Question 1

L2R18TB-AC043-1512

LOS: LOS-6940

Lesson Reference: Lesson 3: Investments in Business Combinations

Difficulty: medium

Company A complies with IFRS and requires its cash generating units (CGU) to test goodwill for impairment annually. The carrying value of its largest CGU exceeds the recoverable value by £200,000. The fair value of the unit's net identifiable assets is estimated to equal the unit's carrying value. Included in the carrying value is £100,000 of goodwill. The *most likely* result of the unit's goodwill impairment test is:

- An impairment loss of £100,000 is reported on the income statement and the goodwill balance is reduced to zero.
- No impairment loss is recognized because the carrying value of the unit equals the estimated fair value of the unit's net assets.
- (selected) An impairment loss of £200,000 is recognized in profit and loss, the goodwill balance drops to zero, and £100,000 is allocated to other non-cash assets in the unit.

Rationale

An impairment loss of £100,000 is reported on the income statement and the goodwill balance is reduced to zero.

IFRS calculates an impairment loss as: recoverable amount of the CGU less the carrying value of the CGU. The impairment loss to be reported on the income statement is £200,000 (the carrying value exceeds the recoverable value by £200,000). Under IFRS, the impairment loss is first absorbed by the goodwill allocated to that CGU; therefore the CGU's balance is reduced to zero and the excess of £100,000 is allocated to other non-cash assets in the CGU. Choice A would be correct under U.S. GAAP, where the maximum impairment loss is the carrying value of goodwill.

Rationale

No impairment loss is recognized because the carrying value of the unit equals the estimated fair value of the unit's net assets.

IFRS calculates an impairment loss as: recoverable amount of the CGU less the carrying value of the CGU. The impairment loss to be reported on the income statement is £200,000 (the carrying value exceeds the recoverable value by £200,000). Under IFRS, the impairment loss is first absorbed by the goodwill allocated to that CGU; therefore the CGU's balance is reduced to zero and the excess of £100,000 is allocated to other non-cash assets in the CGU. Choice A would be correct under U.S. GAAP, where the maximum impairment loss is the carrying value of goodwill.

Rationale

An impairment loss of £200,000 is recognized in profit and loss, the goodwill balance drops to zero, and £100,000 is allocated to other non-cash assets in the unit.

IFRS calculates an impairment loss as: recoverable amount of the CGU less the carrying value of the CGU. The impairment loss to be reported on the income statement is £200,000 (the carrying value exceeds the recoverable value by £200,000). Under IFRS, the impairment loss is first absorbed by the goodwill allocated to that CGU; therefore the CGU's balance is reduced to zero and the excess of £100,000 is allocated to other non-cash assets in the CGU. Choice A would be correct under U.S. GAAP, where the maximum impairment loss is the carrying value of goodwill.

Question 2

L2FR-TB0009-1412

LOS: LOS-6930

Lesson Reference: Lesson 1: Investments in Financial Assets

Difficulty: medium

Christy Inc. is a company that has invested $415,000 in the debt securities of Borrow Co. and is considering whether to classify the financial asset as held-to-maturity, held-for-trading, or available-for-sale. The securities have a par value of $550,000 and pay a coupon of 1% paid annually. The market rate of interest when the bond was purchased was 7%. The interest income from this holding will be:

- ○ Higher if classified as held-to-maturity than if classified as available-for-sale.
- ● The same if classified as held-to-maturity as if classified as available-for-sale.
- ○ Lower if classified as held-to-maturity than if classified as available-for-sale.

Rationale

This Answer is Correct

Under both classifications the interest income of this bond will be shown on the income statement.

Question 3

L2R18TB-AC045-1512

LOS: LOS-6930

Lesson Reference: Lesson 4: Investments in SPEs/VIEs

Difficulty: medium

Zen Builders & Co. (ZBC) forms a special purpose entity (SPE) and contributes $5 million in cash. ZBC plans to provide all the services to build and maintain a new shopping complex in a developing suburban area that will be owned by the SPE. Three other capital providers contribute $85 million and between them will have 90 percent voting interest in the SPE which has been set up as a limited liability company. ZBC will absorb some of the profits and the majority of the losses. ZBC's special purpose entity is *most likely* to be:

- ○ held off the balance sheet because ZBC does not have majority voting control.
- ○ consolidated because ZBC provides the majority of the services to the SPE.
- ● consolidated because ZBC is considered the primary beneficiary.

Rationale

✗ **held off the balance sheet because ZBC does not have majority voting control.**

ZBC is required to consolidate the SPE regardless of its voting interest. It is considered the primary beneficiary because it absorbs the majority of losses. The primary beneficiary must consolidate. The primary beneficiary may also receive the majority or some of the gains, but if these two entities differ, it is the one that absorbs the losses that must consolidate.

Rationale

✗ **consolidated because ZBC provides the majority of the services to the SPE.**

ZBC is required to consolidate the SPE regardless of its voting interest. It is considered the primary beneficiary because it absorbs the majority of losses. The primary beneficiary must consolidate. The primary beneficiary may also receive the majority or some of the gains, but if these two entities differ, it is the one that absorbs the losses that must consolidate.

Rationale

✓ **consolidated because ZBC is considered the primary beneficiary.**

ZBC is required to consolidate the SPE regardless of its voting interest. It is considered the primary beneficiary because it absorbs the majority of losses. The primary beneficiary must consolidate. The primary beneficiary may also receive the majority or some of the gains, but if these two entities differ, it is the one that absorbs the losses that must consolidate.

Question 4
L2R18TB-ITEMSET-AC019-1512
LOS: LOS-6940
Lesson Reference: Lesson 3: Investments in Business Combinations
Difficulty: medium

Use the following information to answer the next three questions:

On the first of the year 20X3, Parent Corp. issues 500,000 shares of its $1 par common stock to purchase 80 percent of the outstanding shares of Subsidiary Inc. Parent's stock current trades at $40 per share. Parent complies with IFRS and will account for minority interest using the partial goodwill method. The following table presents financial information ($000s) for both companies before the parent reported the acquisition.

	Parent Book Value	**Subsidiary Book Value**	**Subsidiary Fair Value**
Current assets	$50,000.0	$5,000.0	$5,000.0
Inventory	60,000.0	6,000.0	8,000.0
Property, plant, and equipment	110,000.0	13,000.0	19,000.0
	$220,000.0	$24,000.0	$32,000.0
Current payables	40,000.0	4,000.0	4,000.0
Long-term liabilities	80,000.0	8,000.0	8,000.0
	120,000.0	12,000.0	12,000.0
Net assets	$100,000.0	$12,000.0	$20,000.0
Shareholders' equity:			
Capital stock ($1 par)	$20,000	$2,000	
Additional paid in capital	24,000	3,000	
Retained earnings	56,000	7,000	

Use the data in the preceding table to answer the following questions related Parent's acquisition of Subsidiary.

i.
The value of inventory reported on the consolidated balance sheet immediately after the acquisition under IFRS and U.S. GAAP is *closest to*:

- $66.4 million.
- $66.0 million.
- $68.0 million.

Rationale
This Answer is Correct
Parent (the acquirer) must include 100 percent of the fair value of the assets and liabilities of Subsidiary, even though less than 100 percent of the entity is acquired. The combined value of inventory is $68 million ($60 million + 8 million). Choice A incorrectly includes only 80 percent of the fair value of Subsidiary's inventory. Choice B incorrectly adds the book (not market) value of Subsidiary's inventory.

Rationale
This Answer is Correct
Parent (the acquirer) must include 100 percent of the fair value of the assets and liabilities of Subsidiary, even though less than 100 percent of the entity is acquired. The combined value of inventory is $68 million

($60 million + 8 million). Choice A incorrectly includes only 80 percent of the fair value of Subsidiary's inventory. Choice B incorrectly adds the book (not market) value of Subsidiary's inventory.

Rationale

This Answer is Correct

Parent (the acquirer) must include 100 percent of the fair value of the assets and liabilities of Subsidiary, even though less than 100 percent of the entity is acquired. The combined value of inventory is $68 million ($60 million + 8 million). Choice A incorrectly includes only 80 percent of the fair value of Subsidiary's inventory. Choice B incorrectly adds the book (not market) value of Subsidiary's inventory.

ii.

In comparison to U.S. GAAP, Parent's consolidated financial statements will *most likely* show:

- higher goodwill by $4 million.
- higher net income by $1 million.
- lower total stockholder's equity by $1 million.

Rationale

This Answer is Incorrect

U.S. GAAP only allows the full goodwill method and the question states that Parent will account for this transaction using the partial goodwill method under IFRS. Partial goodwill is the purchase price less the share (80 percent) of the fair value of Subsidiary's net assets purchased. The purchase price for 80 percent of Subsidiary is $20 million (500,000 shares at $40 per share). The fair value of 100 percent of Subsidiary's net assets is $20 million. Based on the fact that Parent paid $20 million for 80 percent, we can calculate that Parent would have paid $25 million ($20 million /0.80) to acquire 100 percent of Subsidiary. Full goodwill is the fair value of 100 percent of Subsidiary ($25 million) less 100 of the fair value of Subsidiary's net assets ($20 million).

Minority interest is the percent not controlled by Parent (20 percent) multiplied by either: (1) the fair value of Subsidiary's net identifiable assets ($20 million) under the partial goodwill method or (2) Subsidiary's fair value ($25 million) under full goodwill The following table presents the data (in $000s) for both.

	Partial Goodwill (IFRS only)	**Full Goodwill (IFRS and U.S. GAAP)**
Fair value of consideration	$20,000	
Fair value of net assets (80 percent × $20,000)	16,000	
Goodwill recognized	$4,000	
Fair value of entity (100 percent)		$25,000
Fair value of net assets (100 percent × $20,000)		20,000
Goodwill recognized		$5,000
Minority interest		
Fair value of entity (20 percent × $25,000)		$5,000
Fair value of net assets (20 percent × $20,000)	$4,000	

Under the partial goodwill method, the minority interest is lower by $1 million ($5 million – $4 million) than it is under full goodwill. This results in a lower total equity because minority interest is accounted for as a part of equity on the consolidated financial statements.

Choice B is incorrect because net income is not affected. Choice A is incorrect because goodwill is $1 million higher under U.S. GAAP.

Rationale

This Answer is Incorrect

U.S. GAAP only allows the full goodwill method and the question states that Parent will account for this transaction using the partial goodwill method under IFRS. Partial goodwill is the purchase price less the share (80 percent) of the fair value of Subsidiary's net assets purchased. The purchase price for 80 percent of Subsidiary is $20 million (500,000 shares at $40 per share). The fair value of 100 percent of Subsidiary's net assets is $20 million. Based on the fact that it Parent paid $20 million for 80 percent, we can calculate that Parent would have paid $25 million ($20 million /0.80) to acquire 100 percent of Subsidiary. Full goodwill is the fair value of 100 percent of Subsidiary ($25 million) less 100 of the fair value of Subsidiary's net assets ($20 million).

Minority interest is the percent not controlled by Parent (20 percent) multiplied by either: (1) the fair value of Subsidiary's net identifiable assets ($20 million) under the partial goodwill method or (2) Subsidiary's fair value ($25 million) under full goodwill The following table presents the data (in $000s) for both.

	Partial Goodwill (IFRS only)	**Full Goodwill (IFRS and U.S. GAAP)**
Fair value of consideration	$20,000	
Fair value of net assets (80 percent × $20,000)	16,000	
Goodwill recognized	$4,000	
Fair value of entity (100 percent)		$25,000
Fair value of net assets (100 percent × $20,000)		20,000
Goodwill recognized		$5,000
Minority interest		
Fair value of entity (20 percent × $25,000)		$5,000
Fair value of net assets (20 percent × $20,000)	$4,000	

Under the partial goodwill method, the minority interest is lower by $1 million ($5 million – $4 million) than it is under full goodwill. This results in a lower total equity because minority interest is accounted for as a part of equity on the consolidated financial statements.

Choice B is incorrect because net income is not affected. Choice A is incorrect because goodwill is $1 million higher under U.S. GAAP.

Rationale

This Answer is Incorrect

U.S. GAAP only allows the full goodwill method and the question states that Parent will account for this transaction using the partial goodwill method under IFRS. Partial goodwill is the purchase price less the share (80 percent) of the fair value of Subsidiary's net assets purchased. The purchase price for 80 percent of Subsidiary is $20 million (500,000 shares at $40 per share). The fair value of 100 percent of Subsidiary's net assets is $20 million. Based on the fact that it Parent paid $20 million for 80 percent, we can calculate that Parent would have paid $25 million ($20 million /0.80) to acquire 100 percent of Subsidiary. Full goodwill is the fair value of 100 percent of Subsidiary ($25 million) less 100 of the fair value of Subsidiary's net assets ($20 million).

