

A D V A N C E D

# ACCOUNTING



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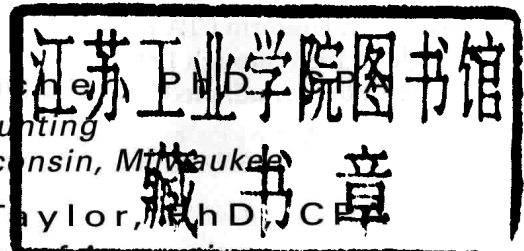
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# ACCOUNTING

S I X T H E D I T I O N

Paul M. Fischer, Ph.D., CPA  
Professor of Accounting  
University of Wisconsin, Milwaukee

William J. Taylor, Ph.D., CPA  
Assistant Professor of Accounting  
University of Wisconsin, Milwaukee



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# Preface

The sixth edition of **ADVANCED ACCOUNTING** contains significant revisions in the areas of business combinations, governmental and not-for-profit accounting, and multinational accounting. The full coverage of earnings per share calculations found in the first four editions returns by popular demand.

This text is known for its close linking of accounting theory and practice and for its “learn by example” approach to teaching. Every topic contains complete and realistic examples. Students learn best by applying concepts directly to examples. End-of-chapter materials provide a variety of means to accomplish this. Questions are used to reinforce theory. Exercises are short, focused applications of specific topics in the chapter and make great assignments to be done prior to class. Problems tend to be more comprehensive than exercises, often combining topics. They work well as after-class assignments. New to this edition, in the business combinations chapters, are selected cases which provide a new opportunity to blend theoretical and numerical analysis. The authors have found that these work really well when used as group projects. Be aware that the instructor’s solutions manual contains precise descriptions of every exercise, problem, and case to aid the instructor’s choice of assignment material. All end-of-chapter materials are in the order in which the topics are developed in the chapter narrative.

The **STUDENT COMPANION ENRICHMENT MANUAL**, available for students, provides several advantages to users. First, it contains a second copy of every consolidated worksheet in the text. This allows the student to set the text narrative explaining a worksheet procedure right next to the

worksheet in the enrichment manual to which it applies. Second, it contains a review outline of each chapter and other supporting materials to reinforce the chapter. Third, it contains a blend of questions and efficient problems for each chapter. The problems are structured so that each concept in the chapter is applied to a short example. Answers are provided for student feedback. Finally, it provides additional enrichment material in the areas of branch accounting and the Securities and Exchange Commission.

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## HIGHLIGHTS OF CHANGES IN THE SIXTH EDITION

The following changes from the fifth edition are most notable:

1. The flow of topics in business combinations has been modified to place the most critical topics in the first six chapters. These are the topics most often needed in practice and are more frequently tested on the CPA Exam. The seventh and eighth chapters in this section contain a variety of advanced consolidation issues. Each topic within Chapters 7 and 8 is treated separately so that an instructor may choose which topics are to be covered when time is limited.
2. Chapter 1, which deals with business combinations accomplished through an acquisition of assets has been modified to include the 1993 change in tax law that permits a deduction for goodwill using a 15-year amortization period. The comparison of purchase and pooling and the accounting for the costs of a busi-

- ness combination have been made easier to understand.
3. We have modified our exclusive "Determination and Distribution of Excess Schedule" to include debit and credit labels to ease the distribution of the excess of cost or book value on the worksheet. This strengthens the importance of this schedule in providing all support for the elimination of the investment account and the resulting account adjustments.
  4. The impact of deferred tax liabilities that result from a tax-free exchange is an important topic but is troublesome to students. We have found that it becomes a blockage to the understanding of more important topics in Chapters 2 and 3. The material on deferred tax liabilities resulting from a tax-free exchange has thus been moved to an appendix following Chapter 3. The coverage considers the new change in the deductibility of goodwill.
  5. Regarding intercompany transactions in Chapters 4 and 5, users of the text asked that we add journal entry format eliminations to the narrative in addition to their inclusion in sample worksheets. We have done this.
  6. Chapter 11 includes an end-of-chapter problem that requires students to translate a foreign subsidiary's financial statements and prepare a consolidated worksheet. A follow-up problem uses the same basic facts except that the functional currency is the dollar. This requires the remeasurement of the foreign subsidiary's financial statements. These problems provide an excellent opportunity to compare and contrast translation and remeasurement.
  7. Chapter 13 deals with the disclosure of earnings per share data. This topic was not covered in the previous edition of the text but had been in all other editions. Many adopters of the text felt that the coverage of this topic was excellent and that it was a logical topic to be included in an advanced financial accounting course. As before, the computation of primary and fully diluted earnings per share is treated in a comprehensive manner.
  8. Wherever possible, the text has included footnote disclosures from actual financial statements in order to help students understand how accounting information is communicated.
  9. The importance of developing critical thinking skills is addressed in the end-of-chapter materials. These materials include questions that require the student to do more than merely "push the numbers." Students are asked to evaluate the accounting effect of various alternatives. For example: "Would it be better to hedge a foreign currency transaction with a forward contract or a foreign loan?"
  10. We have incorporated FASB Statements No. 116 and 117 as well as the latest GASB pronouncements in the extensive revision of the governmental and not-for-profit chapters. This new material keeps students up to date on the current changes occurring in these areas of financial reporting.

