

新世纪高校**会计学**英文版教材

ADVANCED  
ACCOUNTING

(7th Edition)

# 高级会计学

(第 7 版)

Floyd A. Beams

John A. Brozovsky 著

Craig D. Shoulders



上海财经大学出版社  
Shanghai University of  
Finance & Economics Press



新世纪高校会计学教材译丛

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**Floyd A. Beams**

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*Virginia Polytechnic Institute and State University*

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# Preface

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This seventh edition of *Advanced Accounting* contains 21 chapters plus two appendices and is designed for financial accounting courses above the intermediate level. The seventh edition has been updated to reflect recent business developments and changes in accounting standards and regulatory requirements. The chapter content is revised for better and more efficient coverage.

An important feature of this book is its student orientation, and special effort was expended to maintain that emphasis in this seventh edition. The student-oriented features include the shading of working paper entries, presenting working papers on single upright pages, and integrating excerpts from business publications and corporate annual reports in the text. A student orientation is also reflected in the assignment material, which is designed to provide variety and maintain student interest. The text includes many exhibits that summarize complex material and both clarify and reinforce the underlying concepts. All exhibits should be read and reviewed in conjunction with the text. The assignment material, including items from past CPA Examinations, is closely aligned with chapter coverage. In addition, the names of parent and subsidiary companies begin with P and S for convenient identification and reference.

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## NEW TO THIS EDITION

The most important changes in this seventh edition of *Advanced Accounting* include:

- Chapter 10 has been updated to include changes in the handling of earnings per share introduced in *Statement No. 128*. The tax section was also modified to incorporate the deductibility of goodwill in “taxable” business combinations.
- Chapter 13 has been updated to incorporate the new hedging rules introduced in *Statement No. 133*, “Accounting for Derivative Instruments and Hedging Activities.”
- Chapter 15 has been updated for the modification of segment reporting according to *Statement No. 131*.
- Chapters 19 through 21 have been totally reorganized and updated. The addition of a government and not-for-profit expert in Dr. Craig Shoulders has provided a very significant improvement in the handling of the not-for-profit area of accounting.

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## ORGANIZATION

The first 11 chapters cover business combinations, the equity and cost methods of accounting for investments in common stock, and consolidated financial statements. This emphasis reflects the importance of business combinations and consolidations in advanced accounting courses, as well as in financial accounting and reporting practices.

Accounting standards for business combinations under the purchase and pooling of interests methods are introduced in Chapter 1, along with applicable accounting and reporting standards. Chapter 1 also provides relevant background material relating to the form and economic impact of business combinations. The Financial Accounting Standards Board (FASB) has indicated that it plans to move toward aligning the standards of U.S. generally accepted accounting principles with those of other nations, particularly those of our NAFTA trading partners. For example, the standard-setting boards of the United States and Canada held joint meetings in their deliberations on revised segment reporting principles (*Statement No. 131*), and the FASB's stated objectives for the earnings-per-share standard (*Statement No. 128*) include making EPS computations similar to those of other countries. In light of this trend, it is likely that the long-awaited standards for consolidation principles will also reflect some movement toward international standards. Differences in international accounting related to business combinations are introduced in Chapter 1.

The equity method of accounting as a one-line consolidation is discussed in Chapter 2 and integrated throughout subsequent chapters on consolidations. This parallel one-line consolidation/consolidation coverage permits alternate computations for such key concepts as consolidated net income and consolidated retained earnings and helps the instructor explain the objectives of consolidation procedures. It also permits students to check their logic by alternative approaches to key computations.

The one-line consolidation is established as the standard for a parent company in accounting for its subsidiaries, but the coverage does not ignore situations in which the parent company uses the cost method or an incomplete equity method to account for its subsidiaries and other investees. These methods are illustrated in the text and included in assignment material so that students are prepared for consolidation assignments regardless of the method used by the parent company in accounting for its subsidiary investments.

Accounting and reporting matters related to pooled subsidiaries are integrated into Chapters 3 through 11. Consolidated financial statements and push-down accounting are introduced in Chapter 3. Chapter 3 also includes an illustration of two methods considered by the FASB for allocating the purchase price to (1) the *total* fair values of the subsidiary's identifiable net assets and *purchased* goodwill and (2) the *total* fair values of the subsidiaries identifiable net assets and *implied* goodwill.

Chapter 4 introduces the student to consolidation working paper techniques and procedures. The three-section, financial statement working paper approach is presented as basic, but the trial balance approach is also illustrated and included in the problem material. Consolidation working papers for a parent company that uses the equity method as a one-line consolidation are presented first to set the standard. Subsequently, working papers are illustrated under an incomplete (or simple) equity method and the cost method, both for the year of acquisition and the following year.

