South Valley University
Faculty of Commerce
Accounting Department
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Lectures in

Contemporary Accounting Issues

Collection

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IN THE NAME OF ALLAH, THE MOST GRACIOUS, THE MOST MERCIFUL

THIS TEXTBOOK IS DEDICATED TO
THE MEMORY OF MY FATHER AND MY MOTHER
&
MY WIFE AND MY CHILDREN

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Preface

Praise to *Almighty ALLAH* who gave me the strength, patience, and ability to complete this textbook.

This textbook has been written to provide students with the comprehensive tools necessary to succeed in the modern world of accounting. The emphasis throughout of this textbook is on financial accounting concepts and on the application of those concepts to problems arising in business organizations.

Therefore, this textbook is divided into a variety of chapters intended to put the students, who study business, on the right way towards understanding contemporary accounting issues. Chapter one of this issue covers the departmental accounts. Chapter two introduces to the accounting for branches. Chapter three is entitled accounting for business combinations. Chapter four also discusses consolidated financial statements on the date of business combination.

CHAPTER ONE
DEPARTMENTAL ACCOUNTS

CHAPTER ONE

DEPARTMENTAL ACCOUNTS

1.1 Introduction:

In the real world, a business may have a number of **Departments** each one deals in a different type of goods. For instance, one department may be dealing in furniture, the other may be dealing in textile, and still another may be dealing in gifts and so on. Hence and in order to determine the net profit or loss made by each Department, it will be advisable to prepare separately *Trading and Profit & Loss Account* of each Department at the end of the accounting year. To a great extent, preparation of such Departmental Accounts is helpful to the business regarding the following respects:

(1) It enables the business to compare the performance of one Department with that of another.

(2) It helps the business in formulating proper policies relating to the expansion of the business. Accordingly, new profitable lines of production or trading can be taken up while the existing lines of production or trading which are giving a loss can be closed down.

(3) It helps in appropriate rewarding or penalising the Departmental employees on the basis of the results implemented by them.

1.2 Maintenance of Columnar Subsidiary Books:

Practically, the preparation of *Departmental Trading and Profit & Loss Account* requires maintenance of proper subsidiary books having appropriate columns for different departments. For example, if an enterprise has three department, namely ***A, B and C***, the subsidiary books such as Purchase Book, Purchase Returns Book, Sales Book, Sales Returns Book, etc, should have separate columns for each of the departments. Cash book may also have columns for recording cash sales of each of the departments separately in case the volume of cash sales is quite large. The pro forma of a Purchases Book having columns for different Departments is shown below:

Purchase Book

Date	Particulars	Deptt. A	Deptt. B	Deptt. C

The same design of rulings can be followed in case of other subsidiary books also.

1.3 Departmentalization of Expenses:

Logically and in order to ascertain the net profit or loss made by each department, it is necessary that each department is charged with a proper share of the various business expenses. The following basis may be adopted for departmentalization of such expenses:

1- Expenses incurred specifically for a particular department should be directly charged to that department. For instance, salaries payable to each of the departmental managers will be charged to the respective departments. Similarly, if there are separate electricity meters for each of the departments, the electricity expenses should be charged to each of the departments on the basis of the electricity bills received for each one of them.

2- Expenses which have been incurred for the business as a whole but capable of being apportioned over different departments on a suitable basis should be charged to the different departments, on such basis. Of course, there are no hard and fast rules as regards the basis to be apply for apportionment of such expenses. Nevertheless, the following basis for apportionment may be adopted:

(a) **Departmental wages.** Expenses which directly vary with the departmental wages can be apportioned on this basis. For example, premium for work persons' compensation, insurance, etc may be apportioned on this basis.

*(b)***Capital value of the assets.** Expenses such as depreciation of buildings, plants and machinery, fire insurance premiums regarding this assets etc, may be apportioned on this basis.

(c) **Floor area**. Expenses such as lighting (unless metered separately), rent and rates, wages of night watchmen etc, may be apportioned on this basis.

(d) **Number of workers employed**. Expenses of workers' canteen, welfare, personnel and time keeping departments etc, may be apportioned on this basis.

(e) **Production hours of direct labour**. Works manager's remuneration, general over-time expenses, cost of inter-departmental transport should be charged to the various departments in the ratio which the Departmental Direct Labour Hours bear to the Total Factory Direct Labour Hours.

*(f)***Technical estimate**. Advice of the technical personnel may also be useful for the apportionment of certain expenses. For

example, the cost of the central conditioning consumed by a particular department may be estimated on the basis of the engineer's estimate.

3- Expenses which cannot be allocated or apportioned over different departments in a reasonable manner should be charged to the total profit of all the departments taken together. For this purpose, the profit shown by the different departments should be brought down in one account which will be termed as the General Profit & Loss Account and all such expenses should be charged there. General Manager's salary, Directors' fees, Auditors' remuneration, financial interest etc. are some of the expenses which fall in this category.

1.4 Types of Problems:

The common problems relating to departmental accounts can be put in the following categories:

(1) Problems relating to Departmentalization of Expenses.

(2) Problems relating to Computation of Departmental Costs.

(3) Problems relating to Inter-departmental Transfers:

(a) When such transfers are at cost.

(b) When such transfers are at a price higher than the cost.

In the following pages, practical illustrations will be given in respect of each of these types of problems.

(1) Departmentalization of Expenses:

Illustration 1.1:

Elmasrya Auto Garage has three departments: Cars and Trucks, Two wheelers, and Servicing. The former two sell spare parts and occupy a godown-showroom. The servicing department uses a garage and additional site.

The following particular ended are extracted from the books of the business for the year ended 31st of December 2023, from which you are required to prepare:

(a) A departmental Trading and Profit and Loss Account.
(b) A general Profit and Loss Account, and
(c) A Balance Sheet.

Stock 1/1/023	L.E.
Cars and Trucks	100,000
Two-wheelers	27,500
Purchases:	
Cars and Trucks	350,000
Two-Wheelers	110,000
Sales:	
Cars and Trucks	600,000
Two-Wheelers	300,000
Servicing	100,000
Wages of counter-salespersons:	
Cars and Trucks	30,000
Two-wheelers	12,000
Wages of garage labour	10,800
Office salaries and wages	12,000
Godown and showroom rent	24,000
Land and Garage Building	272,000
Office Expenses	36,000
Garage Equipment	100,000
Showroom Furniture	70,000
Office Van	24,000
Sundry Debtors	12,000
Sundry Creditors	60,000
Bank Overdraft	17,200
Power and Lighting	36,000
Bank Interest	1,000
Cash in hand	900
Drawings A/c	12,000
Proprietor’s Capital Account	163,000

The following further information is also available:

(1) Included in “Land and Garage Building” is cost of site used by the servicing department L.E.200,000.

(2) Closing stock on 31/12/2023 at the departments: Cars and Trucks L.E.90,000. Two-wheelers L.E.32,500.

(3) 50% of power and lighting is to be charged to servicing Department, the balance equally to the other departments.

(4) Rates for depreciation are: Building 5%; Garage Equipment 15%; Showroom furniture 10% and Office Van 20%.

(5) Outstanding expenses were: Interest L.E.150 and Office expenses L.E.2,000.

(6) Interest and all expenses relating to the office are to considered common and charged to the General Profit and Loss A/c.

(7) The departments using the showroom share the space and furniture equally.

Solution:

Elmasrya Auto Garage
Departmental Trading and Profit and Loss Account
For the Year ending December 31st, 2023

Particulars	Cars & Trucks L.E.	Two Wheelers L.E.	Servicing L.E.	Particulars	Cars & Trucks L.E.	Two Wheelers L.E.	Servicing L.E.
Opening stock	100000	27500		Sales	600000	300000	100000
Purchases	350000	110000		Closing			
Wages	30000	12000	10800	Stock	90000	32500	
Gross Profit c/d	210000	183000	89200				
Totals	690000	332500	100000	*Totals*	690000	332500	100000
Godown & Showroom Rent	12000	12000		Gross Profit			
Power & Lighting	9000	9000	18000	b/d	210000	183000	89200
Depreciation:							
Building			3600				
Garage Equipment			15000				
Furniture	3500	3500					

Net Profit c/d	185500	158500	52600				
Totals	210000	183000	89200	*Totals*	210000	183000	89200

General Profit & Loss Account
For the Year ending December 31st, 2023

Office Salaries & Wages	12000	Profit b/d:	
Office Expenses 36000		Cars & Truck Dept.	185500
Outstanding 2000	38000	Two wheelers Dept.	158500
Depreciation on Van	4800	Servicing Dept.	52600
Bank interest 1000			
Outstanding 150	1150		
Net Profit	340650		
Totals	396600	*Totals*	396600

Balance Sheet
Assets As at December 31st, 2023 Liabilities

Current Assets:		Bank Overdraft	17200
Cash-in-Hand	900	Outstanding Expenses:	
sundry Debtors	12000	Interest 150	
Stock in trade:		Office Expenses 2000	2150
Cars & Trucks 90000		Sundry Creditors	60000
Two Wheelers 32500	122500	Capital 163000	
Fixed Assets:		Net Profit 340650	
Land	200000	503650	
Garage Building 72000		Less: Drawings 12000	491650
Less: Depreciation 3600	68400		
Garage Equip. 100000			
Less: Depreciation 15000	85000		
Show Room			
Furniture 70000			
Less: Depreciation 7000	63000		
Office Van 24000			
Less: Depreciation 4800	19200		
Totals	571000	*Totals*	571000

(2) Computation Departmental Costs:

Illustration 1.2:

The following purchases were made by a business entity having three departments:

Department A 1,000 units, B 2,000 units, and C 2,000 units; all at a total cost of L.E.100,000.

Stocks on 1st of January were: Department A 120 units, Department B 80 units and department C 152 units. The sales were:

Department A 1,020 units at L.E.20 each. Department B 1,920 units at L.E.22.50 each. Department C 2,496 units at L.E.25 each.

The rate of gross profit is the same in each case. Prepare Departmental Trading Account.

Solution:

In order to determine the rate of Gross Profit, it is assumed that all units purchased have been sold away.

Sales:	Dept. A 1,000 units × L.E.20 =	L.E. 20,000
	Dept. B 2,000 units × L.E.22.50 =	L.E. 45,000
	Dept. C 2,400 units × L.E.26 =	L.E. 60,000
	Total Sales	L.E. 125,000
Less	Cost of Purchases	100,000
	Gross Profit	25,000

Gross Profit as a percentage = 25000/125000 × 100 = 20%

Cost Price of units purchased for each department can now be ascertained as follows:

	Selling Price	Gross Profit	Cost
Dept. A	L.E.20	L.E.4	L.E.16
Dept. B	22.50	4.50	18
Dept. C	25	5	20

Units of closing sock Opening stock + Purchases - Sales

	Opening stock	+ Purchases	- Sales	=
Dept. A	120	+ 1000	- 1020	=100
Dept. B	80	+ 2000	- 1920	=160
Dept. C	152	+ 2400	- 2496	= 56

Departmental Trading Account can now be prepared as follows:

Departmental Trading Account

Particulars	Dept A	Dept B	Dept C	Particulars	Dept A	Dept B	Dept C
Opening stock	1920	1440	3040	Sales	20400	43200	62400
Purchases	16000	36000	48000	Closing stock	1600	2880	1120
Gross Profit	4080	8640	12480				
Totals	22000	46080	63520	*Totals*	22000	46080	63520

Illustration 1.3:

Adam sells two products manufactured in his own factory. The goods are made in two Departments, A and B for which separate sets of accounts are kept. Some of the manufactured goods of Department A are used as Raw Material by Department B and *vice versa.*

From the following data, you are required to ascertain the total cost of goods manufactured in Department A and B.

Particulars	**Dept. A**	**Dept. B**
Total units manufactured	1000000	500000
Total cost of manufacture (excluding inter-departmental transfers)	10000	5000

Department A transferred 250000 units to Department B and the latter transferred 100000 units to the former.

Solution:

Suppose a is the total cost of department A and b is the total cost of department B.

a = L.E.10000 + 1/5 b
b = L.E.5000 + ¼ a
or a = L.E.10000 + 1/5 (5000 + ¼ a)
a = L.E.10000 + 1000 + 1/20 a
a = L.E.11000 + 1/20 a
or 20 a = L.E.220000 + a
or 19 a = 220000 or a = L.E.11579
Now b = L.E.5000 + ¼ a

= L.E.5000 + ¼ × L.E.11579
= L.E.5000 + 2895 = L.E.7895.

Total Cost of Goods Manufactured

Particulars	**Dept. A L.E.**	**Dept. B L.E.**
Cost as determined above	11579	7895
Less: Transfer to department (¼ and 1/5)	2895	1579
	8684	6316

(3) Inter-Departmental Transfers:

Actually, transfers of goods or services may take place from one department to another. While preparing the Departmental Trading and Profit and Loss Account, the department receiving the goods or services should be debited with the value of the goods or services so supplied and department providing such goods or services should be credited with the same amount.

The transfer of goods from one department to another is usually at cost. However, if such transfer is at a profit, the profit or loss of each department should be ascertained on the basis of the transfer price itself. Nevertheless, if the goods transferred by one department to another at a profit, still remain unsold with the transferee department, an appropriate reserve for unrealized profit will have to be created by means of the following journal entry.

General Profit & Loss Account Dr
To Stock Reserve Account Cr

In case the transferee department has also some stock in the beginning of the accounting year, including some unrealized profit, against which stock reserve was created last year, such reserve will also be transferred to the General Profit & Loss Account by preparing the following journal entry.

Stock Reserve Account Cr
To General Profit & Loss Account Dr

Alternatively, a single journal entry may be prepared for the unrealized profit on the basis of the difference between unrealized profit included in the opening and closing stocks. This will be clear with the help of the following detailed illustration.

<u>Illustration 1.4:</u>

From the following Trial Balance, you are required to prepare Departmental Trading and Profit and Loss Account for the year ending 31st December, 2023 and the Balance Sheet as at that date.

		L.E.
Stock Jan. 1	A Department	1700000
	B Department	1450000
Purchases	A Department	3540000
	B Department	3020000
Sales	A Department	6080000
	B Department	5125000
Wages	A Department	820000
	B Department	270000

Rent, Rates, Taxes and Insurance	939000
Sundry Expenses	360000
Salaries	300000
Lighting and Heating	210000
Discount allowed	222000
Discount received	65000
Advertising	368000
Carriage Inward	234000
Furniture and Fittings	300000
Machinery	2100000
Sundry Debtors	606000
Sundry Creditors	1860000
Capital Account	4766000
Drawings	450000
Cash at Bank	1007000

The following additional information is also available:

1- Internal transfer of goods from A to B Department L.E.42,000.

2- The items Rent, Rates and Taxes and insurance, Sundry Expenses, Lighting and Heating, Salaries and carriage are to be apportioned 2/3rd to A Department and 1/3rd to B Department.

3- Advertising is to apportioned equally.

4- Discount allowed and received are to be apportioned on the basis of Departmental Sales and Purchases (excluding Transfers).

5- Depreciation at 10 per cent annually on Furniture and Fittings and on Machinery is to charge 3/4th to A Department and 1/4th to B Department.

6- Services rendered by B Department to A Department are included in its wages L.E.50,000.

7- Stock on 31st of December, 2023 in A Department was worth L.E.1,674,000 and in B Department was worth L.E.1,205,000.

Solution:

Departmental Trading & Profit & Loss Account
For the year ending 31st December, 2023

Particulars	Dept A	Dept B	Particulars	Dept A	Dept B
Opening stock	1700000	1450000	Sales	6080000	5125000
Purchases	3540000	3020000	Transfers	42000	50000
Wages	820000	270000	Closing stock	1674000	1205000
Transfer	50000	42000			
Carriage inward	156000	78000			
Gross Profit	1530000	1520000			
Totals	7796000	6380000	*Totals*	7796000	6380000
Salaries	200000	100000	Gross Profit	1530000	1520000
Rent, Rates, Taxes & Insurance	625000	313000	Discount Received	35000	30000
Sundry expenses Lighting,	240000	120000	Net Loss	126000	------
Heating	140000	70000			
Advertising	184000	184000			
Depreciation:					
Machinery	158000	52000			
Furniture	22000	8000			
Discount All.	121000	101000			

Net Profit	------	602000			
Totals	1691000	1550000	*Totals*	1691000	1550000

Balance Sheet
As on 31st December, 2023

Assets	*L.E.*	*Liabilities*	*L.E.*
Machinery 2100000 Less: Depr. 210000 Furniture 300000 Less: Depr. 30000 Stock in trade Sundry Debtors Cash at Bank	 1890000 270000 2879000 606000 1007000	Capital 4766000 (+): Profit 476000 5242000 (-) Drawings 450000 Sundry Creditors	 4792000 1860000
Totals	6652000	*Totals*	6652000

Illustration 1.5:

Peace Hotel prepares separate Departmental Profit and Loss Accounts. The nature of their operations requires frequent supply of articles/services from one department to another. The Hotel consisted of three departments: Apartments, Boarding and Restaurant. It had been decided that the Apartments Department will charge, for service supplied to other departments the cost thereof plus 10% thereon. The same, Boarding Department was to charge the other departments cost plus 20% thereof in respect of supplies to them. The Restaurant Department supplies to the other departments were charged at the prevailing rates applicable to outsiders. The Accounts for the year ended on December 31, 2023 had been closed without taking into account interdepartmental debits and credits. From the following figures, you are required to

show the net variation in the Departmental Profit & Loss Accounts as a result of such adjustments.

	L.E.
(1) Cost of Apartments services extended to:	
Boarding Staff	8400
Restaurant	4500
(2) Cost of supplies made by Boarding Department to:	
Apartments Staff	29800
Restaurant Staff	5400
(3) Values of supplies made by the Restaurant to:	
Apartments Staff	400
Boarding Staff	5600

Additionally, the following are the charges to be made for Inter-change of staff from one department to another for temporary periods during the year:

Boarding staff lent to Apartments Dept	4400
Apartments staff lent to Boarding Dept	1100

Solution:

Profit and Loss (Adjustment) Account

Particulars	Apartment A L.E	Boarding B L.E.	Restaurant R L.E.	Particulars	Apartment A L.E	Boarding B L.E.	Restaurant R L.E.
Rent of Apartments	-----	9240	4950	Apartment rents from: B 9240 R 4950	14190	-----	------
Boarding Charges	35760	------	6480	Boarding charges from: A 35760 R 6480	----	42240	------
Restaurant Expenses	400	5600	-----	Restaurant sales: A 400 B 5600	-----	-----	6000
Charge in respect of staff borrowed	4400	1100	-----	Recoveries in respect of staff lent	1100	4400	------
Increase of dept profit or decrease in dept loss	-----	30700	-----	Decrease in dept profit or increase in dept loss	25270	------	5430
Totals	*40560*	*46640*	*11430*	*Totals*	*40560*	*46640*	*11430*

Notes: 10% has been added to costs of Apartments services to find out transfer price to Boarding and Restaurant. 20% has been added to costs of Boarding Department to find out transfer price for Apartment and Restaurant.

Illustration 1.6:

From the following balances extracted from the books of an enterprise, prepare Departmental Trading Account and General Profit and Loss Account for the year ended December 31st, 2023 and a Balance Sheet as on that date after adjusting the unrealized departmental profits if any.

Particulars	Dr. L.E.	Cr. L.E.
1. Capital…………………………………………………		300000
2. Land and Building……………………………………..	125000	
3. Furniture………………………………………………	25000	
4. Opening Stock: Dept A……………………………....	30000	
Dept B………………………………	40000	
5. Purchases: Dept A………………………………	1000000	
Dept B………………………………	1500000	
6. Sales: Dept A………………………………		2000000
Dept B………………………………		3200000
7. General Expenses……………………………………..	1400000	
8. Sundry Debtors……………………………………….	200000	
9. Sundry Creditors……………………………………....	---------	100000
10. Drawings……………………………………………	280000	
11. Cash and Bank………………………………………	1000000	
Totals	*5600000*	*5600000*

Additional Information:

1- Closing Stock of Dept. A L.E.130000 including goods from Dept. B L.E.40000 at cost to Dept. A. Dept. B L.E.260000 including goods from Dept. A L.E.90000 at cost to Dept. B.

2- Sales of Department A includes transfer of goods to Dept. B of the value of L.E.200000 and sales of Dept. B includes transfer of goods to Department A of the value of L.E.300000, both at market price to transferor Dept.

3- Opening Stock of Dept. A and Dept. B includes goods of the value of L.E.10000 and L.E.15000 taken from Dept. B and Dept A respectively at cost to transferor Depts.

4- Depreciate land and building by 5% and furniture by 10% annually.

Solution:

Departmental Trading account and General Profit and Loss Account
For the year ended 31/12/2023

Particulars	Dept A L.E.	Dept B L.E.	Total L.E.	Particulars	Dept A L.E.	Dept B L.E.	Total L.E.
Opening Stock	30000	40000	70000	Sales	1800000	2900000	4700000
Purchases*	700000	1300000	2000000	Transfers	200000	300000	-------
Transfers	300000	200000	-------	Closing Stock	130000	260000	390000
Gross Profit	1100000	1920000	3020000				
Totals	*2130000*	*3460000*	*5090000*	*Totals*	*2130000*	*3460000*	*5090000*
General Expenses			1400000	Gross Profit:			
Depreciation:				Dept A		1100000	
Building		6250		Dept B		1920000	3020000
Furniture		2500	8750				
Reserve on Closing Stock:**							
Transfers From: A		49500					
From: B		24000	73500				
Net Profit			1537750				
Totals			*3020000*				*3020000*

*Excluding inter-department transfers.
**Since inter-department transfers in opening stocks are at costs, no stock reserve for opening stock has been created.

Note: The unrealized profit on inter-department transfers determined as follows:
Transfers included in Closing Stock × Gross Profit/Sales + Transfers
Dept. A = 40000 × 1920000/3200000 = 24000
Dept. B = 90000 × 1100000/2000000 = 49500

Balance Sheet
As at 31st December, 2023

Land & Buildings Balance 125000 Less: Depreciation 6250	118750	Capital: Balance 300000 Add: Profit 1537750 1837750	
Furniture 25000 Less: Depreciation 2500	22500	Less: Drawings 280000	1557750
Stock 390000 Less: Stock Reserve 73500	316500	Sundry Creditors	100000
Sundry Debtors	200000		
Cash and Bank	1000000		
Total	*1657750*	*Totals*	*1657750*

Illustration 1.7:

An Enterprise has a factory which includes two manufacturing Departments *X* and *Y*. Part of the output of X Department is transferred to Y Department for further processing and the balance is directly transferred to the Selling Department. The entire production of Y Department is transferred to the Selling Department. Inter-departmental stock transfers are made as follows:

X Department to Y Department of 33⅓% over-departmental cost.
X Department to Selling Department of 50% over departmental cost.
Y Department to Selling Department of 25% over departmental cost.

The following information is given for the year ending 31st December, 2023.

Particulars	Department X		Department Y		Selling Department	
	MT	L.E.	MT	L.E.	MT	L.E.
Opening Stock	60	60000	20	40000	50	145000
Raw Material Consumption	90	100000	20	20000		
Labor Charges	--	50000	--	80000	--	--
Sales	--	---	--	--	--	500000
Closing Stock	30	---	50	--	60	--

Out of the total production in X Department 30 MT were for transfer to the Selling Department. Apart from these stocks which were transferred during the year, the balance output and the entire opening and closing stocks of X Department were for transfer to Y Department. The per tone material and labor consumption in X Department on production to be transferred directly to the selling Department is 300% of the labor and material consumption on production meant for Y Department.

Required: Prepare Departmental Trading and Profit and Loss Account and General Profit and Loss Account; ignoring material wastages.

Solution:

Departmental Trading and Profit And Loss Account

	Dept. X		Dept. Y		Selling Dept.			Dept. X		Dept. Y		Selling Dept.	
	Qty	Amount	Qty	Amount	Qty	Amount		Qty	Amount	Qty	Amount	Qty	Amount
Opening Stock*	60	60000	20	40000	50	145000	Sales					100	500000
Raw Material Consumed	90	100000	20	20000			Stock transfer	120	255000*	80	200000		
Labor Charge		50000		80000			Closing Stock	30	30000	50	100000	60	180000
Stock transferred from X Dept.			90	120000	30	135000							
Stock transferred from Y Dept.					80	200000							
Gross Profit		75000		40000		200000							
Totals	*150*	*285000*	*130*	*300000*	*160*	*680000*		*150*	*285000*	*130*	*300000*	*160*	*680000*

* 90 tones L.E.120000
 30 tones L.E.135000
120 tones L.E.255000

General Profit and Loss Account

Stock Reserve (increase required): Y Dept.	8182	Gross Profit from: X Dept.	75000
Selling Dept.	11160	Y Dept.	40000
Net Profit	295658	Selling Dept.	200000
Totals	*315000*	*Totals*	*315000*

Working Notes:

Value of goods transferred

1- X Department	MT	Amount
Qty. and value of production*	210	210000
Transferred to Selling Dept.	90	90000
Balance meant for transfer to Y Dept.1	120	120000
Closing stock of Dept. X	30	30000
Actual transfer to Y Dept.	90	90000
Add Profit of 33⅓%		30000
Total Qty. and value of goods transferred To Y Department	90	120000
Cost of goods transferred to Selling Department	30	90000
Add: Profit of 50%		45000
Quantity and value of goods transferred to Selling Department	30	135000

Total transfer 120000 + 135000= 255000 from Dept. X

*The proportion of cost between output meant for Dept. Y and Selling Dept. is 1:3. Thus, the output of 30 units meant for Selling Dept. is equivalent to 90 units of Dept. Y.

2- Department Y		
Qty. and value of production	130	260000
Less: Closing stock of Y Dept.	50	100000
Cost of goods transferred to selling Dept.	80	160000
Add: Profit of 25%		40000
Quantity and value of goods transferred to Selling Department	80	200000

Stock Reserve for unrealized profit of Y Department.

Transfer from X Dept.		120000
Own cost (Raw material and labor)		100000
		220000
Increase in Closing Stock	(100000-40000)	60000
Prop. Of X Dept.	60000 × 120000/220000	32727
Unrealized profit (33⅓% of cost) on 25%on Transfer Price		8182

3- Selling Department

Transfer directly from X Dept.	135000
Total transfers from Depts. X and Y	335000

Share in increase of unsold stock

135000/335000 × 35000 = 14104

Profit charged by X Dept.(50% on cost or 33⅓% on 14104)	4701 (1)
Transfer from Y Dept. to Selling Dept.	200000

Share of increase in unsold stock transferred from Y Dept.

200000/335000 × 35000 = 20896
Profit charged by Y Dept.
(25% on cost or 2o% on L.E.20896) 4179 (2)
Cost of Dept. Y of goods transferred to
Selling Dept. (20896 – 4179) 16717
Share of goods transferred from Dept.
X to Dept. Y in L.E.16717 = 16717 × 120000/220000 = 9118
Profit charged by Dept. X on goods
transferred to Dept. Y (33⅓% on cost or ¼ of L.E.9118) 2280 (3)
Total unrealized profit in closing stock
with Selling Dept. (4701 + 4179 + 2280) = L.E.11160

1.5 Questions and Practical Problems:

1. State whether each of the following statements is ‘**True’** or ‘**False’**.

a. If the rate of gross profit of the departments is the same, the cost price of these departments will be in the ratio of their respective sales price.

b. The fire insurance on building is allocated on the basis of floor area occupied by each department.

c. Depreciation on plant is divided equally over the different departments.

d. Bad debts are charged to the General Profit and Loss since there is no proper basis for their apportionment.

e. Management expenses are charged to the General Profit and Loss Account.

f. Stock Reserve for unrealized profit for inter-departmental transfer of goods is charged to General Profit and Loss Account.

g. In Departmental Accounts, Work-Persons’ Compensation Insurance should be apportioned on the basis of the number of workers in each department.

2. Choose the best answer for each of the following:

(1) Non-departmental items of expenses are:

a- charged to Departments on the basis of total sales.

b- charged to the General Profit and Loss Account.

c- charged to departments according to the fixed assets employed.

(2) Repair to machinery is apportioned over different departments according to:

a- the number of machines in each department.

b- value of machinery.

c- floor area occupied by each machine.

(3) In case goods are transferred from department A to department B at a price so as to include a profit of 25% on the cost, the amount of stock reserve on a closing stock of L.E.6000 in department B will be:

a- L.E.1200.

b- L.E.1500.

c- L.E.2000.

(4) The cost of electric power should be apportioned over different departments according to:

a- Horse Power of Motors.

b- Number of light points.

c- Horse Power X Machine Hours.

Practical Problems:

DEPARTMENTALIZATION OF EXPENSES

1. The Trading and Profit and Loss Account of Egyptian Electronics for the year ending 31st of December, 2023 is as below:

Details	L.E.	Details	L.E.
Purchases:		Sales:	
Transistors (X)	160000	Transistors (X)	175000
Tape Recorders (Y)	125000	Tape Recorders (Y)	40000
Spare Parts for servicing and repairs jobs (Z)	80000	Servicing and repair jobs (Z)	35000
Salaries and Wages	48000	Stock 31/12/2014:	
Rent	10800	Transistors (X)	60100
Sundry Expenses	11000	Tape Recorders (Y)	20300
Profit	40200	Spare parts for servicing and repairs jobs (Z)	44600
Totals	*475000*	*Totals*	*475000*

Prepare Departmental Accounts for each of the three Departments X, Y and Z mentioned above after taking into consideration the following:

(1) Transistors and Tape Recorders are sold at the Showroom, Servicing and Repairs are carried out at the Workshop.

(2) Salaries and Wages comprise as follows: Showroom ¾. Workshop ¼. It was decided to allocate the showroom salaries and wages in ratio 1:2 between Departments X and Y.

(3) The workshop rent is L.E.500 per month. The rent of the showroom is to be divided equally between the Departments X and Y.

(4) Sundry Expenses are to be allocated on the basis of the turnover of each Department.

(**Ans.** *Net Profit:* Dept. X L.E.55200; Dept. Y L.E.4500; *Net Loss* Dept. Z L.E.19500.)

[Answer Key: Opening Balance of Suspense Account (Dr L.E.17,200)].

2. Samsung Brothers are leading paper merchants and booksellers. Their Wholesale business is in paper and their retail show room conducts business in stationery, books and magazines. The following balances are extracted from their books as at the end of their financial year 31st December, 2023:

Particulars	L.E.
Capital	300000
Stock: January 1st, 2023:	
Paper	200000
Stationery	50000

Books	100000
Magazines	25000
Purchases:	
Paper	800000
Stationery	300000
Books	350000
Magazines	300000
Sales:	
Paper	1000000
Stationery	360000
Books	420000
Magazines	420000
Rent	60000
Lighting	24000
Showroom maintenance	18000
Showroom fittings	180000
Sundry Debtors (for paper)	100000
Sundry creditors	150000
Salaries:	
Showroom staff	36000
Wholesale business staff	12000
Showroom cashier	12000
General Office Salaries	11000
General Office Expenses	44000
Cash and Bank Balances	8000

You are required by the firm to prepare their Departmental Trading and Profit and Loss Account for the financial year under reference with the help of the following additional information:

(1) Closing stock at the end of the year in the various departments was:

Paper L.E.180000. Stationery L.E.40000. Books L.E.120000. Magazines L.E.30000

(2) Rent and lighting are for premises taken on lease, General office accommodation is negligible. Wholesale department uses

1500 sq. feet. The balance of 1500 sq. feet is occupied by the showroom with equal division among stationery, books and magazines.

(3) Showroom fittings are to be depreciated by 10% annually.

(**Ans.** *Net Profit* Paper L.E.101000, Stationer L.E.600, Books L.E.36700 and Magazines L.E.71700.)

