

Project – Chapter 2 (Master)

Paris Corporation purchased all of the stock of Subway Company. As part of the purchase, Paris paid its third party law firm legal fees of \$10,000. Paris' Vice President also spent a great deal of time working on this acquisition. The Vice President's salary for this period was \$5,000. Paris Stock is trades on a major stock exchange at \$100 per share. The balance sheet data for the two companies and fair market value information for Subway Company immediately before the business combination were:

	Paris Corp.	Subway Company	
	<u>Book Value</u>	<u>Book Value</u>	<u>Fair Market Value</u>
Notes Receivable	\$240,000	\$20,000	\$20,000
Accounts Receivable	140,000	35,000	30,000
Inventory	170,000	130,000	185,000
Patents	80,000	40,000	30,000
Buildings & Equipment	380,000	210,000	50,000
Less: Accumulated Depreciation	<u>-190,000</u>	<u>-200,000</u>	
Total Assets	<u>\$820,000</u>	<u>\$235,000</u>	<u>\$315,000</u>
Accounts Payable	\$85,000	\$55,000	\$55,000
Bonds Payable	150,000	120,000	\$110,000
Common Stock			
\$10 par value	200,000		
\$6 par value		18,000	
Additional Paid-In Capital	160,000	10,000	
Retained Earnings	<u>225,000</u>	<u>32,000</u>	_____
Total Liabilities & Equity	<u>\$820,000</u>	<u>\$235,000</u>	
Total Fair Market Value			<u>\$150,000</u>

1. What are the Priority Accounts associated with the net assets of Subway Company?

Notes Receivable	\$20,000
Accounts Receivable	30,000
Inventory	185,000
Accounts Payable	-55,000
Bonds Payable	<u>-110,000</u>
Total Fair Market Value	<u>\$70,000</u>

2. At what price would Paris record goodwill? At what price would Paris record an extraordinary gain? At what price would Paris have a bargain purchase?

Goodwill	Greater than \$150,000
Extraordinary Gain	Less than \$70,000
Bargain Purchase	Less than \$150,000 down to \$70,000
Price = Fair Market Value	\$150,000

3. Assume that Paris paid \$200,000 for Subway:
- a. What is the journal entry that Paris makes to record the purchase of the stock of Subway?

The amount given for the stock is \$210,000 (\$200,000 cash to seller + \$10,000 in direct acquisition fees).

D. Investment in Subway	\$210,000	
C. Cash (to seller)		200,000
Cash (to lawyers)		10,000

- b. What are the book values of Subway's net assets? How will they be adjusted in order to place them on the Consolidation Balance Sheet?

Paris paid \$210,000 for a company with net assets having a fair market value of \$150,000. There is \$60,000 of goodwill (\$210,000 - \$150,000). All other assets and liabilities are adjusted to their fair market value.

	<u>Book Value</u>	<u>Adjustment</u>	<u>Final Value</u>
Notes Receivable	\$20,000	\$0	\$20,000
Accounts Receivable	\$35,000		35,000
Allowance (Bad Debt)		-5,000	-5,000
Inventory	130,000	55,000	185,000
Patents	40,000	-10,000	30,000
Buildings & Equipment (net)	10,000	40,000	50,000
Goodwill	0	60,000	60,000
Accounts Payable	-55,000	0	-55,000
Bonds Payable	-120,000		-120,000
Bond Discount	0	<u>10,000</u>	<u>10,000</u>
Total	<u>\$60,000</u>	<u>\$150,000</u>	<u>\$210,000</u>

- c. What is the EL entry on the Consolidation Worksheet?

D. Common Stock	18,000	
Additional Paid-In Capital	10,000	
Retained Earnings	32,000	
C. Investment in Subway		\$60,000

d. What is the D entry on the Consolidation Worksheet?

D. Inventory	55,000	
Buildings & Equipment	40,000	
Goodwill	60,000	
Bond Discount	10,000	
C. Allowance (Bad Debt)		\$5,000
Patents		10,000
Investment in Subway		150,000

Notice that the credit to Investment in Subway in the D entry is equal to the total adjustment calculated in subpart b.

4. Assume that Paris paid \$100,000 for Subway:

a. What is the journal entry that Paris makes to record the purchase of the net assets of Subway?

The amount given for the stock is \$110,000 (\$100,000 cash to seller + \$10,000 in direct acquisition fees).

D. Investment in Subway	\$110,000	
C. Cash (to seller)		100,000
Cash (to lawyers)		10,000

b. What are the book values of Subway's net assets? How will they be adjusted in order to place them on the Consolidation Balance Sheet?