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## ORGANIZATION OF THE BOOK

The sixth edition remains flexible in terms of the order in which topics are covered. There are no dependencies between major sections of the text except that coverage of consolidations should precede multinational accounting if one is to understand accounting for foreign subsidiaries. Clearly, the text contains more topics than can be covered in a single semester. The book contains adequate coverage to fill two advanced courses. Where only one semester is available, a careful selection of topics can be made. It would be our advice to cover only the first six chapters in business combinations when only a single semester is available.

The text is divided into the following major topics:

### **BUSINESS COMBINATIONS—BASIC TOPICS (CHAPTERS 1–6)**

This advanced book is unique in that it devotes an initial chapter to the basic issues of purchase and

pooling of interests accounting in the context of direct asset acquisitions. This provides an opportunity to focus on theoretical concepts without being concerned about the mechanics of consolidations. The most difficult concept in the chapter is the combining of stockholders' equities in a pooling of interests, and this is aided by a unique "equity transfer diagram."

Chapters 2 through 5 cover the basics of preparing a consolidated income statement and balance sheet. In 1977 we introduced the "Determination and Distribution of Excess Schedule" and the "Income Distribution Schedule." These schedules are much appreciated by students and faculty. The determination and distribution schedule (quickly termed the D&D schedule by students) analyzes the difference between the price paid in a purchase and the underlying equity of the subsidiary. It provides a check figure for all subsequent years' worksheets, provides all information for the distribution of differences between book and market values, and provides all data for the amortization of the differences. The schedule provides rules for all types of purchase situations and for alternative consolidation theories. The income distribution schedule (known as the IDS) is a set of T accounts that distributes income between the minority and controlling interest. It also provides a useful check function to assure that all intercompany eliminations are accounted for properly. Covering these chapters will provide the student with all topics needed for the CPA Exam. In fact, Chapter 5 goes beyond the current content of the exam. The exam is very limited in its coverage of intercompany bonds and has not tested intercompany leases despite their popularity in practice as of the publication date of this text.

With regard to the alternative worksheet methods and why we follow the approaches we do: First, consider the method used to record the investment in the subsidiary's and the parent's books. There are two key points of general agreement. The first is that it doesn't really matter which method is used since the investment account is eliminated! Second, when the course is over a student should know how to handle each method:

simple equity, full (we call it sophisticated) equity, and cost. The real issue is which method is the easiest one to learn first. We believe the winner is simple equity since it is totally symmetric with the equity accounts of the subsidiary. It simplifies elimination of subsidiary equity against the investment account. Every change in subsidiary equity is reflected, on a pro rata basis, in the parent's investment account. Thus, the simple equity method becomes the mainline method of the text. We teach the student to convert investments maintained under the cost method to the simple equity method. In practice, most firms and the majority of the problems in the text use the cost method. This means that the simple equity method is employed to solve problems that begin as either simple equity or cost method problems.

We also cover the sophisticated equity method which amortizes the excess of cost or book value through the investment account. This method should also adjust for intercompany profits through the investment account. The method is cumbersome because it requires the student to deal with amortizations of excess and intercompany profits in the investment account before getting to the consolidated worksheet, which is designed to handle these topics. You end up teaching consolidating procedures without the benefit of a worksheet! We cover this method after the student is proficient with a worksheet and the other methods. Thorough understanding of the sophisticated method is important so that it can be applied to influential investments that are not consolidated.

The second major concern among advanced-text professors has to do with the worksheet style used. There are three choices: the horizontal (trial balance) format, the vertical (stacked) method, and the balance sheet only. Again, we do cover all three, but our mainline method is the horizontal format. Horizontal is by far the most appealing to students. They have used it in both introductory and intermediate accounting. It is also the most likely method to be found in practice. On this basis, we use it initially to develop all topics. We do cover the vertical format, but not until the student is proficient with the horizontal format. There is no differ-

ence in the elimination entries; only the worksheet logistics differ. It takes only one problem assignment to teach the students this approach so they are prepared for its possible appearance on the CPA Exam. The balance-sheet-only format has no reason to exist other than its use as a CPA Exam testing shortcut. We cover it in an appendix.

Chapter 6 (Chapter 8 in the fifth edition) is more critical for those entering practice than it is for the CPA Exam. It contains cash flow for consolidated firms, taxation issues, and the use of the sophisticated equity method for influential investments. Taxation is the most difficult topic in consolidation, especially where the parent and subsidiary are taxed separately as opposed to filing a consolidated return. Every intercompany transaction is a tax allocation issue. Teaching the tax allocation issues with every topic as it is introduced is very confusing to students. We prefer to have the students fully understand worksheet procedures without taxes and then introduce taxes.

### **BUSINESS COMBINATIONS— SPECIALIZED TOPICS (CHAPTERS 7, 8, AND APPENDICES)**

These chapters deal with topics that occasionally surface in practice and have not appeared on the CPA Exam for over 10 years. Studying these chapters perfects the students' understanding of consolidations and stockholders' equity accounting, thus affording a valuable experience. Chapter 7 (Chapter 6 in the fifth edition) deals with piecemeal acquisitions of an investment in a subsidiary, sale of the parent's investment, and the impact of preferred stock in the subsidiary's equity structure. Chapter 8 deals with the impact of subsidiary equity transactions including stock dividends, sale of common stock shares, and subsidiary reacquisitions of shares. The chapter also considers indirect or three-tier ownership structures and reciprocal holdings where the subsidiary owns parent shares.

