CHAPTER 3

THE REPORTING ENTITY AND THE CONSOLIDATION OF LESS-THAN-WHOLLY-OWNED SUBSIDIARIES WITH NO DIFFERENTIAL

ANSWERS TO QUESTIONS

Q3-1 The basic idea underlying the preparation of consolidated financial statements is the notion that the consolidated financial statements present the financial position and the results of operations of a parent and its subsidiaries as if the related companies actually were a single company.

Q3-2 Without consolidated statements it is often very difficult for an investor to gain an understanding of the total resources controlled by a company. A consolidated balance sheet provides a much better picture of both the total assets under the control of the parent company and the financing used in providing those resources. Similarly, the consolidated income statement provides a better picture of the total revenue generated and the costs incurred in generating the revenue. Estimates of future profit potential and the ability to meet anticipated cash flows often can be more easily assessed by analyzing the consolidated statements.

Q3-3 Parent company shareholders are likely to find consolidated statements more useful. Noncontrolling shareholders may gain some understanding of the basic strength of the overall economic entity by examining the consolidated statements; however, they have no control over the parent company or other subsidiaries and therefore must rely on the assets and earning power of the subsidiary in which they hold ownership. The separate statements of the subsidiary are more likely to provide useful information to the noncontrolling shareholders.

Q3-4 A parent company has the ability to exercise control over one or more other entities. Under existing standards, a company is considered to be a parent company when it has direct or indirect control over a majority of the common stock of another company. The FASB has proposed adoption of a broader definition of control that would not be based exclusively on stock ownership.

Q3-5 Creditors of the parent company have primary claim to the assets held directly by the parent. Short-term creditors of the parent are likely to look only at those assets. Because the parent has control of the subsidiaries, the assets held by the subsidiaries are potentially available to satisfy parent company debts. Long-term creditors of the parent generally must rely on the soundness and operating efficiency of the overall entity, which normally is best seen by examining the consolidated statements. On the other hand, creditors of a subsidiary typically have a priority claim to the assets of that subsidiary and generally cannot lay claim to the assets of the other companies. Consolidated statements therefore are not particularly useful to them.

Q3-6 When one company holds a majority of the voting shares of another company, the investor should have the power to elect a majority of the board of directors of that company and control its actions. Unless the investor holds controlling interest, there is always a chance that another party may acquire a sufficient number of shares to gain control of the company, or that the other shareholders may join together to take control.

Q3-7 The primary criterion for consolidation is the ability to directly or indirectly exercise control. Control normally has been based on ownership of a majority of the voting common stock of another company. The Financial Accounting Standards Board is currently working on a

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broader definition of control. At present, consolidation should occur whenever majority ownership is held unless other circumstances indicate that control is temporary or does not rest with the parent.

Q3-8 Consolidation is not appropriate when control is temporary or when the parent cannot exercise control. For example, if the parent has agreed to sell a subsidiary or plans to reduce its ownership below 50 percent shortly after year-end, the subsidiary should not be consolidated. Control generally cannot be exercised when a subsidiary is under the control of the courts in bankruptcy or reorganization. While most foreign subsidiaries should be consolidated, subsidiaries in countries with unstable governments or those in which there are stringent barriers to funds transfers generally should not be consolidated.

Q3-9 Strict adherence to consolidation standards based on majority ownership of voting common stock has made it possible for companies to use many different forms of control over other entities without being forced to include them in their consolidated financial statements. For example, contractual arrangements often have been used to provide control over variable interest entities even though another party may hold a majority (or all) of the equity ownership.

Q3-10 Special-purpose entities are corporations, trusts, or partnerships created for a single specified purpose. They usually have no substantive operations and are used only for financing purposes. Special-purpose entities generally have been created by companies to acquire certain types of financial assets from the companies and hold them to maturity. The special-purpose entity typically purchases the financial assets from the company with money received from issuing some form of collateralized obligation. If the company had borrowed the money directly, its debt ratio would be substantially increased.

Q3-11 A variable interest entity normally is not involved in general business activity such as producing products and selling them to customers. They often are used to acquire financial assets from other companies or to borrow money and channel it other companies. A very large portion of the assets held by variable interest entities typically is financed by debt and a small portion financed by equity holders. Contractual agreements often give effective control of the activities of the special-purpose entity to someone other than the equity holders.

Q3-12 ASC 810-10-20 provides a number of guidelines to be used in determining when a company is a primary beneficiary of a variable interest entity. Generally, the primary beneficiary will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both.

Q3-13 Indirect control occurs when the parent controls one or more subsidiaries that, in turn, hold controlling interest in another company. Company A would indirectly control Company Z if Company A held 80 percent ownership of Company M and that company held 70 percent of the ownership of Company Z.

Q3-14 It is possible for a company to exercise control over another company without holding a majority of the voting common stock. Contractual agreements, for example, may provide a company with complete control of both the operating and financing decisions of another company. In other cases, ownership of a substantial portion of a company's shares and a broad based ownership of the other shares may give effective control to a company even though it does not have majority ownership. There is no prohibition to consolidation with less than majority ownership; however, few companies have elected to consolidate with less than majority control.

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Q3-15 The consolidated statements are prepared from the viewpoint of the parent company shareholders and only the amounts assignable to parent company shareholders are included in the consolidated stockholders' equity balances. Subsidiary shares held by the parent are not owned by an outside party and therefore cannot be reported as shares outstanding. Those held by the noncontrolling shareholders are included in the balance assigned to noncontrolling shareholders in the consolidated balance sheet rather than being shown as stock outstanding.

Q3-16 While it is not considered appropriate to consolidate if the fiscal periods of the parent and subsidiary differ by more than 3 months, a difference in time periods cannot be used as a means of avoiding consolidation. The fiscal period of one of the companies must be adjusted to fall within an acceptable time period and consolidated statement prepared.

Q3-17 The noncontrolling interest, or minority interest, represents the claim on the net assets of the subsidiary assigned to the shares not controlled by the parent company.

Q3-18 The procedures used in preparing consolidated and combined financial statements may be virtually identical. In general, consolidated statements are prepared when a parent company either directly or indirectly controls one or more subsidiaries. Combined financial statements are prepared for a group of companies or business entities when there is no parent-subsidiary relationship. For example, an individual who controls several companies may gain a clearer picture of the financial position and operating results of the overall operations under his or her control by preparing combined financial statements.

Q3-19* Under the proprietary theory the parent company includes only a proportionate share of the assets and liabilities and income statement items of a subsidiary in its financial statements. Thus, if a subsidiary is 60 percent owned, the parent will include only 60 percent of the cash and accounts receivable of the subsidiary in its consolidated balance sheet. Under current practice the full amount of the balance sheet and income statement items of the subsidiary are included in the consolidated statements.

Q3-20* Under both current practice and the entity theory the consolidated statements are viewed as those of a single economic entity with a shareholder group that includes both controlling and noncontrolling shareholders, each with an equity interest in the consolidated entity. The assets and liabilities of the subsidiary are included in the consolidated statements at 100 percent of their fair value at the date of acquisition and consolidated net income includes the earnings to both controlling and noncontrolling shareholders. A major difference occurs in presenting retained earnings in the consolidated balance sheet. Under current accounting practice, only undistributed earnings related to the controlling interest are included in the retained earnings balance.

Q3-21* The entity theory is closest to the newly adopted procedures used in current practice.

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SOLUTIONS TO CASES

C3-1 Computation of Total Asset Values

The relationship observed should always be true. Assets reported by the parent company include its investment in the net assets of the subsidiaries. These totals must be eliminated in the consolidation process to avoid double counting. In addition, subsidiary assets and liabilities at the time the subsidiaries were acquired by the parent may have had fair values different from their book values, and the amounts reported in the consolidated financial statements would be based on those fair values.

C3-2 Accounting Entity [AICPA Adapted]

(1) Units created by or under law, such as corporations, partnerships, and, occasionally, sole proprietorships, probably are the most common types of accounting entities.

(2) Product lines or other segments of an enterprise, such as a division, department, profit center, branch, or cost center, can be treated as accounting entities. For example, financial reporting by segment was supported by investors, the Securities and Exchange Commission, financial executives, and members of the accounting profession.

(3) Most large corporations issue consolidated financial reports. These statements often include the financial statements of a number of separate legal entities that are considered to constitute a single economic entity for financial reporting purposes.

(4) Although the accounting entity often is defined in terms of a business enterprise that is separate and distinct from other activities of the owner or owners, it also is possible for an accounting entity to embrace all the activities of an owner or a group of owners. Examples include financial statements for an individual (personal financial statements) and the financial report of a person's estate.

(5) The entire economy of the United States also can be viewed as an accounting entity. Consistent with this view, national income accounts are compiled by the U. S. Department of Commerce and regularly reported.

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C3-3 Joint Venture Investment

a. **ASC 810** is the primary authoritative literature dealing with the types of ownership issues arising in this situation. Under normal circumstances, the company holding majority ownership in another entity is expected to consolidate that entity in preparing its financial statements. Thus, unless other circumstances dictate, Dell should have planned to consolidate DFS as a result of its 70 percent equity ownership. While **ASC 810** is highly complex and greater detail of the ownership agreement may be needed to decide this matter, the literature appears to permit equity holders to avoid consolidating an entity if the equity holders (1) do not have the ability to make decisions about the entity's activities, (2) are not obligated to absorb the expected losses of the entity if they occur, or (3) do not have the right to receive the expected residual returns of the entity if they occur [ASC 810-10-15-14].

It does appear that Dell and CIT Group do, in fact, have the ability to make operating and other decisions about DFS, they must absorb losses in the manner set forth in the agreement, and they must share residual returns in the manner set forth in the agreement. Control appears to reside with the equity holders and should not provide a barrier to consolidation.

Dell might argue that it need not consolidate DFS because the joint venture agreement apparently did allocate losses initially to CIT. However, these losses were to be recovered from future income. Thus, both Dell and CIT were to be affected by the profits and losses of DFS. Given the importance of DFS to Dell and representation on the board of directors by CIT, DFS would not be expected to sustain continued losses.

In light of the joint venture arrangement and Dell's ownership interest, consolidation by Dell seems appropriate and there seems to be little support for Dell not consolidating DFS.

b. No, not currently. Dell did employ off-balance sheet financing in the past. It sells customer financing receivables to qualifying special-purpose entities. In accordance with standards prior to 2011, qualifying SPEs were not consolidated. Thus, these transactions were considered to be "off balance sheet financing." However, Dell began consolidating these entities as VIEs in 2011 (see the 2011 financial statements, footnote 4).

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C3-4 What Company is That?

