Impact of Accounting for Operating Leases as Capital Leases

Virtually all firms have some amount of commitment under operating leases. The change in debt ratios for some firms is relatively minor, as is the case for PepsiCo. For other firms, particularly airlines and retail stores, the effect can be significant. Even for firms for which the effect is relatively small, adding the effect of capitalizing operating leases to the effect of other off-balance-sheet obligations can result in a combined material effect. Thus, the analyst should examine the effect of leases when assessing the risk and accounting quality of a firm's financial statements. The analyst should also consider the effects of off-balance-sheet leases when determining capital structure weights and debt costs for the weighted average cost of capital calculations used in enterprise valuation.

SUMMARY

This chapter explores various accounting issues related to measuring the financing activities of the firm. Both profitability analysis and risk analysis are affected by management's choice between interest-bearing debt and shareholders' equity to finance the acquisition of operating capacity. The proper measurement and reporting of liabilities enables the analyst to understand the risk of investing in the firm's debt and equity instruments, and the existence of off-balance-sheet arrangements complicates the analysis.

Although we provide a broad description of liability recognition, this chapter focuses primarily on the set of liabilities arising from transactions with lending institutions that generate notes and bonds payable. Typically, these liabilities are generated to raise funds for investments in long-term assets used in operations. The next chapter (Chapter 7) examines the accounting issues surrounding these long-term assets. Chapter 8 returns to measuring and reporting liabilities generated from operating activities, such as accounts payable, provisions, deferred tax liabilities, and pension liabilities.

QUESTIONS, EXERCISES, PROBLEMS, AND CASES

Questions and Exercises

6.1 COMMON EQUITY TRANSACTIONS. Describe the directional effect (increase, decrease, or no effect) of each transaction on the components of the book value of common shareholders' equity shown in the chart on the next page.

- **a.** Issuance of $1 par value common stock at an amount greater than par value
- **b.** Donation of land by a governmental unit to a corporation
- **c.** Cash dividend declared
- **d.** Previously declared cash dividend paid
- **e.** Property dividend declared and paid
- **f.** Large stock dividend declared and issued
- **g.** Small stock dividend declared and issued
- **h.** 2-for-1 stock split announced and issue
- **i.** Stock options granted
- **j.** Recognition of compensation expense on stock options
- **k.** Stock options exercised
- **l.** Stock options expired
- **m.** Treasury stock acquired (company uses the cost method)

n. Treasury stock in Transaction m reissued at an amount greater than original acquisition price
o. Treasury stock in Transaction m reissued at an amount less than the original acquisition price
p. Restricted stock issued (grant date)
q. Recognition of compensation expense related to restricted stock
r. Granting of stock appreciation rights to be settled with cash
s. Recognition of compensation expense on stock appreciation rights
t. Reacquisition and retirement of common stock at an amount greater than original issue price

Item	Common Stock	Additional Paid-in Capital	Deferred Compensation	Retained Earnings (use * to indicate income statement effect)	Treasury Stock at Cost	Total Common Shareholders' Equity
a						
b						
c						
...						

6.2 COMMON EQUITY ISSUE. Assume that a start-up manufacturing company raises capital through a series of equity issues.

a. Using the financial statement template below, summarize the financial statement effects of the following transactions. Identify the account affected and use plus and minus signs to indicate the increases and decreases in the specific element of the balance sheet (assets, liabilities, components of shareholders' equity).
   (1) Issues 100,000 shares of $1 par value common stock for $10 per share.
   (2) Receives land in exchange for 10,000 shares of $1 par common stock when the common stock is trading in the market at $15 per share. The land has no readily determinable market value.
   (3) Receives subscriptions for the issue of 40,000 shares of $1 par value common. The share issue price is $20, of which 30 percent is received as a down payment. Subsequently, the remaining 70 percent is received.

	Assets	=	Liabilities	+	Shareholders' Equity		
					CC	AOCI	RE

Journal entry:

b. In each case, how does the company measure the transaction? What measurement attribute is used?