The Appendices to the Consolidations Chapters should not be dismissed from the study plan for a semester. The material on alternative consolidation theories is conceptually important. It summarizes the FASB's 1991 Discussion Memorandum

and compares alternative theories to current practice. Studying it reinforces the students' understanding and prepares them for changes that may occur. The students enjoy this material more than any other in consolidations. We are really pleased with how well our techniques adapt to alternative theories.

The other topic in the Appendices is accounting for leveraged buyouts. This is a popular topic and is easily mastered using consolidation techniques. Students enjoy mastering it since it is a common business phenomenon that sounds difficult but really isn't. It particularly appeals to students with an interest in financial management.

### **MULTINATIONAL ACCOUNTING (CHAPTERS 9–11)**

As business has developed beyond national boundaries, the discipline of accounting also has evolved internationally. As our global economy develops, so does the demand for reliable and comparable financial information. Chapter 9 discusses the international accounting environment and compares accounting principles among several countries. This comparison illustrates the need for the harmonization of accounting standards. Approaches to the harmonization of standards and the various organizations involved are identified. Chapter 10 discusses accounting for foreign currency transactions. The basic mechanics of exchange rates and the business risks resulting from exchange rate changes are set forth. The use of forward contracts as a hedge against rate change fluctuations is discussed and the accounting for such hedges is demonstrated. Chapter 11 demonstrates the remeasurement and/or translation of a foreign entity's financial statements into a U.S. investor's currency. Whenever possible, examples of footnote disclosure relating to international accounting issues are presented.

### **SPECIAL REPORTING CONCERNS (CHAPTERS 12 AND 13)**

The utility of financial information is increased if it is communicated on a timely basis. Therefore,

interim financial statements and reporting requirements have become widely accepted. In Chapter 12 the concept of an interim period as an integral part of a larger annual accounting period is set forth as a basis for explaining the specialized accounting principles of interim reporting. Particular attention is paid to the determination of the interim income tax provision including the tax implications of net operating losses. The topic of segmental reporting is also discussed in Chapter 12 and the various disclosure requirements as well. A worksheet format for developing segmental data is used, and students are able to review the segmental footnote disclosure for a large public company.

In Chapter 13 students are given a comprehensive discussion of the disclosure of earnings per share data. Supporting schedules are used to facilitate the calculation of per share amounts. The calculation of primary earnings per share is developed, and then with that background, students are exposed to the calculation of fully diluted earnings per share. The chapter concludes with a comprehensive illustration dealing with the calculation of both primary and fully diluted earnings per share.

## **ACCOUNTING FOR PARTNERSHIPS (CHAPTERS 14 AND 15)**

Chapters 14 and 15 take the student through the entire life cycle of a partnership beginning with formation and ending in liquidation. Although new forms of organization such as the limited liability corporation are available, partnerships continue to be a common form of organization. Practicing accountants must be aware of the characteristics of this form of organization and the unique accounting principles. The accounting aspects of profit and loss agreements, changes in the composition of partners (admissions and withdrawals), and partnership liquidations are fully illustrated. In addition to accounting principles, certain income tax principles relating to partnerships are set forth. The end-of-chapter material in this area focuses on evaluating various alternative strategies available to partners, for example, deciding whether it would be better to liquidate a partnership or admit a new partner.

## **GOVERNMENTAL AND NOT-FOR-PROFIT ACCOUNTING (CHAPTERS 16–19)**

Chapters 16 and 17 have been updated to include recent Governmental Accounting Standards Board (GASB) pronouncements. Chapter 16 includes a complete discussion of measurement focus and basis of accounting issues for state and local governments. The deferral of GASB Statement No. 11 and the issues involved in its implementation are outlined for the reader.

In Chapter 16 we introduce the unique accounting and financial reporting issues of state and local governments. The chapter also covers the basics of accounting and financial reporting for the general fund and the two account groups. This order emphasizes the “working capital” focus of the general fund and the resulting need to account for fixed assets and long-term liabilities elsewhere.

Chapter 17 covers the accounting and financial reporting of the specialized funds of government: those established to account for restricted operating resources, long-term construction projects or acquisition of major fixed assets, and servicing of principal and interest on long-term debt. The chapter also covers the unique accounting issues of various trust funds and proprietary (business-type) funds.

Chapters 18 and 19 have been completely rewritten to include recent Financial Accounting Standards Board (FASB) standards on accounting and financial reporting for such organizations as private not-for-profit health care entities, private universities, and voluntary health and welfare organizations. The new FASB standards represent the most comprehensive change in the history of financial reporting by not-for-profit organizations. The standards define how the resources of a private not-for-profit organization are to be divided into unrestricted, temporarily restricted, or permanently restricted net asset classifications. Financial statements also are based on net asset classifications. A statement of cash flows is now required. The new standards represent a shift away from fund accounting to organization-wide financial reporting. As such, they supersede sections of the existing individual industry audit guides that have



been accepted as generally accepted accounting practices to date.

In Chapter 18 we provide an overall summary of the new accounting and financial reporting standards as they apply to all not-for-profit organizations. We then offer a complete description of accounting and illustrations of the financial reports of public universities. Since the GASB has not changed accounting for public universities, these organizations will continue to follow the AICPA audit guidance. The next section in this chapter illustrates accounting and financial reporting for private not-for-profits following the new FASB guidance. For ease of presentation, these illustrations are presented without regard to a fund structure. However, since the new FASB guidance does not preclude funds-based reporting, an appendix is included incorporating the new standards within the existing funds structure. This gives the instructor the option of teaching the material for private universities with or without funds.

