Testbank
Chapter 2 – Business Combinations

True or False

1) The transaction costs of issuing shares in an acquisition are expensed.

Answer: False

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section "Consideration Transferred-Costs of Issuing Debt and Equity Instruments"

2) Goodwill acquired in a business combination should be tested for impairment once a year.

Answer: True

Difficulty: Easy
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination
Feedback: Review section "Goodwill"

3) IFRS defines a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses.

Answer: True

Difficulty: Medium
Learning Objective: Understand the nature of a business combination and its various forms.
Section Reference: Nature of a Business Combination
Feedback: Review section "Definition of Business Combination"

4) A business combination could occur without any exchange of assets or equity between the entities involved in the exchange.

Answer: True

Difficulty: Medium
Learning Objective: Understand the nature of a business combination and its various forms.
Section Reference: Nature of a Business Combination
Feedback: Review section “Forms of Business Combinations”

5) Having recognized any contingent liabilities of the acquiree as liabilities, the acquirer must then determine a subsequent measurement for the liability. The liability is initially recognized at book value.

Answer: False

Difficulty: Medium
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination.
Feedback: Review section “Contingent Liabilities”

6) Having recognized goodwill arising in the business combination, goodwill cannot be revalued.

Answer: True

Difficulty: Easy
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination.
Feedback: Review section “Goodwill”

7) The use of physical possession as the key criterion to determine the acquisition date ensures that the substance of the transaction determines the accounting rather than the form of the transaction.

Answer: False

Difficulty: Easy
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.

Section Reference: Accounting for a Business Combination: Basic Principles
Feedback: Review section “Determining the Acquisition Date”

8) An acquirer can obtain its controlling interest in the acquiree by acquiring further shares and thereby adding to its previously held equity interest.

Answer: True

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section “Existence of a Previously Held Equity Interest”

9) The acquirer is usually the entity that has the largest minority voting interest in an entity that has a widely dispersed ownership.

Answer: True

Difficulty: Medium
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for a Business Combination: Basic Principles
Feedback: Review section “Identifying the Acquirer”

10) Subsequent to the acquisition date, a contingent liability is measured as the amount initially recognized less, if appropriate, cumulative amortization recognized.

Answer: False

Difficulty: Medium
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination.
Feedback: Review section “Contingent Liabilities”

11) Where the acquirer purchases the acquiree’s assets and liabilities, the acquiree may continue in existence or it may liquidate.

Answer: True

Difficulty: Medium

Learning Objective: Prepare the accounting records of the acquiree.
Section Reference: Accounting in the Records of the Acquiree
Feedback: Review section “Purchase of the Acquiree’s Assets and Liabilities”

12) Normally, the entity that is the acquirer is the one that undertakes action to take over the acquiree.

Answer: True

Difficulty: Medium
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for a Business Combination: Basic Principles
Feedback: Review section “Identifying the Acquirer”

13) At the acquisition date, the contingent consideration is measured at book value.

Answer: False

Difficulty: Medium
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination
Feedback: Review section “Contingent Consideration”

14) Accounting fees for an acquisition should be deferred and amortized.

Answer: False

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section “Consideration Transferred to the Acquiree-Acquisition-Related Costs”

15) The acquirer is usually the combining entity whose owners have the ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity.

Answer: True

Difficulty: Medium
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for a Business Combination: Basic Principles
Feedback: Review section “Identifying the Acquirer"

Multiple Choice

16) Under IFRS 3, Business Combinations, which method must be used to account for business combinations?

a) Purchase method.
b) Acquisition method.
c) New entity method.
d) Pooling-of-interests method.

Answer: b

Difficulty: Easy
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for a Business Combination: Basic Principles
Feedback: See “Identifying the Acquirer”

17) How should legal fees for an acquisition be treated?

a) Capitalized as part of the acquisition cost.
b) Expensed in the period of acquisition.
c) Deferred and amortized.
d) Deferred until the company is disposed of or wound-up.

Answer: b

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: See “Consideration Transferred to the Acquiree-Acquisition-Related Costs”

18) Cowan Ltd. acquired 100% of the net assets of Opus Co. for $1,120,000. At the time of acquisition, Opus had the following:

	Book Value	Fair value
Inventory	$2,800,000	$2,800,000
Land	168,000	238,000
Liabilities	1,960,000	1,960,000

In this acquisition, how much goodwill has been created?

a) $0
b) 42,000
c) $70,000
d) $112,000

Answer: b

Difficulty: Moderate
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: See “Recognizing and Measuring Assets Acquired and Liabilities Assumed”

19) How should the transaction costs of issuing shares in acquisition be recognized?

a) Deducted from shareholders' equity, net of related income tax benefits.
b) Expensed.
c) Capitalized as part of the cost of the shares.
d) Deducted in total from shareholders' equity.

Answer: a

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: See “Consideration Transferred to the Acquiree- Costs of Issuing Debt and Equity Instruments”

20) After an exchange of shares in a business combination, each group of shareholders held 50% of the voting rights. Which of the following factors would be the strongest to be considered in determining the acquirer?

a) Composition of the board of directors.
b) If there are material transactions between the combining companies.
c) Which company initiated the combination.
d) Head office location.

Answer: a

Difficulty: Medium
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for Business Combination: Basic Principles
Feedback: See “Identifying the Acquirer”

21) How should the cost of issuing debt (that is subsequently shown at amortized cost) in an acquisition be recognized initially?

a) Amortized over the term of the debt.
b) Deducted from shareholders' equity.
c) Deducted from the value of the debt.
d) Expensed.

