

**Chapter 3**  
**The Reporting Entity and Consolidation of Less-than-Wholly-Owned Subsidiaries with No Differentials**

**Multiple Choice Questions:**

1. Consolidated financial statements tend to be most useful for:

- A. Creditors of a consolidated subsidiary.
- B. Investors and long-term creditors of the parent company.
- C. Short-term creditors of the parent company.
- D. Stockholders of a consolidated subsidiary.

*Answer: B*

*Learning Objective: 03-01*

*Topic: The Usefulness and Limitations of Consolidated Financial Statements*

*Blooms: Understand*

*AACSB: Reflective Thinking*

*AICPA: FN Reporting*

*Difficulty: 2 Medium*

2. Company Pea owns 90 percent of Company Essone which in turn owns 80 percent of Company Esstwo. Company Esstwo owns 100 percent of Company Essthree. Consolidated financial statements should be prepared to report the financial status and results of operations for:

- A. Pea.
- B. Pea plus Essone.
- C. Pea plus Essone plus Esstwo.
- D. Pea plus Essone plus Esstwo plus Essthree.

*Answer: D*

*Learning Objective: 03-02*

*Topic: Direct and Indirect Control*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Decision Making*

*Difficulty: 2 Medium*

3. In which of the following cases would consolidation be inappropriate?

- A. The subsidiary is in bankruptcy.
- B. Subsidiary's operations are dissimilar from those of the parent.
- C. The parent owns 90 percent of the subsidiary's common stock, but all of the subsidiary's nonvoting preferred stock is held by a single investor.
- D. Subsidiary is foreign.

*Answer: A*

*Learning Objective: 03-02*

*Topic: Direct and Indirect Control*

*Blooms: Remember*

*AACSB: Reflective Thinking*

*AICPA: FN Reporting*

*Difficulty: 1 Easy*

4. On January 1, 20X8, Zeta Company acquired 85 percent of Theta Company's common stock for \$100,000 cash. The fair value of the noncontrolling interest was determined to be 15 percent of the book value of Theta at that date. What portion of the retained earnings reported in the consolidated balance sheet prepared immediately after the business combination is assigned to the noncontrolling interest?

- A. None
- B. 15 percent
- C. 100 percent
- D. Cannot be determined

*Answer: A*

*Learning Objective: 03-03*

*Topic: Noncontrolling interest*

*Blooms: Understand*

*AACSB: Reflective Thinking*

*AICPA: FN Reporting*

*Difficulty: 2 Medium*

**The following data applies to Questions 5-7:**

On January 3, 20X9, Redding Company acquired 80 percent of Frazer Corporation's common stock for \$344,000 in cash. At the acquisition date, the book values and fair values of Frazer's assets and liabilities were equal, and the fair value of the noncontrolling interest was equal to 20 percent of the total book value of Frazer. The stockholders' equity accounts of the two companies at the acquisition date are:

	<b>Redding</b>	<b>Frazer</b>
Common Stock (\$5 par value)	\$500,000	\$200,000
Additional Paid-In Capital	300,000	80,000
Retained Earnings	350,000	150,000
Total Stockholders' Equity	<u>\$1,150,000</u>	<u>\$430,000</u>

Noncontrolling interest was assigned income of \$11,000 in Redding's consolidated income statement for 20X9.

5. Based on the preceding information, what amount will be assigned to the noncontrolling interest on January 3, 20X9, in the consolidated balance sheet?

- A. \$86,000
- B. \$44,000
- C. \$68,800
- D. \$50,000

*Answer: A*

*Learning Objective: 03-03*

*Topic: Noncontrolling interest*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

6. Based on the preceding information, what is the total stockholders' equity in the consolidated balance sheet as of January 3, 20X9?

- A. \$1,580,000
- B. \$1,064,000
- C. \$1,150,000
- D. \$1,236,000

*Answer: D*

*Learning Objective: 03-05*

*Topic: Prepare a Consolidated Worksheet*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

7. Based on the preceding information, what will be the amount of net income reported by Frazer Corporation in 20X9?

- A. \$44,000
- B. \$55,000
- C. \$66,000
- D. \$36,000

*Answer: B*

*Learning Objective: 03-04*

*Topic: The Effect of Noncontrolling Interest (NI and RE)*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

**The following data applies to Questions 8 – 10:**

On January 2, 20X2, Kentucky Company acquired 70% of Bluegrass Corporation's common stock for \$420,000 cash. At the acquisition date, the book values and fair values of Bluegrass' assets and liabilities were equal, and the fair value of the noncontrolling interest was equal to 30% of the total book value of Bluegrass. The stockholders' equity accounts of the two companies at the acquisition date are as follows:

	<u>Kentucky</u>	<u>Bluegrass</u>
Common Stock (\$10 par value)	\$600,000	\$350,000
Additional Paid-In Capital	450,000	50,000
Retained Earnings	<u>250,000</u>	<u>200,000</u>
Total Stockholders' Equity	\$1,300,000	\$600,000

Noncontrolling interest was assigned income of \$15,000 in Kentucky's consolidated income statement for 20X2.