3. The following is the trial balance of Automatic Motors and Garage on 31st December, 2023:

Particulars	L.E.	L.E.
Capital Account		76250
Drawings	8500	
Opening Stocks: Petrol and oil	1650	
Spare parts and tires	5500	
Tools	2200	
Hire cars	72000	
Purchases: Tools	4000	
Spare parts and tires	32000	
Petrol and oil	41250	
Advertising Expenses	4500	
Rent, Rates and Taxes	12000	
Insurance premium: On hire cars	4000	
Fire, theft and burglary cases	425	
Wages: Drivers	12000	
Repairs Department	16500	
Office	7500	
Garage	1000	
Sales: Petrol and oil		23000
Spare parts and tires		37000
Garage Receipts		4000
Repairs Department		1000
Hire Receipts		70000
License fees and permit fees for hire cars	3000	
Office Expenses	4000	
Sundry Debtors	400	
Sundry Creditors		1200
Commission received on cars sold		5000
Loans		4000
Cash in hand and at Bank	2000	

Totals	*234450*	*234450*

The following additional information is also provided to you:

(1) The loan was taken on 1st of October, 2023 on which interest at 12% is to be paid.

(2) Stocks on hand on 31st December, 2023 were as follows:
Tools L.E.5000, Petrol and oil L.E.4300 and Spare parts and tires L.E.10000.

(3) Petrol and oil whose value was L.E.15600 and L.E.1800 were used by hire cars and repairs department respectively. Besides, the owner of the garage drew petrol and oil worth L.E.3000 for his personal car.

(4) Repairs department performed work during the year as under:
On owner's car L.E.600 and on hire cars L.E.7500.

(5) Spare parts used by the Repairs Department in the year cost L.E.4000 and by the hire carsL.E.750.

(6) Depreciation on hire cars to be provided at 30% annually.

(7) Licenses and taxes amounting to L.E.200 on owner's car have been paid and included in Rent, Rates and Taxes.

(8) Rent, Rates and Taxes to be distributed as below:

a. Repairs Department ½. b. Spare parts ¼.

c. Garage ⅛. d. Office ⅛.

You are required to prepare a Departmental Trading Account, a Profit and Loss Account for the year ended 31st December, 2023 and a balance Sheet as at that date.

[Answer Key: Profit; Garage L.E.1525, Petrol & Oil L.E.4775, Spare parts L.E.11300. Hire Cars L.E.5550, Repairs (Loss) L.E.7300, Net Business Profit L.E.2830, B/S Total L.E.72100].

4. Cairo Limited has three departments X, Y and Z. From the particulars given below, compute:

a. The values of stock as on 31st of December, 2023 and

b. The departmental trading results.

Particulars	Dept. X	Dept. Y	Dept. Z
	L.E.	L.E.	L.E.
(1) Stock as on 1st Jan. 2023	24000	36000	12000
Purchases	146000	124000	48000
Actual Sales	172500	159400	74600
Gross Profit on normal selling prices	20%	25%	33⅓%
(2) During the year certain items were sold at discount and these discounts were reflected in the value of sales shown above. The items sold at discount were:			
Sales at normal prices	10000	3000	1000
Sales at actual prices	7500	2400	600

[Answer: Gross Profit Dept. X L.E.32500, Dept. Y L.E.39400 and Dept. Z L.E.24600.]

ASCERTAINMENT OF DEPARTMENTAL COSTS

5. Kamal Nayle purchased goods for his three departments as follows:

Dept. A 2000 pieces
Dept. B 14000 pieces — Total cost L.E.51000
Dept. C 4000 pieces

Sales of three departments were as follows: Dept. A 1800 pieces at L.E.15 per piece. Dept. B 15000 pieces at L.E.18 per piece. Dept. C 4500 pieces at L.E.6 per piece.

Other information about stock in the beginning was as follows:

Dept. A 1000 pieces.

Dept. B 4000 pieces.

Dept. C 600 pieces.

Kamal informs you that the rate of gross profit is the same in all departments. You are required to prepare trading account for the three departments.

[Answer Key: Gross Profit: A Dept. L.E.22500 B Dept. L.E.225000, C Dept. L.E.22500].

INTER-DEPT. TRANSFERS

6. A firm had two departments, cloth and ready made clothes. The clothes were made by the firm itself out of cloth supplied by the cloth department at its selling price. From the following figures, prepare Departmental Trading and Profit and Loss Account for the year 2023.

Particulars	Cloth Department	Readymade Clothes
Opening Stock 1/1/2023	300000	50000
Purchases	2000000	15000
Sales	2200000	450000
Transfer to Readymade Cloth Department	300000	……..
Expenses:		
Manufacturing	……….	60000
Selling	20000	6000
Stock on 31/12/2023	200000	60000

The stocks in the readymade clothes department may be considered as consisting of 75% cloth and 25% other expenses. The cloth department earned gross profit at the rate of 15% in 2022. General expenses of the business as a whole came to L.E.110000.

[Answer Key: Net Profit: Cloth Dept. L.E.380000; Readymade Clothes Dept. L.E.79000, Total Net Profit of the business L.E.347425. Hint: Increase in Stock Reserve by L.E.1575].

7. Qena Highway Garage consists of three departments: Spares, Service and Repairs. Each department is managed by a departmental manager whose commission is respectively 5%, 10% and 10% of the respective departmental profit, subject, however, to a minimum of L.E.3000 in each case. Inter-departmental transfers take place at 'loaded' price as follows:

From Spares to Service 5% above cost

From Spares to Repairs 10% above cost

From Repairs to Service 10% above cost

In respect of the year ended on December 31st, 2023, the firm had already prepared and closed the departmental trading and profit and loss account. Subsequently it was discovered that the closing stocks of various departments had included inter-departmentally transferred goods at 'loaded' price instead of the correct cost price. From the following information you are required to prepare a statement re-computing the departmental profit or loss.

Particulars	Spares L.E.	Services L.E.	Repairs L.E.
Final Net Profit/Loss Inter-departmental transfers included at ‘loaded’ price in the departmental stocks	19000 (loss) …..	25200 (profit) 32500 (10500 from Spares and 22000 from Repairs)	36000 (profit) 2100 (from Spares)

[Answer: Real Net Profit (loss): Spares L.E.(19691); Service L.E.25200 and Repairs L.E.34200]

8. Alexandria Ltd. has three departments A, B & C. The following information is given:

Particulars	A	B	C
Opening Stock	3000	4000	6000
Consumption of direct materials	8000	12000	……
Wages	5000	10000	……
Closing Stock	4000	14000	8000
Sales	…….	…….	34000

Stocks of each department are valued at cost to the department concerned. Stocks of A department are transferred to B at a margin of 50% above departmental cost. Stocks of B department are transferred to C department at a margin of 10% above departmental cost.

Other expenses were:

Salaries	L.E.2000
Printing & Stationery	L.E.1000
Rent	L.E.6000
Interest paid	L.E.4000
Depreciation	L.E.3000

Allocate expenses in the ratio of departmental gross profits. Opening figures of reserves for unrealized profits on Departmental Stocks were:

Department B L.E.1000

Department C L.E.2000

Required: Prepare Departmental Trading and Profit and Loss Account.

[Answer: Net Loss Dept. A L.E.2000; Dept. B L.E.1000; Dept. C L.E.1000, Total Net loss after adjustment for stock reserves L.E.4918.]

9. Messrs G.B.T. carried on business as Drapers and Tailors. The partners, G, B and T were in charge of the departments X, Y and Z respectively. The partners are entitled to remuneration equal to 50% of the profits (without taking the partner's remuneration into consideration) of the respective Departments of which they are in charge and the balance of the profits are to be divided among G, B and T in the ratio of 5:3:2. The following are the balances of the Revenue Item in the books for the year 31st December, 2023.

Opening Stock:	L.E.		L.E.
Department X	75780	Salaries and wages	96000
Y	48000	Advertising	4500
Z	40000	Rent	21600
Purchases: Department X	281400	Discount Allowed	27000
Y	161200	Discount Received	1600
Z	88800	Sundry expenses	24300
Sales: Department X	360000	Depreciation on	
Y	270000	Furniture and Fittings	1500
Z	180000		
Closing Stock: Department X	90160		
Y	34960		
Z	43180		

Instructions:

a. Prepare the Departmental accounts for each of the three Departments in a columnar form.

b. Show the distribution of Profits amongst the Partners after taking into account the following:

(1) Goods having a transfer price of L.E.21400 and L.E.1200 were transferred from Department X and Y respectively to Department Z. The inter-departmental transfers are made at 125% of the cost.

(2) The various items shall be apportioned among the three Departments in the following proportion:

Particulars	Dept. X	Dept. Y	Dept. Z
Rent	2	2	5
Salaries	1	1	1
Depreciation	1	1	1
Discount received	8	5	3

All the other expenses: on the basis of the sales (excluding inter-departmental transfers) of each department.

(3) The opening stock of Department Z does not include any goods transferred from other departments, but the closing stock includes L.E.17100 valued at the inter-departmental transfer prices.

[Answer: Net Profit, Dept. X L.E.63880, Dept. Y L.E.49660, Dept. Z L.E.20580]

10. X Ltd. has a factory which has two manufacturing Departments A and B. Part of the output of A Dept. is transferred to B Dept. for further processing and balance is directly transferred to the Selling Department. The entire production of B Department is

transferred to the Selling Department. Inter department stock transfers are made as follows:

A Dept. to B Dept. at 20% over departmental cost.

A Department to Selling Department at 30% over departmental cost.

B Department to Selling Department at 25% over departmental cost.

The following information is given for the year ending 31st December 2023.

Particulars	Department A		Department B		Department C.	
	M.T.	L.E.	M.T.	L.E.	M.T.	L.E.
Opening Stock	60	60000	20	40000	50	160000
Raw material consumption	100	110000	30	30000		
Labor Charges		60000		80000		
Sales						600000
Closing Stock	40		60		60	

Out of production in A Department 30 M.T were for transfer to the Selling Department and the balance to B Department. The per tone material and labor consumption in A Department on production to be transferred directly to the Selling Department is 200% of the labor and material consumption on production meant for B Department. Prepare Department Profit and Loss Account.

[Answer: Profit: Dept. A L.E.44640, Dept. B L.E.50490, Selling Dept. L.E.281286].

(Hint: Closing Stock (FIFO) Dept. A L.E.44000, Dept. B L.E.81960, Selling Dept. L.E.190456). It is assumed that no work has been done on the units in closing stock in Dept. A. In Dept. B the closing stock is a mixture of material introduced directly and

those transferred from Dept. B i.e., 60/120 of L.E.166920. Closing stock of Selling Dept. is 60/110 of L.E.349170. The other assumption could be that the closing stocks are out of the finished output of the concerned department.

{Answers: [1. True or False (a) T (b) T (c) F (d) F (e) T (f) T (g) F]. [2. (1) b (2) b (3) a (4) c.]}

CHAPTER TWO
ACCOUNTING FOR BRANCHES

CHAPTER TWO

Accounting for Branches

2.1 Introduction:

As a business enterprise grows, it may establish one or more branches to market its products over a large district (territory). Although branches of an enterprise are not separate legal entities, they are separate economic and accounting entities whose special features necessitate accounting procedures tailored for those features, such as ***reciprocal*** ledger accounts.

The term ***branch*** is used to describe a business unit located at some distance from the ***home office***. This unit carries merchandise obtained from the home office, makes sales, approves customers' credit, and makes collections from its customers.

A branch may obtain goods solely from the home office, or a portion may be purchased from outside suppliers. The cash receipts of the branch often are deposited in a bank account belonging to the home office; the branch expenses then are paid from an ***imprest cash fund*** or a bank account provided by the home office. As the imprest cash fund is depleted, the branch submits a list of cash payments supported by ***vouchers*** and receives a check or an

electronic or wire transfer from the home office to replenish the fund.

The use of an imprest cash fund gives the home office considerable control over the cash transactions of the branch. Nevertheless, it is common practice for a large branch to maintain its own bank account. The extent of autonomy (independency) and responsibility of a branch varies, even among different branches of the same business enterprise.

A segment of a business enterprise also may be operated as a ***division***, which generally has more autonomy than a branch. The accounting procedures for a division not organised as a separate corporation ***(subsidiary company)*** are similar to those used for branches. When a business segment is operated as a separate corporation, consolidated financial statements are generally required. Consolidated financial statements are described in a following chapter.

2.2 Accounting System for a Branch

The accounting system of one business enterprise with branches may provide for a complete set of accounting records at each branch; policies of another such enterprise may keep all accounting records in the home office. For example, branches of drug and grocery chain stores submit daily reports and business documents to the home office, which enters all transactions by branches in computerized accounting records kept in a central location. The home office may not even conduct operations of its own; it may serve only as an accounting and control centre for the branches.

A branch may maintain a complete set of accounting records consisting of journals, ledgers, and a chart of accounts similar to those of an independent business enterprise. Financial statements are prepared by the branch accountant and forwarded to the home office. The number and types of ledger accounts, the internal control structure, the form and content of the financial statements, and the accounting policies generally are prescribed (imposed) by the home office.

This section is on a branch operation that maintains a complete set of accounting records. Transactions recorded by a branch should

include all controllable expenses and revenue for which the branch manager is responsible. If the branch manager has responsibility over all branch assets, liabilities, revenue, and expenses, the branch accounting records should reflect this responsibility. <u>Expenses such as depreciation often are not subject to control by a branch manager; therefore, both the branch plant assets and the related depreciation ledger accounts generally are maintained by the home office.</u>

2.3 Reciprocal Ledger Accounts:

The accounting records maintained by a branch include a ***Home Office*** ledger account that is **credited** for all merchandise, cash, or other assets provided by the home office; it is **debited** for all cash, merchandise, or other assets sent by the branch to the home office or to other branches. The *Home Office* account is similar to ownership equity account that shows the net investment by the home office in the branch. At the end of an accounting period when the branch closes its accounting records, the Income Summary account is closed to the Home Office account. A net income increases the credit balance of the Home Office account; a net loss decreases this balance.

In the home office accounting records, a ***reciprocal ledger account*** with a title such as **Investment in Branch** is maintained. This noncurrent asset account is debited for cash, merchandise, and services provided to the branch by the home office, and for net income reported by the branch. It is credited for cash or other assets received from the branch, and for net losses reported by the branch. Thus, the Investment in Branch account reflects the *equity method of accounting.* A separate investment account generally is

maintained by the home office for each branch. If there is only one branch, the account title is likely to be Investment in Branch; if there are numerous branches, each account title includes a name or number to identify each branch.

2.4 Expenses Incurred by Home Office and Allocated to Branches

In practice, some business enterprises follow a policy of notifying each branch of expenses incurred by the home office on the branch's behalf. As stated previously, plant assets located at a branch generally are carried in the home office accounting records. If a plant asset is acquired by the home office for the branch, the journal entry for the acquisition is a debit to an appropriate asset account such as *Equipment: Branch* and a credit to Cash or an appropriate liability account. **If the branch acquires a plant asset, it debits the *Home Office* ledger account and credits *Cash* or an appropriate liability account. The home office debits an asset account such as *Equipment: Branch* and credits *Investment in Branch*.**

The home office also usually acquires insurance, pays property and other taxes, and arranges for advertising that benefits all branches. Obviously, such expenses as depreciation, property taxes, insurance, and advertising must be considered in determining the profitability of a branch. A policy decision must be made as to whether these expense data are to be retained at the home office or

are to be reported to the branches so that the income statement prepared for each branch will give a complete picture of its operations. An expense incurred by the home office and allocated to a branch is recorded by the home office by a debit to Investment in Branch and a credit to an appropriate expense ledger account; the branch debits an expense account and credits Home Office.

If the home office does not make sales, but functions only as an accounting and control centre, most or all of its expenses may be allocated to the branches. To facilitate comparison of the operating results of the various branches, the home office may charge each branch interest on the capital invested in that branch. Such interest expense recognised by the branches would be offset by interest revenue recognized by the home office and would not be displayed in the ***combined*** income statement of the business enterprise as a whole.

2.5 Alternative Methods of Billing Merchandise Shipments to Branches:

Practically, three methods are available to the home office for billing merchandise shipped to its branches. The shipments may be billed:

(1) At home office cost.

(2) At a percentage above home office cost.

(3) At the branch's retail selling price.

The shipment of merchandise to a branch does not constitute a sale, because owner-ship of the merchandise does not change.

1- **Billing at home office cost**. It is the simplest procedure and is widely used. It avoids the complication of unrealized gross profit in inventories and permits the financial statements of branches to give a meaningful picture of operations. However, billing merchandise to branches at home office cost attributes all gross profits of enterprise to the branches, even though some of the merchandise may be manufactured by the home office. Under these circumstances, home office cost may not be the most realistic basis for billing shipments to branches.

2- **Billing at a percentage above home office cost.** Adopting this method (such as 110% of cost) may be intended to allocate a reasonable gross profit to the home office. When merchandise is billed to a branch at a price above home office cost, ***the net income reported by the branch is understated and the ending inventories are overstated for the enterprise as a whole***. Adjustments must be made by the home office to eliminate the excess of billed prices over cost ***(intracompany profits)*** in the preparation of combined financial statements for the home office and the branch.

3- **Billing at branch retail selling prices.** Billing shipments to a branch at branch retail selling prices may be based on a desire to strengthen internal control over inventories. The inventories ledger account of the branch shows the merchandise received and sold at retail selling prices. As a result, the account will show the ending inventories that should be on hand at retail prices. The home office record of shipments to a branch, when considered along with sales reported by the branch, provides a perpetual inventory stated at selling prices. If the physical inventories taken periodically at the branch do not agree with the amounts thus computed, an error or theft may be indicated and should be investigated promptly.

2.6 Separate Financial Statements for Branch and for Home Office

Logically, a separate income statement and balance sheet should be prepared for a branch in order that management of the enterprise may review the operating results and financial position of the branch. The branch's income statement has no unusual features if merchandise is billed to the branch at home office cost. However, if merchandise is billed to the branch at branch retail selling prices, the branch's income statement will show a net loss approximating the amount of operating expenses. The only unusual aspect of the balance sheet for a branch is the use of the Home Office ledger account instead of the ownership equity accounts for a separate business enterprise. The separate financial statements prepared for a branch may be revised at the home office to include expenses incurred by the home office allocable to the branch and to show the results of branch operations after elimination of any intracompany profits on merchandise shipments.

Additionally, separate financial statements also may be prepared for the home office so that management will be able to appraise the results of its operations and its financial position. Nevertheless, it is

important to emphasize that separate financial statements of the home office and of the branch are prepared ***for internal use only***; they do not meet the needs of investors or other external users of financial statements.

Illustration 2.1:

Illustrative Journal Entries for Operations of a Branch:

Egypt Company bills merchandise to Qena Branch **at home office cost** and that Qena Branch maintains complete accounting records and prepares financial statements. ***Both the home office and the branch use the perpetual inventory system.*** Equipment used at the branch is carried in the home office accounting records. Certain expenses, such as advertising and insurance, incurred by the home office on behalf of the branch, are billed to the branch. Transactions and events during the first year (2022) of operation of Qena Branch are summarized below:

1. Cash of L.E.1000 was forwarded by the home office to Qena Branch.
2. Merchandise with a home office cost of L.E.60000 was shipped by the home office to Qena Branch.
3. Equipment was acquired by Qena Branch for L.E.500, to be carried in the home office accounting records. (other plant assets for Qena Branch generally are acquired by the home office.
4. Credit sales by Qena Branch amounted to L.E.80000; the branch's cost of the merchandise sold was L.E.45000.
5. Collections of trade accounts receivable by Qena Branch amounted to L.E.62000.

6. Payments for operating expenses by Qena Branch totalled L.E.20000.
7. Cash of L.E.37500 was remitted by Qena Branch to the home office.
8. Operating expenses incurred by the home office and charged to Qena Branch totalled L.E.3000.

Instructions:

Record these transactions and events in the accounting records of home office and Qena Branch.

Solution:

Home Office Accounting Records Journal Entries			Qena Branch Accounting Records Journal Entries		
(1) Investment in Qena Branch………………	1000		Cash…………………	1000	
Cash…………….		1000	Home Office……		1000
(2) Investment in Qena Branch…………….	60000		Inventories…………..	60000	
Inventories……….		60000	Home Office………		60000
(3) Equipment: Qena Branch…………..	500		Home Office………..	500	
Investment in Qena Branch…………..		500	Cash……………….		500
(4) None			Trade Accounts Receivable……………	80000	
			Sales……………….		80000
			Cost of Goods Sold….	45000	
			Inventories………..		45000
(5)None			Cash…………………	62000	
			Trade Accounts Receivable……….		62000
(6)None			Operating Expenses….	20000	
			Cash………………..		20000
(7) Cash……………….	37500		Home Office………..	37500	
Investment in Qena Branch………		37500	Cash……………….		37500
(8) Investment in Qena Branch……….	3000		Operating Expenses…	3000	
Operating Expenses…		3000	Home Office………		3000

On the other hand, if a branch obtains merchandise from outsiders as well as from the home office, the merchandise acquired from the home office may be recorded in a separate **Inventories from Home Office** ledger account.

In the home office accounting records, the *Investment in Quena Branch* ledger account has a debit balance of L.E.26000 [before the accounting records are closed and the branch net income of L.E.12000 (L.E.80000 – L.E.45000 – L.E.20000 – L.E.3000 = L.E.12000) is transferred to the *Investment in Quena Branch* ledger account], as illustrated below (Reciprocal Ledger Account in Accounting Records of Home Office Prior to Equity-Method Adjusting Entry).

Investment in Qena Branch

Date	Explanation	Debit	Credit	Balance
2022	Cash sent to branch (1)	1000		1000 dr
	Merchandise billed to branch at home office cost (2)	60000		61000 dr
	Equipment acquired by branch, carried in home office accounting records (3)		500	60500 dr
	Cash received from branch (7)		37500	23000 dr
	Operating expenses billed to branch (8)	3000		26000 dr

In the accounting records of Qena Branch, the *Home Office* ledger account has a credit balance of L.E.26000 (before the accounting records are closed and the net income of L.E.12000 is

transferred to the **Home Office** account), as shown below [Reciprocal Ledger Account in Accounting Records of Qena Branch Prior to Closing Entry].

Home Office

Date	Explanation	Debit	Credit	Balance
2022	Cash received from home office (1)		1000	1000 cr
	Merchandise received from home office (2)		60000	61000 cr
	Equipment acquired (3)	500		60500 cr
	Cash sent to home office (7)	37500		23000 cr
	Operating expenses billed by home office (8)		3000	26000 cr

2.7 Combined Financial Statements for Home Office and Branch

A balance sheet for distribution to creditors, stockholders, and government agencies must show the financial position of a business enterprise having branches as a ***single entity***. A convenient starting point in the preparation of a combined balance sheet consists of the adjusted trial balances of the home office and of the branch. A working paper for the combination of these trial balances is illustrated on the following pages.

The assets and liabilities of the branch are substituted for the ***Investment in Branch*** ledger account included in the home office trial balance. Similar accounts are combined to produce a single total amount for cash, trade accounts receivable, and other assets and liabilities of the enterprise as a whole.

In the preparation of a combined balance sheet, reciprocal ledger accounts are eliminated because they have no significance when the branch and home office report as a single entity. The balance of the ***Home Office*** account is offset against the balance of the ***Investment in Branch*** account; in addition, any receivables and payables

between the home office and the branch (or between two branches) are eliminated.

The operating results of the enterprise (the home office and all branches) are shown by an income statement in which the revenue and expenses of the branches are combined with corresponding revenue and expenses for the home office. Any intracompany profits or losses are eliminated.

Working Paper for Combined Financial Statements:

A working paper for combined financial statements has three purposes:

(1) to combine ledger account balances for like revenue, expenses, assets, and liabilities;

(2) to eliminate any intracompany profits or losses, and

(3) to eliminate the reciprocal accounts.

Assume that the perpetual inventories of L.E.15000 (L.E.60000 – L.E.45000 =15000) at the end of 2022 for Qena Branch had been verified by a physical count. The following working paper for Egypt Company is based on the transactions and events of Illustration 2.1 above and additional assumed data for the home office trial balance. All the routine year-end adjusting entries (except the home office

entries on presented next) are assumed to have been made, and the working paper is begun wit the adjusted trial balances of the home office and Qena Branch.

EGYPT COMPANY
Working Paper for Combined Financial Statements of Home Office and Qena Branch
For Year Ended December 31, 2022
(Perpetual Inventory System: Billing at Cost)

	Adjusted Trial Balances			
	Home Office	**Qena Branch**	**Eliminations**	**Combined**
	Dr (Cr)	**Dr (Cr)**	**Dr (Cr)**	**Dr (Cr)**
Income Statement				
Sales	(400000)	(80000)		(480000)
Cost of goods sold	235000	45000		280000
Operating expenses	90000	23000		113000
Net income (to statement of retained earnings below)	75000	12000		87000
Totals	-0000-	-0000-		-0000-
Statement of Retained Earnings				
Retained earnings, beginning of year	(70000)			(70000)
Net (income) (from income statement above)	(75000)	(12000)		(87000)
Dividends declared	40000			40000
Retained earnings, end of year (to balance sheet below)				117000
Totals				-0000-
Balance Sheet				
Cash	25000	5000		30000
Trade accounts receivable (net)	39000	18000		57000
Inventories	45000	15000		60000
Investment in Qena Branch	26000		(a) (26000)	
Equipment	150000			150000
Accumulated depreciation of equipment	(10000)			(10000)
Trade accounts payable	(20000)			(20000)
Home office		(26000)	(a) 26000	
Common stock,L.E.10 par	(150000)			(150000)
Retained earnings (from statement of retained earnings above)				(117000)
Totals	-0000-	-0000-	-0000-	-0000-

(a) To eliminate reciprocal ledger account balances.

Note that the L.E.26000 debit balance of the *Investment in Qena Branch* ledger account and the L.E.26000 credit balance of the

Home Office account are the balances **before the respective accounting records are closed**, that is, before the L.E.12000 net income of Qena Branch is entered in these two reciprocal accounts. In the Elimination column, elimination (a) offsets the balance of the *Investment in Qena Branch* account against the balance of the *Home Office* account. ***This elimination appears in the working paper only;*** it is not entered in the accounting records of either the home office or Qena Branch because its only purpose is to facilitate the preparation of combined financial statements.

Illustrating Combined Financial Statements: The above working paper provides the information for the combined financial statements of Egypt Company as follows:

EGYPT COMPANY
Income Statement
For Year Ended December 31, 2022

	L.E.
Sales	480000
Cost of goods sold	280000
Gross margin on sales	200000
Operating expenses	113000
Net income	87000
Basic earnings per share of common stock	5.80

EGYPT COMPANY
Statement of Retained Earnings
For Year Ended December 31, 2022

	L.E.
Retained earnings, beginning of year	70000
Add: Net Income	87000
Subtotal	157000
Less: Dividends (L.E.2.67 per share)	40000
Retained earnings, end of year	117000

EGYPT COMPANY
Balance Sheet
December 31, 2022

Assets		L.E.
Cash		30000
Trade accounts receivable (net)		57000
Inventories		60000
Equipment	L.E.150000	
Less: Accumulated depreciation	10000	140000
Total assets		287000
Liabilities and Stockholders' Equity		L.E.
Liabilities		
Trade accounts payable		20000
Stockholders' equity		
Common stock, L.E.10 par, 15000 shares authorized, issued and outstanding	L.E.150000	
Retained earnings	117000	267000
Total liabilities and stockholders' equity		287000

Home Office Adjusting and Closing Entries and Branch Closing Entries

The home office's equity-method adjusting and closing entries for branch operating results and the branch's closing entries on December 31, 2022, are as follows:

Home Office Accounting Records
Adjusting and Closing Entries
(Perpetual Inventory System)

Investment in Qena Branch………………………..	12000	
Income: Qena Branch…………………………..		12000
Income: Qena Branch……………………………..	12000	
Income Summary ………………………………		12000

Qena Branch Accounting Records
Closing Entries
(Perpetual Inventory System)

Sales……………………………………………		
Income Summary………………………………	80000	80000

Income Summary………………………………..	68000	
Cost of Goods Sold……………………………..		45000
Operating Expenses…………………………….		23000
Income Summary…………………………………	12000	
Home Office…………………………………….		12000

2.8 Billing of Merchandise to Branches at Prices above Home Office Cost

Previously, it was stated that the home offices of some business enterprises bill merchandise shipped to branches at home office cost plus a markup percentage (or alternatively at branch retail selling prices). Because both these methods involve similar modifications of accounting procedures, a single example illustrates the key points involved.

Illustration 2.2:

The prior illustration (2.1) for Egypt Company will be used with one changed assumption: the home office bills merchandise shipped to Qena Branch at a markup of 50% above home office cost, or 33⅓% of billed price.

Notice: Billed price = cost + 0.50 cost; therefore, markup on billed price is: 0.50/ (1 + 0.50) or 33⅓%.
In other words, billed price = cost + markup on cost.
Markup on billed price = markup on cost/cost + markup on cost

Under this assumption, the journal entries for the first year's events and transactions by the home office and Qena Branch are the same as those presented previously (Illustration 2.1), except for the journal entries for shipments of merchandise from the home office to Qena Branch. These shipments (L.E.60000 cost + 50% markup

on cost = L.E.90000) are recorded under the perpetual inventory system as follows:

Home Office Accounting Records
Journal Entries

(2) Investment in Qena Branch………………………… Inventories……………………………………… Allowance for Overvaluationof Inventories: Qena Branch…………………………………………..	90000	 60000 30000

Qena Branch Accounting Records
Journal Entries

(2) Inventories…………………………………………. Home Office………………………………………	90000	 90000

In the accounting records of the home office, the Investment in Qena Branch ledger account prepared previously (Illustration 2.1), now has a debit balance of L.E.56000 before the accounting records are closed and the branch net income or loss is entered in the Investment in Qena Branch account. This account is L.E.30000 larger than the L.E.26000 balance in the prior illustration (2.1). The increase represents the 50% markup over cost (L.E.60000) of the merchandise shipped to Qena Branch, as illustrated below (Reciprocal Ledger Account in Accounting Records of Home Office Prior to Equity-Method Adjusting Entry).

Investment in Qena Branch

Date	Explanation	Debit	Credit	Balance
2022	Cash sent to branch (1)	1000		1000 dr
	Merchandise billed to branch at markup of 50% over home office cost, or 33⅓% of billed price (2)	90000		91000 dr
	Equipment acquired by branch, carried in home office accounting records (3)		500	90500 dr
	Cash received from branch (7)		37500	53000 dr
	Operating expenses billed to branch (8)	3000		56000 dr

In the accounting records of Qena Branch, the *Home Office* ledger account now has a credit balance of L.E.56000, before the accounting records are closed and the net income or loss is entered in the **Home Office** account, as shown below [Reciprocal Ledger Account in Accounting Records of Qena Branch Prior to Closing Entry].

Home Office

Date	Explanation	Debit	Credit	Balance
2022	Cash received from home office (1)		1000	1000 cr
	Merchandise received from home office (2)		90000	91000 cr
	Equipment acquired (3)	500		90500 cr
	Cash sent to home office (7)	37500		53000 cr
	Operating expenses billed by home office (8)		3000	56000 cr

Qena Branch recorded the merchandise received from the home office at billed prices of L.E.90000; the home office recorded the shipment by credits of L.E.60000 to Inventories and L.E.30000 to Allowance for Overvaluation of Inventories: Qena Branch. Use of the allowance account enables the home office to maintain a record

of the cost of merchandise shipped to Qena Branch as well as the amount of unrealized gross profit on the shipments.

At the end of the accounting period, Qena Branch reports its inventories (at billed prices) at L.E.22500. The cost of these inventories is L.E.15000 (L.E.22500 ÷ 1.50 = L.E.15000). In the home office accounting records, the required balance of the Allowance for Overvaluation of Inventories: Qena Branch ledger account is L.E.7500 (L.E.22500 – L.E.15000 = L.E.7500); therefore, this account balance must be reduced from its present amount of L.E.30000 to L.E.7500. The reason for this reduction is that ***the 50% markup of billed prices over cost has become realized gross profit to the home office with respect to the merchandise sold by the branch.*** Consequently, at the end of the year the home office reduces its allowance for overvaluation of the branch inventories to the L.E.7500 excess valuation contained in the ending inventories. The debit adjustment of L.E.22500 in the allowance account is offset by a credit to the ***Realized Gross Profit: Qena Branch Sales*** account, because it represents additional gross profit of the home office resulting from sales by the branch.