Answer: c

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: See "Consideration Transferred to the Acquiree- Costs of Issuing Debt and Equity Instruments"

22) Whaley Company assigned goodwill of $60,000 to one of the reporting divisions of Rory company when it initially acquired it. Four years later the following information for this division follows:

	Carrying Amount	Fair Value
Cash	$ 20,000	$20,000
Inventory	35,000	40,000
Equipment	125,000	160,000
Goodwill	60,000	
Accounts Payable	30,000	30,000

Based on the preceding information, what amount of goodwill will be reported for this division if its fair valueof the division is now determined to be $200,000?

a) $0
b) $60,000
c) $30,000
d) $10,000

Answer: d

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: See "Recognizing and Measuring Assets Acquired and Liabilities Assumed"

23) Attridge Ltd. and Ion Ltd. exchanged shares in a business combination. After the share exchange, each company held the same number of voting shares. Which of the following statements is TRUE?

a) A number of factors must be considered to determine which company is the acquirer.
b) There is no acquirer as this is not a proper business combination.

c) The company with the highest net assets is considered the acquirer.
d) The companies must ask the courts to decide which company is the acquirer.

Answer: a

Difficulty: Medium
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for a Business Combination: Basic Principles
Feedback: See “Identifying the Acquirer”

24) How often should goodwill acquired in a business combination be tested for impairment?

a) At least once a year.
b) At least once every two years.
c) Whenever there is an indication of impairment.
d) Whenever there is a change in circumstances in the business.

Answer: a

Difficulty: Easy
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination
Feedback: See “Goodwill”

25) Which of the following statements is FALSE?

a) IFRS defines a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses.
b) IFRS 3 applies only to combinations involving ‘businesses’, thereby excluding other exchanges of assets between entities.
c) A business generally must be capable of providing a return to the owners, and would always involve entities whose activities have inputs, processes and outputs.
d) IFRS 3 excludes certain combinations of businesses from its scope, including those established as joint ventures or under common control.

Answer: c

Difficulty: Hard
Learning Objective: Understand the nature of a business combination and its various forms.
Section Reference: Nature of a Business Combination
Feedback: See “Definition of Business Combination”

26) Which of the following statements regarding contingent liabilities subsequent to the initial accounting for a business combination is FALSE?

a) Having recognized any contingent liabilities of the acquiree as liabilities, the acquirer must then determine a subsequent measurement for the liability.
b) The liability is initially recognized at fair value.
c) Subsequent to acquisition date, the liability is measured as the amount initially recognized less, if appropriate, cumulative amortization recognized.
d) The liability would be measured at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

Answer: c

Difficulty: Hard
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination.
Feedback: See “Contingent Liabilities”

27) At the acquisition date, the contingent consideration is:

a) Measured at book value.
b) Classified either as equity or as a liability.
c) Classified as equity.
d) Classified as a liability.

Answer: b

Difficulty: Medium
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination.
Feedback: See “Contingent Consideration”

28) Which of the following statements regarding acquirers and acquirees is FALSE?

a) The acquiree is usually the entity that has the largest minority voting interest in an entity that has a widely dispersed ownership.
b) The acquirer is usually the combining entity whose owners have the ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity.
c) In a takeover, it is normally the larger company that takes over the smaller company.
d) Normally, the entity that is the acquirer is the one that undertakes action to take over the acquiree.

Answer: a

Difficulty: Medium
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for Business Combination: Basic Principles

Feedback: See “Identifying the Acquirer”

29) Under IFRS 3.25, an acquirer is required to recognize and measure:

a) The effect of any temporary differences of an acquiree that exist at the acquisition date or that arise as a result of the acquisitions.
b) The effect of any temporary differences and carryforwards of an acquiree that exist at the acquisition date or that arise as a result of the acquisitions.
c) The effect of any carryforwards of an acquiree that arise as a result of the acquisitions.
d) Any temporary differences and carryforwards of an acquiree that exist at the acquisition date.

Answer: b

Difficulty: Hard
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: See “Recognizing and Measuring Assets Acquired and Liabilities Assumed-Income Taxes”

30) Falter acquired 100% of Krystal's net assets for $300,000. On the acquisition date, the fair value of the current assets and the net capital assets were $208,000 and $432,000 respectively. The fair value of the liabilities equalled their book value. What is the amount of goodwill created in this acquisition?

	Falter Co.	*Krystal Ltd.*
Current assets	$ 480,000	$ 80,000
Net capital assets	800,000	480,000
	$ 1,280,000	$ 560,000
Current liabilities	$ 336,000	$ 280,000
Long-term debt	160,000	96,000
Share capital	720,000	1,000,000
Retained earnings	64,000	84,000
	$ 1,280,000	$ 560,000

a) $(48,000)
b) $ 0
c) $36,000
d) $80,000

Answer: c

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: See “Recognizing and Measuring Assets Acquired and Liabilities Assumed”

31) There are many forms of business combinations that can occur. However, for which of the following are the requirements for accounting for a business combination NOT used?

a) A acquires the assets only of B, and B pays off the liabilities and then liquidates.
b) A acquires all the assets and only some of the liabilities of B, and B pays the remaining liabilities before liquidating.
c) The business combination results in the formation of a joint venture.
d) A acquires a group of net assets of B, the group of net assets constituting a business, such as a division, branch or segment, of B.

Answer: c

Difficulty: Moderate
Learning Objective: Understand the nature of a business combination and its various forms.
Section Reference: Nature of a Business Combination
Feedback: See "Forms of Business Combinations"

32) Which of the following statements regarding accounting in the records of the acquiree is FALSE?
a) Where the acquirer purchases the acquiree's assets and liabilities, the acquiree may continue in existence or it may liquidate.
b) If the acquiree subsequently decides to liquidate, it transfers the cash remaining to the shareholders as a liquidating dividend.
c) When the acquirer buys only shares in the acquiree from the shareholders of the acquiree, there are no entries in the records of the acquiree because the transaction is between the acquirer and the shareholders of the acquiree entity.
d) Where the acquirer purchases the acquiree's assets and liabilities, the acquiree must liquidate.