Information for answering this case can be obtained from the SEC's EDGAR database (www.sec.gov) and from the home pages for Viacom (www.viacom.com), ConAgra (www.conagra.com), and Yum! Brands (www.yum.com).

a.. Viacom is well known for ownership of companies in the entertainment industry. On January 1, 2006, Viacom divided its operations by spinning off to Viacom shareholders ownership of CBS Corporation. Following the division Viacom continues to own MTV, Nickelodeon, Nick at Nite, Comedy Central, Paramount Pictures, Paramount Home Entertainment, SKG, BET, Dreamworks, and other related companies. Sumner Redstone holds controlling interest in both Viacom and CBS and serves as Executive Chairman of both companies.

b. Some of the well-known product lines of ConAgra include Healthy Choice, Pam, Peter Pan, Slim Jim, Swiss Miss, Orville Redenbacher's, Hunt's, Reddi-Wip, VanCamp, Libby's, LaChoy, Egg Beaters, Wesson, Banquet, Blue Bonnet, Chef Boyardee, Parkay, and Rosarita.

c. Yum! Brands, Inc., is the world's largest quick service restaurant company. Well known brands include Taco Bell, KFC, and Pizza Hut. Yum was originally spun off from Pepsico in 1997. Prior to its current name, Yum's name was TRICON Global Restaurants, Inc.

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C3-5 Subsidiaries and Core Businesses

Most of the information needed to answer this case can be obtained from articles available in libraries, on the Internet, or through various online databases. Some of the information is available in filings with the SEC (www.sec.gov).

a. General Electric was never able to turn Kidder, Peabody into a profitable subsidiary. In fact, Kidder became such a drain on the resources of General Electric, that GE decided to get rid of Kidder. Unfortunately, GE was unable to sell the company as a whole and ultimately broke the company into pieces and sold the pieces that it could. GE suffered large losses from its venture into the brokerage business.

b. Sears, Roebuck and Co. has been a major retailer for many decades. For a while, Sears attempted to provide virtually all consumer needs so that customers could purchase financial and related services at Sears in addition to goods. It owned more than 200 other companies. During that time, Sears sold insurance (Allstate Insurance Group, consisting of many subsidiaries), real estate (Coldwell Banker Real Estate Group, consisting of many subsidiaries), brokerage and investment advisor services (Dean Witter), credit cards (Sears and Discover Card), and various other related services through many different subsidiaries. During the mid-nineties, Sears sold or spun off most of its subsidiaries that were unrelated to its core business, including Allstate, Coldwell Banker, Dean Witter, and Discover. On March 24, 2005, Sears Holding Corporation was established and became the parent company for Sears, Roebuck and Co. and K Mart Holding Corporation. From an accounting perspective, Kmart acquired Sears, even though Kmart had just emerged from bankruptcy proceedings. Following the merger the company now has approximately 2,350 full-line and off-mall stores and 1,100 specialty retail stores in the United States, and approximately 370 full-line and specialty retail stores in Canada.

c. PepsiCo entered the restaurant business in 1977 with the purchase of Pizza Hut. By 1986, PepsiCo also owned Taco Bell and KFC (Kentucky Fried Chicken). In 1997, these subsidiaries were spun off to a new company, TRICON Global Restaurants, with TRICON's stock distributed to PepsiCo's shareholders. TRICON Global Restaurants changed its name to YUM! Brands, Inc., in 2002. Although PepsiCo exited the restaurant business, it continued in the snack-food business with its Frito-Lay subsidiary, the world's largest maker of salty snacks. PepsiCo bought Quaker Oats Company in 2001—an acquisition that brought Gatorade under the PepsiCo name.

d. When consolidated financial statements are presented, financial statement users are provided with information about the company's overall operations. Assessments can be made about how the company as a whole has fared as a result of all its operations. However, comparisons with other companies may be difficult because the operations of other companies may not be similar. If a company operates in a number of different industries, consolidated financial statements may not permit detailed comparisons with other companies unless the other companies operate in all of the same industries, with about the same relative mix. Thus, standard measures used in manufacturing and merchandising, such as gross margin percentage, inventory and receivables turnover, and the debt-to-asset ratio, may be useless or even misleading when significant financial-services operations are included in the financial statements. Similarly, standard measures used in comparing financial institutions might be distorted when financial statement information includes data relating to manufacturing or merchandising operations. A partial solution to the problem results from providing disaggregated (segment or line-of-business) information along with the consolidated financial statements, as required by the accounting literature.

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C3-6 International Consolidation Issues

The following answers are based on information from the Financial Accounting Standards Board website at www.fasb.org, the International Accounting Standards Board website at www.iasb.org, and from the PricewaterhouseCoopers publication entitled *IFRS and US GAAP: similarities and differences,* available online at http://www.pwc.com/us/en/issues/ifrs-reporting/publications/ifrs-and-us-gaap-similarities-and-differences.jhtml.

a. Consolidation under IFRS is required when an entity is able to govern the policies of another entity in order to obtain benefits. To determine if consolidation is necessary, IFRS focuses on the concept of control. Factors of control, such as voting rights and contractual rights, are given by international standards. If control is not apparent, a general assessment of the relationship is required, including an evaluation of the allocation of risks and benefits.

b. Under IFRS, Goodwill is reviewed annually (or more frequently) for impairment. Goodwill is initially allocated at the organizational level where cash flows can be clearly identified. These cash generating units (CGUs) may be combined for purposes of allocating goodwill and for the subsequent evaluation of goodwill for potential impairment. However, the aggregation of CGUs for goodwill allocation and evaluation must not be larger than a segment.

Similar to U.S. GAAP, the impairment review must be done annually, but the evaluation date does not have to coincide with the end of the reporting year. However, if the annual impairment test has already been performed prior to the allocation of goodwill acquired during the fiscal year, a subsequent impairment test is required before the balance sheet date.

While U.S. GAAP requires a two-step impairment test, IFRS requires a one-step test. The recoverable amount, which is the greater of the net fair market value of the CGU and the value of the unit in use, is compared to the book value of the CGU to determine if an impairment loss exists. A loss exists when the carrying value exceeds the recoverable amount. This loss is recognized in operating results. The impairment loss applies to all of the assets of the unit and must be allocated to assets in the unit. Impairment is allocated first to goodwill. If the impairment loss exceeds the book value of goodwill, then allocation is made on a pro rata basis to the other assets in the CGU.

c. Under IFRS, entities have the option of measuring noncontrolling interests at either their proportion of the fair value or at full fair value. When using the full fair value option, the full value of goodwill will be recorded on both the controlling and noncontrolling interest.

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C3-7 Off-Balance Sheet Financing and VIEs

a. Off-balance sheet financing refers to techniques that allow companies to borrow while keeping the debt, and related assets, from being reported in the company's balance sheet.

b. (1) Funds to acquire new assets for a company may be borrowed by a third party such as a VIE, with the acquired assets then leased to the company.
(2) A company may sell assets such as accounts receivable instead of using them as collateral.
(3) A company may create a new VIE and transfer assets to the new entity in exchange for cash (generally borrowed by the VIE).

c. VIEs may serve a genuine business purpose, such as risk sharing among investors and isolation of project risk from company risk.

d. VIEs may be structured to avoid consolidation. To the extent that standards for consolidation are rule-based, it is possible to structure a VIE so that it is not consolidated even if the underlying economic substance of the entity would indicate that it should be consolidated. By artificially removing debt, assets, and expenses from the financial reports of the sponsoring company, the financial position of a company and the results of its operations can be distorted. The FASB has been working to ensure that rule-based consolidation standards result in financial statements that reflect the underlying economic substance.

C3-8 Consolidation Differences among Major Corporations

a. Union Pacific is rather unusual for a large company. It has only two subsidiaries:
Union Pacific Railroad Company
Southern Pacific Rail Corporation

b. ExxonMobil does not consolidate majority owned subsidiaries if the minority shareholders have the right to participate in significant management decisions. ExxonMobil does consolidate some variable interest entities even though it has less than majority ownership according to its Form 10-K "because of guarantees or other arrangements that create majority economic interests in those affiliates that are greater than the Corporation's voting interests." The company uses the equity method, cost method, and fair value method to account for investments in the common stock of companies in which it holds less than majority ownership and does not consolidate.

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SOLUTIONS TO EXERCISES

E3-1 Multiple-Choice Questions on Consolidation Overview [AICPA Adapted]

1. **d** – Consolidated financial statements are intended to provide a meaningful representation of the overall position and activities of a single *economic* entity comprising a number of separate legal entities (subsidiaries).

   (a) *Incorrect*. While consolidation can help improve the reliability of the financial information, it does not fully describe the accounting concept of reliability.
   (b) *Incorrect.* While consolidated financial statements should be materially stated, this is not the focus of consolidation.
   (c) *Incorrect.* In consolidation, each subsidiary exists as a separate legal entity while the consolidated entity represents the economic activity of the parent and all subsidiaries.

2. **c** – Under certain circumstances, a company can lose the ability to exercise control of a subsidiary even when a controlling interest is held. For example, if the subsidiary were under a legal reorganization or bankruptcy. As long as control cannot be exercised, consolidated financial statements would not be prepared.

   (a) *Incorrect*. A finance company can be consolidated.
   (b) *Incorrect.* Consolidation can still occur even when the fiscal year-ends of the two companies are more than three months apart as long as the subsidiary adjusts its fiscal year-end to match the parent.
   (d) *Incorrect.* There is no requirement that the parent and subsidiary be in related industries.

3. **b** – The consolidation method is typically used when ownership is greater than 50% of the common stock of the subsidiary. Penn directly controls Sell and indirectly controls Vane, thus, Sell and Vane should both be consolidated.

   (a) *Incorrect*. Because Sell owns greater than 50% Vane's common stock, Vane would be consolidated.
   (c) *Incorrect.* Because Penn owns greater than 50% Sell's common stock, Sell would be consolidated.
   (d) *Incorrect.* Because Penn owns greater than 50% Sell's common stock, Sell would be consolidated. Because Sell owns greater than 50% Vane's common stock, Vane would also be consolidated.

4. **b** – The companies are each separate *legal* entities, but in substance they are one *economic* entity

   (a) *Incorrect*. The companies are not one in form, each company is a separate legal entity.
   (c) *Incorrect.* The companies are not one in form, each company is a separate legal entity.
   (d) *Incorrect.* The companies are one in substance as they are one economic entity.

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E3-2 Multiple-Choice Questions on Variable Interest Entities

1. **c** – SPE's are typically financed primarily by debt, while equity financing is only a small portion. SPE's tend to be very highly leveraged.

   (a) *Incorrect*. Equity financing is typically much smaller in SPE's than in companies such as General Motors. SPE's tend to be very highly leveraged.
   (b) *Incorrect.* SPE's are generally financed through debt, not equity.
   (d) *Incorrect.* SPE's are not typically designed to distribute large dividends as a function of their typical business purpose.

2. **d** – A VIE is generally not limited as to the legal form of business that it takes (i.e. corporation, partnership, joint venture, trust, etc.).

