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ADVANCED Accounting

MODUL PRAKTIKUM

AKUNTANSI KEUANGAN LANJUTAN 2

Disusun Oleh:
Dikdik Saleh Sadikin, SE., MSi.

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BANKING SCHOOL
Reaching The Future with Integrity

Edisi 1

MODUL
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Disusun oleh:
Dikdik Saleh Sadikin, SE., MSi

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Kata Pengantar

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Isi dan format modul ini berupa ringkasan materi Akuntansi Keuangan Lanjutan yang banyak mengacu dan mengutip pada buku: Advanced Accounting karangan Debra C. Jeter & Paul K.Chaney, edisi kelima, John Wiley & Sons, Inc USA, tahun 2014. Di samping itu, penulis menambahkan materi dari : Advanced Financial Accounting karangan Richard E.Baker dkk, edisi ketujuh, McGraw-Hill International Edition,USA ,tahun 2005.

Harapan penyusun semoga diktat kuliah ini banyak manfaatnya. Mungkin diktat kuliah ini masih ada kekurangan dan kesalahan, untuk itu penyusun mohon maaf. Kritik dan saran dari semua pihak sebagai bahan penyempurnaan diktat kuliah ini sangat kami harapkan.

Jakarta , 9 Nopember 2015.

Penyusun

Dikdik S Sadikin

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Introduction Business Combinations and The Conceptual Framework

Learning Objectives :

1. Describe historical trends in types of business combination.
2. Identify the major reasons firm combine.
3. Identify the factors that managers should consider in exercising due diligence in business combinations.
4. Identify defensive tactics used to attempt to block business combinations.
5. Distiguish between an asset and a stock acquisition.
6. Indicate the factors used to determine the price and the method of payment for a business combination.
7. Calcuate an estimate of the value of goodwill to be included in an offering price by discounting expected future excess earnings over some period of years.
8. Decribe two alternative views of consolidated financial statements : the economic entity and the parent company concepts.
9. Decribe some of the current joint project of the FASB and the International Accounting Standards Board (IASB), and their primary objectives.

Referensi

Debra C. Jetter, Advance Accounting, International Student Version, 5th edition, John Wiley, 2012.

INTRODUCTION

This chapter introduces you to a fascinating topic which will occupy a considerable part of your course – Business Combinations. Many new terms will be reviewed, and a little history will help you to get a perspective of the quickly changing role of business combinations in our current business climate. You should take particular note of the terms *merger, consolidation*, and *stock acquisition*, as they are defined by accountants. The concept of how businesses determine how much to offer in a business combination is also reviewed, as well as some cautions about the transactions.

CHAPTER OUTLINE

1.1 Introduction

- A. Merger activity has slowed in the new century.
  1. Is bigger really better? – not everyone agrees.
  2. Antitrust laws prohibit mergers that lessen competition.
  3. Less competition might, in the long run, decrease benefits to stockholders and consumers.
- B. Many mergers have not led to the growth that companies hoped for.

1.2 Nature of the Combination

- A. Definitions

1. *Friendly combination*: The boards of two companies mutually agree to join together
2. *Unfriendly (hostile) combination*: A company resists being acquired but the acquiring company still pursues the combination
3. T*ender offer*: The acquiring company goes directly to the stockholders of the target company

B. Defense tactics: Ways the target company can resist a hostile takeover
1. Poison pill
2. Greenmail
3. White knight (white squire)
4. Pac-man defense
5. Selling the crown jewels
6. Leveraged buyout

1.3 Business Combinations

A. Why?
1. External expansion over internal expansion
   a. *External expansion:* A company grows by buying other companies
   b. *Internal expansion:* A company chooses to grow by increasing its own operations, generally through retained earnings
2. Operating synergies
   a. A company can combine with its competition (horizontal) or with its suppliers and customers (vertical).
      i) Already existing organization
      ii) Combination of strengths
      iii) Economies of scale
   b. A company can expand into the international market
   c. A company can derive tax savings
   d. A company can diversify to other industries to minimize risk
   e. A company can divest divisions, which are not part of the company's core business

B. Why not?
1. Growth outstrips management expertise
2. Divestitures might result
3. Dilution of equity might occur
4. Size might lead to inefficiencies of current efficiencies

1.4 Business Combinations: Historical Perspective

A. Three periods
1. Horizontal integration: 1880 – 1904
   a. A company buys one or more of its competitors in order to increase its market share
   b. Large holding companies were used to create monopolies
2. Vertical integration: 1905 – 1930
   a. A company buys its suppliers and/or its customers to streamline production and the marketing channel
   b. Originally developed along with assembly lines and then for the war effort for World War I, the technique persisted after the war ended.
3. Merger mania: 1945 – present

    a. Rapid expansion in the number and dollar value of combinations has been seen
    b. This era can be subdivided into separate trends
        i) Mergers from the 1950 to the 1970s were generally *conglomerate* mergers primarily motivated by a desire for diversification
        ii) The 1980s and 1990s were known for *strategic acquisitions* – made for operating synergies, when firms' strengths were complementary
    c. Most recently, the Federal Government is calling for a review of merger activity in general

1.5 Terminology and Types of Combinations

A. Asset acquisition (we'll study this in Chapter 2): All (100 percent) of the assets of one company are bought by another company, and the acquired company ceases to exist
    1. Statutory merger: (A Company + B Company = A Company)
    2. Statutory consolidation: (A Company + B Company = C Company)

B. Stock acquisition (Chapters 3 – 9): The acquiring company lists the acquired company on its books as an investment, but the acquired company continues to be a separate *legal* entity, and the two companies are considered to be a single *economic* entity when the acquiring company owns a majority (50 percent or more) interest.
    1. Separate legal entities: (A Company + B Company = A, Parent + B, Subsidiary)
    2. Consolidated financial statements which combine the statements of both companies must be prepared

1.6 Takeover premiums

A. When the acquiring company pays more than market price for the target company's stock, a takeover premium arises

B. Reasons for a takeover premium
    1. The acquiring company's own stock prices are at a level which makes it good to issue stock at a premium
    2. The target company's assets are worth more than its stock price would indicate
    3. The acquiring company feels a pressing need to expand
        a. Expansion in the global marketplace
        b. Target company has high cash flows that can benefit the acquiring company
        c. Payout options for executives (golden parachutes) are very high
    4. Some analysts have suggested that companies are just paying too much

1.7 Avoiding Pitfalls before the Deal

A. Be skeptical about percentages presented by selling company

B. Analyze the target company for assumed liabilities as well as assumed assets

C. Check expense allocations

D. Look for nonrecurring items, changes in estimates, accruals

E. Use caution when dealing with CEO's egos

1.8 Determining Price and Method of Payment

A. The acquiring company must decide how to finance the acquisition – cash, stock, debt.

B. In the 1990s, stock swaps were a common means of acquisition because of the high value of stocks. That made determining the price difficult.
    1. Stock exchange ratio
    2. Negotiated price

C. Companies also use net asset and future earnings combinations to determine the value of a company
   1. The price should be based on the current value of the net assets acquired and the expected earning power in the future
      a. Goodwill is the excess of cost over the fair value of the net assets acquired
      b. Goodwill usually arises when expected earnings exceed the normal rate of return
   2. The merger is dilutive if EPS decreases after the acquisition and accretive if EPS increases

1.9 Alternative Concepts of Consolidated Financial Statements

A. When the business combination is the result of a stock acquisition (a parent-subsidiary relationship), then a consolidated entity results from that acquisition. FASB ASC Topics 805 [Business Combinations] and 810 [Consolidations] require that consolidated statements be presented viewing the firm as one entity (the economic entity concept).
B. Parent company concept
   1. Emphasis to parent company's stockholders
   2. Stockholders' equity of the consolidated entity is also the stockholders' equity of the parent company
   3. The consolidated financial statements are meant to be informative about the parent's total ownership
C. Economic entity concept
   1. Emphasizes control of the whole by a single management
   2. Consolidated financial statements are information about a group of legal entities operating as a single economic entity
D. Noncontrolling interest
   1. Under the economic entity concept, a noncontrolling interest is part of the ownership equity in the entire economic unit
   2. Under the parent company concept, the nature and classification of noncontrolling interest is unclear. It is reported below liabilities, but above stockholders' equity
E. Consolidated net income
   1. Parent company concept – only includes net income after deducting noncontrolling interest in income
   2. Economic entity concept – consolidated net income is the total realized combined income, some of which belongs to the noncontrolling interest
F. Consolidated balance sheet values
   1. Parent company concept – write up the subsidiary's assets by the parent company's share of the difference between cost and fair value
   2. Economic entity concept – write up the subsidiary's assets by the entire difference between cost and fair value
G. Intercompany profit
   1. Total elimination – eliminate 100 percent of all unrealized profit in intercompany sales
   2. Partial elimination – eliminate only the parent's percentage of unrealized profit in intercompany sales
H. Current practice
   1. The economic entity concept

2. Don't worry if this all looks pretty confusing now – you'll learn it all in the next eight chapters!

1.10 FASB's Conceptual Framework

A. Economic Entity vs. Parent Concept and the Conceptual Framework
   1. The adoption of the economic entity concept over the parent company concept is due in part to joint project of the FASB and the IASB to converge accounting standards and to have the same conceptual framework.
   2. FASB and IASB are currently working on a conceptual framework together, the first phase of which (SFAC No. 8: Conceptual Framework for Financial Reporting), is complete.
   3. The parent company concept is tied to the historical cost principle. Advocates of this approach argued that it produced more reliable values, and reliability is considered as one of the primary qualitative characteristics. The current IASB conceptual statement does not refer to historical cost as a valuation basis.
   4. The economic entity concept is an integral part of the FASB's current conceptual framework and is named specifically in SFAC No 5. The economic entity concept is argued to produce more relevant information
   4. The two primary characteristics of information often find themselves in conflict.

B. Overview of FASB's Conceptual Framework - see Figure 1-2 of the textbook for a brief summary of Statements of Financial Accounting Concepts (SFAC) issued by FASB

C. Linking the Conceptual Framework to Advanced Accounting Issues
   1. Comparability is an enhancing quality of the fundamental qualities of relevance and faithful representation.
   2. The quality of comparability was very much at stake in FASB's decision to eliminate the pooling of interests method for business combinations

D. Distinguishing between Earnings and Comprehensive Income
   1. Earnings are revenues and gains minus expenses and losses, with the exception of any losses or gains explicitly stated by FASB to bypass earnings and be reported in other comprehensive income
   2. Some changes in market values of investments and foreign currency translation adjustment are examples of such "odd" gains. Certain gains or losses related to net pension liability may bypass earnings as well
   3. Items which bypass earnings will not appear in retained earnings, and will appear on the balance sheet as a separate component of stockholders' equity.
   4. FASB ASC Topic 220 [Statement of Comprehensive income] which proposes the use of a single statement of comprehensive income is expected to become final in 2011.

E. Asset Impairment and the Conceptual Framework
   1. FASB's former approach of amortization of intangible assets illustrates the consumption of benefit approach, while the impairment standard illustrates a loss or lack of benefit approach
   2. The consumption of benefit approach emphasizes a more direct matching of expenses to revenues, while the loss or lack of benefit approach represents an example of those types of expenses that are most difficult to match adequately to the generation of revenue

1.11 FASB Codification Project

A. The FASB Accounting Standard Codification is the single source of authoritative non-governmental U.S generally accepted accounting principles
B. Replaces GAAP hierarchy.
C. Will make convergence of U.S. GAAP and international standards easier since topic and section material correlate
D. Intended to simplify classification of existing and future standards by restructuring all authoritative U.S. GAAP into one online database with a common referencing system
E. Referencing codification involves up to four numbers (topic -subtopic- section- paragraph)
F. General Principles (Topic 105)
G. Topics organized into four areas
   1. Presentation (topics 205-299)
   2. Financial Statement Accounts (topics 305-700)
   3. Broad Transactions (topics 805-899).
   4. Industries (topics 905-999)

MULTIPLE CHOICE QUESTIONS

Choose the BEST answer for the following questions.

_____ 1. Each of the following is an advantage of an external expansion *except:* A company
   a. can increase its market share by buying its competition.
   b. can make the distribution channel more efficient by buying its suppliers or customers.
   c. must divest itself of a portion of the purchased company to survive.
   d. can diversify to other industries to minimize risk.

_____ 2. A hostile takeover can be resisted by a:
   a. poison pill.
   b. white knight.
   c. pac-man defense.
   d. all of the above.

_____ 3. The combination technique where large holding companies are used to create monopolies is:
   a. horizontal integration.
   b. vertical integration.
   c. merger mania.
   d. diversification.

_____ 4. The combination technique generally used to streamline the production and marketing channels of a company is:
   a. horizontal integration.
   b. vertical integration.
   c. merger mania.
   d. diversification.

_____ 5. The type of business combination where two companies join to make a third company is a:
   a. statutory merger.

b. statutory consolidation.
c. stock acquisition.
d. asset acquisition.

______ 6. When the target company in an acquisition resists the offer of the acquiring company, the combination is often called a:
a. friendly combination.
b. stock acquisition.
c. hostile combination.
d. leveraged buyout.

______ 7. A takeover premium often results from the:
a. assets of the target company being worth more than the market price of the shares would indicate.
b. acquiring company getting a bargain on the stock.
c. target company having a need for more cash.
d. acquiring company not needing to expand.

______ 8. When an acquiring company exercises due diligence in attempting a business combination, it should:
a. be skeptical about accepting the target company's stated percentages.
b. analyze the target company for assumed liabilities as well as assets.
c. look for nonrecurring items such as changes in estimates.
d. all of the above.

______ 9. If earnings per share decline after a business combination, the combination is:
a. dilutive.
b. accretive.
c. an acquisition.
d. a pooling of interests.

______10. What should an acquiring company use to determine the value of a target company?
a. Fair value of total assets
b. Fair value of net assets
c. Future earnings estimates
d. Both the fair value of net assets and expected future earnings

______11. The economic entity concept has been adopted by which, if any, standard setting bodies:
a. FASB.
b. IASB.
c. FASB and IASB.
d. neither FASB nor IASB.

______12. The economic entity concept:
a. stresses the subsidiary's individual control over its operations.

b. looks at the substance of the economic entity rather than the form of the separate legal entities.
c. keeps the books of the parent company completely separate from the books of the subsidiary at all times, even in the reported financial statements.
d. all of the above.

_____13. The noncontrolling interest under the economic entity concept is classified as:
a. an asset.
b. a liability.
c. ownership equity
d. none of the above.

_____14. Which is the current practice used?
a. the parent company concept.
b. the economic entity concept.
c. a combination of the two.
d. none of the above.

EXERCISE

1. **Estimating Goodwill and Potential Offering Price**

Plantation Homes Companya is considering the acquisition os Condominiums, Inc. Early in 2008. To access the amount it might be willing to pay. Plantation Homes makes the following computations and assumptions.

A. Condominiums, Inc. has identifiable assets with a total fair value of $15,000,000 and liabilities of $8,000,000. The assets include office equipment with a fair value approximating book value, buildings with a fair value 30% higher than book value, and land with a fair value 75% higher than book value. The remaining lives of the assets are deemed to approximately equal to those used by Condominium, Inc.

B. Condominium, Inc's pretax incomes for the years 2005 through 2007 were $1,200,000, $1,500,000 and $950,000 respectively. Plantation Homes believes that an average of the earnings represents a fair estimate of annual earnings for the indefinite future. However, it may need to consider adjustment to the following items included in pretax earnings.

Depreciation on buildings (each year)	960,000
Depreciation on equipment (each year)	50,000
Extraordinary loss (year 2007)	300,000
Sales commissions (each year)	250.000

C. The normal rate of return on net assets for the industry is 15%.

Required :

A. Assume further that Plantation Homes feels that it must earn a 25% return on its investment and that goodwill is determined by capitalizing excess earnings. Based on these assumptions, calculate a reasonable offering price for Condominium, Inc. Indicate how much of the price consists of goodwill. Ignore tax effects.

