

Accounting and Reporting for the SEC

**Consolidated Financial Statements:
On Date of Purchase Business Combination**

**ACCOUNTING FOR
PARTNERSHIPS AND BRANCHES**

**MOSICH
|
LARSEN**

MODERN ADVANCED ACCOUNTING

**THIRD
EDITION**



Accounting for Multinational Enterprises

Accounting for Nonprofit Organizations

**BUSINESS COMBINATIONS
AND CONSOLIDATED FINANCIAL STATEMENTS**

Partnership Organization and Operation

Installment Sales; Consignments

Accounting for Estates and Trusts

Bankruptcy: Liquidation and Reorganization

Governmental Units: General Fund

MODERN ADVANCED ACCOUNTING

Third Edition

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PREFACE

The third edition of ***Modern Advanced Accounting*** represents a major revision. Although the number of chapters has been maintained at eighteen, extensive rearrangement of the subject matter has been made, and the emphasis given certain topics has been changed significantly.

This book may be used in a one-semester or two-quarter course, at either the undergraduate level or the graduate level. The emphasis throughout the book is on financial accounting concepts and on analysis of the problems that arise in the application of these underlying concepts to specialized accounting entities—partnerships, branches, affiliated companies, governmental units, nonprofit organizations, and estates and trusts—and on special topics such as installment sales, consignments, segments of business enterprises, interim reporting, accounting and reporting for the Securities and Exchange Commission, accounting for multinational enterprises, and bankruptcy.

The third edition reflects the continuing changes that have been occurring in the development of accounting principles and practices, with special attention to the official pronouncements and exposure drafts of the Financial Accounting Standards Board (FASB), the Securities and Exchange Commission (SEC), the American Institute of Certified Public Accountants (AICPA), and the National Council on Governmental Accounting (NCGA).

We have prepared the third edition of ***Modern Advanced Accounting*** as a companion volume for ***Intermediate Accounting*** (by the same author team), thus creating a coordinated series for the important intermediate-advanced financial accounting sequence of courses as a foundation for a professional education for accountants.

NEW FEATURES OF THIS EDITION

Every chapter has been updated to include recent changes in law and relevant pronouncements by accounting rule-making bodies. For example, the following have been fully incorporated in this edition: (1) FASB's "Objectives of Financial Reporting by Nonbusiness Organizations," (2) "Foreign Currency Translation" (*FASB Statement No. 52*), (3) NCGA's *Governmental Accounting and Financial Reporting Principles*, and (4) the *Bankruptcy Reform Act of 1978*.

The coverage of business combinations and consolidated financial statements has been expanded, although we again were able to deal with these topics in seven chapters. Pooling-type consolidations are presented in a single chapter (compared with two chapters in the second edition), and special topics are covered in two chapters (compared with one chapter in the earlier editions). Accounting for governmental

units is presented in two chapters instead of one, the discussion of financial forecasts has been eliminated because the pressure for publication of financial forecasts has diminished in recent years, and a condensed presentation of accounting and reporting for the Securities and Exchange Commission is included in Chapter 15 of this edition.

Extensive efforts have been made to expand the number and variety of short exercises and problems. Many multiple-choice questions and problems relating to advanced accounting topics have been adapted from recent CPA examinations and included in the end-of-chapter learning materials (questions, exercises, cases, and problems).

We have divided the new edition into five sections to give clearer focus to the subject matter and to provide a psychological benefit for students by making the material appear more digestible.

ORGANIZATION OF SUBJECT MATTER

We anticipate that the organization of chapters into five cohesive and meaningful parts will be useful to instructors and students. This arrangement should facilitate the planning and presentation of the subject matter and, we hope, make it easier for students to learn and retain the concepts and procedures presented. A brief description of the contents of each of the five parts follows.

Part One: Accounting for partnerships and branches (Chapters 1 to 3)

The first part deals with the accounting principles and procedures for partnerships, joint ventures, and branch operations. Partnerships and joint ventures are covered in the first two chapters, which carry the student from the basic concepts often presented in the introductory accounting course to the CPA examination level, with its more complex problems of profit sharing, realignment of partners' equities, and liquidation. Chapter 3, which deals with home office–branch relationships and combined financial statements, provides a logical stepping-stone to the seven chapters dealing with business combinations and consolidated financial statements.