Working Paper When Billings to Branches Are at Prices above Cost.

When a home office bills merchandise shipments to branches at prices above home office cost, preparation of the working paper for combined financial statements is facilitated by an analysis of flow of merchandise to a branch, such as the following for Qena Branch of Egypt Company:

Egypt Company
Flow of Merchandise for Qena Branch
During 2022

	Billed Brice L.E.	**Home Office Cost L.E.**	**Markup (50% of Cost; 33⅓% of Billed Price)**
Beginning inventories	--------	--------	------
Add: Shipments from home office	90000	60000	30000
Available for sale	90000	60000	30000
Less: Ending inventories	22500	15000	7500
Cost of goods sold	67500	45000	22500

The Markup column in the foregoing analysis provides the information needed for the Eliminations column in the working paper for combined financial statements below:

EGYPT COMPANY

Working Paper for Combined Financial Statements of Home Office and Qena Branch

For Year Ended December 31, 2022

(Perpetual Inventory System: Billings above Cost)

	Adjusted Trial Balances			
	Home Office	Qena Branch	Eliminations	Combined
	Dr (Cr)	Dr (Cr)	Dr (Cr)	Dr (Cr)
Income Statement				
Sales…………………………………	(400000)	(80000)		(480000)
Cost of goods sold…………………..	235000	67500	(a) (22500)	280000
Operating expenses………………….	90000	23000		113000
Net income (loss) (to statement of retained earnings below)……………………..	75000	(10500)	(b) 22500	87000
Totals ……………………………..	-0000-	-0000-		-0000-
Statement of Retained Earnings				
Retained earnings, beginning of year…	(70000)			(70000)
Net (income) loss (from income statement above)…………………………………	(75000)	10500	(b) (22500)	(87000)
Dividends declared……………………	40000			40000
Retained earnings, end of year (to balance sheet below)……………………………..				117000
Totals……………………………………				-0000-
Balance Sheet				
Cash………………………………….	25000	5000		30000
Trade accounts receivable (net)……..	39000	18000		57000
Inventories………………………….	45000	22500	(a) (7500)	60000
Investment in Qena Branch………...	56000		(c) (56000)	----------
Allowance for overvaluation of inventories: Qena Branch………………………..	(30000)		(a) 30000	---------
Equipment………………………….	150000			150000
Accumulated depreciation of equipment…	(10000)			(10000)
Trade accounts payable……………..	(20000)			(20000)
Home office…………………………		(56000)	(c) 56000	----------
Common stock, L.E.10 par…………	(150000)			(150000)
Retained earnings (from statement of retained earnings above)………………				(117000)
Totals…………………………………	-0000-	-0000-	-0000-	-0000-

(a) To reduce ending inventories and cost of goods sold of branch to cost, and to eliminate unadjusted balance of Allowance of Overvaluation of Inventories: Qena Branch ledger account.
(b) To increase income of home office by portion of merchandise markup that was realized by branch sales.
(c) To eliminate reciprocal ledger account balances.

The foregoing working paper differs from the previous working paper by the inclusion of an elimination to restate the ending

inventories of the branch to cost. Also, the income reported by the home office is adjusted by the L.E.22500 of merchandise markup that was realized as a result of sales by the branch. The amounts in the Eliminations column appear only in the working paper. The amounts represent a mechanical step to aid in the preparation of combined financial statements and are not entered in the accounting records of either the home office or the branch.

Combined Financial Statements

Because the amounts in the Combined column of the working paper above are the same as in the working paper prepared when the merchandise shipments to the branch were billed at home office cost, the combined financial statements are identical to those illustrated previously.

Home Office Adjusting and Closing Entries and Branch Closing Entries

The December 31, 2022, adjusting and closing entries of the home office are illustrated below:

Home Office Accounting Records
Adjusting and Closing Entries

Income: Qena Branch………………………..	10500	
Investment in Qena Branch…………………		10500
To record net loss reported by branch.		
Allowance for Overvaluation of Inventories: Qena Branch………………………………………..	22500	
Realized Gross Profit: Qena Branch Sales….		22500

To reduce allowance to amount by which ending inventories of branch exceed cost.		
Realized Gross Profit: Qena Branch Sales………..	22500	
Income: Qena Branch…………………………..		10500
Income Summary………………………………		12000
To close branch net loss and realized gross profit to Income Summary ledger account.		

After the foregoing journal entries have been posted, the ledger accounts in the home office general ledger used to record branch operations are as follows:

Investment in Qena Branch

Date	Explanation	Debit	Credit	Balance
2022	Cash sent to branch	1000		1000 dr
	Merchandise billed to branch at markup of 50% over home office cost, or 33⅓% of billed price	90000		91000 dr
	Equipment acquired by branch, carried in home office accounting records		500	90500 dr
	Cash received from branch		37500	53000 dr
	Operating expenses billed to branch	3000		56000 dr
	Net loss for 2022 reported by branch		10500	45500 dr

Allowance for Overvaluation of Inventories: Qena Branch

Date	Explanation	Debit	Credit	Balance
2022	Markup on merchandise shipped to branch during 2022 (50% of cost)		30000	30000 cr
	Realization of 50% markup on merchandise sold by branch during 2022	22500		7500 cr

Realized Gross Profit: Qena Branch

Date	Explanation	Debit	Credit	Balance
2022	Realization of 50% markup on merchandise sold by branch during 2022		22500	22500 cr
	Closing entry	22500		-0000-

Income: Qena Branch

Date	Explanation	Debit	Credit	Balance
2022	Net loss for 2022 reported by branch	10500		10500 dr
	Closing entry		10500	-0000-

In the ***separate*** balance sheet for the home office, the L.E.7500 credit balance of the Allowance of Overvaluation of Inventories: Qena Branch account is deducted from the L.E.45500 debit balance of the Investment in Qena Branch account, thus reducing the carrying amount of the investment account to a cost basis with respect to shipments of merchandise to the branch. In the ***separate*** income statement for the home office, the L.E.22500 realized gross profit on Qena Branch sales may be displayed following gross margin on sales, L.E.165000 (L.E.400000 – L.E.235000 cost of goods sold = L.E.165000).

The closing entries for branch at the end of 2014 are as follows:

Qena Branch Accounting Records
Closing Entries
(Perpetual Inventory System)

Sales……………………………………………….	80000	
Income Summary……………………………….		80000
Income Summary………………………………….	90500	
Cost of Goods Sold……………………………		67500
Operating Expenses…………………………….		23000
To close revenue and expense ledger accounts.		
Home Office………………………………………	10500	
Income Summary………………………………		10500
To close the net loss in the Income Summary account to the Home Office account.		

Accordingly, after these closing entries have been posted by the branch, the following Home Office ledger account in the accounting records of Qena Branch has a credit balance of L.E.45500, the same debit balance of the Investment in Qena Branch account in the accounting records of the home office:

Home Office

Date	Explanation	Debit	Credit	Balance
2022	Cash received from home office		1000	1000 cr
	Merchandise received from home office		90000	91000 cr
	Equipment acquired	500		90500 cr
	Cash sent to home office	37500		53000 cr
	Operating expenses billed by home office		3000	56000 cr
	Net loss for 2022	10500		45500 cr

2.9 Treatment of Beginning Inventories Priced Above Cost

The foregoing working paper shows how the ending inventories and the related allowance for overvaluation of inventories were handled. However, because 2022 was the first year of operations for Qena Branch, no beginning inventories were involved.

Perpetual Inventory System

Under the perpetual inventory system, no special problems arise when the beginning inventories of the branch include an element of unrealized gross profit. The working paper eliminations would be similar to those illustrated previously.

Periodic Inventory System

The illustration of a second year of operations (2023) of Egypt Company demonstrates the handling of beginning inventories carried by Qena Branch at an amount above home office cost.

Illustration 2.3

Assume that both the home office and Qena Branch adopted the periodic inventory system in 2023. When the periodic inventory system is used, the home office credits ***Shipments to Branch*** (an offset account to Purchases) for the home office cost of merchandise shipped and Allowance for Overvaluation of Inventories for the markup over home office cost. The branch debits ***Shipments from***

Home Office (analogous to a Purchases account) for the billed price of merchandise received.

The beginning inventories for 2023 were carried by Qena Branch at L.E.22500, or 150% of the cost of L.E.15000 (L.E.15000 × 1.50 = L.E.22500). Assume that during 2023 the home office shipped merchandise to Qena Branch that cost L.E.80000 and was billed at L.E.120000, and that Qena Branch sold for L.E.150000 merchandise that was billed at L.E.112500. The journal entries to record the shipments and sales under the periodic inventory system are illustrated below (Journal Entries for Shipments to Branch at a Price above Home Office Cost, Periodic Inventory System):

Home Office Accounting Records
Journal Entries

Investment in Qena Branch…………………………	120000	
Shipments to Qena Branch………………………		80000
Allowance for Overvaluation of Inventories: Qena Branch……………………………………………		40000

Qena Branch Accounting Records
Journal Entries

Shipment from Home Office………………………..	20000	
Home Office………………………………………		120000
Cash (or Trade Accounts Receivable)………………	150000	
Sales………………………………………………		150000

The branch inventories at the end of 2023 amounted to L.E.30000 (L.E.22500 + L.E.120000 – L.E.112500 = L.E.30000) at billed prices, representing cost of L.E.20000 plus a 50% markup on cost (L.E.20000 × 1.50 = L.E.30000). The flow of merchandise for Qena Branch during 2023 is summarizes below:

Egypt Company
Flow of Merchandise for Qena Branch
During 2023

	Billed Brice L.E.	Home Office Cost L.E.	Markup (50% of Cost; 33⅓% of Billed Price)
Beginning inventories………………	22500	15000	7500
Add: Shipments from home office…	120000	80000	40000
Available for sale………………….	142500	95000	47500
Less: Ending inventories…………..	(30000)	(20000)	(10000)
Cost of goods sold………………….	112500	75000	37500

The activities of the branch for 2023 and end-of-period adjusting and closing entries are reflected in the four home office ledger accounts below.

Investment in Qena Branch

Date	Explanation	Debit	Credit	Balance
2023	Balance, Dec 31, 2023			45500dr
	Merchandise billed to branch at markup of 50% over home office cost, or 33⅓% of billed price	120000		165500dr
	Cash received from branch		113000	52500dr
	Operating expenses billed to branch	4500		57000dr
	Net income for 2023 reported by branch	10000		67000dr

Allowance for Overvaluation of Inventories: Qena Branch

Date	Explanation	Debit	Credit	Balance
2023	Balance, Dec. 31, 2022			7500cr
	Markup on merchandise shipped to branch during 2023 (50% of cost)		40000	47500cr
	Realization of 50% markup on merchandise sold by branch during 2023	37500		10000cr

Realized Gross Profit: Qena Branch

Date	Explanation	Debit	Credit	Balance
2023	Realization of 50% markup on merchandise sold by branch during 2023		37500	37500cr
	Closing entry	37500		-0000-

Income: Qena Branch

Date	Explanation	Debit	Credit	Balance
2023	Net income for 2023 reported by branch		10000	10000cr
	Closing entry	10000		-0000-

In the accounting records of the home office at the end of 2023, the balance required in the Allowance for Overvaluation of Inventories: Qena Branch ledger account is L.E.10000, that is, the billed price of L.E.30000 less cost of L.E.20000 for merchandise in the branch's ending inventories. Therefore, the allowance account balance is reduced from L.E.47500 to L.E.10000. This reduction of L.E.37500 represents the 50% markup on merchandise above cost that was realized by Qena Branch during 2023 and is credited to the Realized Gross Profit: Qena Branch Sales account.

The Home Office account in the branch general ledger shows the following activity and closing entry for 2023:

Home Office

Date	Explanation	Debit	Credit	Balance
2023	Balance, Dec. 31, 2022			45500cr
	Merchandise received from home office		120000	165500cr
	Cash sent to home office	113000		52500cr
	Operating expenses billed by home office		4500	57000cr
	Net income for 2023		10000	67000cr

The working paper for combined financial statements under the periodic inventory system, which reflects pre-adjusting and pre-closing balances for the reciprocal ledger accounts and the Allowance for Overvaluation of Inventories: Qena Branch account, is shown as below:

EGYPT COMPANY

Working Paper for Combined Financial Statements of Home Office and Qena Branch

For Year Ended December 31, 2023

(Periodic Inventory System: Billings above Cost)

	Adjusted Trial Balances			
	Home Office	**Qena Branch**	**Eliminations**	**Combined**
	Dr (Cr)	**Dr (Cr)**	**Dr (Cr)**	**Dr (Cr)**
Income Statement				
Sales	(500000)	(150000)		(650000)
Inventories, Dec.31, 2022	45000	22500	(b) (7500)	60000
Purchases	400000			400000
Shipments to Qena Branch	(80000)		(a) (80000)	----------
Shipments from Home Office		120000	(a) (120000)	----------
Inventories, Dec. 31, 2023	(70000)	(30000)	(c) 10000	(90000)
Operating expenses	120000	27500		147500
Net income (to statement of retained earnings below)	85000	10000	(d) 37500	132500
Totals	-0000-	-0000-		-0000-
Statement of Retained Earnings				
Retained earnings, beginning of year	(117000)			(117000)
Net (income) (from income statement above)	(85000)	(10000)	(d) (37500)	(132500)
Dividends declared	60000			60000
Retained earnings, end of year (to balance sheet below)				189500
Totals				-0000-
Balance Sheet				
Cash	30000	9000		39000
Trade accounts receivable (net)	64000	28000		92000
Inventories	70000	30000	(c) (10000)	90000
Investment in Qena Branch	57000		(e) (57000)	----------
Allowance for overvaluation of inventories : Qena Branch	(47500)		(a) 40000 (b) 7500	----------
Equipment	158000			158000
Accumulated depreciation of equipment	(15000)			(15000)
Trade accounts payable	(24500)			(24500)
Home office		(57000)	(e) 57000	----------
Common stock,L.E.10 par	(150000)			(150000)
Retained earnings (from statement of retained earnings above)				(189500)
Totals	-0000-	-0000-	-0000-	-0000-

(a) To eliminate reciprocal ledger accounts for merchandise shipments.
(b) To reduce beginning inventories of branch to cost.
(c) To reduce ending inventories of branch to cost.
(d) To increase income of home office by portion of merchandise markup that was realized by branch sales.
(e) To eliminate reciprocal ledger account balances.

2.10 Reconciliation of Reciprocal Ledger Accounts

Practically, at the end of an accounting period, the balance of the Investment in Branch ledger account in the accounting records of the home office may not agree with the balance of the Home Office account in the accounting records of the branch because certain transactions may have been recorded by one office but not by the other. The situation is comparable to that of reconciling the ledger account for Cash in Bank with the balance in the monthly bank statement. The lack of agreement between the reciprocal ledger account balances causes no difficulty during an accounting period, but at the end of each period the reciprocal account balances must be brought into agreement before combined financial statements are prepared.

Illustration 2.4

As an illustration of the procedure for reconciling reciprocal ledger account balances at year-end, assume that the home office and branch accounting records of Misr Company on December 31, 2022, contain the data below.

Investment in Aswan Branch
(in Home Office Accounting Records)

Date	Explanation	Debit	Credit	Balance
2022				
Nov. 30	Balance			62,500dr
Dec. 10	Received cash from branch		20,000	42,500dr
27	Collection of branch trade accounts receivable		1,000	41,500dr
29	Shipment of merchandise	8,000		49,500dr

Home Office (in Aswan Branch Accounting Records)

Date	Explanation	Debit	Credit	Balance
2022				
Nov. 30	Balance			62,500cr
Dec. 7	Cash sent to home office	20,000		42,500cr
28	Acquired equipment	3,000		39,500cr
30	Collection of home office trade accounts receivable		2,000	41,500cr

Instructions

a. Prepare a working paper to reconcile the reciprocal ledger accounts of Misr Company's home office and Aswan Branch to the corrected balances on December 31, 2022.
b. Prepare journal entries on December 31, 2022, for the (1) home office and (2) Aswan Branch of Misr Company to bring the accounting records up to date. Both the home office and the branch use the perpetual inventory system.

Solution

Comparison of the two reciprocal ledger accounts discloses four reconciling items, described as below:

1. A debit of L.E.8,000 in the Investment in Aswan Branch ledger account without a related credit in the Home Office account.

On December 29, 2022, the home office shipped merchandise costing L.E.8,000 to the branch. The home office debits its reciprocal ledger account with the branch on the date merchandise is shipped, but the branch credits its reciprocal account with the home office when the merchandise is received a few days later. The

required journal entry on December 31, 2022, in the ***branch accounting records***, assuming use of the perpetual inventory system, appears as follows:

Branch Journal Entry for Merchandise in Transit from Home Office

Inventories in Transit…………………………	8,000	
Home Office………………………………..		8,000
To record shipment of merchandise in transit from home office.		

In taking a physical inventory on December 31, 2022, the branch personnel must add to the inventories on hand the L.E.8,000 of merchandise in transit. When the merchandise is received in 2023, the branch debits Inventories and credits Inventories in Transit.

2. A credit of L.E.1,000 in the Investment in Aswan Branch ledger account without a related debit in the Home Office account.

On December 27, trade accounts receivables of the branch were collected by the home office. The collection was reported by the home office by a debit to Cash and a credit to Investment in Aswan Branch. No journal entry had been made by Aswan Branch; therefore, the following journal entry is required in ***the accounting records of Aswan Branch*** on December 31, 2022:

Branch Journal Entry for Trade Accounts Receivable Collected by Home Office

Home Office Trade Accounts Receivable To record collection of accounts receivable by home office.	1,000	 1,000

3. A debit of L.E.3,000 in the Home Office ledger account without a related credit in the Investment in Aswan Branch account.

On December 28, 2022, the branch acquired equipment for L.E.3,000. Because the equipment used by the branch is carried in the accounting records of the home office, the journal entry made by the branch was a debit to Home Office and a credit to Cash. No journal entry had been made by the home office; therefore, the following journal entry is required on December 31, 2022, ***in the accounting records of the home office:***

Home Office Journal Entry for Equipment Acquired by Branch

Equipment: Aswan Branch Investment in Aswan Branch To record equipment acquired by branch.	3,000	 3,000

4. A credit of L.E.2,000 in the Home Office ledger account without a related debit in the Investment in Aswan Branch account.

On December 30, 2022, trade accounts receivables of the home office were collected by Aswan Branch. The collection was recorded by Aswan Branch by a debit to Cash and a credit to Home Office. No journal entry hade been made by the home office;

therefore, the following journal entry is required ***in the accounting records of the home office*** on December 31, 2022:

Home Office Journal Entry for Trade Accounts Receivable Collected by Branch

Investment in Aswan Branch Trade Accounts Receivable To record collection of accounts receivable by Aswan Branch.	2,000	2,000

The effect of the foregoing end-of-period journal entries is to update the reciprocal ledger accounts, as shown by the following reconciliation:

MISR COMPANY-HOME OFFICE AND ASWAN BRANCH
Reconciliation of Reciprocal Ledger Accounts
December 31, 2022

	Investment in Aswan Branch Account (in home office accounting records)	**Home Office Account (in branch accounting records)**
Balances before adjustments	L.E.49,500 dr	L.E.41,500 cr
Add: (1) Merchandise shipped to branch by home office		8,000
(4) Home office trade accounts receivable collected by branch	2,000	
Less: (2) Branch trade accounts receivable collected by home office		(1,000)
(3) Equipment acquired by branch	(3,000)	
Adjusted balances	L.E. 48,500 dr	L.E.48,500 cr

2.11 Transactions between Branches

Efficient operations may on occasion require that merchandise or other assets be transferred from one branch to another. Generally, a branch does not carry a reciprocal ledger account with another branch but records the transfer in the ***Home Office*** ledger account. For instance, if Sohag Branch ships merchandise to Assut Branch, Sohag Branch debits Home Office and credits Inventories (assuming that the perpetual inventory system is used). On receipt of the merchandise, Assut Branch debits Inventory and credits Home Office. The home office records the transfer between branches by a debit to Investment in Assut Branch and a credit to Investment in Sohag Branch.

The transfer of merchandise from one branch to another does not justify increasing the carrying amount of inventories by the freight costs incurred because of the indirect routing (dispatch). The amount of freight costs properly included in inventories at a branch is limited to the cost of shipping the merchandise ***directly*** from the home office to its present location. Excess freight costs are recognized as expenses of the home office.

Illustration 2.5

In order to illustrate the accounting for excess freight costs on inter-branch transfers of merchandise, assume the data below.

The home office shipped merchandise costing L.E.6,000 to Red Sea Branch and paid freight costs of L.E.400. Subsequently, the home office instructed Red Sea Branch to transfer this merchandise to Menia Branch. Freight costs of L.E.300 were paid by Red Sea Branch to carry out this order. If the merchandise had been shipped directly from the home office to Menia Branch, the freight costs would have been L.E.500.

Instructions

Pass the journal entries required in the three sets of accounting records (assuming that the perpetual inventory system is used).

Solution

In Accounting Records of Home Office:

Investment in Red Sea Branch…………………………	6,400	
Inventories……………………………………………..		6,000
Cash……………………………………………………		400
To record shipment of merchandise and payment of freight costs.		
Investment in Menia Branch……………………………	6,500	
Excess Freight Expense-Interbrunch Transfers…………	200	
Investment in Red Sea Branch………………………..		6,700
To record transfer of merchandise from Red Sea Branch to Menia Branch under instruction of home office. Interbranch freight of L.E.300 paid by Red Sea Branch caused total freight costs on this merchandise to exceed direct shipment costs by L.E.200 (L.E.400 + L.E.300 – L.E.500 = 200).		

In Accounting Records of Red Sea Branch:

Freight in (or Inventories)……………………………..	400	
Inventories………………………………………….	6,000	
Home Office………………………………………		6,400
To record receipt of merchandise from home office with freight costs paid in advance by home office.		
Home Office…………………………………………..	6,700	
Inventories………………………………………….		6,000
Freight in (or Inventories)……………………….		400
Cash………………………………………………		300
To record transfer of merchandise to Menis Branch under instruction of home office and payment of freight costs of L.E.300.		

In Accounting Records of Menia Branch:

Freight in (or Inventories)……………………………..	500	
Inventories………………………………………….	6,000	
Home Office………………………………………		6,500
To record receipt of merchandise from Red Sea Branch under instruction of home office and normal freight costs billed by home office.		

Recognizing excess freight costs on merchandise transferred from one branch to another as expenses of the home office is an example of the accounting principle that expenses and losses should be given prompt recognition. The excess freight costs from such shipments generally result from inefficient planning of original shipments and should not be included in inventories.

In recognizing excess freight costs of interbranch transfers as expenses attributable to the home office, the assumption was that

the home office makes the decisions directing all shipments. If branch managers are given authority to order transfers of merchandise between branches, the excess freight costs are recognized as expenses attributable to the branches whose managers authorized the transfers.

2.12 Exercises and Practical Problems

Exercises:

(Exercise 2.1)

Select the best answer for each of the following multiple-choice questions:

1. May the Investment in Branch ledger account of a home office be accounted for by the:

	Cost Method of Accounting?	Equity Method of Accounting?
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

2. Which of the following generally is not a method of billing merchandise shipments by a home office to a branch?

a. Billing at cost.
b. Billing at a percentage below cost.
c. Billing at a percentage above cost.
d. Billing at retail selling prices.

3. A branch journal entry debiting Home Office and crediting Cash may be prepared for:

a. The branch's transmittal of cash to the home office only.
b. The branch's acquisition for cash of plant assets to be carried in the home office accounting records only.
c. Either *a* or *b*.
d. Neither *a* nor *b*.

4. A home office's Allowance for Overvaluation of Inventories: Branch ledger account, which has a credit balance, is:

a. An asset valuation account.
b. A liability account.
c. An equity Account.
d. A revenue account.

5. Does a branch use Shipments from Home Office ledger account under the:

	Perpetual Inventory System?	Periodic Inventory System?
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

6. A journal entry debiting Cash in Transit and crediting Investment in Branch is required for:
a. The home office to record the mailing of a check to the branch early in the accounting period.
b. The branch to record the mailing of a check to home office early in the accounting period.
c. The home office to record the mailing of a check by the branch on the last day of the accounting period.
d. The branch to record the mailing of a check to the home office on the last day of the accounting period.
7. For a home office that uses the periodic inventory system of accounting for shipments of merchandise to the branch, the credit balance of Shipments to Branch ledger account is displayed in the home office's separate:
a. Income statement as an offset to Purchases.
b. Balance sheet as an offset to Investment in Branch.
c. Balance sheet as an offset to Inventories.
d. Income statement as revenue.
8. If the home office maintains accounts in its general ledger for a branch's plant assets, the branch debits its acquisition of office equipment to:
a. Home Office.
b. Office Equipment.
c. Payable to Home Office.
d. Office Equipment Carried by Home Office.
9. In a working paper for combined financial statements of the home office and the branch of a business enterprise, an elimination that debits Shipments to Branch and credits Shipments from Home Office is required under:
a. The periodic inventory system only.
b. The perpetual inventory system only.
c. Both the periodic inventory system and the perpetual inventory system.
d. Neither the periodic inventory system nor the perpetual inventory system.
10. The appropriate journal entry for the home office to recognize the branch's expenditure of L.E.1,000 for equipment to be carried in the home office accounting records is:

a. Equipment 1,000
Investment in Branch 1,000
b. Home Office 1,000
Equipment 1,000
c. Investment in Branch 1,000
Cash 1,000
d. Equipment: Branch 1,000
Investment in Branch 1,000

11. On January 31, 2023, East Branch of Cairo Company, which uses the perpetual inventory system, prepared the following journal entry:

Inventories in Transit 10,000
Home Office 10,000

To record shipment of merchandise in transit from home office.

When the merchandise is received on February 4, 2023, East Branch should:

a. Prepare no journal entry.
b. Debit Inventories and credit Home Office, L.E.10,000
c. Debit Home Office and credit Inventories in Transit, L.E.10,000.
d. Debit Inventories and credit Inventories in Transit, L.E.10,000.

12. If a home office bills merchandise shipments to the branch at a markup of 20% on cost, the markup on billed price is:

a. 16⅔%
b. 20%
c. 25%
d. Some other percentage.

13. The appropriate journal entry in the accounting records of the home office to record a L.E.10,000 cash remittance in transit from the branch at the end of an accounting period is:

a. Cash 10,000
Cash in Transit 10,000
b. Cash in Transit 10,000
Investment in Branch 10,000
c. Cash 10,000
Home Office 10,000
d. Cash in Transit 10,000
Cash 10,000

(Exercise 2.2)

On September 1, 2023, Edfina Company established a branch in Sinai. Following are the first three transactions between the home office and Sinai Branch of Edfina Company:

Sept. 1 Home office sent L.E.10,000 to the branch for an imprest bank account.

Sept. 2 Home office shipped merchandise costing L.E.60,000 to the branch, billed a markup of 20% on billed price.

Sept. 3 Branch acquired office equipment for L.E.3,000, to be carried in the home office accounting records.

Both the home office and the Sinai branch of Edfina Company use the perpetual inventory system.

Prepare journal entries for the foregoing transactions:

a. In the accounting records of the home office.

b. In the accounting records of the Sinai branch.

(Exercise 2.3)

On September 1, 2023, Western Company established the Eastern Branch. Separate accounting records were set up for the branch. Both the home office and the Eastern Branch use the periodic inventory system. Among the intracompany transactions were the following:

Sept. 1 Home office mailed a check for L.E.50,000 to the branch. The check was received by the branch on September 3.

Sept. 4 Home office shipped merchandise costing L.E.95,000 to the branch, at a billed price of L.E.125,000. The branch received the merchandise on September 8.

Sept. 11 the branch acquired a truck for L.E.34,200. The home office maintains the plant assets of the branch in its accounting records.

Prepare journal entries for the foregoing intracompany transactions:

a. In the accounting records of the home office.

b. In the accounting records of the Eastern Branch.

(Exercise 2.4)

Among the journal entries of the home office of Wally Corporation for the month of January 2023, were the following:

2023	Explanation	L.E. dr	L.E. cr
Jan 2	Investment in Luxor Branch………………………	100,000	
	Inventories……………………………………		80,000
	Allowance for Overvaluation of Inventories: Luxor Branch………………………………………..		20,000
	To record merchandise shipped to branch.		
	Equipment: Luxor Branch………………………..	5,000	
18	Investment in Luxor Branch……………………		5,000
	To record acquisition of equipment by branch for cash.		
	Investment in Luxor Branch……………………..	8,000	
	Operating Expenses……………………………		8,000
31	To record allocation of operating expenses to branch.		

Prepare related journal entries for the Luxor Branch of Wally Corporation: the branch uses the perpetual inventory system.

(Exercise 2.5)

Among the journal entries for business transactions and events of the Hoover Street of Tanta Company during January 2023, were the following:

2023	Explanation	L.E. dr	L.E. cr
Jan.	Inventories……………………………………………	60,000	
12	Home Office………………………………………		60,000
	To record the receipt of merchandise shipped Jan. 10 from the home office and billed at a markup of 20% on billed price.		
25	Cash…………………………………………………..	25,000	
	Home Office………………………………………..		25,000
	To record collection of trade accounts receivable of home office.		
	Operating Expenses………………………………….	18,000	
31	Home Office………………………………………		18,000
	To record operating expenses allocated by home office.		

Prepare appropriate journal entries for the home office of Tanta Company.

(Exercise 2.6)

Among the journal entries of the home office of Turbo Company for the month ended August 31, 2023, were the following:

2023	Explanation	L.E. dr	L.E. cr
Aug.	Investment in Nido Branch…………………………….	10,000	
6	Cash………………………………………………….		10,000

	To record payment of account payable of branch.		
14	Cash………………………………………………… Investment in Nido Branch…………………………. To record collection of trade account receivable of branch.	6,000	6,000
22	Equipment: Nido Branch………………………………. Investment in Nido Branch…………………………… To record branch acquisition of equipment for cash, to be carried in home office accounting records.	20,000	20,000

Prepare appropriate journal entries for Nido Branch of Turbo Company.

(Exercise 2.7)

Prepare journal entries in the accounting records of both the home office and the Alexandria Branch of World Company to record each of the following transactions or events:

a. Home office transferred cash of L.E.5,000 and merchandise (at home office cost) of L.E.10,000 to the branch. Both the home office and the branch use the perpetual inventory system.

b. Home office allocated operating expenses of L.E.1,500 to the branch.

c. Alexandria Branch informed the home office that it had collected L.E.416 on a note payable to the home office. Principal amount of the note was L.E.400.

d. Alexandria Branch made sales of L.E.12,500, terms 2/10, n/30, and incurred operating expenses of L.E.2,500. The cost of goods sold was L.E.8,000, and the operating expenses were paid in cash.

e. Alexandria Branch had a net income of L.E.500. (Debit Income Summary in the accounting records of the branch.)

(Exercise 2.8)

Newland Company has a policy of accounting for all plant assets of its branches in the accounting records of the home office. Contrary to this policy, the accountant for Dhab Branch prepared the following journal entries for the equipment acquired by Dhab Branch at the direction of the home office:

2023

Aug. 1	Equipment	20,000	
	Cash		20,000

To record acquisition of equipment with an economic life of 10 years and a residual value of L.E.2,000.

Dec. 31 Depreciation Expenses 750
Accumulated Depreciation
of equipment 750

To recognize depreciation of equipment by the straight-line method (L.E.18,000 × 5/120).

Prepare appropriate journal entries for Dhab Branch and the home office on December 31, 2023, the end of the fiscal year, assuming that the home office had prepared no journal entries for the equipment acquired by the Dhab Branch on August 1, 2023. Neither set of accounting records has been closed.

(Exercise 2.9)

The home office of Port Said Company ships merchandise to the Nile-Star Branch at a billed price that includes a markup on home office cost of 25%. The Inventories ledger account of the branch, under the perpetual inventory system, showed a December 31, 2022, debit balance, L.E.120,000; a debit for a shipment received January 16, 2023, L.E.500,000; total credits for goods sold during January 2023, L.E.520,000; and a January 31, 2023, debit balance, L.E.100,000 (all amounts are home office billed prices).

