Greener Pastures? The Morning Dew Dairy Case

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Abstract
This case study deals with some of the practical considerations surrounding the accounting for the acquisition of a closely-held integrated dairy products operation and the subsequent disposal of a portion of the acquired assets. Specifically use and oversight of appraisers for determining fair value amounts necessary for acquisition accounting is examined. Additionally, the accounting implications of the subsequent disposal of assets are considered in light of the initial acquisition accounting.

The Case (Part 1)
Jack Green had just returned from ten days of hiking the John Muir Trail. Hiking in the Sierra Nevada Range of California is one of Jack's favorite pastimes and he never tires of the Muir Trail. Jack is an audit manager for Garcia, Weir & Hart LLP. Jack specializes in large closely held companies and has an extensive client list. Upon returning to his vehicle and turning on his Smartphone he notices several text messages from one of his clients Grady Williams. Although reluctant to get back into work, Jack and Grady are friends so he immediately returns his call. Grady is the CFO of Morning Dew Dairy and interestingly Jack worked as a milkman for five years in the Midwest before attending university. This helped establish the friendship between the two accountants and they constantly make milkman jokes whenever they work together.

Grady Williams informs Jack that his firm, Morning Dew Dairy, Inc. (MDD), just acquired Rio Grande Dairy. MDD produces a variety of consumer dairy products such as milk, cheese, spreads and desserts. They are a closely-held third-generation family-owned corporation distributing through grocery stores in California and Oregon. They have production facilities in Yakima, Washington, Petaluma and Bakersfield, California.

Grady wants Jack to advise him on what steps might be necessary to make sure the accounting for the acquisition goes smoothly. Jack asks for a narrative of the transaction so he can get as much information as possible and subsequently receives the following information via email from Grady's administrative assistant.

> Morning Dew has a December 31 year end. Recently (October 1, Year 1) MDD entered into a binding agreement to purchase Rio Grande Dairy (Rio). Rio is also a multi-generational closely-held, family-owned corporation. Rio has production facilities in El Paso, Texas, Boise, Idaho, and Ventura, California.
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> Both firms have substantial holdings of real estate, livestock and equipment used in farming, production and transportation. As well as having their own dairy farming operations, they both have contracts with surrounding dairies to provide MDD and Rio with raw milk. Both also have very similar product lines. Rio, however, is the market leader in a line of Mexican style cheeses that Morning Dew is very interested in adding to their existing distribution network. On the other hand, Morning Dew has a line of yogurt products, which Rio does not, and Morning Dew plans to introduce those products to Rio's distribution network. Morning Dew intends to keep the Rio Grande label as it

enjoys considerable brand loyalty in the Latino community. Both of the firms' other product lines, milk, spreads and Anglo style cheeses compete heavily with each other in the profitable southern California marketplace. Morning Dew intends on blending the complimentary product lines into a single distribution network.

The purchase price for Rio Grande Dairy is $75,000,000 and the deal closes on June 1, Year 2. The acquisition is being funded with a combination of cash, bank financing and outside institutional investors that will have a minority stock interest in Morning Dew.

As Jack processes all of the information Grady provided he recalls attending a CPE (continuing professional education) course on Business Combinations recently that was sponsored by an appraisal firm. After some thought, Jack decides that he needs answers to the following questions and gives the assignment of answering the questions to you the newest hire at Garcia, Weir & Hart LLP.

Part 1 Questions:

1) Will an appraisal or appraisals be required to account for this acquisition?
2) If yes to question 1, what appraisal(s) will be required?
3) If needed, when will the appraisals need to take place?
4) Who would engage the appraiser(s)?
5) Should audit firms be involved in the selection of the appraiser(s)?
6) How should MDD account for the costs of appraisals if required?
7) From a practical standpoint, if multiple appraisers are utilized, what should be done to coordinate their activities?

The Case (Part 2)

Two years after Morning Dew acquired Rio (June 1, Year 4) the management of MDD decides to sell the Ventura dairy farm and production facility and move Ventura's Rio product line operations to the Morning Dew facilities in Bakersfield, California. MDD management does not want the Ventura facility to be sold to a competitor, especially their main competitor the well-established Mexican cheese producer Antonio's Queso Excelente. Consequently, MDD plans to auction all of the Ventura production equipment and livestock. Terms of the auction scheduled to take place during the second quarter of Year 5, will require all equipment and livestock be removed from the facilities within thirty and ten days respectively. The real estate will then be auctioned, likely in July of Year 5, thus ensuring that competitors cannot acquire the facility intact. Additionally, the purchaser of the property will have to enter into a ten year covenant not-to-compete. MDD will retain all current contracts that the Ventura operation has with other milk producers and ship the raw milk to Bakersfield for processing and production of Rio product lines.

As a result of the original appraisal(s) undertaken to facilitate the acquisition two years prior, the following purchase price allocation was made:

Acquisition	
Purchase Price	75,000,000
Cash, A/R, Inventory	10,000,000
Fair Value of Equipment & Livestock	30,000,000
Fair Value of Real Estate	40,000,000
Fair Value of Intangible Assets	10,000,000
Fair Value of Liabilities	30,000,000
Net Fair Value	60,000,000
Goodwill	15,000,000

Jack recalls that you worked on the acquisition project two years ago and has ask you to assist in this years' audit of Morning Dew Dairy, Inc. Now you are a senior on the audit staff and again Jack asks you to respond to the following questions regarding the engagement.

Part 2 Questions:

1. Aside from the normal on-going issues relating to the audit, are there any concerns that need to be addressed in regard to MDD's plans for the Ventura operation? Are any non-typical disclosures required?
2. Is there a need for any appraisal(s)? If yes, what needs to be appraised and why?

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