Minority interest is the percent not controlled by Parent (20 percent) multiplied by either: (1) the fair value of Subsidiary's net identifiable assets ($20 million) under the partial goodwill method or (2) Subsidiary's fair value ($25 million) under full goodwill The following table presents the data (in $000s) for both.

	Partial Goodwill (IFRS only)	**Full Goodwill (IFRS and U.S. GAAP)**
Fair value of consideration	$20,000	
Fair value of net assets (80 percent × $20,000)	16,000	
Goodwill recognized	$4,000	
Fair value of entity (100 percent)		$25,000
Fair value of net assets (100 percent × $20,000)		20,000
Goodwill recognized		$5,000
Minority interest		
Fair value of entity (20 percent × $25,000)		$5,000
Fair value of net assets (20 percent × $20,000)	$4,000	

Under the partial goodwill method, the minority interest is lower by $1 million ($5 million – $4 million) than it is under full goodwill. This results in a lower total equity because minority interest is accounted for as a part of equity on the consolidated financial statements.

Choice B is incorrect because net income is not affected. Choice A is incorrect because goodwill is $1 million higher under U.S. GAAP.

iii.

Brewing, GmbH acquires an 80 percent interest in Tasty Inc. The fair value of Tasty is 20 percent greater than the book value of its net identifiable assets (i.e., fair value of net assets = 1.2 × book value of net assets). Brewing complies with IFRS and accounts for the investment in Tasty using the acquisition method and partial goodwill.

In contrast to U.S. GAAP reporting, the post-combination financial statements prepared by Brewing will *most likely* indicate:

- (selected) higher return on equity.
- lower return on assets.
- higher total equity.

Rationale

This Answer is Incorrect

Partial goodwill results in lower goodwill. Therefore, total equity is lower and this results in a higher return on equity. Full goodwill results in higher goodwill, which causes total assets to be higher and results in lower relative return ratios. There is no effect on net income.

Rationale

This Answer is Incorrect

Partial goodwill results in lower goodwill. Therefore, total equity is lower and this results in a higher return on equity. Full goodwill results in higher goodwill, which causes total assets to be higher and results in lower relative return ratios. There is no effect on net income.

Rationale

This Answer is Incorrect

Partial goodwill results in lower goodwill. Therefore, total equity is lower and this results in a higher return on equity. Full goodwill results in higher goodwill, which causes total assets to be higher and results in lower relative return ratios. There is no effect on net income.

Question 5
L2FR-TBX103-1502
LOS: LOS-6950
Lesson Reference: Lesson 4: Investments in SPEs/VIEs
Difficulty: easy
When accounting for intercorporate investments using the equity method, relative to using the acquisition method, total assets are *most likely* to be:

- (selected) Lower.
- Higher.
- The same.

Rationale

This Answer is Correct

Total assets will be higher under the acquisition method since 100% of the assets of the subsidiary will be consolidated onto the group accounts. Under the equity method, the investment is initially shown at historical cost.

Question 6

L2R18TB-AC036-1512

LOS: LOS-6930

Lesson Reference: Lesson 3: Investments in Business Combinations

Difficulty: medium

Big Co. merges with Medium Co. in an all-stock transaction valued at $10 million, which is twice the net asset value (using book values) of Medium Co. The estimated fair values of Medium Co.'s net assets are equal to their book value except for a building that is understated by $1 million and has a remaining useful life of 10 years. Big Co. complies with U.S. GAAP. The amount of goodwill Big Co. will report in its merger with Medium Co. is *closest* to:

- ○ $5.0 million.
- ○ $4.9 million.
- ● $4.0 million.

Rationale

✗ $5.0 million.

The $10 million purchase price is twice Medium Co.'s net asset value using book values; therefore, Medium Co.'s net assets are $5 million and the result is an excess purchase price of $5 million. Medium Co.'s building has a fair value that exceeds its book value by $1 million. Excess purchase price is first attributed to the building (PP&E), which results in $1 million of the excess purchase cost being allocated to PP&E. The remaining $4 million ($5 million – 1 million) of excess purchase price is accounted for as goodwill.

Rationale

✗ $4.9 million.

The $10 million purchase price is twice Medium Co.'s net asset value using book values; therefore, Medium Co.'s net assets are $5 million and the result is an excess purchase price of $5 million. Medium Co.'s building has a fair value that exceeds its book value by $1 million. Excess purchase price is first attributed to the building (PP&E), which results in $1 million of the excess purchase cost being allocated to PP&E. The remaining $4 million ($5 million – 1 million) of excess purchase price is accounted for as goodwill.

Rationale

✓ $4.0 million.

The $10 million purchase price is twice Medium Co.'s net asset value using book values; therefore, Medium Co.'s net assets are $5 million and the result is an excess purchase price of $5 million. Medium Co.'s building has a fair value that exceeds its book value by $1 million. Excess purchase price is first attributed to the building (PP&E), which results in $1 million of the excess purchase cost being allocated to PP&E. The remaining $4 million ($5 million – 1 million) of excess purchase price is accounted for as goodwill.

Question 7
L2R18TB-AC032-1512
LOS: LOS-6940
Lesson Reference: Lesson 2: Investments in Associates and Joint Ventures
Difficulty: medium

Lynx Corp. acquires a 25 percent interest in Tyger Companies for $200,000 on January 1, 20X3. In 20X3 Tyger reports net income of $80,000 and pays dividends of $20,000. Select January 1, 20X3 financial information for Tyger is presented in the following table:

	Tyger Book Value ($000)	Tyger Fair Value ($000)
Current assets	100.0	100.0
Property, plant, and equipment*	500.0	600.0
Land	200.0	200.0
	800.0	900.0
Liabilities	400.0	400.0
Net assets	400.0	500.0

*PP&E are depreciated on a straight-line basis and have a 10-year remaining useful life.

If Lynx complies with IFRS and accounts for the investment in Tyger using the equity method, then the carrying value of the investment in Tyger that Lynx will report on its balance sheet at the end of 20X3 is *closest* to:

- $205,000
- $212,500
- $217,500

Rationale

$205,000

To calculate the carrying value, any excess purchase price attributable to identifiable assets must be determined. The excess purchase price is $100,000, calculated as the cost of the investment less the book value of the shares purchased [$200,000 – (25 percent × $400,000)]. PP&E are the only assets with fair value in excess of book value by $100,000. Lynx will allocate $25,000 of the excess purchase price to PP&E, which is 25 percent × ($600,000 – 500,000). The remaining $75,000 of excess purchase price is deemed to be goodwill.

Carrying value can then be calculated as:

Purchase price	$200,000
Plus: Lynx's share of net income: 25 percent × $80,000	20,000
Less: Dividends received: 25 percent × $20,000	(5,000)
Less: Depreciation of excess purchase price attributable to PP&E: $25,000/10	(2,500)
Carrying value of Lynx's investment in Tyger at the end of 20X3	$212,500

Rationale

$212,500

To calculate the carrying value, any excess purchase price attributable to identifiable assets must be determined. The excess purchase price is $100,000, calculated as the cost of the investment less the book value of the shares purchased [$200,000 – (25 percent × $400,000)]. PP&E are the only assets with fair value in excess of book value by $100,000. Lynx will allocate $25,000 of the excess purchase price to PP&E, which is 25 percent × ($600,000 – 500,000). The remaining $75,000 of excess purchase price is deemed to be goodwill.

Carrying value can then be calculated as:

Purchase price	$200,000
Plus: Lynx's share of net income: 25 percent × $80,000	20,000
Less: Dividends received: 25 percent × $20,000	(5,000)
Less: Depreciation of excess purchase price attributable to PP&E: $25,000/10	(2,500)
Carrying value of Lynx's investment in Tyger at the end of 20X3	$212,500

Rationale

$217,500

To calculate the carrying value, any excess purchase price attributable to identifiable assets must be determined. The excess purchase price is $100,000, calculated as the cost of the investment less the book value of the shares purchased [$200,000 – (25 percent × $400,000)]. PP&E are the only assets with fair value in excess of book value by $100,000. Lynx will allocate $25,000 of the excess purchase price to PP&E, which is 25 percent × ($600,000 – 500,000). The remaining $75,000 of excess purchase price is deemed to be goodwill.

Carrying value can then be calculated as:

Purchase price	$200,000
Plus: Lynx's share of net income: 25 percent × $80,000	20,000
Less: Dividends received: 25 percent × $20,000	(5,000)
Less: Depreciation of excess purchase price attributable to PP&E: $25,000/10	(2,500)
Carrying value of Lynx's investment in Tyger at the end of 20X3	$212,500

Question 8

L2FR-TB0012-1412

LOS: LOS-6940

Lesson Reference: Lesson 1: Investments in Financial Assets

Difficulty: medium

Which of the following statements regarding the equity method is most accurate?

- (selected) Both IFRS and U.S. GAAP prohibit the reversal of impairment losses if the fair value subsequently increases.
- IFRS prohibits the reversal of impairment losses if the fair value subsequently increases, but under U.S. GAAP such reversals are allowed.
- U.S. GAAP prohibits the reversal of impairment losses if the fair value subsequently increases, but under IFRS such reversals are allowed.

Rationale

This Answer is Correct

IFRS and U.S. GAAP are unanimous in that, under the equity method, the reversal of impairment losses if the fair value subsequently increases is not allowed.

Question 9
L2FR-ITEMSET-TB0033-1412
LOS: LOS-6950
Lesson Reference: Lesson 3: Investments in Business Combinations
Difficulty: medium

The next three questions relate to the following information:

	A plc	B plc	
	Book Value (£)	**Book Value (£)**	**Fair Value (£)**
Cash	40,000	20,000	20,000
Inventory	150,000	75,000	75,000
PPE	410,000	105,000	165,000
Total assets	600,000	200,000	260,000
Total liabilities	200,000	100,000	100,000
Net assets	400,000	100,000	160,000

A plc acquires 90% of the outstanding shares of B plc in exchange for shares of A plc's common stock with a fair value of £190,000.

i.
The value of PPE on the consolidated balance sheet under both IFRS and U.S. GAAP after the acquisition will be:
- ○ £515,000.
- ○ £558,500.
- ● £575,000.

Rationale
This Answer is Correct
A plc would consolidated 100% of the fair value of the assets of B plc; hence, PPE on the consolidated balance sheet would be £410,000 + £165,000 = £575,000.

ii.
The value of goodwill under the full goodwill method will be closest to:
- ○ £30,000.
- ○ £46,000.
- ● £51,111.

Rationale
This Answer is Correct

Full goodwill = Fair value of subsidiary – Fair value of net assets of subsidiary.

In this case, this equals (£190,000 / 0.9) – £160,000 = £51,111.

iii.
The value of noncontrolling interest under the full goodwill method will be closest to:
- ○ £16,000.
- ● £21,111.

○ £51,111.

Rationale

This Answer is Correct

Noncontrolling interest under full goodwill = Minority share Fair value of subsidiary.

In this case, this equals 0.1(£190,000/0.9) = £21,111.

Question 10
L2FR-ITEMSET-PQ1718-1411
LOS: LOS-6930
LOS: LOS-6940
LOS: LOS-6950
Lesson Reference: Lesson 2: Investments in Associates and Joint Ventures
Difficulty: medium

Use the following information to answer the next 3 questions:

On January 1, 2011, Sentura Ltd. acquired a 30% equity interest in Altin Corporation for $2.2 million. The following information regarding Altin's assets and liabilities on the date of acquisition is provided:

	Book Value ($)	**Fair Value ($)**
Current assets	850,000	850,000
Plant and equipment	3,850,000	4,250,000
Land	2,295,000	2,935,00
Total assets	6,995,000	8,035,000
Liabilities	1,380,000	1,380,000
Net assets	5,615,000	6,655,000

The following information is also available:

- Sentura uses the equity method to account for its investment in Altin.
- Plant and equipment are depreciated on a straight-line basis to zero over a term of 20 years.
- Altin reports net income of $800,000 for 2011 and pays dividend of $350,000.
- During 2011, Sentura made downstream sales of $300,000 worth of goods to Altin for $400,000, out of which Altin sold goods worth $340,000 to outside parties.
- $8,000 of profit from an upstream sale from Altin to Sentura during 2011 was still in Sentura's inventory at the end of 2011 as the goods had not been sold to an outside party yet.

i.
The amount of goodwill included in the purchase price is *closest to*:

- $515,500
- $203,500
- $395,500

Rationale
This Answer is Correct

Purchase price	$2,200,000
Proportionate share in book value of Altin's net assets (=30% × 5,615,000)	1,684,500
Excess purchase price	515,500
Less: Attributable to plant and equipment [= 30% × (4,250,000 – 3,850,000)	(120,000)

Less: Attributable to land = [30% × (2,935,000 – 2,295,000)	(192,000)
Goodwill (residual)	**$203,500**

ii.