Prepare a working paper for the home office of Port Said Company to analyze the flow of merchandise to Nile-Star Branch during January 2023.

(Check Figure: Markup in cost of goods sold, L.E.104,000).

(Exercise 2.10)

The flow of merchandise from the home office of Sharm El-Sheikh Company to its Rafah Branch during the month of April 2023, may be analyzed as follows:

Sharm El-Sheikh Company
Flow of Merchandise for Rafah Branch
For Month of April 2023

	Billed Price	Cost	Markup
Beginning inventories L.E.	180,000	150,000	30,000
Add: Shipment from home office (Apr. 16)	540,000	450,000	90,000
Available for sale	720,000	600,000	120,000
Less: Ending inventories	120,000	100,000	20,000
Cost of goods sold L.E.	600,000	500,000	100,000

From the foregoing information, reconstruct a three-column ledger account Allowance for Overvaluation of Inventories: Rafah Branch for the home office of Sharm El-Sheikh Company, beginning with the March 31, 2023, balance, L.E.30,000 credit.
(Check Figure: Apr. 30 balance L.E.20,000 credit).

(Exercise 2.11)
On May 31, 2023, Green Branch of Garden Company reported a net income of L.E.80,000 for May 2023, and a L.E.240,000 ending inventory at billed price of merchandise received from the home office at a 25% markup on billed. Prior to adjustment, the May 31, 2023, balance of the home office's Allowance for Overvaluation of Inventories: Green Branch was L.E.200,000 credit.

Prepare journal entries on May 31, 2023, for the home office of Garden Company to reflect the foregoing facts.

(Exercise 2.12)
Superman Textile Company has a single branch in South Valley. On March 1, 2023, the home office accounting records included an Allowance for Overvaluation of Inventories: South Valley Branch ledger account with a credit balance of L.E.32,000. During March, merchandise costing L.E.36,000 was shipped to the South Valley Branch and billed at a price representing a 40% markup on the billed price. On March 31, 2023, the branch prepared an income statement indicating a net loss of L.E.11,500 for March and ending inventories at billed prices of L.E.25,000.
Instructions
a. Prepare a working paper to compute the home office cost of the branch inventories on March 1, 2023, assuming a uniform markup on all shipments to the branch.
b. Prepare a journal entry to adjust the Allowance for Overvaluation of Inventories: South Valley Branch ledger account on March 31, 2023, in the accounting records of the home office.
(Check Figure: b. Debit allowance for overvaluation of inventories, L.E.46,000).

(Exercise 2.13)
The home office of Oasis Company which uses the perpetual inventory system bills shipments of merchandise to the Yellow

Branch at a markup of 25% on the billed price. On August 31, 2023, the credit balance of the home office's Allowance for Overvaluation of Inventories: Yellow Branch ledger account was L.E.60,000. On September 17, 2023, the home office shipped merchandise to the branch at a billed price of L.E.400,000. The branch reported an ending inventory, at billed price, of L.E.160,000 on September 30, 2023.

Prepare journal entries involving the Allowance for Overvaluation of Inventories: Yellow Branch ledger account of the home office of Oasis Company on September 17 and 30, 2023. Show supporting computations in the explanations for the entries.
(Check Figure: Sept. 30, credit realized gross profit, L.E.120,000).

(Exercise 2.14)
On January 31, 2023, the unadjusted credit balance of the Allowance for Overvaluation of Inventories: Red Branch of the home office of Mountain Company was L.E.80,000. The branch reported a net income of L.E.60,000 for January 2023 and an ending inventory on January 31, 2023, of L.E.81,000, at billed prices that included a markup of 50% on home office cost.

Prepare journal entries for the home office of Mountain Company on January 31, 2023, for the foregoing facts.

(Exercise 2.15)
The home office of Gerga Company bills its only branch at a markup of 25% above home office cost for all merchandise shipped to that Bardees Branch. Both the home office and the branch use the periodic inventory system. During 2023, the home office shipped merchandise to the branch at a billed price of L.E.30,000. Bardees Branch inventories for 2023 were as follows:

	Jan. 1	**Dec. 31**
Purchased from home office (at billed price)	15,000	19,500
Purchased from outsiders	6,800	8,670

Prepare journal entries (including adjusting entry) for the home office of Gerga Company for 2023 to reflect the foregoing information.
(Check Figure: Credit realized gross profit, L.E.5,100).

(Exercise 2.16)

On May 31, 2023, the unadjusted balances of the Investment in Toy Branch ledger account of the home office of Argentina Company and the Home Office account of the Toy Branch of Argentina Company were L.E.380,000 debit and L.E.140,000 credit, respectively.

Additional Information

1. On May 31, 2023, the home office had shipped merchandise to the branch at a billed price of L.E.280,000; the branch did not receive the shipment until June 3, 2023. Both the home office and the branch use the perpetual inventory system.
2. On May 31, 2023, the branch had sent a L.E.10,000 "dividend" to the home office, which did not receive the check until June 2, 2023.
3. On May 31, 2023, the home office had prepared the following journal entry, without notifying the branch:

Cash	50,000	
Investment in Toy Branch		50,000

To record collection of a trade account receivable of branch.

Prepare journal entries on May 31, 2023, for (*a*) the home office and (*b*) the Toy Branch of Argentina Company to reconcile the reciprocal ledger accounts.

Problems

(Problem 2.1)

Strongman, Inc., established Reno Branch on January 2, 2023. During 2023, Strongman's home office shipped merchandise to Reno Branch that cost L.E.300,000. Billings were made at prices marked up 20% above home office cost. Freight costs of L.E.15,000 were paid by the home office. Sales by the branch were L.E.450,000, and branch operating expenses were L.E.96,000, all for cash. On December 31, 2023, the branch took a physical inventory that showed merchandise on hand of L.E.72,000 at billed prices. Both the home office and the branch use the periodic inventory system.

Instructions

Prepare journal entries for Reno Branch and the home office of Strongman, Inc., to record the foregoing transactions and events, ending inventories, and adjusting and closing entries on December

31, 2023. (Allocate a proportional amount of freight costs to the ending inventories of the branch.)

(Problem 2.2)

Included in the accounting records of the home office and Solo Branch, respectively, of Logo Company were the following ledger accounts for the month of January 2023:

Investment in Solo Branch
(in Home Office Accounting Records)

Date	Explanation	Debit	Credit	Balance
2023				
Jan. 1	Balance			39,200dr
9	Shipment of merchandise	4,000		43,200dr
21	Receipt of cash		1,600	41,600dr
27	Collection of branch trade accounts receivable		1,100	40,500dr
31	Shipment of merchandise	6,000		46,500dr
31	Payment of branch trade accounts payable	2,000		48,500dr

Home Office (in Solo Branch Accounting Records)

Date	Explanation	Debit	Credit	Balance
2023				
Jan. 1	Balance			39,200cr
10	Receipt of merchandise		4,000	43,200cr
19	Remittance of cash	1,600		41,600cr
28	Acquisition of furniture	1,200		40,400cr
30	Return of merchandise	2,200		38,200cr
31	Remittance of cash	2,500		35,700cr

Instructions

a. Prepare a working paper to reconcile the reciprocal ledger accounts of Logo Company's home office and Solo Branch to the corrected balances on January 31, 2023.

b. Prepare journal entries on January 31, 2023, for the (1) home office and (2) Solo Branch of Logo Company to bring the accounting records up to date. Both the home office and the branch use the perpetual inventory system.

(Check Figure: Adjusted balances L.E.42,600.)

(Problem 2.3)

The home office of Grand Corporation operates a branch to which it bills merchandise at prices marked up 20% above home office cost. The branch obtains merchandise only from the home office and sells it at prices averaging markups 10% above the prices billed by the home office. Both the home office and the branch maintain

perpetual inventory records and both close their accounting records on December 31.

On March 10, 2023, a fire at the branch destroyed a part of the inventories. Immediately after the fire, a physical inventory of merchandise on hand and not damaged amounted to L.E.16,500 at branch retail selling prices. On January 1, 2023, the inventories of the branch at billed prices had been L.E.18,000. Shipments from the home office during the period January 1 to March 10, 2023, were billed to the branch in the amount of L.E.57,600. The accounting records of the branch show that net sales during this period were L.E.44,880.

Instructions

Prepare journal entries on March 10, 2023, to record the uninsured loss from fire in the accounting records of (*a*) the branch and (*b*) the home office of Grand Company. Show supporting computations for all amounts. Assume that the loss was reported at billed prices by the branch to the home office and that it was recorded in the intracompany reciprocal ledger accounts.

(Check Figure: *a.* Debit loss from fire, L.E.19,800; *b.* Debit loss from fire, L.E.16,500.)

(Problem 2.4)

On December 31, 2023, the Investment in Lion Branch ledger account in the accounting records of the home office of Zoo Company shows a debit balance of L.E.55,500. You ascertain the following facts in analyzing this account:

1. On December 13, 2023, merchandise billed at L.E.5,800 was in transit from the home office to the branch. The periodic inventory system is used by both the home office and the branch.
2. The branch had collected a home office trade account receivable of L.E.560 on December 30, 2023; the home office was not notified.
3. On December 29, 2023, the home office had mailed a check for L.E.2,000 to the branch, but the accountant for the home office had recorded the check as a debit to the Charitable Contributions ledger account; the branch had not received the check as of December 31, 2023.
4. Branch net income for December 2023 was recorded erroneously by the home office at L.E.840 instead of L.E.480 on December

31, 2023. The credit was recorded by the home office in the Income: Lion Branch ledger account.

5. On December 28, 2023, the branch had returned supplies costing L.E.220 to the home office; the home office had not recorded the receipt of the supplies. The home office records acquisitions of supplies in the Inventory of Supplies ledger account.

Instructions

a. Assuming that all other transactions and events have been recorded properly, prepare a working paper to compute the unadjusted balance of the Home Office ledger account in the accounting records of Zoo Company's Lion Branch on December 31, 2023.

b. Prepare journal entries for the home office of Zoo Company on December 31, 2023, to bring its accounting records up to date. Closing entries have not been made.

c. Prepare journal entries for Lion Branch of Zoo Company on December 31, 2023, to bring its accounting records up to date.

d. Prepare reconciliation on December 31, 2023, of the Investment in Lion branch ledger account in the accounting records of the home office and the Home Office account in the accounting records of Lion Branch of Zoo Company. Use a single column for each account and start with the unadjusted balances.

(Check Figures: *a.* Unadjusted balance, L.E.49,680; *d.* Adjusted Balance, L.E.57,480.)

(Problem 2.5)

Luxor Company's home office bills shipments of merchandise to its Savoy Branch at 140% of home office cost. During the first year after the branch was opened, the following were among the transactions and events completed:

1. The home office shipped merchandise with a home office cost of L.E.110,000 to Savoy Branch.
2. Savoy Branch sold for L.E.80,000 cash merchandise that was billed by the home office at L.E.70,000, and incurred operating expenses of L.E.16,500 (all paid in cash).
3. The physical inventories taken by Savoy Branch at the end of the first year were L.E.82,460 at billed prices from the home office.

Instructions

a. Assuming that the perpetual inventory system is used both by the home office and by Savoy Branch, prepare for the first year:

(1) All journal entries, including closing entries, in the accounting records of Savoy Branch of Luxor Company.

(2) All journal entries, including the adjustment of the Inventories Overvaluation account, in the accounting records of the home office of Luxor Company.

b. Assuming that the periodic inventory system is used both by the home office an by Savoy Branch, prepare for the first year:

(1) All journal entries, including closing entries, in the accounting records of Savoy Branch of Luxor Company.

(2) All journal entries, including the adjustment of the Inventories Overvaluation account, in the accounting records of the home office of Luxor Company.

(Problem 2.6)

You are making an audit for the year ended December 31, 2023, of the financial statements of Marina Company, which carries on merchandise operations at both a home office and branch. The unadjusted trial balances of the home office and the branch are shown below:

MARINA COMPANY
Unadjusted Trial Balances
December 31, 2023

	Home Office Dr (Cr)	**Branch Dr (Cr)**
Cash L.E.	22,000	10,175
Inventories, Jan. 1, 2023	23,000	11,550
Investment in branch	60,000	
Allowance for overvaluation of branch inventories, Jan. 1, 2023	(1,000)	
Other assets (net)	197,000	48,450
Current liabilities	(35,000)	(8,500)
Common stock, L.E.2.50 par	(200,000)	
Retained earnings, Jan. 1, 2023	(34,000)	
Dividends declared	15,000	
Home office		(51,000)
Sales	(169,000)	(144,700)
Purchases	190,000	
Shipments to branch	(110,000)	
Shipments from home office		104,500
Freight-in from home office		5,225
Operating expenses	42,000	24,300
Totals	-0000-	-0000-

The audit for the year ended December 31, 2023, disclosed the following:

1. The branch deposits all cash receipts in a local bank for the account of the home office. The audit working papers for the cash cut off include the following:

Amount	Date Deposited by Branch	Date recorded by Home Office
L.E.1,050	Dec. 27, 2023	Dec. 31, 2023
1,100	Dec. 30, 2023	Not recorded
600	Dec. 31, 2023	Not recorded
300	Jan. 2, 2024	Not recorded

2. The branch pays operating expenses incurred locally from an imprest cash account that is maintained with a balance of L.E.2,000. Checks are drawn once a week on the imprest cash account, and the home office is notified of the amount needed to replenish the account. On December 31, 2023, a L.E.1,800 reimbursement check was in transit from the home office to the branch.
3. The branch received all its merchandise from the home office. The home office bills the merchandise shipments at a markup of 10% above home office cost. On December 31, 2023, a shipment with a billed price of L.E.5,500 was in transit to the branch. Freight costs of common carriers typically are 5% of billed price. Freight costs are considered to be inventoriable costs. Both the home office and the branch use the periodic inventory system.
4. Beginning inventories in the trial balance are shown at the respective costs to the home office and to the branch. The physical inventories on December 31, 2023, were as follows:

Home office, at cost	L.E.30,000
Branch, at billed price (excluding Shipment in transit and freight)	9,900

Instructions

a. Prepare journal entries to adjust the accounting records of the home office of Marina Company on December 31, 2023.

b. Prepare journal entries to adjust the accounting records of Marina Company's branch on December 31, 2023.

c. Prepare a working paper for combined financial statements of Marina Company. Compute the amounts in the adjusted trial balances for the home office and the branch by incorporating the

journal entries in *(a)* and *(b)* with the amounts in the unadjusted trial balances.

(**Check Figure**: *c.* Combined net income, L.E.63,120.)

(Problem 2.7)

On January 4, 2023, Solo Company opened its first branch, with instructions to the branch manager to perform the functions of granting credit, billing customers, accounting for receivables, and making cash collections. The branch paid its operating expenses by checks drawn on its bank account. The branch obtained merchandise solely from the home office; billings from these shipments ***were at cost to the home office.*** The adjusted trial balances for the home office and the branch on December 31, 2023, were as follows:

SOLO COMPANY **Adjusted Trial Balances** **December 31, 2023**		
	Home Office Dr (Cr)	**Branch Dr (Cr)**
Cash L.E.	46,000	14,600
Notes receivable	7,000	
Trade accounts receivable (net)	80,400	37,300
Inventories, Jan. 1, 2023	95,800	24,200
Investment in branch	82,700	
Furniture and equipment (net)	48,100	
Trade accounts payable	(41,000)	
Common stock, L.E.2 par	(200,000)	
Retained earnings, Dec. 31, 2022	(25,000)	
Dividends declared	30,000	
Home office		(82,700)
Sales	(394,000)	(101,100)
Cost of goods sold	200,500	85,800
Operating expenses	69,500	21,900
Totals	-0000-	-0000-

The physical inventories on December 31, 2023, were in agreement with the perpetual inventory records of the home office and the branch.

Instructions

a. Prepare a four-column working paper for combined financial statements of the home office and branch of Solo Company for the year ended December 31, 2023.

b. Prepare closing entries on December 31, 2023, in the accounting records of the branch of Solo Company.

c. Prepare adjusting and closing entries pertaining to branch operations on December 31, 2023, in the accounting records of the home office of Solo Company.

(Check Figure: *a.* Combined net income, L.E.117,400.)

(Problem 2.8)

The unadjusted general ledger trial balances on December 31, 2023, for Sinai Cola Corporation's home office and its only branch are shown below:

SINAI COLA COMPANY **Unadjusted Trial Balances** **December 31, 2023**		
	Home Office Dr (Cr)	**Branch Dr (Cr)**
Cash L.E.	28,000	23,000
Trade accounts receivable (net)	35,000	12,000
Inventories, Jan. 1, 2023 (at cost to home office)	70,000	15,000
Investment in branch	30,000	
Equipment (net)	90,000	
Trade accounts payable	(46,000)	(13,500)
Accrued liabilities	(14,000)	(2,500)
Home office		(19,000)
Common stock, L.E.10 par	(50,000)	
Retained earnings, Jan. 1, 2023	(48,000)	
Dividends declared	10,000	
Sales	(450,000)	(100,000)
Purchases	290,000	24,000
Shipments from home office		45,000
Operating expenses	55,000	16,000
Totals	-0000-	-0000-

Your audit disclosed the following:

1. On December 10, 2023, the branch manager acquired equipment for L.E.500, but failed to notify the home office. The branch accountant, knowing that branch equipment is carried in the home office ledger, recorded the proper journal entry in the branch accounting records. It is Sinai Cola's policy not to recognise depreciation on equipment acquired in the last half of a year.
2. On December 27, 2023, Moro, Inc., a customer of the branch, erroneously paid its account of L.E.2,000 to the home office. The

accountant made the correct journal entry in the home office accounting records but did not notify the branch.

3. On December 30, 2023, the branch remitted to the home office cash of L.E.5,000, which had not been received by the home office as of December 31, 2023.
4. On December 31, 2023, the branch accountant erroneously recorded the December allocated expenses from the home office as L.E.500 instead of L.E.5,000.
5. On December 31, 2023, the home office shipped merchandise billed at L.E.3,000 to the branch; the shipment had not received by the branch as of December 31, 2023.
6. The inventories on December 31, 2023, excluding the shipment in transit, were: home office-L.E.60,000 (at cost); branch-L.E.20,000 (consisting of L.E.18,000 from home office at billed price and L.E.2,000 from suppliers). Both the home office and the branch use the periodic inventory system.
7. The home office erroneously billed shipments to the branch at a markup of 20% above home office cost, although the billing should have been at cost. The Sales ledger account was credited for the invoices' price by the home office.

Instructions

a. Prepare journal entries for the home office of Sinai Cola Company on December 31, 2023, to bring the accounting records up to date and to correct any errors. Record ending inventories by an offsetting credit to the Income Summary ledger account. Do not prepare other closing entries.

b. Prepare journal entries for the branch of Sinai Cola Company on December 31, 2023, to bring the accounting records up to date and to correct any errors. Record ending inventories at cost to the home office by an offsetting credit to the Income Summary ledger account. Do not prepare other closing entries.

c. Prepare a working paper to summarize the operations of Sinai Company for the year ended December 31, 2023. Disregard income taxes and use the following column headings:

Revenue & Expenses	Home Office	Branch	Combined

(Check Figure: *c.* Combined net income, L.E.107,000.)

(Problem 2.9)

The following reciprocal ledger accounts were included in the accounting records of the home office and the Senzo Branch of Spinneys Company on April 30, 2023. You have been retained by Spinneys to assist it with some accounting work preliminary to the preparation of financial statements for the quarter ended April 30, 2023.

Investment in Senzo Branch

Date	Explanation	Debit	Credit	Balance
2023				
Feb. 1	Balance			124,630dr
6	Shipment of merchandise 160 units @ L.E.49	7,840		132,470dr
17	Note receivable collected by branch	2,500		134,700dr
Mar. 31	Cash deposited by branch		2,000	132,970dr
Apr. 2	Merchandise returned by branch		450	132,520dr
26	Loss on disposal of branch equipment	780		133,300dr
28	Operating expenses charged to branch	1,200		134,500dr
29	Corrected loss on disposal of branch equipment from L.E.780 to L.E.250		530	133,970dr

Home Office

Date	Explanation	Debit	Credit	Balance
2023				
Feb. 1	Balance			124,620cr
8	Merchandise from home office, 160 units @ L.E.49		7,480	132,110cr
14	Received shipment directly from supplier, invoice to be paid by home office		2,750	134,860cr
15	Note receivable collected for home office		2,500	137,360cr
Mar30	Deposited cash in account of home office	2,000		135,360cr
31	Returned merchandise to home office	450		134,910cr
Apr 29	Paid repair bill for home office	375		134,535cr
30	Excess merchandise returned to home office (billed at cost)	5,205		129,330cr
30	Preliminary net income for quarter (before any required corrections)		13,710	143,040cr

Additional Information

1. Branch equipment is carried in the accounting records of the home office; the home office notifies the branch periodically as to the amount of depreciation applicable to equipment used by the branch. Gains or loss on disposal of branch equipment are reported to the branch and included in the income statement of the branch.
2. Because of the error in recording the shipment from the home office on February 8, 2023, the sale of the 160 units has been

debited improperly by the branch to cost of goods sold at L.46.75 a unit.

3. On April 30, 2023, the branch collected trade accounts receivable of L.E.350 belonging to the home office, but the branch employee who recorded the collection mistakenly treated the trade accounts receivable as belonging to the branch.
4. The branch accountant recorded the preliminary net income of L.E.13,710 by a debit to Income Summary and a credit to Home Office, although the revenue and expense ledger accounts had not been closed.

Instructions

a. Reconcile the reciprocal ledger accounts of the home office and Senzo Branch of Spinneys Company to the correct balances on April 30, 2023. Use a four-column working paper (debit and credit columns for the Investment in Senzo Branch account in the home office accounting records and a debit and credit columns for the Home Office account in the branch accounting records). Start with the unadjusted balances on April 30, 2023, and work to corrected balances, including explanations of all adjusting or correcting items.

b. Prepare journal entries for Senzo Branch of Spinneys Company on April 30, 2023, to bring its accounting records up to date, assuming that corrections still may be made to revenue and expense ledger accounts. The branch uses the perpetual inventory system. Do not prepare closing entries.

c. Prepare journal entries for the home office of Spinneys Company on April 30, 2023, to bring its accounting records up to date. The home office uses the perpetual inventory system and has not prepared closing entries. Do not prepare closing entries.

(Check Figure: *b.* Adjusted balances, L.E.143,390.)

(Problem 2.10)

Stars a single proprietorship owned by Egyptians, sells merchandise at both its home office and a branch. The home office bills merchandise shipped to the branch at 125% of home office cost, and is the only supplier for the branch. Shipments of merchandise to the branch have been recorded improperly by the home office by credits to Sales for the billed price. Both the home office and the branch use the perpetual inventory system.

Stars have engaged you to audit its financial statements for the year ended December 31, 2023. This is the first time the proprietorship has retained an independent accountant. You were provided with the following unadjusted trial balances.

STARS **Unadjusted Trial Balances** **December 31, 2023**		
	Home Office Dr (Cr)	**Branch Dr (Cr)**
Cash L.E.	31,000	13,000
Trade accounts receivable (net)	20,000	22,000
Inventories	40,000	8,000
Investment in branch	45,000	
Equipment (net)	150,000	
Trade accounts payable	(23,000)	
Accrued liabilities		(2,000)
Note payable, due 2026	(51,000)	
Home office		(10,000)
Egyptians, capital, Jan. 1, 2023	(192,000)	
Egyptians drawing	50,000	
Sales	(390,000)	(160,000)
Purchases	250,000	93,000
Operating expenses	70,000	36,000
Totals	-0000-	-0000-

Additional Information

1. On January 1, 2023, inventories of the home office amounted to L.E.25,000 and inventories of the branch amounted to L.E.6,000. During 2023, the branch was billed for L.E.105,000 for shipments from the home office.
2. On December 28, 2023, the home office billed the branch for L.E.12,000, representing the branch's share of operating expenses paid by the home office. These billings had not been recorded by the branch.
3. All cash collections made by the branch were deposited in a local bank to the bank account of the home office. Deposits of this nature included in the following:

Amount	Date Deposited By Branch	Date recorded By Home Office
L.E.5,000	Dec. 28, 2023	Dec. 31, 2023
3,000	Dec. 30, 2023	Not recorded
7,000	Dec. 31, 2023	Not recorded
2,000	Jan. 2, 2024	Not recorded

4. Operating expenses incurred by the branch were paid from an imprest bank account that was reimbursed periodically by the home office. On December 30, 2023, the home office had mailed a reimbursement check in the amount of L.E.3,000, which had not been received by the branch as of December 31, 2023.
5. A shipment of merchandise from the home office to the branch was in transit on December 31, 2023.

Instructions

a. Prepare journal entries to adjust the accounting records of home office on December 31, 2023. Establish an allowance for overvaluation of branch inventories.

b. Prepare journal entries to adjust the accounting records the branch on December 31, 2023.

c. Prepare a working paper for combined financial statements of Stars on December 31, 2023. Compute the amounts for the adjusted trial balances for the home office and the branch by incorporating the journal entries in *(a)* and *(b)* with the amounts in the unadjusted trial balances.

d. After the working paper in *(c)* is completed, prepare all required adjusting and closing entries on December 31, in the accounting records of Stars' home office.

(Check Figure: *c.* Combined net income, L.E.86,600.)

CHAPTER THREE

ACCOUNTING FOR BUSINESS COMBINATIONS

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Accounting for Business Combinations

3.1 Introduction:

The Financial Accounting Standards Board (FASB, 2001) has defined ***business combination*** as: "business combination occurs when an entity acquires net assets that constitute a business or acquires equity interests of one or more other entities and obtains control over that entity or entities". ***Entity***: A business enterprise, a new entity formed to complete a business combination, or a mutual enterprise-an entity, not investor-owned, that provides, lower costs, or other economic benefits directly to its owners, members, or participants.

Business: An asset group that constitutes a business.

Control: Ownership by one company, directly or indirectly, of the outstanding voting shares of another company.

Commonly, business combinations are often referred to as ***mergers and acquisitions.*** Generally, the FASB (Ibid.) has suggested the following definitions for terms commonly used in discussions of business combinations:

(1) ***Combined enterprise:*** The accounting entity that results from business combination.

(2) ***Constituent companies:*** The business enterprises that inter into a business combination.

(3) ***Combinor:*** A constituent company entering into a business combination whose owners as a group end up with control of the ownership interests in the combined enterprise.

(4) ***Combinee:*** A constituent company other than the combinor in a business combination.

3.2 Methods for Arranging Business Combinations

The 4 common methods for carrying out a business combination are: Statutory merger; Statutory consolidation; Acquisition of common stock; and Acquisition of assets.

1. Statutory Merger:

A statutory merger, as its name implies, is executed under provisions of applicable laws. In a statutory merger, the boards of directors of the constituent companies approve a plan for the exchange of voting common stock (and perhaps some preferred stock, cash, or long-term debt) of one of the corporations (the ***Survivor***) for all the outstanding voting common stock of the other corporations. Stockholders of all constituent companies must approve the terms of the merger; some provisions require approval by two-thirds of the stockholders. The survivor corporation issues its common stock or other consideration to the stockholders of the other corporations in exchange for all their holdings, thus acquiring ownership of those corporations. The other corporations ***then are dissolved and liquidated and thus cease to exist as separate legal entities***, and their activities often are continued as ***division*** of the survivor, which now owns the ***net assets*** (assets minus liabilities),

rather than the outstanding common stock, of the liquidated corporations.

In short, the procedures in a statutory merger are:

(1) The boards of directors of the constituent companies work out the terms of the merger.

(2) Stockholders of the constituent companies approve the terms of the merger, in accordance with applicable corporate bylaws and other laws.

(3) The survivor issues its common stock or other consideration to the stockholders of the other constituent companies in exchange for all their outstanding voting common stock of those companies.

(4) The survivor dissolves and liquidates the other constituent companies, receiving in exchange for its common stock investments the net assets of those companies.

2. Statutory Consolidation:

A statutory consolidation also is consummated in accordance with applicable laws. However, in a consolidation a ***new corporation is formed to issue its common stock*** for the outstanding common stock of two or more existing corporations, ***which then go out of***

existence. The new corporation thus acquires the net assets of the defunct (finished or dead) corporations, whose activities may be continued as divisions of the new corporation.

The procedures in a statutory consolidation are:

(1) The boards of directors of the constituent companies work out the terms of the consolidation.

(2) Stockholders of the constituent companies approve the terms of the consolidation, in accordance with applicable corporate bylaws and other laws.

(3) A new corporation is formed to issues its common stock to the stockholders of the constituent companies in exchange for all their outstanding voting common stock of those companies.

(4) The new corporation dissolves and liquidates the constituent companies, receiving in exchange for its common stock investments the net assets of those companies.

3. Acquisition of Common Stock:

One corporation (the ***investor***) may issue preferred or common stock, cash, debt instrument, or a combination thereof, to acquire from present stockholders a controlling interest in the voting common stock of another corporation (the ***investee***).

This stock acquisition program may be accomplished through direct acquisition in the stock market, through negotiations with the principal stockholders of a closely held corporation, or through a tender offer to stockholders of a publicly owned corporation. A ***tender offer*** is a publicly announced intention to acquire, for a stated amount of consideration, a maximum number of shares of the combinee's common stock *tendered* by holders thereof to an agent, such as investment banker or a commercial bank. The price per share stated in the tender offer usually is well above the prevailing market price of the combinee's common stock.

Accordingly, if a controlling interest in the combinee's voting common stock is acquired, that corporation becomes ***affiliated*** with the combinor ***parent company*** as a ***subsidiary***, but ***is not dissolved and liquidated and remains a separate legal entity.***

Business combinations arranged through common stock acquisitions require authorization by the combinor's board of directors and may require ratification by the combinee's stockholders.

Business combinations that result in a parent company-subsidiary relationship are discussed in Chapter Four

4. Acquisition of Assets:

A business enterprise may acquire from another enterprise all or most of the gross assets or net assets of the other enterprise for cash, debt instrument, preferred or common stock, or a combination thereof. The transaction generally must be approved by the boards of directors and stockholders or other owners of the constituent companies. The selling enterprise ***may continue its existence as a separate entity or it may be dissolved and liquidated;*** it does not become an ***affiliate*** of the combinor.

3.3 Establishing the Price for a Business Combination:

An important early step in planning a business combination is deciding on an appropriate price to pay. The amount of cash or debt securities, or the number of shares of preferred or common stock, to be issued in a business combination generally is determined by several of the following methods:

(1) Capitalization of expected average annual earnings of the combine at a desired rate of return.

(2) Determination of current fair value of the combinee's net assets (including goodwill).

The price for a business combination consummated (completed, accomplished) for cash or debt instruments generally is expressed in terms of the total pound amount of the consideration issued. When common stock is issued by the combinor in a business combination, the price is expressed as a ratio of the number of shares of the combinor's common stock to be exchanged for each share of the combinee's common stock.

Illustration 3.1

Illustration of exchange ratio: The negotiating offers of Banha Corporation have agreed with the stockholders of Aga Company to

acquire all 20,000 outstanding shares of Aga common stock for a total price of L.E.1,800,000. Banha's common stock presently is trading in the market at L.E.65 a share. Stockholders of Aga agree to accept 30,000 shares of Banha's common stock at value of L.E.60 a share in exchange for their stock holding in Aga. The exchange ratio is expressed as 1.5 shares of Banha's common stock for each share of Aga's common stock, in accordance with the following computation:

Number of shares of Banha Corporation common stock to be issued	30,000
Number of shares of Aga Company common stock to be exchanged	20,000
Exchange ratio: 30,000 ÷ 20,000	1.5 : 1

3.4 Purchase Method of Accounting for Business Combination

In practice, ***Purchase Accounting*** is considered the only acceptable method for business combination. The following points provide the foundation for applying the purchase method of accounting for business combination.