B. Assume that Plantation Homes feels that it must earn a 15% return on its investment, but the average excess earnings are to be capitalized for three year only. Based on these assumptions, calculate a reasonable offering price for Condominiums, Inc. Indicate how much of price consist of goodwill. Ignore tax effects.

2. Estimating Goodwill and Valuation

Alpha Company is considering the purchase of Beta Company. Alpha has collected the following data about Beta :

	Beta Company Book Value	Estimated Market Value
Total identifiable assets	$585,000	$750,000
Total liabilities	$320,000	$320,000
Owner's equity	$265,000	

Cummulative total net cash earning for the past five years of $850,000 includes extraordinary cash gains of $67,000 and nonrecurring cash losses of $48,000.

Alpha Company expect a return on its investment of 15%. Assume that Alpha prefers to use cash earnings rather than accrual based earnings to estimate its offering price, and that it estimates the total valuations of Beta to be equal to the present value of cash based earnings (rather than excess earnings) discounted over five years. (Goodwill is then computed as the amount implied by the excess of the total valuation over the identifiable net assets valuation)

Required :

A. Compute (a) an offering price base on the information above that Alpha might be willing to pay, and (b) the amount of goodwill included in that price.

B. Compute the amount of goodwill actually recorded, assuming the negotiations result in a final purchase price of $625,000 cash.

Accounting for Business Combinations

Learning Objectives :

1. Describe the major changes in the accounting for business combinations passed by the FASB in December 2007, and the reasons for those changes.
2. Describe the two major changes in the accounting for business combinations approved by the FASB in 2001, as well as the reasons for those changes.
3. Discuss the goodwill impairment test described in SFAS No. 142 [ASC 350–20–35], including its frequency, the steps laid out in the new standard, and some of the likely implementation problems.
4. Explain how acquisition expenses are reported.
5. Describe the use of pro forma statements in business combinations.
6. Describe the valuation of assets, including goodwill, and liabilities acquired in a business combination accounted for by the acquisition method.
7. Explain how contingent consideration affects the valuation of assets acquired in a business combination accounted for by the acquisition method.
8. Describe a leveraged buyout.
9. Describe the disclosure requirements according to Current GAAP related to each business combination that takes place during a given year.
10. Describe at least one of the differences between U.S. GAAP and IFRS related to the accounting for business combinations.

Referensi

Debra C. Jetter, Advance Accounting, International Student Version, 5th edition, John Wiley, 2012.

INTRODUCTION

This chapter introduces you to the new technique for recording a business combination. It also gives you some background on how the new rules evolved, and what was done before the recent changes. There are some important illustrations in the book concerning the techniques.

CHAPTER OUTLINE

2.1 Historical Perspective on Business Combinations

- A. Historically, there were two methods
  1. Purchase
  2. Pooling of interests – restricted by APB Opinion No. 16 in 1970
- B. New rules
  1. SFAS No. 141 discontinued the “pooling method” and allows for the “purchase method” only.
  2. SFAS No. 141R replaced SFAS 141. Only one method is allowed, the “acquisition method”.
  3. SFAS No. 141R requires that fair values of all assets and liabilities on the acquisition date, defined as the date the acquirer obtains control of the acquire, be reflected in financial statements.

4. These topics are now codified in FASB ASC Topic 805 [Business Combinations].
5. SFAS No. 142, now included in FASB ASC Topic 810 [Consolidations], changes the way goodwill is accounted for at acquisition and FASB ASC Topic 350 how goodwill is accounted for subsequent to acquisition.
6. FASB ASC Topic 810 [Consolidations] on reporting for non-controlling interests is covered in Chapter 3.
7. The new standards try to overcome criticisms that have haunted the accounting for some time:
   a. Differences between U.S. GAAP and International Financial Reporting Standards
   b. Lack of consistency, understandability and usefulness in accounting for step acquisitions
8. The essence of the changes is that the acquired business should be recognized at its fair value on the acquisition date (defined as the date when control is obtained), rather than its cost.

2.2 Goodwill Impairment Test required by FASB ASC paragraph 350-20-35-18

A. Goodwill must be tested annually to see if its value has permanently declined.
   1. For "new" goodwill, the loss is current.
   2. For goodwill from acquisitions prior to the new ruling, the loss is treated as a change in accounting principle.

B. Technique
   1. Goodwill is assigned to a reporting unit.
   2. There is a two-step process.
      a. Step 1. Determine whether the carrying value of the reporting unit is greater than zero
         i. If CV < zero and circumstances suggest that it is more likely than not that goodwill has been impaired, step 2 is necessary
         ii. Such circumstances include unanticipated competition, loss of key personnel, and adverse regulatory action
      b. Step 2. Compare the carrying value of goodwill to its "implied fair value" (calculated as FV of reporting unit – FV of identifiable net assets)
         i. Same as original value calculation on date of acquisition
         ii. Acquisition price – FV of identifiable net assets = goodwill
   3. When the loss is recognized, goodwill has a new carrying value which can't be written up
   4. Other assets should be tested for impairment first

2.3. Disclosures Mandated by FASB
   1. FASB ASC paragraph 805-30-50-1 includes disclosure for goodwill
      a. Total amount of goodwill acquired and amount expected to be tax deductible
      b. Amount of goodwill divided by reporting segment
   2. FASB ASC paragraph 350-20-45-1
      a. Presentation in financial statements (if impairment occurs)
         i. Aggregate goodwill on a separate line on the balance sheet
         ii. Aggregate impairment loss in operating section of the income statement
      b. FASB ASC paragraph 350-20-50-2 included in notes to the financial statements
         i. Description of the circumstances
         ii. Amount of loss and method of determining FV of reporting unit

iii. Nature and amounts of losses

c. Transitional disclosure is required until all statements presented reflect the new ruling

3. FASB ASC paragraph 805-10-50-2 includes other required disclosures
   a. Name and description of acquiree
   b. The acquisition date
   c. The percentage of voting equity acquired
   d. The primary reasons for the business combination
   e. The fair value of acquiree and the basis of measuring the fair value
   f. The fair value of consideration transferred
   g. The amounts recognized for each major class of asset and liabilities
   h. The maximum potential amount of future payments

2.4 Other Intangible Assets

A. Acquired intangibles other than goodwill should be amortized over their limited economic lives and be reviewed for impairment in accordance with FASB ASC Section 350-30-35 [Intangibles – Subsequent Measurement]

B. Other intangibles with indefinite lives should not be amortized until their economic lives are determined. Instead it should be tested annually for impairment.

2.5 FASB ASC paragraph 805-10-25-23 treatment of acquisition expenses

A. Excluded from measurement of consideration paid
   1. Direct and indirect expenses are expensed
   2. Security issue costs are assigned to valuation of the securities

2.6 Pro Forma (as if) Statements and Disclosure Requirement

A. Pro forma statements serve two functions
   1. To provide information when planning the combination
   2. To disclose relevant information after the combination

B. Planning function
   1. To estimate purchase price
   2. To explain combination to stockholders
   3. Must be clearly labeled pro forma

C. Notes to the financial statements should include
   1. Results of operations as if the companies had been together all year
   2. Results of operations of the prior year as if the companies had been together all year

2.7 Explanation of Acquisition Accounting

A. This method treats the combination as an acquisition of one company by another
   1. The cost of the acquisition is cash and debt given
   2. Assets by issuing stock
      a. Valued at fair value of stock issued or fair value of asset acquired, whichever is more clearly evident
      b. Quoted market price of stock is preferred fair value, if stock is actively traded
      c. For issued stock from new or closely held companies use the fair value of assets
   3. Value implied by the purchase price is allocated to identifiable assets acquired and liabilities assumed, using fair values

4. Any excess of value implied by the purchase price exceeding the sum of the fair values of the net assets is recorded as goodwill, which is not amortized but can be adjusted for impairment
   a. This avoids creative manipulation in the valuation of assets
   b. In-process R&D that is acquired as part of a business combination is capitalized
5. If the fair values of the net assets exceed the value implied by the purchase price, the buyer has a "bargain acquisition." This amount is recognized in income.

B. Income Tax Consequences in Business Combinations Accounted for by the Acquisition Method
   1. Fair values of net assets might be different from income tax valuations of those assets
   2. Current GAAP requires deferred taxes be recorded for those differences

C Bargain Acquisition
   1. Value implied by the purchase price is below the fair value of identifiable net assets
   2. Any previously recorded goodwill on the seller's books is eliminated
   3. An ordinary gain is recorded to the extent that the fair value of net assets exceeds the consideration paid.

2.8 Contingent Consideration in an Acquisition

A. Sometimes a purchase agreement includes a contingency in the contract
   1. The purchaser might have to give more cash or securities if certain events happen
   2. There's usually a stated contingency period, which should be disclosed
   3. All contingent consideration must be measured and recognized at fair value on the acquisition date
   4. Subsequent adjustments usually result from events or changes in circumstances that take place after the acquisition date and, thus, should not be treated as adjustments to the consideration paid.
   5. Contingent consideration classified as equity shall not be remeasured

B. Adjustments during the Measurement Period
   1. The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognized at the acquisition date.
   2. The measurement period ends as soon as the acquirer has the needed information about facts and circumstances, not to exceed one year from the acquisition date.

C. Contingency based on both future earnings and stock prices – all additional contingent consideration is recorded

2.9 Leveraged Buyouts (LBOs)

A. Leveraged buyouts occur when management and outside investors buy all the outstanding shares of stock and the old corporation becomes a new, closely-held corporation
   1. The management group gives whatever stock they hold
   2. Large amounts of money are borrowed (the "leverage")

B. LBOs are viewed as business combinations.

2.10 IFRS versus U.S. GAAP

A. Project on business combinations was the first of several joint projects to move converge standards.

B. Significant difference is that IFRS allows user choice of writing all assets including goodwill up fully (U.S. GAAP) or write goodwill up only to the extent of the parent's percentage of ownership

MULTIPLE CHOICE QUESTIONS

Choose the BEST answer for the following questions.

_____ 1. The currently acceptable method(s) of accounting for a business combination is (are):
- a. statutory merger
- b. pooling of interests
- c. acquisition
- d. both acquisition and pooling

_____ 2. The general idea of the acquisition method is the:
- a. acquiring company is buying an asset.
- b. acquiring and the acquired companies are joining as if they were always together.
- c. acquisition always results in parent-subsidiary relationship.
- d. assets of the acquired company are recorded at their fair market values.

_____ 3. The advantages of an acquisition include:
- a. one company acquires another and control passes.
- b. the transaction is based on book values given and received.
- c. the companies report as if they had always been together.
- d. earnings per share are generally higher than in a pooling.

_____ 4. What is parent's cost in an acquisition?
- a. The par value of the stock issued
- b. The fair value of the net assets acquired
- c. The book value of the net assets acquired
- d. The cash, debt, or fair value of stock given up

_____ 5. What is goodwill?
- a. The excess of cost over fair value of net assets acquired
- b. The excess of cost over book value of net assets acquired
- c. The excess of fair value of net assets acquired over cost
- d. The amortized excess of fair value of assets acquired over their book value

_____ 6. What is the current technique for the disposition of goodwill acquired in a business combination?
- a. Amortized over some period not to exceed 40 years
- b. Amortized over some period not to exceed 20 years
- c. Expensed in the year of combination
- d. Capitalized at original value unless impairment occurs

_____ 7. What is a bargain acquisition?
- a. When parent's cost is far above the fair value of S's net assets acquired
- b. When parent cannot determine a fair value of its stock issued in the acquisition
- c. When parent purchases S for less than the fair market value of the net assets acquired
- d. When parent increases the value of the long-lived assets to reflect its excess cost

_____ 8. If parent offers a contingency based on earnings:
- a. parent's original stockholders might be entitled to additional payments

b. subsidiary's original stockholders might be entitled to additional payments
c. the amounts determined are always added to the purchase price of the acquisition
d. there is concern from subsidiary's original stockholders that the purchase price offered by parent might be too high

_____ 9. Impairment of goodwill
a. causes the asset account to be decreased.
b. is the only time goodwill from a business combination is expensed.
c. cannot ever be reclaimed in future periods.
d. all of the above.

_____10. Which of the following is a *drawback* of an asset acquisition compared to a stock acquisition?
a. Since the target company does not persist as a separate entity, its liability and its regulated status, if any, may extend to the parent.
b. The consolidated statements reflect both historical cost and fair market values.
c. Parent can use a variety of resources to acquire subsidiary.
d. Fair values are sometimes difficult to objectively determine.

_____11. A leveraged buyout includes:
a. a group of employees and third party investors making a tender offer for all the common stock of a corporation.
b. most of the capital for the new corporation comes from debt.
c. treatment as business combination.
d. all of the above.

EXERCISE

1. **Consolidation**

Condensed balance sheets for Phillips Company and Solina Company on January 1, 2010, are as follows :

	Phillips	Solina
Current assets	$180,000	$85,000
Plant and equipment (net)	$450,000	$140,000
Total assets	$630,000	$225,000
Total liabilities	$95,000	$35,000
Common stock, $10 par value	$350,000	$160,000
Other contributed capital	$125,000	$55,000
Retained earnings (deficit)	$60,000	($25,000)
Total liabilities and equities	$630,000	$225,000

On January 1, 2010, the stockholders of Phillip and Solina agreed to a consolidation. Because FASB requires that one party to be recognized as the acquirer and the other as the acquire, it was agreed that Phillips was acquiring Solina. Phillips agreed to issue 20,000 shares of its $10 par stock to acquire all the net assets of Solina at a time when the fair value of Phillips'common stock was $15 per share.

On the date of consolidation, the fair values of Solina's current assets and liabilities were equal to their book values. The fair value of plant and equipment was, however

$150,000. Phillips will incure $20,000 of direct acquisition cost and $6,000 in stock issue costs.

Required :

Prepare the journal entries on the books of Phillips to record the acquisitions of Solina Company's net assets.

2. **Merger and Consolidation, Goodwill Impairment**

Stockholder of Acme Company, Baltic Company, and Colt Company are considering alternative arrangement for a business combination. Balance sheets and the fair value of each company's asset on October 1,2011, were as follows :

	Acme	Baltic	Colt
Assets	$3,900,000	$7,500,000	$950,000
Liabilities	$2,030,000	$2,200,000	$260,000
Common stock, $20 par value	$2,000,000	$1,800,000	$540,000
Other contributed capital		$600,000	$190,000
Retained earnings (deficit)	($130,000)	$2,900,000	($40,000)
Total equities	$3,900,000	$7,500,000	$950,000
Fair values of assets	$4.200.000	$9,000,000	$1,300,000

Acme Company shares have a fair value of $50. A fair (market) price is not available for shares of the other companies because they are closely held. Fair values of liabilities equal book values.

Required :

A. Prepare a balance sheet for the business combination. Assume thef following : Acme Company acquires all the assets and assumes all the liabilities of Baltic and Colt Companies by issuing in exchange 140,000 shares of its common stock to Baltic Company and 40,000 shares of its common stock to Colt Company.

B. Assume, further, that acquisition was consummated on October 1, 2011, as described above. However, by the end of 2012. Acme was concerned that the fair values of one or both of the acquired units had deteriorated. To test for impairment, Acme decided to measure goodwill impairment using the present value of future cash flow to estimate the fair value of the reporting units (Baltic and Colt). Acme accumulated the following data :

Year 2012	Present Value of Future Cash Flow	Carrying Value of Identifiable Net Assets*	Fair Value Identifiable Net Assets
Baltic	$6,500,000	$6,340,000	$6,350,000
Colt	$1,900,000	$1,200,000	$1,000,000

*Identifiable Net Assets do not include goodwill.

Prepare the journal entry, if needed, to record goodwill impairment at December 31, 2012.