8. Based on the preceding information, what amount will be assigned to noncontrolling interest on January 2, 20X2, in the consolidated balance sheet?

- A. \$120,000
- B. \$126,000
- C. \$180,000
- D. \$420,000

*Answer: C*

*Learning Objective: 03-03*

*Topic: Noncontrolling interest*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

9. Based on the preceding information, what is the total stockholders' equity in the consolidated balance sheet as of January 2, 20X2?

- A. \$1,120,000
- B. \$1,300,000
- C. \$1,480,000
- D. \$1,900,000

*Answer: C*

*Learning Objective: 03-05*

*Topic: Prepare a Consolidated Worksheet*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

10. Based on the preceding information, what will be the amount of net income reported by Bluegrass Corporation in 20X2?

- A. \$45,000
- B. \$50,000
- C. \$75,000
- D. \$105,000

*Answer: B*

*Learning Objective: 03-04*

*Topic: The Effect of Noncontrolling Interest (NI and RE)*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

**The following data applies to Questions 11 – 12:**

On January 3, 20X9, Jane Company acquired 75 percent of Miller Company's outstanding common stock for cash. The fair value of the noncontrolling interest was equal to a proportionate share of the book value of Miller Company's net assets at the date of acquisition. Selected balance sheet data at December 31, 20X9, are as follows:

	<b>Jane</b>	<b>Miller</b>
Total Assets	<u>\$504,000</u>	<u>\$216,000</u>
Liabilities	\$144,000	\$72,000
Common Stock	120,000	60,000
Retained Earnings	<u>240,000</u>	<u>84,000</u>
	<u>\$504,000</u>	<u>\$216,000</u>

11. Based on the preceding information, what amount should be reported as noncontrolling interest in net assets in Jane Company's December 31, 20X9, consolidated balance sheet?

- A. \$90,000
- B. \$54,000
- C. \$36,000
- D. \$0

*Answer: C*

*Learning Objective: 03-04*

*Topic: The Effect of Noncontrolling Interest (NI and RE)*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

12. Based on the preceding information, what amount will Jane Company report as common stock outstanding in its consolidated balance sheet at December 31, 20X9?

- A. \$120,000
- B. \$180,000
- C. \$156,000
- D. \$264,000

*Answer: A*

*Learning Objective: 03-05*

*Topic: Prepare a Consolidated Worksheet*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

**The following data applies to Questions 13 – 14:**

On January 1, 20X6, Joseph Company acquired 80% of Salt Company's outstanding stock for cash. The fair value of the noncontrolling interest was equal to a proportionate share of the book

value of Salt Company's net assets at the date of acquisition. Selected balance sheet data at December 31, 20X6 are as follows:

	<u>Joseph</u>	<u>Salt</u>
Total Assets	<u>\$564,000</u>	<u>\$241,000</u>
Liabilities	\$180,000	\$65,000
Common Stock	150,000	80,000
Retained Earnings	<u>234,000</u>	<u>96,000</u>
	<u>\$564,000</u>	<u>\$241,000</u>

13. Based on the preceding information, what amount should be reported as noncontrolling interest in net assets in Joseph Company's December 31, 20X6, consolidated balance sheet?

- A. \$35,200
- B. \$48,200
- C. \$76,800
- D. \$112,800

*Answer: A*

*Learning Objective: 03-04*

*Topic: The Effect of Noncontrolling Interest (NI and RE)*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

14. Based on the preceding information, what amount will Joseph Company report as common stock outstanding in its consolidated balance sheet at December 31, 20X6?

- A. \$214,000
- B. \$150,000
- C. \$184,000
- D. \$230,000

*Answer: B*

*Learning Objective: 03-05*

*Topic: Prepare a Consolidated Worksheet*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

15. Xing Corporation owns 80 percent of the voting common shares of Adams Corporation. Noncontrolling interest was assigned \$24,000 of income in the 20X9 consolidated income statement. What amount of net income did Adams Corporation report for the year?

- A. \$150,000
- B. \$96,000
- C. \$120,000
- D. \$30,000

*Answer: C*

*Learning Objective: 03-04*

*Topic: The Effect of Noncontrolling Interest (NI and RE)*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

16. Orange Corporation owns 70 percent of the voting common shares of McNichols Corporation, purchased at book value. Noncontrolling interest was assigned \$21,000 of income in the 20X0 consolidated income statement. What amount of net income did McNichols Corporation report for the year?