The amount of equity income to be reported on Sentura's income statement for 2011 is *closest to*:

- ○ $258,600
- ○ $234,000
- ● $227,100

Rationale

This Answer is Correct

Downstream sale:

Sentura's profit on sales to Altin = $400,000 – $300,000 = $100,000

Percentage of goods remaining unsold = ($400,000 – $340,000 / $400,000) = 15%

Therefore, total unrealized profit = 15% × $100,000 = $15,000

Sentura's proportionate share of unrealized profit = 30% × $15,000 = $4,500

Upstream sale:

Unrealized profit = $8,000

Sentura's proportionate share in the unrealized profit = 30% × 8,000 = $2,400

Proportionate share in Altin's 2011 earnings (= 30% × 800,000)	$240,000
Less: Amortization of excess purchase price attributable to PP&E (= 120,000 / 20)	(6,000)
Less: Proportionate share of unrealized profit on downstream sale	(4,500)
Less: Proportionate share of unrealized profit on upstream sale	(2,400)
Equity income	**$227,100**

iii.

The value of its investment in Altin recognized by Sentura on the balance sheet for 2011 is *closest* to:

- ○ $2,329,000
- ○ $2,335,200
- ● $2,322,100

Rationale

This Answer is Correct

Purchase price	$2,200,000
Add: Proportionate share in net income (= 30% × 800,000)	240,000
Less: Dividends received (= 30% × 350,000)	(105,000)
Less: Amortization of excess purchase price attributable to PP&E (= 120,000 / 20)	(6,000)
Less: Proportionate share of unrealized profit on downstream sale	(4,500)
Less: Proportionate share of unrealized profit on upstream sale	(2,400)
Investment balance at December 31, 2011	**$2,322,100**

Question 11
L2R18TB-ITEMSET-AC014-1512
LOS: LOS-6950
LOS: LOS-6940
Lesson Reference: Lesson 3: Investments in Business Combinations
Difficulty: medium

Use the following information to answer the next two questions:

Sterling, GmbH acquires a 60 percent interest in Baker Tooling for €150,000. Baker's net identifiable assets have a fair value of €225,000 and the fair value of the entire company is €250,000. Sterling reports in accordance with IFRS and accounts for its investment in Baker using partial goodwill under the acquisition method.

i.
If goodwill is measured using the partial goodwill method, the amount of goodwill recognized is *closest to*:

- €15,000
- €25,000
- €45,000

Rationale
This Answer is Correct
IFRS allows two options to measure goodwill under the acquisition method: partial and full goodwill. Partial goodwill is the fair value of the consideration (the actual purchase price) less the fair value of the share of the net assets purchased. Full goodwill measures the fair value of the entire entity against the fair value of 100 percent of the net assets. See the comparison calculations that follow:

Goodwill Method	**Partial (IFRS only)**	**Full (IFRS and U.S. GAAP)**
Fair value of consideration	€150,000	
Fair value of net assets		
(60 percent × €225,000)	135,000	
Goodwill recognized	€15,000	
Fair value of entity (100 percent)		€250,000
Fair value of net assets		
(100 percent)		225,000
Goodwill recognized		€25,000

Rationale
This Answer is Correct
IFRS allows two options to measure goodwill under the acquisition method: partial and full goodwill. Partial goodwill is the fair value of the consideration (the actual purchase price) less the fair value of the share of the net assets purchased. Full goodwill measures the fair value of the entire entity against the fair value of 100 percent of the net assets. See the comparison calculations that follow:

Goodwill Method	**Partial (IFRS only)**	**Full (IFRS and U.S. GAAP)**
Fair value of consideration	€150,000	
Fair value of net assets		
(60 percent × €225,000)	135,000	
Goodwill recognized	€15,000	
Fair value of entity (100 percent)		€250,000

Goodwill Method	Partial (IFRS only)	Full (IFRS and U.S. GAAP)
Fair value of net assets		
(100 percent)		225,000
Goodwill recognized		€25,000

Rationale

This Answer is Incorrect

IFRS allows two options to measure goodwill under the acquisition method: partial and full goodwill. Partial goodwill is the fair value of the consideration (the actual purchase price) less the fair value of the share of the net assets purchased. Full goodwill measures the fair value of the entire entity against the fair value of 100 percent of the net assets. See the comparison calculations that follow:

Goodwill Method	Partial (IFRS only)	Full (IFRS and U.S. GAAP)
Fair value of consideration	€150,000	
Fair value of net assets		
(60 percent × €225,000)	135,000	
Goodwill recognized	€15,000	
Fair value of entity (100 percent)		€250,000
Fair value of net assets		
(100 percent)		225,000
Goodwill recognized		€25,000

ii.

If Sterling had reported under U.S. GAAP instead of how it reported the acquisition under IFRS, then its financial statements would *most likely* show which of the following results?

- ○ No change in equity ratios.
- ○ A higher debt-to-equity ratio.
- ● A lower total asset turnover ratio.

Rationale

This Answer is Incorrect

U.S. GAAP only allows the full goodwill method. This method produces a higher goodwill value, which increases total assets and total shareholders' equity in comparison to the partial goodwill method. The total asset turnover ratio, which is sales divided by average total assets, will be lower in comparison to the partial goodwill method because the denominator in the ratio is greater.

Choice A is incorrect because shareholders' equity is increased, which affects equity ratios. Choice B is incorrect because the debt-to-equity ratio will be lower, not higher, under the full goodwill method as there is higher equity under the full goodwill method.

Rationale

This Answer is Incorrect

U.S. GAAP only allows the full goodwill method. This method produces a higher goodwill value, which increases total assets and total shareholders' equity in comparison to the partial goodwill method. The total asset turnover ratio, which is sales divided by average total assets, will be lower in comparison to the partial goodwill method because the denominator in the ratio is greater.

Choice A is incorrect because shareholders' equity is increased, which affects equity ratios. Choice B is incorrect because the debt-to-equity ratio will be lower, not higher, under the full goodwill method as there is higher equity under the full goodwill method.

Rationale

This Answer is Incorrect

U.S. GAAP only allows the full goodwill method. This method produces a higher goodwill value, which increases total assets and total shareholders' equity in comparison to the partial goodwill method. The total asset turnover ratio, which is sales divided by average total assets, will be lower in comparison to the partial goodwill method because the denominator in the ratio is greater.

Choice A is incorrect because shareholders' equity is increased, which affects equity ratios. Choice B is incorrect because the debt-to-equity ratio will be lower, not higher, under the full goodwill method as there is higher equity under the full goodwill method.

Question 12
L2R18TB-AC042-1512
LOS: LOS-6930
Lesson Reference: Lesson 1: Investments in Financial Assets
Difficulty: medium

An operations manager of Company A makes the following statement to his team: “The board has just announced our investment in Company B, one of our key suppliers. We will fully integrate them into our operations in a manner similar to the other small companies we have recently bought. I am a bit concerned, however, since the owners of Company B retained 40 percent ownership. I still hope we get the full synergies and reduced lead times we expect. I hear we have strong board representation and I was assured by our management that our Company will be in control of all major strategic and financial decisions!”

The transaction described by the manager is *most likely* a(an):

- joint venture.
- acquisition.
- merger.

Rationale
joint venture.
The transaction is most likely an acquisition because ownership is over 50 percent and the plan is to fully integrate Company B into Company A. Furthermore, a controlling interest is also indicated by control of strategic and financial decisions.

Rationale
acquisition.
The transaction is most likely an acquisition because ownership is over 50 percent and the plan is to fully integrate Company B into Company A. Furthermore, a controlling interest is also indicated by control of strategic and financial decisions.

Rationale
merger.
The transaction is most likely an acquisition because ownership is over 50 percent and the plan is to fully integrate Company B into Company A. Furthermore, a controlling interest is also indicated by control of strategic and financial decisions.

Question 13
L2R18TB-ITEMSET-AC012-1512
LOS: LOS-6950
LOS: LOS-6930
Lesson Reference: Lesson 2: Investments in Associates and Joint Ventures
Difficulty: medium

Use the following information to answer the next 2 questions:

Crill Ltd. invests $100,000 for a 30 percent stake in Smith Inc. on January 1, 20X1. The cost of the investment is equal to the net book value of the shares purchased. Crill's management appropriately applies the equity method of accounting. In 20X1, Crill sells $200,000 of inventory to Smith for $250,000. Smith sells 60 percent of this inventory to third parties in 20X1 and the remaining inventory is sold in 20X2. Using the equity method and properly accounting for the intercompany transaction, Crill's investment in Smith is recorded at $110,000 on Crill's balance sheet at the end of 20X1.

i.
If Smith had sold substantially less than 60 percent of the inventory purchased from Crill in 20X1 to a third party, but Smith's net income remains the same due to a boost in other revenues, then the carrying value of the investment that Crill will report on its December 31, 20X1 balance sheet will *most likely* be:

- (selected) less than $110,000.
- more than $110.000.
- equal to the $110,000.

Rationale
This Answer is Correct

To calculate the carrying value of an investment in an associate, the investor's share of the associate's net income is added to the initial investment and the proportionate share of dividends is deducted. Any impact to the equity income line on the investor's income statement will have a direct impact on the balance sheet carrying value for the investment. If a smaller portion of the intercompany transaction is allowed to be recognized in year 20X1 then a *greater portion of unrealized profit must be deducted from the investor's share of the associate's net income.*

Remember intercompany transactions must be validated by a third party or the inventory must be used in order for profit to be recognized by the investor—in this case from the downstream sale of inventory from Crill to Smith. Since the question tells us to assume that the starting net income remains unchanged, if less than 60 percent is resold to third parties, then the amount of equity income which is added to the initial investment will be less and the result is a decline from the $110,000 year end carrying value when 60 percent of the inventory had been resold.

Rationale
This Answer is Correct

To calculate the carrying value of an investment in an associate, the investor's share of the associate's net income is added to the initial investment and the proportionate share of dividends is deducted. Any impact to the equity income line on the investor's income statement will have a direct impact on the balance sheet carrying value for the investment. If a smaller portion of the intercompany transaction is allowed to be recognized in year 20X1 then a *greater portion of unrealized profit must be deducted from the investor's share of the associate's net income.*

Remember intercompany transactions must be validated by a third party or the inventory must be used in order for profit to be recognized by the investor—in this case from the downstream sale of inventory from Crill to Smith. Since the question tells us to assume that the starting net income remains unchanged, if less than 60 percent is resold to third parties, then the amount of equity income which is added to the initial investment will be less and the result is a decline from the $110,000 year end carrying value when 60 percent of the inventory had been resold.

Rationale

This Answer is Incorrect

To calculate the carrying value of an investment in an associate, the investor's share of the associate's net income is added to the initial investment and the proportionate share of dividends is deducted. Any impact to the equity income line on the investor's income statement will have a direct impact on the balance sheet carrying value for the investment. If a smaller portion of the intercompany transaction is allowed to be recognized in year 20X1 then a *greater portion of unrealized profit must be deducted from the investor's share of the associate's net income.*

Remember intercompany transactions must be validated by a third party or the inventory must be used in order for profit to be recognized by the investor—in this case from the downstream sale of inventory from Crill to Smith. Since the question tells us to assume that the starting net income remains unchanged, if less than 60 percent is resold to third parties, then the amount of equity income which is added to the initial investment will be less and the result is a decline from the $110,000 year end carrying value when 60 percent of the inventory had been resold.

ii.

Based on the original facts given, what is the amount of realized profit that Crill will include in its calculation of equity income at the end of 20X2 from the sale of inventory to Smith?

- (selected) $6,000
- $9,000
- $15,000

Rationale

This Answer is Incorrect

In 20X2, the remaining portion of the inventory Crill sold to Smith is sold to a third party and can be recognized by Crill in its calculation of equity income. The total profit was $50,000 ($250,000 – $200,000) of which 40 percent, or $20,000, can be recognized in 20X2. Crill recognizes its proportionate share, which is $6,000 ($20,000 × 0.30).

Choice B is the amount of realized profit that was recognized in 20X1 (0.60 × $50,000 × 0.30 = $9,000). Choice C is the total amount of realized profit that was recognized in both years ($50,000 × 0.30 = $15,000).

Rationale

This Answer is Incorrect

In 20X2, the remaining portion of the inventory Crill sold to Smith is sold to a third party and can be recognized by Crill in its calculation of equity income. The total profit was $50,000 ($250,000 – $200,000) of which 40 percent, or $20,000, can be recognized in 20X2. Crill recognizes its proportionate share, which is $6,000 ($20,000 × 0.30).

Choice B is the amount of realized profit that was recognized in 20X1 (0.60 × $50,000 × 0.30 = $9,000). Choice C is the total amount of realized profit that was recognized in both years ($50,000 × 0.30 = $15,000).