3. **Purchase of Net Assets Using Bonds**

On January 1, 2011, Perez Company acquired all the assets and assumed all the liabilities of Stalton Company and merged Stalton into Perez. In exchange for the net assets of

Stalton, Perez gave its bond payable with a maturity value of $600,000, a stated interest rate of 10%. Interest payable semiannually on June 30 dan December 31, a maturity date of January 1, 2021, and a yield rate of 12%. Balance sheets for Perez and Stalton (as well as fair value data) on January 1, 2011, were as follow :

	Perez	Stalton	
	Book value	Book Value	Fair Value
Cash	$250,000	$114,000	$114,000
Receivables	$352,700	$150,000	$135,000
Inventories	$848,300	$232,000	$310,000
Land	$700,000	$100,000	$315,000
Buildings	$950,000	$410,000	$54,900
Accumulated depreciation-Buildings	($325,000)	($170,500)	
Equipment	$262,750	$136,450	$39,450
Accumulated depreciation-Equipment	($70,000)	($90,450)	
Total assets	$2,968,700	$881,500	$968,350
Current Liabilities	$292,700	$95,300	$95,300
Bonds payable, 8% due 1/1/2016, Interest payable 6/30 dan 12/31		$300,000	$260,000
Common stock, $15 par value	$1,200,000		
Common stock, $5 par value		$236,500	
Other contributed capital	$950,000	$170,000	
Retained earnings	$526,000	$79,700	
Total Equities	$2,968,700	$881,500	

Required :

Prepare the journal entry on the books of Perez Company to record the acquisition of Stalton Company's assets and liabilities in exchange for the bonds.

4. **Cash Acquisition, Contingent Consideration**

Pham Company acquired the asset (except for cash and assumed the liabilities of Senn Company on January 1,2011, paying $720,000 cash, Senn Company's December 31, 2010, balance sheet, reflecting both book values and fair values, showed :

	Book Value	Fair Value
Account receivable (net)	$72,000	$65,000
Inventory	$86,000	$99,000
Land	$110,000	$162,000
Building (net)	$369,000	$450,000
Equipment (net)	$237,000	$288,000
Total	$874,000	$1,064,000
Account payable	$83,000	$83,000
Notes payable	$180,000	$180,000
Common stock, $2 par value	$153,000	
Other contributed capital	$229,000	
Retained earnings	$229,000	
Total	$874,000	

As part of negotiation, Pham Company agreed to pay the former stockholders of Senn Company $135,000 cash if the post combination earnings of the combined companya (Pham) reached certain level during 2011 and 2012.

Required :

A. Record the journal entry on the books of Pham Company to record the acquisition on January 1, 2011. It is expected that the earnings target is likely to be met.
B. Assuming the earnings contingency is met, prepare the journal entry on Pham Company's book to settle the contingency on January 2, 2013.
C. Assuming the earnings contingency is not met, prepare the necessary journal entry on Pham Company's books on January 2, 2013.

Consolidated Financial Statements – Date of Acquistion

Learning Objectives :

1. Understand the concept of control as used in reference to consolidations.
2. Explain the role of a noncontrolling interest in business combinations.
3. Describe the reasons why a company acquires a subsidiary rather than its net assets.
4. Describe the valuation and classification of accounts in consolidated financial statements.
5. List the requirements for inclusion of a subsidiary in consolidated financial statements.
6. Discuss the limitations of consolidated financial statements.
7. Record the investment in the subsidiary on the parent's books at the date of acquisition.
8. Prepare the consolidated workpapers and eliminating entries at the date of acquisition.
9. Compute and allocate the difference between implied value and book value of the acquired firm's equity.
10. Discuss some of the similarities and differences between U.S. GAAP and IFRS with respect to the preparation of consolidated financial statements at the date of acquisition.

Referensi

Debra C. Jetter, Advance Accounting, International Student Version, 5th edition, John Wiley, 2012.

INTRODUCTION

As we learned in Chapters 1 and 2, there are many types of business combinations. Chapter 2 focused on the purchase in its entirety of one company by another - an asset acquisition. Chapter 3 explains the method of combination that results in one company owning a majority interest in another company - often called a stock acquisition. This chapter will discuss the elements of controlling interest and noncontrolling interest, why a company might pursue a stock acquisition instead of a merger or consolidation, and how valuation becomes a part of the acquisition. In addition, the chapter explains how to account for the Parent-Subsidiary Relationship that results from the stock acquisition.

CHAPTER OUTLINE

3.1 Definitions

A. *Subsidiary*

1. A subsidiary is a company that is controlled directly or indirectly by another company.
2. The controlling company is called the *Parent.*
3. The subsidiary remains a separate legal entity.

B. *Controlling interest*

1. Portion of equity of consolidated group attributable to parent
2. The SEC defines three levels of control:

a. *Majority-owned* – more than 50% of the outstanding shares of a corporation are owned by the parent company and/or the parent's other subsidiaries (usually referred to as control)

b. *Totally held*

i. Substantially all of the subsidiary's stock is controlled by the parent – usually considered to be more than 90% but less than 100%.
ii. The subsidiary is not significantly indebted to other parties besides the parent or its other subsidiaries.

c. *Wholly owned* -- the parent and/or the parent's other subsidiaries owns or controls 100% of the subsidiary.

3. Variable Interest Entities (VIE)
   a. VIE - entity (investee) in which the investor holds controlling interest not based on the majority of voting rights.
   b. Variable interests are contractual, ownership or other pecuniary interests that change with changes in the fair value of the entity's net assets, exclusive of variable interests.
   b. Current GAAP requires that existing unconsolidated VIEs be consolidated by their primary beneficiary if the entities' risks are not dispersed effectively.
   c. Primary beneficiary is the party that will absorb majority of the VIEs expected losses, returns or both.

C. *Noncontrolling interest (NCI)* those holding shares not held by Controlling Interest or Parent.

3.2 Requirements for the Inclusion of Subsidiaries in the Consolidated Financial Statements

A. When the parent combines the subsidiary's assets, liabilities, owners' equity, revenue and expense accounts with its own, the results are called Consolidated Financial Statements.
B. Current GAAP requires the parent to prepare consolidated financial statements that include all of its subsidiaries unless a few very specific circumstances are true.
   1. Control does not rest with the parent.
   2. A foreign subsidiary has restrictive rules from the other country.
C. Essentially, if the parent cannot control the subsidiary, it should not consolidate the subsidiary's information with its own.
D. The reason for consolidated statements is a *substance over form* issue – in **form,** there are two (or more) separate legal entities – the Parent and the Subsidiary. However, in **substance,** since the parent controls the management of the subsidiary; there are not two accounting entities.

3.3 Reasons for Subsidiary Companies

A. Purchasing the stock on the open market is often easier than negotiating with the board of a target company.
   1. Open market purchases - stock is purchased by the acquiring company through the traditional stock market
   2. Tender offers - the acquiring company announces that it is interested in buying directly from current stockholders
   3. The parent can get an already existing business instead of having to create a new one.
B. The parent can control the subsidiary with much less investment – buying 50% of something is much cheaper than buying 100% of it!
C. Even though in substance the parent and the subsidiary are one entity, in the eyes of the law they are separate, so the parent protects itself with limited liability over the subsidiary's debts.

3.4 Consolidated Financial Statements

A. The combined statements of the parent and the subsidiary are called c*onsolidated financial statements*.

1. They include all the statements – income statement, balance sheet, cash flows, owners' equity
2. They eliminate the effects of transactions between the affiliates (parents and their subsidiaries)

B. The parent company has a single asset account – Investment in Subsidiary – which accounts for its entire investment in the subsidiary
   1. The consolidated statements will show the details of the subsidiary's asset accounts and liability accounts as they affect the consolidated entity's financial position
   2. The consolidated statements also show the subsidiary's asset and liability accounts at their value on the date of acquisition, rather than their book value

C. The consolidated statements are for the benefit of the parent's stockholders and creditors, who ultimately are the most concerned with the results of operations of the consolidated entity.

D. However, consolidated statements are not substitutes for the statements prepared by the separate subsidiaries. Creditors of the subsidiaries must look to the statements of individual legal entities to assess the degree of protection of their claims. Likewise, noncontrolling stockholders need the statements of the individual companies to determine the degree of investment risk involved

3.5 Investments at the Date of Acquisition

A. Business combinations are all valued the same way as was discussed in Chapter 2 – the primary difference here is how to prepare the consolidated financial statements when there has been a stock acquisition instead of an asset acquisition.

B. In this book, the examples and problems have been simplified – the parent company's name always begins with a P, and the subsidiary company's name always begins with an S – that makes everything easier to understand!

C. Recording investments in the parent's books
   1. Because the parent and the subsidiary continue to be two separate entities, there are always going to be two sets of books. As far as S's books are concerned, the affiliation with P is generally ignored. However, on P's books the relationship must be addressed.
   2. P has to "pay" for S, even though it doesn't have to acquire all of S's assets – it's buying S's equity instead
      a. Consideration must be given for what is paid.
         i. P can pay for its investment in S with cash, stock, debt, or some combination,
         ii. The investment should be recorded at the fair value of the assets given up or received, whichever is more clearly evident
         iii. Direct costs of acquiring the stock of S and indirect costs are expensed.
      b. P should record the investment in its books at its cost.
      c. Journal entries - to record the investment:

To record P's investment in S		
Investment in S Company		
Cash (Or Stock or Debt or all three!)		

      d. P creates an asset account which is a long-term investment. This account will be the only balance sheet account on *P's books* which addresses the investment.

3.6 The Use of Workpapers

A. Purposes

1. There are two sets of books - P's and S's - the information must be combined in order to create a single set of financial statements.
2. The workpaper entries are never *recorded or posted,* since they are made for the consolidated entity, not for either P or S.
3. If the consolidated statements reflect the single accounting entity, then all intercompany transactions must be eliminated
    a. P's investment account is eliminated against S's equity accounts – the only equity in the consolidated entity is P's; however, the NCI is also reflected in the consolidated balance sheet.
    b. Advances between the parent and subsidiary – the entity cannot loan money to itself.
    c. Any revenue paid by one affiliate to another – the consolidated entity cannot earn from itself.
        i. Interest revenue
        ii. Dividend revenue
        iii. Management fees
        iv. Sales of merchandise or assets

B. Preliminary information

1. What P actually acquires is all or part of an interest in S's *net assets* (assets – liabilities), otherwise known as S's equity.
2. Computation and Allocation of Difference Between Implied Value and Book Value (CAD schedule)
    a. Determine the percentage of stock acquired in the subsidiary
    b. Use the purchase price to compute the implied value of the subsidiary. Simply divide the purchase price by the percentage acquired.
    c. Compare *the value implied by the purchase price* to the *book value* of S's equity.
3. The result may be:
    a. Implied value = S's equity
    b. Implied value > S's equity
    c. Implied value < S's equity
4. On the date of acquisition, there is no revenue or expense to eliminate, because P is buying its share of S's income earned to date. Therefore, only the balance sheet accounts are combined
5. If the value implied by the purchase price is not equal to S's equity, there is a *difference between Implied and Book Value*
    a. The difference between implied and book value is generally because S's assets have a higher fair market value than their book value.
    b. Traditionally, S's assets are consolidated at their fair values rather than their book values.
        i. If the excess of fair value over book value of the identifiable net assets is still less than the difference between implied and book value, the excess is goodwill.

ii. If the excess of fair value over book value of the identifiable net assets is more than the difference between implied and book value, an ordinary gain is recognized.

iii. In this chapter, we will either assume that the difference between implied and book value is goodwill or is attributable to land. More realistic assumptions will be addressed later.

C. Eliminations on the Date of Acquisition

1. Implied Value = S's net assets

To eliminate P's investment against S's equity		
Common Stock – S		
Other Contributed Capital – S		
Retained Earnings – S		
Investment in S		
Noncontrolling Interest (If appropriate)		

2. Implied value doesn't equal S's net assets

To eliminate P's investment against S's equity		
Common Stock - S		
Other Contributed Capital - S		
Retained Earnings - S		
Difference between Implied and Book Value (this could also be a credit, but it is unlikely!)		
Investment in S		
Noncontrolling Interest		
To allocate the difference between implied and book value		
Land (Or other appropriate account)		
Difference between Implied and Book Value		

3. Partial ownership or wholly owned
   a. One of the advantages of a stock acquisition is that P doesn't have to buy 100% of S's equity - partial ownership is common.
   b. The noncontrolling interest becomes a part of the consolidated statements.
      i. Part of consolidated equity, clearly labeled as noncontrolling interest.
      ii. NCI is shown in consolidated equity as the first item.
4. Reasons an acquiring company may pay more than book value
   a. The fair value of assets may exceed its recorded value because of appreciation
   b. Existence of unrecorded goodwill, as reflected by its above-normal capacity
   c. Liabilities, generally long-term ones, may be overvalued
   d. A variety of market factors may affect the price paid for the stock

D. The workpaper

1. The eliminations must be on a workpaper, because they are never recorded or posted in a set of books.
2. The workpaper starts with the trial balances of the separate entities and uses eliminations to remove the duplicated information - investment against equity, receivables against payables, etc.

E. Other Issues
   1. S's treasury stock
      a. If S owns treasury stock, it must be accounted for in the business combination.
      b. S's equity is considered net of treasury stock (S's outstanding shares)
      c. S's treasury stock must be eliminated on the workpaper:

To eliminate P's Investment against S's Equity		
Common Stock - S		
Other Contributed Capital - S		
Retained Earnings - S		
Difference between Implied and Book Value		
Treasury Stock – S		
Investment in S		
Noncontrolling Interest		

   2. Intercompany balance sheet eliminations
      a. If the affiliated companies have any existing intercompany transactions, those transactions must be eliminated against each other.
      b. There will be reciprocal accounts in the two company's balance sheets – Accounts Receivable/Accounts Payable; Advances From/Advances To
      c. An example of the eliminating entry:

To eliminate intercompany accounts		
Accounts Payable to S		
Accounts Receivable from P		
Advances From P Company		
Advances To S Company		

   3. Adjusting entries prior to eliminating entries
      a. There is a possibility that one affiliate has not recorded an intercompany transaction. Usually, this is a result of timing.
      b. The transaction must be included on the workpaper in order to have the reciprocal accounts to eliminate.
      c. The resulting transactions are called *adjustments* and are labeled differently from the eliminations, since they will eventually appear in both affiliate's books.

3.7 Comprehensive Illustration – the textbook has a complete illustration of more than one subsidiary company beginning on page 108 which you might like to review again.

3.8 Comparison of Business Combinations and Consolidations under U.S. GAAP and IFRS are presented in Illustration 3-8.

3.9 Limitations of Consolidated Statements

A. Certain stakeholders of P and S might find that the consolidated statements have limited usefulness.

B. Parent company stakeholders
   1. Creditors and regulatory agencies which need information about the P-only entity.
   2. Financial analysis is more difficult on a consolidated entity than on a single entity.

C. Subsidiary company stakeholders
   1. Noncontrolling interest stockholders have no equity interest in P. Therefore, their earnings and capital appreciation are on the S-only financial statements.
   2. Because of limited liability, S creditors may have no recourse to P's assets.

MULTIPLE CHOICE QUESTIONS

Choose the BEST answer for the following questions.

_____ 1 A parent-subsidiary relationship may be distinguished from a merger by:

a. the number of affiliates joining.
b. the resulting legal entity or entities.
c. the price paid for the subsidiary.
d. whether the affiliation was accomplished with a cash payment or stock transaction.

_____ 2. Which of the following best describes the SEC's definition of a *totally held* company?

a. At least 50 percent of the stock of the subsidiary is owned by the parent.
b. No more than 90 percent of the stock is owned by the parent.
c. The parent owns 100 percent of the subsidiary.
d. The parent owns or controls substantially all of the subsidiary's stock.

_____ 3. What are consolidated financial statements?

a. Statements which show the combined assets, liabilities, revenues and expenses of a parent and its subsidiaries
b. Statements which are constructed by the parent company
c. Statements which are prepared from no books, but from a workpaper
d. All of the above

_____ 4. Which of the following is *NOT* a reason for a parent-subsidiary relationship?

a. It is easier to establish a parent-subsidiary relationship than a merger.
b. The parent has limited responsibility for the liabilities of the subsidiary.
c. The relationship is permanent – the parent can never sell its interest in the subsidiary.
d. The parent can establish a controlling interest with a smaller investment.

_____ 5. The argument of *substance over form* asserts that:

a. in form the companies are a single entity but in substance they are separate entities.
b. in form the companies are separate legal entities but in substance they are a single entity.
c. in form and substance the companies are separate legal entities.
d. in form and substance the companies are a single entity.