- A. \$70,000
- B. \$63,000
- C. \$30,000
- D. \$147,000

*Answer: A*

*Learning Objective: 03-04*

*Topic: The Effect of Noncontrolling Interest (NI and RE)*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

17. Zeta Corporation and its subsidiary reported consolidated net income of \$320,000 for the year ended December 31, 20X8. Zeta owns 80 percent of the common shares of its subsidiary, acquired at book value. Noncontrolling interest was assigned income of \$30,000 in the consolidated income statement for 20X8. What is the amount of separate operating income reported by Zeta for the year?

- A. \$170,000
- B. \$150,000
- C. \$120,000
- D. \$200,000

*Answer: A*

*Learning Objective: 03-04*

*Topic: The Effect of Noncontrolling Interest (NI and RE)*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

18. Maple Corporation and its subsidiary reported consolidated net income of \$380,000 for the year ended December 31, 20X5. Maple owns 75% of the common shares of its subsidiary, acquired at book value. Noncontrolling interest was assigned income of \$25,000 in the consolidated income statement for 20X5. What is the amount of separate operating income reported by Maple for the year?

- A. \$95,000
- B. \$100,000
- C. \$280,000
- D. \$285,000

*Answer: C*

*Learning Objective: 03-04*

*Topic: The Effect of Noncontrolling Interest (NI and RE)*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

**The following data applies to Questions 19 – 24:**

On January 1, 20X8, Wilhelm Corporation acquired 90 percent of Kaiser Company's voting stock, at underlying book value. The fair value of the noncontrolling interest was equal to 10 percent of the book value of Kaiser at that date. Wilhelm uses the equity method in accounting for its ownership of Kaiser. On December 31, 20X9, the trial balances of the two companies are as follows:

Item	Wilhelm Corporation		Kaiser Company	
	Debit	Credit	Debit	Credit
Current Assets	\$200,000		\$140,000	
Depreciable Assets	350,000		250,000	
Investment in Kaiser Company Stock	162,000			
Depreciation Expense	27,000		10,000	
Other Expenses	95,000		60,000	
Dividends Declared	20,000		10,000	
Accumulated Depreciation		\$118,000		\$80,000
Current Liabilities		100,000		80,000
Long-Term Debt		100,000		50,000
Common Stock		100,000		50,000
Retained Earnings		150,000		100,000
Sales		250,000		110,000
Income from Subsidiary		36,000		
	<u>\$854,000</u>	<u>\$854,000</u>	<u>\$470,000</u>	<u>\$470,000</u>

19. Based on the preceding information, what amount would be reported as total assets in the consolidated balance sheet at December 31, 20X9?

- A. \$805,000
- B. \$712,000
- C. \$742,000
- D. \$1,102,000

*Answer: C*

*Learning Objective: 03-05*

*Topic: Prepare a Consolidated Worksheet*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

20. Based on the preceding information, what amount would be reported as total liabilities in the consolidated balance sheet at December 31, 20X9?

- A. \$330,000
- B. \$712,000
- C. \$318,000
- D. \$130,000

*Answer: A*

*Learning Objective: 03-05*

*Topic: Prepare a Consolidated Worksheet*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

21. Based on the preceding information, what amount would be reported as retained earnings in the consolidated balance sheet prepared at December 31, 20X9?

- A. 314,000
- B. 294,000
- C. 150,000
- D. 424,000

*Answer: B*

*Learning Objective: 03-05*

*Topic: Prepare a Consolidated Worksheet*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 1 Easy*

22. Based on the preceding information, what amount would be reported as noncontrolling interest in the consolidated balance sheet at December 31, 20X9?

- A. \$27,000
- B. \$4,000
- C. \$15,000
- D. \$18,000

*Answer: D*

*Learning Objective: 03-03*

*Topic: Noncontrolling interest*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

23. Based on the preceding information, what amount would be reported as total stockholder's equity in the consolidated balance sheet at December 31, 20X9?

- A. \$412,000
- B. \$394,000
- C. \$542,000
- D. \$348,000

*Answer: A*

*Learning Objective: 03-05*

*Topic: Prepare a Consolidated Worksheet*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

24. Based on the preceding information, what amount would be reported as income to controlling interest in the consolidated financial statements for 20X9?

- A. \$168,000
- B. \$138,000
- C. \$164,000
- D. \$150,000

*Answer: C*

*Learning Objective: 03-04*

*Topic: The Effect of Noncontrolling Interest (NI and RE)*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

25. Blue Company owns 80 percent of the common stock of White Corporation. During the year, Blue reported sales of \$1,000,000, and White reported sales of \$500,000, including sales to Blue of \$80,000. The amount of sales that should be reported in the consolidated income statement for the year is:

- A. \$500,000.
- B. \$1,300,000.
- C. \$1,420,000.
- D. \$1,500,000.