The general discussion of partnership operation and liquidation has been streamlined, and the accounting for the incorporation of a partnership has been relocated from *Intermediate Accounting* to Chapter 2. The Eliminations column in the working paper for combined financial statements of home office and branch is presented as a single column to parallel the form used in the working papers for consolidated financial statements in Chapters 5 to 10.

Part Two: Business combinations and consolidated financial statements (Chapters 4 to 10)

This important section of the book has been thoroughly revised and expanded in the third edition. By combining the two chapters on consolidated financial statements for pooling-type business combinations into a single chapter and splitting the special topics relating to consolidations into two chapters, we were able to present this section in seven chapters. This will permit students to absorb the key facets of purchase-type business combinations before being exposed to the consolidation techniques for pooling-type business combinations. Formal consolidated financial statements are illustrated in this edition, and the cost method of accounting for the investment in subsidiary is included in an appendix in order not to distract students from the more widely used and more appropriate equity method of accounting.

Among the new features in this section are (1) more extensive use of journal entries, ledger accounts, and illustrations to permit students to follow readily the changes in intercompany accounts and to understand the complex concepts presented; (2) expansion of the discussion relating to negative goodwill; (3) expanded discussion and illustrations of the equity method of accounting to cover two years subsequent to a business combination; and (4) illustration of accounting for the acquisition by the parent company of additional shares of common stock directly from the subsidiary. The use of a Retained Earnings of Subsidiary ledger account for a parent company under the equity method of accounting is extensively illustrated for both purchase-type and pooling-type business combinations.

Part Three: Accounting for nonbusiness organizations (Chapters 11 to 13)

The single chapter of the previous editions on accounting for governmental units is expanded to two chapters in this edition. The general fund is covered in Chapter 11, and the other funds and account groups are included in Chapter 12. This part of the book is concluded with a significantly updated Chapter 13, "Accounting for Nonprofit Organizations."

The objectives of financial reporting by nonbusiness organizations, as included in **FASB Statement of Financial Accounting Concepts No. 4**, are discussed in Chapter 11 to set the stage for the accounting principles illustrated in this section of the textbook. The discussion and illustrations relating to governmental units are based on **Governmental Accounting and Financial Reporting Principles**, issued in 1979 by the National Council on Governmental Accounting. With two chapters allocated to governmental units, we are able to present more complete illustrations of accounting procedures for capital projects funds, debt ser-

vice funds, special assessment funds, agency and trust funds, and the general fixed assets and general long-term debt account groups.

Part Four: Special topics in financial accounting (Chapters 14 to 16)

We have relocated the coverage of installment sales and consignments to this section (Chapter 14) because of their specialized nature and because discussion of these topics in the front part of the book proved to be distracting. Industry segments, interim reports, and accounting and reporting for the SEC are covered in Chapter 15, including a description of the functions of the Chief Accountant, the Division of Corporation Finance, and the Division of Enforcement of the SEC. In Chapter 16, "Accounting for Multinational Enterprises," we have thoroughly incorporated the provisions of much-discussed **FASB Statement No. 52**, "Foreign Currency Translation," issued in 1981.

Part Five: Accounting for fiduciaries (Chapters 17 and 18)

The final section of the book includes chapters entitled "Bankruptcy: Liquidation and Reorganization" and "Accounting for Estates and Trusts." Although some instructors may not cover these two traditional topics in their courses, we feel that it is imperative to include them for those who wish to do so. Many accountants in today's practice environment must assist clients with problems of bankruptcy, liquidation, reorganization, and the accounting for estates and trusts.

We have incorporated the relevant provisions of the **Bankruptcy Reform Act of 1978** in Chapter 17. However, in our discussion of estates and trusts we focus on financial accounting matters rather than on the complex estate and inheritance tax provisions of federal and state statutes.

Carefully selected financial statements (or portions thereof) of publicly owned corporations and of a nonprofit organization (American Accounting Association) are presented in appendixes at the end of appropriate chapters. A complete *Form 10-K* of a publicly owned corporation is included in an appendix at the end of Chapter 15. Thus, students may trace many of the theoretical concepts in the text to real-world situations. As in prior editions, compound interest tables are included in an appendix at the end of the book.