_____ 6. How does P record its investment in S?

a. At the fair market value of the assets received.
b. At the fair market value of the assets given up.
c. At the book value of the assets received.
d. At the book value of the assets given up.

_____ 7. Why does the parent company use a worksheet in the preparation of consolidated financial statements?

a. Because there are no consolidated journals and ledgers.
b. Because certain intercompany transactions must be eliminated.
c. Because there might be a difference between the value implied by the purchase price and the value of the net assets.
d. All of the above

_____ 8. The *difference between value implied by the purchase price and book value* results when the:

a. book value of the net assets acquired is different from the fair value of the identifiable assets acquired.
b. fair value of the net assets acquired is different from the fair value of the net assets used .

c. book value of the net assets acquired is different from the fair value of the consideration paid.
d. book value of the net assets acquired is different from the book value of the assets used.

______ 9. What is the *noncontrolling interest*?
a. The interest of the parent company if that company owns less than 100 percent of the subsidiary.
b. The interest of the other stockholders of the subsidiary company which appears on the consolidated statements.
c. The equity of a subsidiary company which is in legal reorganization.
d. The difference between the P’s investment account and the book value of the S’s net assets.

______10. An elimination entry:
a. allows the consolidated entity to remove assets and liabilities that would be double counted when the assets and liabilities of the parent company and subsidiary company are added together.
b. appears only on the workpaper.
c. helps support the substance over form argument.
d. all of the above.

______11. What is the effect of S’s treasury stock on the consolidated statements?
a. The treasury stock is included as a deduction from total equity.
b. The treasury stock is included as a liability.
c. The treasury stock is eliminated in the entry to offset P’s investment against its share of S’s equity.
d. P cannot create a parent-subsidiary relationship if S has treasury stock.

______12. P Company has loaned $10,000 to S Company. P recorded the transfer in its books, but S has not yet recorded the receipt of cash. On the workpaper, the proper entry would be to:
a. eliminate P’s note receivable against S’s general liabilities.
b. reverse the entry in P’s books until next year.
c. adjust S’s liabilities to reflect the loan from P to S before preparing the eliminating entry.
d. ignore the intercompany loan.

______13. When are consolidated statements for a parent and subsidiary NOT indicated?
a. When the parent does not have actual control over the actions of the subsidiary.
b. When the fiscal year ends of the two companies are not the same.
c. When the subsidiary company is in a foreign company.
d. Consolidated statements must always be prepared when the P owns more than 50 % of S.

______ 14. In whose books are elimination entries recorded?
a. Both P’s and S’s
b. Neither P’s nor S’s
c. P’s only
d. S’s only

______ 15. Which of the following is NOT a limitation of consolidated statements?
a. P’s and S’s creditors may have no recourse to the consolidated assets
b. The noncontrolling interest stockholders have no real equity interest in the parent company.

c. Regulatory agencies may need separate P-only and S-only information.
d. All of the above are limitations.

EXERCISE

1. **Stock Purchases Entries**

On January 1, 2011, Polo company purchased 100% of the common stock of Save Company by issuing 40,000 shares of its (Polo's) $ 10 par value common stock with a market price of $17,50 per share. Polo incurred casth expenses of $20,000 for registering and issuing the common stock. The stockholder's equity section of the two companie's balance sheets on December 31,2010, were :

	Polo	Save
Common stock, $10 par value	$350,000	$320,000
Other contributed capital	$590,000	$175,000
Retained earnings	$380,000	$205,000

Required :

A. Prepare the journal entry on the books of Polo Company to record the purchase of the common stock of Save Company and related expenses.
B. Prepare elimination entry required for the preparation of a consolidated balance sheet workpaper on the date of acquisition.

2. **Consolidated Balance Sheet, Stock Purchase**

On January 2, 2011, Prunce Company acquired 90% of the outstanding common stock on Sun Company for $192,000 cash. Just before the acquisition, the balance sheets of the two companies were as follow :

	Prunce	Sun
Cash	$260.000	$64,000
Account receivable (net)	$142,000	$23,000
Inventory	$117,000	$54,000
Plant and Equipment (net)	386,000	98,000
Land	63,000	32,000
Total assets	968,000	271,000
Account payable	$104,000	$47,000
Mortgage payable	$72,000	$39,000
Common stock, $2 par value	$400,000	$70,000
Other contributed capital	$208,000	$20,000
Retained earnings	$184,000	$95,000
Total equities	$968,000	$271,000

The fair values of Sun Company's assets and liabilities are equal to their book values with the exception of land.

Required :

A. Prepare a journal entry to record the purchase of Sun Company's common stock

B. Prepare a consolidated balance sheet at the date of acquisition.

3. **Intercompany Receivables and Payables**

Polychromasia, Inc. had a number of receivables from subsidiaries at the balance sheet date, as well as several payable to subsidiaries. Of its five subsidiaries, four are consolidated in the financial statement (Green Company, Black Inc., White & Sons, and Silver Co.). Onlu the Brown Company is not consolidated with Polychromasia and the other affiliates. The following list of receivables and payables shows balances at 12/31/10.

Interest receivable from the Brown Company	$50,000
Interest payable to Black Inc.	75,000
Intercompany payable to Silver Co.	105,000
Long-term advance to Green Company	150,000
Long term payable to Silver Co.	450,000
Long-term receivable from Brown Company	500,000

Required :

A. Show the classification and amount(s) that should be reported in the consolidated balance sheet of Polychromasia, Inc. and Subsidiaries at 12/31/10 as receivable from subsidiaries.

B. Show the classification and amount(s) that should be reported in the consolidated balance sheet of Polychromasia, Inc. and Subsidiaries at 12/31/10 as payable to subsidiaries.

4. **Stock Acquisition, Journal Entry by Parent**

Peep Inc. acquired 100% of the outstanding common stock of Shy Inc. for $2,500,000 cash and 15,000 shares of its common stock ($2 par value). The stock's market value was $40 on the acquisition date.

Required :

Prepare the journal entry to record the acquisition.

5. **Acquistion Costs**

Assume the same information from Exercise 3-8. In addition, Peep Inc. incurred the following direct costs:

Accounting fees for the purchase	$15,000
Legal fees for registering the common stock	30,000
Other legal fees for the acquisition	45,000
Travel expenses to meet with Shy managers	5,000
SEC filing fees	2,000
	$97,000

Before the acquisition consummation date. $90,000 of the direct costs was charged to a deffered charges account pending the completion of the acquisition. The remaining $7,000 has not been accrued or paid.

Required :

Prepare the journal entry to record both the acquisition and the direct costs.

6. **Consolidated Balance Sheet Workpaper**

On January 1, 2011, Perry Company purchased 8,000 shares of Soho Company's common stock for $120,000. Immediately after the stock acquisition, the statements of financial position of Perry and Soho appeared as follows:

Assets	Perry	Soho
Cash	$39,000	$19,000
Account receivable	$53,000	$31,000
Inventory	$42,000	$25,000
Investment in Soho Company	$120,000	
Plant Assets	$160,000	$110,500
Accumulated Depreciation – plant assets	($52,000)	($19,500)
Liabilities and Owner's Equity	$362,000	$166,000
Total		
Current liabilities	$18,500	$26,000
Mortgage notes payable	$40,000	
Common stock, $10 par value	$120,000	$100,000
Other contributed capital	$135,000	$16,500
Retained Earning	$48,500	$23,500
Total	$362,000	$166,000

Required :

A. Calculate the percentage of Soho acquired by Perry Company. Prepare a schedule to compute the difference between book value of equity and the value implied by the purchase price. Any difference between the book value of equity and the value implied by the purchase price relates to subsidiary plant assets.

B. Prepare a consolidated balance sheet workpaper as of January 1, 2011.

C. Suppose instead that Perry acquired the 8,000 shares for $20 per share including a $5 per share control premium. Prepare a computation and allocation of difference schedule.

7. **Intercompany Bond Holdings at Par, 90% Owned Subsidiary**

Balance sheet for P Company and S Company on August 1, 2011, are as follow :

Assets	P Company	S Company
Cash	$165,500	$106,000
Receivables	$366,000	$126,000
Inventory	$261,000	$108,000
Investment in bonds	$306,000	
Investment in S Company stock	$586,500	
Plant and equipment (net)	$573,000	$320,000
Land	$200,000	$300,000
Total	$2.458,000	$960,000

Account payable	$174,000	$58,000
Accrued expenses	$32,400	$26,000
Bond payable, 8%		$200,000
Common stock	$1,500,000	$460,000
Other contributed capital	$260,000	$60,000
Retained earnings	$491,600	$156,000
Total	$2,458,000	$960,000

Required :

Prepare a workpaper for a consolidated balance sheet for P Company and its subsidiary on August 1, 2011, taking into consideration the following :

1. P Company acquired 90% of the outstanding stock of S Company on August 1, 2011, for a cash payment of $586,500.
2. Included in the Investment in Bonds account are $40,000 par value of S Company bonds payable that were purchased at par by P Company in 2002. The bonds pay interest on April 30 and October 31. S Company has appropriately accrued interest expense on August 1,2011; P Company, however, inadvertently failed to accrue interest income on the S Company Bonds,
3. Included in P Company receivables is a $ 35,000 cash advance to S Company that was mailed on August 1,2011. S Company had not yet received the advance at the time of the preparataion of its August 1,2011, balance sheet.
4. Assume that any excess of book value over the value implied by purchase price is due to overvalued plant and equipment.

8. **Purchasing Using Cash and Using Stock**

Balance sheet for Prego Company and Sprague Company as of December 31,2010 , follow :

	Prego Company	Sprague Company
Cash	$700,000	$111,000
Account receivable (net)	$892,000	$230,000
Inventory	$544,000	$60,000
Property and equipment	$1,927,000	$468.000
Land		
Total Assets		
Acount Payable	$302,000	$152,000
Notes payable	588,000	61,000
Long-term debt	350,000	90,000
Common Stock	1,800,000	500,000
Other Contributed Capital	543,000	80,000
Retained earnings	600,000	80,000
Total equities	$4,183,000	$963,000

The fair values of Sprague Company's assets and liabilities are equal to their book values.

Required :

Prepare a consolidated balance sheet as of January 1, 2011, under each of the following assumptions:

a. On January 1, 2011, Prego Company purchased 90% of the outstanding common stock of Sparague Company for $594,000.

b. On January 1, 2011, Prego Company exchanged 11,880 of its $20 par value common shares with a fair value of $50 per share for 90% of the outstanding common shares of Sparague Company. The transaction is a purchase.

9. **Intercompany Items, Two Subsidiaries**

On February 1, 2011, Punto Company purchase 95% of the outstanding common stock of sara Company and 85% of the outstanding common stock of Rob Company. Immediately before the two acquisitions, balance sheets of the three companies were as follows:

	Punto	Sara	Rob
Cash	$165,000	$45,000	$17,000
Accounts Receivable	$35,000	$35,000	$26,000
Notes Receivable	$18,000	0	0
Merchandise Inventory	$106,000	$35,500	$14,000
Prepaid Insurance	$13,500	$2,500	$500
Advances to Sara Company	$10,000		
Advances to rob Company	$5,000		
Land	$248,000	$43,000	$15,000
Buildings(net)	$100,000	$27,000	$16,000
Equipment(net)	$35,000	$10,000	$2,500
Total	$735,500	$198,000	$91,000
Accounts Payable	$ 25,500	$ 20,000	$10,500
Income tax payable	$30,000	$10,000	0
Notes payable	0	$6,000	$10,500
Bonds payable	$100,000	0	0
Common stock, $10 par value	$300,000	$144,000	$42,000
Other contributed capital	$150,000	$12,000	$38,000
Retained earnings (defisit)	$130,000	$6,000	($10,000)
Total	$735,500	$198,000	$91,000

The following additional information is relevant.

1. One week before the acquisitions, Punto Company had advanced $10,000 to Sara Company and $5000 to rob Company. Sara Company recorded an increase to accounts payable for its advance, but Rob Company had not recorded the transaction.
2. On adate of acquisition, Punto Company owed Sara Company $12,000 for purchases on account, and Rob Company owed Punyo company $3,000 and sara company

$6,000 for such purchases. The goods purchased had all been sold to outside parties prior to acquisition.

3. Punto Company exchanged 13,400 shares of its common stock with a fair value of $12 per share for 95% of the outstanding common stock of Sara Company. In addition, stock issue fees of $4000 were paid in case. The acquisition was accounted for as a purchase.
4. Punto Company paid $50,000 cash for the 85% interest in Rob Company.
5. Three thousands dollars of Sara Companies notes payable and $9,500 of Rob Companies notes payable were payable to Punto Company.
6. Assume that for Sara, any difference between book value and the value implied by the purchase price relates to subsidiary land. Whoever, for Rob, assume that any excess of book value over the value imlit by the purchase price is due to overvalued buildings.

Required:

a. Give the book entries to record the two acquisitions in the accounts of Punto Company.
b. Prepare a consolidated balance sheet workpaper immeditialy after acquisition.
c. Prepare a consolidated balance sheet at the date of acquisition for Punto Company and its subsidiaries.

10. **Intercompany Notes, 90% Acquistion**

On January 1, 2009, Pope Company purchased 90% of Sun Companies common stock for $5,800,000 cash. Immeditialy after the acquisition the two companies balance sheets were as follows:

	Pope	Sun
Cash	$297,000	$165,000
Accounts receivable	$432,000	$468,000
Notes receivable	$90,000	
Inventory	$1,980,000	$1,447,000
Investment in Sun company	$5,800,000	
Plant and equipment (net)	$5,730,000	$3,740,000
Land	$1,575,000	$908,000
Total	$15,904,000	$6,728,000
Accounts payable	$698,000	$247,000
Notes payable	$2,250,000	$110,000
Common stock ($15 par)	$4,500,000	$5,250,000
Other contributed capital	$5,198,000	$396,000
Treasury stock held		($1,200,000)
Retained earnings	$3,258,000	$1,925,000
Total	$15,904,000	$6,728,000

Sun Companies note payable includes a $90,000 note payable to Pope company, plus $20,000 payable to a bank. Any difference between book value and the value implied by the purchase price relates to subsidiary propertry and equipment.

Required :

a. Prepare a computation and allocation schedule for the difference between book value of equity and the value implied by the purchase price.
b. Prepare a consolidated balance sheet workpaper on January 1, 2009.

11. **Consolidated Workpaper,Partially Owned Subsidiary, Cost Method**

Place company purchased 92% of the common stock of Shaw, Inc. on January 1, 2010, for $400,000. Trial balances at the end of 2010 for the companies were:

	Place	Shaw
Cash	$80,350	$87,000
Accounts and Notes receivable	$200,000	$210,000
Inventory,1/1	$70,000	$50,000
Investment in Shaw, Inc	$400,000	0
Plant assets	$300,000	$200,000
Dividends declared	$35,000	$22,000
Purchases	$240,000	$150,000
Selling expenses	$28,000	$20,000
Other expenses	$15,000	$13,000
	$1,368,350	$752,000
Accounts and notes payable	$99,110	$38,000
Other liabilities	$45,000	$15,000
Common stock ,$10 par	$150,000	$100,000
Other contributed capital	$279,000	$149,000
Retained earnings, 1/1	$225,000	$170,000
Sales	$550,000	$280,000
Dividen income	$20,240	0
	$1,368,350	$752,000

Inventory balances on December 31, 2010, were $25,000 for Place and $15,000 for Shaw, Inc. Shaw's accounts and notes payable contained a $15,000 note payable to Place.

Required:

Prepare a workpaper for the preparation of consolidated financial statement on December 31,2010. The difference between book value of equity acquired and the value implied by the purchase price relates to subsidiary land, wihich is included in plant asset.