Rationale

This Answer is Incorrect

In 20X2, the remaining portion of the inventory Crill sold to Smith is sold to a third party and can be recognized by Crill in its calculation of equity income. The total profit was $50,000 ($250,000 – $200,000) of which 40 percent, or $20,000, can be recognized in 20X2. Crill recognizes its proportionate share, which is $6,000 ($20,000 × 0.30).

Choice B is the amount of realized profit that was recognized in 20X1 (0.60 × $50,000 × 0.30 = $9,000). Choice C is the total amount of realized profit that was recognized in both years ($50,000 × 0.30 = $15,000).

Question 14
L2FR-PQ1710-1411
LOS: LOS-6930
LOS: LOS-6940
LOS: LOS-6950
Lesson Reference: Lesson 3: Investments in Business Combinations
Difficulty: medium

An analyst gathered the following information regarding the cash generating unit of Diago Inc.:

Goodwill allocated to cash generating unit = $800,000

Carrying value of unit = $5,500,000

Recoverable amount of unit = $4,900,000

Fair value of identifiable net assets of unit = $4,500,000

The impairment loss recognized under IFRS is *closest to*:

- (selected) $600,000
- $400,000
- $200,000

Rationale

This Answer is Correct

Impairment loss = Carrying value of unit – Recoverable amount of unit

Impairment loss = $5,500,000 – $4,900,000 = $600,000

Question 15

L2FR-PQ1701-1411

LOS: LOS-6930

LOS: LOS-6940

LOS: LOS-6950

Lesson Reference: Lesson 1: Investments in Financial Assets

Difficulty: medium

Which of the following is *least* likely regarding reclassification of financial assets under U.S. GAAP?

- (selected) When HFT securities are reclassified as AFS securities, any unrealized gains/losses are recognized in other comprehensive income.
- When HTM securities are reclassified as AFS securities, any unrealized gains/losses are recognized in other comprehensive income.
- When AFS debt securities are reclassified as HTM securities, the cumulative amount of unrealized gains/losses that have been recognized in other comprehensive income are amortized over the security's remaining life.

Rationale

This Answer is Correct

When HFT securities are reclassified as AFS securities, any unrealized gains/losses have already been recognized on prior year income statements.

Question 16

L2R18TB-AC041-1512

LOS: LOS-6950

Lesson Reference: Lesson 3: Investments in Business Combinations

Difficulty: medium

Company A issues common shares with a $1 par value each to acquire a controlling interest in Company B. As of the acquisition date, which component of stockholders' equity in the post-combination financial statements would *most likely* not increase?

- Capital stock.
- Retained earnings.
- Additional paid-in capital.

Rationale

Capital stock.

Under consolidation, at the acquisition date, only the parent company's retained earnings are included; the subsidiary's retained earnings are included in post-acquisition periods. In a stock transaction, the capital stock balance increases to reflect the new shares issued and additional paid-in capital increases to reflect the balance of the fair value of the consideration (market value of the shares issued).

Rationale

Retained earnings.

Under consolidation, at the acquisition date, only the parent company's retained earnings are included; the subsidiary's retained earnings are included in post-acquisition periods. In a stock transaction, the capital stock balance increases to reflect the new shares issued and additional paid-in capital increases to reflect the balance of the fair value of the consideration (market value of the shares issued).

Rationale

Additional paid-in capital.

Under consolidation, at the acquisition date, only the parent company's retained earnings are included; the subsidiary's retained earnings are included in post-acquisition periods. In a stock transaction, the capital stock balance increases to reflect the new shares issued and additional paid-in capital increases to reflect the balance of the fair value of the consideration (market value of the shares issued).

Question 17
L2R18TB-AC037-1512
LOS: LOS-6950
Lesson Reference: Lesson 3: Investments in Business Combinations
Difficulty: medium
Big Co. merges with Medium Co. in an all-stock transaction valued at $10 million, which is twice the net asset value of Medium Co. The fair value estimates of Medium Co.'s net assets are equal to their book value except for a building that is understated by $1 million and has a remaining useful life of 20 years. Big Co complies with U.S. GAAP in accounting for its merger with Medium Co. In previous transactions Big Co. used the pooling of interests method. In comparison to pooling, the consolidated financial statements Big Co. will report in its merger with Medium Co. will *most likely* show:

- ○ lower total equity.
- ◉ higher total assets.
- ○ higher total revenue.

Rationale
✗ **lower total equity.**
The pooling method combined assets at historical costs which typically generated lower asset bases and lower total equity relative to fair value methods. Comparatively, revenue is not affected. Accounting for the merger under the acquisition method requires assets to be combined at fair value; therefore total assets will be higher.

Rationale
✓ **higher total assets.**
The pooling method combined assets at historical costs which typically generated lower asset bases and lower total equity relative to fair value methods. Comparatively, revenue is not affected. Accounting for the merger under the acquisition method requires assets to be combined at fair value; therefore total assets will be higher.

Rationale
✗ **higher total revenue.**
The pooling method combined assets at historical costs which typically generated lower asset bases and lower total equity relative to fair value methods. Comparatively, revenue is not affected. Accounting for the merger under the acquisition method requires assets to be combined at fair value; therefore total assets will be higher.

Question 18
L2FR-PQ1706-1411
LOS: LOS-6930
LOS: LOS-6940
LOS: LOS-6950
Lesson Reference: Lesson 4: Investments in SPEs/VIEs
Difficulty: medium
ABC Company sets up an SPV to securitize accounts receivables. When it sells accounts receivable to the SPV, the accounting entries that ABC will perform are *most* likely that:

- (selected) Accounts receivable will fall and cash flow from operating activities will rise.
- Accounts receivable will rise and cash flow from operating activities will fall.
- Accounts receivable will remain the same and cash flow from operating activities will fall.

Rationale

This Answer is Correct

Since ABC is selling receivables to the SPV, it will reduce its accounts receivable. It will treat the sale as a collection of receivables and therefore classify the cash inflow as CFO.

Question 19
L2R18TB-AC033-1512
LOS: LOS-6950
Lesson Reference: Lesson 2: Investments in Associates and Joint Ventures
Difficulty: medium

Lynx Corp. acquires a 25 percent interest in Tyger Companies for $200,000 on January 1, 20X3. In 20X3 Tyger reports net income of $80,000 and pays dividends of $20,000. Select January 1, 20X3 financial information for Tyger is presented in the following table:

	Tyger Book Value ($000)	**Tyger Fair Value ($000)**
Current assets	100.0	100.0
Property, plant, and equipment*	500.0	600.0
Land	200.0	200.0
	800.0	900.0
Liabilities	400.0	400.0
Net assets	400.0	500.0

*PP&E are depreciated on a straight-line basis and have a 10-year remaining useful life.

Lynx complies with IFRS and accounts for the investment in Tyger using the equity method.

Ellen Bear, CFO at Lynx, reviews the financial information for Tyger and believes the fair value of land is understated by $40,000 on January 1, 20X3. In comparison to what Lynx's 20X3 financial statements will show using the original data, the adjusted 20X3 financial statements using the new market value of land will *most likely* report:

- (selected) no change in carrying value.
- higher total assets.
- higher goodwill.

Rationale
✔ **no change in carrying value.**
Goodwill will be lower because under the equity method, the excess purchase price is first allocated to specific assets based on fair values. The excess purchase price will be allocated first to PP&E and land, with the remainder allocated to goodwill. The carrying value will not change, however, because only assets with economic useful lives are amortized or depreciated and reduce carrying value. Assets, such as land and goodwill, have indefinite useful lives; they are not amortized and do not reduce the carrying value. Note that the total assets are unchanged as the adjustment will increase land by $40,000 and reduce goodwill recognized by the same amount.

Rationale
✘ **higher total assets.**
Goodwill will be lower because under the equity method, the excess purchase price is first allocated to specific assets based on fair values. The excess purchase price will be allocated first to PP&E and land, with the remainder allocated to goodwill. The carrying value will not change, however, because only assets with economic useful lives are amortized or depreciated and reduce carrying value. Assets, such as land and goodwill, have indefinite useful lives; they are not amortized and do not reduce the carrying value. Note

that the total assets are unchanged as the adjustment will increase land by $40,000 and reduce goodwill recognized by the same amount.

Rationale

higher goodwill.

Goodwill will be lower because under the equity method, the excess purchase price is first allocated to specific assets based on fair values. The excess purchase price will be allocated first to PP&E and land, with the remainder allocated to goodwill. The carrying value will not change, however, because only assets with economic useful lives are amortized or depreciated and reduce carrying value. Assets, such as land and goodwill, have indefinite useful lives; they are not amortized and do not reduce the carrying value. Note that the total assets are unchanged as the adjustment will increase land by $40,000 and reduce goodwill recognized by the same amount.

Question 20
L2FR-PQ1704-1411
LOS: LOS-6930
LOS: LOS-6940
LOS: LOS-6950
Lesson Reference: Lesson 2: Investments in Associates and Joint Ventures
Difficulty: medium
Under the equity method of accounting for investments in affiliates, dividends received from the affiliate *most* likely have an impact on:

- (selected) Only the value of the investment recognized on the parent's balance sheet.
- Only the income from the affiliate recognized on the parent's income statement.
- The value of the investment recognized on the parent's balance sheet and the income from the affiliate recognized on the parent's income statement.

Rationale

This Answer is Correct

Dividends received from the affiliate reduce the carrying value of the investment in the affiliate on the parent’s balance sheet. Dividends do not have any impact on the amount reported on the income statement.

Question 21
L2R18TB-AC035-1512
LOS: LOS-6950
Lesson Reference: Lesson 2: Investments in Associates and Joint Ventures
Difficulty: medium

On January 1, 20X0, Company A acquires a significant, but non-controlling interest in Company B. The price paid by Company A was well in excess of the proportionate share of Company B's net assets at book value. At the time of the investment, the fair value of Company B's net assets equaled the book value, except for equipment estimated to be undervalued by €60,000.

During 20X0 Company B buys inventory from Company A every month and 30 days later it sells all inventory it purchased to third parties. Company B pays an annual dividend. If Company A complies with IFRS, then the December 31, 20X0 carrying value of its investment in Company B will *most likely* be lower if during 20X0:

- Company B paid no annual dividend.
- the equipment was undervalued by €40,000 rather than €60,000.
- Company B purchased the same amount of inventory from Company A, but sold it 90 days later.

Rationale
Company B paid no annual dividend.

This transaction will be accounted for using the equity method since it is a significant, but non-controlling interest. The carrying value Company A will report is calculated as the purchase price plus its share of Company B's net income less its share of Company B's dividends paid. Company A's share of Company B's net income is reduced by the share of the unrealized profit from the downstream transaction. If Company B takes longer (90 days versus 30 days) to resell the inventory, then more of Company A's profit from selling to Company B would be unrealized. This increase in unrealized profit will decrease the carrying value reported by Company A.

Choice A is incorrect because a decrease in dividends or no dividend would increase the carrying value. Choice B is incorrect because the amortization of excess purchase price attributable to identifiable assets decreases Company A's share of Company B's net income. If the excess purchase price allocated to equipment decreases from €60,000 to €40,000, then the amount to amortize decreases and Company A's net income will increase, not decrease.

Rationale
the equipment was undervalued by €40,000 rather than €60,000.

This transaction will be accounted for using the equity method since it is a significant, but non-controlling interest. The carrying value Company A will report is calculated as the purchase price plus its share of Company B's net income less its share of Company B's dividends paid. Company A's share of Company B's net income is reduced by the share of the unrealized profit from the downstream transaction. If Company B takes longer (90 days versus 30 days) to resell the inventory, then more of Company A's profit from selling to Company B would be unrealized. This increase in unrealized profit will decrease the carrying value reported by Company A.

Choice A is incorrect because a decrease in dividends or no dividend would increase the carrying value. Choice B is incorrect because the amortization of excess purchase price attributable to identifiable assets decreases Company A's share of Company B's net income. If the excess purchase price allocated to

equipment decreases from €60,000 to €40,000, then the amount to amortize decreases and Company A's net income will increase, not decrease.

Rationale

Company B purchased the same amount of inventory from Company A, but sold it 90 days later.

This transaction will be accounted for using the equity method since it is a significant, but non-controlling interest. The carrying value Company A will report is calculated as the purchase price plus its share of Company B's net income less its share of Company B's dividends paid. Company A's share of Company B's net income is reduced by the share of the unrealized profit from the downstream transaction. If Company B takes longer (90 days versus 30 days) to resell the inventory, then more of Company A's profit from selling to Company B would be unrealized. This increase in unrealized profit will decrease the carrying value reported by Company A.