Answer: d

Difficulty: Hard
Learning Objective: Prepare the accounting records of the acquiree.
Section Reference: Accounting in the Records of the Acquiree
Feedback: See "Purchase of the Acquiree's Assets and Liabilities"

33) Which of the following is NOT a reason why a private enterprise may be acquired as a bargain purchase?

a) The business only has equity financing and has no debt financing.
b) It is a family business and the next generation does not want to continue the business.
c) The owner has health problems and does not have a successor.
d) The owner is no longer interested in the business.

Answer: a

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer

Feedback: See “Recognizing and Measuring Goodwill or a Gain from a Bargain Purchase”

34) Quast Co. plans to acquire Fairweather Co. Fairweather has substantial depreciable assets that have fair values in excess of their book values. Considering only the income tax impact, which of the following statements is TRUE?

a) Quast would prefer to purchase Fairweather's shares and Fairweather would prefer to sell its assets to Quast.
b) Both Quast and Fairweather would prefer Quast to purchase Fairweather's shares.
c) Both Quast and Fairweather would prefer Quast to purchase Fairweather's assets.
d) Quast would prefer to purchase Fairweather's assets and Fairweather would prefer to sell its shares to Quast.

Answer: d

Difficulty: Hard
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: See “Consideration Transferred to the Acquiree-Income Taxes”

35) Conway Ltd. acquired all the assets and liabilities of Elliott Ltd. by issuing common shares to Elliott. After this transaction, Elliott owned 30% of Conway's outstanding shares. How should Conway record Elliott's assets and liabilities on its books?

a) At their fair market value.
b) At their original cost.
c) At their net book value.
d) At their fair market value plus an allocated share of goodwill to each item.

Answer: a

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: See “Recognizing and Measuring Assets Acquired and Liabilities Assumed”

36) Tilman Company paid $360,000 to acquire the net assets of Wilver Company. If the business combination is treated as an acquisition and the fair value of Wilver Company’s current assets is $135,000, its plant and equipment is $363,000, and its liabilities are $84,000, Tilman Company’s financial statements immediately after the combination will include which additional item due to the acquisition of Wilver Company:

a) Negative goodwill of $54,000.
b) Plant and equipment of $498,000.
c) Plant and equipment of $414,000.
d) A gain of $54,000.

Answer: d

Difficulty: Medium
Learning Objective 3: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: See “Recognizing and Measuring Assets Acquired and Liabilities Assumed”

37) Which of the following statements about a bargain purchase is TRUE?

a) It is reported on the financial statements as an "excess of fair value over cost of assets acquired".
b) Assets and liabilities of the acquired company are reported at their fair value.
c) It is reported as a deferred credit on the financial statements called negative goodwill.
d) Assets and liabilities of the acquired company are reported at net book value.

Answer: b

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: See “Recognizing and Measuring Goodwill or a Gain from a Bargain Purchase”

38) A business combination involves the joining together of assets and liabilities under the control of a specific entity. Therefore, the business combination occurs at the date:

a) the net assets are under the control of the acquirer.
b) the contract is signed.
c) the consideration is paid.
d) nominated in the contract.

Answer: a

Difficulty: Easy
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for Business Combination: Basic Principles
Feedback: See “Determining the Acquisition Date”

39) Which of the following statements regarding step acquisitions is FALSE?

a) An acquirer can obtain its controlling interest in the acquiree by acquiring further shares and thereby adding to its previously held equity interest.
b) There may be a number of step purchases of shares in the acquiree prior to the obtaining of control.
c) The acquirer will recognize an investment in the acquiree with each step acquisition being measured at book value.
d) In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognize the resulting gain or loss, if any, in profit or loss.

Answer: c

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: See “Existence of a Previously Held Equity Interest”

40) The use of _______________ as the key criterion to determine the acquisition date ensures that the substance of the transaction determines the accounting rather than the form of the transaction.

a) physical possession
b) control
c) payment of consideration
d) valuation.

Answer: b

Difficulty: Easy
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for Business Combination: Basic Principles
Feedback: See “Determining the Acquisition Date”

41) Xenon acquired 100% of Volt's net assets for $300,000. On the acquisition date, the fair value of the current assets and the net capital assets were $208,000 and $438,000 respectively. The fair value of the liabilities equalled their book value. On Xenon's statement of financial position, what is the total of its shareholders' equity?

	Xenon Co.	*Volt Ltd.*
Current assets	$ 480,000	$ 80,000
Net capital assets	800,000	480,000
	$ 1,280,000	$ 560,000
Current liabilities	$ 336,000	$ 280,000
Long-term debt	160,000	96,000
Share capital	720,000	100,000
Retained earnings	64,000	84,000
	$ 1,280,000	$ 560,000

a) $968,000
b) $184,000
c) $784,000
d) $1,084,000

Answer: c

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.

Section Reference: Accounting in the Records of the Acquirer
Feedback: See “Shares Acquired in an Acquiree”

42) Having recognized goodwill arising in the business combination, which of the following statements regarding the subsequent accounting is FALSE?

a) Goodwill is subject to amortization.
b) Goodwill is subject to an annual impairment test.
c) Goodwill cannot be revalued.
d) IAS38 does not allow the recognition of internally generated goodwill.

Answer: a

Difficulty: Easy
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination.
Feedback: See “Goodwill”

43) Most business combinations are an exchange of equal amounts, given markets in which the parties to the business combinations are informed and willing participants in the transaction. Therefore, the existence of a _____________ is expected to be an unusual or rare event.

a) bargain purchase
b) contingent liability
c) carryforward
d) contingent consideration.