*Answer: C*

*Learning Objective: 03-05*

*Topic: Prepare a Consolidated Worksheet*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

26. Silver Company owns 60 percent of the common stock of Gold Corporation. During the year, Silver reported sales of \$500,000, and Gold reported sales of \$200,000, including sales to Silver of \$50,000. The amount of sales that should be reported in the consolidated income statement for the year is

- A. \$500,000
- B. \$650,000
- C. \$700,000
- D. \$750,000

*Answer B*

*Learning Objective: 03-05*

*Topic: Prepare a Consolidated Worksheet*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

(Note: This is a Kaplan CPA Review Question)

27. For which of the following reporting units is the preparation of combined financial statements most appropriate?

- A. A corporation and a foreign subsidiary with nonintegrated homogeneous operations.
- B. A corporation and a majority-owned subsidiary with nonhomogeneous operations.
- C. Several corporations with related operations owned by one individual.
- D. Several corporations with related operations with some common individual owners.

*Answer: C*

*Learning Objective: 03-06*

*Topic: Combined Financial Statements*

*Blooms: Remember*

*AACSB: Reflective Thinking*

*AICPA: FN Reporting*

*Difficulty: 1 Easy*

28. Which of the following usually does not represent a variable interest?

- A. Common stock, with no special features or provisions
- B. Senior debt
- C. Subordinated debt
- D. Loan or asset guarantees

*Answer: B*

*Learning Objective: 03-07*

*Topic: Variable Interest Entities*

*Blooms: Understand*

*AACSB: Reflective Thinking*

*AICPA: FN Reporting*

*Difficulty: 2 Medium*

29. All of the following statements accurately describe Special Purpose Entities (SPEs) except for:

- A. SPEs are corporations, trust or partnerships created for a single specified purpose.
- B. SPEs usually have no substantive operations and are used for financing operations.
- C. SPEs are used for asset securitization, risk sharing and taking advantage of tax statutes.
- D. A variable interest entity (VIE) is a type of SPE with a limited number of equity investors.

*Answer: D*

*Learning Objective: 03-07*

*Topic: Off-Balance Sheet Financing*

*Blooms: Remember*

*AACSB: Reflective Thinking*

*AICPA: FN Decision Making*

*Difficulty: 1 Easy*

30. On December 31, 20X9, Rudd Company acquired 80 percent of the common stock of Wilton Company. At the time, Rudd held land with a book value of \$100,000 and a fair value of \$260,000; Wilton held land with a book value of \$50,000 and fair value of \$600,000. Using the parent company theory, at what amount would land be reported in a consolidated balance sheet prepared immediately after the combination?

- A. \$550,000
- B. \$590,000
- C. \$700,000
- D. \$860,000

*Answer: B*

*Learning Objective: Appendix 3B*

*Topic: Theories of Consolidation*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

31. Princeton Company acquired 75 percent of the common stock of Sheffield Corporation on December 31, 20X9. On the date of acquisition, Princeton held land with a book value of \$150,000 and a fair value of \$300,000; Sheffield held land with a book value of \$100,000 and fair value of \$500,000. Using the entity theory, at what amount would land be reported in a consolidated balance sheet prepared immediately after the combination?

- A. \$650,000
- B. \$500,000
- C. \$550,000
- D. \$375,000

*Answer: A*

*Learning Objective: Appendix 3B*

*Topic: Theories of Consolidation*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

32. Pepper Company acquired 60 percent of the common stock of Safton Corporation on December 31, 20X9. On the date of acquisition, Pepper held land with a book value of \$200,000 and a fair value of \$350,000; Safton held land with a book value of \$150,000 and fair value of \$300,000. At what amount would land be reported in a consolidated balance sheet prepared immediately after the combination?

- A. \$290,000
- B. \$500,000
- C. \$590,000
- D. \$650,000

*Answer: B*

*Learning Objective: Appendix 3B*

*Topic: Theories of Consolidation*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

33. Under ASC 805, consolidation follows largely which theory approach?

A. Proprietary

B. Parent company

C. Entity

D. Variable

*Answer: C*

*Learning Objective: Appendix 3B*

*Topic: Theories of Consolidation*

*Blooms: Remember*

*AACSB: Reflective Thinking*

*AICPA: FN Reporting*

*Difficulty: 1 Easy*

34. For a less-than-wholly-owned subsidiary, goodwill under the parent theory:

A. exceeds goodwill under the proprietary theory.

B. exceeds goodwill under the entity theory.

C. is less than goodwill under the entity theory.

D. is less than goodwill under the proprietary theory.

*Answer: C*

*Learning Objective: Appendix 3B*

*Topic: Theories of Consolidation*

*Blooms: Understand*

*AACSB: Reflective Thinking*

*AICPA: FN Reporting*

*Difficulty: 2 Medium*

**The following data applies to Questions 35 – 37:**

Small-Town Retail owns 70 percent of Supplier Corporation's common stock. For the current financial year, Small-Town and Supplier reported sales of \$450,000 and \$300,000 and expenses of \$290,000 and \$240,000, respectively.