The pronouncements of the FASB, the AICPA, the SEC, the now-defunct Accounting Principles Board, and other authoritative bodies are interwoven into the discussion and in problem material throughout the book. However, we believe that an accounting textbook should encourage students to participate in a critical evaluation of accounting principles and make them aware of the conflicts and shortcomings that exist

within the traditional structure of accounting theory. Therefore, we have tried to provide students with a conceptual framework for making this evaluation.

REVIEW QUESTIONS, EXERCISES, CASES, AND PROBLEMS

An abundance of learning and assignment material is provided at the end of each chapter. This material is divided into four groups: review questions, exercises, cases, and problems. All end-of-chapter material has been tested in class by the authors.

The review questions are intended for use by students as a self-testing and review device to measure their comprehension of key points in each chapter. Many of the questions are provocative, which makes them suitable for class discussion and written assignments.

An exercise typically covers a specific point or topic and does not require extensive computations. Instructors may use the exercises to supplement problem assignments, for class discussion, and for examination purposes.

The cases require analytical reasoning but involve little or no quantitative data. Students are required to analyze business situations, to apply accounting principles, and to propose or evaluate a course of action. However, they are not required to prepare lengthy working papers or otherwise to manipulate accounting data on an extensive scale. The cases have proved to be an effective means of encouraging students to take positions in the argument of controversial accounting issues. Many of the cases have been adapted from actual business situations, court cases, or Uniform CPA Examinations. The review questions and cases are especially recommended if the instructor wishes to develop student skills in communicating accounting concepts and in evaluating the merits of opposing arguments.

Many of the problems are new, and those carried over from the second edition generally have been updated and revised. A feature of this edition is the inclusion of a large number of short problems closely correlated with the text material. The difficulty rating of problems is carefully tailored to help students achieve a smooth learning progression based on the "building-block approach." The book includes most of the problems in the Accounting Theory and Accounting Practice sections of recent Uniform CPA Examinations that are appropriate for advanced accounting, although many have been considerably modified to conform with the latest authoritative pronouncements. In addition, several problems have been designed especially to demonstrate the concepts presented in the theoretical discussion included in the chapter. Probably no more than a third of the cases and problems would be used in a given course; consequently, ample opportunity exists to vary homework assignments from semester to semester.

SUPPLEMENTS AVAILABLE WITH THIS EDITION

As was the case with previous editions, the third edition of **Modern Advanced Accounting** is accompanied by a comprehensive package of supplementary items for both students and instructors. For this edition, however, several innovations have been made:

For the student

- 1 A student **Study Guide**, prepared by the authors, is designed to help students measure their progress by providing immediate feedback. It contains an outline of the more important points for each chapter, plus a variety of objective questions and short exercises. Answers to the questions and exercises appear at the end of each Study Guide chapter to help students evaluate their understanding of the subject matter. The authors have found that use of the Study Guide by students considerably increases their learning.
- 2 **Accounting Work Sheets** (partially filled-in working papers) for the problems are available for purchase by students. On these work sheets the company names, problem numbers, numerous headings, and some preliminary data (such as trial balances) have been entered to save students' time and to facilitate rapid review by the instructor. Many adopters of previous editions have found that use of the partially filled-in working papers permits assignment of a wider variety of problems and eliminates much student frustration in deciding on a proper solution format.
- 3 A **Checklist of Key Figures** is provided for most problems. In this edition of **Modern Advanced Accounting** the checklist appears on the inside front and back covers of the textbook. The purpose of the checklist is to aid students in verifying intermediate figures in problem solutions and in discovering errors.

For the instructor

- 1 A comprehensive **Solutions Manual** is available from the publisher to adopters of the text. The Solutions Manual contains answers to all review questions, exercises, cases, and problems in the text. In addition, at the beginning of each chapter, there are short descriptions, time estimates, and difficulty ratings for each of the problems, to help instructors choose problems that best fit the needs of their individual classes and courses in terms of scope, level, and emphasis.
- 2 A booklet of **Examination Questions**, with test material arranged chapter by chapter, is available free of charge. It contains an abundant number of true-or-false and multiple-choice questions and short problems for each chapter. Instructors should find the booklet a most useful source of material when assembling their own examinations, since they can emphasize those topics or chapters that meet their course outline. Complete answers are provided for all questions and problems.
- 3 An **Instructor's Teaching Guide** is a new teaching aid available with this edition of the text. It is designed to assist instructors in preparing assignments and in covering the materials thoroughly in class. The authors' goals in providing this new supplement were to make the task of instructors easier and to enable them to use their time more efficiently, so that the students' learning process would be enhanced.
- 4 **Overhead Transparencies** of problem solutions are available for most of the problems in the text. For longer, more complex problems, the transparencies are considered by many instructors to be a highly effective means of showing desired organization and format of solutions.