6.3 DIVIDENDS. Following is the shareholders' equity section of All-Wood Doors on a day its common stock is trading at $130 per share.

Common stock ($2 par value, 40,000 shares issued and outstanding)	$ 80,000
Additional paid-in capital on common stock	1,600,000
Retained earnings	3,000,000

a. Use the financial statement template below to show the financial statement effects of the following dividend events. (Assume that the events are independent.)
(1) Cash dividend declaration and payment of $1 per share
(2) Property dividend declaration and payment of shares representing a short-term investment in Screen Products, Ltd., with a fair value of $10,000
(3) 10 percent stock dividend
(4) 100 percent stock dividend
(5) 3-for-1 stock split
(6) 1-for-2 reverse stock split

Assets	=	Liabilities	+	Shareholders' Equity		
				CC	AOCI	RE
Journal entry:						

b. Which events changed the book value of common equity? Under what conditions will these events lead to future increases and decreases in ROE?

6.4 CASH FLOW EFFECTS OF EQUITY AND DEBT FINANCING. Identify where the cash flow effect of each of the following transactions is reported in the statement of cash flows: operating, investing, or financing section. State the direction of each change. State *None* if there is no cash flow effect.

a. Issuance of stock for cash
b. Issuance of stock for land
c. Acquisition of treasury stock
d. Reissuance of treasury stock
e. Declaration of a cash dividend
f. Payment of a cash dividend previously declared
g. Declaration and issuance of a large stock dividend
h. Declaration and issuance of a small stock dividend
i. Granting of stock options
j. Exercise of stock options
k. Granting of RSUs
l. Issuance of long-term notes payable
m. Issuance of convertible bonds
n. Conversion of convertible bonds to common stock
o. Payment of interest on bonds
p. Retirement of bonds at book value
q. Retirement of bonds at a gain
r. Retirement of bonds at a loss

6.5 ACCOUNTING FOR A NOTE PAYABLE. Assume that on December 31, 2010, The Coca-Cola Company borrows money from a consortium of banks by issuing a

b. Refer to Part a. Lilly's statement of cash flows includes a cash inflow in the section on cash flows from financing activities of $12.5 million for Year 5 and $46.5 million for Year 4. The amounts are labeled "Issuance of common stock under stock plans." Who provided these cash inflows to Lilly? In general terms, how are the amounts determined?

c. Lilly states in the note: "Stock options are granted to employees at exercise prices equal to the fair market value of our stock at the dates of grant." Discuss why Lilly structured the stock option grants this way.

d. The note reports $397.5 million of remaining unrecognized compensation cost related to nonvested stock options. What portion of this amount will be reported as compensation expense in the second quarter ending June 30, Year 5? Does this amount represent total stock-based compensation expense for the quarter?

e. Prior to *Statement No. 123 (Revised 2004)*, firms were required to report pro forma earnings per share, taking into consideration stock-based compensation. As discussed in the chapter, *Statement No. 123 (Revised 2004)* requires stock-based compensation to be reported in the income statement, and thus included in the calculations of reported earnings per share. In addition to properly following GAAP (that is, *Statement No. 123 Revised 2004*), many firms present non-GAAP earnings numbers before deducting the effects of stock compensation as a supplemental disclosure in their annual reports (which is comparable to the old reported earnings number before 123R). Why do companies do this? Which earnings number is more meaningful, net income or this non-GAAP measure?

6.23 STOCK-BASED COMPENSATION–VESTING AND VALUATION MODELS. Exhibits 6.16 and 6.17 provide footnote excerpts to the financial reports of The Coca-Cola Company and Eli Lilly and Company that discuss the stock option grants given to the employees of the two firms. Each firm uses options extensively to reward employees for their performance.