35. Based on the preceding information, what is the amount of net income to be reported in the consolidated income statement for the year under the parent company theory approach?

- A. \$220,000
- B. \$202,000
- C. \$160,000
- D. \$200,000

*Answer: B*

*Learning Objective: Appendix 3B*

*Topic: Theories of Consolidation*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

36. Based on the preceding information, what is the amount of net income to be reported in the consolidated income statement for the year under the proprietary theory approach?

- A. \$210,000
- B. \$202,000
- C. \$160,000
- D. \$200,000

*Answer: B*

*Learning Objective: Appendix 3B*

*Topic: Theories of Consolidation*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

37. Based on the preceding information, what is the amount of net income to be reported in the consolidated income statement for the year under the entity theory approach?

- A. \$210,000
- B. \$202,000
- C. \$160,000
- D. \$220,000

*Answer: D*

*Learning Objective: Appendix 3B*

*Topic: Theories of Consolidation*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

38. Quid Corporation acquired 75 percent of Pro Company's common stock on December 31, 20X6. Goodwill (attributable to Quid's acquisition of Pro shares) of \$300,000 was reported in the consolidated financial statements at December 31, 20X6. Parent company approach was used in determining this amount. What is the amount of goodwill to be reported under proprietary theory approach?

- A. \$300,000
- B. \$400,000
- C. \$150,000
- D. \$100,000

*Answer: A*

*Learning Objective: Appendix 3B*

*Topic: Theories of Consolidation*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

39. Quid Corporation acquired 60 percent of Pro Company's common stock on December 31, 20X4. Goodwill (attributable to Quid's acquisition of Pro shares) of \$150,000 was calculated under the proprietary theory approach. What is the amount of goodwill that should be reported under entity theory approach?

- A. \$150,000
- B. \$200,000
- C. \$250,000
- D. \$100,000

*Answer: C*

*Learning Objective: Appendix 3B*

*Topic: Theories of Consolidation*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

**The following data applies to Questions 40 – 41:**

On January 1, 20X9, Heathcliff Corporation acquired 80 percent of Garfield Corporation's voting common stock. Garfield's buildings and equipment had a book value of \$300,000 and a fair value of \$350,000 at the time of acquisition.

40. Based on the preceding information, what will be the amount at which Garfield's buildings and equipment will be reported in consolidated statements using the parent company approach?

- A. \$350,000
- B. \$340,000
- C. \$280,000
- D. \$300,000

*Answer: B*

*Learning Objective: Appendix 3B*

*Topic: Theories of Consolidation*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

41. Based on the preceding information, what will be the amount at which Garfield's buildings and equipment will be reported in consolidated statements using the current accounting practice?

- A. \$350,000
- B. \$340,000
- C. \$280,000
- D. \$300,000

*Answer: A*

*Learning Objective: Appendix 3B*

*Topic: Theories of Consolidation*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

42. Cosby Corporation acquired 60 percent of Huxtable Corporation's voting common stock. Huxtable's buildings and equipment had a book value of \$200,000 and a fair value of \$250,000 at the time of the acquisition. What will be the amount at which Huxtable's buildings and equipment will be reported in consolidated statements on the acquisition date?

- A. \$150,000
- B. \$200,000
- C. \$230,000
- D. \$250,000

*Answer: D*

*Learning Objective: Appendix 3B*

*Topic: Theories of Consolidation*

*Blooms: Understand*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 2 Medium*

43. On January 1, 20X9, Gold Rush Company acquires 80 percent ownership in California Corporation for \$200,000. The fair value of the noncontrolling interest at that time is determined to be \$50,000. It reports net assets with a book value of \$200,000 and fair value of \$230,000. Gold Rush Company reports net assets with a book value of \$600,000 and a fair value of \$650,000 at that time, excluding its investment in California. What will be the amount of goodwill that would be reported immediately after the combination under current accounting practice?

- A. \$50,000
- B. \$30,000
- C. \$40,000
- D. \$20,000

*Answer: D*

*Learning Objective: Appendix 3B*

*Topic: Theories of Consolidation*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

44. On January 1, 20X5, Seaside Company acquires 90 percent ownership in Rainbow Corporation for \$180,000. The fair value of the noncontrolling interest at that time is determined to be \$20,000. Rainbow reports net assets with a book value of \$160,000 and fair value of \$175,000. Seaside Company reports net assets with a book value of \$480,000 and a fair value of \$525,000 at that time, excluding its investment in Rainbow. What will be the amount of goodwill that would be reported immediately after the combination?

- A. \$5,000
- B. \$20,000
- C. \$25,000
- D. \$40,000

*Answer: C*

*Learning Objective: Appendix 3B*

*Topic: Theories of Consolidation*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

**Essay Questions:**

45. Consolidated financial statements are required by GAAP in certain circumstances. This information can be very useful to stockholders and creditors. Yet, there are limitations to these financial statements for which the users must be aware. What are at least three (3) limitations of consolidated financial statements?