CONTRIBUTIONS BY OTHERS

The many instructors and students who used the first two editions of this book have contributed to the improvements in this edition. Their suggestions for modification of certain problems and expansion or contraction of certain sections of the text material have been most useful. Especially helpful was the advice received from Robert W. Hill, California Polytechnic University at San Luis Obispo; Jerry Arnold, Alan A. Cherry, and John Lacey, of the University of Southern California; Joe J. Cramer, Howard University, Washington, D.C.

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We acknowledge the permission received from the American Institute of Certified Public Accountants to quote from many of its pronouncements and to adapt materials from the Uniform CPA Examinations. All quotations and material from the Uniform CPA Examinations are copyright by the American Institute of Certified Public Accountants.

We also are grateful to the Financial Accounting Standards Board, which granted us permission to quote from **FASB Statements, Discussion Memoranda, Interpretations, and Exposure Drafts**. All quotations used are copyrighted by the Financial Accounting Standards Board, High Ridge Park, Stamford, Connecticut 06905, U.S.A., and are reprinted with permission. Copies of the complete documents are available from the Financial Accounting Standards Board.

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A. N. Mosich
E. John Larsen

CONTENTS

PREFACE

xv

PART ACCOUNTING FOR ONE PARTNERSHIPS AND BRANCHES

CHAPTER 1	PARTNERSHIP ORGANIZATION AND OPERATION	3
	Nature of partnerships.	
	Organization of Partnership	3
	Characteristics of a partnership. Deciding between a partnership and a corporation. Is the partnership a separate entity? The partnership contract. Owners' equity accounts for partners. Loans to and from partners. Valuation of investments by partners.	
	Income-Sharing Plans	8
	Partners' equity in assets versus share in earnings. Division of net income or loss. Financial statements for a partnership. Adjustment of net income of prior years.	
	Changes in Ownership	20
	Accounting for changes in partners. Accounting and managerial issues. Admission of a new partner. Acquisition of an interest by direct payment to one or more partners. Investment in partnership by new partner. Bonus or goodwill allowed to existing partners. Bonus or goodwill allowed to new partner. Retirement of a partner.	
CHAPTER 2	PARTNERSHIP LIQUIDATION; JOINT VENTURES	49
	Liquidation of a Partnership	49
	The meaning of liquidation. Division of losses and gains during liquidation. Distribution of cash or other assets to partners. Final settlement with partners. Equity of each partner is sufficient to absorb loss from liquidation. Equity of one partner is not sufficient to absorb that partner's share of loss from liquidation. Equities of two partners are not sufficient to absorb their shares of loss from liquidation. Partnership is insolvent but partners are personally solvent. Partnership is insolvent and partners are personally insolvent.	

	Installment Payments to Partners	62
	General principles guiding installment payment procedures. Advance planning for installment payments to partners. Withholding of cash for unpaid liabilities and liquidation expenses.	
	Incorporation of a Partnership	69
	Income tax aspects concerning incorporation of a partnership.	
	Joint Ventures	75
	Present-day ventures. Accounting for a joint venture.	
CHAPTER 3	ACCOUNTING FOR BRANCHES; COMBINED FINANCIAL STATEMENTS	96
	Branches and divisions. Accounting system for a sales agency. Accounting system for a branch. Reciprocal accounts. Expenses incurred by home office and charged to branches. Alternative methods of billing merchandise shipments to branch. Separate financial statements for branch and home office. Combined financial statements for home office and branch. Working paper for combined financial statements. Billing of merchandise to branches at price above cost. Working paper when billings to branches are at prices above cost. Treatment of beginning inventories priced above cost. Reconciliation of reciprocal ledger accounts. Transactions between branches. Start-up costs of opening new branches.	
PART TWO	BUSINESS COMBINATIONS AND CONSOLIDATED FINANCIAL STATEMENTS	
CHAPTER 4	BUSINESS COMBINATIONS	143
	Business Combinations: Why and How?	143
	Antitrust considerations. Methods for arranging business combinations. Establishing the price for a business combination.	
	Methods of Accounting for Business Combinations	146
	Purchase accounting. Determination of cost of a combinee. Allocation of cost of a combinee. Illustration of purchase	