Required

Review Exhibits 6.16 and 6.17 and answer the following questions.

a. Explain the concept of vesting. Discuss why firms typically include a vesting feature in the stock-based compensation plans that they offer to their employees.

b. What are the vesting characteristics of the two plans discussed in the exhibits? What effect do they have on stock-based compensation expense using the fair value method as required by *Statement No. 123 (Revised 2004)?*

c. For each firm, (1) what is the life of the options granted, (2) how does option life relate to the vesting period, and (3) why might the weighted-average *expected* life of the options be less than the full life of the options?

d. The Coca-Cola Company uses the Black-Scholes valuation model for estimating the fair value of the stock options, whereas Eli Lilly and Company utilizes a lattice-based option valuation model. Both valuation techniques are permitted by GAAP. Perform an Internet search to determine which valuation model is more commonly used by the largest publicly held firms. Speculate on why this is the case.

6.24 INTERPRETING STOCK OPTION DISCLOSURES. Exhibit 6.18 summarizes the information disclosed by General Electric Company (GE) regarding its stock option plans for Year 2 to Year 4. Assume an income tax rate of 35 percent.

QUESTIONS, EXERCISES, PROBLEMS, AND CASES

Questions and Exercises

7.1 CAPITALIZATION VERSUS EXPENSING DECISION. When a firm incurs costs on an item to be used in operations, management must decide whether to treat the cost as an asset or an expense. Assume that a company used cash to acquire machinery expected to contribute to the generation of revenues over a three-year period and the company erroneously expensed the cost to acquire the machine.

a. Describe the effects on ROA of the error over the three-year period.
b. Explain how the error would affect the statement of cash flows.

7.2 SELF-CONSTRUCTED ASSETS. Assume that a company needs to acquire a large special-purpose materials handling facility. Given that no outside vendor exists for this type of facility and that the company has available engineering, management, and productive capacity, the company borrows funds and builds the facility. Identify the costs to construct this facility that should be capitalized as assets.

7.3 NATURAL RESOURCES. The three types of costs incurred in oil production are acquisition costs (costs to acquire the oil fields, minus the cost of the land, plus the present value of future cash flows necessary to restore the site), exploration costs (costs of drilling), and development costs (pipes, roads, and so on, to extract and transport the oil to refineries). Should each of these costs be capitalized or expensed? Explain.

7.4 RESEARCH AND DEVELOPMENT COSTS. U.S. GAAP requires firms to expense immediately all internal expenditures for R&D costs. Alternatively, GAAP could require firms to capitalize and subsequently amortize all internal expenditures on R&D that have future potential. Why have standard setters chosen not to allow the capitalization alternative? How would analysts be better served if GAAP required capitalization of R&D costs?

7.5 CAPITALIZATION OF SOFTWARE DEVELOPMENT COSTS. In practice, very few firms capitalize costs of developing computer software. However, *Statement No. 86* requires that firms capitalize (and subsequently amortize) development costs once the "technological feasibility" stage of a product is reached. Review the Adobe Systems illustration in the chapter (Example 5) and discuss why the firm does not capitalize any software development costs.

7.6 TESTING FOR GOODWILL IMPAIRMENT. Goodwill is an intangible asset that firms report on their balance sheets as a result of acquiring other firms. Goodwill generally has an indefinite life and should not be amortized, but should be tested for impairment at least annually. Describe the procedures prescribed by U.S. GAAP and IFRS to test for goodwill impairment. How do these procedures differ from the procedure followed for testing the impairment of a patent, which is an intangible asset with a definite life?

7.7 EARNINGS MANAGEMENT AND DEPRECIATION MEASUREMENT. Earnings management entails managers using judgment and reporting estimates in such a way as to alter reported earnings to their favor.

a. Discuss the three factors that must be estimated in measuring depreciation.
b. Provide an illustration as to how each of these factors can be employed to manage earnings.

7.8 CORPORATE ACQUISITIONS AND GOODWILL. Not every acquisition results in goodwill reported in the consolidated balance sheet. Describe the valuation procedures followed by the acquiring firms to determine whether any goodwill should be recorded as a result of an acquisition and the circumstances that could lead to no recognition of goodwill in an acquisition.