12. **Consolidated Workpaper,Partially Owned Subsidiary-Subsequent Years**

On January 1, 2010, Perez Company purchased 90% of the capital stock of Sanchez Company for $85,000. Sanchez company had capital stock of $70,000 and retained earnings of $12,000 at that time. On December 31, 2014,the trial balances of the two companies were:

	Perez	Sanchez
Cash	$13,000	$14,000
Account receivable	$22,000	$36,000
Inventory,1/1	$14,000	$8,000
Advance to Sanchez Company	$8,000	0
Investments in Sanchez Company	$85,000	0
Plant and equipment	$50,000	$44,000
Land	$17,800	$6,000
Dividends declared	$10,000	$12,000
Purchases	$84,000	$20,000
Other expense	$10,000	$16,000
Total debit	$313,800	$156,000
Accounts payable	$6,000	$6,000
Other liabilities	$37,000	0
Advance from perez company	0	$8,000
Capital stock	$100,000	$70,000
Retained earnings	$50,000	$30,000
Sales	$110,000	$42,000
Dividen income	$10,800	0
Total credits	$313,800	$156,000
Inventory,12/31	$40,000	$15,000

Any difference between book value and the value implied by the purchase price relates to goodwill.

Required:

a. What method is being used by Perez to account for its investment in Sanchez Company ?How can you tell ?
b. Prepare a workpaper for the preparation of the consolidated financial statement on 12/31/14.

Consolidated Financial Statements After Acqusition

Learning Objectives :

1. Describe the accounting treatment required under current GAAP for varying levels of influence or control by investors.
2. Prepare journal entries on the parent's books to account for an investment using the cost method, the partial equity method, and the complete equity method.
3. Understand the use of the workpaper in preparing consolidated financial statements.
4. Prepare a schedule for the computation and allocation of the difference between implied and book values.
5. Prepare the workpaper eliminating entries for the year of acquisition (and subsequent years) for the cost and equity methods.
6. Describe two alternative methods to account for interim acquisitions of subsidiary stock at the end of the first year.
7. Explain how the consolidated statement of cash flows differs from a single firm's statement of cash flows.
8. Understand how the reporting of an acquisition on the consolidated statement of cash flows differs when stock is issued rather than cash.
9. Describe some of the differences between U.S. GAAP and IFRS in accounting for equity investments.

Referensi

Debra C. Jetter, Advance Accounting, International Student Version, 5th edition, John Wiley, 2012.

INTRODUCTION

In this chapter you will find out about how consolidated financial statements – the combined statements of the parent company and all of its subsidiaries – are prepared at the end of the first and subsequent years after acquisition. You'll also discover that there are alternatives for accounting for these combinations, but that the end result will be the same regardless of your choice! Again, it is very important to recognize the very specific definitions you will use in this and the following chapters.

CHAPTER OUTLINE

4.1 Accounting for Investments by the Cost, Partial Equity, and Complete Equity Methods

A. Definition of control
   1. No significant influence
      a. The parent company owns less than 20% of the subsidiary company.
      b. The investment is carried at fair value at current year end as trading or available for sale securities – the *cost* method, with an adjustment to fair value.
   2. Significant influence (no control)

a. The parent company owns 20 to 50% of the subsidiary.
b. The investment is measured under the *equity* method; may be elected to be carried at fair value. Election is irrevocable.

3. Effective control
   a. The parent company owns greater than 50% of the subsidiary.
   b. Consolidated statements are required (investment eliminated) and the investment may be recorded using the *cost, partial equity,* or *complete equity* method.

B. Cost method on books of the investor
   1. If S pays dividends, they become income to P, so long as they are not taken from retained earnings originally bought from S as a part of the acquisition (liquidating dividends)
   2. Year 1 – P's books:

To record the initial investment		
Investment in S		
Cash (or Stock or Debt)		
To record P's share of S's dividends		
Cash		
Dividend Income		

   3. Subsequent years – P's books

To record P's share of S's dividends (assuming they are issued out of current earnings)		
Cash		
Dividend Income		

To record P's share of S's dividends (assuming they are a return of investment – liquidating dividends)		
Cash		
Investment in S (Return of portion of investment)		

C. Partial equity method on books of investor
   1. Under the partial equity method, P Company records its share of S's income or loss, whether or not S declares dividends. If S does declare dividends, the amount received by P becomes a reduction of the investment account.
   2. Year 1 – P's books:

To record the initial investment		
Investment in S		
Cash		
To record P's share of S's income		
Investment in S		
Equity in Subsidiary Income		
To record P's share of S's dividends		
Cash		
Investment in S		

   3. Any year subsequent

To record P's share of S's income		
Investment in S		
Equity in Subsidiary Income		

To record P's share of S's loss		
Equity in Subsidiary Loss		
Investment in S		
To record P's share of S's dividends		
Cash		
Investment in S		

D. Complete equity method on books of investor

1. When using the complete equity method, P must account for its share of S's income (loss) and dividends, and, in addition, account for any difference between its original cost and the book value of the net assets it acquired; for example, P may need to record a transaction to recognize the effect of excess depreciation on equity in subsidiary income.
2. Year 1 – P's books

To record the initial investment		
Investment in S		
Cash		
To record P's share of S's income		
Investment in S		
Equity in Subsidiary Income		
To adjust equity in S income for excess depreciation		
Equity in Subsidiary Income		
Investment in S		
To record P's share of S's dividends		
Cash		
Investment in S		

3. All subsequent years will be the same as the last three transactions above

4.2 Consolidated Statements after Acquisition – Cost Method

A. Workpaper format

1. The workpaper accumulates, classifies, and arranges information so that consolidated statements can be prepared. It starts with the information from the trial balances of the affiliated companies.
2. Each section of the workpaper (as found on page 145 of your textbook) represents one financial statement, and the total of each section is carried forward to the next section.
3. Elimination entries are made to remove the intercompany items.
4. A computation and allocation schedule (CAD) must be prepared to determine the difference between implied and book value, and to allocate that difference.

	Parent Share	Non-Controlling Share	Implied Value
Purchase price and implied value	___________	___________	___________
Less: Book value of equity:			
Common stock			
Other contributed capital			
Retained earnings	___________	___________	___________
Total book value	___________	___________	___________

Difference between implied and book value			
Allocation of difference	____________	____________	____________
Balance	-0-	-0-	-0-

5. If P owns less than 100% of S, there will be a noncontrolling interest in S's income and S's equity accounts.
   a. Since we combine all of S's assets and liabilities with P's (not just P's share of S's assets and liabilities), the part of S that P doesn't own must be accounted for.
   b. The noncontrolling interest in equity is included as the first item in the equity section of the balance sheet; the noncontrolling interest is included in consolidated net income. Consolidated net income is allocated to controlling and noncontrolling interests.
   c. The noncontrolling interest in S can be calculated by finding its share of S's assets and liabilities, based on the value implied by the purchase price.
6. The beginning retained earnings eliminated in the first elimination entry is in the retaining earnings section of the workpaper, and the total of the retained earnings section is carried forward to the balance sheet section (the entire line is carried forward in the workpaper).
7. Consolidated retained earnings is P's retained earnings plus its share of the net increase in S's retained earnings since acquisition, plus or minus any adjustments for excess depreciation, amortization, etc.
8. The eliminations carry forward from one section to the next, and the debit and credit columns will balance only at the bottom of the worksheet.

B. Year of acquisition – cost method
   1. P must eliminate its share of S's equity accounts.

To eliminate P's share of S's equity- *investment entry*		
Common Stock – S		
Other Contributed Capital – S		
Beginning Retained Earnings – S		
Difference between implied and book value (from table)		
Investment in S (P's original cost)		
Noncontrolling Interest		

   2. P must allocate the difference between implied and book value (in this chapter, we generally assume it to be attributable to land or goodwill, thus deferring the entries for excess depreciation, amortization, etc. to Chapter 5).

To allocate the difference between implied and book value- *differential entry*		
Goodwill or Land (Depending on the assumptions given)		
Difference between Implied and Book Value		

   3. P must eliminate its share of S's dividends

To eliminate P's share of S's dividends- *dividend entry*		
Dividend Income (P)		
Dividends Declared (S)		

C. Year after acquisition – cost method

1. After the first year, S's beginning retained earnings will no longer be the same as it was on the date of acquisition.
    a. You must calculate the difference in order to establish reciprocity between P's Investment in S Company account and S's equity accounts (or to convert to equity):

Calculation of amount to establish reciprocity	
S's retained earnings at the beginning of the current year	
Less: S's retained earnings at acquisition	___________
S's undistributed earnings since acquisition	
× P's percentage of ownership of S	___________
P's share of S's undistributed earnings since acquisition	

    b. The elimination entry to establish reciprocity (convert to equity):

To establish reciprocity between P's investment account and S's equity		
Investment in S		
Beginning Retained Earnings – P (From above)		

    c. This entry adjusts P's beginning retained earnings to consolidated retained earnings at the end of the previous year.
2. The entry to eliminate P's investment account will be the same as before, except the amount for S's beginning retained earnings and P's investment account will change every year, as will the entry to NCI.

To eliminate P's share of S's equity		
Common stock – S (probably the same every year)		
Other contributed capital – S (probably the same)		
Beginning retained earnings – S (changes every year)		
Difference between implied and book value (same each year)		
Investment in S (P's original cost + adjustment from reciprocity entry above)		
Noncontrolling Interest (From CAD + its share of post-acquisition earnings)		

3. The other entries – to allocate the difference between implied and book value and to eliminate intercompany dividends – will be the same as in the first year, although some adjustments will be needed in Chapter 5 (when the difference is attributable to depreciable assets, for example).

4.3 Recording Investments in Subsidiaries – Equity Method (Partial or Complete)

A. Investment carried at equity – year of acquisition
1. In this chapter, the partial equity and full equity methods are the same – we'll look at the differences in Chapter 5, when we learn more about allocating the difference between implied and book value.
2. Remember, under the equity method, P records its share of S's income whether it is distributed or not.
3. The computation and allocation of the difference between implied and book value (CAD) will be just the same as it was for the cost method.
4. The entry to eliminate P's investment against S's equity will be just the same.
5. The entry which eliminates intercompany income and dividends will be different.

a. P Company has an account called Equity in S Income, rather than a dividend income account. This account must be eliminated.
b. S has a dividends declared account. P's share must be eliminated against Investment.
c. The entry to do both:

To eliminate P's share of S's dividends and eliminate P's equity in S income account (assuming S's income was greater than its dividends)		
Equity in S Income (P)		
Investment in S		
Dividends Declared (S)		

6. The completion of the workpaper follows the same process, and the consolidated statements will be identical.

B. Investment carried at equity – year after acquisition.
1. Since P has already reflected its share of S's income in its retained earnings and investment, there is no need to establish reciprocity (convert to equity). P's investment account reflects its share of S's undistributed income since acquisition.
2. The entries on the workpaper will be the same as the year of acquisition, remembering that S's beginning retained earnings, P's investment account, and any NCI will change every year. They will reflect the undistributed earnings found in S's retained earnings.

C. Summary of workpaper eliminating entries.
1. At this point in your studies, you have learned about three workpaper entries for the cost method, and two for the equity and partial equity methods.
2. Study the list on page 164 of your textbook to familiarize yourself completely with the eliminating entries that you should know by the end of this chapter.

4.4 Elimination of Intercompany Revenue and Expense Items

A. Many parent/subsidiary relationships are entered into because of a prior affiliation between the companies – most often some type of supplier/customer relationship.
B. The intercompany transactions that occur after the affiliation must be eliminated. In form, there are two entities, but in substance, there is only one entity.
C. All intercompany transactions result in equal but opposite accounts in the books of the two affiliates. If P has lent money to S, then the entry to eliminate intercompany interest revenue and expense is:

To eliminate intercompany transactions		
Interest Revenue (P)		
Interest Expense (S)		

4.5 Interim Acquisitions of Subsidiary Stock

A. Preliminary information
1. Until now we have assumed that the acquisition of S by P has occurred at the end of the fiscal year. This is seldom the case. Often, P's acquisition of S is an interim acquisition.
2. Under the acquisition method, P buys its share of S's income to the date of acquisition. Any income earned after that time should appear in the consolidated statements.
3. Two alternatives have been used to account for the partial year earnings which occur when the acquisition does not happen at year end.
4. The problem is further complicated by the choice of the cost method or the equity method of accounting for the combination.

B. Interim acquisition under the cost method

1. Full-year reporting alternative
   a. S's trial balance reflects earnings for its entire year, a portion of which has been purchased by P as a part of the acquisition.
   b. S's income must be divided between the portion earned prior to acquisition and the portion earned subsequently.
   c. The division begins with the computation and allocation of the difference between implied and book value (CAD):

	Parent Share	Non-Controlling Share	Implied Value
Purchase price and implied value	____________	____________	____________
Less: Book value of equity:			
Common stock			
Retained earnings 1/1			
Income purchased (1/1 to date of acquisition)			
Dividends declared (1/1 to date of acquisition)	(__________)	(__________)	(__________)
Total book value	____________	____________	____________
Difference between implied and book value			
Allocation of difference	____________	____________	____________
Balance	-0-	-0-	-0-

   d. The book value of the equity acquired thus includes the income and dividends which have occurred since the beginning of the year – P purchases its share of S's income.
   e. The entry to eliminate P's share of S's equity in the year of acquisition will include an account called subsidiary income before to acquisition. This account decreases consolidated net income.

To eliminate P's share of S's equity		
Common Stock – S		
Beginning Retained Earnings – 1/1		
Subsidiary Income Before Acquisition		
Difference between Implied and Book Value (from above)		
Investment in S (P's original cost)		
Noncontrolling Interest		
Dividends Declared – S (Prior to acquisition)		

2. Partial-year reporting alternative
   a. When the partial-year alternative is used, the subsidiary company must close its books as of the date of acquisition. In that case, the income earned from the end of the last fiscal year to the date of acquisition (and any dividends declared before acquisition) will be reflected in S's retained earnings on the date of acquisition.
   b. The computation and allocation of the difference between implied and book value:

	Parent Share	Non-Controlling Share	Implied Value
Purchase price and implied value	______________	______________	______________
Less: Book value of equity			
Common stock			
Retained earnings	______________	______________	______________
Total book value	______________	______________	______________
Difference between implied and book value			
Allocation of difference	______________	______________	______________
Balance	-0-	-0-	-0-

c. The workpaper entry to eliminate P's investment will use S's retained earnings on the date of acquisition, which includes income purchased.

d. In years subsequent to the acquisition, S's retained earnings at the beginning of the current year will be used.

e. Whether or not the full-year or partial-year method is used, under the cost method the entry to establish reciprocity (convert to equity) uses S's retained earnings at the date of acquisition.

C. Interim acquisition under the equity method

1. Full-year reporting alternative

a. If P uses the equity method, by year end it will have recorded its share of S's income earned and dividends declared since the acquisition.

b. The computation and allocation schedule will be the same as the cost method.

c. The eliminating entries will include the entry to adjust P's investment account to its balance at the beginning of the year:

To eliminate P's share of S's income and dividends*		
Equity in S Income – P		
Investment in S		
Dividends Declared – S (P's %)		

* Can be separated into 2 entries, one to eliminate dividends and the other to eliminate P's share of S's income

d. The entry to eliminate P's investment in S will include S's income before acquisition and any dividends declared by S before acquisition:

To eliminate P's share of S's equity		
Common Stock – S		
Beginning Retained Earnings – 1/1		
Subsidiary Income Before Acquisition		
Difference between Implied and Book Value		
Investment in S (P's original cost)		
Noncontrolling Interest		
Dividends Declared – S		

2. Partial-year reporting alternative

a. S will close its books as of the date of acquisition. P will record its share of S's income and dividends after the date of acquisition under the equity method.
b. The eliminating entries will be the same as if the acquisition took place at the end of S's fiscal year. No special eliminating entries will be made.

4.6 Consolidated Statement of Cash Flows

A. General information
1. Generally, the statement of cash flows for a consolidated entity is the same as a statement of cash flows for a single corporation. The consolidated income statement is the starting point.
2. Three items on the consolidated statement of cash flows might require modification:
a. Begin with consolidated net income, including the NCI.
b. Dividends paid must include not only those paid by P to its stockholders, but also those paid by S to its noncontrolling stockholders.
c. If P purchased S by issuing stock, there is no cash flow for investing activities. However, if P uses cash, there is. In either case there is a note.