Answer: a
Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: See “Recognizing and Measuring Goodwill or a Gain from a Bargain Purchase”

44) Where the acquirer buys shares of the acquiree from the shareholders, there is _____ effect on the acquiree records.

a) considerable
b) minimal
c) contingent
d) no

Answer: d

Difficulty: Medium
Learning Objective: Prepare the accounting records of the acquiree.
Section Reference: Accounting in the Records of the Acquiree

Feedback: See “Purchase of Acquiree’s Shares from the Shareholders”

45) Where the contingent consideration is a financial liability, it will be accounted for under IFRS #9 and measured at ____________ value with movements being accounted for in accordance with that standard.

a) book
b) fair
c) carrying
d) future

Answer: b

Difficulty: Easy
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination.
Feedback: See “Contingent Consideration”

46) Having recognized a contingent consideration and classified it as equity, the subsequent treatment is:

a) It is re-measured at fair value with changes in the income statement.
b) It is carried at book value with no adjustments made.
c) No remeasurement is required and the subsequent settlement is accounted for within equity.
d) It is re-measured at fair value with changes in OCI.

Answer: c

Difficulty: Medium
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination.
Feedback: See “Contingent Consideration”

47) The acquisition-related costs associated with a business combination are accounted for as ____________ in the periods in which they are incurred and the services are received.

a) liabilities
b) expenses
c) equity
d) goodwill

Answer: b

Difficulty: Medium

Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: See "Consideration Transferred- to the Acquiree- Acquisition"

48) When the future income of the acquiree is regarded as uncertain, the agreement may contain a clause that requires the acquirer to provide additional consideration to the acquiree if the income of the acquiree exceeds a specified amount over some specified period. For example, A may agree to pay $100,000 to acquire B and promise to pay an additional $50,000 in two years if B earns at least $100,000 for the next two years. A is concerned that the owners of B are integral to the success of B and may not stay involved if they receive full payment immediately. This is an example of:

a) goodwill.
b) contingent consideration.
c) monetary assets.
d) intangible assets.

Answer: b

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: See "Consideration Transferred- to the Acquiree-Contingent Consideration"

49) A may issue its shares to acquire the shares of B. However, because of the greater number of A shares given to the former B shareholders relative to those held by the shareholders in A before the combination, the former shareholders in B may have the majority of shares in A and be able to determine the operating and financial policies of the combined entities. This is known as a:

a) Reverse acquisition.
b) Goodwill gesture.
c) Hostile takeover.
d) Contingent consideration.

Answer: a

Difficulty: Easy
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for Business Combination: Basic Principles
Feedback: See "Identifying the Acquirer"

50) A business combination could occur without any exchange of ____________ between the entities involved in the exchange.

a) assets
b) assets or equity
c) liabilities

d) equity.

Answer: b

Difficulty: Medium
Learning Objective: Understand the nature of a business combination and its various forms.
Section Reference: Nature of a Business Combination
16) Under IFRS 3, Business Combinations, which method must be used to account for business combinations?

a) Purchase method.
b) Acquisition method.
c) New entity method.
d) Pooling-of-interests method.

Answer: b

Difficulty: Easy
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for a Business Combination: Basic Principles
Feedback: Review section "Identifying the Acquirer"

17) How should legal fees for an acquisition be treated?

a) Capitalized as part of the acquisition cost.
b) Expensed in the period of acquisition.
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d) Deferred until the company is disposed of or wound-up.

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c) $70,000
d) $112,000

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Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section “Recognizing and Measuring Assets Acquired and Liabilities Assumed”

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a) Deducted from shareholders' equity, net of related income tax benefits.
b) Expensed.
c) Capitalized as part of the cost of the shares.
d) Deducted in total from shareholders' equity.

Answer: a

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section “Consideration Transferred to the Acquiree- Costs of Issuing Debt and Equity Instruments”

20) After an exchange of shares in a business combination, each group of shareholders held 50% of the voting rights. Which of the following factors would be the strongest to be considered in determining the acquirer?

a) Composition of the board of directors.
b) If there are material transactions between the combining companies.
c) Which company initiated the combination.
d) Head office location.

Answer: a

Difficulty: Medium
Learning Objective: Explain the basic steps in the acquisition method of accounting for

business combinations.
Section Reference: Accounting for Business Combination: Basic Principles
Feedback: Review section “Identifying the Acquirer”

21) How should the cost of issuing debt (that is subsequently shown at amortized cost) in an acquisition be recognized initially?

a) Amortized over the term of the debt.
b) Deducted from shareholders' equity.
c) Deducted from the value of the debt.
d) Expensed.

Answer: c

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section “Consideration Transferred to the Acquiree- Costs of Issuing Debt and Equity Instruments”

22) Whaley Company assigned goodwill of $60,000 to one of the reporting divisions of Rory company when it initially acquired it. Four years later the following information for this division follows:

	Carrying Amount	Fair Value
Cash	$ 20,000	$20,000
Inventory	35,000	40,000
Equipment	125,000	160,000
Goodwill	60,000	
Accounts Payable	30,000	30,000

Based on the preceding information, what amount of goodwill will be reported for this division if its fair value of the division is now determined to be $200,000?

a) $0
b) $60,000
c) $30,000
d) $10,000

Answer: d

Difficulty: Medium

Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section “Recognizing and Measuring Assets Acquired and Liabilities Assumed”

23) Attridge Ltd. and Ion Ltd. exchanged shares in a business combination. After the share exchange, each company held the same number of voting shares. Which of the following statements is TRUE?

a) A number of factors must be considered to determine which company is the acquirer.
b) There is no acquirer as this is not a proper business combination.
c) The company with the highest net assets is considered the acquirer.
d) The companies must ask the courts to decide which company is the acquirer.

Answer: a

Difficulty: Medium
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for a Business Combination: Basic Principles
Feedback: Review section “Identifying the Acquirer”

24) How often should goodwill acquired in a business combination be tested for impairment?

a) At least once a year.
b) At least once every two years.
c) Whenever there is an indication of impairment.
d) Whenever there is a change in circumstances in the business.