7.9 CORPORATE ACQUISITIONS AND ACQUISITION RESERVES. Often the application of the acquisitions method entails establishing one or more acquisition reserves. Define an acquisition reserve, provide several examples of such reserves, and discuss how the quality of accounting information can be diminished as a result of misusing acquisition reserves.

7.10 ACCOUNTING FOR AVAILABLE-FOR-SALE AND TRADING MARKETABLE EQUITY SECURITIES. Firms invest in marketable securities for a variety of reasons. One of the most common reasons is to temporarily invest excess cash. Securities that qualify for the available-for-sale reporting classification are accounted for differently from those that qualify for the trading reporting classification. Describe the similarity between the reporting for the two classifications. Also describe the differences in reporting between the two classifications.

7.11 EQUITY METHOD FOR MINORITY, ACTIVE INVESTMENTS. GAAP requires firms to account for equity investments in which ownership is between 20 and 50 percent using the equity method. Ace Corporation owns 35 percent of Spear Corporation during 2010. Spear Corporation reported net income of $100.4 million for 2010 and declared and paid dividends of $25 million during the year.

- **a.** Calculate the equity income that Ace Corporation reports in 2010 related to its ownership in Spear Corporation.
- **b.** What does Ace Corporation report in its statement of cash flows for 2010 related to its ownership in Spear Corporation?
- **c.** Assuming that Ace Corporation's balance sheet account, Investment in Spear Corporation, is $1,100 million at the beginning of 2010, what is the balance in the account at the end of 2010? Support your answers with calculations.

7.12 CONSOLIDATION OF VARIABLE-INTEREST ENTITIES. Some accounting theorists propose that firms should consolidate any entity in which they have a "controlling financial interest." Typically, the percentage of equity ownership that one firm has in another entity determines whether consolidation is appropriate, with greater than 50 percent ownership requiring consolidation. Why is the percentage of ownership criterion often *not* appropriate for judging whether a VIE should be consolidated? What criterion is used to determine whether a VIE should be consolidated?

7.13 CHOICE OF A FUNCTIONAL CURRENCY. Choosing the functional currency is a key decision for translating the financial statements of foreign entities of U.S. firms into U.S. dollars. Qing Corporation, a U.S. firm that sells car batteries, formed a wholly owned subsidiary in Mexico to manufacture components needed in the production of the batteries. Approximately 50 percent of the subsidiary's sales are to Qing Corporation. The subsidiary also sells the components it manufactures to independent third parties, and these sales are denominated in Mexican pesos. Financing for the manufacturing plants in Mexico is denominated in U.S. dollars, but labor contracts are denominated in both dollars and pesos. All material contracts are denominated in Mexican pesos. Senior managers of

the subsidiary are employees of Qing Corporation who have been transferred to the subsidiary for a tour of international service. Is the functional currency of the subsidiary the peso or the U.S. dollar? Explain your reasoning.

7.14 FOREIGN CURRENCY AS FUNCTIONAL CURRENCY. Identify the exchange rates used to translate income statement and balance sheet items when the foreign currency is defined as the functional currency. Discuss the logic for the use of the exchange rates you identified.

Problems and Cases

7.15 ANALYZING DISCLOSURES REGARDING FIXED ASSETS. Exhibit 7.29 presents selected financial statement data for three chemical companies: Monsanto Company, Olin Corporation, and NewMarket Corporation. (NewMarket was formed from a merger of Ethyl Corporation and Afton Chemical Corporation.)

Required

a. Compute the average total depreciable life of assets in use for each firm.
b. Compute the average age to date of depreciable assets in use for each firm at the end of the year.