Consolidation under the cost and incomplete equity methods is illustrated using both the traditional approach (alternate working paper entries) and the conversion-to-equity approach (adjusted to the equity method through a schedule and a working paper entry).

Intercompany transactions involving inventories, plant assets, and bonds are covered in Chapters 5, 6, and 7. Chapter 8 covers ownership changes in subsidiaries.

Chapter 9 covers complex affiliation structures, and Chapter 10 covers subsidiaries with preferred stock, consolidated earnings per share, and income taxation for consolidated entities.

Chapter 11 covers consolidation theories, leveraged buyouts, push-down accounting, and corporate joint ventures. An appendix to the chapter discusses current

cost implications for consolidations. Chapters 9, 10, and 11 cover specialized topics, so their coverage is not essential background for assignment of subsequent chapters.

Chapter 12 covers accounting and reporting practices for branch operations, including the use of perpetual inventory practices in the combining working papers. The use of perpetual inventory procedures makes the combining working paper entries for branches compatible with those for consolidations.

Foreign currency issues continue to be important to American business enterprises. The survival of many American businesses depends on access to foreign markets, suppliers, and capital. Chapter 13 covers foreign currency transactions, including imports and exports and forward or similar contracts to hedge against exchange losses. It has been updated for *FASB Statement 133*. Chapter 14 covers translation and remeasurement of foreign-entity financial statements, one-line consolidations of equity investees, consolidation of foreign subsidiaries for external reporting purposes, and combining foreign branch operations.

Chapter 15 examines disclosures for industry segments and interim financial reporting and has been updated for *FASB Statement 131*. Chapter 16 covers organization, operations, and dissolution of partnership entities, and Chapter 17 extends partnership coverage to liquidations.

Chapter 18 covers corporate liquidations, reorganizations, and debt restructurings for financially distressed companies.

Chapters 19 and 20 provide an introduction to governmental accounting, and the final chapter (Chapter 21) introduces accounting for voluntary health and welfare organizations, hospitals, and colleges and universities. These chapters have been totally reorganized and updated to provide the best available assistance for the student to gain a basic grasp of not-for-profit accounting.

Appendix A provides an overview of SEC accounting requirements, and Appendix B provides a review of fiduciary accounting for estates and trusts.

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## SUPPLEMENTARY MATERIALS

The supplementary materials for the seventh edition of *Advanced Accounting* include three manuals:

- The solutions manual
- A resource manual that contains (a) comprehensive outlines of all chapters; (b) class illustrations; (c) descriptions of all exercises and problems, including estimated times for completion; (d) alternative lesson plans covering different chapters; and (e) a checklist for students of key figures in the problems
- A test bank manual

The following additional material is available to adopters:

- Transparencies for solutions to exercises and problems
- A diskette containing test material (This is the same as the material contained in the manual.)
- Excel spreadsheet templates for consolidation and other working paper problems
- Partially completed working papers for consolidation and other working paper problems in the textbook (These working papers are hard copy of the Excel templates included on the diskettes.)

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## ACKNOWLEDGMENTS

Many people have made valuable contributions to the seventh edition of *Advanced Accounting* and we are happy to recognize their contributions. We are indebted to the many users of prior editions for their helpful comments and constructive criticism. We also acknowledge the help and encouragement that we received from our students at Virginia Tech who, often unknowingly, participated in class-testing of various sections of the manuscript.

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# Business Combinations

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In general terms, **business combinations** unite previously separate business entities. Although the overriding objective of business combinations must be profitability, the immediate concern of many combinations is to gain operating efficiencies through horizontal or vertical integration of operations or to diversify business risks through conglomerate operations.

**Horizontal integration** is the combination of firms in the same business lines and markets. The 1997 business combination between Atmos Energy Corporation and United Cities Gas Company, both natural gas utilities, is an example of horizontal integration. The combined company serves more than one million customers in 12 states and expects cost savings from the combined operations of \$375 million over the next 10 years.

**Vertical integration** is the combination of firms with operations in different, but successive, stages of production and/or distribution. Tultex Corporation, already a vertically-integrated company that spins yarn, knits, dyes, cuts, and sews activewear and sports apparel, acquired California Shirt Sales and T-Shirt City in 1997. Both companies are apparel distributors and will provide Tultex with distribution outlets for its manufactured goods.