Chapter 19 covers accounting and financial reporting for health care entities and voluntary health and welfare organizations. The chapter also incorporates for each type of organization the most recent FASB standards in addition to existing AICPA audit guidance that has not been superseded. In this chapter, funds are viewed as internal control and management tools. External financial statements are illustrated without a funds structure. As in Chapter 18, however, a funds-based illustration is included in the appendix for both health care organizations and voluntary health and welfare organizations.

## **FIDUCIARY ACCOUNTING (CHAPTERS 20 AND 21)**

The role of estate planning and the use of trusts are important to many individuals and present some unique accounting principles. The tax implications of estate planning are discussed so that the student has a basic understanding of this area. Various accounting reports necessary for the administration of an estate or trust are illustrated in Chapter 20.

No business is immune from financial difficulty. Chapter 21 discusses various responses to

such difficulties including: troubled debt restructuring, quasi-reorganizations, corporate liquidations, and corporate reorganizations.

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## **SUPPLEMENTARY MATERIALS**

The materials supporting this text include a solutions manual, transparencies, an examination book, and templates, with solutions, for use with Lotus 1-2-3. For the student, the STUDENT COMPANION ENRICHMENT MANUAL, which includes a study guide and preprinted consolidation working papers, is available.

## **FOR THE INSTRUCTOR**

**Solutions Manual.** The manual accompanying this text provides descriptions of all exercises and problems with their estimated completion time. The manual contains answers to all end-of-chapter questions and solutions to all exercises and problems, along with the logic for the solutions when appropriate. In particular, answers to multiple-choice questions include supporting explanations and computations.

**Transparencies.** The set of transparencies contains blank worksheets, solutions for all of the consolidation problems, and selected solutions from the remainder of the text.

**Examination Book.** The test bank contains multiple-choice questions and examination problems for each chapter along with the solutions. These materials may be reproduced by the instructor.

**Templates.** Both student and solution templates for use with Lotus 1-2-3 are available. They are accompanied by problem instructions in ASCII form for easy conversion to most word processing programs. The templates are for use with selected nonconsolidation chapters as well as the consolidation chapters. General instructions and a complete summary of the problems are provided. The diskettes are for use with IBM hardware.

## FOR THE STUDENT

### **Student Companion Enrichment Manual.**

This book is composed of three main sections: the Text Companion (TC), the Enrichment (E), and the Study Guide (SG). Reproduced on removable pages within the TC are the ends of Chapters 2–8 plus appendix worksheets to allow the students easy reference as they study the related text narrative. Also in the TC section are several supporting examples, diagrams, and illustrations to assist understanding of complex topics. The E section contains coverage of branch accounting and the SEC as background information for the students. The SG section contains a detailed outline and several learning activities (such as true/false, multiple choice, matching, and short problems) for each chapter of the text. The solutions for these activities appear at the end of the section. The SG material assists students in their mastery of subject areas.

**Working Papers for Consolidations.** The working papers for solving the consolidation problems in Chapters 2–8 and Chapter 11 contain preprinted trial balances as a means of saving time. The pages are bound in a single volume and are perforated for easy removal. Blank worksheets are included at the end for extra assignments. These may be duplicated if more are needed.

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To all who have communicated with us either directly or through South-Western with feedback, thank you. We welcome questions, suggestions, and comments from all users of this text as we endeavor to provide you with the highest-quality materials.

Paul M. Fischer  
William James Taylor

# About the Authors

**William James Taylor** primarily teaches financial accounting and auditing at both the undergraduate and graduate levels. In addition he is involved in teaching a CPA review course and continuing professional education seminars. He has been recognized for his teaching excellence and has received both the Amoco Outstanding Professor Award and the School of Business Administration Advisory Council Teaching Award. He earned his PhD from Georgia State University and is a CPA. His professional experience includes working for Deloitte and Touche and Arthur Andersen & Co. in their audit practices. His private consulting activities include business valuations, litigation services, and issues affecting closely held businesses.

Dr. Taylor is actively involved in the Wisconsin Institute of Certified Public Accountants and chairs several task forces dealing with the 150-hour educational requirement and minority issues. He is also a member of the American Institute of CPAs and the American Accounting Association. He serves as a director and officer for a number of organizations.

**Paul M. Fischer** is the Jerry Leer Professor of Accounting at the University of Wisconsin—Milwaukee. He teaches intermediate and advanced financial accounting and has received both the AMOCO Outstanding Professor Award and the School of Business Administration Advisory Council Teaching Award. He also teaches CPA review classes and continuing education classes, and provides executive training courses for several large corporations. He earned his undergraduate accounting degree at Milwaukee and earned an MBA and PhD at the University of Wisconsin—Madison. Dr. Fischer is a CPA and is a member of the American Institute of CPAs, the Wisconsin Institute of CPAs and the American Accounting Association. He is a past president of the Midwest Region of the American Accounting Association.

Dr. Fischer has previously authored *Cost Accounting: Theory and Applications* (with Frank), *Financial Dimensions of Marketing Management* (with Crissy and Mossman), journal articles, and computer software. He actively pursues research and consulting interests in the areas of leasing, pension accounting, and business combinations.