accounting with goodwill. Illustration of purchase accounting with “negative goodwill.” Pooling-of-interests accounting. Illustration of pooling-of-interests accounting. Popularity of pooling accounting. Abuses of pooling accounting. Abuses of purchase accounting. Action by the AICPA. Conditions requiring pooling accounting. Presentation of business combinations in financial statements. Disclosure of business combinations in notes to financial statements.

Appraisal of Accounting Standards for Business Combinations 168
 Criticism of purchase accounting. Criticism of pooling accounting. FASB study of accounting for business combinations.

Appendix: Specified Conditions for Pooling-of-Interests Accounting 170

CHAPTER 5 CONSOLIDATED FINANCIAL STATEMENTS: ON DATE OF PURCHASE BUSINESS COMBINATION 192
 Nature of consolidated financial statements. Should all subsidiaries be consolidated? The meaning of “controlling financial interest.” Criticism of traditional concept of control. Unconsolidated subsidiaries in consolidated financial statements.

Consolidation of Wholly Owned Subsidiary on Date of Purchase-Type Business Combination 195

Consolidation of Partially Owned Subsidiary on Date of Purchase-Type Business Combination 204
 Nature of minority interest. Consolidated balance sheet for partially owned subsidiary. Alternative methods for valuing minority interest and goodwill. “Negative goodwill” in consolidated balance sheet. Footnote disclosure of consolidation policy. Advantages and shortcomings of consolidated financial statements.

CHAPTER 6 CONSOLIDATED FINANCIAL STATEMENTS: SUBSEQUENT TO DATE OF PURCHASE BUSINESS COMBINATION 236

Accounting for Operating Results of Wholly Owned Purchased Subsidiaries 236
 Equity method. Cost method. Choosing between equity method and cost method. Illustration of equity method for wholly owned purchased subsidiary for first year after business

combination. Illustration of equity method for wholly owned purchased subsidiary for second year after business combination.

**Accounting for Operating Results of
Partially Owned Purchased Subsidiaries 253**

Illustration of equity method for partially owned purchased subsidiary for first year after business combination. Illustration of equity method for partially owned purchased subsidiary for second year after business combination. Concluding comments on equity method of accounting.

**Appendix: Cost Method for
Partially Owned Purchased Subsidiary 270**

Illustration of cost method for partially owned purchased subsidiary for first year after business combination. Illustration of cost method for partially owned purchased subsidiary for second year after business combination.

**CHAPTER 7 CONSOLIDATED FINANCIAL STATEMENTS:
POOLING BUSINESS COMBINATION 296**

**Consolidation of Wholly Owned Pooled Subsidiary
on Date of Business Combination 297**

**Consolidation of Partially Owned Pooled Subsidiary
on Date of Business Combination 303**

**Consolidation of Wholly Owned Pooled Subsidiary
Subsequent to Date of Business Combination 308**

**Consolidation of Partially Owned Pooled Subsidiary
Subsequent to Date of Business Combination 316**

**Accounting for Intercompany Transactions not Involving Profit
or Loss 323**

Loans on notes or open account. Leases of assets. Rendering of services. Income taxes applicable to intercompany transactions. Summary: Intercompany transactions and balances.

**CHAPTER 8 CONSOLIDATED FINANCIAL STATEMENTS:
INTERCOMPANY PROFITS AND LOSSES 347**

Importance of eliminating or including intercompany profits and losses.