The Priority Accounts would get their full fair market value:

Notes Receivable	\$20,000
Accounts Receivable	35,000
Allowance (Bad Debt)	-5,000
Inventory	185,000
Accounts Payable	-55,000
Bonds Payable	-120,000
Bond Discount	<u>10,000</u>
Total Fair Market Value	<u>\$70,000</u>

The remaining \$40,000 would be allocated to the remaining according to their relative fair market values:

Patents	30,000	$30,000/80,000 \times \$40,000$	\$15,000
Buildings & Equipment	<u>50,000</u>	$50,000/80,000 \times \$40,000$	<u>\$25,000</u>
Total Fair Market Value	<u>\$80,000</u>		<u>\$40,000</u>

	<u>Book Value</u>	<u>Adjustment</u>	<u>Final Value</u>
Notes Receivable	\$20,000	\$0	\$20,000
Accounts Receivable	\$35,000		35,000
Allowance (Bad Debt)		-5,000	-5,000
Inventory	130,000	55,000	185,000
Patents	40,000	-25,000	15,000
Buildings & Equipment (net)	10,000	15,000	25,000
Accounts Payable	-55,000	0	-55,000
Bonds Payable	-120,000		-120,000
Bond Discount	0	<u>10,000</u>	<u>10,000</u>
Total	<u>\$60,000</u>	<u>\$50,000</u>	<u>\$110,000</u>

c. What is the EL entry on the Consolidation Worksheet?

D. Common Stock	18,000	
Additional Paid-In Capital	10,000	
Retained Earnings	32,000	
C. Investment in Subway		\$60,000

d. What is the D entry on the Consolidation Worksheet?

D. Inventory	55,000	
Buildings & Equipment	15,000	
Bond Discount	10,000	
C. Allowance (Bad Debt)		\$5,000
Patents		25,000
Investment in Subway		50,000

Notice that the credit to Investment in Subway in the D entry is equal to the total adjustment calculated in subpart b.

5. Assume that Paris paid \$30,000 for Subway:

a. What is the journal entry that Paris makes to record the purchase of the net assets of Subway?

The amount given for the stock is \$40,000 (\$30,000 cash to seller + \$10,000 in direct acquisition fees).

D. Investment in Subway	\$40,000	
C. Cash (to seller)		30,000
Cash (to lawyers)		10,000

- b. What are the book values of Subway's net assets? How will they be adjusted in order to place them on the Consolidation Balance Sheet?

The Priority Accounts would get their full fair market value:

Notes Receivable	\$20,000
Accounts Receivable	35,000
Allowance (Bad Debt)	-5,000
Inventory	185,000
Accounts Payable	-55,000
Bonds Payable	-120,000
Bond Discount	<u>10,000</u>
Total Fair Market Value	<u>\$70,000</u>

The remaining assets would get no book value.

	<u>Book Value</u>	<u>Adjustment</u>	<u>Final Value</u>
Notes Receivable	\$20,000	\$0	\$20,000
Accounts Receivable	\$35,000		35,000
Allowance (Bad Debt)		-5,000	-5,000
Inventory	130,000	55,000	185,000
Patents	40,000	-40,000	0
Buildings & Equipment (net)	10,000	-10,000	0
Accounts Payable	-55,000	0	-55,000
Bonds Payable	-120,000		-120,000
Bond Discount	0	<u>10,000</u>	<u>10,000</u>
Total		<u>\$10,000</u>	<u>\$70,000</u>

Because Paris only paid a total of \$40,000 for Subway, it must recognize a \$30,000 extraordinary gain (\$70,000 - \$40,000).

- c. What is the EL entry on the Consolidation Worksheet?

D. Common Stock	18,000	
Additional Paid-In Capital	10,000	
Retained Earnings	32,000	
C. Investment in Subway		\$60,000

Notice that the credit to Investment in Subway is \$60,000, but there is only \$40,000 in the Investment in Subway account in subpart a. There is an artificial \$20,000 credit balance (deficit) in the Investment in Subway account.

d. What is the D entry on the Consolidation Worksheet?

D. Inventory	55,000	
Bond Discount	10,000	
Investment in Subway	20,000	
C. Allowance (Bad Debt)		\$5,000
Patents		40,000
Buildings & Equipment		10,000
Extraordinary Gain		30,000

Notice that the extraordinary gain is equal to the total adjustment calculated in subpart b plus the artificial credit balance (deficit) to the Investment in Subway account created in subpart c.