# *Contents in Brief*

---

## **PART 1 COMBINED CORPORATE ENTITIES AND CONSOLIDATIONS 1**

|   |   |     |
|---|---|-----|
| Chapter 1                                 | Introduction to Business Combinations                           | 2   |
| Chapter 2                                 | Consolidated Statements at the Date of Acquisition              | 61  |
| Chapter 3                                 | Consolidated Statements Subsequent to Acquisition               | 122 |
| Chapter 4                                 | Intercompany Transactions: Merchandise, Plant Assets, and Notes | 212 |
| Chapter 5                                 | Intercompany Transactions: Bonds and Leases                     | 286 |
| Chapter 6                                 | Cash Flow, EPS, Taxation, and Unconsolidated Investments        | 347 |
| Chapter 7                                 | Special Issues in Accounting for an Investment in a Subsidiary  | 404 |
| Chapter 8                                 | Subsidiary Equity Transactions; Indirect and Mutual Holdings    | 484 |
| Appendices to the Consolidations Chapters |   | 542 |

---

## **PART 2 MULTINATIONAL ACCOUNTING 581**

|            |   |     |
|------------|---|-----|
| Chapter 9  | The International Accounting Environment    | 582 |
| Chapter 10 | Foreign Currency Transactions               | 599 |
| Chapter 11 | Translation of Foreign Financial Statements | 632 |

---

## **PART 3 SPECIAL REPORTING CONCERNS 681**

|            |   |     |
|------------|---|-----|
| Chapter 12 | Interim Reporting and Segmental Data      | 682 |
| Chapter 13 | The Disclosure of Earnings Per Share Data | 736 |

---

## **PART 4 PARTNERSHIPS 774**

|            |   |     |
|------------|---|-----|
| Chapter 14 | Partnerships: Characteristics, Formation, and Accounting for Activities | 775 |
| Chapter 15 | Partnerships: Ownership Changes and Liquidations                        | 803 |

---

## **PART 5 GOVERNMENTAL AND NOT-FOR-PROFIT ACCOUNTING 845**

|            |   |      |
|------------|---|------|
| Chapter 16 | Governmental Accounting: The General Fund and the Account Groups  | 846  |
| Chapter 17 | Governmental Accounting: Other Governmental Funds, Proprietary Funds, and Fiduciary Funds                         | 904  |
| Chapter 18 | Accounting for Not-for-Profit Organizations: Public and Private Universities                                      | 969  |
| Chapter 19 | Accounting for Not-for-Profit Organizations: Health Care Providers and Voluntary Health and Welfare Organizations | 1041 |

---

## **PART 6 FIDUCIARY ACCOUNTING 1119**

|            |   |      |
|------------|---|------|
| Chapter 20 | Estates and Trusts: Their Nature and the Accountant's Role      | 1120 |
| Chapter 21 | Debt Restructuring, Corporate Reorganizations, and Liquidations | 1151 |

# Contents

## **PART 1 COMBINED CORPORATE ENTITIES AND CONSOLIDATIONS**

### **Chapter 1 Introduction to Business Combinations**

Economic Advantages of Combinations 3

Obtaining Control 4

Accounting Ramifications 6

Pooling vs. Purchase 7  
     *Effect on Future Statements 8      Expenses to*  
     *Accomplish a Combination 10      Summary 11*

Asset Acquisition as a Purchase 11  
     *Calculating and Recording Goodwill 13*  
     *Recording a Purchase 14      Recording Bargain*  
     *Purchases 15      Allocating the Purchase Price—*  
     *Special Concerns 17      Issuing Securities as*  
     *Consideration 22      Mixing Securities as*  
     *Consideration 24      Including Contingent*  
     *Consideration in a Purchase Agreement 24*

Asset Acquisition as a Pooling of Interests 27  
     *Criteria for the Use of the Pooling Method 27*  
     *Pooling of Interests Accounting 32*

Reporting Requirements 37

### **Chapter 2 Consolidated Statements at the Date of Acquisition**

The Function of Consolidated  
Statements 61

Traditional Criteria for Consolidated  
Statements 62

Consolidation with or without Majority  
Ownership 63

*Control by Ownership of, or Ability to Exercise,*  
     *a Majority of Voting Rights 63      Control by*  
     *Ownership of a Large Minority of Voting Rights*  
     *64      Control Through Management Contract,*  
     *Lease, or Other Contractual Arrangement 64*

Techniques of Consolidation 65

*Reviewing an Asset Acquisition 65*  
     *Consolidating a Stock Acquisition 66*

Stock Acquisition Accounted for as a  
Purchase 68

Consolidation of the Purchase of  
100% Interest 69

*Bargain Purchase Procedures 71      Subsidiary*  
     *with Previously Recorded Goodwill 77*  
     *Depreciable Assets 78      Adjustment of*  
     *Assumed Liabilities 79*

Consolidation of the Purchase of  
Less-than-100% Interest 80

*Adjustment of Subsidiary Accounts to Reflect*  
     *Market Value 83      Bargain Purchase*  
     *Procedures 85*

Push-Down Accounting 87

Investment in a Subsidiary Accounted for  
as a Pooling of Interests 89

*Consolidating a 100% Interest Under Pooling 89*  
     *Consolidating a Less-than-100% Interest under*  
     *Pooling 90      Recognizing and Correcting the*  
     *Improperly Recorded Investment Account 91*

