchase price is below the fair value of the net identifiable assets.  
Investment: \$190,000; recorded at the fair value of the net identifiable assets.

**E1-12 Goodwill Recognition** [LO 1-5](#)

Spur Corporation reported the following balance sheet amounts on December 31, 20X1:

Balance Sheet Item	Historical Cost	Fair Value
Cash & Receivables	\$ 50,000	\$ 40,000
Inventory	100,000	150,000
Land	40,000	30,000
Plant & Equipment	400,000	350,000
Less: Accumulated Depreciation	(150,000)	
Patent		130,000
Total Assets	<u>\$440,000</u>	<u>\$700,000</u>
Accounts Payable	\$ 80,000	\$ 85,000
Common Stock	200,000	
Additional Paid-In Capital	20,000	
Retained Earnings	140,000	
Total Liabilities & Equities	<u>\$440,000</u>	

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**Required**

Planket acquired Spur Corporation's assets and liabilities for \$670,000 cash on December 31, 20X1. Give the entry that Planket made to record the purchase.

# Solution

## E1-12 Goodwill Recognition

Journal entry to record acquisition of Spur Corporation net assets:

Cash and Receivables	40,000	
Inventory	150,000	
Land	30,000	
Plant and Equipment	350,000	
Patent	130,000	
Goodwill	55,000	
Accounts Payable		85,000
Cash		670,000

### Computation of goodwill

Fair value of consideration given		\$670,000
Fair value of assets acquired	\$700,000	
Fair value of liabilities assumed	<u>(85,000)</u>	
Fair value of net assets acquired		<u>615,000</u>
Goodwill		<u>\$ 55,000</u>

## E1-13 Acquisition Using Debentures LO 1-5

Planter Corporation used debentures with a par value of \$625,000 to acquire 100 percent of Sorden Company's net assets on January 1, 20X2. On that date, the fair value of the bonds issued by Planter was \$608,000. The following balance sheet data were reported by Sorden:

Balance Sheet Item	Historical Cost	Fair Value
Cash & Receivables	\$ 55,000	\$ 50,000
Inventory	105,000	200,000
Land	60,000	100,000
Plant & Equipment	400,000	300,000
Less: Accumulated Depreciation	(150,000)	
Goodwill	10,000	
Total Assets	<u>\$480,000</u>	<u>\$650,000</u>
Accounts Payable	\$ 50,000	\$ 50,000
Common Stock	100,000	
Additional Paid-In Capital	60,000	
Retained Earnings	<u>270,000</u>	
Total Liabilities & Equities	<u>\$480,000</u>	

### Required

Give the journal entry that Planter recorded at the time of exchange.

# Solution

## E1-13 Acquisition Using Debentures

Journal entry to record acquisition of Sorden Company net assets:

Cash and Receivables	50,000	
Inventory	200,000	
Land	100,000	
Plant and Equipment	300,000	
Discount on Bonds Payable	17,000	
Goodwill	8,000	
Accounts Payable		50,000
Bonds Payable		625,000

### Computation of goodwill

Fair value of consideration given		\$608,000
Fair value of assets acquired	\$650,000	
Fair value of liabilities assumed	<u>(50,000)</u>	
Fair value of net assets acquired		<u>600,000</u>
Goodwill		<u>\$ 8,000</u>

## E1-11 Balances Reported Following Combination LO 1-5

Palm Corporation and Staple Company have announced terms of an exchange agreement under which Palm will issue 8,000 shares of its \$10 par value common stock to acquire all of Staple Company's assets. Palm shares currently are trading at \$50, and Staple \$5 par value shares are trading at \$18 each. Historical cost and fair value balance sheet data on January 1, 20X2, are as follows:

Balance Sheet Item	Palm Corporation		Staple Company	
	Book Value	Fair Value	Book Value	Fair Value
Cash & Receivables	\$150,000	\$150,000	\$ 40,000	\$ 40,000
Land	100,000	170,000	50,000	85,000
Buildings & Equipment (net)	300,000	400,000	160,000	230,000
Total Assets	<u>\$550,000</u>	<u>\$720,000</u>	<u>\$250,000</u>	<u>\$355,000</u>
Common Stock	\$200,000		\$100,000	
Additional Paid-In Capital	20,000		10,000	
Retained Earnings	330,000		140,000	
Total Equities	<u>\$550,000</u>		<u>\$250,000</u>	

### Required

What amount will be reported immediately following the business combination for each of the following items in the combined company's balance sheet?