B. There is a complete illustration of a consolidated statement of cash flows after acquisition on pages 178-180 of your textbook.

C. There is a complete illustration of a consolidated statement of cash flows in the year of acquisition on pages 182-183 of your textbook. It is more difficult in the first year than in subsequent years, since the previous year's balance sheet was not consolidated.
1. The beginning of the year balances on the balance sheet are for P Company only, so comparisons between beginning and end of year amounts must be reconciled.
a. Any cash spent or received in the acquisition itself will be part of the investing section of the statement of cash flows.
b. The changes between this year's and last year's balances should include P's assets and liabilities for the entire year.
2. S's cash balance on the date of acquisition should be included as a decrease of the cash paid for the investment as of that date. Only the actual total cash outlay (P's cash paid – S's cash on hand) will be cash outflow.

4.7 Comparison of the *equity method* under U.S. GAAP to *accounting for associates* method under IFRS is shown on page 184 of textbook.

MULTIPLE CHOICE QUESTIONS

Choose the BEST answer for the following questions.

_____ 1. If a corporation shows effective control over another corporation, the first corporation owns:
a. less than 20 percent of the second corporation.
b. between 20 and 50 percent of the second corporation.
c. over 50 percent of the second corporation.
d. 100 percent of the second corporation.

_____ 2. The cost method of accounting for a parent-subsidiary relationship records P's share of S's:
a. dividends as income for the year.
b. income whether dividends are paid or not.
c. dividends as a reduction of the investment account.
d. none of the above.

_____ 3. The primary difference between the partial equity and the complete equity methods of accounting for business combinations is:

a. under the complete equity method, the combination assumes that the two businesses have always been together.
b. under the complete equity method, the parent records amortization and/or depreciation to account for the difference between implied and book value.
c. under the partial equity method the parent records its share of dividends as income.
d. there is no difference between the partial equity and full equity methods.

_____ 4. What is the purpose of the consolidated statements workpaper?

a. The workpaper allows for year-end adjustments of accruals and deferrals.
b. The workpaper takes the balances from the consolidated ledger to prepare the consolidated financial statements.
c. The workpaper helps the accountant determine the amount of consolidated income taxes.
d. The workpaper accumulates, classifies, and arranges information from the trial balances of the affiliated companies.

_____ 5. What is the noncontrolling interest in S's income?

a. The difference between P's reported income and S's reported income
b. The part of S's income that is owned by shareholders other than P
c. The allocation of difference between implied and book value
d. The portion of S's income that is not included in consolidated income

_____ 6. What is consolidated retained earnings?

a. P's retained earnings plus S's retained earnings.
b. P's retained earnings only.
c. P's retained earnings plus P's share of the net increase in S's retained earnings since acquisition.
d. P's retained earnings plus P's share of S's net income for the current year less P's share of S's dividends declared.

_____ 7. Under the cost method, to establish reciprocity (convert to equity), P's share:

a. of the difference between S's retained earnings at the beginning and the end of the year must be added to P's investment.
b. of the difference between S's reported income and the noncontrolling interest income must be added to P's investment.
c. of the difference between S's retained earnings at the beginning of the year and at acquisition must be added to P's investment.
d. of S's dividends must be subtracted from P's investment.

_____ 8. Under the equity methods, the elimination entry to establish reciprocity (convert to equity) between P's investment and S's equity:

a. will add P's share of S's undistributed income to P's investment.
b. does not have to be made.
c. will have S record its noncontrolling interest in income.
d. will have S decrease its retained earnings to reflect income not distributed.

_____ 9. Why should intercompany revenues and expenses be eliminated?

a. Because the consolidated entity cannot earn from itself.
b. Because the consolidated entity cannot owe itself a debt.

c. Because the consolidated financial statements would include overstated amounts.
d. Both A and C.

_____10. What is meant by an interim acquisition of subsidiary stock?
a. P purchases a controlling interest in S's equity at some time other than the end of the fiscal year.
b. P purchases S's treasury stock.
c. P restates its income to include both pre-acquisition and post-acquisition earnings.
d. P divides its income into pre-acquisition and post-acquisition earnings.

_____11. Under the partial-year reporting alternative:
a. S generally closes its books at the date of acquisition.
b. P buys its share of S's pre-acquisition earnings.
c. retained earnings eliminated are from the date of acquisition, not the beginning of the fiscal year.
d. all of the above.

_____12. The accounting for investments using the *equity method* under U.S. GAAP and using the *investment in associates* method under IFRS is the same for all the following issues except:
a. that P and S have uniform accounting policies.
b. P's carrying value of S's investment account.
c. definition of P having significant influence over S
d. allowance of 3-month reporting period difference between P and S

_____13. In a consolidated statements workpaper, which items are carried forward from one section to another?
a. P's retained earnings, but not S's
b. The total of the income section to the retained earnings section and then the total of the retained earnings section to the balance sheet section.
c. The eliminations must balance for each section in order to carry them forward.
d. Each section on the workpaper is separate, so no numbers are carried forward.

EXERCISE

1. **Consolidated Workpaper,Partially Owned Subsidiary-Subsequent Years**

On January 1, 2009, Plank Company purchased 80% of the outstanding capital stock of Scoba Company for $53,000. At that time Scoba's stock holder's equity consisted of capital stock $55,000; other contributed capital , $5,000; and retained earnings, $5,000. On December 31, 2013,the trial balances of the two companies' trial balance were as follow :

	Plank	Scoba
Cash	$42,000	$22,000
Account receivable	$21,000	$17,000
Inventory	15,000	8,000
Investments in Scoba Company	$61,000	0
Land	$52,000	$48,000
Dividends declared	$10,000	$8,000
Cost of Goods Sold	$84,500	$20,000

Other expense	$10,000	$12,000
	$296,400	$135,000
Accounts payable	$12,000	$6,000
Other liabilities	$5,000	$4,000
Capital stock	$100,000	$55,000
Other contributed Capital	$20,000	$5,000
Retained Earnings, 1/1	$40,000	$15,000
Sales	$105,000	$50,000
Equity in Subsidiary Income	$14,400	$156,000
	$296,400	$135,000

The account payable of Scoba Company include $3,000 payable to Plank Company.

Required:

a. What method is being used by Plank to account for its investment in Scoba Company ?How can you tell ?
b. Prepare a consolidated statements workpaper at December 31,2013. Any difference between book value and the value implied by the purchase prices relates to subsidiary land.

2. **Consolidated Workpaper, Equity Method**

Poco Company purchased 80% of Solo Company's common stock on January 1, 2010, for $250,000. On December 31,2010, the companies prepared the following trial balances :

	Poco	Solo
Cash	$161,500	$125,000
Inventory	$210,000	$195,000
Investment in Solo Company	$402,000	
Land	$75,000	$150,000
Cost of Good Sold	$410,000	$125,000
Other expense	$100,000	$80,000
Dividends Declared	$30,000	$15,000
Total Debits	$1,388,500	$690,000
Accounts payable	$154,500	$35,000
Common Stock	$200,000	$150,000
Other contributed Capital	$60,000	$35,000
Retained Earnings, 1/1	$50,000	$60,000
Sales	$760,000	$410,000
Equity in Subsidiary Income	$164,000	
Total Credits	$1,388,500	$690,000

Required :

Prepare a consolidated statements workpaper at December 31,2010. Any difference between book value and the value implied by the purchase prices relates to goodwill.

3. **Equity Method, Two Consecutive Years**

On January 1, 2010, Parker Company purchased 90% of the outstanding common stock of Sid Company for $180,000. At the time, Sid's stockholder's equity consisted of common stock $120,000; other contributed capital $20,000; retained earnings $25,000. Assume that any difference between book value of equity and the value implied by the purchase price is attributable to land. On December 31,2010, the two companies trial balance were as follow:

	Parker	Sid
Cash	$65,000	$35,000
Account Receivable	$40,000	$30,000
Inventory	$25,000	$15,000
Investment in Sid Company	$184,500	
Plant and Equipment	$110,000	$85,000
Land	$48,500	$45,000
Dividen Declared	$20,000	$15,000
Cost of Goods Sold	$150,000	$60,000
Operating Expenses	$35,000	$15,000
Total Debits	$678,000	$300,000
Account Payable	$20,000	$15,000
Other Liabilities	$15,000	$25,000
Common Stock, par value $10	$200,000	$120,000
Other Contributed Capital	$70,000	$20,000
Retained Earnings, 1/1	$55,000	$25,000
Sales	$300,000	$95,000
Equity in Subsidiary Income	$18,000	
Total Credits	$678,000	$300,000

Required:

A. Prepare a consolidated statements workpaper at December 31,2010.

B. Prepare a consolidated statements workpaper on December 31, 2011, assuming trial balances for Parker and Sid on that date were :

	Parker	Sid
Cash	$70,000	$20,000
Account Receivable	$60,000	$35,000
Inventory	$45,000	$30,000
Investment in Sid Company	$193,500	
Plant and Equipment	$125,000	$90,000
Land	$48,500	$45,000
Dividen Declared	$20,000	$15,000
Cost of Goods Sold	$160,000	$65,000
Operating Expenses	$35,000	$20,000

Total Debits	$752,000	$320,000
Account Payable	$16,500	$16,000
Other Liabilities	$15,000	$24,000
Common Stock, par value $10	$200,000	$120,000
Other Contributed Capital	$70,000	$20,000
Retained Earnings, 1/1	$168,000	$30,000
Sales	$260,000	$110,000
Equity in Subsidiary Income	$22,500	
Total Credits	$752,000	$320,000

4. **Consolidated Statement of Cash Flow, Indirect Method**

A consolidated income statement for 2011 and comparative consolidated balance sheet for 2010 dan 2011 for P Companya and its 80% owned subsidiary follow :

P COMPANY AND SUBSIDIARY
Consolidated Income Statement
for the Year Ended December 31,2011

Sales	$1,900,000
Cost of goods sold	$1,000,000
Gross margin	$900,000
Expenses	$300,000
Operating income before tax	$600,000
Dividend Income	$50,000
Income before tax	$550,000
Income taxes	$220,000
Consolidated net income	$330,000
Less : Noncontrolling interest in consolidated net income	$66,000
Controlling interest in consolidated net income	$264,000

P COMPANY AND SUBSIDIARY
Consolidated Balance Sheet
December 31,2010 and 2011

Assets	2010	2011
Cash	$250,000	$300,000
Account Receivable	$360,000	$250,000
Inventories	$210,000	$190,000
Equipment (net)	$950,000	$500,000
Long term investments	$800,000	$800,000
Goodwill	$175,000	$175,000
Total assets	$2,745,000	$2,215,000

P COMPANY AND SUBSIDIARY
Consolidated Balance Sheet
December 31,2010 and 2011

Liabilities and Equity	2011	2010
Account payable	$268,000	$500,000
Acrued payable	$260,000	$200,000
Bond payable	$200,000	
Premium on Bond Payable	$40,000	
Noncontrolling interest	$148,000	$90,000
Common stock, $1 par value	$600,000	$430,000
Other contributed capital	$275,000	$225,000
Retained earnings	$954,000	$750,000
Total Equities	$2,745,000	$2,215,000

Other information :

1. Equipment depreciation was $95,000.
2. Equipment was purchased during the year for cash, $545,000
3. Dividends paid during 2011 :
   a. Declared and paid by S Company, $40,000
   b. Declared and paid by P Company, $60,000
4. The bond payable were issued on December 30,2011, for $240,000
5. Common stock issued during 2011, 150,000 shares

   Required :

   Prepare a consolidated statement of cash flows for the year ended December 31, 2011, using the indirect method.

6. Consolidated Statement of Cash Flow, Direct Method

A consolidated income statement for the year December 31,201, and comparative balance sheets for 2011 and 2012 for Park Company and its 90% owned subsidiary SCR, Inc. are as follow :

PARKS COMPANY AND SUBSIDIARY
Consolidated Income Statement
for the Year Ended December 31, 2012

Sales		$239,000
Cost of goods sold		$104,000
Gross margin		$135,000
Depreciation expense	$27,000	
Other operating expenses	$72,000	$99,000
Income from operations		$36,000
Investment income		$4,500
Consolidated net income		$40,500
Noncontrolling interest in consolidated net income		$3,000
Controlling interest in consolidated net income		$37,500

PARKS COMPANY AND SUBSIDIARY
Consolidated Balance Sheet

December 31,2010 and 2011

	2012	2011
Cash	$36,700	$16,000
Receivables	$55,000	$90,000
Inventory	$126,000	$92,000
Property, plant, and equipment(net of depreciation)	$231,000	$225,000
Longterm investment	$39,000	$39,000
Goodwill	$60,000	$60,000
Total assets	$547,700	$522,000
Account payable	$67,500	$88,500
Accrued expenses	$30,000	$41,000
Bond payable, due July1, 2020	$100,000	$150,000
Total liabilities	$197,500	$279,500
Noncontrolling interest	$32,200	$30,000
Common stock	$187,500	$100,000
Retained earnings	$130,500	$112,500
Total stockholder's equity	$318,000	$212,500
Total Equities	$547,700	$522,000

SCR, Inc. declared and paid oan $8,900 dividend during 2012.

Required :

Prepare a consolidated statement of cash flow using the direct method.

Allocation and Depreciation of Differences Between Implied and Book Values

Learning Objectives :

1. Calculate the difference between implied and book values and allocate to the subsidiary's assets and liabilities.
2. Describe FASB's position on accounting for bargain acquisitions.
3. Explain how goodwill is measured at the time of the acquisition.
4. Describe how the allocation process differs if less than 100% of the subsidiary is acquired.
5. Record the entries needed on the parent's books to account for the investment under the three methods: the cost, the partial equity, and the complete equity methods.
6. Prepare workpapers for the year of acquisition and the year(s) subsequent to the acquisition, assuming that the parent accounts for the investment using the cost, the partial equity, and the complete equity methods.
7. Understand the allocation of the difference between implied and book values to long-term debt components.
8. Explain how to allocate the difference between implied and book values when some assets have fair values below book values.
9. Distinguish between recording the subsidiary depreciable assets at net versus gross fair values.
10. Understand the concept of push down accounting.

Referensi

Debra C. Jetter, Advance Accounting, International Student Version, 5th edition, John Wiley, 2012.

<u>INTRODUCTION</u>

With the new rulings concerning goodwill, companies are coming to grips with a different method of accounting for any differences found between the book value, fair value, and cost of an acquisition. In previous chapters, we've assumed that any difference between implied and book value was attributable to land – that's an easy solution to what can become a very complex problem. The premium paid by P for its interest in S can be connected to several things – S's assets and liabilities are undervalued; S has the potential of excess future earnings; P really wants to own S. In this chapter we'll look at the real allocation of the difference between implied and book value.