**Conglomeration** is the combination of firms with unrelated and diverse products and/or service functions. Firms may diversify to reduce the risk associated with a particular line of business, or to even out cyclical earnings, such as a utility's acquisition of a manufacturing company. Several utilities combined with telephone companies after the 1996 Telecommunications Act allowed utilities to enter the telephone business. For example, in November 1997, Texas Utilities Company acquired Lufkin-Conroe Communications Company, a local-exchange telephone company, to diversify into a communication business.

## Reasons for Business Combinations

If expansion is a proper goal of business enterprise, why does a business expand through combination rather than by building new facilities? Among the many possible reasons for electing business combination as the vehicle for expansion are:

**Cost Advantage.** It is frequently less expensive for a firm to obtain needed facilities through combination than through development. This is particularly true in periods of inflation.

**Lower Risk.** The purchase of established product lines and markets is usually less risky than developing new products and markets. Business combination is especially less risky when the objective is diversification. For companies in industries already plagued with excess manufacturing capacity, business combinations may be the only way to grow.

**Fewer Operating Delays.** Plant facilities acquired through a business combination are operative and already meet environmental and other governmental regulations. The time to market is critical, especially in the technology industry. Firms constructing new facilities can expect numerous delays in construction, as well as in getting the necessary governmental approval to commence operations. Environmental impact studies alone can take months or even years to complete.

**Avoidance of Takeovers.** Many companies combine to avoid being acquired themselves. Smaller companies tend to be more vulnerable to corporate takeovers, so many of them adopt aggressive buyer strategies as the best defense against takeover attempts by other companies.

**Acquisition of Intangible Assets.** Business combinations bring together both intangible and tangible resources. Thus, the acquisition of patents, mineral rights, research, customer databases, or management expertise may be a primary motivating factor in a particular business combination.

**Other Reasons.** Firms may choose a business combination over other forms of expansion for business tax advantages (for example, tax-loss carryforwards), for personal income and estate-tax advantages, and for personal reasons. One of several motivating factors in the 1998 business combination of Wheeling-Pittsburgh Steel, a subsidiary of WHX, with Handy & Harman was Handy & Harman's overfunded pension plan, which virtually eliminated Wheeling-Pittsburgh Steel's unfunded pension liability. The egos of company management and takeover specialists may play an important role in some business combinations.

## Antitrust Considerations

Federal antitrust laws prohibit business combinations that restrain trade or impair competition. The U.S. Department of Justice and the Federal Trade Commission (FTC) have primary responsibility for enforcing federal antitrust laws. For example, in 1997 the FTC blocked Staples's proposed \$4.3 billion acquisition of Office Depot, arguing in federal court that the takeover would be anticompetitive. Business combinations in particular industries are subject to review by additional federal agencies. For example, the Federal Reserve Board reviews bank mergers, the Department of Transportation scrutinizes mergers of companies under its jurisdiction, the Department of Energy has jurisdiction over some electric utility mergers, and the Federal Communications Commission (FCC) rules on the transfer of communication licenses. After the Justice Department cleared a \$23 billion merger between Bell Atlantic Corporation and Nynex Corporation, the merger was delayed by the FCC because of its concern that consumers would be deprived of competition. The FCC later approved the merger. Such disputes are settled in federal courts.

In addition to federal antitrust laws, most states have some type of statutory takeover regulations. Some states aim at preventing or delaying hostile takeovers of the business enterprises incorporated in their states. On the other hand, some states have passed antitrust exemption laws to protect hospitals from antitrust laws when they pursue cooperative projects.

Interpretations of antitrust laws vary from one administration to another, from department to department, and from state to state. Even the same department under the same administration can change its mind. A completed business combination can be reexamined by the FTC at any time. Deregulation in the banking, telecommunication, and utility industries permits business combinations that once would have been forbidden. In 1997, the Justice Department and the FTC jointly issued new guidelines for evaluating proposed business combinations that allow companies to argue that cost savings or better products could offset potential anticompetitive effects of a merger.

---

## THE FORM OF BUSINESS COMBINATIONS

*Business combination* is a general term that encompasses all forms of combining previously separate business entities. Such combinations are **acquisitions** when one corporation acquires the productive assets of another business entity and integrates those

assets into its own operations. Business combinations are also acquisitions when one corporation obtains operating control over the productive facilities of another entity by acquiring a majority of its outstanding voting stock. The acquired company need not be dissolved; that is, the acquired company does not have to go out of existence.

The terms **merger** and **consolidation** are often used as synonyms for acquisitions. However, in accounting there is a difference. A merger entails the dissolution of all but one of the business entities involved. A consolidation entails the dissolution of all the business entities involved and the formation of a new corporation.

