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Students' Department

H. P. Baumann, *Editor*

AMERICAN INSTITUTE EXAMINATIONS

[Note.—The fact that these answers appear in The Journal of Accountancy should not cause the reader to assume that they are the official answers of the board of examiners. They represent merely the opinions of the editor of the *Students' Department*.]

Examination in Accounting Theory and Practice—Part I

November 15, 1934, 1.30 P. M. to 6.30 P. M.

Solve all problems.

No. 1 (25 points):

On January 1, 1933, the F company purchased 90% of the stock of Company G and 80% of the stock of Company H. Wishing to acquire the remaining stock of the more profitable company (Company H) Company F on June 30, 1933, disposed of 200 shares of its holdings in Company G at a price of $160 per share, and on that date was successful in acquiring an additional 10% of the stock of Company H in exchange for the entire proceeds of the sale of Company G stock.

The investment accounts on the books of Company F are carried at cost except the account representing the investment in capital stock of Company G: this account has been credited with the proceeds of the 200 shares sold.

From the following post-closing trial balances of the three companies at December 31, 1933, prepare:

1. A consolidated balance-sheet
2. A statement of consolidated earned surplus
3. A statement of goodwill

Assets	F	G	H
Current assets	$152,500	$150,000	$105,000
Investment in subsidiary companies—			
Company G:			
Capital stock	220,000		
Advances	25,000		
Company H:			
Capital stock	214,000		
Advances	40,000		
Buildings and equipment		170,000	235,000
	$651,500	$320,000	$340,000

Liabilities	F	G	H
Capital stock:			
Company F—3,000 shares	$300,000		
Company G—2,000 shares		$200,000	
Company H—1,000 shares			$100,000
Due to parent company		25,000	40,000
Accounts payable	235,000	40,000	25,000
Surplus at beginning of year	166,500	60,000	145,000

Profit for the year	* $20,000	$15,000	$40,000
Dividends (paid Dec. 31, 1933)	*70,000*	*20,000*	*10,000*
	$651,500	$320,000	$340,000

* Dividends received from subsidiary companies, less expenses of parent company.

It is assumed that the profits of the companies for the year 1933 were divided equally between the two six months periods.

Solution:

Probably as good a start as any in the solution of this problem is to determine the cost of the investment in Companies G and H, as this information is necessary to compute the goodwill arising in the purchases.

An analysis of the investment account for the stock of Company G at December 31, 1933, would show:

	Shares	Amount
Balance, December 31, 1933	1,600	$220,000
Sale price of stock sold	200	32,000
Cost of original purchase (90%)	1,800	$252,000
Cost per share ($252,000 ÷ 1,800)		$140

The 200 shares of stock of Company G cost the F company $28,000 (200 times $140), which amount should have been credited to the investment account, rather than the selling price of $32,000. The adjustment necessary to reflect the correct cost in the investment account and to transfer the realized profit to the surplus account follows:

Investment in Company G	$4,000	
Surplus (F company)		$4,000

To transfer the profit on the sale of 200 shares of stock of Company G to the surplus account

After the investment account has been charged with the $4,000 debit in the above entry, it will show that the cost of the 1,600 shares held on December 31, 1933, cost (1,600 times $140) $224,000. (Since the F company is following the practice of carrying its investments at cost and taking subsidiaries' profits into income when they are realized in the form of dividends, a share of Company G's profits for the six months ended June 30, 1933, has not been added to the cost of the stock sold in computing the profit on the sale. Correspondingly, in taking up F company's share of G's profit for 1933, no consideration is given to the profit applicable to the stock sold. This profit was in effect realized by the sale of the stock, and forms part ($750) of the $4,000 profit.)

The cost of the two purchases of the capital stock of Company H is determined in the following analysis of the investment account:

	Shares	Amount
Cost of first purchase	800	$182,000
Cost of second purchase	100	32,000
Total	900	$214,000

Having obtained the cost of the several purchases of stock in the subsidiaries, the candidate may now proceed with the statement of goodwill. It will be noticed in the following statement, and in the consolidated balance-sheet, that the goodwill arising from the second purchase of stock of Company H is deducted from the surplus arising from the first purchase ("negative goodwill"). Whether the remaining, or net "negative goodwill" should be applied against the goodwill arising from the purchase of the stock of Company G is open to question.

(3) The F Company and its subsidiaries, Companies G and H. Statement showing computation of goodwill (and surplus arising from consolidation), December 31, 1933

	Book value			Goodwill (surplus arising from consolida- tion*)
	Total	Propor- tionate interest	Cost of stock purchased	
Acquisition of stock of Company G:				
Book value—January 1, 1933:				
Capital stock............	$200,000			
Surplus.................	60,000			
Total.................	$260,000			
80% thereof.............		$208,000	$224,000	$ 16,000
Acquisition of stock of Company H:				
First purchase: January 1, 1933:				
Net worth:				
Capital stock..........	$100,000			
Surplus...............	145,000			
Total—January 1, 1933..	$245,000			
80% thereof..............		$196,000	$182,000	$14,000*
Second purchase, June 30, 1933:				
Profit for the six months January 1, 1933 to June 30, 1933.............	20,000			
Total, June 30, 1933.....	$265,000			
10% thereof..............		26,500	32,000	5,500
Totals................		$222,500	$214,000	$8,500*

(2) The F Company and its subsidiaries, Companies G and H. Statement of consolidated surplus for the year ended December 31, 1933