<u>CHAPTER OUTLINE</u>

5.1 Allocation of Difference Between Implied and Book Values to Assets and Liabilities of Subsidiary: Acquisition Date

A. Asset and liability values must be adjusted for any difference between the book value of S's assets and the value implied by the purchase price
B. Wholly owned subsidiary
   1 Determine the difference between implied and book value
   2. If there is an excess of value implied by the purchase price over the fair values of the net identifiable assets, the "extra" becomes goodwill
   3. If there is an excess of fair value of identifiable net assets over the value implied by the purchase price – a bargain purchase – the "extra" must be recognized as an ordinary gain
C. Bargain purchase
   1. In a bargain purchase, the value implied by the purchase price is less than fair value of identifiable net assets
      a. The purchase may occur where there is an excess of the implied value over book value, but implied value is less than the fair value of identifiable net assets (FV>IV>BV)
      b. The bargain may occur where implied value is below book value, as well as fair value (BV>FV>IV)
   2. General rules under prior GAAP (before 2007 standard)
      a. Current assets, long-term investments in marketable securities, assets to be disposed of, and prepaid pension plans are recorded at fair market value
      b. Any previously recorded goodwill is eliminated
      c. Long-lived assets are recorded at fair market value less an adjustment for the bargain
      d. If the long-lived assets are reduced to zero, an extraordinary gain is recorded
D. Impact of goodwill
   1. Since acquisitions are now the only acceptable way to record business combinations, there has been much discussion of the impact of goodwill on financial statements long-term
      a. Goodwill amortization would have decreased income while having no real effect on operations
      b. The new rules allow companies to capitalize goodwill and not amortize it unless impaired
E. Case 1 – value implied by the purchase price in excess of fair value of identifiable net assets of a ***wholly-owned subsidiary***
   1. Some assumptions:
      a. P acquires 100% of S for $100,000
      b. The book value of the equity acquired is $50,000
      c. The calculation to determine goodwill:

	Parent Share	Non-Controlling Share	Implied Value
Purchase price and implied value	**$100,000**	**$0**	$100,000
Less: Book value of equity:			
Common stock	30,000	0	30,000
Retained earnings	20,000	0	20,000
Total book value	50,000	0	50,000
Difference between implied and book value	50,000	0	50,000
Adjust identifiable assets to fair value: inventory, plant and equipment, intangibles and other than goodwill Equipment (from below) Land (from below)	 (10,000) (30,000)	 0	 (10,000) (30,000)
Excess of implied over fair value	10,000	0	10,000
Allocate to goodwill	(10,000)	0	(10,000)
Balance	$-0-	$-0-	$-0-

Asset	Fair Value	Book Value	Difference
Land	$60,000	$30,000	$30,000
Equipment	40,000	30,000	10,000
			$40,000

2. The entries to eliminate the investment:

To eliminate P's investment in S		
Capital Stock – S	30,000	
Retained Earnings – S	20,000	
Difference between Implied and Book Value	50,000	
Investment in S		100,000

To allocate difference between implied and book value		
Land	30,000	
Equipment	10,000	
Goodwill	10,000	
Difference between Implied and Book Value		50,000

F. Case 2 – adjustment with ***less than wholly-owned subsidiaries***

1. Some assumptions:
   a. P acquires 80% of S for $80,000
   b. The book value of the equity acquired is $40,000
   c. P's share of the identifiable assets is $32,000
   d. The calculation to determine goodwill:

	Parent Share	Non-Controlling Share	Implied Value
Purchase price and implied value	$80,000	$20,000	$100,000
Less: Book value of equity acquired	40,000	10,000	50,000
Difference between implied and book value	40,000	10,000	50,000
Adjust identifiable assets to fair value inventory, plant and equipment, intangibles other than goodwill Equipment Land	(8,000) (24,000)	(2,000) (6,000)	(10,000) (30,000)
Excess of implied over fair value	8,000	2,000	10,000
Allocate to goodwill	(8,000)	(2,000)	(10,000)
Balance	$-0-	$-0-	$-0-

2. The entries to eliminate the investment account:

To eliminate P's investment in S		
Capital Stock – S	30,000	
Retained Earnings – S	20,000	
Difference between Implied and Book Value	50,000	
Investment in S		80,000
Noncontrolling Interest		20,000

To allocate difference between implied and book value		
Land	30,000	
Equipment	10,000	
Goodwill	10,000	
Difference between Implied and Book Value		50,000

G. Case 3 – Value implied by the purchase price less than fair value of identifiable net assets, and less than wholly-owned subsidiary

1. Some assumptions:
   a. P acquires 80% of S for $70,000
   b. The book value of the equity acquired is still $40,000
   c. P's share of the identifiable assets is still $32,000
   d. The calculation to determine the bargain

	Parent Share	Non-Controlling Share	Implied Value
Purchase price and implied value	**$70,000**	$**17,500**	$87,500
Less: Book value of equity acquired	40,000	10,000	**50,000**
Difference between implied and book value	30,000	7,500	37,500
Adjust identifiable assets to fair value inventory, plant and equipment, intangibles other than goodwill Equipment Land	 (8,000) (24,000)	 (2,000) (6,000)	 (10,000) (30,000)
Excess of fair value over implied value	(2,000)	(500)	(2,500)
Parent's gain	2,000		
Increase noncontrolling interest to fair value of assets		500	
Total allocated bargain			2,500
Balance	$-0-	$-0-	$-0-

2. The entries to eliminate the investment

To eliminate P's investment in S		
Capital Stock – S	30,000	
Retained Earnings – S	20,000	
Difference between Implied and Book Value	37,500	

Investment in S		70,000
Noncontrolling Interest		17,500
To allocate difference between implied and book value		
Land	30,000	
Equipment	10,000	
Difference between Implied and Book Value		37,500
Noncontrolling Interest		500
Gain on Acquisition		2,000

H. Case 4 – the value implied by the purchase price is less than both the BV and the FV – a real "bargain purchase"

1. Some assumptions:
   a. P acquires 80% of S for $36,000
   b. The book value of the equity acquired is still $40,000
   c. P's share of the identifiable assets is still $32,000
   d. The calculation to determine the bargain

	Parent Share	Non-Controlling Share	Implied Value
Purchase price and implied value	$36,000	$9,000	$45,000
Book value of equity acquired	40,000	10,000	50,000
Difference between implied and book value	(4,000)	(1,000)	(5,000)
Adjust identifiable assets to fair value inventory, plant and equipment, intangibles other than goodwill Equipment Land	(8,000) (24,000)	(2,000) (6,000)	(10,000) (30,000)
Excess of fair value over implied value	(36,000)	(9,000)	(45,000)
Parent's gain	36,000		
Increase noncontrolling interest to fair value of assets		9,000	
Total allocated bargain			45,000
Balance	$-0-	$-0-	$-0-

2. Elimination entries

To eliminate P's investment in S		
Capital Stock – S	30,000	
Retained Earnings – S	20,000	
Difference between Implied and Book Value		5,000
Investment in S		36,000
Noncontrolling Interest		9,000
To allocate difference between implied and book value		
Land	30,000	
Equipment	10,000	
Difference between Implied and Book Value	5,000	
Gain on Acquisition		36,000
Noncontrolling Interest		9,000

5.2 Effect of Allocation and Depreciation of Differences between Implied and Book Values on Consolidated Net Income – Year Subsequent to Acquisition

A. When we adjust depreciable asset balances, the depreciation recorded on S's books no longer reflect the consolidated entity's depreciation expense.

B. We must adjust depreciation expense to reflect these differences

1. Calculation of depreciation expense on the purchased assets (use Case 1 above)

Asset	Fair Value	Book Value	Difference
Land	$50,000	$20,000	$30,000
Equipment	40,000	30,000	10,000
			$40,000

2. Assume the equipment has an estimated useful life of 5 years.

	P	S	Difference
Depreciation Calculation: Cost / EUL	40,000 / 5	30,000 / 5	10,000 / 5
Depreciation expense	$8,000	$6,000	$2,000

3. When the difference between implied and book value is allocated to assets and to goodwill, the extra depreciation expense will be included
4. The technique accounts for the fact that the difference between implied and book value is not necessarily permanent, but is a result of buying depreciable assets
5. Remember, however, that the goodwill recorded is not amortized, and remains on the books of the consolidated entity indefinitely, unless there is a permanent impairment.

5.3 Consolidated Statements Workpaper – Investment Recorded Using the Cost Method

A. Workpaper entries for the above combination, assuming the cost method:

1. Year of acquisition

To eliminate P's investment in S		
Capital Stock – S	30,000	
Retained Earnings – S	20,000	
Difference between Implied and Book Value	50,000	
Investment in S		100,000
To allocate difference between implied and book value		
Land (not depreciable)	30,000	
Equipment ($10,000 – depr. of $2,000)	8,000	
Depreciation Expense	2,000	
Goodwill	10,000	
Difference between Implied and Book Value		50,000

2. Second year

To eliminate P's investment in S		
Capital Stock – S	30,000	
Retained Earnings – S (no income for simplicity!)	20,000	
Difference between Implied and Book Value	50,000	
Investment in S		100,000
To allocate difference between implied and book value		
Beginning Retained Earnings – P	2,000	
Land (not depreciable)	30,000	
Equipment ($10,000 – depr. of $4,000)	6,000	
Depreciation Expense	2,000	
Goodwill	10,000	
Difference between Implied and Book Value		50,000

B. Note

1. The difference between implied and book value written off during the year is an expense.
2. The previous years' write-offs decrease P's beginning retained earnings as a substitute for consolidated retained earnings
3. Remember – none of these transactions gets recorded in the books, so the effect must accumulate over the life of the consolidation
4. The other workpaper entries are the same as we studied in earlier chapters

5. Noncontrolling interest is reduced for its share of write-offs

5.4 Cost Method Analysis of Controlling and Noncontrolling Interests in Consolidated Net Income and Retained Earnings

A. In order to calculate controlling interest in consolidated income, we must adjust P's income to reflect its income from independent operations plus or minus its income from its combination with S

B. The general formula is:

P's income from independent operations
+ P's share of S's reported income OR - P's share of S's reported loss
± P's share of adjustments relating to depreciation or amortization of the difference between implied and book value
Controlling interest in Consolidated Net Income

C. Consolidated retained earnings is also P's retained earnings adjusted for its income from S, adjusted for excess depreciation, amortization, and impairment

D. The general formula is:

P's retained earnings
+ P's share of S's increase in retained earnings from the date of acquisition OR - P's share of S's decrease in retained earnings from the date of acquisition
+ The cumulative effect of adjustments to date relating to the depreciation/amortization of the difference between implied and book value
Consolidated Retained Earnings

5.5 Consolidated Statements Workpaper – Investment Recorded Using Partial Equity Method

A. Under the partial equity method, P records its equity in S's income in the books, but it doesn't separate them into separate income and expense accounts

B. In the partial equity method, P doesn't record the amortization/depreciation of the difference between implied and book value of the acquisition

C. Therefore, the workpaper entries to eliminate the investment and to allocate the difference between implied and book value are the same as the ones we just studied for the cost method.

D. The other workpaper entries we studied for the partial equity method in previous chapters will still be the same. The example in your book takes you through the entire process

5.6 Partial Equity Method Analysis of Controlling and Noncontrolling Interests in Consolidated Net Income and Retained Earnings

A. Under the partial equity method, the method for calculating controlling interest in consolidated net income is the same as under the cost method:

P's income from independent operations
+ P's share of S's reported income OR - P's share of S's reported loss
± P's share of adjustments relating to depreciation or amortization of the difference between implied and book value
Controlling interest in Consolidated Net Income

B. Under the partial equity method, consolidated retained earnings is calculated as follows:

P's recorded partial equity basis retained earnings
± The cumulative effect of adjustments to date relating to the depreciation/amortization of the difference between implied and book value
Consolidated Retained Earnings

5.7 Consolidated Statements Workpaper – Investment Recorded Using Complete Equity Method

A. Even though the complete equity method has P recording depreciation in its books, some entries on the workpaper must still "move" the amounts into the appropriate accounts

B. P adjusts its Equity in S Income account for the amortization/depreciation of the difference between implied and book value – usually this decreases the account

To record P's share of S's income		
Investment in S		
Equity in S Income		
To record P's share of amortization/depreciation		
Equity in S Income		
Investment in S		

C. The workpaper entries, then, must move the amounts into the appropriate depreciation/amortization account

1. At the date of acquisition (just like the cost and partial equity methods):

To eliminate P's investment in S		
Common Stock – S		
Difference between Implied and Book Value		
Investment in S		
To amortize/depreciate the difference between implied and book value		
Various Assets		
Difference between Implied and Book Value		

2. In years subsequent to acquisition, the adjustment must be to the investment in S account, instead of P's beginning retained earnings

To eliminate P's investment in S		
Common Stock – S		
Difference between Implied and Book Value		
Investment in S		
To amortize/depreciate the difference between implied and book value		
Investment in S (total of previous years' depreciation)		
Various Assets (net of accumulated depreciation/amortization)		
Difference between Implied and Book Value		

5.8 Complete Equity Method Analysis of Controlling Interest in Consolidated Net Income and Retained Earnings

A. Controlling interest in consolidated net income is the same as we calculated for the cost method and the partial equity method

B. Consolidated retained earnings is the same as P's retained earnings – we've already included all the information relating to the combination in P's books

5.9 Additional Considerations Relating to Treatment of Difference Between Implied and Book Values

A. Allocation of difference between implied and book value to debt
   1. Adjustment of contingent liabilities and reserves
   2. P could allocate amounts to contingent liabilities, thus creating a larger addition to assets or more goodwill
   3. Some controversy surrounds this technique

B. Allocation of difference between implied and book values to long-term debt
   1. Long-term debt should be valued on the consolidated statements at its fair value
      a. The best fair value is quoted market price
      b. Present value techniques can be used if there is no market price
   2. Workpaper entries must be made to amortize the discount/premium resulting from the restatement of the long term asset – interest expense will be affected.

C. Allocating the difference to assets (liabilities) with fair value less (greater) than book values
   1. If an asset's fair value is less than its book value, the resulting adjustment will be a decrease to depreciation/amortization expense as well as a decrease to the asset account
   2. If a liability's fair value is greater than its book value, the difference becomes unamortized bond premium, which decreases interest expense over time
   3. Essentially, the workpaper entries are the same, but backwards! (see text illustration on Page 265 of the difference)

D. Reporting accumulated depreciation in consolidated financial statements as a separate balance
   1. In order to separate the asset account from its related accumulated depreciation account, we must calculate the "sound" – used fair value – value of the asset on the date of acquisition
   2. We must also calculate depreciation on the asset based on its sound value – this will be different from depreciation on its original cost
   3. When we allocate the difference between implied and book value, we will write up the asset to its sound value each year
   4. When we increase depreciation expense, we will increase accumulated depreciation instead of decreasing the asset

To allocate, depreciate and amortize the difference between implied and book value – cost method		
Beginning Retained Earnings – P (subsequent years)		
COGS (usually only first year)		
Depreciation Expense (this year's amount)		
Equipment (total original allocation)		
Land (total original allocation)		
Goodwill (total original allocation unless impaired)		
Accumulated Depreciation (all depreciation taken since acquisition including this year's)		
Difference between Implied and Book Value		

E. Disposal of depreciable assets by subsidiary
   1. If S sells depreciable assets before the end of their estimated useful life, the gain or loss recorded by S will not reflect the consolidated entity's cost of that equipment
   2. The consolidated entity's gain or loss is calculated by comparing the fair value associated to the asset to the amount received by S for that asset

S's original cost
+ Allocation of the difference between implied and book value
Consolidated entity cost
- (S's accumulated depreciation + depreciation of allocation)
Consolidated book value
- Amount received by S on the disposal
Consolidated gain (loss)

3. The workpaper entry to adjust S's gain or loss to the consolidated gain or loss:
   a. Loss:

To adjust S's gain or loss and eliminate remaining undepreciated allocation		
Beginning Retained Earnings – P (all depr.exp. allocations to date)		
Gain on Disposal of Equipment – S		
Loss on Disposal of Equipment – Consolidated Entity (if the amount above is negative)		
Difference between Implied and Book Value (remaining undepreciated allocation)		

   b. Gain:

To adjust S's gain or loss and eliminate remaining undepreciated allocation		
Beginning Retained Earnings – P (all depr.exp. allocations to date)		
Gain on Disposal of Equipment – S		
Gain on Disposal of Equipment – Consolidated Entity (if the amount above is positive)		
Difference between Implied and Book Value (remaining undepreciated allocation)		

5.10 Push Down Accounting

A. Definition: The fair values of S's assets as determined in its combination with P become part of S's actual records – P's cost then becomes the cost S accounts for. This eliminates the difference between implied and book value

1. Arguments for:
   a. New owners have established a new company, so assets should be valued at their cost on the date of acquisition by P
   b. Push down accounting creates symmetry between P-only, S-only, and consolidated statements
2. Arguments against:
   a. The change of ownership didn't cause the subsidiary to consider itself a new business.
   b. If there are noncontrolling stockholders, the S-only statements are misleading.
3. Three factors should be considered:
   a. Does S have outstanding debt held by the public?

b. Does S have preferred stock not acquired by P?
c. What percentage of S has P purchased?

