ADVANCED

ACCOUNTING

SIXTH EDITION

FISCHER & TAYLOR

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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.

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.

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 difference 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.

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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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.

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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.

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