6. Refer to Question 3. Assume that Paris purchased 80% of the stock of Subway for \$160,000, and it paid it lawyers \$8,000.

a. What is the journal entry that Paris makes to record the purchase of the net assets of Subway?

The amount given for the stock is \$168,000 (\$160,000 cash to seller + \$8,000 in direct acquisition fees).

D. Investment in Subway	\$168,000	
C. Cash (to seller)		160,000
Cash (to lawyers)		8,000

b. What are the book values of Subway's net assets? How will they be adjusted in order to place them on the Consolidation Balance Sheet?

Paris paid \$168,000 for 80% of a company. The fair market value of 80% of its net assets \$120,000. There is \$48,000 of goodwill (\$168,000 - \$120,000). Eighty percent of all other assets and liabilities are adjusted to their fair market value. If you take 80% of the adjustments calculated in Question 3, you will get the same result:

	<u>100% Adjustment</u>	<u>80% Adjustment</u>
Notes Receivable	\$0	\$0
Accounts Receivable		
Allowance (Bad Debt)	-5,000	-4,000
Inventory	55,000	44,000
Patents	-10,000	-8,000
Buildings & Equipment (net)	40,000	32,000
Goodwill	60,000	48,000
Accounts Payable	0	0
Bonds Payable		
Bond Discount	<u>10,000</u>	<u>8,000</u>
Total	<u>\$150,000</u>	<u>\$120,000</u>

c. What is the EL entry on the Consolidation Worksheet?

D. Common Stock	14,400	
Additional Paid-In Capital	8,000	
Retained Earnings	25,600	
C. Investment in Subway		\$48,000

d. What is the D entry on the Consolidation Worksheet?

D. Inventory	44,000	
Buildings & Equipment	32,000	
Goodwill	48,000	
Bond Discount	8,000	
C. Allowance (Bad Debt)		\$4,000
Patents		8,000
Investment in Subway		120,000

7. Refer to Question 4. Assume that Paris purchased 80% of the stock of Subway for \$80,000, and it paid it lawyers \$8,000.

a. What is the journal entry that Paris makes to record the purchase of the net assets of Subway?

The amount given for the stock is \$88,000 (\$80,000 cash to seller + \$8,000 in direct acquisition fees).

D. Investment in Subway	\$88,000	
C. Cash (to seller)		80,000
Cash (to lawyers)		8,000

- b. What are the book values of Subway's net assets? How will they be adjusted in order to place them on the Consolidation Balance Sheet?

Paris paid \$88,000 for 80% of a company. The fair market value of 80% of its net assets \$120,000. Paris had a bargain purchase. Eighty percent of the Priority Accounts will be adjusted to their fair market value (\$56,000). The remaining amount paid by Paris for Subway (\$32,000) will be allocated to the Non-Priority Accounts according to their relative fair market value.

Patents	24,000	$24,000/64,000 \times \$32,000$	\$12,000
Buildings & Equipment	<u>40,000</u>	$40,000/64,000 \times \$32,000$	<u>\$20,000</u>
Total Fair Market Value	<u>\$64,000</u>		<u>\$32,000</u>

	<u>BV</u>	<u>80% of BV</u>	<u>Adjustment</u>	<u>Final Value</u>
Patents	\$40,000	\$32,000	-\$20,000	\$12,000
Buildings & Equipment	<u>10,000</u>	8,000	<u>+12,000</u>	<u>\$20,000</u>
Total	<u>\$64,000</u>			<u>\$32,000</u>

If you take 80% of the amounts calculated in Question 4, you will get the same result.

	<u>100% Adjustment</u>	<u>80% Adjustment</u>
Notes Receivable	\$0	\$0
Accounts Receivable		
Allowance (Bad Debt)	-5,000	-4,000
Inventory	55,000	44,000
Patents	-25,000	-20,000
Buildings & Equipment (net)	15,000	12,000
Accounts Payable	0	0
Bonds Payable		
Bond Discount	<u>10,000</u>	<u>8,000</u>
Total	<u>\$50,000</u>	<u>\$40,000</u>

- c. What is the EL entry on the Consolidation Worksheet?

D. Common Stock	14,400	
Additional Paid-In Capital	8,000	
Retained Earnings	25,600	
C. Investment in Subway		\$48,000

d. What is the D entry on the Consolidation Worksheet?