3.4.1 Determination of the Combinor

Because the carrying amounts of the net assets of the combinor are not affected by a business combination, the combinor must be accurately identified. The FASB stated that in a business combination effected solely by the distribution of cash or other assets or by incurring liabilities, the combinor is the distributing or incurring constituent company. For combinations effected by the issuance of equity securities, consideration of all the facts and circumstances is required to identify the combinor. Nevertheless, a common theme is that the combinor is the constituent company whose stockholders as a group retains or receives the largest portion of the voting rights of the combined enterprise and thereby can elect a majority of the governing board of directors or other group of the combined enterprise (FASB, Statement No. 141, 2001).

3.4.2 Computation of Cost of a Combinee

The cost of a combinee in a business combination accounted for by the purchase method is the total of (1) the amount of consideration paid by the combinor, (2) the combinor's ***direct*** "out-of-pocket" costs of the combination, and (3) any ***contingent consideration*** that is determinable on the date of the business combination.

(1) Amount of Consideration

Generally, this is the total amount of cash paid, the current fair value of other assets distributed, the present value of debt securities issued, and the current fair (or market) value of equity securities issued by the combinor.

(2) Direct Out-of-Pocket Costs

Included in this category are some legal fees, some accounting fees, and finder's fees. A ***finder's fee*** is paid to the investment banking firm or other organization or individuals that investigated the combine, assisted in determining the price of the business combination, and otherwise rendered services to bring about the combination.

Costs of registering with the Securities Exchange and issuing ***debt securities*** in a business combination are debited t**o Bond Issue Cost**; they are not part of the cost of the combinee. Cost of

registering with the Securities Exchange and issuing ***equity securities*** are not direct costs of the business combination but are offset against the proceeds from the issuance of the securities. ***Indirect*** out-of-pocket costs of the combination, such as salaries of officers of constituent companies involved in negotiation and completion of the combination, are recognized as expenses incurred by the constituent companies.

(3) Contingent Consideration

Contingent consideration is additional cash, other assets, or securities that may be issuable in the future, contingent on future events such as a specified level of earnings or a designated market price for a security that had been issued to complete the business combination. Contingent consideration that is ***determinable*** on the consummation date of a combination is recorded as part of the cost of the combination; contingent consideration ***not determinable*** on the date of the combination is recorded when the contingency is resolved and the additional consideration is paid or issued (or becomes payable or issuable).

Illustration 3.2

Illustration of Contingent Consideration: The contract for Nor Company's acquisition of the net assets of Rob Company provided

that Nor would pay L.E.800,000 cash for Rob's net assets (including goodwill), which would be included in the Robb Division of Nor Company. The following contingent consideration also was included in the contract:

1. Nor was to pay Rob L.E.100 a unit for all sales by Robb Division of a slow-moving product that had been written down to scrap value by Rob prior to the business combination. No portion of the L.E.800,000 price for Rob's net assets involved the slow-moving product.
2. Nor was to pay Rob 25% of any pretax financial income in excess of L.E.500,000 (excluding income from sale of the slow-moving product) of Robb Division for each of the four years subsequent to the business combination.

On January 2, 2023, the date of completion of the business combination, Rob Company had firm, noncancelable sales orders for 500 units of the slow-moving products. The sales orders and all units of the slow-moving product were transferred to Nor by Rob.

Nor's cost of the net assets acquired from Rob includes L.E.50,000 (500 × L.E.100 = L.E.50,000) for the ***determinable*** contingent consideration attributable to the backlog (accumulated)

of sales orders for the slow-moving product. However, because any pretax accounting income of Robb Division for the next four years cannot be determined on January 2, 2023, no provision for the 25% contingent consideration is included in Nor's cost on January 2, 2023. The subsequent accounting for such contingent consideration is described in the following sections.

3.4.3 Allocation of Cost of a Combinee

The FASB required that the cost of a combinee in a business combination be allocated to assets (other than goodwill) acquired and liabilities assumed based on their estimated fair values on the date of the combination. Any excess of total costs over the amounts thus allocated is assigned to goodwill.

Methods for determining fair values included present values for receivables and most liabilities; net realizable value less reasonable profit for work in process and finished goods inventories; and appraised values for land, natural resources, and nonmarketable securities.

Other matters involved in the allocation of the cost of a combine in a business combination are:

1- A part of the cost of a combinee is allocable to identifiable tangible and intangible assets that resulted from research and development activities of the combinee or are to be used in research and development activities of the combined enterprise. Subsequently, such assets are to be expensed unless they may be used for other than research and development activities in the future (FASB, 1975).

2- In a business combination, leases of the combinee-lessee are classified by the combined enterprise as they were by the combine (FASB, 1978).

Goodwill

Goodwill frequently is recognized in business combinations because the total cost of the combine exceeds the current fair value of identifiable net assets of the combinee. The amount of goodwill recognized on the date the business combination is consummated may be adjusted subsequently when contingent consideration becomes issuable.

Negative Goodwill

In some business combinations (known as ***bargain purchase***), the current fair values assigned to the identifiable net assets acquired exceed the total cost of the combinee. A bargain purchase is most

likely to occur for a combinee with a history of losses or when common stock prices are extremely low. The excess of the current fair values over total cost is applied pro rata (apportioning) to reduce (but not below zero) the amounts initially assigned to all the acquired assets ***except*** financial assets other than investments accounted for by the equity method; assets to be disposed of by sale; deferred tax assets; prepaid assets relating to pension or other postretirement benefits; and any other current assets. If any excess of current fair values over cost of the combinee's net assets remains after the foregoing reduction, it is recognized as an extraordinary gain by the combinor.

3.4.4 Illustration of Purchase Accounting for Statutory Merger, with Goodwill

Illustration 3.3

On December 31, 2023, Mansour Company (the combinee) was merged into Samsung Corporation (the combinor or survivor). Both companies used the same accounting principles for assets, liabilities, revenue, and expenses and both had a December 31fiscal year. Samsung issued 150,000 shares of its L.E.10 par common stock (current fair value L.E.25 a share) to Mansour's stockholders for all 100,000 issued and outstanding shares of Mansour's no-par, L.E.10

stated value common stock. In addition, Samsung paid the following out-of-pocket costs associated with the business combination:

	L.E.
Accounting fees:	
For investigation of Mansour Company as prospective combinee	5,000
For Stock Exchange registration Statement for Samsung common stock	60,000
Legal fees:	
For the business combination	10,000
For Stock Exchange registration Statement for Samsung common stock	50,000
Finder's fees:	51,250
Printer's charges for printing securities and Stock Exchange registration statement	23,000
Stock Exchange Registration statement fee	750
Total out-of-pocket costs	L.E. 200,000

There was no contingent consideration in the merger contract.

Immediately prior to the merger, Mansour Company's condensed balance sheet was as follows:

MANSOUR COMPANY (combinee)
Balance Sheet (prior to business combination)
December 31, 2023

Assets	
Current assets	L.E.1,000,000
Plant assets (net)	3,000,000
Other assets	600,000
Total assets	L.E.4,600,000
Liabilities and Stockholders' Equity	
Current liabilities	L.E. 500,000
Long-term debt	1,000,000
Common stock, no par, L.E.10	1,000,000
Additional paid-in capital	700,000
Retained earnings	1,400,000
Total liabilities & stockholders' equity	4,600,000

The board of directors of Samsung Corporation determined the current fair values of Mansour Company’s identifiable assets and liabilities (identifiable net assets) as follows:

Current assets	L.E.1,150,000
Plant assets	3,400,000
Other assets	600,000
Current liabilities	(500,000)
Long-term debt (present value)	(950,000)
Identifiable net assets of combine	L.E.3,700,000

The condensed journal entries that follow are required for Samsung Corporation (the combinor) to record the merger with Mansour Company on December 31, 2023, as a business combination. Samsung uses an investment ledger account to accumulate the total cost of Mansour Company prior to assigning the cost to identifiable net assets and goodwill. Combinor’s journal entries for business combination (Statutory Merger) will be as below:

SAMSUNG CORPORATION (combinor) **Journal Entries** **December 31, 2023**		
Investment in Mansour Company Common Stock (150,000 × L.E.25)	3,750,000	
Common Stock (150,000 × L.E.10)		1,500,000
Paid-in Capital in Excess of Par		2,250,000
To record merger with Mansour Company.		
Investment in Mansour Company Common Stock		
(L.E.5,000 + 10,000 + 51,250)	66,250	
Paid-in Capital in Excess of Par (L.E.60,000 + 50,000 + 23,000 + 750)	133,750	
Cash		200,000

To record payment of out-of-pocket costs incurred in merger with Mansour Company. Accounting, legal, and finder's fees in connection with the merger are recognized as an investment cost; other out-of-pocket costs are recorded as a reduction in the proceeds received from issuance of common stock.		
Current Assets	1,150,000	
Plant Assets	3,400,000	
Other Assets	600,000	
Discount on Long-Term Debt	50,000	
Goodwill	116,250	
Current Liabilities		500,000
Long-Term Debt		1,000,000
Investment in Mansour Company		
Common Stock (3,750,000 + 66,250)		3,816,250
To allocate total cost of liquidated Mansour Company to identifiable assets and liabilities, with the remainder to goodwill.		

Amount of goodwill is computed as follows:

Total cost of Mansour Company (L.E.3,750,000 + L.E.66,250)		L.E.3,816,250
Less: Carrying amount of Mansour's Identifiable net assets (L.E.4,600,000-L.E.1,500,000)	L.E.3,100,000	
Excess (deficiency) of current fair values of identifiable net asset over carrying amounts:		
Current assets	150,000	
Plant assets	400,000	
Long-term debt	50,000	3,700,000
Amount of goodwill:		L.E. 116,250

Note that no adjustments are made in the foregoing journal entries to reflect the current fair values of Samsung's identifiable net assets or goodwill, ***because Samsung is the combinor in the business combination.***

Mansour Company (the combine) prepares the condensed journal entry below to record the dissolution and liquidation of the company on December 31, 2023.

MANSOUR COMPANY (combinee) Journal Entry December 31, 2023		
Current Liabilities	500,000	
Long-Term Debt	1,000,000	
Common Stock, L.E.10 stated value	1,000,000	
Paid-in Capital in Excess of Stated Value	700,000	
Retained Earnings	1,400,000	
Current Assets		1,000,000
Plant Asses (net)		3,000,000
Other Assets		600,000
To record liquidation of company in conjunction with merger with Samsung Corporation.		

3.4.5 Illustration of Purchase Accounting for Acquisition of Net Assets, with Bargain Purchase Excess

Illustration 3.4

On December 31, 2023, Cairo Corporation acquired the net assets of Geza Corporation directly from Geza for L.E.400,000 cash, in a business combination. Cairo paid legal fees of L.E.40,000 in connection with the combination.

The condensed balance sheet of Geza prior to the business combination, with related current fair value data, is presented below:

GEZA CORPORATION (combinee) **Balance Sheet (prior to business combination)** **December 31, 2023**		
	Carrying Amounts	**Current Fair Values**
Assets	L.E.	L.E.
Current assets	190,000	200,000
Investment in marketable debt securities (held to maturity)	50,000	60,000
Plant assets (net)	870,000	900,000
Intangible assets (net)	90,000	100,000
Total assets	1,200,000	1,260,000
Liabilities and Stockholders' Equity	L.E.	L.E.
Current liabilities	240,000	240,000
Long-term debt	500,000	520,000
Total liabilities	740,000	760,000
Common stock, L.E.1 par	600,000	
Deficit	(140,000)	
Total stockholders' equity	460,000	
Total liabilities & stockholder's equity	1,200,000	

Thus, Cairo acquired identifiable net assets with a current fair value of L.E.500,000 (L.E.1,260,000 – L.E.760,000 = L.E.500,000) for a total cost of L.E.440,000 (L.E.400,000 + L.E.40,000 = L.E.440,000). The L.E.60,000 excess of current fair value of the net assets over their cost to Cairo (L.E.500,000 – L.E.440,000 = L.E.60,000) is prorated (allocated) to the plant assets and intangible assets in the ratio of their respective current fair values, as follows:

To plant assets:	$60{,}000 \times \frac{900{,}000}{900{,}000+100{,}000} =$	L.E.54,000
To intangible assets:	$60{,}000 \times \frac{100{,}000}{900{,}000+100{,}000} =$	6,000
Total excess of current fair value of identifiable net assets over combinor's cost		L.E.60,000

No part of the L.E.60,000 bargain-purchase excess is allocated to current assets or to investment in marketable securities.

The journal entries below record Cairo Corporation's acquisition of the net assets of Geza Corporation and payment of L.E.40,000 legal fees:

CAIRO CORPORATION (combinor) **Journal Entries** **December 31, 2023**		
Investment in Net Assets of Geza Corporation…………………	400,000	
Cash……………………………………………………….		400,000
To record acquisition of net assets of Geza Corporation.		
Investment in Net Assets of Geza Corporation…………………	40,000	
Cash…………………………………………………..		40,000
To record payment of legal fees incurred in acquisition of net assets of Geza Corporation.		
Current Assets…………………………………………………..	200,000	
Investment in Marketable Debt Securities…………………………	60,000	
Plant Assets (900,000 – 54,000)……………………………………	846,000	
Intangible Assets (100,000 – 6,000)……………………………..	94,000	
Current Liabilities………………………………………………..		240,000
Long-Term Debt………………………………………………….		500,000
Premium on Long-Term Debt (520,000 – 500,000)……………...		20,000
Investment in Net Assets of Geza Corporation (400,000 + 40,000)…		440,000
To allocate total cost of net assets acquired to identifiable net assets, with excess of current fair value of the net assets over their cost prorated to noncurrent assets other than investment in marketable debt securities.		

3.4.6 Other Topics In Accounting for Business Combinations

Statutory Consolidation

Because a new corporation issues common stock to effect a statutory consolidation, one of the constituent companies in a

statutory consolidation must be identified as the combinor, under the criteria described on the foregoing pages.

Once the combinor has been identified, the corporation recognizes net assets acquired from the combinor at their ***carrying amount*** in the combinor's accounting records; however, net assets acquired from the combinee are recognized by the new corporation at their ***current fair value***.

Illustration 3.5

To illustrate, assume the following balance sheets of the constituent companies involved in a statutory consolidation on December 31, 2023:

LAMY CORPORATION AND DOHA COMPANY
Separate Balance Sheets (prior to business combination)
December 31,2023

	Lamy Corporation	**Doha Company**
Assets	L.E.	L.E.
Current assets	600,000	400,000
Plant assets (net)	1,800,000	1,200,000
Other assets	400,000	300,000
Total assets	2,800,000	1,900,000
Liabilities and Stockholders' Equity	L.E.	L.E.
Current liabilities	400,000	300,000
Long-term debt	500,000	200,000
Common stock, L.E.10 par	430,000	620,000
Additional paid-in capital	300,000	400,000
Retained earnings	1,170,000	380,000
Total liabilities & stockholders' equity	2,800,000	1,900,000

The current fair values of both companies' liabilities were equal to carrying amounts. Current fair values of identifiable assets were as

follows for Lamy and Doha, respectively: current assets, L.E.800,000 and L.E.500,000; plant assets, L.E.2,000,000 and L.E.1,400,000; other assets, L.E.500,000 and L.E.400,000.

On December 31, 2023, in a statutory consolidation approved by shareholders of both constituent companies, a new corporation, LamDoh Corporation, issued 74,000 shares of no-par, no-stated-value common stock with an agreed value of L.E.60 a share, based on the following valuation assigned by the negotiating directors to the two constituent companies' identifiable net asset and goodwill:

	Lamy Corporation	**Doha Company**
Current fair value of identifiable net assets:	L.E.	L.E.
Lamy: L.E.800,000 + 2,000,000 + 500,000 -400,000 – 500,000	2,400,000	
Doha: L.E.500,000 + 1,400,000 + 400,000 -300,000 -200,000		1,800,000
Goodwill	180,000	60,000
Net assets' current fair value	2,580,000	1,860,000
Number of shares of LamDoh common stock to be issued to constituent companies' stockholders, at L.E.60 a share agreed value	Share 43,000	Share 31,000

Because the former stockholders of Lamy Corporation receive the larger interest in the common stock of LamDoh Corporation ($\frac{43}{74}$, or 58%), Lamy is the combinor in the business combination. Assuming that LamDoh paid L.E.200,000 out-of-pocket costs (L.E.110,000 Direct; L.E.90,000 indirect) of the statutory consolidation after it was consummated on December 31, 2023,

LamDoh's journal entries would be as follows (journal entries for new corporation):

LAMDOH CORPORATION **Journal Entries** **December 31, 2023**		
Investment in Lamy Corporation and Doha Company Common Stock (74,000 × L.E.60)	4,440,000	
Common Stock, no par		4,440,000
To record consolidation of Lamy Corporation and Doha Company as a purchase.		
Investment in Lamy Corporation and Doha Company Common Stock	110,000	
Common Stock, no par	90,000	
Cash		200,000
To record payment of costs incurred in consolidation of Lamy Corporation and Doha Company. Accounting, legal, and finder's fees in connection with the consolidation are recognized as an investment cost; other out-of-pocket costs are recorded as a reduction in the proceeds received from the issuance of common stock.		
Current Assets (600,000 + 500,000)	1,100,000	
Plant Assets (1,800,000 + 1,400,000)	3,200,000	
Other Assets (400,000 + 400,000)	800,000	
Goodwill	850,000	
Current Liabilities (400,000+ 300,000)		700,000
Long-Term Debt (500,000 + 200,000)		700,000
Investment in Lany Corporation and Doha Company Common Stock (4,440,000 + 110,000)		4,550,000
To allocate total cost of investment to identifiable assets and liabilities, at carrying amount for combinor Lamy Corporation's net assets and at a current fair value for combine Doha Company's net assets with the remainder to goodwill.		

Amount of goodwill is computed as follows:

Total cost of investment (L.E.4,440,000 + L.E.110,000)		L.E.4,550,000
Less: Carrying amount of Lamy's identifiable net assets	L.E.1,900,000	
Current fair value of Doha's identifiable net assets	1,800,000	3,700,000
Amount of goodwill		L.E. 850,000

Note in the forgoing journal entry that because of the combinor's net assets' being recognized at carrying amount and because of the

L.E.110,000 direct out-of-pocket costs of the business combination, the amount of goodwill is L.E.850,000, rather than L.E.240,000 (L.E.180,000 + L.E.60,000= L.E.240,000), the amount assigned by the negotiating directors to goodwill in the determination of the number of shares of common stock to be issued in the combination.

3.4.7 Subsequent Issuance of Contingent Consideration

As indicated previously, contingent consideration that is ***determinable*** on the date of a business combination is included in the measurement of cost of the combine. Any other contingent consideration is recorded when the contingency is resolved and the additional consideration becomes issuable or is issued.

Returning to the Nor Company illustration (Illustration 3.1), assume that by December 31, 2023, the end of the first year following Nor's acquisition of the net assets of Rob Company, another 300 units of the slow-moving product had been sold, and Nor's Robb Division had pretax financial income of L.E.580,000 (exclusive of income from the slow-moving product). On December 31, 2023, Nor prepares the following journal entry to record the resolution of contingent consideration:

Goodwill Payable to Rob Company To record payable contingent consideration applicable to January 2, 2023, business combination as follows: Sales of slow-moving product (300 × L.E.100) L.E.30,000 Pretax income of Robb Division (L.E.580,000 – L.E.500,000 × 0.25) 20,000 Total payable L.E.50,000	50,000	 50,000

Some business combinations involve contingent consideration based on subsequent market prices of debt or equity securities issued to effect the combination. Unless the subsequent market price equals at least a minimum amount on a subsequent date or dates, additional securities, cash, or other assets must be issued by the combinor to compensate for the deficiency.

For example, assume the following journal entry for the statutory merger of Suleiman Corporation and Mero Company on January 2, 2023 (Journal Entry for Business Combination-Statutory Merger):

Investment in Mero Company Common Stock (120,000 × L.E.12)	1,440,000	
Common Stock, L.E.5 stated value (120,000 × L.E.5)		600,000
Paid-in Capital in Excess of Stated Value		840,000
To record merger with Mero Company as a purchase.		

Assume that terms of the Suleiman-Mero business combination required Suleiman to issue additional shares of its common stock to the former stockholders of Mero if the market price of Suleiman's common stock was less than L.E.12 a share on December 31, 2023.

If the market price of Suleiman's common stock was L.E.10 on that date, Suleiman prepares the following journal entry on that date:

Paid-in Capital in Excess of Stated Value (24,000 × L.E.5)……….	120,000	
Common Stock to be Issued for Contingent Consideration……..		120,000
To record additional shares of common stock to be issued under terms of Jan. 2, 2023, merger with Mero Company, as follows:		
-Required value of common stock issued in merger (120,000 × L.E.12) L.E.1,440,000		
-Less: Market value of common stock, Dec. 31, 2023 (120,000 × L.E.10) 1,200,000		
-Market value of additional common stock to be issued L.E.240,000		
-Number of additional shares of common stock to be issued (L.E.240,000 ÷ L.E.10) 24,000		

3.4.8 Financial Statements Following a Business Combination

The balance sheet for a combined enterprise issued as of the date of a business combination accomplished through a statutory merger, statutory consolidation, or acquisition of assets includes all the assets and liabilities of the constituent companies. (The ***consolidated*** balance sheet issued immediately following a combination that results in a parent-subsidiary relationship is described in the next Chapter). In a balance sheet following a business combination, assets and liabilities of the combinor are at ***carrying amount,*** assets acquired from the combine are at ***current fair value*** (adjusted for any bargain-purchase excess), and ***retained earnings is that of the combinor only.*** The income statement of the combined enterprise for the accounting period in which a business

combination occurred includes the operating results of the combinee ***after the date of the combination only.***

3.5 Exercises and Practical Problems

Exercises:

(Exercise 3.1)

Select the best answer for each of the following multiple-choice questions:

1. Is one or more of the constituent companies always liquidated in a business combination carried out by means of:

A Statutory Merger?	A Statutory Consolidation?	An Acquisition of Common Stock?
a. Yes	Yes	Yes
b. Yes	No	Yes
c. Yes	Yes	No
d. No	Yes	Yes

2. The cost of a combine in a business combination includes all the following except:

a. Legal fees and finder's fee.

b. Cost of registering and issuing debt securities issued to effect the combination.

c. Amount of consideration.

d. Contingent consideration that is determinable.

3. Are the combinees ***always*** liquidated in business combinations accomplished by a(n):

Statutory Merger?	Statutory Consolidation?	Acquisition of Common Stock?	Acquisition of Assets?
a. Yes	Yes	Yes	No
b. Yes	Yes	No	Yes
c. Yes	Yes	No	No
d. Yes	No	No	Yes

4. In a "bargain purchase" business combination, the excess of the current fair value of the combinee's identifiable net assets over the cost to the combinor is:

a. Credited to the combinor's Negative Goodwill ledger account.

b. Offset against the balance of the combinor's Investment in Combinee Company ledger account.

c. Credited to the combinor's Additional Paid-in Capital ledger account.

d. Accounted for in some other manner.

5. The term ***survivor*** is associated with a business combination accomplished through:

a. A statutory merger.
b. A statutory consolidation.
c. An acquisition of common stock.
d. An acquisition of assets.

6. Does the date-of-combination cost of the combinee in a business combination include:

	Determinable Contingent Consideration?	**Nondeterminable Contingent Consideration?**
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

7. In the balance sheet of a combined enterprise on the date of a business combination, ***unallocated*** negative goodwill is displayed:
a. In stockholders' equity.
b. In a note to financial statements.
c. As an offset to total assets.
d. As a deferred credit.
e. In some other manner.

(Exercise 3.2)

The balance sheet of Melton Company on January 31, 2023, showed current assets, L.E.100,000; other assets, L.E.800,000; current liabilities, L.E.80,000; long-term debt, L.E.240,000; common stock (10,000 shares, L.E.10), L.E.100,000; and retained earnings, L.E.480,000. On that date, Melton merged with Sinai Corporation in a business combination in which Sinai issued 35,000 shares of its L.E.1 par (current fair value L.E.20 a share) common stock to stockholders of Melton in exchange for all their outstanding common stock. The current fair values of Melton's liabilities were equal to their carrying amounts; the current fair values of Melton's current assets and other assets (none intangible) were L.E.120,000 and L.E.850,000, respectively, on January 31, 2023. Also on that date, Sinai paid direct out-of-pocket costs of the business combination, L.E.40,000, and costs of registering and issuing its common stock, L.E.70,000.

Prepare journal entries for Sinai Corporation to record its merger with Melton Company on January 31, 2023.

(Check Figure: Debit goodwill, L.E.90,000.)

(Exercise 3.3)

The condensed balance sheet of Geo Company on March 31, 2023, is shown below:

GEO COMPANY **Balance Sheet (prior to business combination)** **March 31, 2023**	
Assets	L.E.
Cash	20,000
Other current assets	140,000
Plant assets (net)	740,000
Total assets	900,000
Liabilities and Stockholders' Equity	L.E.
Current liabilities	80,000
Long-term debt	200,000
Common stock, L.E.2 par	180,000
Additional paid-in capital	120,000
Retained earnings	320,000
Total liabilities and stockholders' equity	900,000

On March 31, 2023, Master Corporation paid L.E.700,000 cash for all the net assets of Geo (except cash) in a business combination. The carrying amounts of Geo are other current assets and current liabilities were the same as their current values. However, current fair values of Geo's plant assets and long-term debt were L.E.920,000 and L.E.190,000, respectively. Also on March 31, Master paid the following direct out-of-pocket costs for the business combination with Geo:

Legal fees	L.E. 10,000
Finder's fee	70,000
CPA firm's fee for audit of Geo Company's March 31, 2023, financial statements	20,000
Total out-of-pocket costs of business combination	L.E.100,000

Prepare a working paper to compute the amount of goodwill or bargain-purchase excess in the business combination of Master Corporation and Geo Company on March 31, 2023.
(Check Figure: Amount of Goodwill, L.E.10,000.)

(Exercise 3.4)

The balance sheet of Combinee Company on January 31, 2023, was as follows:

COMBINEE COMPANY **Balance Sheet (prior to business combination)** **January 31, 2023**			
Assets	L.E.	**Liabilities and Stockholders' Equity**	L.E.
Current assets	300,000	Current liabilities	200,000
Plant assets	600,000	Long-term debt	300,000
Other assets	100,000	Common stock, no par or stated value	100,000
		Retained earnings	400,000
Total assets	1,000,000	Total liabilities and stock holder's equity	1,000,000

On January 31, 2023, Combinor Company issued L.E.700,000 face amount of 6% 20-year bonds due January 31, 2043, with a present value of L.E.625,257, to Combinee Company for its net assets. On January 31, 2023, the current fair values of Combinee's liabilities equal their carrying amount; however, current fair values of Combinee's assets were as follows:

Current assets……………………..	L.E.320,000
Plant assets………………………..	680,000
Other assets (none intangible)……………………..	120,000

Also on January 31, 2023, Combinor paid out-of-pocket costs of the combination as follows:

Accounting, legal, and finder's fees incurred for combination	L.E. 80,000
Costs of registering 6% bonds with SEC	110,000
Total out-of-pocket costs	L.E.190,000

Prepare journal entries dated January 31, 2023, for Combinor Company to record its acquisition of the net assets of Combinee Company.
(Check Figure: Debit goodwill, L.E.85,257.)

(Exercise 3.5)
On March 31, 2023, Combinor Company issued 100,000 shares of its L.E.1 par common stock (current fair value L.E.5 a share) for the net assets of Combinee Company. Also on that date, Combinor paid the following out-of-pocket costs in connection with the combination:

Accounting, legal, and finder's fees incurred for combination L.E.	70,000
Costs associated with SEC registration Statement	50,000
Total out-of-pocket costs	L.E.120,000

The balance sheet of Combinee on March 31, 2023, with related current fair values, was as follows:

COMBINEE COMPANY Balance Sheet (prior to business combination) March 31, 2023		
	Carrying Amounts	**Current Fair Values**
Assets	L.E.	L.E.
Current assets	200,000	260,000
Plant assets (net)	400,000	480,000
Other assets (none intangible)	140,000	150,000
Total assets	740,000	
Liabilities and Stockholders' Equity	L.E.	L.E.
Current liabilities	80,000	80,000
Long-term debt	260,000	260,000
Common stock, no par or stated value	150,000	
Retained earnings	250,000	
Total liabilities & stockholder's equity	740,000	

Prepare journal entries for Combinor Company on March 31, 2023, to record the business combination with Combinee Company. (Check Figure: Debit goodwill, L.E.20,000.)

(Exercise 3.6)

On May 31, 2023, Buyers Corporation acquired for L.E.560,000 cash all the net assets except cash of Sellers Company, and paid L.E.60,000 cash to a law firm for legal services in connection with the business combination. The balance sheet of Sellers on May 31, 2023, was as follows:

SELLERS COMPANY Balance Sheet (prior to business combination) May 31, 2023			
Assets	L.E.	**Liabilities and Stockholders' Equity**	L.E.
Cash	40,000	Liabilities	620,000
Other current assets	280,000	Common stock, L.E.1 par	250,000
Plant assets (net)	760,000	Retained earnings	330,000
Intangible assets	120,000		
Total assets	1,200,000	Total liabilities and stock holder's equity	1,200,000

The present value of Sellers' liabilities on May 31, 2023, was L.E.620,000. The current fair values of its noncash assets were as follows on May 31, 2023:

Other current assets……………………	L.E.300,000
Plant assets………………………….	780,000
Intangible assets………………………	130,000

Prepare journal entries for Buyers Corporation on May 31, 2023, to record the acquisition of the net assets of Sellers Company except cash.
(Check Figure: Debit goodwill, L.E.30,000.)

(Exercise 3.7)
On September 26, 2023, Acquirer Corporation paid L.E.160,000 cash to Disposer Company for all its net assets except cash, and L.E.10,000 for direct out-of-pocket costs of the business combination. There was no contingent consideration. Current fair values of Disposer's identifiable net assets on September 26, 2023, were as follows:

	Current Fair Values
Cash	L.E. 10,000
Other current assets	120,000
Plant assets	150,000
Intangible assets	50,000
Current liabilities	90,000
Long-term debt (face amount L.E.60,000)	50,000

Prepare journal entries for Acquirer Corporation on September 26, 2023, to record the business combination.
(Check Figure: Debit intangible assets, L.E.47,500.)

(Exercise 3.8)
On December 31, 2023, Combinor Company issued 100,000 shares of its L.E.1 par common stock (current fair value L.E.5 a share) in exchange for all the outstanding common stock of Combinee Company in a statutory merger. Also on that date, Combinor paid the following out-of-pocket costs in connection with the combination:

Accounting, legal, and finder's fees relating to business combination	L.E. 70,000
Costs associated with SEC registration Statement	50,000
Total out-of-pocket costs	L.E.120,000

The balance sheet of Combinee on December 31, 2023, was as follows:

COMBINEE COMPANY **Balance Sheet (prior to business combination)** **December 31, 2023**	
Assets	L.E.
Other current assets	200,000
Plant assets (net)	400,000
Other assets (none intangible)	140,000
Total assets	740,000
Liabilities and Stockholders' Equity	L.E.
Current liabilities	80,000
Long-term debt	260,000
Common stock, no par or stated value	150,000
Retained earnings	250,000
Total liabilities and stockholders' equity	740,000

The current fair values of Combinee's identifiable net assets were equal to their carrying amounts on December 31, 2023.