EXHIBIT 7.29

Three Chemical Companies
Selected Financial Statement Data on Depreciable Assets
(amounts in millions)
(Problem 7.15)

	NewMarket Corporation	Monsanto Company	Olin Corporation
Depreciable Assets at Cost:			
Beginning of year	$752	$4,611	$1,796
End of year	777	4,604	1,826
Accumulated Depreciation:			
Beginning of year	584	2,331	1,301
End of year	611	2,517	1,348
Net Income	33	267	55
Depreciation expense	27	328	72
Deferred tax liability relating to depreciable assets:			
Beginning of year	13	267	83
End of year	9	256	96
Income tax rate	35%	35%	35%
Depreciation method for financial reporting	Straight-Line	Straight-Line	Straight-Line
Depreciation method for tax reporting	Accelerated	Accelerated	Accelerated

c. Compute the amount of depreciation expense recognized for tax purposes for each firm for the year using the amount of the deferred taxes liability related to depreciation timing differences.
d. Compute the amount of net income for the year for each firm assuming that depreciation expense for financial reporting equals the amount computed in Part c for tax reporting.
e. Compute the amount each company would report for property, plant, and equipment (net) at the end of the year if it had used accelerated (tax reporting) depreciation instead of straight-line depreciation.
f. What factors might explain the difference in average total life of the assets of NewMarket Corporation and Olin Corporation relative to the assets of Monsanto Company?
g. What factors might explain the older average age for depreciable assets of NewMarket Corporation and Olin Corporation relative to Monsanto Company?

7.16 ASSET IMPAIRMENTS

Hammerhead Paper Company owns a press used in the production of fine paper products. The press originally cost \$2,000,000, and it has a current carrying amount of \$1,200,000. A decrease in the demand for fine paper products has caused the company to reassess the future cash flows from using the machine. The company now estimates that it will receive cash flows of \$160,000 per year for 12 years. The company uses a 10 percent discount rate to compute the present value for this investment. A similar machine recently sold for \$1,000,000 in the secondhand market. Hammerhead estimates that it would cost \$50,000 to sell the machine.

Required

a. Compute the amount of Hammerhead's press impairment, if any, under U.S. GAAP and IFRS.

Sterling Co. acquires Vineyard Aging, Inc., on January 1, 2010, by paying \$2,000,000 in cash. At the date of acquisition, the price is allocated as follows:

Price paid	\$ 2,000,000
Fair value of Vineyard's identifiable assets	(1,600,000)
Goodwill	\$ 400,000

One year later on December 31, 2010, Sterling estimates the fair value of the unit to be \$1,800,000. The carrying value of Vineyard's identifiable assets is \$1,500,000 after impairment tests are applied.

Required

b. Compute the amount of Sterling's goodwill impairment, if any.
c. How is the goodwill impairment reflected in the financial statements?

7.17 UPWARD REVALUATIONS UNDER IFRS

Bed and Breakfast (B&B), an Italian company operating in the Tuscany region, follows IFRS and has made the choice to remeasure long-lived assets at fair value. B&B purchased land in 2009 for €150,000. At the end of the next four years, the land is worth €160,000 in 2009, €155,000 in 2010, €140,000 in 2011, and €145,000 in 2012.

Required

a. Describe how B&B will reflect the changes in the land's value in each of its annual financial statements.

b. Assume that the asset was a building with a ten-year remaining useful life as of the end of 2009. After writing the building upward to €160,000, how much should B&B charge to depreciation expense in 2009?

7.18 APPLICATION OF *STATEMENT NO. 115* FOR INVESTMENTS IN MARKETABLE EQUITY SECURITIES. SunTrust Banks owns a large block of Coca-Cola Company (Coke) common stock that it has held for many years. SunTrust indicates in a note to its financial statements that all equity securities held by the bank, including its investment in Coke stock, are classified as available for sale. A recent annual report of SunTrust reports the following information for its Coke investment (amounts in thousands):

Coke common stock investment, market value on December 31, 2006	$2,324,826
Coke common stock investment, market value on December 31, 2005	$1,945,622
Net income for 2006	$2,109,742

Required

a. Calculate the effect of the change in the market value of SunTrust's investment in Coke's common stock on SunTrust's 2006 (1) net income and (2) shareholders' equity. Ignore taxes.

b. How would your answer to Part a differ if SunTrust classified its investment in Coke's common stock as a trading security?

c. Does the value reported on SunTrust's balance sheet for the investment in Coke's stock differ depending on the firm's reason for holding the stock (that is, whether it is classified as available for sale versus trading by management)? Explain.