   (a) *Incorrect*. This type of entity can be a VIE.
   (b) *Incorrect.* This type of entity can be a VIE.
   (c) *Incorrect.* This type of entity can be a VIE.

3. **a** – A primary beneficiary is defined as an enterprise that will absorb the majority of the VIE's expected losses, receive a majority of the VIE's expected residual returns, or both. However, if one entity receives the residual returns and another absorbs the expected losses, the entity absorbing the majority of the losses is deemed to be the primary beneficiary.

   (b) *Incorrect*. A qualified owner would not absorb a majority of the VIE's expected losses.
   (c) *Incorrect.* A major facilitator would not absorb a majority of the VIE's expected losses.
   (d) *Incorrect.* A critical management director would not absorb a majority of the VIE's expected losses.

4. **b** – The company that has the most at stake is typically required to consolidate the VIE. This has been defined as the entity receiving a majority of the VIE's profits, and/or absorbing the majority of its losses.

   (a) *Incorrect*. Contrary to requirements for consolidating other entities, legal control is not enough to require consolidation for VIE's.
   (c) *Incorrect.* Intercompany transfers have no effect on determining whether to consolidate.
   (d) *Incorrect.* VIE's can vary in size in relation to their owning companies, thus the proportionate size of the two entities is irrelevant.

E3-3 Multiple-Choice Questions on Consolidated Balances [AICPA Adapted]

1. **b** – Total book value of net assets is $120,000 (50,000 + 70,000). The amount attributed to the noncontrolling interest = 25% * 120,000 = $30,000.

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2. **b** – The consolidated balance in common stock is always equal to the parent's common stock and the common stock of the subsidiary is eliminated.

   (a) *Incorrect*. The common stock of Kidd Company is eliminated in consolidation.
   (c) *Incorrect.* The only amount to be reported in the consolidated balance sheet is the amount of common stock on Pare's books. The common stock is not allocated based on ownership percentage, but rather is eliminated in its entirety prior to consolidation.
   (d) *Incorrect.* The common stock of Kidd Company is eliminated, and not added to the common stock balance of the parent.

3. **a** – Neely directly controls Randle, and indirectly controls Walker as a result of owning 40% plus an additional 30% as a result of Randle's ownership of Walker, thus Neely should consolidate both Randle and Walker.

   (b) *Incorrect*. Due to foreign restrictions, Neely does not control Walker and thus should not consolidate, regardless of its 90% ownership.
   (c) *Incorrect.* Because Walker is in a legal reorganization, Neely does not maintain control, and thus cannot consolidate.
   (d) *Incorrect.* Neely only maintains 40% ownership of Walker and thus does not maintain control. Walker should not be consolidated.

E3-4 Multiple-Choice Questions on Consolidation Overview
[AICPA Adapted]

1. **d** – Consolidation occurs when one company acquires a controlling interest in another company. This controlling interest is typically defined has owning greater than 50% of the company.

   (a) *Incorrect*. The equity method alone does not require consolidation until greater than 50% ownership is obtained. When more than 50% ownership is obtained, the consolidating entity can elect to use either the equity method or the cost method in recording the investment account.
   (b) *Incorrect.* When more than 50% ownership is obtained, the consolidating entity can elect to use either the equity method or the cost method in recording the investment account.
   (c) *Incorrect.* Significant influence does not qualify for consolidation. Instead, the parent company must maintain a controlling interest before consolidating.

2. **a** – The consolidated net earnings contains the net earnings of Aaron as well as the net earnings of Belle. Thus, the consolidated net earnings are greater than just Aaron's own net earnings.

   (b) *Incorrect*. Unless Belle has no income for the year, the consolidated income will be greater than the net earnings of Aaron.
   (c) *Incorrect.* Aaron's consolidated earnings will only be less than the earnings of Aaron if Belle suffers a net loss for the year, but the facts say this is not the case.
   (d) *Incorrect.* False. It can be determined based on the information given.

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3. **b** – When the acquisition takes place, X Company only includes the earnings of Y Company for the portion of the year in which a controlling ownership was held.

   (a) *Incorrect*. Earnings of X Company for the entire year would be included in consolidated net income.
   (c) *Incorrect.* Only the portion of Y Company's earnings during the period in which X Company maintained a controlling interest in Y Company would be included in consolidated net income.
   (d) *Incorrect.* Earnings from Y Company would be reported in consolidated net income only for the period in which X Company controlled Y Company during the year. The distribution of a dividend by Y Company is irrelevant.

4. **d** – Consolidation typically occurs when greater than 50% of the voting stock is obtained because the parent company is said to have control over the subsidiary.

   (a) *Incorrect*. Consolidation is required when over 50% is obtained. Additionally, the cost method can also be used if desired.
   (b) *Incorrect.* The lower-of-cost-or-market method is not an appropriate method used in consolidation.
   (c) *Incorrect.* Consolidation is required when over 50% is obtained. Additionally, the equity method can also be used if desired.

E3-5 Balance Sheet Consolidation

a. $470,000 = $470,000 - $44,000 (cash outlay) + $44,000 (investment)

b. $616,000 = ($470,000 - $44,000 (investment) + $190,000

c. $405,000 = $270,000 + $135,000

d. $211,000

Acquisition price	$ 44,000	
÷ percent purchased	80%	
Total fair value of Bristol Corporation's NA	$ 55,000	
NCI in NA of Bristol Corporation		$ 11,000
Guild Corporation's Stockholder's Equity		200,000
Total Consolidated Stockholder's Equity		$ 211,000

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E3-6 Balance Sheet Consolidation with Intercompany Transfer

a. $631,500 = $510,000 + $121,500 (investment)

b. $845,000 = $510,000 + $350,000 - $15,000 (intercompany receivable on Potter's books)

c. $656,500 = ($320,000 + $121,500) + $215,000

d. $203,500

Acquisition price	$ 121,500	
÷ percent purchased	90%	
Total fair value of Stately Corporation's NA	$ 135,000	
NCI in NA of Stately Corporation		$ 13,500
Potter Company's Stockholder's Equity		190,000
Total Consolidated Stockholder's Equity		$ 203,500

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E3-7 Subsidiary Acquired for Cash

Note: Since the financial statements of these two companies are quite simple, it is possible to prepare the consolidated balance sheet without completing all of the steps for a consolidation. However, we present the formal calculations without skipping any steps.

Equity Method Entries on Fineline Pencil's Books:

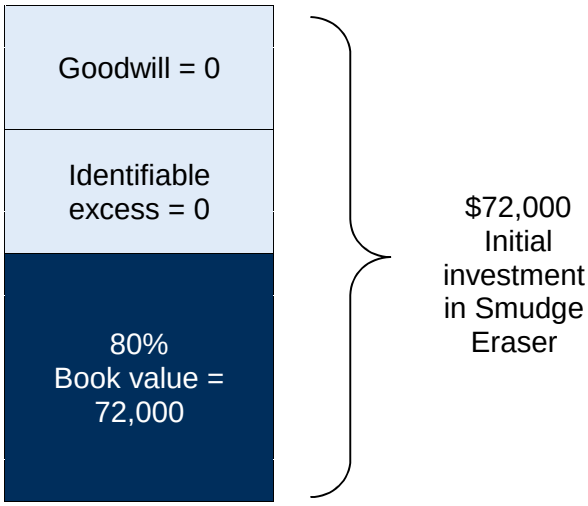
Investment in Smudge Eraser	72,000	
Cash		72,000

Record the initial investment in Smudge Eraser

Book Value Calculations:

	NCI 20%	+	Fineline Pencil 80%	=	Common Stock	+	Retained Earnings
Book value at acquisition	18,000		72,000		50,000		40,000

1/1/X3



Basic Elimination Entry

Common stock	**50,000**	
Retained earnings	**40,000**	
Investment in Smudge Eraser		**72,000**
NCI in NA of Smudge Eraser		**18,000**

	Investment in Smudge Eraser		
Acquisition Price	**72,000**		
		72,000	**Basic Entry**
	0		

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E3-7 (continued)

	Fineline Pencil	Smudge Eraser	Elimination Entries DR	Elimination Entries CR	Consolidated
Balance Sheet					
Cash	128,000	50,000			178,000
Other Assets	400,000	120,000			520,000
Investment in Smudge Eraser	72,000			72,000	0
Total Assets	**600,000**	**170,000**	**0**	**72,000**	**698,000**
Current Liabilities	100,000	80,000			180,000
Common Stock	300,000	50,000	50,000		300,000
Retained Earnings	200,000	40,000	40,000		200,000
NCI in NA of Smudge Eraser				18,000	18,000
Total Liabilities & Equity	**600,000**	**170,000**	**90,000**	**18,000**	**698,000**

Fineline Pencil Company and Subsidiary
Consolidated Balance Sheet
January 2, 20X3

Cash ($128,000 + $50,000)	$178,000
Other Assets ($400,000 + $120,000)	520,000
Total Assets	$698,000
Current Liabilities ($100,000 + $80,000)	$180,000
Common Stock	300,000
Retained Earnings	200,000
Noncontrolling Interest in Net Assets of Smudge Eraser	18,000
Total Liabilities and Stockholders' Equity	$698,000

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E3-8 Subsidiary Acquired with Bonds

Note: Since the financial statements of these two companies are quite simple, it is possible to prepare the consolidated balance sheet without completing all of the steps for a consolidation. However, we present the formal calculations without skipping any steps.