- Common Stock.
- Cash and Receivables.
- Land.
- Buildings and Equipment (net).
- Goodwill.
- Additional Paid-In Capital.
- Retained Earnings.

# Solution

## E1-11 Balances Reported Following Combination

a. Stock Outstanding: $\$200,000 + (\$10 \times 8,000 \text{ shares})$	\$280,000
b. Cash and Receivables: $\$150,000 + \$40,000$	190,000
c. Land: $\$100,000 + \$85,000$	185,000
d. Buildings and Equipment (net): $\$300,000 + \$230,000$	530,000
e. Goodwill: $(\$50 \times 8,000) - \$355,000$	45,000
f. Additional Paid-In Capital: $\$20,000 + [(\$50 - \$10) \times 8,000]$	340,000
g. Retained Earnings	330,000

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## Combination Effected through Acquisition of Stock (1 of 3)

- Assume that Point Corporation exchanges 10,000 shares of its stock with a total market value of \$610,000 for all of Sharp Company's shares.
- Point incurs merger costs of \$40,000 in connection with the combination.
- Point incurs stock issue costs of \$25,000 in connection with the combination.
- What entries should Point record upon receipt of the Sharp stock?

## Combination Effected through Acquisition of Stock (2 of 3)

- Point would record merger and stock issue costs related to acquisition of Sharp with the following entry:

Acquisition Expense	40,000	
Deferred Stock Issue Costs	25,000	
Cash		65,000

Record merger and stock issue costs related to acquisition of Sharp Company.

## Combination Effected through Acquisition of Stock (3 of 3)

- Point would record the acquisition of Sharp stock with the following entry:

Investment in Sharp Stock	610,000	
Common Stock		100,000
Additional Paid-In Capital		485,000
Deferred Stock Issue Costs		25,000

Record acquisition of Sharp company stock.

## Financial Reporting Subsequent to a Business Combination

- Financial statements prepared subsequent to a business combination reflect the combined entity beginning on the date of combination going forward.
- When a combination occurs during a fiscal period, income earned by the acquiree prior to the combination is not reported in the income of the combined enterprise.

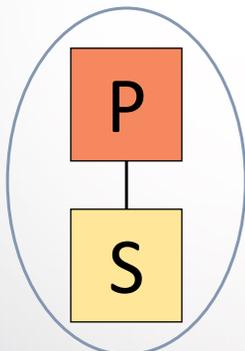
## Practice Quiz Question

**Which of the following costs can be added to the cost of an acquisition?**

- a. Legal fees.
- b. Accounting fees.
- c. Costs of issuing common stock.
- d. A pro rata portion of the CEO's salary.
- e. Travel costs.
- f. Costs of the M&A department.
- g. None of the above.

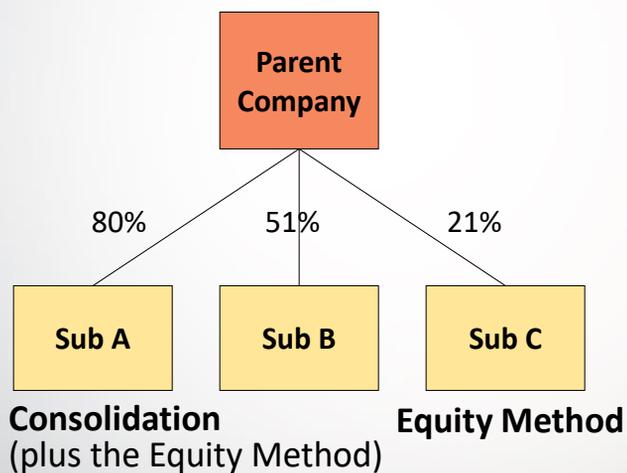
## Consolidation: The Concept (1 of 2)

- Parent creates or gains control of the subsidiary
- ♦ The result: a single reporting entity



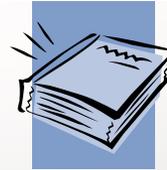
## Consolidation: The Big Picture

How do we report the results of subsidiaries?



## Consolidation: The Concept (2 of 2)

- Two or more separate entities under common control
- Present “as if ” they were one company
- Two or more sets of books are merged together into one set of financial statements



**Thank You!**