7.19 EFFECT OF AN ACQUISTION ON THE DATE OF ACQUISITION BALANCE SHEET. Lexington Corporation acquired all of the outstanding common stock of Chalfont, Inc., on January 1, 2009. Lexington gave shares of its no par common stock with a market value of $504 million in exchange for the Chalfont common stock. Chalfont will remain a legally separate entity after the exchange, but Lexington will prepare consolidated financial statements with Chalfont each period. Exhibit 7.30 presents the balance sheets of Lexington and Chalfont on January 1, 2009, just prior to the acquisition. The market value of Chalfont's fixed assets exceeds their book value by $80 million. Chalfont owns a copyright with a market value of $50 million. Chalfont is a defendant in a lawsuit that it expects to settle during 2009 at a cost of $30 million. The firm carries no insurance against such lawsuits. Lexington plans to establish an acquisition reserve for this lawsuit.

Required

a. Prepare a schedule that shows the allocation of the consideration given to individual assets and liabilities under the acquisition method. Ignore deferred tax effects.

b. Prepare a consolidated balance sheet for Lexington and Chalfont on January 1, 2009. Show your supporting calculations for any amount that is not simply the sum of the amounts for Lexington and Chalfont from their separate financial records.

Part V—Investments in Long-Lived Assets

Presented below is a portion of Note 8 to Starbucks' 2008 Consolidated Financial Statements.

Note 8: Property, Plant and Equipment
Property, plant and equipment consisted of the following *(in millions)*:

Fiscal Year Ended	Sep 28, 2008	Sep 30, 2007
Land	$ 59.1	$ 56.2
Buildings	217.7	161.7
Leasehold improvements	3,363.1	3,179.6
Store equipment	1,045.3	1,007.0
Roasting equipment	220.7	208.8
Furniture, fixtures and other	517.8	477.9
Work in progress	293.6	215.3
	$ 5,717.3	$ 5,306.5
Less accumulated depreciation and amortization	(2,760.9)	(2,416.1)
Property, plant and equipment, net	$ 2,956.4	$ 2,890.4

Required

a. Estimate the average total estimated useful life of depreciable property, plant, and equipment. Starbucks reports $604.5 million of depreciation and amortization in the statement of cash flows, of which $1.5 million relates to amortization of limited-life intangible assets. Does the estimate reconcile with stated accounting policy on useful lives for property, plant, and equipment? Explain.

b. How should an analyst interpret fluctuations in this estimate for a given company over time? How should an analyst interpret differences in this estimate between a company and its competitors?

c. Estimate the average age of depreciable assets, the percentage of PP&E that has been used up, and the remaining useful life. How might an analyst use this information?

Part VI—Brand Name

In 2008, Interbrand listed Starbucks as having the 85th most valuable brand name in the world and estimated brand value to be $3.9 billion. Examine the disclosures for intangible long-lived assets in Part II and tangible long-lived assets in Part V. Where in the financial statements does Starbucks disclose brand value?

CASE 7.2

DISNEY ACQUISITION OF MARVEL ENTERTAINMENT

In September 2009, The Walt Disney Company announced that it would acquire Marvel Entertainment in a $4 billion cash and common stock deal. On a per-share basis, the consideration given by Disney to Marvel shareholders represents a 29 percent premium over Marvel's share price at the date of acquisition. Disney acquires the more than 5,000 characters in Marvel's library, including Iron Man, Spider-Man, X-Men, Captain America, and the Fantastic Four. Exhibit 7.41 presents the Condensed Consolidated Balance Sheet of Marvel at the end of its June 30, 2009 second quarter.

