

# ADVANCED FINANCIAL ACCOUNTING

THIRD EDITION

INTERNATIONAL EDITION

RICHARD E. BAKER  
VALDEAN C. LEMBKE  
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## **ADVANCED FINANCIAL ACCOUNTING**

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# ABOUT THE AUTHORS

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# PREFACE

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The third edition of *Advanced Financial Accounting* is a comprehensive and highly illustrated presentation of the accounting and reporting principles used in a variety of business entities. The daily business press carries many stories about the merger and acquisition mania of multicorporate entities, the foreign activities of multinational firms, the operations of governmental and nonprofit entities, and other topics typically included in advanced accounting. Accountants must know how to deal with the accounting and reporting ramifications of these events.

## KEY FEATURES

The key features of this book are the clear and readable discussions of concepts and the detailed demonstrations of these concepts through illustrations and explanations. The many favorable responses from student users of the earlier editions confirm our belief that clear presentation and comprehensive illustrations are essential to learning the sophisticated topics in an advanced accounting course. Other features of the Third Edition include the following:

- *A building-block approach based on a strong conceptual foundation.* Students are provided with a thorough conceptual foundation before advancing to the procedures. The basics of the topics are discussed first, and the complexities are added gradually in successive steps.
- *The use of a continuous case for each major subject matter area.* The comprehensive case of Peerless Products Corporation and its subsidiary, Special Foods, Inc., has been continued. An important advantage of using a continuous, comprehensive case is that students must become familiar with only one set of data and can then move more quickly through the discussion and illustrations. The case adds realism to the study of advanced accounting and permits students to see the effects of each successive step on the financial reports of a company. After students become familiar with the basic example, they can focus on the point of each new illustration without having to absorb a new set of data. Comparisons of different outcomes from alternative accounting methods can be quickly and readily evaluated because the same base illustration is used to discuss each alternative. The accounting and reporting procedures for each alternative are presented and then compared and contrasted with

one another. Students can clearly see each step of the process and can more easily assess the important differences between alternatives. The positive feedback about the use of the comprehensive case methodology in the earlier editions supports the effectiveness of this approach for learning advanced accounting.

- *Extensive illustrations of key concepts.* The book is heavily illustrated with complete workpapers, financial statements, and other computations and comparisons used in developing an understanding of each topic. The illustrations are cross-referenced to the relevant text discussion. Workpaper entries presented in the consolidation material are separately identified with an (E) and are shaded to clearly differentiate them from book entries. The extensive use of illustrations makes the learning process more efficient by allowing students to quickly and readily see the applications of the concepts. In addition, the illustrations reinforce understanding of the concepts by demonstrating the effects of the accounting concepts on the financial statements. In this manner, students understand that the many workpaper procedures typically covered in advanced accounting are the means to a desired end, not the end in themselves.

- *Comprehensive coverage with significant flexibility.* The subject matter of advanced accounting is expanding at an unprecedented rate. New topics are being added, and traditional topics require more extensive coverage. Flexibility is therefore essential in an advanced accounting text. Most one-term courses are unable to cover all the topics included in this text. In recognition of time constraints, this text is structured to provide the most efficient use of the time available. The self-contained units of subject matter allow for substantial flexibility in sequencing the course materials. In addition, individual chapters are organized to allow for opportunities to go into greater depth on some topics through the use of the “Additional Considerations” sections. Several chapters include appendixes containing discussions of alternative accounting procedures or illustrations of procedures or concepts that are of a supplemental nature.

## ORGANIZATION

The first part of the text covers business combinations and intercorporate ownership. The preparation of consolidated financial statements is discussed, beginning with the basic consolidation process and continuing through a variety of intercompany transactions. The continuous case of Peerless Products Corporation and its subsidiary, Special Foods, Inc., is used to demonstrate the concepts of consolidation. Accounting procedures for branches and agencies also are considered in this section of the text.

The next part of the text deals with multinational operations, including the treatment of transactions denominated in foreign currencies and the translation of the financial statements of foreign entities. These concepts are presented in the context of Peerless Products Corporation and its German subsidiary.