Choice A is incorrect because a decrease in dividends or no dividend would increase the carrying value. Choice B is incorrect because the amortization of excess purchase price attributable to identifiable assets decreases Company A's share of Company B's net income. If the excess purchase price allocated to equipment decreases from €60,000 to €40,000, then the amount to amortize decreases and Company A's net income will increase, not decrease.

Question 22
L2FR-ITEMSET-PQ1716-1411
LOS: LOS-6930
LOS: LOS-6940
LOS: LOS-6950
Lesson Reference: Lesson 2: Investments in Associates and Joint Ventures
Difficulty: medium

Use the following information to answer the next 2 questions:

On January 1, 2011, Parco Ltd. purchased a 25% interest in Atalco Ltd. for $1.5 million. The purchase price was equal to the value of the purchased equity in the book value of Atalco's net assets. The following table lists income reported and dividends paid by Atalco Ltd. for 2011 and 2012. Parco uses the equity method to account for its investment in Atalco.

	Income	**Dividends**
2011	$950,000	$500,000
2012	$1,100,000	$600,000
Total	**$2,050,000**	**$1,100,000**

i.
The amount of investment income from Atalco recognized on Parco's income statement for 2011 and 2012 is *closest to*:

	2011	**2012**
A	$112,500	$125,000
B	$950,000	$1,100,000
C	$237,500	$275,000

- ○ Row A
- ○ Row B
- ● Row C

Rationale
This Answer is Correct

Equity income for 2011 = 25% of $950,000 = $237,500

Equity income for 2012 = 25% of $1,100,000 = $275,000

ii.
The amount related to its investment in Atalco that appears on Parco's balance sheet for 2012 is *closest to*:

- ● $1,737,500
- ○ $2,012,500
- ○ $1,920,500

Rationale
This Answer is Correct

Initial cost	$1,500,000
Add: Share of Atalco’s 2011 income (25% of $950,000)	237,500

Less: Share of dividends declared by Atalco for 2011 (25% of $500,000)	125,000
Add: Share of Atalco's 2012 income (25% of $1,100,000)	275,000
Less: Share of dividends declared by Atalco for 2012 (25% of $600,000)	150,000
Value of investment in Atalco at the end of 2012	**$1,737,500**

Question 23
L2FR-ITEMSET-PQ1708-1411
LOS: LOS-6930
LOS: LOS-6940
LOS: LOS-6950
Lesson Reference: Lesson 1: Investments in Financial Assets
Difficulty: medium

Use the following information to answer the next five questions:

Consider the following information relating to Philip Materials' (PM) fixed-income investment portfolio. All amounts are in EUR (€).

	Purchase Price (Par Value)	**Market Value, December 31, 2010**	**Market Value, December 31, 2011**	**Classification**
Emmy Corp.	50,000	40,000	38,000	Held-to-maturity
PTCA Int'l	20,000	25,000	28,000	Available-for-sale
Pumi Co.	60,000	66,000	69,000	Held-to-maturity

i.
The balance sheet carrying value of PM's investment portfolio at December 31, 2011 is *closest* to:

- 127,000
- 135,000
- 138,000

Rationale
This Answer is Correct

Held-for-trading and available-for-sale securities are carried at market value, while held-to-maturity securities are carried at historical cost.

Balance sheet carrying value = 50,000 + 28,000 + 60,000 = €138,000

ii.
The company is considering reclassification of all these fixed-income investments as held for trading. Which of the following is *most* likely?

- Reclassification of Emmy Corp would result in a higher balance sheet carrying value, while reclassification of Pumi Co. would result in a lower balance sheet carrying value.
- Reclassification of PTCA Int'l would result in a higher balance sheet carrying value, while reclassification of Pumi Co. would result in a lower balance sheet carrying value.
- Reclassification of Emmy Corp would result in a lower balance sheet carrying value, while reclassification of Pumi Co. would result in a higher balance sheet carrying value.

Rationale
This Answer is Correct

If Emmy Corp. were reclassified as a held-for-trading security, its carrying value would have been the €38,000 fair value rather than the €50,000 historical cost.

If Pumi Co. were reclassified as a held-for-trading security, its carrying value would have been the €69,000 fair value rather than the €60,000 historical cost.

iii.
Compared to PM's reported interest income in 2011, if Pumi Co. were classified as available for sale, interest income would *most* likely be:

- (•) The same
- ( ) Lower
- ( ) Higher

Rationale

This Answer is Correct
The coupon payment is recorded as interest income irrespective of whether securities are held to maturity or available for sale. As the bonds were purchased at par, no adjustment is required for amortization.

iv.
Compared to PM's reported earnings before taxes in 2011, if PTCA Int'l were instead classified as held for trading, earnings before taxes would *most* likely be:

- ( ) The same
- ( ) €8,000 higher
- (•) €3,000 higher

Rationale

This Answer is Correct
When securities are classified as held for trading, unrealized gains and losses are included in income. During 2011 there was an unrealized gain of €3,000 on PTCA Int'l.

v.

Given that the purchase prices were the same as provided in the table above, which of the following would cause PM's reported interest income to be lower?

If the par value of:

- (•) Emmy was €38,000
- ( ) PTCA was €28,000
- ( ) Pumi was €69,000

Rationale

This Answer is Correct
Under the effective interest method, the difference between the purchase price and par value must be amortized. If the par value is less than the purchase price (stated interest rate is greater than the effective rate), interest income would be lower than the coupon received because of amortization of the premium. Emmy would have been purchased at a premium if its par value were €38,000 and its purchase price were €50,000.

Question 24
L2FR-PQ1711-1411
LOS: LOS-6930
LOS: LOS-6940
LOS: LOS-6950
Lesson Reference: Lesson 3: Investments in Business Combinations
Difficulty: medium

An analyst gathered the following information regarding a reporting unit of Sentoro Inc.:

Reporting unit's recognized goodwill = $1,300,000

Carrying value of unit = $5,900,000

Fair value of unit = $5,600,000

Fair value of identifiable net assets of unit = $4,800,000

The impairment loss recognized under U.S. GAAP is *closest* to:

- $800,000
- $300,000
- $500,000

Rationale
This Answer is Correct

Implied goodwill = Fair value of unit – Fair value of identifiable net assets of the unit

Implied goodwill = $5,600,000 – $4,800,000 = $800,000

Impairment loss = Recognized goodwill – Implied goodwill

Impairment loss = $1,300,000 – $800,000 = $500,000

Question 25
L2FR-PQ1705-1411
LOS: LOS-6930
LOS: LOS-6940
LOS: LOS-6950
Lesson Reference: Lesson 3: Investments in Business Combinations
Difficulty: medium
Which of the following is *least* likely if a parent uses the full goodwill method as opposed to the partial goodwill method to account for an acquisition?

- ○ Return on assets and return on equity will be lower under the full goodwill method.
- ◉ Net income and shareholders' equity are the same under both methods.
- ○ The net profit margin will be the same under both methods.

Rationale

This Answer is Correct

Total assets and total equity are higher under the full goodwill method. Therefore, ROE and ROA are lower under the full goodwill method.

Net income and **retained earnings** are the same under both methods, but total shareholders' equity is **higher** under the full goodwill method.

The income statement is the same under both methods.

Question 26
L2FR-PQ1707-1411
LOS: LOS-6930
LOS: LOS-6940
LOS: LOS-6950
Lesson Reference: Lesson 4: Investments in SPEs/VIEs
Difficulty: medium

ABC Company sets up an SPV to securitize accounts receivables.

Given that ABC continues to bear the risk of non-realization of those receivables, which of the following is the *least* likely result from an analyst performing the appropriate adjustments to ABC's financial statements to reflect the fact that the overall arrangement is merely a collateralized borrowing?

- The current ratio would be higher.
- Total cash flow would be the same.
- CFO would be higher.

Rationale

This Answer is Correct

CFO would be **lower** as the cash inflow from the sale was initially classified as CFO by the company and would now be classified as CFF by the analyst.

Total cash flow would be the same.

An analyst would increase accounts receivable and current liabilities upward. If the current ratio was less than one, these adjustments could result in a higher current ratio.

Question 27
L2R18TB-AC031-1512
LOS: LOS-6930
Lesson Reference: Lesson 3: Investments in Business Combinations
Difficulty: medium
Ziller Investments owns 18 percent of Marsh Enterprise. Ziller is deemed to have significant influence over Marsh through its board representation and its ability to influence management and operating decisions. Ziller will *most likely* treat its investment in Marsh as a(n):

- controlling interest investment.
- investment in a financial asset.
- investment in an associate.

Rationale

controlling interest investment.

Under both IFRS and U.S. GAAP the evidence of *the degree of influence and control is more important than the percentage ownership* when it comes to determining the classification of an investment. Since there is significant influence, but not control, Ziller should most likely treat this investment as an investment in an associate using the equity method. Normally, the standard parameter for investments in financial assets is ownership under 20 percent and for investments in associates and joint ventures is ownership between 20 percent and 50 percent.

Rationale

investment in a financial asset.

Under both IFRS and U.S. GAAP the evidence of *the degree of influence and control is more important than the percentage ownership* when it comes to determining the classification of an investment. Since there is significant influence, but not control, Ziller should most likely treat this investment as an investment in an associate using the equity method. Normally, the standard parameter for investments in financial assets is ownership under 20 percent and for investments in associates and joint ventures is ownership between 20 percent and 50 percent.

Rationale

investment in an associate.

Under both IFRS and U.S. GAAP the evidence of *the degree of influence and control is more important than the percentage ownership* when it comes to determining the classification of an investment. Since there is significant influence, but not control, Ziller should most likely treat this investment as an investment in an associate using the equity method. Normally, the standard parameter for investments in financial assets is ownership under 20 percent and for investments in associates and joint ventures is ownership between 20 percent and 50 percent.

Question 28
L2FR-PQ1708-1411
LOS: LOS-6930
LOS: LOS-6940
LOS: LOS-6950
Lesson Reference: Lesson 1: Investments in Financial Assets
Difficulty: medium
Which of the following statements is *least accurate*?

- ○ Held-to-maturity investments are carried at amortized cost.
- ○ Held-for-trading securities are carried at fair value. Any unrealized gains and losses are reported on the P&L.
- ◉ Available-for-sale securities are carried at fair value. Any unrealized gains and losses are reported on the P&L.

Rationale

This Answer is Correct

Available-for-sale securities are carried at fair value, but unrealized gains and losses are reported in other comprehensive income.

Question 29
L2R18TB-ITEMSET-AC022-1512
LOS: LOS-6930
LOS: LOS-6950
Lesson Reference: Lesson 4: Investments in SPEs/VIEs
Difficulty: medium

Use the following information to answer the next 2 questions:

Fran Simon, CFA is analyzing Syncon Ltd. and its pending transaction with Vintz Inc. Syncon announced it formed a special purpose entity and plans to sell $80 million of its accounts receivable to the SPE. Syncon plans to fund the SPE with $8 million in company cash. Equity capital providers will fund the remaining $72 million that the SPE needs. These unrelated equity owners will have 90 percent of the voting rights, with Syncon having 10 percent voting rights. In addition, the outside equity providers will receive 90 percent of the SPE's profits, but only share in 10 percent of any losses.

Select financial information ($000s) for Syncon is presented in the following table:

		Syncon Balance Sheet	
Cash	$75,000.0	Current payables	175,000.0
Accounts receivables	150,000.0	Long-term liabilities	250,000.0
Inventory	200,000.0	Total liabilities	$425,000.0
Other assets	200,000.0	Shareholders' equity	200,000.0
Total assets	**$625,000.0**	**Total liabilities and equity**	**$625,000.0**

Use the data in the preceding table to answer the following questions related to Simon's analysis.

i.
With respect to Syncon's planned special purpose entity, the SPE *most likely* will:

- be consolidated because Syncon plans to sell over 50 percent of its accounts receivable balance.
- not be consolidated because Syncon does not have majority voting rights.
- (selected) be consolidated because Syncon will absorb the majority of the losses.

Rationale
This Answer is Correct
Syncon will be required to consolidate the SPE regardless of its voting interest or the amount of the accounts receivable contributed to the SPE. The primary beneficiary must consolidate and the primary beneficiary, which is generally the sponsor, is determined by the entity that absorbs the majority of losses. The primary beneficiary may also receive the majority of the gains, but if these two entities differ, it is the one who absorbs the losses that must consolidate.

Rationale
This Answer is Correct
Syncon will be required to consolidate the SPE regardless of its voting interest or the amount of the accounts receivable contributed to the SPE. The primary beneficiary must consolidate and the primary beneficiary, which is generally the sponsor, is determined by the entity that absorbs the majority of losses. The primary beneficiary may also receive the majority of the gains, but if these two entities differ, it is the one who absorbs the losses that must consolidate.