EXHIBIT 7.41

Marvel Entertainment, Inc.
Condensed Consolidated Balance Sheets
(unaudited)

	June 30, 2009	December 31, 2008
	(in thousands, except per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 81,039	$105,335
Restricted cash	38,220	12,272
Short-term investments	—	32,975
Accounts receivable, net	29,471	144,487
Inventories, net	13,473	11,362
Income tax receivable	206	2,029
Deferred income taxes, net	25,497	34,072
Prepaid expenses and other current assets	9,164	5,135
Total current assets	$197,070	$347,667
Fixed assets, net	4,194	3,432
Film inventory, net	192,068	181,564
Goodwill	346,152	346,152
Accounts receivable, non-current portion	7,010	1,321
Income tax receivable, non-current portion	5,906	5,906
Deferred income taxes, net—non-current portion	17,046	13,032
Deferred financing costs	3,320	5,810
Restricted cash, non-current portion	42,274	31,375
Other assets	5,489	455
Total assets	$820,529	$936,714
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 2,860	$ 2,025
Accrued royalties	89,912	76,580
Accrued expenses and other current liabilities	33,826	40,635
Deferred revenue	67,468	81,335
Film facility	—	204,800
Total current liabilities	$194,066	$405,375
Accrued royalties, non-current portion	806	10,499
Deferred revenue, non-current portion	93,696	48,939
Film facility, non-current portion	—	8,201
Income tax payable	66,522	59,267
Other liabilities	10,680	8,612
Total liabilities	$365,770	$540,893

EXHIBIT 7.41 (Continued)

	June 30, 2009	December 31, 2008
	(in thousands, except per share amounts)	
Commitments and contingencies	—	—
Marvel Entertainment, Inc. stockholders' equity:		
Preferred stock, $.01 par value, 100,000,000 shares authorized, none issued	—	—
Common stock, $.01 par value, 250,000,000 shares authorized, 134,681,030 issued and 77,997,619 outstanding in 2009 and 134,397,258 issued and 78,408,082 outstanding in 2008	$ 1,347	$ 1,344
Additional paid-in capital	752,438	750,132
Retained earnings	628,628	555,125
Accumulated other comprehensive loss	(4,574)	(4,617)
Total Marvel Entertainment, Inc. stockholders' equity before treasury stock	$1,377,839	$1,301,984
Treasury stock, at cost, 56,683,411 shares in 2009 and 55,989,176 shares in 2008	(921,700)	(905,293)
Total Marvel Entertainment, Inc. stockholders' equity	$ 456,139	$ 396,691
Noncontrolling interest in consolidated Joint Venture	(1,380)	(870)
Total equity	$ 454,759	$ 395,821
Total liabilities and equity	$ 820,529	$ 936,714

Required

a. From a strategic perspective, discuss why you believe Disney would make this acquisition.

b. Assuming that the assets and liabilities of Marvel approximate their individual fair values at the date of acquisition, compute goodwill.

c. This is a 100 percent acquisition. What role does the 29 percent premium play in the computation of goodwill? If this were a less than 100 percent acquisition, how would the 29 percent premium affect the computation of the noncontrolling interest?

d. Disney will record a decrease in its cash and an increase in its shareholders' equity totaling $4 billion at the date of acquisition. Contrast the rest of the financial statement effects on Disney's own records and on its consolidated balance sheet between two scenarios: Marvel is dissolved (a merger) and Marvel continues to exist as a separate legal entity (an acquisition).

e. It is unlikely that the assets and liabilities of Marvel as shown in the condensed quarterly balance sheet approximate their individual fair values at the date of acquisition. Indeed, some of Marvel's most valuable resources might not be recognized on their balance sheet. As a result, the entire excess acquisition price is not likely to be assigned to goodwill. Identify items that are likely to receive a portion of the allocation based on the differences between their book values and fair values.