Special reporting issues in preparing segment and interim reports are discussed and illustrated. In addition, the role of the Securities and Exchange Commission in the regulation of accounting for publicly traded companies is examined.

The next section of the text focuses on partnership accounting and financial reporting in the context of the continuous example of the ABC Partnership. Partnership

formation and operation are presented in one chapter, and a separate chapter covers partnership dissolution and alternative forms of liquidation.

As a reflection of its increasing importance, thorough coverage is given to the accounting and financial reporting requirements for governmental and not-for-profit organizations. Two extensive chapters dealing with state and local governmental entities are followed by two chapters providing comprehensive coverage of accounting for colleges and universities, health care providers, voluntary health and welfare organizations, and other not-for-profit organizations. Each chapter is constructed around a comprehensive, integrated case example and presents the essential linkages between the accounting principles used to measure transactions and the financial reporting required for these entities.

The last part of the text presents the accounting and financial reporting procedures for entities in financial difficulty. The chapter focuses again on the example of Peerless Products Corporation. Impairment of receivables and troubled debt restructurings are presented first, followed by an extensive discussion and illustration of the accounting and financial reporting requirements for companies in legal reorganization or bankruptcy.

## FEATURES OF THE THIRD EDITION

Every effort was made to make this edition the most comprehensive and current advanced accounting text. The following are the major features of the revision:

- *Updating to reflect recent changes in accounting and financial reporting requirements.* Significant revisions were made in the chapters on health care providers, voluntary health and welfare organizations, and other not-for-profit organizations. Changes as a result of **FASB 117** requiring new reporting standards for not-for-profit entities are fully integrated into the two chapters on not-for-profit entities. **FASB 116** establishes new accounting requirements for accounting for contributions. Changes in accounting and reporting certain investments in debt and equity securities under **FASB 115** are discussed and illustrated. Creditor impairment and restructuring of receivables required under **FASB 114** is presented in the chapter on companies in financial difficulty. Recent FASB “Discussion Memorandums” on consolidation procedures and bases of measurement are considered in the chapters on consolidation.

- *Refinement and addition of student learning tools.* On the basis of comments from users of the earlier editions, we have continued to refine both the text and illustrations to clarify complex topics. We believe that, first and foremost, a textbook must be focused on meeting the learning needs of the students. Addition of citations from annual reports makes the material more “real” for the students. Illustrations have been modified or added on topics with which students often have some difficulty. Text has been rewritten to clarify points of discussion. Our goal continues to be to provide the most readable and clear advanced financial accounting textbook.

- *Enhanced end-of-chapter materials.* The end-of-chapter materials have been revised and a broader selection of materials has been provided. A new feature of the

Third Edition is the addition of critical thinking exercises to many of the chapters. These critical thinking exercises require students to prepare arguments, evaluate points of view, and use a variety of data to assess positions taken by participants in the accounting process. A wide range of questions, cases, exercises, and problems is presented at the end of each chapter to permit the instructor to make selections consistent with teaching objectives. Advanced accounting provides important preparation for the Uniform CPA Examination, and CPA Examination questions from recent exams have been included to ensure up-to-date coverage of the exam. Additional integrated, comprehensive problems have been provided as alternative assignment materials. A number of the exercises have been revised to cover more effectively the range of topics presented in each chapter. Items related to the “Additional Considerations” sections of the chapters are noted with an asterisk (\*) next to the item number. Those items related to appendixes are denoted by “A” or “B” to designate the specific appendix. Finally, cases in many of the chapters provide opportunities for students to use discovery learning skills and to enhance their written communication skills.

## ANCILLARY PROGRAM

This text is accompanied by a full ancillary program with items designed to complement your teaching efforts and your students’ learning process. If you would like information and costs on the supplemental materials, please contact your local McGraw-Hill, Inc., representative. We value both your interest and our supplements.

### Student Supplements

In addition to the learning aids contained in the text, the following supplements are available to help students learn advanced accounting:

**Study Guide** Closely coordinated with the text, this study guide contains summaries of the key concepts presented in each chapter and provides self-diagnostic and review materials in the form of multiple-choice, true/false, and fill-in-the-blank questions, as well as both short and comprehensive exercises, and problems. The solutions are given in the study guide so that students can readily assess their achievement level and identify topics that need further review.