D. Inventory	44,000	
Buildings & Equipment	12,000	
Bond Discount	8,000	
C. Allowance (Bad Debt)		\$4,000
Patents		20,000
Investment in Subway		40,000

8. Refer to Question 5. Assume that Paris purchased 80% of the stock of Subway for \$24,000, and it paid it lawyers \$8,000.

a. What is the journal entry that Paris makes to record the purchase of the net assets of Subway?

The amount given for the stock is \$32,000 (\$24,000 cash to seller + \$8,000 in direct acquisition fees).

D. Investment in Subway	\$32,000	
C. Cash (to seller)		24,000
Cash (to lawyers)		8,000

b. What are the book values of Subway's net assets? How will they be adjusted in order to place them on the Consolidation Balance Sheet?

Paris paid \$32,000 for 80% of a company. The fair market value of 80% of its Priority Accounts is \$56,000. Paris is in an extraordinary gain situation. Eighty percent of the Priority Accounts will be adjusted to their fair market value. Eighty percent of the Non-Priority Accounts will be eliminated. If you take 80% of the amounts calculated in Question 5, you will get the same result.

	<u>100%</u> <u>Adjustment</u>	<u>80%</u> <u>Adjustment</u>
Notes Receivable	\$0	\$0
Accounts Receivable		
Allowance (Bad Debt)	-5,000	-4,000
Inventory	55,000	44,000
Patents	-40,000	-32,000
Buildings & Equipment (net)	-10,000	-8,000
Accounts Payable	0	0
Bonds Payable		
Bond Discount	<u>10,000</u>	<u>8,000</u>
Total	<u>\$10,000</u>	<u>\$8,000</u>

c. What is the EL entry on the Consolidation Worksheet?

D. Common Stock	14,400	
Additional Paid-In Capital	8,000	
Retained Earnings	25,600	
C. Investment in Subway		\$48,000

d. What is the D entry on the Consolidation Worksheet?

D. Inventory	44,000	
Bond Discount	8,000	
Investment in Subway	16,000	
C. Allowance (Bad Debt)		\$4,000
Buildings & Equipment		8,000
Patents		32,000
Extraordinary Gain		24,000

9. Assume that Parent purchases all of the stock of Subsidiary for \$200,000. Also assume that Subsidiary has the following balance sheet on the day of purchase:

	Subway Company	
	<u>Book Value</u>	<u>Fair Market Value</u>
Priority Assets	\$80,000	\$120,000
Non-Priority Assets	100,000	200,000
Goodwill	20,000	--
Total Assets	<u>\$200,000</u>	<u>\$320,000</u>
Common Stock	10,000	
Additional Paid-In Capital	90,000	
Retained Earnings	<u>100,000</u>	_____
Total Liabilities & Equity	<u>\$200,000</u>	
Total Fair Market Value		<u>\$320,000</u>

a. What is the EL entry on the Consolidation Worksheet?

D. Common Stock	10,000	
Additional Paid-In Capital	90,000	
Retained Earnings	100,000	
C. Investment in Subway		\$200,000

b. What is the D entry on the Consolidation Worksheet?

Analysis of Purchase Price:

Purchase Price:	\$200,000
Less: Priority Assets FMV:	<u>-120,000</u>
Amount Available For Non-Priority Assets:	<u>80,000</u>

	<u>Book Value</u>	<u>Chap. 1 Val</u>	<u>D entry Adj.</u>
Priority Assets:	\$80,000	\$120,000	+\$40,000
Non-Priority Assets:	100,000	80,000	-20,000
Goodwill:	20,000	0	-20,000

D. Priority Assets	40,000	
C. Non-Priority Assets		\$20,000
Goodwill		20,000

10. Refer to Question 9. Assume that Parent purchased 80% of the stock of Subsidiary for \$160,000.

a. What is the EL entry on the Consolidation Worksheet?

D. Common Stock	8,000	
Additional Paid-In Capital	72,000	
Retained Earnings	80,000	
C. Investment in Subway		\$160,000

b. What is the D entry on the Consolidation Worksheet?

D. Common Stock	8,000	
Additional Paid-In Capital	72,000	
Retained Earnings	80,000	
C. Investment in Subway		\$160,000

	<u>Book Value</u>	<u>80% BkVal</u>	<u>Chap. 1 Val</u>	<u>D entry Adj.</u>
Priority Assets:	\$80,000	\$64,000	\$96,000	+\$32,000
Non-Priority Assets:	100,000	80,000	64,000	-16,000
Goodwill:	20,000	16,000	0	-16,000

D. Priority Assets	32,000	
C. Non-Priority Assets		\$16,000
Goodwill		16,000