Equity Method Entries on Byte Computer's Books:

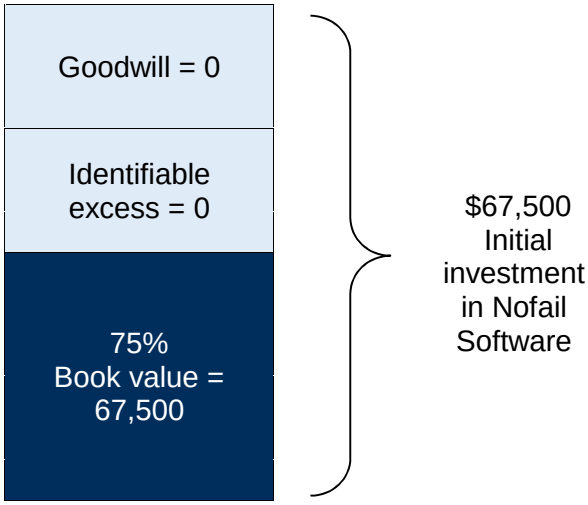
Investment in Nofail Software	67,500	
Bonds Payable		50,000
Premium on Bonds Pay		17,500

Record the initial investment in Nofail Software

Book Value Calculations:

	NCI 25%	+	Byte Computer 75%	=	Common Stock	+	Retained Earnings
Book value at acquisition	22,500		67,500		50,000		40,000

1/1/X3



Basic Elimination Entry

Common stock	**50,000**	
Retained earnings	**40,000**	
Investment in Nofail Software		**67,500**
NCI in NA of Nofail Software		**22,500**

	Investment in Nofail Software		
Acquisition Price	**67,500**		
		67,500	**Basic Entry**
	0		

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E3-8 (continued)

	Byte Computer	Nofail Software	Elimination Entries DR	Elimination Entries CR	Consolidated
Balance Sheet					
Cash	200,000	50,000			250,000
Other Assets	400,000	120,000			520,000
Investment in Nofail Software	67,500			67,500	0
Total Assets	**667,500**	**170,000**	**0**	**67,500**	**770,000**
Current Liabilities	100,000	80,000			180,000
Bonds Payable	50,000				50,000
Bond Premium	17,500				17,500
Common Stock	300,000	50,000	50,000		300,000
Retained Earnings	200,000	40,000	40,000		200,000
NCI in NA of Nofail Software				22,500	22,500
Total Liabilities & Equity	**667,500**	**170,000**	**90,000**	**22,500**	**770,000**

Byte Computer Corporation and Subsidiary
Consolidated Balance Sheet
January 2, 20X3

Cash ($200,000 + $50,000)		$250,000
Other Assets ($400,000 + $120,000)		520,000
Total Assets		$770,000
Current Liabilities		$180,000
Bonds Payable	$50,000	
Bond Premium	17,500	67,500
Common Stock		300,000
Retained Earnings		200,000
Noncontrolling Interest in Net Assets of Smudge Eraser		22,500
Total Liabilities and Stockholders' Equity		$770,000

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E3-9 Subsidiary Acquired by Issuing Preferred Stock

Note: Since the financial statements of these two companies are quite simple, it is possible to prepare the consolidated balance sheet without completing all of the steps for a consolidation. However, we present the formal calculations without skipping any steps.

Equity Method Entries on Byte Computer's Books:

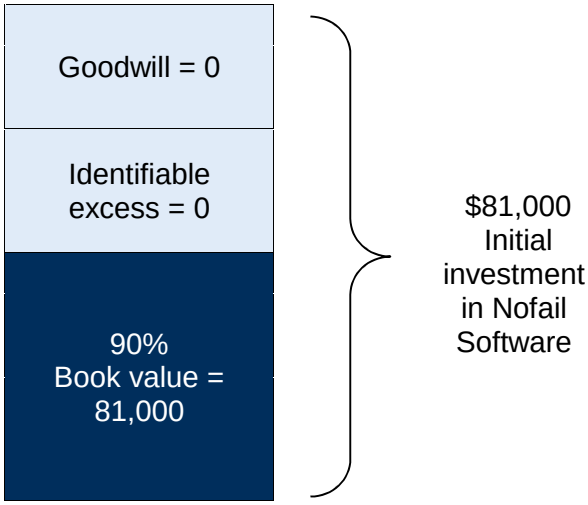
Investment in Nofail Software	81,000	
Preferred Stock		60,000
Additional Paid-In Capital – Pref. Stock		21,000

Record the initial investment in Nofail Software

Book Value Calculations:

	NCI 10%	+	Byte Computer 90%	=	Common Stock	+	Retained Earnings
Book value at acquisition	9,000		81,000		50,000		40,000

1/1/X3



Basic Elimination Entry

Common stock	**50,000**	
Retained earnings	**40,000**	
Investment in Nofail Software		**81,000**
NCI in NA of Nofail Software		**9,000**

	Investment in Nofail Software		
Acquisition Price	**81,000**		
		81,000	**Basic Entry**
	0		

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E3-9 (continued)

	Byte Computer	Nofail Software	Elimination Entries DR	Elimination Entries CR	Consolidated
Balance Sheet					
Cash	200,000	50,000			250,000
Other Assets	400,000	120,000			520,000
Investment in Nofail Software	81,000			81,000	0
Total Assets	**681,000**	**170,000**	**0**	**81,000**	**770,000**
Current Liabilities	100,000	80,000			180,000
Preferred Stock	60,000				60,000
Additional Paid-In Capital	21,000				21,000
Common Stock	300,000	50,000	50,000		300,000
Retained Earnings	200,000	40,000	40,000		200,000
NCI in NA of Nofail Software				9,000	9,000
Total Liabilities & Equity	**681,000**	**170,000**	**90,000**	**9,000**	**770,000**

Byte Computer Corporation and Subsidiary
Consolidated Balance Sheet
January 2, 20X3

Cash ($200,000 + $50,000)	$250,000
Other Assets ($400,000 + $120,000)	520,000
Total Assets	$770,000
Current Liabilities ($100,000 + $80,000)	$180,000
Preferred Stock ($6 x 10,000)	60,000
Additional Paid-In Capital ($2.10 x 10,000)	21,000
Common Stock	300,000
Retained Earnings	200,000
Noncontrolling Interest in Net Assets of Nofail	9,000
Total Liabilities and Stockholders' Equity	$770,000

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E3-10 Reporting for a Variable Interest Entity

Gamble Company
Consolidated Balance Sheet

Cash		$ 18,600,000(a)
Buildings and Equipment	$370,600,000(b)	
Less: Accumulated Depreciation	(10,100,000)	360,500,000
Total Assets		$379,100,000
Accounts Payable		$ 5,000,000
Bonds Payable		20,300,000
Bank Notes Payable		140,000,000
Noncontrolling Interest		5,600,000
Common Stock	$103,000,000	
Retained Earnings	105,200,000	208,200,000
Total Liabilities and Equities		$379,100,000

(a) $18,600,000 = $3,000,000 + $5,600,000 + ($140,000,000 – $130,000,000)
(b) $370,600,000 = $240,600,000 + $130,000,000

E3-11 Consolidation of a Variable Interest Entity

Teal Corporation
Consolidated Balance Sheet

Total Assets		$682,500(a)
Total Liabilities		$550,000(b)
Noncontrolling Interest		22,500(c)
Common Stock	$15,000	
Retained Earnings	95,000	110,000
Total Liabilities and Equities		$682,500

(a) $682,500 = $500,000 + $190,000 - $7,500
(b) $550,000 = $470,000 + $80,000
(c) $22,500 = ($500,000 - $470,000) x 0.75

E3-12 Computation of Subsidiary Net Income

Messer Company reported net income of $60,000 ($18,000 / 0.30) for 20X9.

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E3-13 Incomplete Consolidation

a. Belchfire apparently owns 100 percent of the stock of Premium Body Shop since the balance in the investment account reported by Belchfire is equal to the net book value of Premium Body Shop.

b.

Accounts Payable	$ 60,000	Accounts receivable were reduced by $10,000, presumably as a reduction of receivables and payables.
Bonds Payable	600,000	There is no indication of intercompany ownership.
Common Stock	200,000	Common stock of Premium must be eliminated.
Retained Earnings	260,000	Retained earnings of Premium also must be eliminated in preparing consolidated statements.
	$1,120,000	

E3-14 Noncontrolling Interest

a. The total noncontrolling interest reported in the consolidated balance sheet at January 1, 20X7, is $126,000 ($420,000 x .30).

b. The stockholders' equity section of the consolidated balance sheet includes the claim of the noncontrolling interest and the stockholders' equity section of the subsidiary is eliminated when the consolidated balance sheet is prepared:

Controlling Interest:	
Common Stock	$ 400,000
Additional Paid-In Capital	222,000
Retained Earnings	358,000
Total Controlling Interest	$ 980,000
Noncontrolling Interest	126,000
Total Stockholders' Equity	$1,106,000

c. Sanderson is mainly interested in assuring a steady supply of electronic switches. It can control the operations of Kline with 70 percent ownership and can use the money that would be needed to purchase the remaining shares of Kline to finance additional operations or purchase other investments.

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E3-15 Computation of Consolidated Net Income

a. Ambrose should report income from its subsidiary of $15,000 ($20,000 x .75) rather than dividend income of $9,000.

b. A total of $5,000 ($20,000 x 0.25) should be assigned to the noncontrolling interest in the 20X4 consolidated income statement.

c. Consolidated net income of $70,0000 should be reported for 20X4, computed as follows:

Reported net income of Ambrose	$59,000
Less: Dividend income from Kroop	(9,000)
Operating income of Ambrose	$50,000
Net income of Kroop	20,000
Consolidated net income	$70,000

d. Income of $79,000 would be attained by adding the income reported by Ambrose ($59,000) to the income reported by Kroop ($20,000). However, the dividend income from Kroop recorded by Ambrose must be excluded from consolidated net income.

E3-16 Computation of Subsidiary Balances

a. Light's net income for 20X2 was $32,000 ($8,000 / 0.25).

b.

Common Stock Outstanding (1)	$120,000
Additional Paid-In Capital (given)	40,000
Retained Earnings ($70,000 + $32,000)	102,000
Total Stockholders' Equity	$262,000

(1) Computation of common stock outstanding:

Total stockholders' equity ($65,500 / 0.25)	$262,000
Additional paid-in capital	(40,000)
Retained earnings	(102,000)
Common stock outstanding	$120,000

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E3-17 Subsidiary Acquired at Net Book Value

Note: Since the financial statements of these two companies are quite simple, it is possible to prepare the consolidated balance sheet without completing all of the steps for a consolidation. However, we present the formal calculations without skipping any steps.

Equity Method Entries on Banner Corp.'s Books:

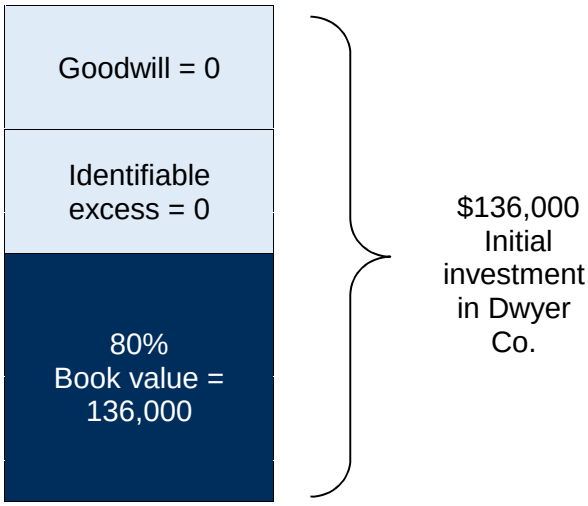
Investment in Dwyer Co.	136,000	
Cash		136,000

Record the initial investment in Dwyer Co.