**Accounting Workpapers** The workpapers are the forms needed to solve most end-of-chapter problems in the text. To increase efficiency for the students, the forms already contain trial balances, other opening data, and column headings.

**Checklist of Key Answers** Key answers are provided for many of the end-of-chapter materials in the text.

### Instructor Supplements

These teaching aids have been prepared by the authors of the textbook, each of whom has taught advanced accounting for many years. The following supplements are available:



**Solutions Manual** Solutions are provided for all questions, cases, exercises, and problems in the text. Solutions are carefully explained and logically presented. Answers to many of the multiple-choice questions include computations and explanations. Instructors can prepare transparencies directly from the solutions manual or can choose from the overhead transparencies available for selected exercises and problems.

**Overhead Transparencies** Large-type transparencies have been prepared for approximately 100 exercises and problems in the text.

**Instructor's Resource Manual** This manual consists of a summary and overview of each chapter and a "key point" outline that may be used to guide class discussion of each chapter. Teaching ideas are offered for the effective use of discovery learning activities, the use of electronic spreadsheeting in advanced accounting, and ways to increase student interest in the material. Descriptions are provided for each case, exercise, and problem to help instructors assign end-of-chapter materials that meet the specific learning objectives of the course. Additional problems are also presented for selected chapters which can be used to demonstrate chapter topics.

**Test Bank** This comprehensive collection of both conceptual and procedural test items has been completely revised. The material is organized by chapter and includes a large variety of multiple-choice questions and exercises and problems that can be used to measure student achievement in the topics in each chapter. The test items are closely coordinated with the text to ensure consistency.

**Computerized Testing Program** Questions in the Test Bank are available through RHTest, the computerized testing program. With RHTest, instructors can create and print tests quickly and easily. The computerized testing program allows instructors to edit, add your own, delete questions, and print scrambled versions of the same test. In addition, instructors may insert your own headings or instructions to a test. RHTest is available in 3.5 inch, DOS and Windows format and is available free to adopters.

**Computer Templates for Workpaper Problems** Spreadsheet templates are provided for problems from the text that require extensive workpaper format solutions. Students can work with the electronic spreadsheet to solve consolidation and other workpaper problems.

## ACKNOWLEDGMENTS

This text includes the thoughts and contributions of many individuals, and we wish to express our sincere appreciation to them. First, and foremost, we thank all the students in our advanced accounting classes, from whom we have learned so much. In many respects, this text is an outcome of the learning experiences we have shared with our students. Second, we wish to thank the many outstanding teachers we have

had in our educational programs, from whom we learned the joy of the educational process.

We are indebted to our colleagues in advanced accounting for helping us reach our goal of writing the best possible advanced financial accounting text. We appreciate the many valuable comments and suggestions from the instructors who used earlier editions of the text. Their comments and suggestions have contributed to making this text a more effective learning tool. We especially wish to thank: Mark Bettner, Bucknell University; Charles Christianson, Luther College; David Doran, Pennsylvania State University, Erie; John Engstrom, Northern Illinois University; David Gotlob, Indiana University–Purdue University at Fort Wayne; Sharron Hoffmans, University of Texas at El Paso; Gordon Hosch, University of New Orleans; David Karmon, Central Michigan University; James Lahey, Northern Illinois University; Ralph McQuade, Jr., Bentley College; Mary Maury, St. John's University; Philip Meyer, Boston University; Jon Nance, Southwest Missouri State University; Terence Reilly, Albright College; Max Rexroad, Illinois State University; Andrew Rosman, University of Connecticut; Norlin Rueschhoff, University of Notre Dame; John Simon, Northern Illinois University; Ted Skekel, University of Texas, San Antonio; Pam Smith, Northern Illinois University; and James Stice, Brigham Young University.