Answer: a

Difficulty: Easy
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination
Feedback: Review section “Goodwill”

25) Which of the following statements is FALSE?

a) IFRS defines a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses.

b) IFRS 3 applies only to combinations involving ‘businesses’, thereby excluding other exchanges of assets between entities.
c) A business generally must be capable of providing a return to the owners, and would always involve entities whose activities have inputs, processes and outputs.
d) IFRS 3 excludes certain combinations of businesses from its scope, including those established as joint ventures or under common control.

Answer: c

Difficulty: Hard
Learning Objective: Understand the nature of a business combination and its various forms.
Section Reference: Nature of a Business Combination
Feedback: Review section “Definition of Business Combination”

26) Which of the following statements regarding contingent liabilities subsequent to the initial accounting for a business combination is FALSE?

a) Having recognized any contingent liabilities of the acquiree as liabilities, the acquirer must then determine a subsequent measurement for the liability.
b) The liability is initially recognized at fair value.
c) Subsequent to acquisition date, the liability is measured as the amount initially recognized less, if appropriate, cumulative amortization recognized.
d) The liability would be measured at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

Answer: c

Difficulty: Hard
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination.
Feedback: Review section “Contingent Liabilities”

27) At the acquisition date, the contingent consideration is:

a) Measured at book value.
b) Classified either as equity or as a liability.
c) Classified as equity.
d) Classified as a liability.

Answer: b

Difficulty: Medium
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination.
Feedback: Review section "Contingent Consideration"

28) Which of the following statements regarding acquirers and acquirees is FALSE?

a) The acquiree is usually the entity that has the largest minority voting interest in an entity that has a widely dispersed ownership.
b) The acquirer is usually the combining entity whose owners have the ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity.
c) In a takeover, it is normally the larger company that takes over the smaller company.
d) Normally, the entity that is the acquirer is the one that undertakes action to take over the acquiree.

Answer: a

Difficulty: Medium
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for Business Combination: Basic Principles
Feedback: Review section "Identifying the Acquirer"

29) Under IFRS 3.25, an acquirer is required to recognize and measure:

a) The effect of any temporary differences of an acquiree that exist at the acquisition date or that arise as a result of the acquisitions.
b) The effect of any temporary differences and carryforwards of an acquiree that exist at the acquisition date or that arise as a result of the acquisitions.
c) The effect of any carryforwards of an acquiree that arise as a result of the acquisitions.
d) Any temporary differences and carryforwards of an acquiree that exist at the acquisition date.

Answer: b

Difficulty: Hard
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section "Recognizing and Measuring Assets Acquired and Liabilities Assumed-Income Taxes"

30) Falter acquired 100% of Krystal's net assets for $300,000. On the acquisition date, the fair value of the current assets and the net capital assets were $208,000 and $432,000 respectively. The fair value of the liabilities equalled their book value. What is the amount of goodwill created in this acquisition?

	Falter Co.	*Krystal Ltd.*
Current assets	$ 480,000	$ 80,000
Net capital assets	800,000	480,000
	$ 1,280,000	$ 560,000
Current liabilities	$ 336,000	$ 280,000
Long-term debt	160,000	96,000
Share capital	720,000	1,000,000
Retained earnings	64,000	84,000
	$ 1,280,000	$ 560,000

a) $(48,000)
b) $ 0
c) $36,000
d) $80,000

Answer: c

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section "Recognizing and Measuring Assets Acquired and Liabilities Assumed"

31) There are many forms of business combinations that can occur. However, for which of the following are the requirements for accounting for a business combination NOT used?

a) A acquires the assets only of B, and B pays off the liabilities and then liquidates.
b) A acquires all the assets and only some of the liabilities of B, and B pays the remaining liabilities before liquidating.
c) The business combination results in the formation of a joint venture.
d) A acquires a group of net assets of B, the group of net assets constituting a business, such as a division, branch or segment, of B.

Answer: c

Difficulty: Medium
Learning Objective: Understand the nature of a business combination and its various forms.

Section Reference: Nature of a Business Combination
Feedback: Review section “Forms of Business Combinations”

32) Which of the following statements regarding accounting in the records of the acquiree is FALSE?

a) Where the acquirer purchases the acquiree’s assets and liabilities, the acquiree may continue in existence or it may liquidate.
b) If the acquiree subsequently decides to liquidate, it transfers the cash remaining to the shareholders as a liquidating dividend.
c) When the acquirer buys only shares in the acquiree from the shareholders of the acquiree, there are no entries in the records of the acquiree because the transaction is between the acquirer and the shareholders of the acquiree entity.
d) Where the acquirer purchases the acquiree’s assets and liabilities, the acquiree must liquidate.

Answer: d

Difficulty: Hard
Learning Objective: Prepare the accounting records of the acquiree.
Section Reference: Accounting in the Records of the Acquiree
Feedback: Review section “Purchase of the Acquiree’s Assets and Liabilities”

33) Which of the following is NOT a reason why a private enterprise may be acquired as a bargain purchase?

a) The business only has equity financing and has no debt financing.
b) It is a family business and the next generation does not want to continue the business.
c) The owner has health problems and does not have a successor.
d) The owner is no longer interested in the business.

Answer: a

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section “Recognizing and Measuring Goodwill or a Gain from a Bargain Purchase”

34) Quast Co. plans to acquire Fairweather Co. Fairweather has substantial depreciable assets that have fair values in excess of their book values. Considering only the income tax impact, which of the following statements is TRUE?

a) Quast would prefer to purchase Fairweather's shares and Fairweather would prefer to sell its assets to Quast.
b) Both Quast and Fairweather would prefer Quast to purchase Fairweather's shares.
c) Both Quast and Fairweather would prefer Quast to purchase Fairweather's assets.
d) Quast would prefer to purchase Fairweather's assets and Fairweather would prefer to sell its shares to Quast.