Book Value Calculations:

	NCI 20%	+	Banner Corp. 80%	=	Common Stock	+	Retained Earnings
Book value at acquisition	34,000		136,000		90,000		80,000

1/1/X8



Basic Elimination Entry

Common stock	**90,000**	
Retained earnings	**80,000**	
Investment in Dwyer Co.		**136,000**
NCI in NA of Dwyer Co.		**34,000**

	Investment in Dwyer Co.		
Acquisition Price	**136,000**		
		136,000	**Basic Entry**
	0		

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E3-17 (continued)

	Banner Corp.	Dwyer Co.	Elimination Entries DR	Elimination Entries CR	Consolidated
Balance Sheet					
Cash	74,000	20,000			94,000
Accounts Receivable	120,000	70,000			190,000
Inventory	180,000	90,000			270,000
Fixed Assets (net)	350,000	240,000			590,000
Investment in Dwyer Co.	136,000			136,000	0
Total Assets	**860,000**	**420,000**	**0**	**136,000**	**1,144,000**
Accounts Payable	65,000	30,000			95,000
Notes Payable	350,000	220,000			570,000
Common Stock	150,000	90,000	90,000		150,000
Retained Earnings	295,000	80,000	80,000		295,000
NCI in NA of Dwyer Co.				34,000	34,000
Total Liabilities & Equity	**860,000**	**420,000**	**170,000**	**34,000**	**1,144,000**

Banner Corporation and Subsidiary
Consolidated Balance Sheet
December 31, 20X8

Cash ($74,000 + $20,000)	$ 94,000
Accounts Receivable ($120,000 + $70,000)	190,000
Inventory ($180,000 + $90,000)	270,000
Fixed Assets (net) ($350,000 + $240,000)	590,000
Total Assets	$1,144,000
Accounts Payable ($65,000 + $30,000)	$ 95,000
Notes Payable ($350,000 + $220,000)	570,000
Common Stock	150,000
Retained Earnings	295,000
Noncontrolling Interest in Net Assets of Dwyer Co.	34,000
Total Liabilities and Stockholders' Equity	$1,144,000

E3-18 Acquisition of Majority Ownership

a. Net identifiable assets: $720,000 = $520,000 + $200,000

b. Noncontrolling interest: $50,000 = $200,000 x 0.25

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E3-19* Measurement of Goodwill

a. $240,000 = computed in the same manner as under the parent company approach.

b. $400,000 = $240,000 / 0.60

c. $400,000 = computed in the same manner as under the entity theory.

E3-20* Assets Under Alternative Accounting Theories

a. Entity theory:

Book Value	($240,000 x 1.00)	$240,000
Fair Value Increase	($50,000 x 1.00)	50,000
		$290,000

b. Parent company theory:

Book Value	($240,000 x 1.00)	$240,000
Fair Value Increase	($50,000 x 0.75)	37,500
		$277,500

c. Proprietary theory:

Book Value	($240,000 x 0.75)	$180,000
Fair Value Increase	($50,000 x 0.75)	37,500
		$217,500

d. Current accounting practice:

Book Value	($240,000 x 1.00)	$240,000
Fair Value Increase	($50,000 x 1.00)	50,000
		$290,000

E3-21* Reported Income under Alternative Accounting Theories

a. Entity theory:

Total revenue ($410,000 + $200,000)	$610,000
Total expenses ($320,000 + $150,000)	470,000
Consolidated net income [$90,000 + ($50,000 x 1.00)]	140,000

b. Parent company theory:

Total revenue ($410,000 + $200,000)	$610,000
Total expenses ($320,000 + $150,000)	470,000
Consolidated net income [$90,000 + ($50,000 x 0.80)]	130,000

c. Proprietary theory:

Total revenue [$410,000 + ($200,000 x 0.80)]	$570,000
Total expenses [$320,000 + ($150,000 x 0.80)]	440,000
Consolidated net income [$90,000 + ($50,000 x 0.80)]	130,000

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d. Current accounting practice:

Total revenue ($410,000 + $200,000)	$610,000
Total expenses ($320,000 + $150,000)	470,000
Consolidated net income [$90,000 + (50,000 x 1.00)]	140,000

E3-22* Applying Alternative Accounting Theories

a. Proprietary theory:

Total revenue [$400,000 + ($200,000 x .75)]	$550,000
Total expenses [$280,000 + ($160,000 x .75)]	400,000
Consolidated net income [$120,000 + ($40,000 x .75)]	150,000

b. Parent company theory:

Total revenue ($400,000 + $200,000)	$600,000
Total expenses ($280,000 + $160,000)	440,000
Consolidated net income [$120,000 + ($40,000 x .75)]	150,000

c. Entity theory:

Total revenue ($400,000 + $200,000)	$600,000
Total expenses ($280,000 + $160,000)	440,000
Consolidated net income ($120,000 + $40,000)	160,000

d. Current accounting practice:

Total revenue ($400,000 + $200,000)	$600,000
Total expenses ($280,000 + $160,000)	440,000
Consolidated net income ($120,000 + $40,000)	160,000

SOLUTIONS TO PROBLEMS

P3-23 Multiple-Choice Questions on Consolidated and Combined Financial Statements [AICPA Adapted]

1. **d** – While previously reported in the 'mezzanine' area between liabilities and equity, FASB 160 (ASC 810) makes it clear that NCI is an element of equity, not a liability.

   (a) *Incorrect*. FASB 160 (ASC 810) states that the NCI is an element of equity, not a liability.
   (b) *Incorrect.* The NCI does not affect the goodwill that results from the consolidation.
   (c) *Incorrect.* The NCI is not reported in the footnotes to the financial statements, but rather it appears as a line item in the equity section of the balance sheet.

2. **b** – The consolidated entity would report the equipment at the asset's fair market value rather than the book value of the asset on the subsidiary's books.

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(a) *Incorrect*. Goodwill arises as a result of the amount paid for acquisition being in excess of the fair value of the net identifiable assets. This differential on the subsidiary's books is reflected as PPE on the parent's books because the asset is recorded at fair value.
(c) *Incorrect.* The excess is not applied to retained earnings, but merely exists in the PPE balance on the consolidated books.
(d) *Incorrect.* This does not arise in a deferred credit. The asset is recorded at its fair value on the consolidated books.

3. **c** – Similar to consolidated statements, combined financial statements require the removal of all intercompany loans and profits. Thus, neither amount is recorded in the combined statements

(a) *Incorrect*. Intercompany loans must be eliminated from combined financial statements.
(b) *Incorrect.* Both intercompany loans and profits must be eliminated from combined financial statements.
(d) *Incorrect.* Combined financial statements require the elimination of intercompany profits.

P3-24 Determining Net Income of Parent Company

Consolidated net income	$164,300
Income of subsidiary ($15,200 / 0.40)	(38,000)
Income from Tally's operations	$126,300

P3-25 Reported Balances

a. The investment balance reported by Roof will be $192,000.

b. The amount of goodwill for the entity as a whole will be $25,000
[($192,000 + $48,000) - ($310,000 - $95,000)].

c. Noncontrolling interest will be reported at $48,000 ($240,000 x 0.20).

P3-26 Acquisition Price

a. $57,000 = ($120,000 - $25,000) x 0.60

b. $81,000 = ($120,000 - $25,000) + $40,000 - $54,000

c. $48,800 = ($120,000 - $25,000) + $27,000 - $73,200

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P3-27 Consolidation of a Variable Interest Entity

Stern Corporation
Consolidated Balance Sheet
January 1, 20X4

Cash			$ 8,150,000	(a)
Accounts Receivable	$12,200,000	(b)		
Less: Allowance for Uncollectibles	(610,000)	(c)	11,590,000	
Other Assets			5,400,000	
Total Assets			$25,140,000	
Accounts Payable			$ 950,000	
Notes Payable			7,500,000	
Bonds Payable			9,800,000	
Stockholders' Equity:				
Controlling Interest:				
Common Stock	$ 700,000			
Retained Earnings	6,150,000			
Total Controlling Interest	$ 6,850,000			
Noncontrolling Interest	40,000			
Total Stockholders' Equity			6,890,000	
Total Liabilities and Stockholders' Equity			$25,140,000	

(a) $ 8,150,000 = $7,960,000 + $190,000
(b) $12,200,000 = $4,200,000 + $8,000,000
(c) $ 610,000 = $210,000 + $400,000

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P3-28 Reporting for Variable Interest Entities

Purified Oil Company
Consolidated Balance Sheet

Cash		$ 640,000
Drilling Supplies		420,000
Accounts Receivable		640,000
Equipment (net)		8,500,000
Land		5,100,000
Total Assets		$15,300,000
Accounts Payable		$ 590,000
Bank Loans Payable		11,800,000
Stockholders' Equity:		
Controlling Interest:		
Common Stock	$ 560,000	
Retained Earnings	2,150,000	
Total Controlling Interest	$2,710,000	
Noncontrolling Interest	200,000	
Total Stockholders' Equity		2,910,000
Total Liabilities and Stockholders' Equity		$15,300,000

P3-29 Consolidated Income Statement Data

a. Sales: ($300,000 + $200,000 - $50,000)	$450,000
b. Investment income from LoCal Bakeries:	$ -0-
c. Cost of goods sold: ($200,000 + $130,000 - $35,000)	$295,000
d. Depreciation expense: ($40,000 + $30,000)	$ 70,000

P3-30 Parent Company and Consolidated Amounts

a. Common stock of Tempro Company on December 31, 20X5		$ 90,000
Retained earnings of Tempro Company		
January 1, 20X5	$130,000	
Sales for 20X5	195,000	
Less: Expenses	(160,000)	
Dividends paid	(15,000)	
Retained earnings of Tempro Company on December 31, 20X5		150,000
Net book value on December 31, 20X5		$240,000
Proportion of stock acquired by Quoton		x 0.80
Purchase price		$192,000

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b.	Net book value on December 31, 20X5	$240,000
	Proportion of stock held by noncontrolling interest	x 0.20
	Balance assigned to noncontrolling interest	$ 48,000

c. Consolidated net income is $143,000. None of the 20X5 net income of Tempro Company was earned after the date of purchase and, therefore, none can be included in consolidated net income.

d. Consolidate net income would be $178,000 [$143,000 + ($195,000 - $160,000)].

P3-31 Parent Company and Consolidated Balances

a.	Balance in investment account, December 31, 20X7		$259,800
	Cumulative earnings since acquisition	110,000	
	Cumulative dividends since acquisition	(46,000)	
	Total	$64,000	
	Proportion of stock held by True Corporation	x 0.75	
	Total Amount Debited to Investment Account		(48,000)
	Purchase Amount		$211,800

b. $282,400 ($211,800 / 0.75) is the fair value of net assets on January 1, 20X5

c. $70,600 ($282,400 x 0.25) is the value assigned to the NCI shareholders on January 1, 20X5.

d. $86,600 = ($259,800 / 0.75) x 0.25 will be assigned to noncontrolling interest in the consolidated balance sheet prepared at December 31, 20X7. Alternatively, this could be calculated by adding the NCI's portion of the cumulative earnings and dividends to the balance of NCI shareholders at acquisition. $70,600 + (64,000 x .25) = $86,600.