Rationale

This Answer is Incorrect

Syncon will be required to consolidate the SPE regardless of its voting interest or the amount of the accounts receivable contributed to the SPE. The primary beneficiary must consolidate and the primary beneficiary, which is generally the sponsor, is determined by the entity that absorbs the majority of losses. The primary beneficiary may also receive the majority of the gains, but if these two entities differ, it is the one who absorbs the losses that must consolidate.

ii.

If the SPE had borrowed the required $72 million by issuing long-term debt instead of using equity funding, then Syncon's consolidated financial statements immediately after the SPE is started will *most likely* reflect:

- a cash balance of $139 million.
- long-term liabilities balance of $322 million.
- an accounts receivable balance of $80 million.

Rationale

This Answer is Incorrect

A consolidated balanced balance sheet will look the same whether a SPE was in place and consolidated or Syncon had borrowed directly against the receivables. The SPEs long-term debt of $72 million will be added to Syncon's preexisting long-term debt of $250 million. Hence, the consolidated financial statement will reflect long-term debt of $322 million.

Choice A is incorrect because the cash balance will be $147 million. Syncon's cash balance on an unconsolidated basis is $147 million ($75 million beginning balance – $8 million spent funding the SPE + $80 million received when the SPE buys the receivables). The SPE's cash balance on an unconsolidated basis is $0 ($80 million received in equity funds – $80 million spent to buy the receivables).

Choice C is incorrect as the receivable balance remains the same. The transfer of the receivables to the SPE is reversed in the consolidation.

Rationale

This Answer is Incorrect

A consolidated balanced balance sheet will look the same whether a SPE was in place and consolidated or Syncon had borrowed directly against the receivables. The SPEs long-term debt of $72 million will be added to Syncon's preexisting long-term debt of $250 million. Hence, the consolidated financial statement will reflect long-term debt of $322 million.

Choice A is incorrect because the cash balance will be $147 million. Syncon's cash balance on an unconsolidated basis is $147 million ($75 million beginning balance – $8 million spent funding the SPE + $80 million received when the SPE buys the receivables). The SPE's cash balance on an unconsolidated basis is $0 ($80 million received in equity funds – $80 million spent to buy the receivables).

Choice C is incorrect as the receivable balance remains the same. The transfer of the receivables to the SPE is reversed in the consolidation.

Rationale

This Answer is Incorrect

A consolidated balanced balance sheet will look the same whether a SPE was in place and consolidated or Syncon had borrowed directly against the receivables. The SPEs long-term debt of $72 million will be added to Syncon's preexisting long-term debt of $250 million. Hence, the consolidated financial statement will reflect long-term debt of $322 million.

Choice A is incorrect because the cash balance will be $147 million. Syncon's cash balance on an unconsolidated basis is $147 million ($75 million beginning balance – $8 million spent funding the SPE + $80 million received when the SPE buys the receivables). The SPE's cash balance on an unconsolidated basis is $0 ($80 million received in equity funds – $80 million spent to buy the receivables).

Choice C is incorrect as the receivable balance remains the same. The transfer of the receivables to the SPE is reversed in the consolidation.

Question 30
L2R18TB-ITEMSET-AC010-1512
LOS: LOS-6930
Lesson Reference: Lesson 2: Investments in Associates and Joint Ventures
Difficulty: medium

Use the following information to answer the next 2 questions:

On January 1, 20X2, YZ Plastics invests $75,000,000 to buy 30 percent of GC Components' shares. The two companies have done business together for many years and this investment increases YZ's influence over operational and management decisions at GC. The exhibit below presents the book values and fair values of GC's reported assets and liabilities on January 1, 20X2.

GC Components ($ millions)	Book Value	Fair Value
Current assets	$20.0	$20.0
Plant and equipment	60.0	90.0
	$80.0	$110.0
Liabilities	30.0	30.0
Net assets	$50.0	$80.0

Additional Information

GC accounts for its plant and equipment using straight-line depreciation, which has a remaining useful life of 10 years.

In 20X2 GC reports net income of $20,000,000 and pays dividends of $5,000,000.

In 20X2 GC sold inventory to YZ. GC made a profit of $6,000,000 on this inventory sale. During 20X2, YZ sold half of the inventory it purchased from GC to third parties.

i.
The equity income that YZ will report on its income statement at the end of 20X2 is *closest to*:
- $5.1 million.
- $4.2 million.
- $3.3 million.

Rationale
This Answer is Correct

Equity income is adjusted for the amortization of excess purchase price attributable to specific assets and the unrealized profit from the intercompany transactions. Excess purchase price attributable to any specific assets is calculated as follows (in $000s):

Purchase price	$75,000
Less: 30 percent of investee's net assets (0.30 × 50,000)	(15,000)
Excess purchase price	$60,000
Excess purchase price attributable to P&E = [0.30 × (90,000 – 60,000)] =	9,000
Goodwill (residual of excess purchase price) =	$51,000

Profit from the upstream transaction (the associate sold to the investor) between the two companies is stated as $6 million. Take note, however, that only *half of the inventory* was sold to third parties in that same year. This means that only *50 percent of the profit is unrealized* and only the *investor's proportionate share* should be deducted from the investor's equity income line. With this understanding, we calculate equity income incorporating the adjustments:

Investor's share of reported income = (0.30 × 20,000) =	$6,000
Amortization of excess purchase price attributable to P&E = (9,000/10)	(900)
Unrealized profit = [(0.30 × (0.50 × 6,000)] =	(900)
YZ's reported share of GC's equity income =	$4,200

Choice A incorrectly forgets to deduct the proportionate share of the unrealized profit and choice C incorrectly treats all of profit on the inventory as being unearned.

Rationale

This Answer is Correct

Equity income is adjusted for the amortization of excess purchase price attributable to specific assets and the unrealized profit from the intercompany transactions. Excess purchase price attributable to any specific assets is calculated as follows (in $000s):

Purchase price	$75,000
Less: 30 percent of investee's net assets (0.30 × 50,000)	(15,000)
Excess purchase price	$60,000
Excess purchase price attributable to P&E = [0.30 × (90,000 – 60,000)] =	9,000
Goodwill (residual of excess purchase price) =	$51,000

Profit from the upstream transaction (the associate sold to the investor) between the two companies is stated as $6 million. Take note, however, that only *half of the inventory* was sold to third parties in that same year. This means that only *50 percent of the profit is unrealized* and only the *investor's proportionate share* should be deducted from the investor's equity income line. With this understanding, we calculate equity income incorporating the adjustments:

Investor's share of reported income = (0.30 × 20,000) =	$6,000
Amortization of excess purchase price attributable to P&E = (9,000/10)	(900)
Unrealized profit = [(0.30 × (0.50 × 6,000)] =	(900)
YZ's reported share of GC's equity income =	$4,200

Choice A incorrectly forgets to deduct the proportionate share of the unrealized profit and choice C incorrectly treats all of profit on the inventory as being unearned.

Rationale

This Answer is Incorrect

Equity income is adjusted for the amortization of excess purchase price attributable to specific assets and the unrealized profit from the intercompany transactions. Excess purchase price attributable to any specific assets is calculated as follows (in $000s):

Purchase price	$75,000
Less: 30 percent of investee's net assets (0.30 × 50,000)	(15,000)
Excess purchase price	$60,000
Excess purchase price attributable to P&E = [0.30 × (90,000 – 60,000)] =	9,000
Goodwill (residual of excess purchase price) =	$51,000

Profit from the upstream transaction (the associate sold to the investor) between the two companies is stated as $6 million. Take note, however, that only *half of the inventory* was sold to third parties in that same year. This means that only *50 percent of the profit is unrealized* and only the *investor's proportionate share* should be deducted from the investor's equity income line. With this understanding, we calculate equity income incorporating the adjustments:

Investor's share of reported income = (0.30 × 20,000) =	$6,000
Amortization of excess purchase price attributable to P&E = (9,000/10)	(900)
Unrealized profit = [(0.30 × (0.50 × 6,000)] =	(900)
YZ's reported share of GC's equity income =	$4,200

Choice A incorrectly forgets to deduct the proportionate share of the unrealized profit and choice C incorrectly treats all of profit on the inventory as being unearned.

ii.

The carrying value of the investment that YZ will report on its December 31, 20X2 balance sheet is *closest to*:

- $76.8 million.
- $77.7 million.
- $78.6 million.

Rationale

This Answer is Incorrect

The calculation for the carrying value is as follows (in $000s):

Purchase price	$75,000
YZ's equity income (from Question 1 above)	4,200
Dividends received = 30 percent × $5,000	(1,500)
Carrying value of YZ's investment in GC at end of 20X2	$77,700

Note that the equity income line already reflects the amortization of any excess purchase price attributable to identifiable assets as well as the unrealized profit from the upstream transaction.

Rationale

This Answer is Incorrect

The calculation for the carrying value is as follows (in $000s):

Purchase price	$75,000
YZ's equity income (from Question 1 above)	4,200

Dividends received = 30 percent × \$5,000	(1,500)
Carrying value of YZ's investment in GC at end of 20X2	\$77,700

Note that the equity income line already reflects the amortization of any excess purchase price attributable to identifiable assets as well as the unrealized profit from the upstream transaction.

Rationale

This Answer is Incorrect

The calculation for the carrying value is as follows (in \$000s):

Purchase price	\$75,000
YZ's equity income (from Question 1 above)	4,200
Dividends received = 30 percent × \$5,000	(1,500)
Carrying value of YZ's investment in GC at end of 20X2	\$77,700

Note that the equity income line already reflects the amortization of any excess purchase price attributable to identifiable assets as well as the unrealized profit from the upstream transaction.

Question 31
L2R18TB-AC039-1512
LOS: LOS-6940
Lesson Reference: Lesson 3: Investments in Business Combinations
Difficulty: medium

Marsh Inc. pays €75,000 for 75 percent of Legend Toys on January 1, 20X2. The following table provides select financial information (€000s) for both companies prepared immediately before the acquisition:

	Marsh Book Value	**Legend Book Value**	**Legend Fair Value***
Total assets Net assets	€220.0	€50.0	€55.0
	€100.0	€25.0	€30.0

*There are no identifiable intangible assets; the increase in fair value is attributed to equipment.

If Marsh complies with IFRS and recognizes minority interest using the full goodwill method, Marsh will report minority interest that is *closest to*:

- €7,500
- €18,750
- €25,000

Rationale
€7,500

Under both IFRS and U.S. GAAP, minority interest using the full goodwill method equals the non-controlling interest (percent not owned by the parent) of the subsidiary's fair value. March purchases 75 percent of Legend for €75,000, which indicates the value of 100 percent of Legend is €100,000 (€75,000/0.75). Therefore, the minority interest under full goodwill is 25 percent of €100,000 or €25,000.

Choice A is the minority interest using partial goodwill (25 percent of the fair value of the net identifiable assets of €30,000). Choice B is 25 percent of the €75,000 that Marsh paid to buy 75 percent of Legend.

Rationale
€18,750

Under both IFRS and U.S. GAAP, minority interest using the full goodwill method equals the non-controlling interest (percent not owned by the parent) of the subsidiary's fair value. March purchases 75 percent of Legend for €75,000, which indicates the value of 100 percent of Legend is €100,000 (€75,000/0.75). Therefore, the minority interest under full goodwill is 25 percent of €100,000 or €25,000.

Choice A is the minority interest using partial goodwill (25 percent of the fair value of the net identifiable assets of €30,000). Choice B is 25 percent of the €75,000 that Marsh paid to buy 75 percent of Legend.

Rationale
€25,000

Under both IFRS and U.S. GAAP, minority interest using the full goodwill method equals the non-controlling interest (percent not owned by the parent) of the subsidiary's fair value. March purchases 75 percent of Legend for €75,000, which indicates the value of 100 percent of Legend is €100,000 (€75,000/0.75). Therefore, the minority interest under full goodwill is 25 percent of €100,000 or €25,000.

Choice A is the minority interest using partial goodwill (25 percent of the fair value of the net identifiable assets of €30,000). Choice B is 25 percent of the €75,000 that Marsh paid to buy 75 percent of Legend.

Question 32
L2FR-TB0011-1412
LOS: LOS-6930
Lesson Reference: Lesson 1: Investments in Financial Assets
Difficulty: medium
McLaren Corp. purchases a 20% stake in Cook Co. for £300,000 on January 1, 2014. During 2014 Cook Co. reports net income of £100,000 and pays a dividend of £20,000. The value of the stake on McLaren's balance sheet at the end of 2014 will be closest to:

- £300,000.
- £316,000.
- £380,000.

Rationale

This Answer is Correct

A 20% stake should be assumed to be a holding of significant influence and hence the equity method of accounting is appropriate. The carrying value of an investment under the equity method is the initial cost plus the investing company's share of net income net of dividends, in this case £300,000 + 0.2 (£100,000 - £20,000) = £316,000.