A *merger* occurs when one corporation takes over all the operations of another business entity and that entity is dissolved. For example, Company A purchases the assets of Company B directly from Company B for cash, other assets, or Company A securities (stocks, bonds, or notes). This business combination is an acquisition, but it is not a merger unless Company B goes out of existence. Alternatively, Company A may purchase the stock of Company B directly from Company B's stockholders for cash, other assets, or Company A securities. This acquisition will give Company A operating control over Company B's assets. It will not give Company A legal ownership of the assets unless it acquires all of Company B stock and elects to dissolve Company B (again, a merger).

A *consolidation* occurs when a new corporation is formed to take over the assets and operations of two or more separate business entities, and those previously separate entities are dissolved. For example, Company D, a newly formed corporation, may acquire the net assets of Companies E and F by issuing stock directly to Companies E and F. In this case, Companies E and F may continue to hold Company D stock for the benefit of their stockholders (an acquisition), or they may distribute the Company D stock to their stockholders and go out of existence (a consolidation). In either case, Company D acquires ownership of the assets of Companies E and F. Alternatively, Company D could issue its stock directly to the stockholders of Companies E and F in exchange for a majority of their shares. In this case, Company D controls the assets of Company E and Company F, but it does not obtain legal title unless Companies E and F are dissolved. Company D must acquire all the stock of Companies E and F and dissolve those companies if their business combination is to be a consolidation. If Companies E and F are not dissolved, Company D will operate as a holding company, and Companies E and F will be its subsidiaries.

Future references in this chapter will use the term merger in the technical sense of a business combination in which all but one of the combining companies go out of existence. Similarly, the term consolidation will be used in its technical sense to refer to a business combination in which all the combining companies are dissolved and a new corporation is formed to take over their net assets. Consolidation is also used in accounting to refer to the accounting process of combining parent and subsidiary financial statements, such as in the expressions "principles of consolidation," "consolidation procedures," and "consolidated financial statements." In future chapters, the meanings of the terms will depend on the context in which they are found.

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## THE ACCOUNTING CONCEPT OF A BUSINESS COMBINATION

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The accounting concept of a business combination is given in *Accounting Principles Board (APB) Opinion No. 16*, "Business Combinations," which became effective on November 1, 1970. According to the APB:

A business combination occurs when a corporation and one or more incorporated or unincorporated businesses are brought together into one accounting entity. The single entity carries on the activities of the previously separate, independent enterprises.<sup>1</sup>

Note that the accounting concept of a business combination emphasizes the single entity and the independence of the combining companies before their union. Although one or more of the combining companies may lose its separate legal identity, dissolution of the legal entities is not necessary within the accounting concept.

Previously separate businesses are brought together into one entity when their business resources and operations come under the control of a single management

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<sup>1</sup>APB Opinion No. 16, paragraph 1.

team. Such control within one business entity is established in business combinations in which:

- 1 One or more corporations become subsidiaries,
- 2 One company transfers its net assets to another, or
- 3 Each company transfers its net assets to a newly formed corporation.<sup>2</sup>

A corporation becomes a **subsidiary** when another corporation acquires a majority (more than 50%) of its outstanding voting stock.<sup>3</sup> Thus, one corporation need not acquire all the stock of another corporation to consummate a business combination. In business combinations in which less than 100% of the voting stock of other combining companies is acquired, the combining companies necessarily retain their separate legal identities and separate accounting records even though they have become one entity for primary reporting purposes.

Business combinations in which one company transfers its net assets to another can be consummated in a variety of ways, but the acquiring company must acquire substantially all the net assets in any case. Alternatively, each combining company can transfer its net assets to a newly formed corporation. Since the newly formed corporation has no net assets of its own, it issues its stock to the other combining companies or to their stockholders or owners.

## A Brief Background on Accounting for Business Combinations

Accounting for business combinations is one of the most important and interesting topics of accounting theory and practice. At the same time, accounting for business combinations is one of the most complex and controversial areas of accounting thought. Business combinations are important and interesting because they involve financial transactions of enormous magnitudes, business empires, success stories and personal fortunes, executive genius, and management fiascos. By their nature, they necessarily involve the takeover of entire companies. Business combinations are complex because each one is unique and must be evaluated in terms of its economic substance, irrespective of its legal form.

Much of the controversy concerning accounting requirements for business combinations involves the pooling of interests method, which became generally accepted in 1950 when the Committee on Accounting Procedure issued *Accounting Research Bulletin (ARB) No. 40*. Although there are conceptual difficulties with the pooling method, the underlying problem that arose with *ARB No. 40* was the introduction of alternative methods of accounting for business combinations (pooling versus purchase). Numerous financial interests are involved in a business combination, and alternate accounting procedures may not be neutral with respect to different interests. That is, the individual financial interests and the final plan of combination may be affected by the method of accounting.

