I. PURCHASE EXAMPLE: DATE OF ACQUISTION

PURCHASE EXAMPLE 1 (Purchase date of acquisition requiring allocation of various costs of acquisition.)

On 4/30/x6 "P" combines with "S" in a combination properly accounted for as a purchase. Both companies use the same accounting principles for assets and liabilities, revenues and expenses. "P" exchanges 150,000 shares of $10 par common stock (market value $25/sh) for all 100,000 shares of "S's" no par $10 stated value common stock.

Other costs of consolidation:

CPA audit fees for SEC registration	$ 60,000
Legal fees for combination	10,000
Legal fees for SEC registration	50,000
Finders fees	56,250
Printing charges for new securities	23,000
SEC registration fees	750
Total	$ 200,000

"S" Company
Balance Sheet
April 30, 19x6

Assets	COST	FMV
Current Assets	$ 1,000,000	$ 1,150,000
Property, plant and equipment	3,000,000	3,400,000
Other assets	600,000	600,000
Total	$ 4,600,000	$ 5,150,000

Equities

Current Liabilities	$ 500,000	$ 500,000
Long-term debt	1,000,000	950,000
Common stock	1,000,000	
PIC	700,000	
Retained earnings	1,400,000	
Total	$ 4,600,000	

REQUIRED:

1. Analyze the investment.
2. Record the investment is "S" assuming that the transaction is a stock purchase.
3. Record the investment in "S" assuming that the transaction is a purchase of assets.

Note: It is essential that the student have an “approach” to consolidation problems. In all cases take the time to identify:

1. Is the problem a purchase or a pooling: This determines the type of analysis that is performed
2. What is the date of the purchase (beginning of year or mid-year): This determines if there is “purchased NI in a purchase, not a factor in a pooling.
3. If a Purchase:
   a. Is there purchased NI? (Purchase consolidations account for Sub income only from date of acquisition)
   b. Is this a “bargain purchase i.e. is the cost < FMV of purchased net assets?
   c. Are there direct and indirect acquisition costs? (Direct Cost are capitalized, Indirect costs are expensed)
   d. Are there tax considerations?
4. If a Pooling:
   a. Is this a mid-year consolidation? (Pooling consolidations include Combiner net income for the entire year, even if the consolidation is completed on 12/30/xx e.g. “instant earnings”)
   b. Is this a “good deal” (par issued < PIC received) or a “bad deal” (Par issued > PIC received?
   c. Are there direct or indirect acquisition costs? (All costs are expensed in a pooling consolidation)

SOLUTION: PURCHASE EXAMPLE 1

REQUIREMENT 1: Analyze the investment

Cost:	Common stock (150,000 x $25).....	$	3,750,000
	Legal fees.....		10,000
	Finders fees.....		56,250
	Total cost.....	$	3,816,250
	Purchased book value:(Total SHE or net assets).	$	3,100,000
	Excess of cost over book value.....	$	716,250

Note: This is a "purchase" so all cost that are "normal and necessary to get the asset ready for its intended use" are capitalized. If this had been a pooling, all costs would have been expensed.

Attributable to:

Current assets.....	$	150,000
Property, plant, and equipment.....		400,000
Long term debt.....		50,000
Total to identifiable FMV accounts.	$	600,000
Balance to Goodwill.....		116,250
Total excess attributed to assets purchased	$	716,250

Note: The excess of cost over book value (whether that amount is positive or negative, must be accounted for. The top part of the analysis computed the excess of cost over BV. The bottom part (Attributable to:) accounts for how the purchaser is going to allocate the cost to the accounts in the consolidated financial statements.

REQUIREMENT 2: Record the investment assuming a purchase of stock

Investment in "S".....	3,816,250	
Common Stock.....		1,500,000
Cash.....		200,000
** PIC ((150,000 x $15)-(133,750).....		2,116,250**

To record investment in "S" company

REQUIREMENT 3: Record the investment assuming a purchase of assets.

Current assets (always record at FMV).....	1,150,000	
Property, plant and equipment.....	3,400,000	
Other assets.....	600,000	
Discount on long-term debt.....	50,000	
Goodwill.....	116,250	
Current liabilities.....		500,000
Long-term debt.....		1,000,000
Common stock.....		1,500,000
PIC.....		2,116,250
Cash.....		200,000

Take a moment to compare requirements 2 and 3.
Requirement 2: This entry is the most common method in recording a purchase consolidation. It records the "Investment" at full cost. It must be followed by elimination entries, which will eliminate the investment account and replace it will the underlying assets and liabilities that were purchased. These assets and liabilities will be valued on the consolidated books IAW the values derived in the analysis (refer to Purchase Consolidation Summary Table in 4C).

Requirement 3: This entry used only when specific assets are purchased (as opposed to purchasing the entire company) and the value of the assets is known and available.

Note that the entry in requirement C takes eliminates all the intermediary steps of recording the investment and then eliminating the investment against the valuation of the assets purchased.

** In a purchase, acquisition costs relating to SEC registration are expensed; all others are capitalized.

PROCEDURE: Recall that this is a pooling, therefore:

1. Reduce PIC created in the acquisition by the expense to be recognized then
2. Recognize expense (debit expenses) only to the extent that expenses exceed PIC created.