We also wish to thank Wayne Higley, Buena Vista College, and Wayne W. McManus, for their assistance in revising end-of-chapter materials for several chapters in the text. Eugene Rozanski, Illinois State University, prepared many of the computer templates, and Jon Bacon, Northern Illinois University, assisted in the preparation of additional computer templates. Typing assistance was provided by Carol Denton, Northern Illinois University. Charles W. Christianson, Luther College, served as a comprehensive problem-checker and reviewed solutions to end-of-chapter materials for both accuracy and completeness. We are grateful for the assistance and direction of the McGraw-Hill team, including Judy Howarth, Joseph Murphy, Denise Puryear, Karen Quigley, and, especially, Alan Sachs, our Executive Editor, who provided support and guidance for this third edition.

Permission has been received from the Institute of Certified Management Accountants of the Institute of Management Accountants to use questions and/or unofficial answers from past CMA examinations. We appreciate the cooperation of the American Institute of Certified Public Accountants for providing permission to adapt and use materials from past Uniform CPA Examinations.

Above all, we extend our deepest appreciation to our wives and children, who continue to provide the encouragement and support necessary for this textbook.

*Richard E. Baker*  
*Valdean C. Lembke*  
*Thomas E. King*

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# CONTENTS

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<b>Preface</b>	<b>xxiii</b>
<b>1 Corporate Expansion and Accounting for Business Combinations</b>	<b>1</b>
THE DEVELOPMENT OF MULTICORPORATE ENTITIES	2
Reasons for Corporate Expansion	2
Forms of Corporate Expansion	2
Frequency of Business Combinations and Multicorporate Entities	4
EXPANSION THROUGH BUSINESS COMBINATIONS	5
Types of Business Combinations	5
Methods of Effecting Business Combinations	6
Valuation of Business Entities	7
ACCOUNTING AND REPORTING ALTERNATIVES	9
PURCHASE ACCOUNTING	10
Nature of Purchase Treatment	10
Determining the Purchase Price	10
Combination Effected through Purchase of Net Assets	11
Combination Effected through Purchase of Stock	16
Financial Reporting Subsequent to a Purchase	17
Disclosure Requirements	17
POOLING OF INTERESTS ACCOUNTING	18
Nature of Pooling Treatment	19
Distinguishing Characteristics of Pooling	20
Combination Effected through Acquisition of Net Assets	20
Differences in Total Par Value	22
	<b>vii</b>

- Tax allocations, interperiod (*see* Interperiod income tax allocation)
- Tax aspects of consolidation, 553–561
- Tax expense allocations, 553–555
- Temporary tax differences, 88–90, 555–561
- Tender offer, 6
- Theories of consolidation (*see* Consolidation, theories of)
- Three-part consolidation workpaper, 218–219, 222–223
- Transfer price, 601
  - (*See also* Intercompany transactions, transfer cost)
- Translation of foreign financial statements, 689–702
  - cumulative translation adjustment, 690
  - current rate method, 691
  - functional currency, 685
    - determining, 685–687
  - functional currency indicators, 685
  - income taxes, 717
  - intercompany transactions, 715–717
  - inventory valuation under remeasurement,
    - lower-of-cost-or-market rule, 714–715
  - proof of remeasurement exchange gain, 712–714
  - remeasurement, 687, 702–708
    - foreign currency, 687
  - remeasurement gain or loss, 703
    - illustrated, 704–708
    - statement presentation, 703
  - statement of cash flows, 714
  - translation, 687
  - translation and consolidation of a foreign subsidiary:
    - illustrated, 690–702
    - third currency as functional currency, 717–718
    - versus remeasurement, 709–710
  - translation adjustment, 689
  - statement presentation, 689
- Transnational accounting (*see* Multinational accounting)
- Treasury stock, 126, 191–192, 484–492, 503–506
- Treasury stock method of accounting for
  - reciprocal ownership, 513–516
- Troubled debt restructuring, 1234–1243
  - illustrated, 1236–1243
- Trust funds, 1050–1056
  - expendable, illustrated, 1053–1056
  - nonexpendable, illustrated, 1050–1053
  - pension trust, 1056–1057
- Trustee accounting and reporting, 1261–1267
  - statement of realization and liquidation, 1262
- Unconsolidated subsidiaries, 62, 68
- Uniform Partnership Act, 844–905
- Unrealized intercompany profits:
  - assignment of elimination, 301–302
  - in consolidation, 86, 131–132, 297
  - elimination of, 297–302, 311–312
  - under equity-method reporting, 86–87
  - multilevel ownership, 513
  - tax effects, 555–561
  - theories of consolidation, 145–147
- Upstream sale, 301
- Valuation:
  - of assets and liabilities, 7
  - of business entities, 7–8
  - of consideration exchanged, 8
  - of earnings, 8
  - of investments in equity securities, 81–84
- Valuation accounts, 82–83, 192–193
- Voluntary health and welfare organizations (VHWOs), 1188–1200
  - accounting for, 1188–1189
  - statement of activities, 1194–1198
    - costs of informational materials, 1197
  - statement of financial position, 1189–1194
  - donated materials and services, 1194–1196
  - investments, 1192–1193
  - land, buildings, and equipment, 1193
  - pledges, 1189–1192
  - public support, 1194
  - statement of functional expenses, 1197–1198
- Workpapers:
  - branch accounting, 606–612
  - consolidation (*see* Consolidation workpapers)