Question 33
L2R18TB-AC040-1512
LOS: LOS-6950
Lesson Reference: Lesson 3: Investments in Business Combinations
Difficulty: medium

Sims Inc. pays €300,000 for 75 percent of Kirk Co. on January 1, 20X2. The following table provides select financial information (€000s) for both companies prepared immediately before the acquisition:

	Sims Inc. Book Value	Kirk Co. Book Value	Kirk Co. Fair Value*
Total assets	€854.0	€250.0	€100.0
Net assets	€200.0	€655.0	€150.0

*There are no identifiable intangible assets; the increase in fair value is attributed to land.

Sims complies with IFRS and recognizes minority interest using the full goodwill method in preparing the post-combination consolidated balance sheet. Jane Emery, CFA, an analyst at Sims, believes the book value of Kirk Co.'s inventory is undervalued. If an adjustment to fair value were made to account for Emery's analysis, the *most likely* change to the post-combination consolidated balance sheet would be a(an):

- ○ increase to reported minority interest.
- ● decrease to reported goodwill.
- ○ increase to total assets.

Rationale

✗ increase to reported minority interest.

If an adjustment for undervalued inventory were made, the fair value of the net assets would increase because the fair value of inventory would increase. If the fair value of the net assets increases, the reported goodwill under the full goodwill method decreases because the fair value of the net assets is deducted from the fair value of the entity to arrive at full goodwill.

Choice A is incorrect because minority interest under full goodwill is measured using the fair value of the entity based on the price paid by the firm buying the majority stake and this price does not change just because the inventory has a higher fair value than originally thought. Choice C is incorrect because total assets remain the same; the increase is inventory is countered by the decrease in goodwill, so the net effect to total assets is zero.

Rationale

✓ decrease to reported goodwill.

If an adjustment for undervalued inventory were made, the fair value of the net assets would increase because the fair value of inventory would increase. If the fair value of the net assets increases, the reported goodwill under the full goodwill method decreases because the fair value of the net assets is deducted from the fair value of the entity to arrive at full goodwill.

Choice A is incorrect because minority interest under full goodwill is measured using the fair value of the entity based on the price paid by the firm buying the majority stake and this price does not change just because the inventory has a higher fair value than originally thought. Choice C is incorrect because total

assets remain the same; the increase is inventory is countered by the decrease in goodwill, so the net effect to total assets is zero.

Rationale

increase to total assets.

If an adjustment for undervalued inventory were made, the fair value of the net assets would increase because the fair value of inventory would increase. If the fair value of the net assets increases, the reported goodwill under the full goodwill method decreases because the fair value of the net assets is deducted from the fair value of the entity to arrive at full goodwill.

Choice A is incorrect because minority interest under full goodwill is measured using the fair value of the entity based on the price paid by the firm buying the majority stake and this price does not change just because the inventory has a higher fair value than originally thought. Choice C is incorrect because total assets remain the same; the increase is inventory is countered by the decrease in goodwill, so the net effect to total assets is zero.

Question 34
L2R18TB-AC038-1512
LOS: LOS-6940
Lesson Reference: Lesson 3: Investments in Business Combinations
Difficulty: medium
Archer Inc. acquires 80 percent of Liquid Company's outstanding stock for $300,000. Liquid's net identifiable assets have a fair value of $250,000. Archer reports under IFRS and recognizes $100,000 in goodwill related to the acquisition. If Archer reports under U.S. GAAP instead, then its consolidated financial statements would *most likely* show:

- lower goodwill and a lower total asset turnover ratio.
- lower goodwill and a higher total asset turnover ratio.
- higher goodwill and a lower total asset turnover ratio.

Rationale

lower goodwill and a lower total asset turnover ratio.

The two options to measure goodwill allowed under IFRS when using the acquisition method are partial and full goodwill. Partial goodwill is the purchase price (the fair value of the consideration) less the fair value of the share of the net assets purchased; full goodwill equals the fair value of the entire entity less the fair value of 100 percent of the net assets. The calculations that follow demonstrate the comparison:

	Partial (IFRS only)	**Full (IFRS and U.S. GAAP)**
Fair value of consideration	300,000	
Fair value of net assets: 80 percent × $250,000	<u>200,000</u>	
Goodwill recognized	100,000	
Fair value of entity 100 percent × ($300,000/0.80)		375,000
Fair value of net assets 100 percent × $250,000		<u>250,000</u>
Goodwill recognized		125,000

Since Archer recognizes $100,000 of goodwill, we can conclude that it is using the partial goodwill method. U.S. GAAP only allows the full goodwill method. In comparison to the partial goodwill method, the full goodwill method produces a higher goodwill value. This higher amount of goodwill increases total assets and total shareholders' equity. Therefore, the total asset turnover ratio (sales divided by average total assets) will be lower for the full goodwill method versus the partial goodwill method because the denominator in the ratio is greater.

Rationale

lower goodwill and a higher total asset turnover ratio.

The two options to measure goodwill allowed under IFRS when using the acquisition method are partial and full goodwill. Partial goodwill is the purchase price (the fair value of the consideration) less the fair value of the share of the net assets purchased; full goodwill equals the fair value of the entire entity less the fair value of 100 percent of the net assets. The calculations that follow demonstrate the comparison:

	Partial (IFRS only)	**Full (IFRS and U.S. GAAP)**
Fair value of consideration	300,000	
Fair value of net assets: 80 percent × $250,000	<u>200,000</u>	

	Partial (IFRS only)	Full (IFRS and U.S. GAAP)
Goodwill recognized	100,000	
Fair value of entity 100 percent × ($300,000/0.80)		375,000
Fair value of net assets 100 percent × $250,000		250,000
Goodwill recognized		125,000

Since Archer recognizes $100,000 of goodwill, we can conclude that it is using the partial goodwill method. U.S. GAAP only allows the full goodwill method. In comparison to the partial goodwill method, the full goodwill method produces a higher goodwill value. This higher amount of goodwill increases total assets and total shareholders' equity. Therefore, the total asset turnover ratio (sales divided by average total assets) will be lower for the full goodwill method versus the partial goodwill method because the denominator in the ratio is greater.

Rationale

✔ **higher goodwill and a lower total asset turnover ratio.**

The two options to measure goodwill allowed under IFRS when using the acquisition method are partial and full goodwill. Partial goodwill is the purchase price (the fair value of the consideration) less the fair value of the share of the net assets purchased; full goodwill equals the fair value of the entire entity less the fair value of 100 percent of the net assets. The calculations that follow demonstrate the comparison:

	Partial (IFRS only)	Full (IFRS and U.S. GAAP)
Fair value of consideration	300,000	
Fair value of net assets: 80 percent × $250,000	200,000	
Goodwill recognized	100,000	
Fair value of entity 100 percent × ($300,000/0.80)		375,000
Fair value of net assets 100 percent × $250,000		250,000
Goodwill recognized		125,000

Since Archer recognizes $100,000 of goodwill, we can conclude that it is using the partial goodwill method. U.S. GAAP only allows the full goodwill method. In comparison to the partial goodwill method, the full goodwill method produces a higher goodwill value. This higher amount of goodwill increases total assets and total shareholders' equity. Therefore, the total asset turnover ratio (sales divided by average total assets) will be lower for the full goodwill method versus the partial goodwill method because the denominator in the ratio is greater.

Question 35
L2R18TB-ITEMSET-AC016-1512
LOS: LOS-6930
LOS: LOS-6950
Lesson Reference: Lesson 3: Investments in Business Combinations
Difficulty: medium

Use the following information to answer the next three questions:

On January 1, 20X1, Acquirer issues 800,000 shares of its $1 par common stock to purchase 100 percent of the outstanding shares of Target. Acquirer's stock has current market value of $20. There are no identifiable intangible assets for Target. The following table presents information for both companies immediately prior to the transaction. All amounts are in thousands of dollars ($000s).

	Acquirer Book Value	**Target Book Value**	**Target Fair Value**
Current assets	$25,000.0	$1,300.0	$1,300.0
Inventory	30,000.0	4,500.0	6,000.0
Property, plant, and equipment	155,000.0	5,500.0	9,000.0
	$110,000.0	$11,300.0	$16,300.0
Current payables	20,000.0	1,400.0	1,400.0
Long-term liabilities	40,000.0	2,000.0	2,000.0
	60,000.0	3,400.0	3,400.0
Net assets	$50,000.0	$7, 900.0	$12,900.0
Shareholders' equity:			
Capital stock ($1 par)	$10,000	$1,600	
Additional paid in capital	12,000	2,800	
Retained earnings	28,000	3,500	

Andrea Clark, CFO, of Acquirer requests George Levin, CFA, a financial analyst working in her group to prepare a post-combination balance sheet using the acquisition method. Use the data in the preceding table to answer the following three questions based on Levin's calculations and analysis.

i.
The amount of additional paid in capital that Acquirer will report on the post-combination balance sheet is *closest to*:

- (selected) $27.2 million.
- $28.0 million.
- $30.0 million.

Rationale

This Answer is Correct

Acquirer paid $16 million for 100 percent of Target's outstanding shares by issuing 800,000 shares of common stock which is currently trading at a market price of $20 (800,000 × $20 = $16 million). Under both IFRS and U.S. GAAP, the post-combination balance sheet must show the fair value of the consideration exchanged. The calculations for the components of shareholders' equity on the post-combination balance sheet are as follows ($000s):

	Acquirer	Common Stock Issued	Consolidated Balance Sheet
Capital stock ($1 par)	$10,000	$800 (800,000 × $1 par) $15,200 ($16,000 - 800)	$10,800
Additional paid in capital	12,000		27,200
Retained earnings	28,000		28,000
Total Stockholders' Equity	$50,000		$66,000

Capital stock is increased to reflect the additional amount of outstanding shares issued at par value (800,000 × $1). Additional paid in capital is increased by the purchase price less the par value of the issued shares, $15.2 million ($16 million – $800,000).

Choice B incorrectly includes the increase to capital stock of 800,000 share of $1 par stock in the calculation for additional paid in capital. Choice C incorrectly includes Target's additional paid in capital.

Rationale

This Answer is Correct

Acquirer paid $16 million for 100 percent of Target's outstanding shares by issuing 800,000 shares of common stock which is currently trading at a market price of $20 (800,000 × $20 = $16 million). Under both IFRS and U.S. GAAP, the post-combination balance sheet must show the fair value of the consideration exchanged. The calculations for the components of shareholders' equity on the post-combination balance sheet are as follows ($000s):

	Acquirer	Common Stock Issued	Consolidated Balance Sheet
Capital stock ($1 par)	$10,000	$800 (800,000 × $1 par) $15,200 ($16,000 - 800)	$10,800
Additional paid in capital	12,000		27,200
Retained earnings	28,000		28,000
Total Stockholders' Equity	$50,000		$66,000

Capital stock is increased to reflect the additional amount of outstanding shares issued at par value (800,000 × $1). Additional paid in capital is increased by the purchase price less the par value of the issued shares, $15.2 million ($16 million – $800,000).

Choice B incorrectly includes the increase to capital stock of 800,000 share of $1 par stock in the calculation for additional paid in capital. Choice C incorrectly includes Target's additional paid in capital.

Rationale

This Answer is Correct

Acquirer paid $16 million for 100 percent of Target's outstanding shares by issuing 800,000 shares of common stock which is currently trading at a market price of $20 (800,000 × $20 = $16 million). Under both IFRS and U.S. GAAP, the post-combination balance sheet must show the fair value of the consideration exchanged. The calculations for the components of shareholders' equity on the post-combination balance sheet are as follows ($000s):

	Acquirer	**Common Stock Issued**	**Consolidated Balance Sheet**
Capital stock ($1 par)	$10,000	$800 (800,000 × $1 par) $15,200 ($16,000 - 800)	$10,800
Additional paid in capital	12,000		27,200
Retained earnings	28,000		28,000
Total Stockholders' Equity	$50,000		$66,000

Capital stock is increased to reflect the additional amount of outstanding shares issued at par value (800,000 × $1). Additional paid in capital is increased by the purchase price less the par value of the issued shares, $15.2 million ($16 million – $800,000).

Choice B incorrectly includes the increase to capital stock of 800,000 share of $1 par stock in the calculation for additional paid in capital. Choice C incorrectly includes Target's additional paid in capital.

ii.

Clark told Levin she questioned the fair values assigned to some of Target's older equipment. If Clark's assumptions were correct and the fair values of Target's identifiable assets were overstated by $2 million, the *most likely* impact to the post-combination balance sheet would be:

- Lower goodwill and an increase in total assets.
- Higher goodwill and no change in total assets.
- Higher goodwill and a decrease in total assets.

