Case Study: Consolidated Balance Sheet At Date Of Purchase

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ABSTRACT

Consolidated financial statements have gained great popularity over the last decade with the resurrection of acquisitions and the increased global expansion of business. This case study provides an actual case study of the preparation and presentation of a Consolidated Balance Sheet on the date of acquisition. An in-depth analysis is provided as to how to value the acquired entity, how to calculate Goodwill and how to measure the Non-Controlling interest portion. Work paper and adjusting entries are also highlighted to help facilitate the consolidation process.

Keywords: Consolidated Balance Sheet on the Date of Acquisition; Goodwill; Non-controlling Interest

INTRODUCTION

This case study will provide a thorough illustration as to the concepts of consolidations on the date of acquisition. On this date, an ensuing Consolidated Balance Sheet is created, whereby the acquiring and the acquired companies are combined as a single entity. Interestingly, there are options as to the consolidation basis which may be utilized, which also includes the push-down method of accounting. The push-down method was illustrated in a previous case study and it is highly recommended that the reader resort to this, which can be found in Harris & Dilling (2015).

An overview of this critical topic will be discussed, followed by a comprehensive illustration demonstrating the results of consolidated results as of the date of acquisition. Note that the resulting Balance Sheet will be the same with the push-down accounting result. This case study is recommended as a group project for an Advanced Accounting course as well as for a graduate Financial Statement Analysis class**.**

FACTS

On December 31, 2011, PA. Inc. purchased 95 percent of Sub. Inc. for 120,000 cash. The Balance Sheet of each corporation just prior to the acquisition is presented below. Additionally, book value and fair value for all of Sub's assets and liabilities are equal, with the exception of Property, Plant and Equipment, whose fair value is 47,000.

Table 1. Balance sheet before acquisition

Balance Sheet		
	PA Inc.	**SUB Inc.**
Assets	**12/31/2011**	**12/31/2011**
Current Assets		
Cash	$170,000	$21,000
Accounts receivable (Net)	60,000	45,000
Inventory	50,000	45,000
Total Current Assests	**$280,000**	**$111,000**
Fixed Assets		
Property, Plant, and Equipment (Net of Accumulated Depreciation)	265,000	42,000
Goodwill		
Total Assets	**545,000**	**153,000**

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	PA Inc.	SUB Inc.
Liabilities		
Current Liabilities		
Accounts Payable	$70,000	$30,000
Accruals Payable	20,000	15,000
Total Current Liabilities	**$90,000**	**$45,000**
Non-Current Liabilities		
Bonds Payable	$180,000	
Total liabilities	**$270,000**	**$45,000**
Shareholders' Equity		
Non-Controlling Interest (Share of Subsidiary)	$	$
Common Stock ($5 Par)	100,000	55,000
Paid In Capital	20,000	8,000
Retained Earnings	155,000	45,000
Total Shareholders' Equity	**$275,000**	**$108,000**
Total Liabilities and Shareholder's Equity	**$545,000**	**$153,000**

REQUIRED

1. Recording the purchase of Sub. Inc. by PA (the parent company).
2. What is the implied fair value of Sub Inc.?
3. Calculate the amount of Goodwill implicit in this purchase.
4. What is the amount of the non-controlling interest share in Sub Inc. at the date of acquisition?
5. What is the consolidated depreciation expense to be reflected in the consolidated Income Statement for 2012 assuming a 10 year depreciation life for property, plant and equipment?
6. Prepare the necessary work paper adjusting entries on the date of purchase.
7. Prepare a consolidated Balance Sheet immediately after this acquisition on 12/31/2011.

RECOMMENDED SOLUTIONS

1. **Record the purchase of Sun Inc. by PA (the parent company).**
   Dr. Investment in Sub 120,000
   Cr. Cash 120,000
   This transaction brings the cash balance in PA down to $50,000.

2. **What is the implied fair value of Sub Inc.?**
   This will equal the price paid for SUB. Inc. divided by the ownership share acquired by PA. Inc.
   The implied fair value of Sub. Inc. is $120,000 divided by 95 percent, which equals $126,316.

3. **Calculate the amount of Goodwill implicit in this purchase.**
   Goodwill will equal the excess value of the company's net identifiable net assets. In this situation, the value of Sub Inc. is the purchase amount paid by PA divided by the share of ownership interest, calculated as follows; 120,000 /.95=126,316. The identifiable net assets of Sub Inc., are its Shareholders' Equity book value, plus or minus fair value adjustments. In this case, the only fair value adjustment is an increase in Property, plant and equipment by $5,000 (47,000-42,000), making the fair value of Bub's identifiable net assets equal to: $108,000 plus 5,000, or $113,000. Goodwill will thus equal: $126,316 less 113,000, or $13,316.