SUMMARY OF KEY CONCEPTS AND TERMS	94
<b>3 The Reporting Entity and Consolidated Financial Statements</b>	<b>120</b>
USEFULNESS OF CONSOLIDATED FINANCIAL STATEMENTS	121
Long-Term Investors	121
Parent Company Management	122
Other Interested Parties	122
LIMITATIONS OF CONSOLIDATED FINANCIAL STATEMENTS	122
SUBSIDIARY FINANCIAL STATEMENTS	123
THE CONSOLIDATED REPORTING DECISION: CONCEPTS AND STANDARDS	123
The Changing Concept of the Reporting Entity	124
Control	124
Indirect Control	125
Ability to Exercise Control	126
Permanence of Control	126
Differences in Fiscal Periods and Accounting Methods	126
OVERVIEW OF THE CONSOLIDATION PROCESS	127
THE CONSOLIDATION PROCESS ILLUSTRATED	127
The Consolidated Entity	128
Mechanics of the Consolidation Process	132
NONCONTROLLING INTEREST	133
EFFECT OF PURCHASE VERSUS POOLING	
ACCOUNTING ON CONSOLIDATION	134
COMBINED FINANCIAL STATEMENTS	135
ADDITIONAL CONSIDERATIONS—THEORIES OF CONSOLIDATION	135
Proprietary Theory	136
Parent Company Theory	137
Entity Theory	139
Current Practice	140
SUMMARY OF KEY CONCEPTS AND TERMS	140
 <i>APPENDIX A: THEORIES OF CONSOLIDATION ILLUSTRATED</i>	 141
ILLUSTRATION OF THE EFFECTS OF DIFFERENT APPROACHES	144
NET ASSETS RECOGNIZED AT ACQUISITION	145
ELIMINATION OF UNREALIZED PROFITS	145
CONSOLIDATED NET INCOME	146
NONCONTROLLING INTEREST	146
 <i>APPENDIX B: ACCOUNTING FOR INTERCORPORATE INVESTMENTS</i>	 147
<b>4 Consolidation as of the Date of Acquisition</b>	<b>165</b>
CONSOLIDATION WORKPAPERS	166
Workpaper Format	166
Nature of Eliminating Entries	167