Prepare journal entries for Combinor Company on December 31, 2023, to record the business combination with Combinee Company. (Check Figure: Credit paid-in capital, L.E.400,000)

(Exercise 3.9)

The balance sheet of Combinee Company on September 24, 2023, was as follows:

COMBINEE COMPANY **Balance Sheet (prior to business combination)** **September 24, 2023**			
Current assets L.E.	200,000	Current liabilities L.E.	100,000
Plant assets	700,000	Long-term debt	300,000
Other assets (none intangible)	100,000	Common stock, no par or stated value	200,000
		Retained earnings	400,000
Total assets	1,000,000	Total liabilities and stock holder's equity	1,000,000

On that date, Combinor Corporation issued 100,000 shares of its L.E.1 par (L.E.30 current fair value) common stock for all the outstanding common stock of Combinee Company in a statutory merger and paid the following out-of-pocket costs in connection with the combination:

Direct out-of-pocket costs of the combination	L.E.130,000
Costs associated with SEC registration statement	50,000
Total out-of-pocket costs	L.E.180,000

The current fair values of Combinee's identifiable net assets were equal to their carrying amounts; nevertheless, L.E.400,000 of Combinor's cost was allocable to identifiable tangible and intangible assets of Combinee that resulted from Combinee's research and development activities. Those assets had no further use in research and development projects.

Prepare journal entries on September 24, 2023, for *(a)* Combinor Corporation and *(b)* Combinee Company to record the statutory merger.
(Check Figure: Credit paid-in capital, L.E.2,900,000.)

(Exercise 3.10)

The balance sheet of Nestor Company on February 28, 2023, with related current fair values of assets and liabilities, was as follows:

NESTOR COMPANY Balance Sheet (prior to business combination) February 28, 2023		
	Carrying Amounts	**Current Fair Values**
Assets	L.E.	L.E.
Current assets	500,000	520,000
Plant assets (net)	1,000,000	1,050,000
Other assets (none intangible)	300,000	310,000
Total assets	1,800,000	
Liabilities and Stockholders' Equity	L.E.	L.E.
Current liabilities	300,000	300,000
Long-term debt	400,000	480,000
Common stock, L.E.1 par	500,000	
Additional paid-in capital	200,000	
Retained earnings	400,000	
Total liabilities & stockholder's equity	1,800,000	

On February 28, 2023, Bragg Corporation issued 600,000 shares of its L.E.1 par common stock (current fair value L.E.2 a share) to Lucy Rowe, sole stockholder of Nestor Company, for all 500,000 shares of Nestor common stock owned by her, in a merger business combination. Because the merger was negotiated privately and Rowe signed a "letter agreement" not to dispose of the Bragg common stock she received, the Bragg stock was not subject to SEC registration requirements. Thus, only L.E.8,000 in legal fees was incurred to effect the merger; these fees were paid in cash by Bragg on February 28, 2023.

Prepare journal entries for Bragg Corporation on February 28, 2023, to record the business combination with Nestor Company. (Check Figure: Credit paid-in capital, L.E.600,000.)

(Exercise 3.11)

The condensed balance sheet of Maxim Company on December 31, 2023, prior to the business combination with Syria Corporation, was as follows:

MAXIM COMPANY **Balance Sheet (prior to business combination)** **December 31, 2023**	
Assets	L.E.
Current assets	400,000
Plant assets (net)	1,200,000
Other assets (none intangible)	200,000
Total assets	1,800,000
Liabilities and Stockholders' Equity	L.E.
Current liabilities	300,000
Common stock, L.E.1 par	400,000
Additional paid-in capital	200,000
Retained earnings	900,000
Total liabilities and stockholders' equity	1,800,000

On December 31, 2023, Syria issued 800,000 shares of its L.E.1 par common stock (current fair value L.E.3 a share) for all the outstanding common stock of Maxim in a statutory merger. Also on December 31, 2023, Syria paid the following out-of-pocket costs of the business combination with Maxim:

Finder's and legal fees relating to business combination	L.E. 30,000
Costs associated with SEC registration Statement	40,000
Total out-of-pocket costs	L.E. 70,000

On December 31, 2023, the current fair values of Maxim's other assets and current liabilities equalled their carrying amounts; current fair values of Maxim's current assets and plant assets were L.E.500,000 and L.E.1,500,000, respectively.

Prepare journal entries for Syria Corporation on December 31, 2023, to record the business combination with Maxim Company. (Check Figure: Debit paid-in capital, L.E.40,000.)

(Exercise 3.12)

On August 31, 2023, Combinor Corporation entered into a statutory merger business combination with Combinee Company, by issuing 100,000 shares of L.E.1 par common stock having a current fair value of L.E.20 a share for all 50,000 outstanding shares of Combinee's no-par, no-stated-value common stock. Also, Combinor paid the following out-of-pocket costs of the combination on August 31, 2023:

Finder's and legal fees relating to business combination	L.E.100,000
Costs associated with SEC registration Statement	150,000
Total out-of-pocket costs	L.E.250,000

On August 31, 2023, Combinee's balance sheet included the following:

	Carrying Amounts	**Current Fair Values**
Current assets	L.E. 500,000	L.E. 600,000
Plant assets (net)	2,600,000	2,800,000
Current liabilities	400,000	400,000
Long-term debt	1,000,000	1,000,000
Common stock	800,000	
Retained earnings	900,000	

Prepare journal entries for Combinor Corporation on August 31, 2023, to record the statutory merger with Combinee Company. (Check Figure: Credit paid-in capital, L.E.1,900,000).

(Exercise 3.13)

On December 31, 2022, Tucker Corporation acquired all the net assets of Loring Company for 100,000 shares of Tucker's L.E.2 par common stock having a current fair value of L.E.16 a share. Terms of the business combination required Tucker to issue additional shares of common stock to Loring on December 31, 2023, if the market price of the common stock was less than L.E.16 a share on that date. Sufficient shares would be issued to make the aggregate market value of the total shares issued to Loring equal to L.E.1,600,000 on December 31, 2023. The market price of Tucker's common stock on that date was L.E.10 a share.

Prepare a journal entry for Tucker Corporation on December 31, 2023, to record the additional shares of common stock issuable to Loring Company on that date.

(Check Figure: Number of additional shares to be issued, 60,000.)

Problems

(Problem 3.1)

On January 31, 2023, Aswan Corporation acquired for L.E.540,000 cash all the net assets except cash of Edfo Company and paid L.E.60,000 cash to a law firm for legal services in connection with the business combination. The balance sheet of Edfo Company on January 31, 2023, prior to the business combination, was as follows:

EDFO COMPANY
Balance Sheet (prior to business combination)
January 31, 2023

Assets	L.E.	**Liabilities and Stockholders' Equity**	L.E.
Cash	40,000	Liabilities	620,000
Other current assets	280,000	Common stock, no par or stated value	250,000
Plant assets (net)	760,000	Retained earnings	330,000
Intangible assets	120,000		
Total assets	1,200,000	Total liabilities and stock holder's equity	1,200,000

The current fair value of Edfo's liabilities on January 31, 2023, was L.E.620,000. The current fair values of its noncash assets were as follows on January 31, 2023:

Other current assets	L.E.300,000
Plant assets	874,000
Intangible assets	76,000

Instructions

Prepare journal entries for Aswan Corporation on January 31, 2023, to record the acquisition of the net assets of Edfo Company except cash. Show computations in the explanation for the journal entries where appropriate.
(Check Figure: Debit plant assets L.E. 846,400.)

(Problem 3.2)

The balance sheet of Cooper Company on August 31, 2023, with related current fair value data, was a follows:

COOPER COMPANY Balance Sheet (prior to business combination) August 31, 2023		
	Carrying Amounts	**Current Fair Values**
Assets	L.E.	L.E.
Current assets	180,000	220,000
Plant assets (net)	640,000	700,000
Intangible assets (net)	80,000	90,000
Total assets	900,000	1,010,000
Liabilities and Stockholders' Equity	L.E.	L.E.
Current liabilities	80,000	80,000
Long-term debt	200,000	190,000
Total liabilities	280,000	270,000
Common stock, no par or stated value	400,000	
Retained earnings	220,000	
Total stockholders' equity	620,000	
Total liabilities & stockholder's equity	900 ,000	

On August 31, 2023, Lionel Corporation issued L.E.1,000,000 face amount of 10-year, 10% bonds (interest payable each February 28 and August 31), for all the net assets of Cooper. Bonds issue costs paid by Lionel on August 31, 2023, totalled L.E.60,000, and the accounting and legal fees to effect the business combination, paid on August 31, 2023, were L.E.40,000.

Instructions

Prepare journal entries on August 31, 2023, to record Lionel Corporation's acquisition of the net assets of Cooper Company. Show the computation of goodwill in the explanation of the relevant journal entry.

(Problem 3.3)

The journal entries for the business combination of Waha Corporation and Andalusia Company on December 31, 2023, were as follows:

WAHA CORPORATION Journal Entries December 31, 2023		
Investment in Andalusia Company Common Stock……	10,000,000	
12% Bonds Payable……………………………….		10,000,000
To record merger with Andalusia Company.		
Investment in Andalusia Company Common Stock……	150,000	
Bond Issue Costs………………………………………..	50,000	
Cash……………………………………………..		200,000
To record payment of costs incurred in merger with Andalusia Company.		
Current Assets (3,140,000 + 560,000)………………….	3,700,000	
Plant Assets (9,070,000 + 330,000)…………………….	9,400,000	
Goodwill………………………………………………..	400,000	
Current Liabilities…………………………………		3,350,000
Investment in Andalusia Company Common Stock..		10,150,000
To allocate total cost of Andalusia Company investment to identifiable assets and liabilities, with the remainder to goodwill.		

Amount of goodwill is computed as follows:

-Total cost of investment (L.E.10,000,000 + L.E.150,000)		L.E.10,150,000
-Less: Carrying amount of Identifiable net assets [(L.E.3,140,000 + L.E.9,070,000) -L.E.3,350,000]	L.E.8,860,000	
-Excess of current fair values of identifiable net asset over carrying amounts: (L.E.560,000 + L.E.330,000)	890,000	9,750,000
Amount of goodwill		L.E. 400,000

Additional Information

1. The stockholders' equity section of Andalusia Company's balance sheet on December 31, 2023 (prior to the merger), include the following:

Common stock, L.E.1 par	L.E.5,000,000
Retained earnings	3,860,000
Total stockholders' equity	L.E.8,860,000

2. There was no contingent consideration in connection with the business combination.

Instructions

Prepare journal entries (omit explanations) for Waha Corporation for the business combination on December 31, 2023, under the assumptions that, instead of issuing bonds, Waha had issued 1,000,000 shares of its no-par, no-stated-value common stock with a current fair value of L.E.10 a share to effect the combination, that the bond issue costs were costs of issuing common stock, that the current fair value of the plant assets was L.E.9,900,000, and that all other facts remained the same.
(Check Figure: Debit plant assets L.E.9,800,000.)

(Problem 3.4)

The balance sheet of Combinee Company On October 31, 2023, was as follows:

COMBINE COMPANY **Balance Sheet (prior to business combination)** **October 31, 2023**	
Assets	L.E.
Cash	60,000
Other current assets	420,000
Plant assets (net)	920,000
Total assets	1,400,000
Liabilities and Stockholders' Equity	L.E.
Current liabilities	180,000
Long-term debt	250,000
Common stock, L.E.5 par	200,000
Additional paid-in capital	320,000
Retained earnings	450,000
Total liabilities and stockholders' equity	1,400,000

Combinor Corporation's board of directors established the following current fair values for Combinee's identifiable net assets other than cash:

Other current assets	L.E. 500,000
Plant assets (net)	1,000,000
Current liabilities	180,000
Long-term debt	240,000

Accordingly, on October 31, 2023, Combinor issued 100,000 shares of its L.E.10 (current fair value L.E.13) common stock for all the net assets of Combinee in a business combination. Also on

October 31, 2023, Combinor paid the following out-of-pocket costs in connection with the combination:

Finder's fee, accounting fees, and legal fees to effect combination	L.E.180,000
Costs associated with SEC registration statement	120,000
Total out-of-pocket costs of business combination	L.E.300,000

Instructions

Prepare journal entries for Combinor Corporation on October 31, 2023, to record the business combination with Combinee Company.
(Check Figure: Debit goodwill, L.E.340,000.)

(Problem 3.5)

Condensed balance sheet data of Conner Company and Capsol Company on July 31, 2023, was as follows:

	Conner Company	**Capsol Company**
Total assets	L.E.700,000	670,000
Total liabilities	L.E.300,000	300,000
Common stock, L.E.25 par	200,000	250,000
Additional paid-in capital	80,000	130,000
Retained earnings (deficit)	120,000	(10,000)
Total liabilities and stockholders' equity	700,000	670,000

On July 31, 2023, Conner and Capsol entered into a statutory consolidation. The new company, Consol Corporation, issued 45,000 shares of L.E.10 par common stock for all the outstanding common stock of Conner and 30,000 shares for all the outstanding common stock of Capsol. Out-of-pocket costs of the business combination may be disregarded.

Instructions

Prepare journal entries for Consol Corporation on July 31, 2023, to record the business combination. Assume that Capsol is the combinor; that current fair values of identifiable assets are L.E.800,000 for Conner and L.E.700,000 for Capsol; that each company's liabilities are fairly stated at L.E.300,000; and that the current fair value of Consol's common stock is L.E.14 a share.
(Check Figure: Debit goodwill, L.E.180,000.)

(Problem 3.6)

The condensed balance sheets of Sinai Corporation, the combinor, prior to and subsequent to its March 1, 2023, merger with Matroh Company, are as follows:

SINAI CORPORATION **Balance Sheets (prior to and subsequent to business combination)** **March 1, 2023**		
	Prior to Business Combination	**Subsequent to Business Combination**
Assets L.E.		
Current assets	500,000	850,000
Plant assets (net)	1,000,000	1,800,000
Total assets L.E.	1,500,000	2,650,000
Liabilities and Stockholders' Equity L.E.		
Current liabilities	350,000	600,000
Long-term debt	100,000	150,000
Common stock, L.E.1 par	400,000	700,000
Additional paid-in capital	310,000	860,000
Retained earnings	340,000	340,000
Total liabilities and stockholders' equity	1,500,000	2,650,000

Prior to the business combination, Matroh had, at both carrying amount and current fair value, total assets of L.E.1,200,000 and total liabilities of L.E.300,000. Out-of-pocket costs of the business combination, L.E.50,000, were paid by Sinai on March 1, 2023; consideration for the combination was common stock having a current fair value of L.E.870,000.

Instructions

Reconstruct the journal entries (omit explanations) that Sinai Corporation prepared on March 1, 2023, to record the business combination with Matroh Company.

(Check Figure: Credit additional paid-in capital, net, L.E.550,000.)

(Problem 3.7)

On October 31, 2023, Solomon Corporation issued 20,000 shares of its L.E.1 par (current fair value L.E.20) common stock for all the outstanding common stock of Midland Company in a statutory merger. Out-of-pocket costs of the business combination paid by Solomon on October 31, 2023, were as follows:

Direct costs of the business combination	L.E.20,870
Costs of registering and issuing common stock	31,130
Total out-of-pocket costs of business combination	L.E.52,000

Midland's balance sheet on October 31, 2023, follows:

MIDLAND COMPANY **Balance Sheet (prior to business combination)** **October 31, 2023**	
Assets	L.E.
Inventories	140,000
Other current assets	80,000
Plant assets (net)	380,000
Total assets	600,000
Liabilities and Stockholders' Equity	L.E.
Payable to Solomon Corporation	75,000
Other liabilities	225,000
Common stock, L.E.3 par	30,000
Additional paid-in capital	120,000
Retained earnings	150,000
Total liabilities and stockholders' equity	600,000

Additional Information

1. The current fair values of Midland's other current assets and all its liabilities equalled the carrying amounts on October 31, 2023.
2. Current fair values of Midland's inventories and plant assets were L.E.170,000 and L.E.420,000, respectively, on October 31, 2023.
3. Solomon's October 31, 2023, balance sheet included an asset entitled Receivable from Midland Company in the amount of L.E.75,000.

Instructions

Prepare Solomon Corporation's journal entries on October 31, 2023, to record the business combination with Midland Company.
(Check Figure: Debit goodwill, L.E.50,870.)

(Problem 3.8)

The balance sheet on March 31, 2023, and the related current fair value data for Old Channel Company were shown below:

OLD CHANNEL COMPANY **Balance Sheet (prior to business combination)** **March 31, 2014**		
	Carrying Amounts	**Current Fair Values**
Assets	L.E.	L.E.
Current assets	500,000	575,000
Plant assets (net)	1,000,000	1,200,000
Patent	100,000	50,000
Total assets	1,600,000	1,825,000
Liabilities and Stockholders' Equity	L.E.	L.E.
Current liabilities	300,000	300,000
Long-term debt	400,000	450,000
Common stock, L.E.10 par	100,000	
Retained earnings	800,000	
Total liabilities & stockholder's equity	1,600,000	

On April 1, 2023, New Channel Corporation issued 50,000 shares of its no-par, no-stated-value common stock (current fair value L.E.14) and L.E.225,000 cash for the net assets of Old Company, in a business combination. Of the L.E.125,000 out-of-pocket costs paid by New on April 1, 2023, L.E.50,000 were accounting, legal, and finder's fees related to the business combination, and L.E.75,000 were costs related to the issuance of common stock.

Instructions

Prepare journal entries for New Channel Corporation on April 1, 2023, to record the business combination with Old Channel Company.
(Check Figure: Debit patent, L.E.46,000.)

(Problem 3.9)

Helwan Company merged into Maadi Corporation in a business combination completed April 30, 2023. Out-of-pocket costs paid by Maadi on April 30, 2023, in connection with the combination were as follows:

Finder's accounting, and legal fees relating to the business combination	L.E.15,000
Costs associated with SEC registration statement for securities issued to Complete the business combination	10,000
Total out-of-pocket costs of business Combination	L.E.25,000

The individual balance sheets of the constituent companies immediately prior to the merger were as follows:

MAADI CORPORATION AND HELWAN COMPANY Balance Sheet (prior to business combination) April 30, 2023		
	Maadi Corporation	**Helwan Company**
Assets	L.E.	L.E.
Current assets	4,350,000	3,000,000
Plant assets (net)	18,500,000	11,300,000
Patents (net)	450,000	200,000
Deferred charges	150,000	
Total assets	23,450,000	14,500,000
Liabilities and Stockholders' Equity	L.E.	L.E.
Liabilities	2,650,000	2,100,000
Common stock, L.E.10	12,000,000	
Common stock, L.E.5 par		3,750,000
Additional paid-in capital	4,200,000	3,200,000
Retained earnings	5,850,000	5,450,000
Less: Treasury stock, at cost, 100,000 shares	(1,250,000)	
Total liabilities & stockholder's equity	23,450,000	14,500,000

Additional Information

1. The current fair values of the identifiable assets and liabilities of Maadi Corporation and of Helwan Company were as follows on April 30, 2023:

MAADI CORPORATION AND HELWAN COMPANY Current Fair Values of Identifiable Net Assets April 30, 2023		
	Maadi Corporation	**Helwan Company**
Assets	L.E.	L.E.
Current assets	4,950,000	3,400,000
Plant assets (net)	22,000,000	14,000,000
Patents	570,000	360,000
Deferred charges	150,000	
liabilities	(2,650,000)	(2,100,000)
Identifiable net assets	25,020,000	15,660,000

2. There were no intercompany transactions prior to the business combination.
3. Before the business combination, Maadi had 3,000,000 shares of common stock authorized, 1,200,000 shares issued, and 1,100,000

shares outstanding. Helwan had 750,000 shares of common stock authorized, issued, and outstanding.

4. Helwan Company was dissolved and liquidated on completion of the merger.

Instructions

Prepare journal entries for Maadi Corporation on April 30, 2023, to record the business combination with Helwan Company under the following assumptions: Maadi paid L.E.3,100,000 cash and issued 10% bonds at face amount of L.E.16,900,000 for all the outstanding common stock of Helwan. The current fair value of the bonds was equal to their face amount.

(Check Figure: Debit goodwill, L.E.4,355,000)

(Problem 3.10)

Luxor Corporation agreed to pay L.E.850,000 cash and issue 50,000 shares of its L.E.10 par (L.E.20 current fair value a share) common stock on September 30, 2022, to Hyundai Company for all the net assets of Hyundai except cash. In addition, Luxor agreed that if the market value of its common stock was no L.E.20 a share or more on September 30, 2023, a sufficient number of additional shares of common stock would be issued to Hyundai to make the aggregate market value of its Luxor common shareholdings equal to L.E.1,000,000 on that date.

The balance sheet of Hyundai on September 30, 2022, with related current fair values of assets and liabilities, is as below:

HYUNDAI COMPANY **Balance Sheet (prior to business combination)** **September 30, 2022**		
	Carrying Amounts	**Current Fair Values**
Assets	L.E.	L.E.
Cash	100,000	100,000
Trade accounts receivable (net)	300,000	300,000
Inventories	520,000	680,000
Sort-term prepayments	20,000	20,000
10% investment in Truman Company common stock (long-term, available for sale)	180,000	180,000
Land	500,000	650,000
Other plant assets (net)	1,000,000	1,250,000
Patents (net)	80,000	100,000
Total assets	2,700,000	3,280,000
Liabilities and Stockholders' Equity	L.E.	L.E.
Liabilities	700,000	700,000
Long-term debt	500,000	480,000
Common stock, L.E.5	600,000	
Additional paid-in capital	400,000	
Retained earnings	500,000	
Total liabilities & stockholder's equity	2,700,000	

Out-of-pocket costs of the business combination paid by Luxor on September 30, 2022, were as follows:

Audit fees-SEC registration statement	L.E. 30,000
Finder's fee	35,000
Legal fees-business combination	15,000
Legal fees-SEC registration statement	20,000
Printing costs-securities and SEC registration statement	25,000
SEC registration fee	350
Total out-of-pocket costs of business combination	L.E.125,350

Instructions

a. Prepare the September 30, 2022, journal entries for Luxor Corporation to reflect the foregoing transactions and events.

b. Assume that on September 30, 2023, the market value of Luxor Corporation's common stock was L.E.16 a share. Prepare a journal entry to record the issuance of additional shares of Luxor common stock to Hyundai on that date and the payment of cash in lieu of fractional shares, if any.

(Check Figure: *a.* Debit patent, L.E.95,000.)

CHAPTER FOUR
CONSOLIDATED FINANCIAL STATEMENTS: ON THE DATE OF BUSINESS COMBINATION

CHAPTER FOUR

CONSOLIDATED FINANCIAL STATEMENTS: ON THE DATE OF BUSINESS COMBINATION

4.1 INTRODUCTION

In this Chapter, topics that will be dealt with include the nature of consolidated financial statements; the concept of ***control*** versus ***ownership*** as the basis for such financial statements; the preparation of consolidated financial statements involving both wholly owned and partially owned subsidiaries; and the nature of minority (noncontroling) interest and its valuation.

4.2 PARENT COMPANY-SUBSIDIARY RELATIONSHIPS

The foregoing chapter, Chapter Three, includes the terms ***investor*** and ***investee*** in the discussion of business combinations involving a combinor's acquisition of common stock of a combine corporation. If the investor acquires a controlling interest in the investee, a ***parent-subsidiary relationship*** is established. The investee becomes a ***subsidiary*** of the acquiring **parent company** (investor) but remains a separate legal entity.

Of course, strict adherence to the legal aspects of such a business combination would require the issuance of separate financial statements for the parent company and the subsidiary on the date of

the combination, and also for all subsequent accounting periods of the affiliation. However, such strict adherence to legal form disregards the substance of most parent-subsidiary relationships. A parent company and its subsidiary are a ***single economic entity***. In recognition of this fact, ***consolidated financial statements*** are issued to report the financial position and operating results of a parent company and its subsidiaries as though they comprised a ***single accounting entity.***

4.2.1 Nature of Consolidated Financial Statements

Consolidated financial statements are similar to the combined financial statements described in Chapter Two for a home office and its branches. Assets, liabilities, revenue, and expenses of the parent company and its subsidiaries are totaled; intercompany transactions and balances are eliminated; and the final consolidated amounts are reported in the consolidated balance sheet, income statement, statement of stockholders' equity, and statement of cash flow.

Nevertheless, the separate legal entity status of the parent and subsidiary corporations necessitates eliminations that generally are more complex than the combination eliminations presented and illustrated in Chapter Two for a home and its branches.

4.2.2 The Meaning of Controlling Interest

Traditionally, an investor's direct or indirect ownership of ***more than 50%*** of an investee'e outstanding common stock has been required to evidence the controlling interest underlying a parent-subsidiary relationship. Nevertheless, even though such a common stock ownership exists, other circumstances may negate (or supersede) the parent company's ***actual*** control of subsidiary. For example:

1. A subsidiary that is in liquidation or reorganization in court-supervised bankruptcy proceedings is not controlled by its parent company.
2. A foreign subsidiary in a country having severe production, monetary, or income tax restrictions may be subject to the authority of the foreign country rather than of the parent company.
3. If ***minority*** shareholders of a subsidiary have the right effectively to ***participate*** in the financial and operating activities of the subsidiary in the ordinary curse of business, the subsidiary's financial statements should not be consolidated with those of the parent company.

It is important to recognize that a parent company's control of a subsidiary might be achieved ***indirectly.*** For instance, if ***A*** Corporation owns 85% of the outstanding common stock of ***B*** Company and 45% of ***C*** Company's common stock, ***B*** also owns 45% of ***C's*** common stock, both ***B*** and ***C*** are controlled by ***A***, because it effectively controls 90% of ***C.*** This effective control consists of 45% owned directly and 45% indirectly.

Furthermore, an investor owning less than 50% of an investee's voting common stock ***in substance*** may control the affiliate , especially if the remaining common stock is scattered (separated) among a large number of stockholders who do not attend stockholder meetings or give proxies (agencies). Effective control of an investee also is possible if the individuals comprising management of the investor corporation own a substantial number of shares of common stock of the investee or successfully solicit (request) proxies from the investee's other stockholders. Therefore, ***Economic substance*** is emphasized over ***legal form*** in adopting a consolidation policy. Accordingly, ***control*** would be defined as a parent company's nonshared decision-making ability that enables it to guide the ongoing activities of its subsidiary and to use that

power to increase the benefits that it derives and limit the losses that it suffers from the activities of that subsidiary (FASB, 1999).

4.3 CONSOLIDATION OF WHOLLY OWNED SUBSIDIARY ON DATE OF BUSINESS COMBINATION

Logically, there is no question of ***control*** of a wholly owned subsidiary. Thus, to illustrate consolidated financial statements for a parent company and a wholly owned subsidiary, the following illustration will be discussed.

Illustration 4.1

Assume that on December 31, 2023, Victory Corporation issued 10,000 shares of its L.E.10 par common stock (current fair value L.E.45 a share) to stockholders of Star Company for all the outstanding L.E.5 par common stock of Star. There was no contingent consideration. Out-of-pocket costs of the business combination paid by Victory on December 31, 2023, consisted of the following:

Finder's and legal fees relating to business Combination	L.E.50,000
Costs associated with SEC registration Statement for Victory common stock	35,000
Total out-of-pocket costs of business combination	L.E.85,000

Assume also that Star Company was to continue its corporate existence as a wholly owned subsidiary of Victory Corporation. Both constituent companies had a December 31 fiscal year and used the same accounting principles and procedures; thus, no adjusting entries were required for either company prior to the combination. The income tax rate for each company was 40%.

Financial statements of Victory Corporation and Star Company for the year ended December 31, 2023, prior to consummation of the business combination, follow:

VICTORY CORPORATION AND STAR COMPANY **Separate Financial Statements (prior to business combination)** **For Year Ended December 31, 2023**		
	Victory Corporation	**Star Company**
Income Statements	L.E.	L.E.
Revenue:		
Net sales	990,000	600,000
Interest revenue	10,000	
Total revenue	1,000,000	600,000
Costs and expenses:		
Cost of goods sold	635,000	410,000
Operating expenses	158,333	73,333
Interest expense	50,000	30,000
Income taxes expense	62,667	34,667
Total costs and expenses	906,000	548,000
Net income	94,000	52,000
Statements of Retained Earnings		
Retained earnings, beginning of year	65,000	100,000
Add: Net income	94,000	52,000
Subtotals	159,000	152,000
Less: Dividends	25,000	20,000
Retained earnings, end of year	134,000	132,000
Balance Sheets		
Assets		
Cash	100,000	40,000
Inventories	150,000	110,000
Other current assets	110,000	70,000
Receivable from Star Company	25,000	
Plant assets (net)	450,000	300,000
Patent (net)		20,000
Total assets	835,000	540,000
Liabilities and Stockholders' Equity		
Payable to Victory Corporation		25,000
Income taxes payable	26,000	10,000
Other liabilities	325,000	115,000
Common stock, L.E.10 par	300,000	
Common stock L.E.5 par		200,000
Additional paid-in capital	50,000	58,000
Retained earnings	134,000	132,000
Total liabilities and stockholders' equity	835,000	540,000

The December 31, 2023, current fair values of Star Company's identifiable assets and liabilities were the same as their carrying amounts, except for the three assets listed below:

Current Fair Values, Dec. 31, 2023	
Inventories	L.E.135,000
Plant assets (net)	365,000
Patent (net)	25,000

Because Star was to continue as a separate corporation and current generally accepted accounting principles do not sanction write-up of assets of a going concern, Star did not prepare journal entries for the business combination. Victory Corporation recorded the combination on December 31, 2023, with the following journal entries (acquisition of 100% of subsidiary's outstanding common stock):

VICTORY CORPORATION (COMBINOR) **Journal Entries** **December 31, 2023**		
Investment in Star Company Common Stock (10,000 × L.E.45)	450,000	
Common Stock (10,000 × L.E.10)…………………..		100,000
Paid-in Capital in Excess Par………………………..		350,000
To record issuance of 10,000 shares of common stock for all the outstanding common stock of Star Company in a business combination.		
Investment in Star Company Common Stock………………....	50,000	
Paid-in Capital in Excess of Par……………………………….	35,000	
Cash……………………………………………………		85,000
To record payment of out-of-pocket costs of business combination with Star Company. Finder's and legal fees relating to the combination are recorded as additional costs of the investment; costs associated with the SEC registration statement are recorded as an offset to the previously recorded proceeds from the issuance of common stock.		

The first journal entry is similar to the entry illustrated in Chapter Three for a statutory merger. An Investment in Common Stock ledger account is debited with the current fair value of the combinor's common stock issued to effect the business combination, and the paid-in capital accounts are credited in the usual manner for any common stock issuance. In the second journal entry, the ***direct*** out-of-pocket costs of the business combination are debited to the Investment in Common Stock ledger account, and the costs that are associated with the SEC registration statement, being costs of issuing the common stock, are applied to reduce the proceeds of the common stock issuance.

Unlike the journal entries for a merger illustrated in Chapter Three, the foregoing journal entries do not include any debits or credits to record individual assets and liabilities of Star Company in the accounting records of Victory Corporation. The reason is that Star was not ***liquidated*** as in a merger; it remains a separate legal entity.

After the foregoing journal entries have been posted, the affected ledger accounts of Victory Corporation (the combinor) are as follows:

Cash

Date	Explanation	Debit	Credit	Balance
2023				
Dec.31	Balance forwarded			100,000dr
31	Out-of-pocket costs of business combination		85,000	15,000dr

Investment in Star Company Common Stock

Date	Explanation	Debit	Credit	Balance
2023 Dec31	Issuance of common stock in business combination	450,000		450,000dr
31	Direct out-of-pocket costs of business combination	50,000		500,000dr

Common Stock, L.E.10 Par

Date	Explanation	Debit	Credit	Balance
2023				
Dec.31	Balance forwarded			300,000cr
31	Issuance of common stock in business combination		100,000	400,000cr

Paid-in Capital in Excess of Par

Date	Explanation	Debit	Credit	Balance
2023				
Dec.31	Balance forwarded			50,000cr
31	Issuance of common stock in business combination		350,000	400,000cr
31	Costs of issuing common stock in business combination	35,000		365,000cr

4.3.1 Preparation of Consolidated Balance Sheet without a Working Paper

Accounting for the business combination of Victory Corporation and Star Company requires a ***fresh start*** for the consolidated entity. This reflects the theory that a business combination that involves a parent company-subsidiary relationship is an ***acquisition of the combinee's net assets*** (assets less liabilities) by the combinor. The operating results of Victory and Star prior to the date of their business combination are those of two separate ***economic***-as well as

legal-entities. Accordingly, a consolidated balance sheet is the only ***consolidated*** financial statement issued by Victory on December 31, 2023, the date of the business combination of Victory and Star.