*Answer:*

Limitations to consolidated financial statements include:

- 1) The operating results and financial position of individual companies included in the consolidation are not disclosed. Therefore, the poor performance or position of one or more companies may be hidden by the good performance and position of others.
- 2) The consolidated statements include the subsidiary's assets, not all assets shown are available to dividend distributions of the parent company.
- 3) Financial ratios are based upon the aggregated consolidated information; therefore, these ratios may not be representative of any single company in the consolidation, including the parent.
- 4) Similar accounts of different companies that are consolidated may not be entirely comparable. For example, the length of operating cycles of different subsidiaries may vary, causing receivables of similar length to be classified differently.
- 5) Additional information about individual companies or groups of companies that have been consolidated may be necessary for fair presentation, resulting in voluminous footnote disclosures.

*Learning Objective: 03-01*

*Topic: The Usefulness and Limitations of Consolidated Financial Statements*

*Blooms: Remember*

*AACSB: Communication*

*AICPA: FN Reporting*

*Difficulty: 1 Easy*

46. In reading a set of consolidated financial statements you are surprised to see the term noncontrolling interest not reported under the Liability section of the Balance Sheet.

Required:

- a. What is a non-controlling interest?
- b. Why must it be reported in the financial statements as an element of equity rather than a liability?

*Answer:*

- a. Noncontrolling interest occurs when less than 100 percent equity is acquired in a subsidiary. It represents the fact that the parent may control but not own the entire subsidiary. The noncontrolling shareholders have a claim on the subsidiary's assets and earnings through their percentage ownership of the stock.
- b. Noncontrolling interest clearly does not meet the definition of a liability. ASC 810 makes clear that the noncontrolling interest's claim on net assets is an element of equity, not a liability. It requires reporting the noncontrolling interest in equity.

*Learning Objective: 03-03*

*Topic: Noncontrolling interest*

*Blooms: Understand*

*AACSB: Communication*

*AICPA: FN Reporting*

*Difficulty: 2 Medium*

47. Parent Company acquired 90% of Son Inc. on January 31, 20X2 in exchange for cash. The book value of Son's individual assets and liabilities approximated their acquisition-date fair values. On the date of acquisition, Son reported the following:

Cash	\$ 350,000	Current Liabilities	\$ 120,000
Inventory	100,000		
Plant Assets (net)	320,000	Common Stock	100,000
Property	<u>500,000</u>	Retained Earnings	<u>1,050,000</u>
Total Assets	<u>\$1,270,000</u>	Total Liabilities & Equity	<u>\$ 1,270,000</u>

During the year Son Inc. reported \$310,000 in net income and declared \$15,000 in dividends. Parent Company reported \$520,000 in net income and declared \$25,000 in dividends. Parent accounts for their investment using the equity method.

Required:

- 1) What journal entry will Parent make on the date of acquisition to record the investment in Son Inc.?
- 2) If Parent were to prepare a consolidated balance sheet on the acquisition date (January 31, 20X2), what is the basic consolidation entry Parent would use in the consolidation worksheet?
- 3) What is Parent's balance in "Investment in Son Inc." prior to consolidation on December 31, 20X2?
- 4) What is the basic consolidation entry Parent would use in the consolidation worksheet on December 31, 20X2?

Problem 47 (continued):

Answer:

1)

Investment in Son Inc.	1,035,000	
Cash		1,035,000

2)

**Basic consolidation entry:**

<b>Common Stock</b>	<b>100,000</b>	
<b>Retained Earnings</b>	<b>1,050,000</b>	
Investment in Son Inc.		1,035,000
NCI in NA of Son Inc.		115,000

3) \$1,300,500

(T-Account not required):

	<u>Investment in Son Inc.</u>		
Beginning Balance	1,035,000		
90% Net Income	279,000		
		13,500	90% Dividends
Ending Balance	1,300,500		

4)

**Basic consolidation entry:**

<b>Common Stock</b>	<b>100,000</b>	
<b>Retained Earnings</b>	<b>1,050,000</b>	
Income from Son Inc.	279,000	
NCI in N'I of Son Inc.	31,000	
Dividends declared		15,000
Investment in Son Inc.		1,300,500
NCI in NA of Son Inc.		144,500

*Learning Objective: 03-04; 03-05*

*Topic: Basic Consolidation Entry; Prepare a consolidation worksheet for a less-than-wholly-owned consolidation.*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

48. On January 1, 20X8, Gregory Corporation acquired 90 percent of Nova Company's voting stock, at underlying book value. The fair value of the noncontrolling interest was equal to 10 percent of the book value of Nova at that date. Gregory uses the equity method in accounting for its ownership of Nova. On December 31, 20X8, the trial balances of the two companies are as follows:

	Gregory Corp.		Nova Company	
	Debit	Credit	Debit	Credit
Current Assets	\$200,000		\$120,000	
Depreciable Assets	300,000		225,000	
Investment in Nova Company Stock	139,500			
Depreciation Expense	30,000		25,000	
Other Expenses	100,000		60,000	
Dividends Declared	30,000		10,000	
Accumulated Depreciation		\$120,000		\$75,000
Current Liabilities		62,000		25,000
Long-Term Debt		75,000		90,000
Common Stock		100,000		75,000
Retained Earnings		120,000		65,000
Sales		300,000		110,000
Income from Subsidiary		22,500		
	<u>\$799,500</u>	<u>\$799,500</u>	<u>\$440,000</u>	<u>\$440,000</u>

Required:

- 1) Provide all consolidating entries required as of December 31, 20X8, to prepare consolidated financial statements.
- 2) Prepare a three-part consolidation worksheet.

Problem 48 (continued):

Answer:

1)

**Book Value Calculations:**

	NCI 10%	+	Gregory Corp. 90%	=	Common Stock	+	Retained Earnings
Beginning Book Value	14,000		126,000		75,000		65,000
+ Net Income	2,500		22,500				25,000
- Dividends	(1,000)		(9,000)				(10,000)
Ending Book Value	15,500		139,500		75,000		80,000

**Basic consolidation entry:**

Common Stock	75,000
Retained Earnings	65,000
Income from Nova Co.	22,500
NCI in NI of Nova Co.	2,500
Dividends declared	10,000
Investment in Nova Co.	139,500
NCI in NA of Nova Co.	15,500

**Optional accumulated depreciation consolidation entry:**

Accumulated Depreciation	50,000
Buildings and Equipment	50,000

(T-Accounts not required)

	Investment in Nova Co.			Income from Nova Co.		
Beginning Balance	126,000					
90% Net Income	22,500			22,500	90% Net Income	
		9,000	90% Dividends			
Ending Balance	139,500			22,500	Ending Balance	
		139,500	Basic	22,500		
	0				0	

Problem 48 (continued):

2)

	Gregory Corp.	Nova Co.	Consolidation Entries		Consolidated
			DR	CR	
<b>Income Statement</b>					
Sales	300,000	110,000			410,000
Less: Other Expenses	(100,000)	(60,000)			(160,000)
Less: Depreciation Expense	(30,000)	(25,000)			(55,000)
Income from Nova Co.	22,500	0	22,500		0
Consolidated Net Income	192,500	25,000	22,500	0	195,000
NCI in Net Income			2,500		(2,500)
<b>Controlling Interest in Net Income</b>	<b>192,500</b>	<b>25,000</b>	<b>25,000</b>	<b>0</b>	<b>192,500</b>
<b>Statement of Retained Earnings</b>					
Beginning Balance	120,000	65,000	65,000		120,000
Net Income	192,500	25,000	25,000	0	192,500
Less: Dividends Declared	(30,000)	(10,000)		10,000	(30,000)
<b>Ending Balance</b>	<b>282,500</b>	<b>80,000</b>	<b>90,000</b>	<b>10,000</b>	<b>282,500</b>
<b>Balance Sheet</b>					
Current Assets	200,000	120,000			320,000
Depreciable Assets	300,000	225,000		50,000	475,000
Less: Accumulated Depreciation	(120,000)	(75,000)	50,000		(145,000)
Investment in Nova Co.	139,500			139,500	0
<b>Total Assets</b>	<b>519,500</b>	<b>270,000</b>	<b>50,000</b>	<b>189,500</b>	<b>650,000</b>
Current Liabilities	62,000	25,000			87,000
Long-Term Debt	75,000	90,000			165,000
Common Stock	100,000	75,000	75,000		100,000
Retained Earnings	282,500	80,000	90,000	10,000	282,500
NCI in NA of Nova Co.				15,500	15,500
<b>Total Liabilities &amp; Equity</b>	<b>519,500</b>	<b>270,000</b>	<b>165,000</b>	<b>10,000</b>	<b>650,000</b>

*Learning Objective: 03-05**Topic: Prepare a Consolidated Worksheet**Blooms: Apply**AACSB: Analytic**AICPA: FN Measurement**Difficulty: 3 Hard*

49. On January 1, 20X8, Gregory Corporation acquired 90 percent of Nova Company's voting stock, at underlying book value. The fair value of the noncontrolling interest was equal to 10 percent of the book value of Nova at that date. Gregory uses the equity method in accounting for its ownership of Nova. On December 31, 20X9, the trial balances of the two companies are as follows:

	<b>Gregory Corp.</b>		<b>Nova Company</b>	
	Debit	Credit	Debit	Credit
Current Assets	\$225,500		\$145,000	
Depreciable Assets	300,000		225,000	
Investment in Nova Company Stock	144,000			
Depreciation Expense	30,000		25,000	
Other Expenses	180,000		85,000	
Dividends Declared	40,000		10,000	
Accumulated Depreciation		\$150,000		\$100,000
Current Liabilities		45,000		20,000
Long-Term Debt		75,000		90,000
Common Stock		100,000		75,000
Retained Earnings		282,500		80,000
Sales		253,500		125,000
Income from Subsidiary		13,500		
	<u>\$919,500</u>	<u>\$919,500</u>	<u>\$490,000</u>	<u>\$490,000</u>

Required:

- 1) Give all consolidating entries required on December 31, 20X8, to prepare consolidated financial statements.
- 2) Prepare a three-part consolidation worksheet as of December 31, 20X8.