Answer: d

Difficulty: Hard
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section “Consideration Transferred to the Acquiree-Income Taxes”

35) Conway Ltd. acquired all the assets and liabilities of Elliott Ltd. by issuing common shares to Elliott. After this transaction, Elliott owned 30% of Conway's outstanding shares. How should Conway record Elliott's assets and liabilities on its books?

a) At their fair market value.
b) At their original cost.
c) At their net book value.
d) At their fair market value plus an allocated share of goodwill to each item.

Answer: a

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section “Recognizing and Measuring Assets Acquired and Liabilities Assumed”

36) Tilman Company paid $360,000 to acquire the net assets of Wilver Company. If the business combination is treated as an acquisition and the fair value of Wilver Company’s current assets is $135,000, its plant and equipment is $363,000, and its liabilities are $84,000, Tilman Company’s financial statements immediately after the combination will include which additional item due to the acquisition of Wilver Company:

a) Negative goodwill of $54,000.
b) Plant and equipment of $498,000.
c) Plant and equipment of $414,000.
d) A gain of $54,000.

Answer: d

Difficulty: Medium
Learning Objective 3: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section “Recognizing and Measuring Assets Acquired and Liabilities Assumed”

37) Which of the following statements about a bargain purchase is TRUE?

a) It is reported on the financial statements as an "excess of fair value over cost of assets acquired".
b) Assets and liabilities of the acquired company are reported at their fair value.
c) It is reported as a deferred credit on the financial statements called negative goodwill.
d) Assets and liabilities of the acquired company are reported at net book value.

Answer: b

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section “Recognizing and Measuring Goodwill or a Gain from a Bargain Purchase”

38) A business combination involves the joining together of assets and liabilities under the control of a specific entity. Therefore, the business combination occurs at the date:

a) the net assets are under the control of the acquirer.
b) the contract is signed.
c) the consideration is paid.
d) nominated in the contract.

Answer: a

Difficulty: Easy
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for Business Combination: Basic Principles
Feedback: Review section “Determining the Acquisition Date”

39) Which of the following statements regarding step acquisitions is FALSE?

a) An acquirer can obtain its controlling interest in the acquiree by acquiring further shares and thereby adding to its previously held equity interest.
b) There may be a number of step purchases of shares in the acquiree prior to the

obtaining of control.
c) The acquirer will recognize an investment in the acquiree with each step acquisition being measured at book value.
d) In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognize the resulting gain or loss, if any, in profit or loss.

Answer: c

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section "Existence of a Previously Held Equity Interest"

40) The use of ______________ as the key criterion to determine the acquisition date ensures that the substance of the transaction determines the accounting rather than the form of the transaction.

a) physical possession
b) control
c) payment of consideration
d) valuation.

Answer: b

Difficulty: Easy
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for Business Combination: Basic Principles
Feedback: Review section "Determining the Acquisition Date"

41) Xenon acquired 100% of Volt's net assets for $300,000. On the acquisition date, the fair value of the current assets and the net capital assets were $208,000 and $438,000 respectively. The fair value of the liabilities equalled their book value. On Xenon's statement of financial position, what is the total of its shareholders' equity?

	Xenon Co.	*Volt Ltd.*
Current assets	$ 480,000	$ 80,000
Net capital assets	800,000	480,000
	$ 1,280,000	$ 560,000
Current liabilities	$ 336,000	$ 280,000
Long-term debt	160,000	96,000
Share capital	720,000	100,000
Retained earnings	64,000	84,000

	$ 1,280,000	$ 560,000

a) $968,000
b) $184,000
c) $784,000
d) $1,084,000

Answer: c

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section “Shares Acquired in an Acquiree”

42) Having recognized goodwill arising in the business combination, which of the following statements regarding the subsequent accounting is FALSE?

a) Goodwill is subject to amortization.
b) Goodwill is subject to an annual impairment test.
c) Goodwill cannot be revalued.
d) IAS38 does not allow the recognition of internally generated goodwill.

Answer: a

Difficulty: Easy
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination.
Feedback: Review section “Goodwill”

43) Most business combinations are an exchange of equal amounts, given markets in which the parties to the business combinations are informed and willing participants in the transaction. Therefore, the existence of a ______________ is expected to be an unusual or rare event.

a) bargain purchase
b) contingent liability
c) carryforward
d) contingent consideration.

Answer: a
Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.

Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section “Recognizing and Measuring Goodwill or a Gain from a Bargain Purchase”

44) Where the acquirer buys shares of the acquiree from the shareholders, there is _____ effect on the acquiree records.

a) considerable
b) minimal
c) contingent
d) no

Answer: d

Difficulty: Medium
Learning Objective: Prepare the accounting records of the acquiree.
Section Reference: Accounting in the Records of the Acquiree
Feedback: Review section “Purchase of Acquiree’s Shares from the Shareholders”

45) Where the contingent consideration is a financial liability, it will be accounted for under IFRS #9 and measured at ____________ value with movements being accounted for in accordance with that standard.

a) book
b) fair
c) carrying
d) future

Answer: b

Difficulty: Easy
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination.
Feedback: Review section “Contingent Consideration”

46) Having recognized a contingent consideration and classified it as equity, the subsequent treatment is:

a) It is re-measured at fair value with changes in the income statement.
b) It is carried at book value with no adjustments made.
c) No remeasurement is required and the subsequent settlement is accounted for within

equity.
d) It is re-measured at fair value with changes in OCI.

Answer: c

Difficulty: Medium
Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination.
Feedback: Review section “Contingent Consideration”

47) The acquisition-related costs associated with a business combination are accounted for as _____________ in the periods in which they are incurred and the services are received.

a) liabilities
b) expenses
c) equity
d) goodwill

Answer: b

Difficulty: Medium
Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section “Consideration Transferred- to the Acquiree- Acquisition”

48) When the future income of the acquiree is regarded as uncertain, the agreement may contain a clause that requires the acquirer to provide additional consideration to the acquiree if the income of the acquiree exceeds a specified amount over some specified period. For example, A may agree to pay $100,000 to acquire B and promise to pay an additional $50,000 in two years if B earns at least $100,000 for the next two years. A is concerned that the owners of B are integral to the success of B and may not stay involved if they receive full payment immediately. This is an example of:

a) goodwill.
b) contingent consideration.
c) monetary assets.
d) intangible assets.