### Chapter 3 Consolidated Statements Subsequent to Acquisition

|   |     |
|---|-----|
| Accounting for the Investment in a<br>Subsidiary        | 122 |
| <i>Equity Method</i> 123 <i>Cost Method</i> 124         |     |
| <i>Example of the Equity and Cost Methods</i> 125       |     |
| Elimination Procedures                                  | 127 |
| <i>Effect of Simple Equity Method on Consolidation</i>  |     |
| 127 <i>Effect of Cost Method on Consolidation</i>       |     |
| 134 <i>Effect of Sophisticated Equity Method</i>        |     |
| <i>on Consolidation</i> 135                             |     |
| Determination of the Method Being Used                  | 137 |
| Complicated Purchase, Several Causes of<br>Excess       | 137 |
| <i>Intraperiod Purchase under the Simple Equity</i>     |     |
| <i>Method</i> 141 <i>Intraperiod Purchase under the</i> |     |
| <i>Cost Method</i> 144                                  |     |
| Pooling of Interests: Subsequent to<br>Acquisition      | 145 |
| <i>Intraperiod Pooling</i> 146                          |     |
| Summary: Worksheet Technique                            | 146 |
| Appendix A: The Vertical Worksheet                      | 147 |
| Appendix B: Tax-Related Adjustments                     | 148 |

### Chapter 4 Intercompany Transactions: Merchandise, Plant Assets, and Notes

|   |     |
|---|-----|
| Intercompany Merchandise Sales                      | 213 |
| <i>No Intercompany Goods in Purchasing Firm's</i>   |     |
| <i>Inventories</i> 215 <i>Intercompany Goods in</i> |     |
| <i>Purchasing Firm's Ending Inventory</i> 217       |     |
| <i>Intercompany Goods in Purchasing Firm's</i>      |     |
| <i>Beginning and Ending Inventories</i> 218         |     |
| <i>Eliminations for Periodic Inventories</i> 220    |     |
| <i>Effect of Lower-of-Cost-or-Market Method on</i>  |     |
| <i>Inventory Profit</i> 221 <i>Losses on</i>        |     |
| <i>Intercompany Sales</i> 222                       |     |
| Intercompany Plant Asset Sales                      | 222 |
| <i>Intercompany Sale of a Nondepreciable Asset</i>  |     |
| 222 <i>Intercompany Sale of a Depreciable</i>       |     |
| <i>Asset</i> 224 <i>Intercompany Long-Term</i>      |     |
| <i>Construction Contracts</i> 227                   |     |

|   |     |
|---|-----|
| Intercompany Debt   | 230 |
| Sophisticated Equity Method: Intercompany<br>Transactions | 231 |
| <i>Unrealized Profits of the Current Period</i> 231       |     |
| <i>Unrealized Profits of Current and Prior Periods</i>    |     |
| 232   |     |

|   |     |
|---|-----|
| Appendix: Intercompany Profit Eliminations<br>on the Vertical Worksheet | 235 |
|---|-----|

### Chapter 5 Intercompany Transactions: Bonds and Leases

|  |     |
|--|-----|
| Intercompany Investment in Bonds                     | 286 |
| <i>Bonds Originally Issued at Face Value</i> 287     |     |
| <i>Bonds Not Originally Issued at Face Value</i> 290 |     |
| <i>Purchase of Only a Portion of the Bonds</i> 292   |     |
| <i>Interest Method of Amortization</i> 292           |     |

|   |     |
|---|-----|
| Intercompany Leases                                     | 294 |
| <i>Operating Leases</i> 294 <i>Capitalizable Leases</i> |     |
| 295   |     |

|  |     |
|--|-----|
| Intercompany Transactions Prior to<br>Business Combination | 300 |
|--|-----|

|   |     |
|---|-----|
| Appendix: Intercompany Leases with<br>Unguaranteed Residual Value | 300 |
|---|-----|

### Chapter 6 Cash Flow, EPS, Taxation, and Unconsolidated Investments

|  |     |
|--|-----|
| Consolidated Statement of Cash Flows                   | 347 |
| <i>Cash Acquisition of Controlling Interest</i>        |     |
| 348 <i>Noncash Acquisition of Controlling</i>          |     |
| <i>Interest</i> 349 <i>Adjustments Resulting from</i>  |     |
| <i>Business Combinations</i> 350 <i>Preparation of</i> |     |
| <i>Consolidated Statement of Cash Flows</i> 352        |     |

|                                 |     |
|---------------------------------|-----|
| Consolidated Earnings Per Share | 356 |
|---------------------------------|-----|

|  |     |
|--|-----|
| Taxation of Consolidated Firms                         | 360 |
| <i>Consolidated Tax Return</i> 361 <i>Separate Tax</i> |     |
| <i>Returns</i> 363                                     |     |

|  |     |
|--|-----|
| Equity Method for Unconsolidated<br>Investments    | 368 |
| <i>Calculation of Equity Income</i> 369 <i>Tax</i> |     |
| <i>Effects of Equity Method</i> 373 <i>Unusual</i> |     |