P3-32 Indirect Ownership

The following ownership chain exists:

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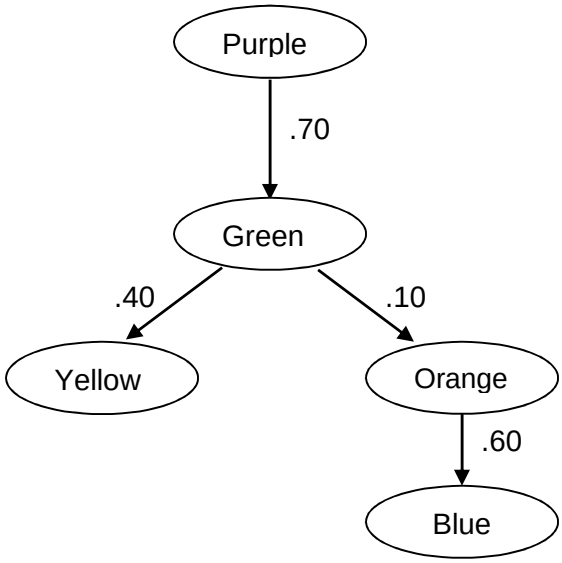

The earnings of Blue Company and Orange Corporation are included under cost method reporting due to the 10 percent ownership level of Orange Corporation. The earnings of Yellow Corporation are included under equity method accounting due to the 40 percent ownership level.

Net income of Green Company:	
Reported operating income	$ 20,000
Dividend income from Orange ($30,000 x 0.10)	3,000
Equity-method income from Yellow ($60,000 x 0.40)	24,000
Green Company net income	$ 47,000
Consolidated net income:	
Operating income of Purple	$ 90,000
Net income of Green	47,000
Consolidated net income	$137,000
Purple company net income (Not Required):	
Operating income of Purple	$ 90,000
Purple's share of Green's net income ($47,000 x 0.70)	32,900
Purple's net income	$122,900

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P3-33 Consolidated Worksheet and Balance Sheet on the Acquisition Date (Equity Method)

a.

Equity Method Entries on Peanut Co.'s Books:

Investment in Snoopy Co.	270,000	
Cash		270,000

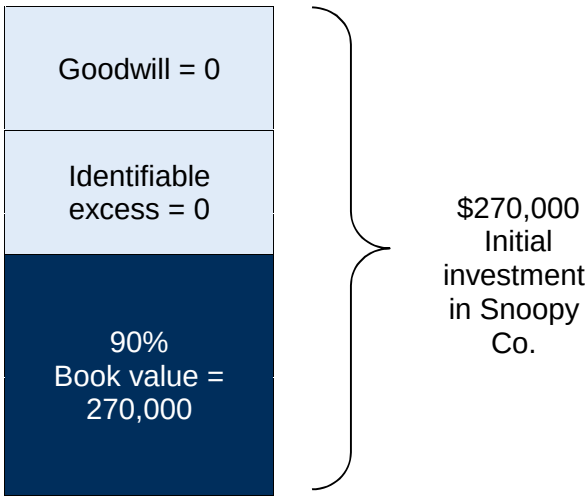
Record the initial investment in Snoopy Co.

b.

Book Value Calculations:

	NCI 10%	+	Peanut Co. 90%	=	Common Stock	+	Retained Earnings
Book value at acquisition	30,000		270,000		200,000		100,000

1/1/X8



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Basic Elimination Entry

Common stock	**200,000**	
Retained earnings	**100,000**	
Investment in Snoopy Co.		**270,000**
NCI in NA of Snoopy Co.		**30,000**

Optional accumulated depreciation elimination entry

Accumulated depreciation	**10,000**	
Building & equipment		**10,000**

P3-33 (continued)

Investment in Snoopy Co.

Acquisition Price	**270,000**		
		270,000	**Basic Entry**
	0		

	Peanut Co.	Snoopy Co.	Elimination Entries DR	Elimination Entries CR	Consolidated
Balance Sheet					
Cash	55,000	20,000			75,000
Accounts Receivable	50,000	30,000			80,000
Inventory	100,000	60,000			160,000
Investment in Snoopy Co.	270,000			**270,000**	0
Land	225,000	100,000			325,000
Buildings & Equipment	700,000	200,000		**10,000**	890,000
Less: Accumulated Depreciation	(400,000)	(10,000)	**10,000**		(400,000)
Total Assets	**1,000,000**	**400,000**	**10,000**	**280,000**	**1,130,000**
Accounts Payable	75,000	25,000			100,000
Bonds Payable	200,000	75,000			275,000
Common Stock	500,000	200,000	**200,000**		500,000
Retained Earnings	225,000	100,000	**100,000**		225,000
NCI in NA of Snoopy Co.				**30,000**	30,000
Total Liabilities & Equity	**1,000,000**	**400,000**	**300,000**	**30,000**	**1,130,000**

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c.

Peanut Co. Consolidated Balance Sheet 1/1/20X8	
Cash	75,000
Accounts Receivable	80,000
Inventory	160,000
Land	325,000
Buildings & Equipment	890,000
Less: Accumulated Depreciation	(400,000)
Total Assets	**1,130,000**
Accounts Payable	100,000
Bonds Payable	275,000
Common Stock	500,000
Retained Earnings	225,000
NCI in NA of Snoopy Co.	30,000
Total Liabilities & Equity	**1,130,000**

P3-34 Consolidated Worksheet at End of the First Year of Ownership (Equity Method)

a.

Equity Method Entries on Peanut Co.'s Books:

Investment in Snoopy Co.	270,000	
Cash		270,000

Record the initial investment in Snoopy Co.

Investment in Snoopy Co.	67,500	
Income from Snoopy Co.		67,500

Record Peanut Co.'s 90% share of Snoopy Co.'s 20X8 income

Cash	18,000	
Investment in Snoopy Co.		18,000

Record Peanut Co.'s 90% share of Snoopy Co.'s 20X8 dividend

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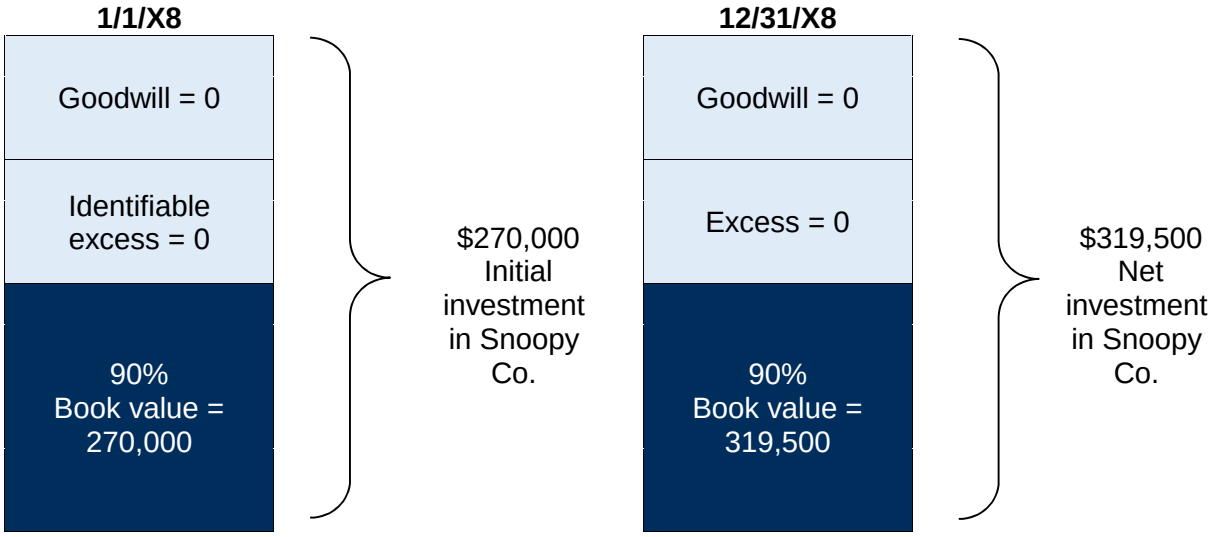
b.

Book Value Calculations:

	NCI 10%	+	Peanut Co. 90%	=	Common Stock	+	Retained Earnings
Beginning book value	**30,000**		**270,000**		**200,000**		**100,000**
+ Net Income	**7,500**		**67,500**				**75,000**
- Dividends	**(2,000)**		**(18,000)**				**(20,000)**
Ending book value	**35,500**		**319,500**		**200,000**		**155,000**



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P3-34 (continued)

Basic Elimination Entry

Common stock	200,000	
Retained earnings	100,000	
Income from Snoopy Co.	67,500	
NCI in NI of Snoopy Co.	7,500	
Dividends declared		20,000
Investment in Snoopy Co.		319,500
NCI in NA of Snoopy Co.		35,500

Optional accumulated depreciation elimination entry

Accumulated depreciation	10,000	
Building & equipment		10,000

	Investment in Snoopy Co.			Income from Snoopy Co.		
Acquisition Price	270,000					
90% Net Income	67,500				67,500	90% Net Income
		18,000	90% Dividends			
Ending Balance	319,500				67,500	Ending Balance
		319,500	Basic	67,500		
	0				0	

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P3-34 (continued)

	Peanut Co.	Snoopy Co.	Elimination Entries DR	Elimination Entries CR	Consolidated
Income Statement					
Sales	800,000	250,000			1,050,000
Less: COGS	(200,000)	(125,000)			(325,000)
Less: Depreciation Expense	(50,000)	(10,000)			(60,000)
Less: Other Expenses	(225,000)	(40,000)			(265,000)
Income from Snoopy Co.	67,500		67,500		0
Consolidated Net Income	392,500	75,000	67,500		400,000
NCI in Net Income			7,500		(7,500)
Controlling Interest in Net Income	**392,500**	**75,000**	**75,000**	**0**	**392,500**
Statement of Retained Earnings					
Beginning Balance	225,000	100,000	100,000		225,000
Net Income	**392,500**	**75,000**	**75,000**	**0**	392,500
Less: Dividends Declared	(100,000)	(20,000)		20,000	(100,000)
Ending Balance	**517,500**	**155,000**	**175,000**	**20,000**	**517,500**
Balance Sheet					
Cash	158,000	80,000			238,000
Accounts Receivable	165,000	65,000			230,000
Inventory	200,000	75,000			275,000
Investment in Snoopy Co.	319,500			319,500	0
Land	200,000	100,000			300,000
Buildings & Equipment	700,000	200,000		10,000	890,000
Less: Accumulated Depreciation	(450,000)	(20,000)	10,000		(460,000)
Total Assets	**1,292,500**	**500,000**	**10,000**	**329,500**	**1,473,000**
Accounts Payable	75,000	60,000			135,000
Bonds Payable	200,000	85,000			285,000
Common Stock	500,000	200,000	200,000		500,000
Retained Earnings	**517,500**	**155,000**	**175,000**	**20,000**	517,500
NCI in NA of Snoopy Co.				35,500	35,500
Total Liabilities & Equity	**1,292,500**	**500,000**	**375,000**	**55,500**	**1,473,000**

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P3-35 Consolidated Worksheet at End of the Second Year of Ownership (Equity Method)

a.