	Intercompany Sales of Merchandise	348
	Intercompany sales of merchandise at cost. Unrealized intercompany profit in ending inventories. Intercompany profit in beginning and ending inventories. Intercompany profit in inventories and amount of minority interest. Should net profit or gross profit be eliminated?	
	Intercompany Sales of Plant Assets and Intangible Assets	356
	Intercompany gain on sale of land. Intercompany gain on sale of depreciable plant asset. Intercompany gain on sale of intangible asset.	
	Acquisition of Affiliate's Bonds	363
	Illustration of acquisition of affiliate's bonds. Accounting for gain in subsequent years. Reissuance of intercompany bonds.	
	Illustration of Effect of Intercompany Profits (Gains) on Minority Interest	372
	Comprehensive Illustration of Working Paper for Consolidated Financial Statements	375
CHAPTER 9	CONSOLIDATED FINANCIAL STATEMENTS: INCOME TAXES, CHANGES IN FINANCIAL POSITION, AND INSTALLMENT ACQUISITIONS	401
	Income Taxes in Business Combinations and Consolidations	401
	Income taxes attributable to current fair values of purchased subsidiary's identifiable net assets. Income taxes attributable to undistributed earnings of subsidiaries. Income taxes attributable to unrealized intercompany profits (gains).	
	Consolidated Statement of Changes in Financial Position	414
	Illustration of consolidated statement of changes in financial position.	
	Installment Acquisition of Subsidiary	418
	Illustration of installment acquisition of parent company's controlling interest. Parent company's journal entries for installment acquisition. Working paper for consolidated financial statements.	
CHAPTER 10	CONSOLIDATED FINANCIAL STATEMENTS: SPECIAL PROBLEMS	446

Changes in Parent Company Ownership Interest in a Subsidiary	446
Parent company acquisition of minority interest. Parent company sale of a portion of its subsidiary common stockholdings. Subsidiary's issuance of additional shares of common stock to the public. Subsidiary's issuance of additional shares of common stock to parent company.	
Subsidiary with Preferred Stock Outstanding	458
Illustration of minority interest in subsidiary with preferred stock. Preferred stock considerations subsequent to date of business combination.	
Stock Dividends Distributed by a Subsidiary	463
Illustration of subsidiary stock dividend.	
Treasury Stock Transactions of a Subsidiary	465
Illustration of treasury stock owned by subsidiary on combination date. Illustration of treasury stock acquired by subsidiary subsequent to combination.	
Indirect Shareholdings and Parent Company's Common Stock Owned by a Subsidiary	470
Indirect shareholdings. Parent company's common stock owned by a subsidiary. Concluding comments on special problems. Unresolved problems in accounting principles for consolidated financial statements.	

PART ACCOUNTING FOR THREE NONBUSINESS ORGANIZATIONS

CHAPTER 11	GOVERNMENTAL UNITS: GENERAL FUND	501
	Objectives of Financial Reporting for Nonbusiness Organizations	501
	Nature of Governmental Units	502
	Accounting Principles for Governmental Units	503
	Funds: The accounting entities for governmental units (principles 2 and 3). The modified accrual basis of accounting (principle 8). Recording the budget (principle 9).	

Accounting for a Governmental Unit's General Fund	513
Illustration of accounting for a general fund. Trial balance at end of fiscal year for a general fund. Financial statements for a general fund. Closing entries for a general fund.	
 CHAPTER 12 GOVERNMENTAL UNITS: OTHER FUNDS AND ACCOUNT GROUPS	 534
Governmental Funds	534
Accounting for special revenue funds. Accounting for capital projects funds. Accounting for debt service funds. Accounting for special assessment funds.	
Proprietary Funds	546
Accounting for enterprise funds. Accounting for internal service funds.	
Fiduciary Funds	548
Accounting for agency funds. Accounting for expendable and nonexpendable trust funds. Accounting for pension trust funds.	
General Fixed Assets and General Long-Term Debt Account Groups	555
Accounting for general fixed assets account groups. Accounting for general long-term debt account groups.	
Annual Reports of Governmental Units	557
Appraisal of accounting principles for governmental units.	
 CHAPTER 13 ACCOUNTING FOR NONPROFIT ORGANIZATIONS	 575
Characteristics of nonprofit organizations.	
Accounting for Nonprofit Organizations	577
Revenue, support, and capital additions of nonprofit organizations. Unrestricted fund. Restricted fund. Endowment fund. Agency fund. Annuity and life income funds. Loan fund. Plant fund. Financial statements for nonprofit organizations. Appraisal of accounting standards for nonprofit organizations.	
Appendix: Financial Statements and Notes of American Accounting Association	591