|  |                                    |   |
|--|------------------------------------|---|
| <i>Equity Adjustments 374</i>  | <i>Disclosure Requirements 377</i> |   |
| <b>Chapter 7</b>   |                                    |   |
| <b>Special Issues in Accounting for an Investment in a Subsidiary</b>          | <b>404</b>                         |   |
| Parent Acquisition of Stock Directly from Subsidiary                           | 404                                |   |
| Piecemeal Acquisition of Interest in Subsidiary                                | 406                                |   |
| <i>Control Achieved upon Initial Investment 406</i>                            |                                    |   |
| <i>Control Not Achieved upon Initial Investment 409</i>                        |                                    |   |
| Sale of Parent's Investment in Common Stock                                    | 414                                |   |
| <i>Sale of Entire Investment 414</i>   |                                    |   |
| <i>Sale of Portion of Investment 418</i>                                       |                                    |   |
| Subsidiary Preferred Stock   | 423                                |   |
| <i>Determination of Preferred Shareholders' Claim on Retained Earnings 424</i> |                                    |   |
| <i>Appportionment of Retained Earnings 424</i>                                 |                                    |   |
| <i>Parent Investment in Subsidiary Preferred Stock 427</i>                     |                                    |   |
| Appendix: Worksheet for a Consolidated Balance Sheet                           | 430                                |   |
| <i>Investment Account 430</i>  |                                    |   |
| <i>Merchandise Sales 430</i>   |                                    |   |
| <i>Plant Asset Sales 431</i>   |                                    |   |
| <i>Investment in Bonds 431</i>   |                                    |   |
| <i>Leases 431</i>  |                                    |   |
| <i>Illustration 431</i>  |                                    |   |
| <b>Chapter 8</b>   |                                    |   |
| <b>Subsidiary Equity Transactions; Indirect and Mutual Holdings</b>            | <b>484</b>                         |   |
| Subsidiary Stock Dividends   | 484                                |   |
| <i>Parent Using the Simple Equity Method 486</i>                               |                                    |   |
| <i>Parent Using the Sophisticated Equity Method 486</i>                        |                                    |   |
| <i>Parent Using the Cost Method 489</i>  |                                    |   |
| Subsidiary Sale of Its Own Common Stock  | 490                                |   |
| <i>Sale of Subsidiary Stock to Minority Shareholders 490</i>                   |                                    |   |
| <i>Parent Purchase of Newly Issued Subsidiary Stock 497</i>                    |                                    |   |
| Subsidiary Purchase of Its Own Common Stock                                    | 499                                |   |
|  |                                    | <i>Purchase of Shares as Treasury Stock 499</i>                         |
|  |                                    | <i>Resale of Shares Held in Treasury 501</i>                            |
|  |                                    | <b>Indirect Holdings 501</b>  |
|  |                                    | <i>Level One Holding Acquired First 502</i>                             |
|  |                                    | <i>Level Two Holding Exists at Time of Parent's Purchase 504</i>        |
|  |                                    | <i>Connecting Affiliates 505</i>  |
|  |                                    | <b>Mutual Holdings 506</b>  |
|  |                                    | <i>Treasury Stock Method 507</i>  |
|  |                                    | <i>Reciprocal Method 509</i>  |
|  |                                    | <b>Appendices to the Consolidations Chapters 542</b>                    |
|  |                                    | <b>Appendix A: Alternative Consolidation Concepts 542</b>               |
|  |                                    | <b>Summary Comparison of the Concepts with Chapter Reference 543</b>    |
|  |                                    | <b>Consolidation Procedures on the Date of Purchase (Chapter 2) 545</b> |
|  |                                    | <i>Parent Company Concept 546</i>                                       |
|  |                                    | <i>Proportionate Concept 547</i>  |
|  |                                    | <i>Economic Unit Concept 547</i>  |
|  |                                    | <b>Consolidation Procedures in Subsequent Periods (Chapter 3) 550</b>   |
|  |                                    | <i>Parent Company Concept 550</i>                                       |
|  |                                    | <i>Proportionate Concept 550</i>  |
|  |                                    | <i>Economic Unit Concept—Full Goodwill 550</i>                          |
|  |                                    | <i>Economic Unit Concept—Purchased Goodwill 552</i>                     |
|  |                                    | <b>Intercompany Inventory and Fixed Asset Sales (Chapter 4) 552</b>     |
|  |                                    | <i>Intercompany Leases 555</i>  |
|  |                                    | <b>Piecemeal Acquisition of Interest in Subsidiary (Chapter 7) 555</b>  |
|  |                                    | <i>Control Achieved upon Initial Investment 555</i>                     |
|  |                                    | <i>Control Not Achieved upon Initial Purchase 557</i>                   |
|  |                                    | <b>Appendix B: Leveraged Buyouts 528</b>                                |
|  |                                    | <i>Market Value Block 573</i>   |
|  |                                    | <i>Equity-Adjusted Block 574</i>  |
|  |                                    | <i>Book Value Block 574</i>   |
|  |                                    | <i>Acquisition Meeting the 80% Monetary Consideration Test 574</i>      |
|  |                                    | <i>Acquisition Not Meeting the 80% Monetary Consideration Test 577</i>  |

**PART 2****MULTINATIONAL ACCOUNTING 581****Chapter 9****The International Accounting Environment 582**

Forms of International Business Involvement 584

The Focus of International Accounting 584

*Factors Influencing the Development of Accounting 586    Accounting Principles in France 587    Accounting Principles in Brazil 589    Accounting Principles in Hungary 590*

Harmonization of Accounting Standards 591

**Chapter 10****Foreign Currency Transactions 599**

The International Monetary System 600

*Alternative International Monetary Systems 600    The Mechanics of Exchange Rates 602*

Accounting for Foreign Currency Transactions 605

*Unsettled Foreign Currency Transactions 607    Hedging with Forward Exchange Contracts 608*