Answer: b

Difficulty: Medium

Learning Objective: Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section “Consideration Transferred- to the Acquiree-Contingent Consideration”

49) A may issue its shares to acquire the shares of B. However, because of the greater number of A shares given to the former B shareholders relative to those held by the shareholders in A before the combination, the former shareholders in B may have the majority of shares in A and be able to determine the operating and financial policies of the combined entities. This is known as a:

a) Reverse acquisition.
b) Goodwill gesture.
c) Hostile takeover.
d) Contingent consideration.

Answer: a

Difficulty: Easy
Learning Objective: Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for Business Combination: Basic Principles
Feedback: Review section “Identifying the Acquirer”

50) A business combination could occur without any exchange of _____________ between the entities involved in the exchange.

a) assets
b) assets or equity
c) liabilities
d) equity.

Answer: b

Difficulty: Medium
Learning Objective: Understand the nature of a business combination and its various forms.
Section Reference: Nature of a Business Combination
Feedback: Review section “Forms of Business Combinations”

Short Answer

51) There are many forms of business combinations that can occur, such as A acquiring the assets only of B, and B paying off the liabilities and then liquidating. Alternatively, A may acquire all the assets and only some of the liabilities of B, and B pays the remaining liabilities before liquidating. The number of possible arrangements is quite large.
What are the two exceptions where the requirements for accounting for a business combination are not used?

There are two exceptions where the requirements for accounting for a business combination are not used:

- *Where the business combination results in the formation of a joint venture.* Such a business combination is accounted for under IFRS 11 *Joint Arrangements.*
- *Where the business combination involves entities or businesses under common control.* Such a business combination occurs where all of the combining entities or businesses ultimately are controlled by the same party or parties both before and after the combination, and where control is not transitory. This situation could arise where A owns 100% of the shares of B. The directors of A form a new entity, C, wholly owned by A, which acquires all the issued shares of B in an internal restructuring. All the combining entities are controlled by A both before and after the restructuring.

Difficulty: Medium
Learning Objective: Learning Objective:Understand the nature of a business combination and its various forms.
Section Reference: Nature of a Business Combination
Feedback: Review section “Forms of Business Combinations”

52) Identify and discuss some indicators provided by IFRS 3 to assist in assessing which entity is the acquirer in situtations of a share for share exchange.

IFRS 3 provides some indicators to assist in assessing which entity is the acquirer:

- *Is there a large minority voting interest in the combined entity?* The acquirer is usually the entity that has the largest minority voting interest in an entity that has a widely dispersed ownership.
- *What is the composition of the governing body of the combined entity?* The acquirer is usually the combining entity whose owners have the ability to elect or appoint, or remove a majority of the members of the governing body of the combined entity.
- *What is the composition of the senior management that governs the combined entity subsequent to the combination?* This is an important indicator given that the criterion for identifying an acquirer is that of control. If A and B combine, is the senior management group of the combined entity dominated by former senior managers of A or B?
- *What are the terms of the exchange of equity interests?* Has one of the combining entities paid a premium over the pre-combination fair value of one of the combing entities, an amount paid in order to gain control?
- *Which entity is the larger?* This could be measured by the fair value of each of the combining entities, or relative revenues or profits. In a takeover, it is normally the larger company that takes over the smaller company (that is, the larger company is the acquirer).
- *Which entity initiated the exchange?* Normally the entity that is the acquirer is the one that undertakes action to take over the acquiree.

- *What are the relative voting rights in the combined entity after the business combination?* The acquirer is usually the entity whose owners have the largest portion of the voting rights in the combined entity. In a reverse acquisition, A may issue its shares to acquire the shares of B. However, because of the greater number of A shares given to the former B shareholders relative to those held by the shareholders in A before the combination, the former shareholders in B may have the majority of shares in A and be able to determine the operating and financial policies of the combined entities.

Difficulty: Medium
Learning Objective: Learning Objective:Explain the basic steps in the acquisition method of accounting for business combinations.
Section Reference: Accounting for a Business Combination: Basic Principles
Feedback: Review section "Identifying the Acquirer"

53) In a business acquisition, an acquirer purchases the assets and liabilities of an entity. What is the "consideration transferred" and how is it measured and calculated?

The consideration transferred is the amount that the acquirer pays to obtain those net assets. This consideration transferred:

- is measured at fair value at acquisition date
- is calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree, and the equity interest issued by the acquirer.

Difficulty: Medium
Learning Objective: Learning Objective:Account in the records of the acquirer for a purchase of net assets.
Section Reference: Accounting in the Records of the Acquirer
Feedback: Review section "Consideration Transferred to the Acquiree"

54) When the acquirer buys only shares in the acquiree from the shareholders of the acquiree, what is the impact on the acquiree's records?

When the acquirer buys only shares in the acquiree from the shareholders of the acquiree, there are no entries in the records of the acquiree because the transaction is between the acquirer and the shareholders of the acquiree entity. The acquiree itself is not involved.

Difficulty: Medium
Learning Objective: Prepare the accounting records of the acquiree.
Section Reference: Accounting in the Records of the Acquiree
Feedback: Review section "Purchase of the Acquiree's Shares from the Shareholders"

55) Having recognized any contingent liabilities of the acquiree as liabilities, the acquirer must then determine a subsequent measurement for the liability. The liability is initially recognized at fair value.

Subsequent to acquisition date, how is the liability measured?