Equity Method Entries on Peanut Co.'s Books:

Investment in Snoopy Co.	72,000	
Income from Snoopy Co.		72,000

Record Peanut Co.'s 90% share of Snoopy Co.'s 20X9 income

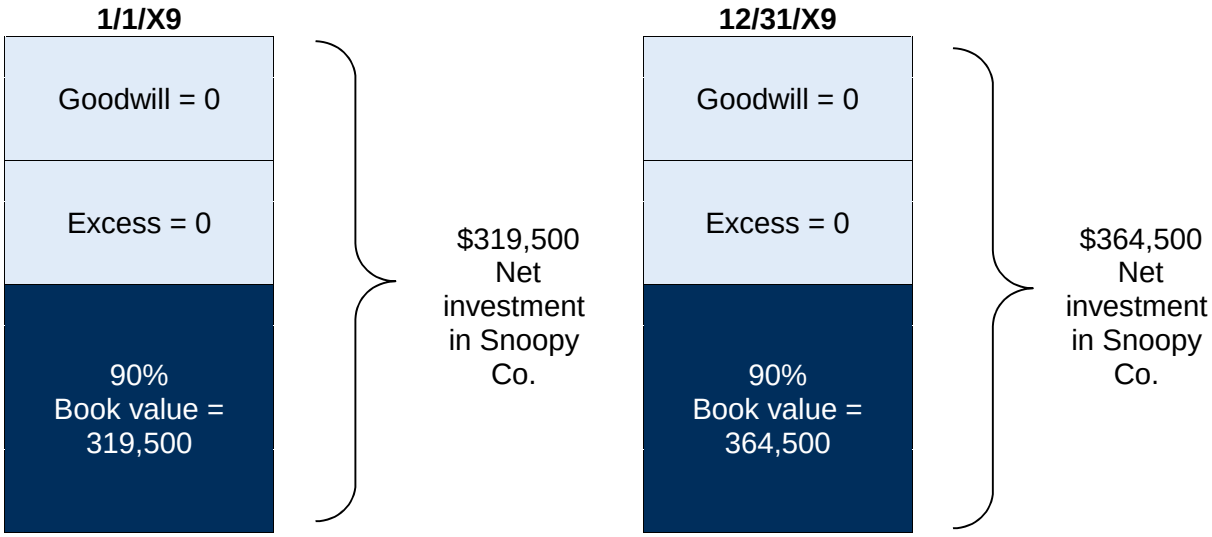
Cash	27,000	
Investment in Snoopy Co.		27,000

Record Peanut Co.'s 90% share of Snoopy Co.'s 20X9 dividend

b.

Book Value Calculations:

	NCI 10%	+	Peanut Co. 90%	=	Common Stock	+	Retained Earnings
Beginning book value	**35,500**		**319,500**		**200,000**		**155,000**
+ Net Income	**8,000**		**72,000**				**80,000**
- Dividends	**(3,000)**		**(27,000)**				**(30,000)**
Ending book value	**40,500**		**364,500**		**200,000**		**205,000**



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P3-35 (continued)

Basic Elimination Entry

Common stock	200,000	
Retained earnings	155,000	
Income from Snoopy Co.	72,000	
NCI in NI of Snoopy Co.	8,000	
Dividends declared		30,000
Investment in Snoopy Co.		364,500
NCI in NA of Snoopy Co.		40,500

Optional accumulated depreciation elimination entry

Accumulated depreciation	10,000	
Building & equipment		10,000

	Investment in Snoopy Co.			Income from Snoopy Co.		
Beginning Balance	319,500					
90% Net Income	72,000				72,000	90% Net Income
		27,000	90% Dividends			
Ending Balance	364,500				72,000	Ending Balance
		364,500	Basic	72,000		
	0				0	

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P3-35 (continued)

	Peanut Co.	Snoopy Co.	Elimination Entries DR	Elimination Entries CR	Consolidated
Income Statement					
Sales	850,000	300,000			1,150,000
Less: COGS	(270,000)	(150,000)			(420,000)
Less: Depreciation Expense	(50,000)	(10,000)			(60,000)
Less: Other Expenses	(230,000)	(60,000)			(290,000)
Income from Snoopy Co.	72,000		72,000		0
Consolidated Net Income	372,000	80,000	72,000		380,000
NCI in Net Income			8,000		(8,000)
Controlling Interest in Net Income	**372,000**	**80,000**	**80,000**	**0**	**372,000**
Statement of Retained Earnings					
Beginning Balance	517,500	155,000	155,000		517,500
Net Income	**372,000**	**80,000**	**80,000**	**0**	372,000
Less: Dividends Declared	(225,000)	(30,000)		30,000	(225,000)
Ending Balance	**664,500**	**205,000**	**235,000**	**30,000**	**664,500**
Balance Sheet					
Cash	255,000	75,000			330,000
Accounts Receivable	190,000	80,000			270,000
Inventory	180,000	100,000			280,000
Investment in Snoopy Co.	364,500			364,500	0
Land	200,000	100,000			300,000
Buildings & Equipment	700,000	200,000		10,000	890,000
Less: Accumulated Depreciation	(500,000)	(30,000)	10,000		(520,000)
Total Assets	**1,389,500**	**525,000**	**10,000**	**374,500**	**1,550,000**
Accounts Payable	75,000	35,000			110,000
Bonds Payable	150,000	85,000			235,000
Common Stock	500,000	200,000	200,000		500,000
Retained Earnings	**664,500**	**205,000**	**235,000**	**30,000**	664,500
NCI in NA of Snoopy Co.				40,500	40,500
Total Liabilities & Equity	**1,389,500**	**525,000**	**435,000**	**70,500**	**1,550,000**

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P3-36 Consolidated Worksheet and Balance Sheet on the Acquisition Date (Equity Method)

a.

Equity Method Entries on Paper Co.'s Books:

Investment in Scissor Co.	296,000	
Cash		296,000

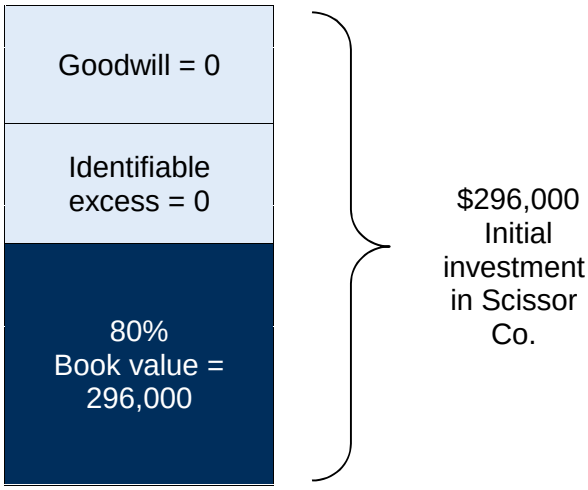
Record the initial investment in Scissor Co.

b.

Book Value Calculations:

	NCI 20%	+	Paper Co. 80%	=	Common Stock	+	Retained Earnings
Book value at acquisition	74,000		296,000		250,000		120,000

1/1/X8



Basic Elimination Entry

Common stock	**250,000**	
Retained earnings	**120,000**	
Investment in Scissor Co.		**296,000**
NCI in NA of Scissor Co.		**74,000**

Optional accumulated depreciation elimination entry

Accumulated depreciation	**24,000**	
Building & equipment		**24,000**

	Investment in Scissor Co.		
Acquisition Price	**296,000**		
		296,000	**Basic Entry**
	0		

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P3-36 (continued)

	Paper Co.	Scissor Co.	Elimination Entries DR	Elimination Entries CR	Consolidated
Balance Sheet					
Cash	109,000	25,000			134,000
Accounts Receivable	65,000	37,000			102,000
Inventory	125,000	87,000			212,000
Investment in Scissor Co.	296,000			296,000	0
Land	280,000	125,000			405,000
Buildings & Equipment	875,000	250,000		24,000	1,101,000
Less: Accumulated Depreciation	(500,000)	(24,000)	24,000		(500,000)
Total Assets	**1,250,000**	**500,000**	**24,000**	**320,000**	**1,454,000**
Accounts Payable	95,000	30,000			125,000
Bonds Payable	250,000	100,000			350,000
Common Stock	625,000	250,000	250,000		625,000
Retained Earnings	280,000	120,000	120,000		280,000
NCI in NA of Scissor Co.				74,000	74,000
Total Liabilities & Equity	**1,250,000**	**500,000**	**370,000**	**74,000**	**1,454,000**

c.

Paper Co.
Consolidated Balance Sheet
1/1/20X8

Cash	134,000
Accounts Receivable	102,000
Inventory	212,000
Land	405,000
Buildings & Equipment	1,101,000
Less: Accumulated Depreciation	(500,000)
Total Assets	**1,454,000**
Accounts Payable	125,000
Bonds Payable	350,000
Common Stock	625,000
Retained Earnings	280,000
NCI in NA of Scissor Co.	74,000
Total Liabilities & Equity	**1,454,000**

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P3-37 Consolidated Worksheet at End of the First Year of Ownership (Equity Method)

a.

Equity Method Entries on Paper Co.'s Books:

Investment in Scissor Co.	296,000	
Cash		296,000

Record the initial investment in Scissor Co.

Investment in Scissor Co.	74,400	
Income from Scissor Co.		74,400

Record Paper Co.'s 80% share of Scissor Co.'s 20X9 income

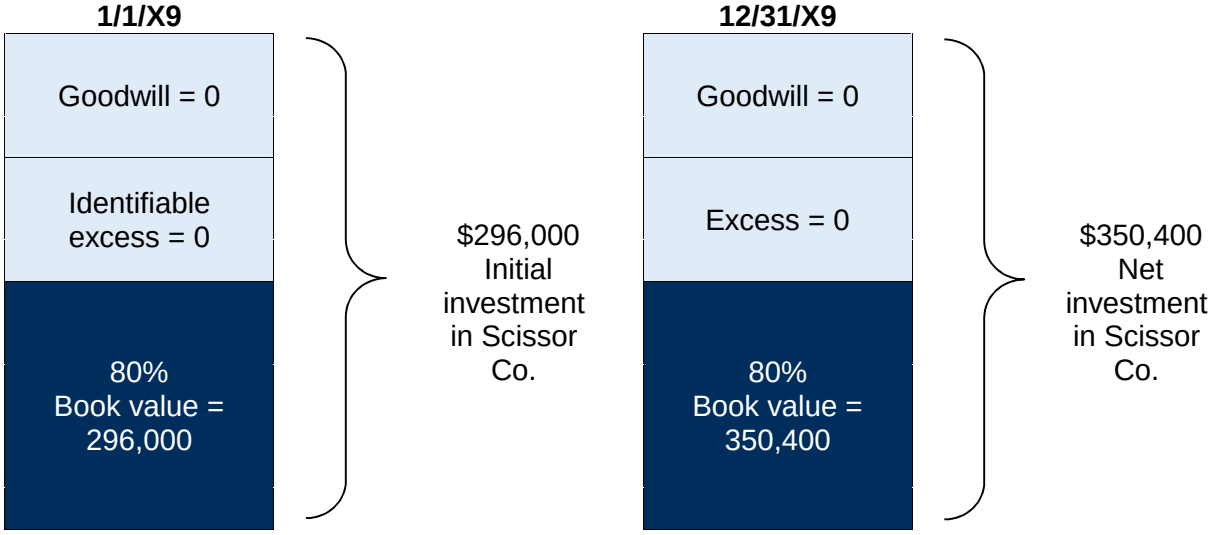
Cash	20,000	
Investment in Scissor Co.		20,000

Record Paper Co.'s 80% share of Scissor Co.'s 20X9 dividend

b.