Disclosure of Off-Balance-Sheet Risk 620

**Chapter 11****Translation of Foreign Financial Statements 632**

Previous Translation Methodologies 633

*Early Standards Established by the FASB 634*

Statement of Financial Accounting Standards No. 52 635

*Functional Currency Identification 636    Objectives of the Translation Process 637    Basic Translation Process: Functional Currency to Reporting Currency 643    Demonstrating the Translation Process 644    Accounting for Translation Adjustments 646    Gains and Losses Excluded from Income 648    Consolidating the Foreign Subsidiary 649    Translation for the Cost or Equity Method: Unconsolidated Investments 651    Remeasured Financial Statements 655    Summary of Translation and Remeasurement Methodologies 660    Tax Allocation and Disclosure Requirements 661*

**PART 3****SPECIAL REPORTING CONCERNS 681****Chapter 12****Interim Reporting and Segmental Data 682**

Interim Reporting 682

*Approaches to Reporting Interim Data 683    Accounting Principles Board Opinion No. 28 683    Accounting for Income Taxes in Interim Statements 688    Accounting for Discontinued Operations 697    Accounting for a Change in Accounting Principle 703    Disclosures of Summarized Interim Data 706*

Reporting for Business Segments of an Enterprise 707

*Statement of Financial Accounting Standards No. 14 709*

**Chapter 13****The Disclosure of Earnings Per Share Data 736**

The Substance of APB Opinion No. 15 736

Primary Earnings Per Share 740

*Options and Warrants 740    The Special 20% Rule 744    Contingent Share Agreements 745    Convertible Securities 747*

Fully Diluted Earnings Per Share 750

*Options and Warrants 750    Contingent Share Agreements 754    Convertible Securities 755*

Disclosure Requirements 755

General Guidelines 756

**PART 4****PARTNERSHIPS 774****Chapter 14****Partnerships: Characteristics, Formation, and Accounting for Activities 775**

Characteristics of a Partnership 775



|  |            |   |            |
|--|------------|---|------------|
| <i>Relationship of Partners 775      Legal Liability of a Partnership 776      Underlying Equity Theories 776      Formation and Agreements 777      Acceptable Accounting Principles 778      Partnership Dissolution 778      Tax Considerations 779</i> |            | <i>Governmental Funds 854      Accounting for Transactions of Governmental Funds 854</i>  |            |
| Accounting for Partnership Activities  | 779        | Use of Budgetary Accounting   | 859        |
| <i>Contributions and Distributions of Capital 779      Division of Profits and Losses 781</i>  |            | General Ledger Entries 859      Subsidiary Ledger Entries 860   |            |
| Appendix: Tax-Related Aspects of a Partnership   | 789        | Overview of General Fund Procedures   | 861        |
| <i>Tax Basis of a Partner's Interest 789</i>   |            | <i>Accounting for the General Fund—An Expanded Example 864      Closing the General Fund 873</i>  |            |
| <i>Avoidance of Double Taxation 791</i>  |            | Financial Reports of the General Fund   | 874        |
| <b>Chapter 15</b>  |            | Balance Sheet 874      Statement of Revenues, Expenditures, and Changes in Fund Balances 874  |            |
| <b>Partnerships: Ownership Changes and Liquidations</b>  | <b>803</b> | Introduction to the Account Groups  | 875        |
| Ownership Changes  | 804        | <i>Accounting and Financial Reporting for General Fixed Assets 876      Accounting and Financial Reporting for General Long-Term Debt 879</i> |            |
| <i>Admission of a New Partner 804</i>  |            | Review of Entries for the General Fund and Account Groups   | 881        |
| <i>Withdrawal of a Partner 817</i>   |            |   |            |
| Partnership Liquidation  | 820        | <b>Chapter 17</b>   |            |
| <i>Liquidation Guidelines 820      Lump Sum Liquidations 824      Installment Liquidations 826</i>   |            | <b>Governmental Accounting: Other Governmental Funds, Proprietary Funds, and Fiduciary Funds</b>  | <b>904</b> |
| <b>PART 5</b>  |            | Special Revenue Funds   | 904        |
| <b>GOVERNMENTAL AND NOT-FOR-PROFIT ACCOUNTING</b>  | <b>845</b> | Capital Projects Funds  | 907        |
| <b>Chapter 16</b>  |            | Debt Service Funds  | 912        |
| <b>Governmental Accounting: The General Fund and the Account Groups</b>  | <b>846</b> | Special Assessments   | 916        |
| Commercial and Governmental Accounting: A Comparison   | 846        | Proprietary Funds   | 921        |
| Background of Governmental Financial Reporting   | 848        | <i>Enterprise Funds 922      Internal Service Funds 929</i>   |            |
| <i>Organization and Processes of the FASB and the GASB 849      Jurisdictions of the FASB and the GASB 849      GASB Objectives of Financial Reporting 851      Measurement Focus and Basis of Accounting 852</i>  |            | Fiduciary Funds: Trust and Agency Funds   | 930        |
| Governmental Accounting Structure of Funds   | 853        | <i>Trust Funds 930      Pension Trust Funds 931      Agency Funds 936</i>   |            |
|  |            | Governmental Accounting—Interactions Among Funds  | 938        |
|  |            | <i>Annual Financial Reporting 942      Reporting Entity Audits of State and Local Governments 944</i>   |            |