Subsequent to acquisition date, the liability is measured as the higher of:

- the amount that would be recognized in accordance with IAS 37; and
- the amount initially recognized less, if appropriate, cumulative amortization recognized in accordance with IFRS 8 *Revenue*.

The liability would be measured at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. This would be used, for example, where a liability was recognized in relation to a court case, or guarantees. Any change would affect income of that period as it represents a change in estimate.

Difficulty: Medium
Learning Objective: Learning Objective:Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination.
Feedback: Review section “Contingent Liabilities”

Problems

56. On December 31, 2012, the statements of financial position of the Radley Company and the Omen Company are as follows: (in 000s)

	Radley	**Omen**	**(FV)**
Cash	$ 500	$ 800	
Accounts Receivable	1,500	1,700	
Inventories	2,000	1,500	
Capital assets (net)	2,500	4,000	$4,300
Total Assets	$6,500	$8,000	
Current liabilities	$ 700	$ 400	
Long term liabilities	800	500	$ 550
Common shares	2,500	1,000	
Contributed surplus	800	1,500	
Retained earnings	1,700	4,600	
Total Equities	$6,500	$8,000	

Radley Company has 100,000 shares of common stock outstanding. Omen Company has 45,000 shares outstanding. On January 1, 2013, Radley issued an additional 90,000 shares of common stock in exchange for all the net assets of Omen. All assets and liabilities have book value equal to fair values, except as noted. In addition, Omen has a patent that has an appraised fair value of $450.

Market value of the new shares issued was $95 per share at the date of acquisition.

Required:
What is the amount of goodwill to be recorded for this business combination? Prepare the journal entry that Radley would record on January 1, 2013 related to this acquisition.
Prepare the consolidated statement of financial position as at January 1, 2013.

Answer:

Calculation of goodwill (in 000s):

Fair value of consideration (90,000 shares @ $95)		$8,550
Consideration received:		
Fair value of net assets acquired:		
Cash	$800	
Accounts receivable	1,700	
Inventories	1,500	
Capital assets	4,300	
Patent	450	
Current liabilities	(400)	
Long-term liabilities	(550)	7,800
Goodwill		$ 750

Journal entry recorded by Radley to record the acquisition:

Dr. Cash	$800	
Accounts receivable	1,700	
Inventories	1,500	
Capital assets	4,300	
Patent	450	
Goodwill	750	
Cr. Current liabilities		400
Long-term liabilities		550
Common shares		8,550

RADLEY COMPANY
Statement of Financial Position
As at January 1, 2013
(in 000s)

Cash (500 + 800)	$ 1,300
Accounts receivable (1,500 + 1,700)	3,200
Inventories (2,000 + 1,500)	3,500
Capital assets (2,500 + 4,300)	6,800
Patent	450
Goodwill	750
Total assets	$16,000

Current liabilities (700 + 400)	$ 1,100
Long-term liabilities (800 + 550)	1,350
Common shares (2,500 + 8,550)	11,050
Contributed surplus	800
Retained earnings	1,700
	$16,000

Difficulty: Hard
Learning Objective: Learning Objective:Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination
Feedback: Review section “Contingent Consideration”

57. On September 1, 2013, Gowan Limited decided to buy the net assets of Jepsen Inc. for $1,200,000 paid for with the issuance of shares. In addition, Gowan has agreed to pay an additional $250,000 if the revenues of Jepsen have a 5% growth over the next two years from the date of the acquisition. It has been determined that the fair value of this contingent consideration

is $175,000.

The balances showing on the statement of financial position for the two companies at August 31, 2013 are as follows:

	Gowan $	Jepsen $
Assets		
Cash	45,000	20,000
Accounts receivable	65,000	35,000
Inventory	50,000	80,000
Investments	0	45,000
Capital assets — net	3,590,000	1,020,000
	3,750,000	1,200,000
Liabilities		
Current liabilities		
Accounts payable	665,000	280,000
Bonds payable	1,350,000	620,000
Shareholders' Equity		
Common shares	950,000	250,000
Retained earnings	785,000	50,000
	3,750,000	1,200,000

After a review of the financial assets and liabilities, Gowan determines that some of the assets of Jepsen have fair values different from their carrying values. These items are listed below:

Capital assets - fair value is $1,350,000
Patent - fair value is $255,000
Brand name — fair value is $135,000

Required:
Determine the amount of goodwill that will be recorded on the business combination.
Prepare the statement of financial position of Gowan as at September 1, 2013.

Answer:

Calculation of goodwill

Fair value of consideration:	
Issuance of shares	$1,200,000
Contingent consideration	175,000
Total consideration paid or payable	$1,375,000

Consideration received

Fair value of net assets acquired:

Cash	$20,000	
Accounts receivable	35,000	
Inventories	80,000	
Investments	45,000	
Capital assets	1,350,000	
Patent	255,000	
Band name	135,000	
Current liabilities	(280,000)	
Long-term liabilities	(620,000)	1,020,000
Goodwill		$ 355,000

GOWAN LIMITED
Statement of Financial Position
As at September 1, 2013

	$
Assets	
Cash (45 + 20)	65,000
Accounts receivable (65 + 35)	100,000
Inventory (50 + 80)	130,000
Investments (45)	45,000
Capital assets — net (3,590 + 1,350)	4,940,000
Patent	255,000
Brand name	135,000
Goodwill	355,000
Total assets	6,025,000
Liabilities	
Current liabilities	
Accounts payable (665 + 280)	945,000
Bonds payable (1,350 + 620)	1,970,000
Contingent liability	175,000
Shareholder's Equity	
Common shares (950 + 1,200)	2,150,000
Retained earnings	785,000
Total liabilities and shareholders' equity	6,025,000

Difficulty: Hard
Learning Objective:Learning Objective: Account for subsequent adjustments to the initial accounting for a business combination.
Section Reference: Subsequent Adjustments to the Initial Accounting for a Business Combination
Feedback: Review section “Contingent Consideration”