Book Value Calculations:

	NCI 20%	+	Paper Co. 80%	=	Common Stock	+	Retained Earnings
Beginning book value	**74,000**		**296,000**		**250,000**		**120,000**
+ Net Income	**18,600**		**74,400**				**93,000**
- Dividends	**(5,000)**		**(20,000)**				**(25,000)**
Ending book value	**87,600**		**350,400**		**250,000**		**188,000**



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P3-37 (continued)

Basic Elimination Entry

Common stock	250,000	
Retained earnings	120,000	
Income from Scissor Co.	74,400	
NCI in NI of Scissor Co.	18,600	
Dividends declared		25,000
Investment in Scissor Co.		350,400
NCI in NA of Scissor Co.		87,600

Optional accumulated depreciation elimination entry

Accumulated depreciation	24,000	
Building & equipment		24,000

	Investment in Scissor Co.			Income from Scissor Co.		
Acquisition Price	296,000					
80% Net Income	74,400				74,400	80% Net Income
		20,000	80% Dividends			
Ending Balance	350,400				74,400	Ending Balance
		350,400	Basic	74,400		
	0				0	

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P3-37 (continued)

	Paper Co.	Scissor Co.	Elimination Entries DR	Elimination Entries CR	Consolidated
Income Statement					
Sales	800,000	310,000			1,110,000
Less: COGS	(250,000)	(155,000)			(405,000)
Less: Depreciation Expense	(65,000)	(12,000)			(77,000)
Less: Other Expenses	(280,000)	(50,000)			(330,000)
Income from Scissor Co.	74,400		74,400		0
Consolidated Net Income	279,400	93,000	74,400		298,000
NCI in Net Income			18,600		(18,600)
Controlling Interest in Net Income	**279,400**	**93,000**	**93,000**	**0**	**279,400**
Statement of Retained Earnings					
Beginning Balance	280,000	120,000	120,000		280,000
Net Income	**279,400**	**93,000**	**93,000**	**0**	279,400
Less: Dividends Declared	(80,000)	(25,000)		25,000	(80,000)
Ending Balance	**479,400**	**188,000**	**213,000**	**25,000**	**479,400**
Balance Sheet					
Cash	191,000	46,000			237,000
Accounts Receivable	140,000	60,000			200,000
Inventory	190,000	120,000			310,000
Investment in Scissor Co.	350,400			350,400	0
Land	250,000	125,000			375,000
Buildings & Equipment	875,000	250,000		24,000	1,101,000
Less: Accumulated Depreciation	(565,000)	(36,000)	24,000		(577,000)
Total Assets	**1,431,400**	**565,000**	**24,000**	**374,400**	**1,646,000**
Accounts Payable	77,000	27,000			104,000
Bonds Payable	250,000	100,000			350,000
Common Stock	625,000	250,000	250,000		625,000
Retained Earnings	**479,400**	**188,000**	**213,000**	**25,000**	479,400
NCI in NA of Scissor Co.				87,600	87,600
Total Liabilities & Equity	**1,431,400**	**565,000**	**463,000**	**112,600**	**1,646,000**

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P3-38 Consolidated Worksheet at End of the Second Year of Ownership (Equity Method)

a.

Equity Method Entries on Paper Co.'s Books:

Investment in Scissor Co.	85,600	
Income from Scissor Co.		85,600

Record Paper Co.'s 80% share of Scissor Co.'s 20X9 income

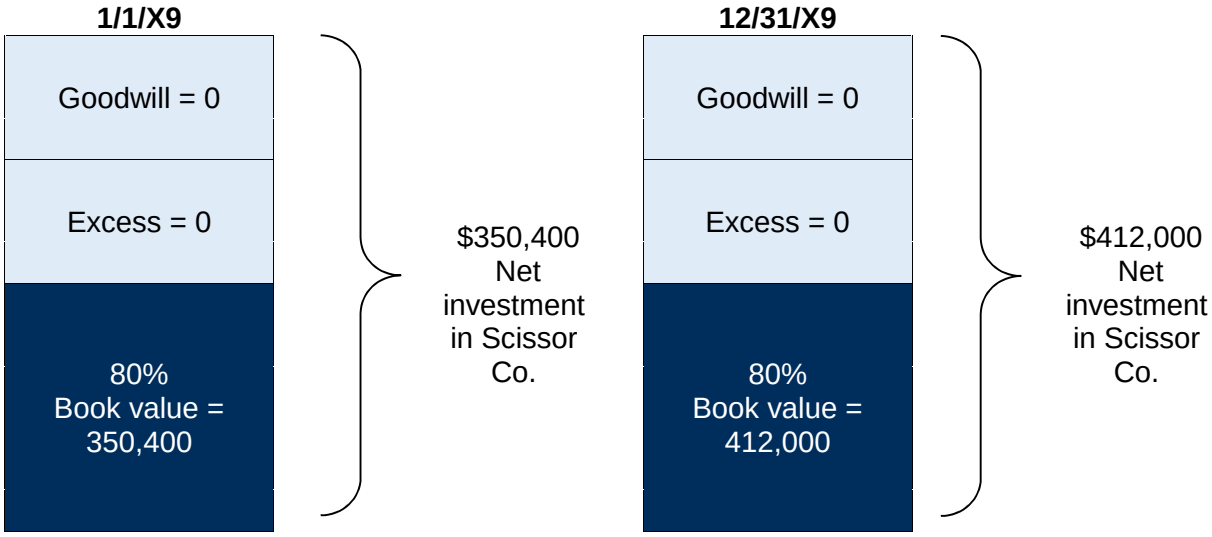
Cash	24,000	
Investment in Scissor Co.		24,000

Record Paper Co.'s 80% share of Scissor Co.'s 20X9 dividend

b.

Book Value Calculations:

	NCI 20%	+	Paper Co. 80%	=	Common Stock	+	Retained Earnings
Beginning book value	**87,600**		**350,400**		**250,000**		**188,000**
+ Net Income	**21,400**		**85,600**				**107,000**
- Dividends	**(6,000)**		**(24,000)**				**(30,000)**
Ending book value	**103,000**		**412,000**		**250,000**		**265,000**



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P3-38 (continued)

Basic Elimination Entry

Common stock	250,000	
Retained earnings	188,000	
Income from Scissor Co.	85,600	
NCI in NI of Scissor Co.	21,400	
Dividends declared		30,000
Investment in Scissor Co.		412,000
NCI in NA of Scissor Co.		103,000

Optional accumulated depreciation elimination entry

Accumulated depreciation	24,000	
Building & equipment		24,000

	Investment in Scissor Co.			Income from Scissor Co.		
Beginning Balance	350,400					
80% Net Income	85,600				85,600	80% Net Income
		24,000	80% Dividends			
Ending Balance	412,000				85,600	Ending Balance
		412,000	Basic	85,600		
	0				0	

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P3-38 (continued)

	Paper Co.	Scissor Co.	Elimination Entries DR	Elimination Entries CR	Consolidated
Income Statement					
Sales	880,000	355,000			1,235,000
Less: COGS	(278,000)	(178,000)			(456,000)
Less: Depreciation Expense	(65,000)	(12,000)			(77,000)
Less: Other Expenses	(312,000)	(58,000)			(370,000)
Income from Scissor Co.	85,600		85,600		0
Consolidated Net Income	310,600	107,000	85,600		332,000
NCI in Net Income			21,400		(21,400)
Controlling Interest in Net Income	**310,600**	**107,000**	**107,000**	**0**	**310,600**
Statement of Retained Earnings					
Beginning Balance	479,400	188,000	188,000		479,400
Net Income	**310,600**	**107,000**	**107,000**	**0**	310,600
Less: Dividends Declared	(90,000)	(30,000)		30,000	(90,000)
Ending Balance	**700,000**	**265,000**	**295,000**	**30,000**	**700,000**
Balance Sheet					
Cash	295,000	116,000			411,000
Accounts Receivable	165,000	97,000			262,000
Inventory	193,000	115,000			308,000
Investment in Scissor Co.	412,000			412,000	0
Land	250,000	125,000			375,000
Buildings & Equipment	875,000	250,000		24,000	1,101,000
Less: Accumulated Depreciation	(630,000)	(48,000)	24,000		(654,000)
Total Assets	**1,560,000**	**655,000**	**24,000**	**436,000**	**1,803,000**
Accounts Payable	85,000	40,000			125,000
Bonds Payable	150,000	100,000			250,000
Common Stock	625,000	250,000	250,000		625,000
Retained Earnings	**700,000**	**265,000**	**295,000**	**30,000**	700,000
NCI in NA of Scissor Co.				103,000	103,000
Total Liabilities & Equity	**1,560,000**	**655,000**	**545,000**	**133,000**	**1,803,000**

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P3-39* Balance Sheet Amounts under Alternative Accounting Theories

a. Proprietary theory:

Cash and inventory [$300,000 + ($80,000 x 0.75)]	$360,000
Buildings and Equipment (net) [$400,000 + ($180,000 x 0.75)]	535,000
Goodwill [$210,000 - ($260,000 x 0.75)]	15,000

b. Parent company theory:

Cash and inventory ($300,000 + $80,000)	$380,000
Buildings and Equipment (net) [$400,000 + $120,000 + ($60,000 x 0.75)]	565,000
Goodwill [$210,000 – ($260,000 x 0.75)]	15,000

c. Entity theory:

Cash and inventory ($300,000 + $80,000)	$380,000
Buildings and Equipment (net) ($400,000 + $180,000)	580,000
Goodwill [($210,000 / 0.75) - $260,000]	20,000

d. Current accounting practice:

Cash and inventory ($300,000 + $80,000)	$380,000
Buildings and Equipment (net) ($400,000 + $180,000)	580,000
Goodwill [($210,000 / 0.75) - $260,000]	20,000

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