The preparation of a consolidated balance sheet for a parent company and its wholly owned subsidiary may be accomplished without the use of a supporting working paper. The parent company's investment account and the subsidiary's stockholders' equity accounts do not appear in the consolidated balance sheet because they are essentially ***reciprocal*** (intercompany) accounts. The parent company (combinor) assets and liabilities (other than intercompany ones) are reflected at ***carrying amounts,*** and the subsidiary (combinee) assets and liabilities (other than intercompany ones) are reflected at ***current fair values,*** in the consolidated balance sheet. Goodwill is recognized to the extent the cost of the parent's investment in 100% of the subsidiary's outstanding common stock exceeds the current fair value of the subsidiary's ***identifiable*** net assets, both tangible and intangible.

Applying the foregoing principles to the Victory Corporation and Star Company parent-subsidiary relationship, the following consolidated balance sheet is produced.

VICTORY CORPORATION AND SUBSIDIARY
Consolidated Balance Sheet
December 31, 2023

Assets		L.E.
Current assets:		
Cash (L.E.15,000 + 40,000)		55,000
Inventories (L.E.150,000 + 135,000)		285,000
Other (L.E.110,000 + 70,000)		180,000
Total current assets		520,000
Plant assets (net) (L.E.450,000 + 365,000)		815,000
Intangible assets:		
Patent (net) (L.E.0 + 25,000)	L.E.25,000	
Goodwill	15,000	40,000
Total assets		1,375,000
Liabilities and Stockholders' Equity		
Liabilities:		
Income taxes payable (L.E.26,000 + 10,000)		36,000
Others (L.E.325,000 + 115,000)		440,000
Total liabilities		476,000
Stockholders' equity:		
Common stock, L.E.10 par	L.E.400,000	
Additional paid-in capital	365,000	
Retained earnings	134,000	899,000
Total liabilities and stockholders' equity		1,375,000

The following are significant aspects of the consolidated balance sheet:

1. The first amounts in the computations of consolidated assets and liabilities (except goodwill) are the parent company's carrying amounts; the second amounts are the subsidiary's current fair values.

2. Intercompany accounts (parent's investment, subsidiary's stockholders' equity, and intercompany receivable/payable) are excluded from the consolidated balance sheet.

3. ***Goodwill*** in the consolidated balance sheet is the cost of the parent company's investment (L.E.500,000) less the current fair value of the subsidiary's identifiable net assets (L.E.485,000), or L.E.15,000. The L.E.485,000 current fair value of the subsidiary's identifiable net assets is computed as follows: L.E.40,000 + 135,000 + 70,000 + 365,000 + 25,000 –L.E.25,000 –10,000 – 115,000 = L.E.485,000.

4.3.2 Working Paper for Consolidated Balance Sheet

The preparation of a consolidated balance sheet on the date of a business combination usually requires the use of a ***working paper for consolidated balance sheet,*** even for a parent company and a wholly owned subsidiary. The format of the working paper, with the individual balance sheet amounts included for both Victory Corporation and Star Company, is shown below:

VICTORY CORPORATION AND SUBSIDIARY
Working Paper for Consolidated Balance Sheet
December 31, 2024

	Victory Corporation	Star Company	Eliminations Increase (Decrease)	Consolidated
Assets				
Cash	15,000	40,000		
Inventories	150,000	110,000		
Other current assets	110,000	70,000		
Intercompany receivable (payable)	25,000	(25,000)		
Investment in Star Company common stock	500,000			
Plant assets (net)	450,000	300,000		
Patent (net)		20,000		
Goodwill				
Total assets	1,250,000	515,000		
Liabilities and Stockholders' Equity				
Income taxes payable	26,000	10,000		
Other liabilities	325,000	115,000		
Common stock, L.E.10 par	400,000			
Common stock, L.E.5 par		200,000		
Additional paid-in capital	365,000	58,000		
Retained earnings	134,000	132,000		
Total liabilities and stockholders' equity	1,250,000	515,000		

4.3.3 Developing the Elimination

As indicated above, Victory Corporation's Investment in Star Company Common Stock ledger account in the working paper for consolidated balance sheet is similar to a home office's Investment in Branch account, as described in Chapter Two. Nevertheless, Star Company is a ***separate corporation,*** not a ***branch;*** therefore, Star has the three conventional stockholders' equity accounts rather than the single Home Office reciprocal account used by a branch. Accordingly, the elimination for the ***intercompany*** accounts of Victory and Star must ***decrease to zero*** the Investment in Star

Company Common Stock account of Victory and the three stockholder's equity accounts of Star. Decreases in assets are effected by ***credits,*** and decreases in stockholder's equity accounts are effected by ***debits;*** therefore, the elimination for Victory Corporation and subsidiary on December 31, 2023 (the date of the business combination), is begun as shown below (a journal entry format is used to facilitate review of the elimination-Elimination of Intercompany Accounts):

Common Stock–Star	200,000	
Additional Paid-in Capital–Star	58,000	
Retained Earnings–Star	132,000	
	390,000	
Investment in Star Company Common Stock–Victory		500,000

The footing of L.E.390,000 of the debit items of the foregoing partial elimination represents the ***carrying amount*** of the net assets of Star Company and is L.E.110,000 less than the credit item of L.E.500,000, which represents the cost of Victory Corporation's investment in Star. As indicated on the foregoing pages, part of the L.E.110,000 difference is attributable to the excess of current fair values over carrying amounts of certain ***identifiable*** tangible and intangible assets of Star. This excess is summarized as follows (the

current fair values of all other assets and liabilities are equal to their carrying amounts):

	Current Fair Values	Carrying Amounts	Excess of Current Fair Values over Carrying Amounts
Inventories	135,000	110,000	25,000
Plant assets (net)	365,000	300,000	65,000
Patent (net)	25,000	20,000	5,000
Totals	525,000	430,000	95,000

Generally accepted accounting principles do not presently permit the write-up of a going concern's assets to their current fair values. Thus, to conform to the requirements of purchase accounting for business combinations, the foregoing excess of current fair values over carrying amounts must be incorporated in the consolidated balance sheet of Victory Corporation and subsidiary by means of the elimination. ***Increases*** in assets are recorded by ***debits;*** thus, the elimination for Victory Corporation and subsidiary begun above is ***continued*** as follows (in journal entry format):

Common Stock–Star	200,000	
Additional Paid-in Capital–Star	58,000	
Retained Earnings–Star	132,000	
Inventories–Star	25,000	
Plant Asset (net)–Star	65,000	
Patent (net)–Star	5,000	
	485,000	
Investment in Star Company Common Stock–Victory		500,000

The revised footing of L.E.485,000 of the debit items of the foregoing partial elimination is equal to the ***current fair value*** of the ***identifiable*** tangible and intangible net assets of Star Company. Thus, the L.E.15,000 difference (L.E.500,000 – 485,000 = L.E.15,000) between the cost of Victory Corporation's investment in Star and the current fair value of Star's identifiable net assets represents ***goodwill of Star,*** in accordance with purchase accounting theory for business combinations, described in Chapter Three. Consequently, the December 31, 2023, elimination for Victory Corporation and subsidiary is completed with a L.E.15,000 ***debit*** to Goodwill–Star.

4.3.4 Completed Elimination and Working Paper for Consolidated Balance Sheet

The completed elimination for Victory Corporation and subsidiary (in journal entry format) and the related working paper for consolidated balance sheet are as follows:

(a) Common Stock–Star	200,000	
Additional Paid-in Capital–Star	58,000	
Retained Earnings–Star	132,000	
Inventories–Star	25,000	
Plant Asset (net)–Star	65,000	
Patent (net)–Star	5,000	
Goodwill–Star	15,000	
Investment in Star Company Common tock–Victory		500,000

To eliminate intercompany investment and equity accounts of subsidiary on date of business combination; and to allocate excess of cost over carrying amount of identifiable assets acquired, with remainder to goodwill.

Working paper for consolidated balance sheet for wholly owned subsidiary on date of business combination is shown below.

VICTORY CORPORATION AND SUBSIDIARY
Working Paper for Consolidated Balance Sheet
December 31, 2023

	Victory Corporation	Star Company	Eliminations Increase (Decrease)	Consolidated
Assets				
Cash	15,000	40,000		55,000
Inventories	150,000	110,000	*(a)* 25,000	285,000
Other current assets	110,000	70,000		180,000
Intercompany receivable (payable)	25,000	(25,000)		---------------
Investment in Star Company common stock	500,000		*(a)* (500,000)	---------------
Plant assets (net)	450,000	300,000	*(a)* 65,000	815,000
Patent (net)		20,000	*(a)* 5,000	25,000
Goodwill			*(a)* 15,000	15,000
Total assets	1,250,000	515,000	(390,000)	1,375,000
Liabilities and Stockholders' Equity				
Income taxes payable	26,000	10,000		36,000
Other liabilities	325,000	115,000		440,000
Common stock, L.E.10 par	400,000			400,000
Common stock, L.E.5 par		200,000	*(a)* (200,000)	--------------
Additional paid-in capital	365,000	58,000	*(a)* (58,000)	365,000
Retained earnings	134,000	132,000	*(a)* (132,000)	134,000
Total liabilities and stockholders' equity	1,250,000	515,000	(390,000)	1,375,000

The following features of the working paper for consolidated balance sheet on the date of the business combination should be emphasized:

1. The elimination is not entered in either the parent company's or the subsidiary's accounting records; it is ***only*** a part of the working paper for preparation of the consolidated balance sheet.
2. The elimination is used to reflect differences between current fair values and carrying amounts of the subsidiary's identifiable net

assets because the subsidiary did not write up its assets to current fair values on the date of the business combination.

3. The Eliminations column in the working paper for consolidated balance sheet reflects ***increases*** and ***decreases***, rather than ***debits*** and ***credits***. Debits and credits are not appropriate in a working paper dealing with ***financial statements*** rather than ***trial balances***.
4. ***Intercompany receivables*** and ***payables*** are placed on the same line of the working paper for consolidated balance sheet and are combined to produce a consolidated amount of zero.
5. The respective corporations are identified in the working paper elimination.
6. The consolidated paid-in capital amounts are those of the parent company ***only***. Subsidiaries' paid-in capital amounts ***always*** are eliminated in the process of consolidation.
7. Consolidated retained earnings on the date of a business combination include ***only*** the retained earnings of the parent company. This treatment is consistent with the theory that purchase accounting reflects a fresh start in an acquisition of net assets (assets less liabilities).

8. The amounts in the consolidated column of the working paper for consolidated balance sheet reflect the financial position of a ***single economic entity*** comprising ***two legal entities,*** with all ***intercompany*** balances of the two entities eliminated.

Consolidated Balance Sheet

The amounts in the consolidated column of the working paper for consolidated balance sheet are presented in the customary fashion in the ***consolidated balance sheet*** of Victory Corporation and subsidiary that follows.

VICTORY CORPORATION AND SUBSIDIARY
Consolidated Balance Sheet
December 31, 2023

Assets		L.E.
Current assets:		
Cash		55,000
Inventories		285,000
Other		180,000
Total current assets		520,000
Plant assets (net)		815,000
Intangible assets:		
Patent (net)	L.E.25,000	
Goodwill	15,000	40,000
Total assets		1,375,000
Liabilities and Stockholders' Equity		
Liabilities:		
Income taxes payable		36,000
Others		440,000
Total liabilities		476,000
Stockholders' equity:		
Common stock, L.E.10 par	L.E.400,000	
Additional paid-in capital	365,000	
Retained earnings	134,000	899,000
Total liabilities and stockholders' equity		1,375,000

In the interest of brevity, notes to financial statements and other required disclosures are omitted. In addition to the foregoing

consolidated balance sheet on December 31, 2023, Victory Corporation's published financial statements for the year ended December 31, 2023, include the ***unconsolidated*** income statement and statement of retained earnings illustrated on the foregoing pages and unconsolidated statement of cash flows.

4.4 CONSOLIDATION OF PARTIALLY OWNED SUBSIDIARY ON DATE OF BUSINESS COMBINATION

The consolidation of a parent company and its ***partially owned*** subsidiary differs from the consolidation of a wholly owned subsidiary in one major respect–the recognition of minority interest. ***Minority interest***, or ***noncontrolling interest***, is a term applied to the claims of stockholders other than the parent company (the ***controlling interest***) to the net income or losses and net assets of the subsidiary. The minority interest in the subsidiary's net income or losses is displayed in the consolidated income statement, and the minority interest in the subsidiary's net assets is displayed in the consolidated balance sheet.

Illustration 4.2

To illustrate the consolidation techniques for a business combination involving a partially owned subsidiary, assume the following facts.

On December 31, 2023, Qena Corporation issued 57,000 shares of its L.E.1 par common stock (current fair value L.E.20 a share) to stockholders of Safaga Company in exchange for 38,000 of the 40,000 outstanding shares of Safaga's L.E.10 par common stock in a business combination. Thus, Qena acquired a 95% interest (38,000

÷ 40,000 = 0.95) in Safaga, which became Qena's subsidiary. There was no contingent consideration. Out-of-pocket costs of the combination, paid in cash by Qena on December 31, 2023, were as follows:

Finder's and legal fees relating to business combination	L.E. 52,250
Costs associated with SEC registration statement	72,750
Total out-of-pocket costs of business combination	L.E.125,000

Financial statements of Qena Corporation and Safaga Company for their fiscal year ended December 31, 2023, prior to the business combination, are as below (there were no intercompany transactions prior to the combination).

QENA CORPORATION AND SAFAGA COMPANY **Separate Financial Statements (prior to business combination)** **For Year Ended December 31, 2023**		
	Qena Corporation	**Safaga Company**
Income Statements	L.E.	L.E.
Net sales	5,500,000	1,000,000
Costs and expenses:		
Cost of goods sold	3,850,000	650,000
Operating expenses	925,000	170,000
Interest expense	75,000	40,000
Income taxes expense	260,000	56,000
Total costs and expenses	5,110,000	916,000
Net income	390,000	84,000
Statements of Retained Earnings		
Retained earnings, beginning of year	810,000	290,000
Add: Net income	390,000	84,000
Subtotals	1,200,000	374,000
Less: Dividends	150,000	40,000
Retained earnings, end of year	1,050,000	334,000
Balance Sheets		
Assets		
Cash	200,000	100,000
Inventories	800,000	500,000
Other current assets	550,000	215,000
Plant assets (net)	3,500,000	1,100,000
Goodwill (net)	100,000	
Total assets	5,150,000	1,915,000
Liabilities and Stockholders' Equity		
Income taxes payable	100,000	16,000
Other liabilities	2,450,000	930,000
Common stock, L.E.1 par	1,000,000	
Common stock L.E.10 par		400,000
Additional paid-in capital	550,000	235,000
Retained earnings	1,050,000	334,000
Total liabilities and stockholders' equity	5,150,000	1,915,000

The December 31, 2023, current fair values of Safaga Company's identifiable assets and liabilities were the same as their carrying amounts, except for the following assets:

Current Fair Values, Dec. 31, 2023	
Inventories	L.E. 526,000
Plant assets (net)	1,290,000
Leasehold	30,000

Because Safaga is continuing as a separate corporation and current generally accepted accounting principles do not permit the write-up of assets of a going concern to current fair values, Safaga Company did not prepare journal entries related to the business combination. Qena Corporation recorded the combination on December 31, 2023, with Safaga by means of the following journal entries (acquisition of 95% of subsidiary's outstanding common stock):

QENA CORPORATION (COMBINOR) **Journal Entries** **December 31, 2023**		
Investment in Safaga Company Common Stock (57,000 × L.E.20)	1,140,000	
Common Stock (57,000 × L.E.1)……………………………..		57,000
Paid-in Capital in Excess Par…………………………………		1,083,000
To record issuance of 57,000 shares of common stock for 38,000 of the 40,000 outstanding shares of Safaga Company common stock in a business combination.		
Investment in Safaga Company Common Stock……………….	52,250	
Paid-in Capital in Excess of Par………………………………..	72,750	
Cash………………………………………………………..		125,000
To record payment of out-of-pocket costs of business combination with Safaga Company. Finder's and legal fees relating to the combination are recorded as additional costs of the investment; costs associated with the SEC registration statement are recorded as an offset to the previously recorded proceeds from the issuance of common stock.		

After the foregoing journal entries have been posted, the affected ledger accounts of Qena Corporation are as follows:

Cash

Date	Explanation	Debit	Credit	Balance
2023				
Dec.31	Balance forwarded			200,000dr
31	Out-of-pocket costs of business combination		125,000	75,000dr

Investment in Safaga Company Common Stock

Date	Explanation	Debit	Credit	Balance
2023 Dec.31	Issuance of common stock in business combination	1,140,000		1,140,000dr
31	Direct out-of-pocket costs of business combination	52,250		1,192,250dr

Common Stock, L.E.1 Par

Date	Explanation	Debit	Credit	Balance
2023				
Dec.31	Balance forwarded			1,000,000cr
31	Issuance of common stock in business combination		57,000	1,057,000cr

Paid-in Capital in Excess of Par

Date	Explanation	Debit	Credit	Balance
2023				
Dec.31	Balance forwarded			550,000cr
31	Issuance of common stock in business combination		1,083,000	1,633,000cr
31	Costs of issuing common stock in business combination	72,750		1,560,250cr

4.4.1 Working Paper for Consolidated Balance Sheet

Because of the complexities caused by the minority interest in the net assets of a partially owned subsidiary and the measurement of goodwill acquired in the business combination, it is advisable to use a working paper for preparation of a consolidated balance sheet for a parent company and its partially owned subsidiary on the date of

the business combination. The format of the working paper is identical to that illustrated before.

4.4.2 Developing the Elimination

The preparation of the elimination for a parent company and a partially owned subsidiary parallels that for a wholly owned subsidiary described earlier in this chapter. First, the ***intercompany*** accounts are reduced to zero, as shown below (in journal entry format):

Common Stock–Safaga	400,000	
Additional Paid-in Capital–Safaga	235,000	
Retained Earnings–Safaga	334,000	
	969,000	
Investment in Safaga Company Common Stock–Qena		1,192,250

The footing of L.E.969,000 of the debit items of the partial elimination above represents the ***carrying amount*** of the net assets of Safaga Company and is L.E.223,250 less than the credit item of L.E.1,192,250. Part of this L.E.223,250 difference is the excess of the total of the cost of Qena Corporation's investment in Safaga Company and the ***minority interest*** in Safaga Company's net assets over the carrying amounts of Safaga's identifiable net assets. This excess may be computed as follows, (the current fair values of all

other assets and liabilities of Safaga are equal to their carrying amounts):

	Current Fair Values	**Carrying Amounts**	**Excess of Current Fair Values over Carrying Amounts**
Inventories	526,000	500,000	26,000
Plant assets (net)	1,290,000	1,100,000	190,000
Leasehold	30,000		30,000
Totals	1,846,000	1,600,000	246,000

Under generally accepted accounting principles, the foregoing differences are not entered in Safaga Company's accounting records. Thus, to conform to the requirements of purchase accounting, the differences must be reflected in the consolidated balance sheet of Qena Corporation and subsidiary by means of the elimination, which is continued below:

Common Stock–Safaga	400,000	
Additional Paid-in Capital–Safaga	235,000	
Retained Earnings–Safaga	334,000	
Inventories–Safaga	26,000	
Plant Asset (net)–Safaga	190,000	
Leasehold–Safaga	30,000	
	1,215,000	
Investment in Star Company Common Stock–Qena		1,192,250

The revised footing of L.E.1,215,000 of the debit items of the foregoing partial elimination represents the ***current fair value*** of the ***identifiable*** tangible and intangible net assets of Safaga Company on December 31, 2023.

Two items now must be recorded to complete the elimination for Qena Corporation and subsidiary. First, the ***minority interest*** in the identifiable net assets (at current fair values) of Safaga Company is recorded by a ***credit.*** The minority interest is computed as below:

Current fair value of Safaga Company's identifiable net assets	L.E.1,215,000
Minority interest ownership in Safaga Company's identifiable net assets (100% minus Qena Corporation's 95% interest)	0.05
Minority interest in Safaga Company's ***identifiable*** net assets (L.E.1,215,000 × 0,05)	L.E. 60,750

Second, the goodwill ***acquired by Qena Corporation*** in the business combination with Safaga Company is recorded by a ***debit***. The goodwill is computed below:

Cost of Qena Corporation's 95% interest in Safaga Company	L.E.1,192,250
Less: Current fair value of Safaga Company's identifiable net assets acquired by Qena (L.E.1,215,000 × 0.95)	1,154,250
Goodwill ***acquired by Qena Corporation***	L.E. 38,000

The working paper elimination for Qena Corporation and subsidiary may now be completed as below (partially owned subsidiary on the date of business combination):

(a) Common Stock–Safaga	400,000	
Additional Paid-in Capital–Safaga	235,000	
Retained Earnings–Safaga	334,000	
Inventories–Safaga	26,000	
Plant Asset (net)–Safaga	190,000	
Leasehold–Safaga	30,000	
Goodwill–Safaga	38,000	
Investment in Safaga Company Common tock–Qena		1,192,250
Minority Interest in Net Assets of Subsidiary		60,750

To eliminate intercompany investment and equity accounts of subsidiary on date of business combination; to allocate excess of cost over carrying amount of identifiable assets acquired, with remainder to goodwill; and to establish minority interest in identifiable net assets of subsidiary on date of business combination (L.E.1,215,000 × 0.05 = L.E.60,750).

4.4.3 Working Paper for Consolidated Balance Sheet

The working paper for consolidated balance sheet on December 31, 2023, for Qena Corporation and subsidiary is shown below (partially owned subsidiary on date of business combination):

QENA CORPORATION AND SUBSIDIARY
Working Paper for Consolidated Balance Sheet
December 31, 2023

	Qena Corporation	Safaga Company	Eliminations Increase (Decrease)	Consolidated
Assets				
Cash	75,000	100,000		175,000
Inventories	800,000	500,000	*(a)* 26,000	1,326,000
Other current assets	550,000	215,000		765,000
Investment in Safaga Company common stock	1,192,250		*(a)*(1,192,250)	--------------
Plant assets (net)	3,500,000	1,100,000	*(a)* 190,000	4,790,000
Leasehold			*(a)* 30,000	30,000
Goodwill	100,000		*(a)* 38,000	138,000
Total assets	6,217,250	1,915,000	(908,250)	7,224,000
Liabilities and Stockholders' Equity				
Income taxes payable	100,000	16,000		116,000
Other liabilities	2,450,000	930,000		3,380,000
Common stock, L.E.1 par	1,057,000			1,057,000
Common stock, L.E.10 par		400,000	*(a)* (400,000)	-------------
Additional paid-in capital	1,560,250	235,000	*(a)* (235,000)	1,560,250
Minority interest in net assets of subsidiary			*(a)* 60,750	60,750
Retained earnings	1,050,000	334,000	*(a)* (334,000)	1,050,000
Total liabilities and stockholders' equity	6,217,250	1,915,000	(908,250)	7,224,000

4.4.4 Nature of Minority Interest

The appropriate classification and presentation of minority interest in consolidated financial statements has been a perplexing (complicating) problem for accountants, especially because it is recognized ***only in the consolidation process*** and does not result from a business transaction or event of either the parent company or the subsidiary. Two concepts for consolidated financial statements have been developed to account for minority interest–the ***parent company concept*** and the ***economic unit concept***. The FASB (1991, pars. 63-64) has described these two concepts as follows:

> The parent company concept emphasizes the interests of the parent's shareholders. As a result, the consolidated financial statements reflect those stockholders' interests in the parent itself, plus their undivided interests in the net assets of the parent's subsidiaries. The consolidated balance sheet is essentially a modification of the parent's balance sheet with the assets and liabilities of all subsidiaries substituted for the parent's investment in subsidiaries.
>
> …[T]he stockholders' equity of the parent company is also the stockholders' equity of the consolidated entity. Similarly, the consolidated income statement is essentially a modification of the parent's income statement with the revenues, expenses, gains, and losses of subsidiaries substituted for the parent's income from investment in the subsidiaries.
>
> The economic unit concept emphasizes control of the whole by a single management. As a result, under this concept (sometimes called the entity theory in the accounting literature), consolidated financial statements are intended to provide information about a group of legal entities–a parent company and its subsidiaries–operating as a single unit. The assets, liabilities, revenues, expenses, gains, and losses of the various component entities are the assets, liabilities, revenues, expenses, gains, and losses of the consolidated entity. Unless all subsidiaries are wholly owned, the business enterprise's proprietary interest (its residual owners'

> equity–assets less liabilities) is divided into the controlling interest (stockholders or other owners of the parent company) and one or more noncontrolling interests in subsidiaries. Both the controlling and the noncontrolling interests are part of the proprietary group of the consolidated entity, even though the noncontrolling stockholders' ownership interests relate only to the affiliates whose shares they own.

In accordance with the foregoing quotation, the ***parent company concept*** of consolidated financial statements apparently treats the minority interest in net assets of a subsidiary as a ***liability***. This liability is increased each accounting period subsequent to the date of a business combination by an ***expense*** representing the minority's share of the subsidiary's net income (or decreased by the minority's share of the subsidiary's net loss). Dividends declared by the subsidiary to minority stockholders decrease the liability to them. Consolidated net income is ***net*** of the minority's share of the subsidiary's net income.

In the ***economic unit concept***, the minority interest in the subsidiary's net assets is displayed in the stockholders' equity section of the consolidated balance sheet. The consolidated income statement displays the minority interest in the subsidiary's net income as a subdivision of total consolidated net income.

The FASB included the following in a ***Proposed Statement of Financial Accounting Standards,*** "Accounting for Financial Instruments with Characteristics of Liabilities, Equity, or Both" (FASB, 2000: par. 36):

> An equity instrument that is issued by a less-than-wholly-owned subsidiary included in the reporting entity to an entity outside the consolidated group and thus representing the noncontrolling equity interest in that subsidiary shall be reported in the consolidated financial statements as a separate component of equity.

Consolidated Balance Sheet for Partially Owned Subsidiary

The consolidated balance sheet of Qena Corporation and its partially owned subsidiary, Safaga Company, is presented as bellow. The consolidated amounts are taken from the working paper for consolidated balance sheet.

QENA CORPORATION AND SUBSIDIARY
Consolidated Balance Sheet
December 31, 2023

Assets			L.E.
Current assets:			
Cash			175,000
Inventories			1,326,000
Other			765,000
Total current assets			2,266,000
Plant assets (net)			4,790,000
Intangible assets:			
Leasehold	L.E.30,000		
Goodwill	138,000		168,000
Total assets			7,224,000
Liabilities and Stockholders' Equity			
Liabilities:			
Income taxes payable			116,000
Others			3,380,000
Total liabilities			3,496,000
Stockholders' equity:	Common stock, L.E.1 par	L.E.1,057,000	
	Additional paid-in capital	1,560,250	
	Minority interest in net assets of subsidiary	60,750	
	Retained earnings	1,050,000	3,728,000
Total liabilities and stockholders' equity			7,224,000

The display of minority interest in net assets of subsidiary in the equity section of the consolidated balance sheet of Qena Corporation and subsidiary is consistent with the economic unit concept of consolidated financial statements. It should be noted that ***there is no ledger account for minority interest in net assets of subsidiary, in either the parent company's or the subsidiary's accounting records***.

4.5 BARGAIN-PURCHASE EXCESS IN CONSOLIDATED BALANCE SHEET

A business combination that results in a parent company–subsidiary relationship may include an excess of current fair values of the subsidiary's identifiable net assets over the cost of the parent company's investment in the subsidiary's common stock. If so, the accounting standards described in Chapter 3 are applied. The excess of current fair values over cost (bargain-purchase excess) is applied pro rata to reduce the amounts initially assigned to noncurrent assets other than financial assets (excluding investments accounted for by the equity method), assets to be disposed of by sale, deferred tax assets, and prepaid assets relating to pensions and other postretirement benefit plans.

4.5.1 Illustration of Bargain-Purchase Excess: Wholly Owned Subsidiary

On December 31, 2023, Goodman Corporation acquired all the outstanding common stock of Sinai Company for L.E.850,000 cash, including direct out-of-pocket costs of the business combination. Stockholders' equity of Sinai totaled L.E.800,000, consisting of common stock, L.E.100,000; additional paid-in capital, L.E.300,000; and retained earnings, L.E.400,000. The current fair

values of Sinai's identifiable net assets were the same as their carrying amounts, except for the following:

	Current Fair Values	Carrying Amounts	Differences
Inventories	L.E. 339,000	320,000	19,000
Long-term investments in marketable debt securities (held to maturity)	61,000	50,000	11,000
Plant assets (net)	1,026,000	984,000	42,000
Intangible assets (net)	54,000	36,000	18,000

Thus, the current fair values of Sinai's identifiable net assets exceeded the amount paid by Goodman by L.E.40,000 [(L.E.800,000 + 19,000 + 11,000 + 42,000 + 18,000) – L.E.850,000 = L.E.40,000]. This L.E.40,000 bargain-purchase excess is offset against amounts originally assigned to Sinai's plant assets and intangible assets in proportion to their current fair values (L.E.1,026,000:L.E.54,000 = 95:5). The December 31, 2023, working paper elimination for Goodman Corporation and subsidiary is as follows (wholly owned subsidiary with bargain-purchase excess on date of business combination):

	Debit	Credit
(a) Common Stock–Sinai	100,000	
Additional Paid-in Capital–Sinai	300,000	
Retained Earnings–Sinai	400,000	
Inventories–Sinai	19,000	
Long-term investments–Sinai	11,000	
Plant Assest (net)–Sinai 42,000 - (40,000 × 0.95)	4,000	
Intangible Assets–Sinai 18,000 - (40,000 × 0.05)	16,000	
Investment in Sinai Company Common tock–Goodman		850,000

To eliminate intercompany investment and equity accounts of subsidiary on date of business combination; and to allocate L.E.40,000 excess of current fair values of

subsidiary's identifiable net assets over cost to subsidiary's plant assets and intangible assets in ratio of L.E.1,026,000: 54,000, or 95%:5%.

4.5.2 Illustration of Bargain-Purchase Excess: Partially Owned Subsidiary

The Goodman Corporation and Sinai Company business combination described in the foregoing section is now changed by assuming that Goodman acquired ***98%,*** rather than ***100%,*** of Sinai's common stock for L.E.833,000 (L.E.850,000 × 0,98 = L.E.833,000) on December 31, 2023, with all other facts remaining unchanged. The excess of current fair values of Sinai's identifiable net assets over Goodman's cost is L.E.39,200 [(L.E.890,000 × 0.98) - L.E.833,000 = L.E.39,200]. Under these circumstances, the working paper elimination for Goodman Corporation and subsidiary on December 31, 2023, is as below (partially-owned subsidiary with bargain-purchase excess on date of business combination):

GOODMAN CORPORATION AND SUBSIDIARY
Working Paper Elimination
December 31, 2023

(a) Common Stock–Sinai	100,000	
Additional Paid-in Capital–Sinai	300,000	
Retained Earnings–Sinai	400,000	
Inventories–Sinai	19,000	
Long-term investments–Sinai	11,000	
Plant Assest (net)–Sinai 42,000 - (39,200 × 0.95)	4,760	
Intangible Assets–Sinai 18,000 - (39,200 × 0.05)	16,040	
Investment in Sinai Company Common tock–Goodman		833,000
Minority interest in Net Assets of Subsidiary (L.E.890,000 × 0.02)		17,800

To eliminate intercompany investment and equity accounts of subsidiary on date of business combination; to allocate parent company's share of excess (L.E.39,200) of current

fair values of subsidiary's identifiable net assets over cost to subsidiary's plant assets and intangible assets in ratio of 95%:5%; and to establish minority interest in net assets of subsidiary on date of business combination.

4.6 Exercises and Practical Problems

Exercises:

(Exercise 4.1)

Select the best answer for each of the following multiple-choice questions:

1. A parent company's correctly prepared journal entry to record the out-of-pocket costs of the acquisition of the subsidiary's outstanding common stock in a business combination was as follows:

Investment in Sinai Company Common Stock…….	36,800	
Cash………………………………………….		36,800

The implication of the foregoing journal entry is that the consideration issued by the parent company for the outstanding common stock of the subsidiary was:

a. Cash.
b. Bonds.
c. Common stock.
d. Cash, bonds, or common stock.