Current accounting requirements for business combinations are found in *APB Opinion No. 16*, which continues to recognize both the pooling and the purchase methods of accounting for business combinations, but not as alternative methods of accounting for the same business combination. Even so, two very different methods of accounting for business combinations continue to be generally accepted. Currently, the Financial Accounting Standards Board (FASB) has a number of projects related to business combinations and consolidations on its agenda, including the possible elimination of the pooling of interest method of accounting for business combinations.

## Methods of Accounting for Business Combinations

There are two generally accepted methods of accounting for business combinations: **the pooling of interests method** and the **purchase method**. However, the two methods “are not alternatives in accounting for the same business combination.”<sup>4</sup> A business combination that meets the criteria of *APB Opinion No. 16* for a pooling of interests must be accounted for under the pooling method. All other business combinations

<sup>2</sup>Ibid., paragraph 5.

<sup>3</sup>The Financial Accounting Standards Board favors a consolidation policy based on control of another enterprise, rather than majority ownership.

<sup>4</sup>Ibid., paragraph 43.



must be accounted for under the purchase method. The two methods are based on different assumptions about the nature of a business combination.

**Pooling of Interests Method** An underlying assumption of the pooling of interests method is that the ownership interests of the combining companies are united and continue relatively unchanged in the new accounting entity. Because none of the combining companies is considered to have acquired the other combining companies, there is no purchase, no purchase price, and, accordingly, no new basis of accountability. Under the pooling method, the assets and liabilities of the combining companies are carried forward to the combined entity at book value. Therefore, any goodwill on the books of the other combining companies will be included as an asset on the books of the surviving (pooled) entity. Retained earnings of the combining companies are also carried forward to the pooled entity (subject to certain limitations to be explained later). Income of the pooled entity includes the incomes of the combining companies for the entire year, regardless of the date on which the business combination is consummated.

Separate companies in a business combination may have used different accounting methods for recording assets and liabilities. In a pooling of interests combination, the amounts recorded by the separate companies under different accounting methods “may be adjusted to the same basis of accounting if the change would otherwise have been appropriate for the separate company. A change in accounting method to conform the individual methods should be applied retroactively, and the financial statements presented for prior periods should be restated.”<sup>5</sup> For example, if one company in a pooling of interests business combination prices its inventories at last-in, first-out (LIFO) cost and the other company at first-in, first-out (FIFO) cost, the historical cost data may be adjusted to either LIFO or FIFO to conform accounting methods.

**Purchase Method** The purchase method is based on the assumption that a business combination is a transaction in which one entity acquires the net assets of the other combining companies. Under the purchase method, the acquiring corporation records the assets received and liabilities assumed at their fair values. The cost of the acquired company is determined in the same manner as for other transactions. This cost is allocated to identifiable assets and liabilities acquired according to their fair values at the date of combination. Any excess of cost over the fair value of net assets acquired is allocated to goodwill and amortized over a maximum period of 40 years. Retained earnings of the acquiring corporation under the purchase method might be decreased as a result of the business combination, but it could never be increased. The income of the acquiring company includes its own income for the period, plus the income of the acquired companies that is earned after the date of the business combination.

The use of different accounting methods (for example, LIFO versus FIFO) by the separate companies in a purchase business combination is not a relevant factor in recording a combination accounted for as a purchase, because all assets and liabilities of the acquired company are recorded at their fair values.

Although these descriptions of the pooling and purchase methods are short, they introduce the two methods and indicate the significant differences in accounting that can result from using one method rather than the other. The two methods are covered in more detail in subsequent sections of this chapter.

## Conditions for Pooling

The pooling of interests concept is based on the assumption that it is possible to unite ownership interests through the exchange of equity securities without an acquisition of one combining company by another.<sup>6</sup> Accordingly, application of the concept is limited to those business combinations in which the combining entities exchange equity securities and the operations and ownership interests continue in a new accounting entity. In *APB Opinion No. 16*, the APB sought to prevent pooling of interests accounting for business combinations that were incompatible with the pooling concept. It did this by specifying (in paragraphs 45 through 48 of *Opinion No. 16*) 12 condi-

<sup>5</sup>Ibid., paragraph 52.

<sup>6</sup>The underlying assumptions of pooling have been challenged by many writers in accounting. For example, see *Accounting Research Study No. 5*, “A Critical Study of Accounting for Business Combinations,” by Arthur R. Wyatt (New York: American Institute of Certified Public Accountants, 1963). FASB considered eliminating pooling of interest in 1997.