Rationale

This Answer is Incorrect

The $16 million price paid by Acquirer represents an excess purchase price of $8.1 million; it exceeds the book value of Target's net assets ($16 million – 7.9 million). The excess purchase price is first allocated to any identifiable assets with fair values in excess of book value, with the remainder assigned to goodwill. Using the original estimates of the fair values for the assets, the fair value of net assets over book value is $5 million ($12.9 million – $7.9 million). Therefore, goodwill is $3.1 ($8.1 million – 5 million) based on the data used by Levin.

If the fair value of net assets over book value were $3 million instead of $5 million (overstated by $2 million); goodwill would be higher at $5.1 ($8.1 million – 3 million). There would be no change to total assets. Goodwill is simply the residual of any excess purchase price not assigned to specific assets.

Rationale

This Answer is Incorrect

The $16 million price paid by Acquirer represents an excess purchase price of $8.1 million; it exceeds the book value of Target's net assets ($16 million – 7.9 million). The excess purchase price is first allocated to any identifiable assets with fair values in excess of book value, with the remainder assigned to goodwill. Using the original estimates of the fair values for the assets, the fair value of net assets over book value is $5 million ($12.9 million – $7.9 million). Therefore, goodwill is $3.1 ($8.1 million – 5 million) based on the data used by Levin.

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Rationale

This Answer is Incorrect

The $16 million price paid by Acquirer represents an excess purchase price of $8.1 million; it exceeds the book value of Target's net assets ($16 million – 7.9 million). The excess purchase price is first allocated to any identifiable assets with fair values in excess of book value, with the remainder assigned to goodwill. Using the original estimates of the fair values for the assets, the fair value of net assets over book value is $5 million ($12.9 million – $7.9 million). Therefore, goodwill is $3.1 ($8.1 million – 5 million) based on the data used by Levin.

If the fair value of net assets over book value were $3 million instead of $5 million (overstated by $2 million); goodwill would be higher at $5.1 ($8.1 million – 3 million). There would be no change to total assets. Goodwill is simply the residual of any excess purchase price not assigned to specific assets.

iii.

If the acquisition had been accounted for using the pooling of interests method rather than the acquisition method, the consolidated financial statements in subsequent periods would *most likely* report:

- Higher revenue.
- Higher net income.
- Higher total equity.

Rationale

This Answer is Incorrect

Pooling of interests combines companies at historical costs. One of the resulting main benefits for immediate future periods is a lower fixed asset base, which generates lower depreciation expense. This lower depreciation results in comparatively higher net income. Similarly, total equity is generally lower under pooling versus methods based on fair value because of the use of historical cost. Revenue is not affected.

Rationale

This Answer is Incorrect

Pooling of interests combines companies at historical costs. One of the resulting main benefits for immediate future periods is a lower fixed asset base, which generates lower depreciation expense. This lower depreciation results in comparatively higher net income. Similarly, total equity is generally lower

under pooling versus methods based on fair value because of the use of historical cost. Revenue is not affected.

Rationale

This Answer is Incorrect

Pooling of interests combines companies at historical costs. One of the resulting main benefits for immediate future periods is a lower fixed asset base, which generates lower depreciation expense. This lower depreciation results in comparatively higher net income. Similarly, total equity is generally lower under pooling versus methods based on fair value because of the use of historical cost. Revenue is not affected.

Question 36
L2FR-TBX101-1502
LOS: LOS-6950
Lesson Reference: Lesson 3: Investments in Business Combinations
Difficulty: easy
When accounting for intercorporate investments using the equity method, relative to using the acquisition method, revenues are *most likely* to be:

- (selected) Lower.
- Higher.
- The same.

Rationale

This Answer is Correct

Under the equity method, revenues recognized will be only those of the parent company. Under the acquisition method, 100% of the revenues of the subsidiary will be consolidated into the group accounts.

Question 37
L2R18TB-AC034-1512
LOS: LOS-6930
Lesson Reference: Lesson 2: Investments in Associates and Joint Ventures
Difficulty: medium
Whistle Inc. acquires a 25 percent interest in Kettle Ltd. for £400,000 on January 1, 20X1. During 20X1 Whistle buys inventory from Kettle; 40 percent of this inventory is resold to a third party by the end of that year. Kettle's net identifiable assets have a fair value at the date of the investment of £1,200,000, which is equal to book value. At the end of 20X1 Kettle reports net income of £300,000 which includes £100,000 profit from the sale of inventory to Whistle. If Whistle complies with IFRS and accounts for the investment in Kettle using the equity method then the equity income that Whistle will report on its income statement at the end of 20X1 is *closest* to:

- £65,000
- £60,000
- £50,000

Rationale
£65,000
Since Whistle reports using the equity method it will show a one-line consolidation of its proportionate share of Kettle's income on its income statement. Whistle adjusts its share of Kettle's net income for the amortization of excess purchase price and unrealized profit from intercompany transactions. Since Kettle's fair value equals book value there is no excess purchase price to allocate. The only adjustment is the unrealized profit from the upstream transaction. If 40 percent of the inventory was sold in 20X3, 60 percent of the profit is unrealized and Whistle must deduct that portion from its share of Kettle's net income.

Whistle's share of Kettle's reported income: 25 percent × £300,000	£75,000
Unrealized profit: 25 percent × (60 percent × £100,000)	(15,000)
Whistle's reported share of Kettle's equity income	£60,000

Rationale
£60,000
Since Whistle reports using the equity method it will show a one-line consolidation of its proportionate share of Kettle's income on its income statement. Whistle adjusts its share of Kettle's net income for the amortization of excess purchase price and unrealized profit from intercompany transactions. Since Kettle's fair value equals book value there is no excess purchase price to allocate. The only adjustment is the unrealized profit from the upstream transaction. If 40 percent of the inventory was sold in 20X3, 60 percent of the profit is unrealized and Whistle must deduct that portion from its share of Kettle's net income.

Whistle's share of Kettle's reported income: 25 percent × £300,000	£75,000
Unrealized profit: 25 percent × (60 percent × £100,000)	(15,000)
Whistle's reported share of Kettle's equity income	£60,000

Rationale
£50,000
Since Whistle reports using the equity method it will show a one-line consolidation of its proportionate share of Kettle's income on its income statement. Whistle adjusts its share of Kettle's net income for the amortization of excess purchase price and unrealized profit from intercompany transactions. Since Kettle's fair value equals book value there is no excess purchase price to allocate. The only adjustment is the

unrealized profit from the upstream transaction. If 40 percent of the inventory was sold in 20X3, 60 percent of the profit is unrealized and Whistle must deduct that portion from its share of Kettle's net income.

Whistle's share of Kettle's reported income: 25 percent × £300,000	£75,000
Unrealized profit: 25 percent × (60 percent × £100,000)	(15,000)
Whistle's reported share of Kettle's equity income	£60,000

Question 38
L2FR-TB0010-1412
LOS: LOS-6930
Lesson Reference: Lesson 1: Investments in Financial Assets
Difficulty: medium
Which of the following classifications for equity investments under the standard for financial investments, IFRS 9, are irrevocable?

- (selected) Both FVOCI and FVPL.
- FVOCI only.
- FVPL only.

Rationale

This Answer is Correct

The choice to measure equity investments at fair value through profit and loss (FVPL) and fair value through other comprehensive income (FVOCI) is irrevocable.

Question 39

L2FR-ITEMSET-PQ1721-1411
LOS: LOS-6930
LOS: LOS-6940
LOS: LOS-6950
Lesson Reference: Lesson 3: Investments in Business Combinations
Difficulty: medium

Use the following information to answer the next 2 questions:

Prime Inc. acquired a 100% equity interest in Super Inc. by issuing 1 million shares of common stock. The par value of each share was $1.5, while the market price of each share at the time of the transaction was $15. The following information relates to the two companies just before the transaction:

	Prime Inc.	**Super Inc.**	
	Book Value ($ '000)	**Book Value ($ '000)**	**Fair Value ($ '000)**
Cash and receivables	16,500	820	820
Inventory	15,000	3,250	5,750
Net PP&E	38,500	6,500	8,000
Total assets	**70,000**	**10,570**	**14,570**
Current payables	9,000	1,650	1,650
Long-term debt	18,500	6,000	5,200
Total liabilities	**27,500**	**7,650**	**6,850**
Net assets	**42,500**	**2,920**	**7,720**
Capital stock ($1.5 par)	9,000	500	
Additional paid-in capital	12,000	700	
Retained earnings	21,500	1,720	
Total shareholders' equity	**42,500**	**2,920**	

Prime Inc. uses the acquisition method to report its investment in Super Inc.

i.
The amount of goodwill reported on the post-combination balance sheet is *closest* to:

- ○ $12,080,000
- ● $7,280,000
- ○ $8,080,000

Rationale

This Answer is Correct

Excess purchase price = Cost of acquisition – Book value of net assets acquired

Excess purchase price = ($15 × 1,000,000) – $2,920,000 = $12,080,000

Allocated to identifiable net assets:

Inventory = $5,750,000 – $3,250,000 = $2,500,000

PP&E = $8,000,000 – $6,500,000 = $1,500,000

Long-term debt = $6,000,000 – $5,200,000 = $800,000

Goodwill = $12,080,000 – $2,500,000 – $1,500,000 – $800,000 = $7,280,000

ii.

Which of the following *most accurately* represents the amount of total assets and additional paid-in capital reported on the post-combination balance sheet?

	Total Assets ($'000)	Additional Paid-in Capital ($'000)
A	91,850	25,500
B	84,570	12,000
C	91,050	13,500

- (selected) Row A
- Row B
- Row C

Rationale

This Answer is Correct

Cash and receivables = $16,500,000 + $820,000 = $17,320,000

Inventory = $15,000,000 + $5,750,000 = $20,750,000

Net PP&E = $38,500,000 + $8,000,000 = $46,500,000

Goodwill = $7,280,000

Total assets = $17,320,000 + $20,750,000 + $46,500,000 + $7,280,000 = $91,850,000

Additional paid-in capital = Parent's additional paid-in capital + (Market value of shares issued – Par value of shares issued)

Additional paid-in capital = $12,000,000 + [($15 × 1,000,000) – ($1.5 × 1,000,000)]

Additional paid-in capital = $25,500,000

Question 40
L2R18TB-AC044-1512
LOS: LOS-6940
Lesson Reference: Lesson 3: Investments in Business Combinations
Difficulty: medium
A reporting unit of Hampton Industries has a carrying value of $2.2 million which includes a recorded goodwill of $700,000. The reporting unit has a fair value of $2.0 million and its net identifiable assets are estimated as of the impairment test date to be valued at $1.7 million. If Hampton applies U.S. GAAP, then the impairment loss is *closest to*:

- $200,000
- $300,000
- $400,000

Rationale
$200,000
U.S. GAAP uses a two-step approach to calculate an impairment loss. First determine if the fair value of the reporting unit is less than its carrying book value. If so, a loss exists. Second, calculate the implied goodwill by deducting the fair value of the net identifiable assets from the fair value of the reporting unit. The implied goodwill is deducted from the carrying value of the goodwill to determine the impairment loss.

U.S. GAAP

Step 1:

Is unit's fair value of reporting < its carrying book value? Yes ($2 million < $2.2 million)

Step 2:

Fair value of reporting unit	$2,000
Less: Fair value of net identifiable assets	1,700
Implied goodwill	$300
Current carrying value of goodwill	$700
Less: Implied goodwill	300
Impairment loss	$400

Rationale
$300,000
U.S. GAAP uses a two-step approach to calculate an impairment loss. First determine if the fair value of the reporting unit is less than its carrying book value. If so, a loss exists. Second, calculate the implied goodwill by deducting the fair value of the net identifiable assets from the fair value of the reporting unit. The implied goodwill is deducted from the carrying value of the goodwill to determine the impairment loss.

U.S. GAAP

Step 1:

Is unit's fair value of reporting < its carrying book value? Yes ($2 million < $2.2 million)

Step 2:

Fair value of reporting unit	$2,000
Less: Fair value of net identifiable assets	1,700
Implied goodwill	$300
Current carrying value of goodwill	$700
Less: Implied goodwill	300

U.S. GAAP

Impairment loss	$400

Rationale

$400,000

U.S. GAAP uses a two-step approach to calculate an impairment loss. First determine if the fair value of the reporting unit is less than its carrying book value. If so, a loss exists. Second, calculate the implied goodwill by deducting the fair value of the net identifiable assets from the fair value of the reporting unit. The implied goodwill is deducted from the carrying value of the goodwill to determine the impairment loss.

U.S. GAAP

Step 1:

Is unit's fair value of reporting < its carrying book value? Yes ($2 million < $2.2 million)

Step 2:

Fair value of reporting unit	$2,000
Less: Fair value of net identifiable assets	1,700
Implied goodwill	$300
Current carrying value of goodwill	$700
Less: Implied goodwill	300
Impairment loss	$400