Company F:			
Balance, January 1, 1933		$166,500	
Dividends received:			
Company G (80% of $20,000)	$16,000		
Company H (90% of $10,000)	9,000	25,000	
Profit on sale of stock of Company G		4,000	$195,500
Deduct:			
Net loss for the year (exclusive of the dividends received from subsidiary companies)		$ 5,000	
Dividends paid, December 31, 1933		70,000	75,000
Balance, December 31, 1933			$120,500
Company G:			
Pro-rata share of the net decrease in the surplus account of Company G during the year:			
Dividends paid		$ 20,000	
Profits for the year		15,000	
Net decrease in surplus account		*$5,000*	
80% thereof			*4,000*
Company H:			
Pro-rata share of the net increase in the surplus account of Company H during the year:			
Six months ended June 30, 1933	$20,000		
80% thereof		$ 16,000	
Six months ended December 31, 1933	$20,000		
Dividends paid	10,000		
Net increase	$10,000		
90% thereof		9,000	25,000
Consolidated surplus, December 31, 1933			$141,500

The following consolidated balance-sheet was prepared by totaling the current assets, buildings and equipment, and accounts payable accounts; by eliminating the reciprocal accounts; and by inserting the goodwill, surplus arising through consolidation, minority interests, and consolidated surplus as derived in the accompanying statements and schedules. The formal working papers shown on page 60 are unnecessary to the solution, and are given here for explanatory purposes only.

(1) The F Company and its subsidiaries, Companies G and H. Consolidated balance-sheet, December 31, 1933

Assets

Current assets		$407,500
Buildings and equipment		405,000
Goodwill arising through consolidation		16,000
		$828,500

Liabilities and capital

Accounts payable		$300,000
Minority interests:		
Company G	$ 51,000	
Company H	27,500	
		78,500
Capital:		
Capital stock—3,000 shares	$300,000	
Surplus	141,500	
Surplus arising through consolidation	8,500	450,000
		$828,500

The minority interest in the subsidiary companies was determined by multiplying the book value of the companies at December 31, 1933, by the percentage of minority interest, as follows:

	Companies	
	G	H
Capital stock	$200,000	$100,000
Surplus, January 1, 1933	60,000	145,000
Profit for the year	15,000	40,000
Dividends paid	20,000*	*10,000*
Book values, December 31, 1933	$255,000	$275,000
Minority interest:		
Percentage	20%	10%
Amount	$ 51,000	$ 27,500

The F Company and its subsidiaries, Companies G and H. Consolidated balance-sheet—working papers, December 31, 1933

Assets	F	G	H	Eliminations and adjustments		Consolidated balance-sheet	
Current assets	$152,500	$150,000	$105,000			$407,500	
Investment in subsidiary companies—							
Company G:							
Capital stock	220,000			(1) $ 4,000	(2) $208,000	16,000	Goodwill
Advances	25,000				(6) 25,000		
Company H:							
Capital stock	214,000				(3) 222,500	*8,500*	Surplus arising from consolidation
Advances	40,000				(6) 40,000		
Buildings and equipment		170,000	235,000			405,000	
Totals	$651,500	$320,000	$340,000			$820,000	
Liabilities							
Capital stock:							
Company F—3,000 shares	$300,000					$300,000	
Company G—2,000 shares		$200,000		(2) 160,000		40,000	Minority interest
Company H—1,000 shares			$100,000	(3) 90,000		10,000	" "
Due to parent company		25,000	40,000	(6) *65,000*			
Accounts payable	235,000	40,000	25,000			300,000	
Surplus at beginning of year:							
Company F	166,500				(1) 4,000	170,500	Surplus
Company G		60,000		(2) 48,000		12,000	Minority interest
Company H			145,000	(3) 130,500		14,500	" "
Profit for the year:							
Company F	20,000			(4) 4,000	(5) 25,000	41,000	Surplus
Company G		15,000		(4) 12,000		3,000	Minority interest
Company H			40,000	(3) 2,000		4,000	" "
Dividends (paid December 31, 1933):				(5) 34,000			
Company F	*70,000*					*70,000*	Surplus
Company G		*20,000*			(4) 16,000	*4,000*	Minority interest
Company H			*10,000*		(5) 9,000	*1,000*	" "
Totals	$651,500	$320,000	$340,000	$549,500	$549,500	$820,000	

Adjusting and elimination entries used in the working papers.

(1)

	Debit	Credit
Investment—Company G	$ 4,000	
Surplus—Company F		$ 4,000
To record the profit on the sale of 200 shares of stock of Company G		

(2)

	Debit	Credit
Capital stock—Company G	160,000	
Surplus at beginning of year—Company G	48,000	
Investment—Company G		208,000
To eliminate the 80% interest in the capital stock and surplus of Company G as at the date of purchase.		

(3)

	Debit	Credit
Capital stock—Company H	90,000	
Surplus at beginning of year—Company H	130,500	
Profit for the year—Company H	2,000	
Investment—Company H		222,500
To eliminate the 90% interest in the capital stock and surplus accounts of Company H, and the 10% interest in the profits for the first six months of 1933. (The latter representing part of the surplus at acquisition of the 10% purchased on June 30.)		

(4)

	Debit	Credit
Profit for the year—Company F	4,000	
Profit for the year—Company G	12,000	
Dividends—Company G		16,000
To transfer to the profits account of Company F its 80% interest in the profits and dividends of Company G.		

(5)

	Debit	Credit
Profit for the year—Company H	34,000	
Dividends—Company H		9,000
Profit for the year—Company F		25,000
To transfer to the profits account of Company F its 90% interest in the dividend of Company H, and its share of the earnings of the latter company for the current year as follows.		

	Six months ended	
	June 30	Dec. 31
Profit	$20,000	$20,000
Per cent	80%	90%
Share	$16,000	$18,000

(6)

Due to parent company	$65,000	
Advances—Company G		$25,000
Advances—Company H		40,000

To eliminate the inter-company accounts.