Problem 49 (continued):

Answer:

1)

**Book Value Calculations:**

	NCI 10%	+	Gregory Corp. 90%	=	Common Stock	+	Retained Earnings
<b>Beginning Book Value</b>	15,500		139,500		75,000		80,000
<b>+ Net Income</b>	1,500		13,500				15,000
<b>- Dividends</b>	(1,000)		(9,000)				(10,000)
<b>Ending Book Value</b>	16,000		144,000		75,000		85,000

**Basic consolidation entry:**

Common Stock	75,000
Retained Earnings	80,000
Income from Nova Co.	13,500
NCI in NI of Nova Co.	1,500
Dividends declared	10,000
Investment in Nova Co.	144,000
NCI in NA of Nova Co.	16,000

**Optional accumulated depreciation consolidation entry:**

Accumulated Depreciation	50,000
Buildings and Equipment	50,000

(T-Accounts not required)

	Investment in Nova Co.			Income from Nova Co.		
Beginning Balance	139,500					
90% Net Income	13,500			13,500	90% Net Income	
		9,000	90% Dividends			
Ending Balance	144,000			13,500	Ending Balance	
		144,000	Basic	13,500		
	0				0	

Problem 49 (continued):  
2)

	Gregory Corp.	Nova Co.	Consolidation Entries		Consolidated
			DR	CR	
<b>Income Statement</b>					
Sales	253,500	125,000			378,500
Less: Other Expenses	(180,000)	(85,000)			(265,000)
Less: Depreciation Expense	(30,000)	(25,000)			(55,000)
Income from Nova Co.	13,500	0	13,500		0
Consolidated Net Income	57,000	15,000	13,500	0	58,500
NCI in Net Income			1,500		(1,500)
<b>Controlling Interest in Net Income</b>	<b>57,000</b>	<b>15,000</b>	<b>15,000</b>	<b>0</b>	<b>57,000</b>
<b>Statement of Retained Earnings</b>					
Beginning Balance	282,500	80,000	80,000		282,500
Net Income	57,000	15,000	15,000	0	57,000
Less: Dividends Declared	(40,000)	(10,000)		10,000	(40,000)
<b>Ending Balance</b>	<b>299,500</b>	<b>85,000</b>	<b>95,000</b>	<b>10,000</b>	<b>299,500</b>
<b>Balance Sheet</b>					
Current Assets	225,500	145,000			370,500
Depreciable Assets	300,000	225,000		50,000	475,000
Less: Accumulated Depreciation	(150,000)	(100,000)	50,000		(200,000)
Investment in Nova Co.	144,000	0		144,000	0
<b>Total Assets</b>	<b>519,500</b>	<b>270,000</b>	<b>50,000</b>	<b>194,000</b>	<b>645,500</b>
Current Liabilities	45,000	20,000			65,000
Long-Term Debt	75,000	90,000			165,000
Common Stock	100,000	75,000	75,000		100,000
Retained Earnings	299,500	85,000	95,000	10,000	299,500
NCI in NA of Nova Co.				16,000	16,000
<b>Total Liabilities &amp; Equity</b>	<b>519,500</b>	<b>270,000</b>	<b>170,000</b>	<b>10,000</b>	<b>645,500</b>

*Learning Objective: 03-05*

*Topic: Second and Subsequent Year Worksheet*

*Blooms: Apply*

*AACSB: Analytic*

*AICPA: FN Measurement*

*Difficulty: 3 Hard*

50. ASC 805 is related to the Consolidation of Variable Interest Entities. Describe what a Variable Interest Entity is and discuss why the FASB has difficulty in prescribing when these entities are consolidated?

*Answer:*

A Variable Interest Entity (VIE) is a legal structure used for business purposes that either:

1. Does not have equity investors that:
  - a. have voting rights or
  - b. doesn't share in all of the entity's profits or losses.
2. Has equity investors that do not provide sufficient financial resources to support the entity's activities.

Therefore, FASB has been trying to define the Primary Beneficiary and from this lead to consolidation not just control as presumed under ASC 805.

*Learning Objective: 03-07*

*Topic: Variable Interest Entities*

*Blooms: Understand*

*AACSB: Communication*

*AICPA: FN Reporting*

*Difficulty: 2 Medium*