2. The traditional definition of ***control*** for a parent company-subsidiary relationship (parent's ownership of more than 50% of the subsidiary's outstanding common stock) emphasizes:

a. Legal form.
b. Economic substance.
c. Both legal form and economic substance.
d. Neither legal form nor economic substance.

3. An investor company that owns more than 50% of the outstanding voting common stock of an investee may not ***control*** the investee if:

a. The investee is in reorganization in bankruptcy proceeding.
b. There is a large passive (not active) minority interest in the investee.
c. A part of the investor company's ownership is ***indirect.***
d. The investee is a finance-related enterprise.

4. ***FASB Statement No. 94,*** "Consolidation of All Majority Owned Subsidiaries," exempts (excludes) from consolidation:

a. No subsidiaries of the parent company.
b. Foreign subsidiaries of the parent company.
c. Finance-related subsidiaries of the parent company.
d. Subsidiaries not controlled by the parent company.

5. If, on the date of the business combination, C = consideration given to the former stockholders of wholly owned subsidiary Sinai Company by Suez Corporation; DOP = direct out-of-pocket costs of the combination; CA = carrying amount and CFV = current fair value of Sinai's identifiable net assets; and GW = goodwill:
a. C + DOP = CA + GW
b. C - DOP = CFV - GW
c. C + DOP = CFV + GW
d. C = CA + GW- DOP
6. In a completed working paper elimination for a parent company and its wholly owned subsidiary on the date of the business combination (in journal entry format), the total of the debits generally equals the:
a. Parent company's total cost of its investment in the subsidiary.
b. Carrying amount of the subsidiary's identifiable net assets.
c. Current fair value of the subsidiary's identifiable net assets.
d. Total paid-in capital of the subsidiary.
7. In a working paper elimination (in journal entry format) for the consolidated balance sheet of a parent company and its wholly owned subsidiary on the date of a business combination, the subtotal of the debits to the subsidiary's stockholders' equity accounts equals the:
a. Current fair value of the subsidiary's ***identifiable*** net assets.
b. Current fair value of the subsidiary's ***total*** net assets, including goodwill.
c. Balance of the parent company's investment ledger account.
d. Carrying amount of the subsidiary's ***identifiable*** net assets.
8. In the working paper for consolidated balance sheet prepared on the date of the business combination of a parent company and its wholly owned subsidiary, whose liabilities had current fair values equal to their carrying amounts, the total of the Elimination column is equal to:
a. The current fair value of the subsidiary's ***identifiable*** net assets.
b. The total stockholder's equity of the subsidiary.
c. The current fair value of the subsidiary's ***total*** net assets, including goodwill.
d. An amount that is not determinable.
9. On the date of business combination of Qena Corporation and its wholly owned subsidiary, Safaga Company, Qena paid (1)

L.E.100,000 to the former stockholders of Safaga for their stockholders' equity of L.E.65,000 and (2) L.E.15,000 for direct out-of-pocket costs of the combination. Goodwill recognized in the business was L.E.10,000. The current fair value of Safaga's identifiable net assets was:

a. L.E.65,000 *b.* L.E.75,000 *c.* L.E.105,000 *d.* L.E.115,000 *e.* L.E.125,000

10. Differences between current fair values and carrying amounts of the identifiable net assets of a subsidiary on the date of a business combination are recognized in a:

a. Working paper elimination.

b. Subsidiary journal entry.

c. Parent company journal entry.

d. Note to the consolidated financial statements.

11. In a business combination resulting in a parent company-wholly owned subsidiary relationship, goodwill developed in the working paper elimination is attributed:

a. In its entry to the subsidiary.

b. In its entry to the parent company.

c. To both the parent company and the subsidiary, in the ratio of current fair values of identifiable net assets.

d. In its entry to the consolidated entity.

12. On the date of the business combination of a parent company and its partially owned subsidiary, under the computation method used in this textbook, the amount assigned to minority interest in net assets of subsidiary is based on the:

a. Cost of the parent company's investment in the subsidiary's common stock.

b. Carrying amount of the subsidiary's ***identifiable*** net assets.

c. Current fair value of the subsidiary's ***identifiable*** net assets.

d. Current fair value of the subsidiary's ***total*** net assets, including goodwill.

13. The debits in the working paper elimination (in journal entry format) for the consolidated balance sheet of Parent Corporation and 90%-owned Subsidiary Company totalled L.E.2,080,000, including a debit of L.E.80,000 to Goodwill-Parent. The credit elements of the elimination are:

Investment in Subsidiary Company Common Stock-Parent	Minority Interest in Net Assets of Subsidiary
a. L.E.2,000,000	L.E. 80,000
b. L.E.1,880,000	L.E.200,000
c. L.E.1,872,000	L.E.208,000
d. Some other amounts.	

14. The cost of Cairo Corporation's 80% investment in Alexandria Company's outstanding voting common stock was L.E.1,200,000, and the current fair value of Alexandria's identifiable net assets, which had a carrying amount of L.E.1,000,000, was L.E.1,250,000. Under the computation method used in this book, Goodwill–Cairo and Minority Interest in Net Assets of Subsidiary are, respectively:

a. L.E.200,000 and L.E.250,000
b. L.E.200,000 and L.E.200,000
c. L.E.250,000 and L.E.300,000
d. Some other amounts.

(Exercise 4.2)

On March 31, 2023, Moon Corporation acquired for L.E.8,200,000 cash all the outstanding common stock of Star Company when Star's balance sheet showed net assets of L.E.6,400,000. Out-of-pocket costs of the business combination may be disregarded. Star's identifiable net assets had current fair values different from carrying amounts as follows:

	Carrying Amounts	Current Fair Values
Plant assets (net)	L.E.10,000,000	11,500,000
Other assets	1,000,000	700,000
Long-term debt	6,000,000	5,600,000

Prepare a working paper to compute the amount of goodwill to be displayed in the consolidated balance sheet of Cairo Corporation and subsidiary on March 31, 2023.

(Check Figure: Amount of goodwill, L.E.200,000.)

(Exercise 4.3)

Single Company's balance sheet on December 31, 2023, was as below:

SINGLE COMPANY Balance Sheet (prior to business combination) December 31, 2023	
Assets	L.E.
Cash	100,000
Trade accounts receivable (net)	200,000
Inventories	510,000
Plant assets (net)	900,000
Total assets	1,710,000
Liabilities and Stockholders' Equity	L.E.
Current liabilities	310,000
Long-term debt	500,000
Common stock, L.E.1 par	100,000
Additional paid-in capital	200,000
Retained earnings	600,000
Total liabilities and stockholders' equity	1,710,000

On December 31, 2023, Master Corporation acquired all the outstanding common stock of Single for L.E.1,560,000 cash, including direct out-of-pocket costs. On that date, the current fair value of Single's inventories was L.E.450,000 and the current fair value of Single's plant assets was L.E.1,000,000. The current fair values of all other assets and liabilities of Single were equal to their carrying amounts.

Prepare a working paper to compute the amount of goodwill to be displayed in the December 31, 2023, consolidated balance sheet of Master Corporation and subsidiary.
(Check Figure: Amount of Goodwill, L.E.620,000.)

(Exercise 4.4)

Following are the December 31, 2023 balance sheets of two Companies prior to their business combination:

POWER CORPORATION AND EFFORT COMPANY Separate Balance Sheets (prior to business combination) December 31, 2023		
	Power Corporation	**Effort Company**
Assets	L.E.	L.E.
Cash	3,000,000	100,000
Inventories (at first-in' first-out cost, which approximates current fair value)	2,000,000	200,000
Plant assets (net)	5,000,000	700,000*
Total assets	10,000,000	1,000,000

Liabilities and Stockholders' Equity	L.E.	L.E.
Current liabilities	600,000	100,000
Common stock, L.E.1 par	1,000,000	100,000
Additional paid-in capital	3,000,000	200,000
Retained earnings	5,400,000	600,000
Total liabilities & stockholder's equity	10,000,000	1,000,000

*Current fair value, Dec. 31, 2023, L.E.1,500,000.

a. On December 31, 2023, Power Corporation acquired all the outstanding common stock of Effort Company for L.E.2,000,000 cash. Prepare a working paper to compute the amount of goodwill to be displayed in the consolidated balance sheet of Power Corporation and subsidiary on December 31, 2023.
b. On December 31, 2023, Power Corporation acquired all the outstanding common stock of Effort Company for L.E.1,600,000 cash. Prepare a working paper to compute the amount of plant assets to be displayed in the consolidated balance sheet of Power Corporation and subsidiary on December 31, 2023.
(Check Figure: *b.* Plant assets, L.E.6,400,000.)

(Exercise 4.5)
The separate balance sheets of Green Corporation and White Company following their business combination, in which Green acquired all of White's outstanding common stock, were as follows:

GREEN CORPORATION AND WHITE COMPANY Separate Balance Sheets (following business combination) May 31, 2023		
	Green Corporation	**White Company**
Assets	L.E.	L.E.
Inventories	60,000	30,000
Other current assets	140,000	110,000
Investment in White Company common stock	250,000	
Plant assets (net)	220,000	160,000
Goodwill (net)	10,000	
Total assets	680,000	300,000
Liabilities and Stockholders' Equity	L.E.	L.E.
Current liabilities	100,000	70,000
Bonds payable	104,000	30,000
Common stock, L.E.1 par	200,000	80,000
Additional paid-in capital	116,000	70,000
Retained earnings	160,000	50,000
Total liabilities & stockholder's equity	680,000	300,000

On May 31, 2023, the current fair values of White's inventories and plant assets (net) were L.E.40,000 and L.E.180,000, respectively; the current fair values of its other assets and its liabilities were equal to their carrying amounts.

Prepare a consolidated balance sheet for Green Corporation and subsidiary on May 31, 2023, without using a working paper.
(Check Figure: Total assets, L.E.780,000.)

(Exercise 4.6)

On May 31, 2023, Egypt Corporation acquired for L.E.950,000 cash, including direct out-of-pocket costs of the business combination, all the outstanding common stock of Farmers Company. There was no contingent consideration involved in the combination. Farmers were to be a subsidiary of Egypt.

Additional Information for May 31, 2023

1. Farmers' stockholders' equity prior to the combination was as follows:

Common stock, L.E.1 par	L.E.100,000
Additional paid-in capital	200,000
Retained earnings	450,000
Total stockholders' equity	L.E.750,000

2. Farmers' liabilities had current fair values equal to their carrying amounts. current fair values of Farmers' inventories, land, and building (net) exceeded carrying amounts by L.E.60,000, L.E.40,000, and L.E.50,000, respectively.

Prepare working paper elimination, in journal entry format for the consolidated balance sheet of Egypt Corporation and subsidiary on May 31, 2023.
(Check Figure: Debit goodwill–Farmers, L.E.50,000.)

(Exercise 4.7)

The condensed separate and consolidated balance sheets of Petrol Corporation and its subsidiary, Oil Company, on the date of their business combination, were as follows:

PETROL CORPORATION AND SUBSIDIARY
Separate and Consolidated Balance Sheets (following business combination)
June 30, 2023

	Petrol Corporation	**Oil Company**	**Consolidated**
Assets	L.E.	L.E.	L.E.
Cash	100,000	40,000	140,000
Inventories	500,000	90,000	620,000
Other current assets	250,000	60,000	310,000
Investment in Oil Company common stock	440,000		
Plant assets (net)	1,000,000	360,000	1,440,000
Goodwill (net)	100,000		120,000
Total assets	2,390,000	550,000	2,620,000
Liabilities and Stockholders' Equity			
Income taxes payable	40,000	35,000	75,000
Other liabilities	580,600	195,000	775,600
Common stock	1,020,000	200,000	1,020,000
Additional paid-in capital	429,400	210,000	429,400
Retained earnings (deficit)	320,000	(90,000)	320,000
Total liabilities and stockholders' equity	2,390,000	550,000	2,620,000

Reconstruct the working paper elimination for Petrol Corporation and subsidiary on June 30, 2023 (in journal entry forma), indicated by the above data.
(Check Figure: Debit goodwill–Oil, L.E.20,000.)

(Exercise 4.8)

On November 1, 2023, Investor Company issued 10,000 shares of its L.E.10 par common stock (current fair value L.E.30) for 85 of the 100 outstanding shares of Investee Company's L.E.100 par common stock, in a business combination. Out-of-pocket costs of the combination were as follows:

Legal and finder's fees associated with the business combination	L.E.36,800
Costs incurred for SEC registration Statement for Investor common Stock	20,000
Total out-of-pocket costs	L.E.56,800

On November 1, 2023, the current fair values of Investee's identifiable net assets were equal to their carrying amounts. On that date, Investee's stockholders' equity consisted of the following:

Common stock, L.E.100 par	L.E. 10,000
Additional paid-in capital	140,000
Retained earnings	70,000
Total stockholders' equity	L.E.220,000

Prepare journal entries for Investor Company on November 1, 2023, to record the business combination with Investee Company.

(Exercise 4.9)

On February 28, 2023, Alexandria Corporation acquired 88% of the outstanding common stock of Tanta Company for L.E.50,000 cash and 5,000 shares of Alexandria's L.E.10 par common stock with a current fair value of L.E.20 a share. Out-of-pocket costs of the business combination paid by Alexandria on February 28, 2023, were as follows:

Legal and finder's fees associated with the business combination	L.E.15,000
Costs associated with SEC registration statement	10,000
Total out-of-pocket costs	L.E.25,000

On February 28, 2023, Tanta's stockholders' equity consisted of common stock, L.E.1 par, L.E.10,000; additional paid-in capital, L.E.30,000; and retained earnings, L.E.60,000. Carrying amounts of the three following identifiable assets or liabilities of Tanta were ***less than current fair values*** on February 28, 2023, by the amounts indicated:

Inventories	L.E.20,000
Plant assets (net)	80,000
Bonds payable, due February 28, 2029	30,000

a. Prepare journal entries for Alexandria on February 28, 2023, to record the business combination with Tanta Company.

b. Prepare a working paper to compute the following amounts for the consolidated balance sheet of Alexandria Corporation and subsidiary on February 28, 2023:

(1) Goodwill (neither Alexandria nor Tanta had goodwill in its separate balance sheet).

(2) Minority interest in net assets of subsidiary.

(Check Figure: *b*. (1) Goodwill, L.E.15,400)

(Exercise 4.10)

Cairo Corporation acquired 70% of the outstanding common stock of Menia Company on July 31, 2023. The unconsolidated balance

sheet of Cairo immediately after the business combination and the consolidated balance sheet of Cairo Corporation and subsidiary were as follows:

CAIRO CORPORATION **Unconsolidated and Consolidated Balance Sheets** **July 31, 2023**		
	Unconsolidated	**Consolidated**
Assets	L.E.	L.E.
Current assets	106,000	146,000
Investment in Menia Company common stock	100,000	
Plant assets (net)	270,000	370,000
Goodwill		11,100
Total assets	476,000	527,100
Liabilities and Stockholders' Equity	L.E.	L.E.
Current liabilities	15,000	28,000
Common stock, no par or stated value	350,000	350,000
Minority interest in subsidiary's net assets		38,100
Retained earnings	111,000	111,000
Total liabilities & stockholder's equity	476,000	527,100

Of the excess payment for the investment in Menia Company common stock, L.E.10,000 was ascribed (attributed) to undervaluation of Menia's plant assets and the remainder was ascribed to goodwill. Current assets of Menia included a L.E.2,000 receivable from Cairo that arose before the business combination.

a. Prepare a working paper to compute the total current assets in Menia Company's separate balance sheet on July 31, 2014.

b. Prepare a working paper to compute the total stockholders' equity in Menia Company's separate balance sheet on July 31, 2023.

c. Prepare a working paper to show how the goodwill of L.E.11,100 included in the July 31, 2023, consolidated balance sheet of Cairo Corporation and subsidiary was computed.

(Check Figure: *a.* Total current assets, L.E.42,000.)

(Exercise 4.11)

Assut Corporation acquired 80% of The outstanding common stock of Sohag Company on May 31, 2023, for L.E.760,000 cash, including direct out-of-pocket costs of the business combination. There was no contingent consideration involved in the combination. Sohag was to be a subsidiary of Assut.

Additional Information for May 31, 2023

1. Sohag Company's stockholders' equity prior to the combination was as follows:

Common stock, no par or stated value	L.E.300,000
Retained earnings	400,000
Total stockholders' equity	L.E.700,000

2. Differences between current fair values and carrying amounts of Sohag's identifiable assets were as follows (the current fair values f Sohag's other assets and its liabilities equalled their carrying amounts):

	Current Fair Values	Carrying Amounts	Differences
Inventories	120,000	80,000	40,000
Land	300,000	250,000	50,000
Building (net)	800,000	740,000	60,000
Totals L.E.	1,220,000	1,070,000	150,000

Prepare a working paper elimination, in journal entry format (omit explanation) for the consolidated balance sheet of Assut Corporation and subsidiary on May 31, 2023.
(Check Figure: Debit goodwill–Assut, L.E.80,000.)

Problems

(Problem 4.1)

On September 30, 2023, Aswan Corporation paid L.E.1,000,000 to stockholders of Edfo Company for 90,000 of Edfo's 100,000 outstanding shares of no-par, no-stated-value common stock; additionally, Aswan paid direct out-of-pocket costs of the combination totalling L.E.80,000 on that date. Carrying amounts and current fair values of Edfo's identifiable net assets on September 30, 2023, were analyzed as follows:

Common stock, no par	L.E.400,000
Retained earnings	500,000
Total carrying amount of identifiable net assets	L.E.900,000
Add: Differences between current fair value and carrying amount:	
Inventories	30,000
Plant assets (net)	60,000
Total current fair value of identifiable net assets	L.E.990,000

Instructions

a. Prepare journal entries for Aswan Corporation on September 30, 2023, to record the business combination with Edfo Company.

b. Prepare working paper elimination for Aswan Corporation and subsidiary (in journal entry format) on September 30, 2023.

(Check Figure: *b.* Debit goodwill–Aswan, L.E.189,000)

(Problem 4.2)

On September 30, 2023, Philly Corporation issued 100,000 shares of its no-par, no-stated-value common stock (current fair value L.E.12 a share) for 18,800 shares of the outstanding L.E.20 par common stock of Stype Company. The L.E.150,000 out-of-pocket costs of the business combination paid by Philly on September 30, 2023, were allocable as follows: 60% to finder's, legal, and accounting fees directly related to the business combination; 40% to the SEC registration statement for Philly's common stock issued in the business combination. There was no contingent consideration.

Immediately prior to the business combination, separate balance sheets of the constituent companies were as follows:

PHILLY CORPORATION AND STYPE COMPANY **Separate Balance Sheet (prior to business combination)** **September 30, 2023**		
	Philly Corporation	**Stype Company**
Assets	L.E.	L.E.
Cash	200,000	100,000
Trade accounts receivable (net)	400,000	200,000
Inventories (net)	600,000	300,000
Plant assets (net)	1,300,000	1,000,000
Total assets	2,500,000	1,600,000
Liabilities and Stockholders' Equity	L.E.	L.E.
Current liabilities	800,000	400,000
Long-term debt		100,000
Common stock, no par or stated value	1,200,000	
Common stock, L.E.20 par		400,000
Retained earnings	500,000	700,000
Total liabilities & stockholder's equity	2,500,000	1,600,000

Current fair values of Stype's identifiable net assets differed from their carrying amounts as follows:

Current Fair Values, Sep. 30, 2023	
Inventories	L.E. 340,000
Plant assets (net)	1,100,000
Long-term debt	90,000

Instructions

a. Prepare journal entries for Philly Corporation on September 30, 2023, to record the business combination with Stype Company.

b. Prepare a working paper for consolidated balance and related working paper elimination (in journal entry format) for Philly Corporation and subsidiary on September 30, 2023. Amounts in working paper should reflect the journal entries in *(a)*.

(Check Figure: *b.* debit goodwill—Philly, L.E.115,000.)

(Problem 4.3)

Separate balance sheets of Blue Corporation and Bird Company on May 31, 2023, together with current fair values of Bird's identifiable net assets, are as follows:

BLUE CORPORATION AND BIRD COMPANY
Separate Balance Sheets (prior to business combination)
May 31, 2023

		Bird Company	
	Blue Corporation	Carrying Amounts	Current Fair Values
Assets	L.E.	L.E.	L.E.
Cash	550,000	10,000	10,000
Trade accounts receivable (net)	700,000	60,000	60,000
Inventories	1,400,000	120,000	140,000
Plant assets (net)	2,850,000	610,000	690,000
Total assets	5,500,000	800,000	
Liabilities and Stockholders' Equity			
Current liabilities	500,000	80,000	80,000
Long-term debt	1,000,000	400,000	440,000
Common stock, L.E.10 par	1,500,000	100,000	
Additional paid-in capital	1,200,000	40,000	
Retained earnings	1,300,000	180,000	
Total liabilities and stockholders' equity	5,500,000	800,000	

On May 31, 2023, Blue acquired all 10,000 shares of Bird's outstanding common stock by paying L.E.300,000 cash to Bird's stockholders and L.E.50,000 cash for finder's and legal fees relating to the business combination. There was no contingent consideration, and Bird became a subsidiary of Blue.

Instructions

(a) Prepare journal entries for Blue Corporation to record the business combination with Bird Company on May 31, 2023.

(b) Prepare a working paper for consolidated balance sheet of Blue Corporation and subsidiary on May 31, 2023, and the related working paper elimination (in journal entry format). Amounts in the working papers should reflect the journal entries in *(a)*.

(Check Figure: *b.* Consolidated plant assets, L.E.3,510,000.)

(Problem 4.4)

On April 30, 2023, Red Corporation issued 30,000 shares of its no-par, no-stated-value common stock having a current fair value of L.E.20 a share for 8,000 shares of Bee Company's L.E.10 par common stock. There was no contingent consideration; out-of-pocket costs of the business combination, paid by Bee on behalf of Red on April 30, 2023, were as follows:

Finder's and legal fees relating to business combination	L.E.40,000
Costs associated with SEC registration statement	30,000
Total out-of-pocket costs of business combination	L.E.70,000

Separate balance sheets of the constituent companies on April 30, 2023, prior to the business combination, were as follows:

RED CORPORATION AND BEE COMPANY
Balance Sheet (prior to business combination)
April 30, 2014

	Red Corporation	Bee Company
Assets	L.E.	L.E.
Cash	50,000	150,000
Trade accounts receivable (net)	230,000	200,000
Inventories	400,000	350,000
Plant assets (net)	1,300,000	560,000
Total assets	1,980,000	1,260,000
Liabilities and Stockholders' Equity	L.E.	L.E.
Current liabilities	310,000	250,000
Long-term debt	800,000	600,000
Common stock, no par or stated value	500,000	
Common stock, L.E.10 par		100,000
Additional paid-in capital		360,000
Retained earnings (deficit)	370,000	(50,000)
Total liabilities and stockholders' equity	1,980,000	1,260,000

Current fair values of Bee's identifiable net assets were the same as their carrying amounts, except for the following:

Current Fair Values Apr. 30, 2023	
Inventories	L.E.440,000
Plant assets (net)	780,000
Long-term debt	620,000

Instructions

a. Prepare a journal entry for Bee Company on April 30, 2023, to record its payment of out-of-pocket costs of the business combination on behalf of Red Corporation.

b. Prepare journal entries for Red Corporation to record the business combination with Bee Company on April 30, 2023.

c. Prepare a working paper for consolidated balance sheet of Red Corporation and subsidiary on April 30, 2023, and the related working paper elimination (in journal entry format). Amounts in the working papers should reflect the journal entries in *(a)* and *(b)*.

(Check Figure: *c.* Minority interest in net assets, L.E.140,000.)

(Problem 4.5)

On July 31, 2023, Grey Corporation issued 20,000 shares of its L.E.2 par common stock (current fair value L.E.10 a share) for all 5,000 shares of outstanding L.E.5 par common stock of Eagle Company, which was to remain a separate corporation. Out-of-pocket costs of the business combination, paid by Grey on July 31, 2023, are shown below:

Finder's and legal fees related to business combination	L.E.20,000
Costs associated with SEC registration statement for Grey common stock	10,000
Total out-of-pocket costs of business combination	L.E.30,000

The constituent companies' separate balance sheets on July 31, 2023, prior to the business combination, were as follows:

GREY CORPORATION AND EAGLE COMPANY
Balance Sheet (prior to business combination)
July 31, 2023

	Grey Corporation	Eagle Company
Assets	L.E.	L.E.
Current assets	800,000	150,000
Plant assets (net)	2,400,000	300,000
Goodwill		20,000
Total assets	3,200,000	470,000
Liabilities and Stockholders' Equity	L.E.	L.E.
Current liabilities	400,000	120,000
Long-term debt	1,000,000	200,000
Common stock, L.E.2 par	800,000	
Common stock, L.E.5 par		25,000
Additional paid-in capital	400,000	50,000
Retained earnings	600,000	75,000
Total liabilities and stockholders' equity	3,200,000	470,000

Eagle's assets and liabilities having July 31, 2023, current fair values different from their carrying amounts were as follows:

	Carrying Amounts	Current Fair Values
Inventories	L.E. 60,000	65,000
Plant assets (net)	300,000	340,000
Long-term	200,000	190,000

There were no intercompany transactions prior to the business combination, and there was no contingent consideration in connection with the combination.

Instructions

a. Prepare Grey Corporation's journal entries on July 31, 2023, to record the business combination with Eagle Company.

b. Prepare working paper elimination (in journal entry format) and the related working paper for consolidated balance sheet of Grey Corporation and subsidiary on July 31, 2023. Amounts in the working papers should reflect the journal entries in *(a).*

(Check Figure: *b.* Consolidated goodwill, L.E.35,000.)

(Problem 4.6)

The unconsolidated and consolidated balance sheets of Sinai Corporation and subsidiary on August 31, 2023, the date of Sinai's business combination with Soda Company, are as follows:

SINAI CORPORATION Unconsolidated and Consolidated Balance Sheets August 31, 2023		
	Unconsolidated	**Consolidated**
Assets L.E.		
Cash	120,000	160,000
Trade accounts receivable, net	380,000	540,000
Inventories	470,000	730,000
Investment in Soda Company common stock	380,000	
Plant assets (net)	850,000	1,470,000
Goodwill		8,000
Total assets L.E.	2,200,000	2,908,000
Liabilities and Stockholders' Equity L.E.		
Current liabilities	430,000	690,000
Long-term debt	550,000	730,000
Premium on long-term debt		20,000
Minority interest in net assets of subsidiary		248,000
Common stock, L.E.1 par	500,000	500,000
Additional paid-in capital	440,000	440,000
Retained earnings	280,000	280,000
Total liabilities and stockholders' equity	2,200,000	2,908,000

On August 31, 2023, Sinai had paid cash of L.E.3 a share for 60% of the outstanding shares of Soda's L.E.1 par common stock and L.E.20,000 cash for legal fees in connection with the business combination. There was no contingent consideration. The equity (book value) of Soda's common stock on August 31, 2023, was L.E.2.8 a share, and the amount of Soda's retained earnings was twice a large as the amount of its additional paid-in capital. The excess of current fair value of Soda's plant assets over their carrying amount on August 31, 2023, was 1⅔ times as large as the comparable excess for Soda's inventories on that date. The current fair values of Soda's cash, trade accounts receivable (net), and current liabilities were equal to their carrying amounts on August 31, 2023.

Instructions

Reconstruct the working paper elimination (in journal entry format) for the working paper for consolidated balance sheet of Sinai Corporation and subsidiary on August 31, 2023.
(Check Figure: Debit additional paid-in capital, L.E.120,000.)

(Problem 4.7)

On October 31, 2023, Soft Corporation acquired 83% of the outstanding common stock of Hard Company in exchange for 50,000 shares of Soft's no-par, L.E.2 stated value (L.E.10 current fair value a share) common stock. There was no contingent consideration. Out-of-pocket costs of the business combination paid by Soft on October 31, 2023, were as follows:

Legal and finder's fees related to business combination	L.E.34,750
Costs associated with SEC registration statement for Soft's common stock	55,250
Total out-of-pocket costs of business combination	L.E.90,000

There were no intercompany transactions between the constituent companies prior to the business combination. Hard was to be a subsidiary of Soft. The separate balance sheets of the constituent companies prior to the business combination follow:

SOFT CORPORATION AND HARD COMPANY
Balance Sheet (prior to business combination)
October 31, 2023

	Soft Corporation	Hard Company
Assets	L.E.	L.E.
Cash	250,000	150,000
Inventories	860,000	600,000
Other current assets	500,000	260,000
Plant assets (net)	3,400,000	1,500,000
Patents (net)		80,000
Total assets	5,010,000	2,590,000
Liabilities and Stockholders' Equity	L.E.	L.E.
Income taxes payable	40,000	60,000
Other current liabilities	390,000	854,000
Long-term debt	950,000	1,240,000
Common stock, no par L.E.2 stated value	1,500,000	
Common stock, L.E.10 par		100,000
Additional paid-in capital	1,500,000	
Retained earnings	630,000	336,000
Total liabilities and stockholders' equity	5,010,000	2,590,000

Current fair values of Hard's identifiable net assets were the same as their carrying amounts on October 31, 2023, except for the following:

Current Fair Values	
Inventories	L.E. 620,000
Plant assets (net)	1,550,000
Patents (net)	95,000
Long-term debt	1,225,000

Instructions

a. Prepare Soft Corporation's journal entries on October 31, 2023, to record the business combination with Hard Company.

b. Prepare working paper eliminations (in journal entry format) on October 31, 2023, and the related working paper for the consolidated balance sheet of Soft Corporation and subsidiary. Amounts in the working papers should reflect the journal entries in *(a)*.

(Check Figure: Consolidated total assets, L.E.7,684,870.)

(Problem 4.8)

On January 31, 2023, Degla Corporation issued L.E.50,000 cash, 6,000 shares of L.E.2 par common stock (current fair value L.E.15 a share), and 5-year, 14%, L.E.50,000 promissory note payable for all 10,000 shares of Dina Company's outstanding common stock. The only out-of-pocket costs paid by Degla to complete the business combination were legal fees of L.E.10,000, because Degla's common stock issued in the combination was not subject to the registration requirements of the SEC. there was no contingent consideration, and 14% was the fair rate of interest for the promissory note issued by Degla in connection with the business combination.

Separate balance sheets of Degla and Dina on January 31, 2023, prior to the business combination, were as follows:

DEGLA CORPORATION AND DINA COMPANY
Separate Balance Sheets (prior to business combination)
January 31, 2023

	Degla Corporation	**Dina Company**
Assets	L.E.	L.E.
Inventories	380,000	60,000
Other current assets	640,000	130,000
Plant assets (net)	1,520,000	470,000
Intangible assets (net)	160,000	40,000
Total assets	2,700,000	700,000
Liabilities and Stockholders' Equity	L.E.	L.E.
Current liabilities	420,000	200,000
Long-term debt	650,000	300,000
Common stock, L.E.2 par	800,000	
Common stock, L.E.15 par		150,000
Additional paid-in capital	220,000	160,000
Retained earnings (deficit)	610,000	(110,000)
Total liabilities and stockholders' equity	2,700,000	700,000

Current fair values of Dina's identifiable net assets that differed from their carrying amounts on January 31, 2023, were as follows:

Current Fair Values	
Inventories	L.E. 70,000
Plant assets (net)	540,000
Intangible assets net	60,000
Long-term debt	350,000

Instructions

a. Prepare journal entries for Degla Corporation on January 31, 2023, to record its business combination with Dina Company.

b. Prepare a working paper for consolidated balance sheet of Degla Corporation and subsidiary on January 31, 2023, and the related working paper elimination (in journal entry format). Amounts in the working papers should reflect the journal entries in *(a)*.

(Check Figure: *b.* Consolidated intangible assets, L.E.215,000.)

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