PREPARATION OF CONSOLIDATED BALANCE SHEET IMMEDIATELY FOLLOWING ACQUISITION OF FULL OWNERSHIP	167
Full Ownership Purchased at Book Value	168
Full Ownership Purchased at More than Book Value	171
Treatment of a Positive Differential	173
Illustration of Treatment of Debit Differential	176
Full Ownership Purchased at Less than Book Value	179
Illustration of Treatment of Credit Differential	180
Ownership Purchased at More than Book Value and Less than Fair Value	182
PREPARATION OF CONSOLIDATED BALANCE SHEET IMMEDIATELY FOLLOWING ACQUISITION OF CONTROLLING INTEREST	183
Controlling Ownership Purchased at Book Value	183
Controlling Ownership Purchased at More than Book Value	185
Illustration of Treatment of Debit Differential	186
Controlling Ownership Purchased at Less than Book Value	188
EFFECT OF COST VERSUS EQUITY ON CONSOLIDATION	188
INTERCORPORATE RECEIVABLES AND PAYABLES	188
ADDITIONAL CONSIDERATIONS	189
Asset and Liability Valuation Accounts at Acquisition	189
Negative Retained Earnings of Subsidiary at Acquisition	191
Other Stockholders' Equity Accounts	191
Push-Down Accounting	192
SUMMARY OF KEY CONCEPTS AND TERMS	193
 <b>5 Consolidation Following Acquisition</b>	 <b>213</b>
OVERVIEW OF THE CONSOLIDATION PROCESS	213
Consolidated Net Income	214
Consolidated Retained Earnings	215
Workpaper Format	218
CONSOLIDATION—100 PERCENT OWNERSHIP	218
Year of Combination	220
Second and Subsequent Years of Ownership	224
CONSOLIDATION—CONTROLLING OWNERSHIP PURCHASED AT BOOK VALUE	226
Year of Combination	227
Second Year of Ownership	230
CONSOLIDATION—CONTROLLING OWNERSHIP PURCHASED AT MORE THAN BOOK VALUE	233
Year of Combination	233
Second Year of Ownership	239
CONSOLIDATION FOLLOWING AN INTERIM ACQUISITION	244
Parent Company Entries	246
Consolidation Workpaper	247

DISCONTINUANCE OF CONSOLIDATION	250
ADDITIONAL CONSIDERATIONS RELATING TO THE ASSIGNMENT OF DIFFERENTIAL	250
Disposal of Differential-Related Assets by Subsidiary	250
Differential Assigned to Liabilities	252
SUMMARY OF KEY CONCEPTS AND TERMS	253
 <i>APPENDIX A: CONSOLIDATION AND THE COST METHOD</i>	254
IMPACT ON THE CONSOLIDATION PROCESS	254
CONSOLIDATION—YEAR OF COMBINATION	254
Parent Company Cost-Method Entries	254
Consolidation Workpaper—Year of Combination	255
CONSOLIDATION—SECOND YEAR OF OWNERSHIP	257
Parent Company Cost-Method Entry	257
Consolidation Workpaper—Second Year Following Combination	257
Consolidated Retained Earnings	261
 <i>APPENDIX B: PUSH-DOWN ACCOUNTING ILLUSTRATED</i>	262
WORKPAPER REVALUATION	262
PUSH-DOWN ACCOUNTING	263
 <b>6 Intercompany Transfers: Noncurrent Assets</b>	<b>295</b>
OVERVIEW OF THE CONSOLIDATED ENTITY	295
Elimination of Intercompany Transfers	296
Elimination of Unrealized Profits and Losses	297
ASSET TRANSFERS INVOLVING LAND	299
Overview of the Profit Elimination Process	299
Assignment of Unrealized Profit Elimination	301
Downstream Sale	303
Upstream Sale	307
Eliminating Unrealized Profits after the First Year	311
Subsequent Disposition of Asset	312
ASSET TRANSFERS INVOLVING DEPRECIABLE ASSETS	314
Downstream Sale	314
Change in Estimated Life of Asset Sold to Subsidiary	324
Upstream Sale	326
Asset Transfers before Year-End	333
ASSET TRANSFERS INVOLVING AMORTIZABLE ASSETS	333
SUMMARY OF KEY CONCEPTS AND TERMS	333
 <i>APPENDIX: INTERCOMPANY TRANSFERS OF NONCURRENT ASSETS—FULLY ADJUSTED EQUITY METHOD AND COST METHOD</i>	334
FULLY ADJUSTED EQUITY METHOD	334
Fully Adjusted Equity-Method Entries—19X1	335