4. **What is the amount of non-controlling interest share in Sub Inc. at the date of acquisition?**
This will equal the implied value of Sub. Inc. times the non-controlling ownership of Sun. Inc.
This will equal $126,316 times 5 percent, or $6,316.

5. **What is the consolidated depreciation expense to be reflected in the consolidated Income Statement for 2012 assuming a 10 year depreciation life for property, plant and equipment?**
The consolidated value of Property, Plant and Equipment as of the date of purchase on 12/31/2011 will be: $265,000 plus $47,000 (42,000 plus 5,000 above), or $312,000. This amount divided by 10 years using the straight line depreciation method will yield a depreciation expense total for 2012 in the amount of $31,200.

6. **Prepare the necessary work paper adjusting entries on the date of purchase.**
The consolidated worksheet elimination entries are as follows:

Dr. Common Stock-Sub	55,000
Dr. Paid In Capital –Sub	8,000
Dr. Retained Earnings-Sub	45,000
Dr. Property, Plant and Equipment	5,000
Dr. Goodwill	13,316
Cr. Investment in Sub	120,000
Cr. Non-controlling Interest in Sub (126,316 times 5 percent)	6,316

7. **Prepare a Consolidate Balance Sheet at the date of purchase on 12/31/2011.**

Table 2. Consolidated balance sheet

Assets	PA INC.	SUB INC.	Adjustments		Consolidate
Current Assets			Dr.	Cr.	
Cash = $191,000-120,000 =	$50,000	$21,000			$71,000
Accounts Receivable (Net)	60,000	45,000			105,000
Inventory	50,000	45,000			95,000
Total Current Assets	160,000	111,000			271,000
Investment in Sub. Inc.	120,000			120,000	
Fixed Assets					
Property, Plant, and Equip. (Net)	265,000	42,000	5,000		312,000
Goodwill			13,316		13,316
Total Assets	545,000	153,000	18,316	120,000	596,316
Liabilities					
Current Liabilities					
Accounts Payable	$70,000	$30,000			$100,000
Accruals Payable	20,000	15,000			35,000
Total Current Liabilities	90,000	45,000			135,000
Non-Current Liabilities					
Bonds Payable	180,000				180,000
Total liabilities	**270,000**	**45,000**			**315,000**
Shareholders' Equity					
Non-Controlling Interest				$6,316	$6,316
Common Stock ($5 Par)	100,000	55,000	55,000		100,000
Paid In Capital	20,000	8,000	8,000		20,000
Retained Earnings	155,000	45,000	45,000		155,000
Total Shareholders' Equity	**275,000**	**108,000**	**108,000**	**6,316**	**281,316**
Total Liabilities and Shareholder's Equity	**545,000**	**153,000**	**126,316**	**126,316**	**596,316**

PA Inc. And SUB Inc. Balance Sheet

	12/31/2011
Assets	
Current Assets	
Cash	$71,000
Accounts Receivable (Net)	105,000
Inventory	95,000
Total Current Assets	**271,000**
Fixed Assets	
Property, Plant, and Equipment (Net of Accumulated Depreciation)	312,000
Goodwill	13,316
Total Assets	**596,316**
Liabilities	
Current Liabilities	
Accounts Payable	100,000
Accruals Payable	35,000
Total Current Liabilities	**135,000**
Non-Current Liabilities	
Bonds Payable	180,000
Total liabilities	**315,000**
Shareholders' Equity	
Non-Controlling Interest (Share of Subsidiary)	6,316
Common Stock ($5 Par)	100,000
Paid In Capital	20,000
Retained Earnings	155,000
Total Shareholders' Equity	**281,316**
Total Liabilities and Shareholder's Equity	**596,316**

CONCLUSION

This case study introduced the student to the concepts of consolidated financial statements on the date of acquisition. A comprehensive illustration was provided, resulting in a Balance Sheet presentation of a consolidated group. Compliant journal entries necessary to record the purchase of the subsidiary, as well as the consolidated worksheet elimination entries were provided towards the presentation of the Balance Sheets. A follow up case study on a full set of financial statements; including a Balance Sheet, Income Statement and Cash Flow Statement subsequent to the acquisition date is highly recommended. Additionally, a case study illustrating the effects of consolidation after the date of acquisition where the push-down accounting method is utilized should also be presented.

AUTHOR BIOGRAPHIES

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REFERENCES

Harris, P. & Dilling, P. (2015 forthcoming). Push-down Accounting: A Comprehensive Case Study, *Journal of Business Case Studies.*