Consolidation Workpaper—19X1	336
Fully Adjusted Equity-Method Entries—19X2	338
Consolidation Workpaper—19X2	339
<b>COST METHOD</b>	<b>341</b>
Consolidation Workpaper—19X1	341
Consolidation Workpaper—19X2	343
 <b>7 Intercompany Inventory Transactions</b>	 <b>366</b>
GENERAL OVERVIEW	366
Transfers at Cost	367
Transfers at a Profit or Loss	366
Effect of Type of Inventory System	368
<b>DOWNSTREAM SALE—PERPETUAL INVENTORY SYSTEM</b>	<b>368</b>
Resale in Period of Intercompany Transfer	369
Resale in Period following Intercompany Transfer	370
Inventory Held Two or More Periods	378
<b>UPSTREAM SALE—PERPETUAL INVENTORY SYSTEM</b>	<b>378</b>
Basic Equity-Method Entries—19X1	379
Consolidation Workpaper—19X1	380
Consolidated Net Income—19X1	382
Basic Equity-Method Entries—19X2	382
Consolidation Workpaper—19X2	383
Consolidated Net Income—19X2	383
<b>SUMMARY COMPARISON OF INTERCOMPANY INVENTORY TRANSACTIONS</b>	<b>385</b>
<b>ADDITIONAL CONSIDERATIONS</b>	<b>385</b>
Sale from One Subsidiary to Another	385
Costs Associated with Transfers	387
Lower of Cost or Market	387
Sales and Purchases before Affiliation	388
<b>SUMMARY OF KEY CONCEPTS AND TERMS</b>	<b>388</b>
 <i>APPENDIX A: INTERCOMPANY TRANSFERS UNDER A PERIODIC INVENTORY SYSTEM</i>	 <b>389</b>
Resale in Period of Intercompany Transfer	389
Resale in Period following Intercompany Transfer	390
Inventory Held Two or More Periods	396
<b>SUMMARY COMPARISON OF PERPETUAL AND PERIODIC INTERCOMPANY INVENTORY SYSTEMS</b>	<b>396</b>
 <i>APPENDIX B: INTERCOMPANY INVENTORY TRANSACTIONS—FULLY ADJUSTED EQUITY METHOD AND COST METHOD</i>	 <b>396</b>
<b>FULLY ADJUSTED EQUITY METHOD</b>	<b>396</b>
Fully Adjusted Equity-Method Entries—19X1	399



Consolidation Elimination Entries—19X1	399
Fully Adjusted Equity-Method Entries—19X2	400
Investment Account Balance	400
Consolidation Elimination Entries—19X2	401
<b>COST METHOD</b>	<b>402</b>
Consolidation Elimination Entries—19X1	402
Consolidation Elimination Entries—19X2	403
 <b>8 Intercompany Indebtedness</b>	 <b>430</b>
CONSOLIDATION OVERVIEW	430
BOND SALE DIRECTLY TO AN AFFILIATE	432
Transfer at Par Value	432
Transfer at a Discount or Premium	433
BONDS OF AFFILIATE PURCHASED FROM A NONAFFILIATE	436
Purchase at Book Value	436
Purchase at an Amount Less than Book Value	436
Purchase at an Amount Greater than Book Value	450
ADDITIONAL CONSIDERATIONS—INTERCORPORATE	
LEASING TRANSACTIONS	451
Operating Leases	452
Direct Financing Leases	452
Sales-Type Leases	454
SUMMARY OF KEY CONCEPTS AND TERMS	457
 <i>APPENDIX: INTERCOMPANY INDEBTEDNESS—FULLY ADJUSTED</i>	
<i>EQUITY METHOD AND COST METHOD</i>	457
FULLY ADJUSTED EQUITY METHOD	458
Fully Adjusted Equity-Method Entries—19X1	458
Consolidation Elimination Entries—19X1	458
Fully Adjusted Equity-Method Entries—19X2	459
Investment Account—19X2	460
Consolidation Elimination Entries—19X2	460
COST METHOD	461
Consolidation Elimination Entries—19X1	461
Consolidation Elimination Entries—19X2	462
 <b>9 Consolidation Ownership Issues</b>	 <b>484</b>
SUBSIDIARY PREFERRED STOCK OUTSTANDING	484
Consolidation with Subsidiary Preferred Stock Outstanding	485
Subsidiary Preferred Stock Held by Parent	486
Subsidiary Preferred Stock with Special Provisions	489
Illustration of Subsidiary Preferred Stock with Special Features	489
CHANGES IN PARENT COMPANY OWNERSHIP	492
Parent's Purchase of Additional Shares from Nonaffiliate	492