B. Status of push down accounting
   1. The SEC requires that push down accounting be used when P buys 95% or more of S at one time
   2. The SEC does not want push down accounting to be used if the ownership change is 80% or less
   3. FASB has not issued a FAS on the issue

MULTIPLE CHOICE QUESTIONS

Choose the BEST answer for the following questions.

_____ 1. The difference between implied and book value may be allocated to:
   a. any assets or liabilities on S's books.
   b. any assets or liabilities on P's books.
   c. only to S's land.
   d. only to P's land.

_____ 2. If there is an excess of fair value over cost:
   a. P must allocate the difference to S's assets as increases to their book values.
   b. P must include goodwill in the elimination entry.
   c. S must revalue its assets to their fair values.
   d. P must recognize a gain.

_____ 3. If P owns less than 100 percent of S, what effect does that have on the allocation of difference between implied and book value?
   a. P must increase S's assets by 100 percent of the difference between implied and book value, regardless of ownership percentage, unless book value exceeds implied value.
   b. P must increase S's assets by 100 percent of the difference between fair value and book value, unless it is a bargain purchase.
   c. P must increase S's assets by its percent of the difference between fair value and book value, as long as the excess of fair value over book value does not exceed the difference between implied and book value.
   d. S must increase the value of its assets by P's share of the excess of fair value over book value as long as it does not exceed the difference between implied and book value.

_____ 4. How does the allocation of the difference between implied and book value show up on the
workpaper, assuming the cost method?
   a. The difference is allocated amount assets and liabilities and then amortized or depreciated over 20 years.

b. The difference is allocated among assets and liabilities and then amortized or depreciated over their useful lives. Any excess is in goodwill.
c. The difference is all assumed to relate to S's land.
d. The difference is all assumed to be goodwill.

_____ 5. In the elimination entry for the partial equity method, the entry to eliminate P's investment in S:
a. is the same as the cost method.
b. adjusts the difference between implied and book value.
c. is not necessary.
d. does not have a difference between implied and book value.

_____ 6. When the partial or complete equity methods are used, where is P's share of S's income
recorded in P's books?
a. Dividend income
b. Equity in S income
c. Investment income
d. It is not recorded

_____ 7. What is the significant difference between the partial equity and the complete equity entries on P's books?
a. P records only its share of S's dividends in the partial equity method.
b. P records only its share of S's dividends in the complete equity method.
c. P records only its share of S's dividends and reported income in the partial equity method
d. P records only its share of S's dividends and income in the complete equity method.

_____ 8. When a specific asset has a fair value less than its book value, the allocation of the difference between implied and book value:
a. ignores the asset.
b. writes the asset up by its proportionate share of the difference.
c. decreases the asset by the excess of book value over fair value.
d. decreases P's cost of investment.

_____ 9. When S disposes of an asset prematurely and records a gain, how does that affect the consolidated financial statements?
a. The workpaper must include an entry to adjust S's gain or loss to reflect the gain or loss to the consolidated entity.
b. S cannot record a gain on the sale of the asset.
c. P records on its books the gain on the sale.
d. The workpaper must include an entry to eliminate S's gain against P's reported income.

_____10. What is the SEC's position on push down accounting?

a. The SEC requires that push down accounting be used for all business combinations.
b. The SEC requires that push down accounting be used for business combinations where P buys 80 percent or more of S.
c. The SEC requires that push down accounting be used for business combinations where P buys 95 percent or more of S.
d. The SEC is silent as to push down accounting.

_____11. If S has long-term debt with a fair value less than its book value (a discount on bonds), how is that handled on the workpaper?
a. S restates the liability to its fair value.
b. S records a discount on bonds.
c. P records a discount on bonds.
d. P includes the discount in its allocation of the difference between implied and book value.

_____12. How would P include a separate account for accumulated depreciation in the consolidated statements?
a. In the allocation, depreciation and amortization elimination entries, accumulated depreciation is increased for the difference, if any, between market value and book value.
b. In the allocation, depreciation and amortization entries, the net effect of the adjustments to the asset account will always equal the total original allocation every year.
c. On the consolidated balance sheet, accumulated depreciation will include P's accumulated depreciation, S's recorded accumulated depreciation, and the cumulative effect of the excess depreciation caused by the allocation of the difference between implied and book value.
d. All of the above.

_____13. When an excess of value implied by the purchase price over fair value creates goodwill, how is that handled on the consolidated statements?
a. Goodwill is amortized over some period not to exceed 20 years.
b. Goodwill is amortized over some period not to exceed 40 years.
c. Goodwill is included in its entirety in the assets unless it is impaired.
d. Goodwill is not shown on the consolidated statements.

_____14. A bargain purchase is when
a. P pays a large premium for its investment in S.
b. There is a significant excess of fair market value over value implied by the purchase price.
c. S gets a share of P's assets in the purchase.
d. None of the above.

EXERCISE

1. **Workpaper Entries and Consolidated Retained Earnings, Complete Equity**

A 90% interest in Saxton Corporation was purchased by Palm Incorporated on January 2, 2012 interest in Saxton Corporation was $3,000,000 on this date, and the balance in retained earnings was $1,000,000. The cost of the investment to Palm Incorporated was $3,750,000.

The balance sheet information available for Saxton Corporation on the acquisition date revealed these value :

	Book value	Fair Value
Inventory (FIFO)	$700,000	$800,000
Equipment	$2,000,000	$2,000,000
Land	$1,600,000	$2,000,000

The equipment was determined to value a 15 year useful life when purchased at the beginning of 2006. Saxton Corporation reported net income in 2011 of $250,000 and $300,000 in 2102. No dividends were declared in either of those years.

Required :

A. Prepare the worksheet entries, assuming tha the complete equity method is used to account for the investment, to eliminate the investment account, and to allocate and depreciate for difference between book value and the value implied by the purchase price in the 2012 consolidated statement workpaper.

B. Calculate the consolidated retained earning for the year ended December 31,2012, assuming that the balance in Palm Incorporated's ending retained earning

2. **Workpaper Entries and Consolidated Net Income, Complete Equity Method**

Perke Corporation purchased 80% of the stock of Superstition Company for $1,970,000 on January 1,2012. On this date, the fair value of the assets and liabilities of Supertition Company was equal to their book value except for the inventory and equipment accounts. The inventory had a fair value of $725,000 and a book value $600,000. Sixty percent of Supertition Company's inventory was sold in 2012; the remainder was sold in 2013. The equipment had a book valueof $900,000 and a fair value of $1,075,000. The remaining useful lif of the equipment is seven years.

The balances in Supertition Company's capital stock and retained earning account on the date of acquisition were $1,200,000 and $600,000, respectively. Perke uses the complete equity method to account for its investment in Supertition. The following financial date are from Supertition Company,s records.

	2012	2013
Net income	$750,000	$900,000
Dividend declared	$150,000	$225,000

Required :

A. In general journal form, prepare the entries on Perke Company's book to account for its investment in Supertition Company for 2012 and 2013.

B. Prepare the eliminating entries necessary for the consolidated statements workpapes in 2012 and 2013.
C. Assuming Perke Corporation's net income for 2012 was $1,000,000, calculate the controlling interest in consolidated net income for 2013.

3. **Workpaper Entries and Consolidated Financial Statements**

On January 1,2011, Palmer's Company acquired 90% interest in Stevens Company at a cost on $1,000,000. At the purchase date, Stevens Company's stockholders' equity consisted of the following :

Common stockSales	$500,000
Retained earnings	$190,00

An examination of Stevens Company's assets and liabilities revealed the following at the date of acquisition :

	Book Value	Fair Value
Cash	$90,726	$90,726
Account receivable	$200,000	$200,000
Inventories	$160,000	$210,000
Equipment	$300,000	$390,000
Accumulated depreciation – Equipment	($100,000)	($130,000)
Land	$190,000	$290,000
Bond payable	($205,556)	($150,000)
Other	$54,830	$54,830
Total	$690,000	$995,556

Additional Information – Date of Acquisition

Stevens Company's equipment had an original life of 15 years and a remaining useful life of 10 years. All the inventory was sold in 2011. Stevens Company purchased its bonds payable on the open market on January 10, 2011, for $150,000 and recognized a gain of $55,556.

Financial statement data for 2013 are presented here :

	Palmer Company	Stevens Company
Sales	$620,000	$340,000
Cost of Sales	$430,000	$240,000
Gross margin	$190,000	$100,000
Depreciation expense	$30,000	$20,000
Other expenses	$60,000	$35,000
Income from operations	$100,000	$45,000
Dividend income	$31,500	
Net Income	$131,500	$45,000

	Palmer	Stevens

	Company	Company
1/1 Retained earnings	$297,600	$210,000
Net Income	$131,500	$45,000
	$429,100	$255,000
Dividends	($120,000)	($35,000)
12/31 Retained earnings	$309,100	$220,000
Cash	$201,200	$151,000
Account Receivable	$221,000	$173,000
Inventories	$100,000	$81,000
Investment in Stevens Company	$1,000,000	
Equipment	$450,000	$300,000
Accumulated depreciations – equipment	($300,000)	($140,000)
Land	$360,000	$290,000
Total assets	$2,032,600	$855,000
Account payable	$323,500	$135,000
Bond payable	$400,000	
Common stock	$1,000,000	$500,000
Retained earnings	$309,100	$220,000
Total liabilities and equity	$2,032,600	$855,000

Required :

A. What method in Palmers using to account for its investment in Stevens ? How can you tell ?

B. Prepare in general journal form the workpaper entry to allocate and depreciate the difference between book value and the value implied by the purchase price in the December 31,2011, consolidated statement workpaper.

C. Prepare a consolidated financial statements workpaper for the year ended December 31,2013.

D. Prepare in good form a schedule or t–account showing the calculation of the controlling and noncontrolling interest in consolidated net income for the year ended December 31,2013.

4. **Eliminating Entries and Worksheets for Varios Years (including Goodwill Impairment)**

   On January 1,2010, Porter Company purchased an 80% interest in the capital stock of Salem Company for $850,000. At that time, Salem Company had capital stock of $550,000 and retained earnings of $800,000. Porter Company uses the the complete equity method to record its investment is Salem Company. Differences between the fair value and the book value of the identifiable assets of Salem Company were as follows :

Fair Value in Excess of Book Value

Equipment	$150,000
Land	$65,000
Inventory	$40,000

The book values of all other assets and liabilities of Salem Company were equal to their fair values on January, 1,2010. The equipment had a remaining life of five years on January, 1, 2010. The inventory was sold in 2010.

Salem Company's net income and dividends declared in 2010 and 2011 were as follows :

Year 2010 Net Income of $100,000; Dividends Declared of $25,000

Year 2011 Net Income of $110,000; Dividends Declared of $35,000

Required :

A. Present the eliminating/adjusting entries needed on the consolidated worksheet for the year ended December 31,2010. (It is not necessary to prepare the worksheet)
B. Present the eliminating/adjusting entries needed on the consolidated worksheet for the year ended December 31,2011. (It is not necessary to prepare the worksheet)

Use the following financial data for 2012 for requirement C through G.

	Parker Company	Salem Company
Sales	$1,100,000	$450,000
Equity in Subsidiary income	$77,200	
Total Revenue	$1,177,200	$450,000
Cost of goods sold	$900,000	$200,000
Depreciation expense	$40,000	$30,000
Other expenses	$60,000	$50,000
Total cost and expense	$1,000,000	$280,000
Net income	$177,200	$170,000
1/1 Retained earnings	$546,400	$230,000
Net income	$177,200	$170,000
Dividend declared	($90,000)	($60,000)
12/31 Retained earnings	$635,600	$340,000
Cash	$70,000	$65,000
Account Receivable	$260,000	$190,000
Inventory	$240,000	$175,000
Investment in Salem Company	$925,000	
Land		$320,000
Plant and Equipment	$360,000	$280,000
Total assets	$1,855,000	$1,030,000
Account payable	$132,000	$110,000

Notes payable	$90,000	$30,000
Capital stock	$1,000,000	$550,000
Retained earnings	$633,600	$340,000
Total liabilities and equity	$1,855,600	$1,030,000

Required :

C. Although no goodwill impairment was reflected at the end of 2010 and 2011, the goodwill impairment test conducted at December 31,2012 revealed implied goodwill form Salem Company to be only $150,000. The impairment was reflected in the books of the parent. Prepare a t-account calculation of the controlling and noncontrolling interests in consolidated income for the year ended December 31,2012.

D. Prepare a consolidated financial statements workpaper for the year ended December 31,2012.

E. Prepare a consolidated statement of financial position and a consolidated income statement for the year ended December 31,2012.

F. Describe the effect on consolidated balance if Salem Company uses the LIFO cost flow assumption in pricing its inventory and there has been no decrease in ending inventory quantities since 2010.

G. Prepare an analytical calculation of consolidated retained earnings for the year ended December 31, 2012.

Elimination of Realized Profit on Intercompany Sales of Inventory

Learning Objectives :

1. Describe the financial reporting objectives for intercompany sales of inventory.
2. Determine the amount of intercompany profit, if any, to be eliminated from the consolidated statements.
3. Understand the concept of eliminating 100% of intercompany profit not realized in transactions with outsiders, and know the authoritative position.
4. Distinguish between upstream and downstream sales of inventory.
5. Compute the noncontrolling interest in consolidated net income for upstream and downstream sales, when not all the inventory has been sold to outsiders.
6. Prepare consolidated workpapers for firms with upstream and downstream sales using the cost, partial equity, and complete equity methods.
7. Discuss the treatment of intercompany profit earned prior to the parent subsidiary affiliation.

Referensi

Debra C. Jetter, Advance Accounting, International Student Version, 5th edition, John Wiley, 2012.

INTRODUCTION

In this chapter, we'll look at the effects of intercompany sales of merchandise on the consolidated statements. As we learned earlier, many business combinations involve a company buying its supplier or customer – vertical integration. When P sells to or buys from S, we have intercompany sales which must be eliminated in the consolidated statements. We can't buy from ourselves. In order to make the new information easier to understand, we'll assume that there is no difference between implied and book value.

CHAPTER OUTLINE

6.1 Effects of Intercompany Sales of Merchandise on the Determination of Consolidated Balances

A. Definitions
   1. *Downstream sale* – P sells merchandise to S
   2. *Upstream sale* – S sells merchandise to P
   3. *Horizontal sale* – one subsidiary sells merchandise to another subsidiary
   4. *Unrealized inventory profit* – when the selling affiliate records a gain on the sale but the buying affiliate hasn't sold the merchandise to a third party, it must be eliminated

B. Objectives
   1. Consolidated sales include only sales to parties outside the consolidated entity
   2. Consolidated cost of sales includes only the original cost paid by the consolidated entity for merchandise sold to third parties
   3. Consolidated inventory on the balance sheet reflects the original purchase price to the consolidated entity (cost to the first affiliate which buys the merchandise)

C. Determination of consolidated sales, cost of sales, and inventory balances, assuming downstream sales
   1. P sells merchandise to S, assuming P makes a profit (S > Cost of Sales)
   2. If S sells all of its merchandise purchased from P, there is no ending inventory.
   3. Eliminating entry:

To eliminate intercompany sales		
Sales (P)		
Purchases (cost of sales) (S)		

   4. If S sells only a part of the merchandise purchased from P, S's inventory will reflect P's selling price, not P's cost. The difference is unrealized profit in ending inventory, which must be eliminated.
      a. As far as P-only and S-only records are concerned, the sale and purchase are recorded just like any sale or purchase
      b. The eliminating entry must remove excess cost from S's inventory and from the consolidated statement's income

To eliminate unrealized profit in ending inventory		
Ending Inventory (income statement - COS)		
Inventory (balance sheet)		

D. Year 2 eliminating entries – downstream sales
   1. As you might see, what we are doing is reflecting a timing difference – it's not that P's profit is never realized, it's just deferred until that merchandise is sold outside the affiliated group.
   2. Each year we have to look back at the profit we deferred at the end of the last year. That profit will be realized this year, because, by the end of year 2, S will have sold the merchandise it bought from P in year 1.
   3. There might also be new unrealized profit in year 2's ending inventory, so we'll have to eliminate that while we realize last year's unrealized profit in beginning inventory.
   4. New eliminating entries for year 2
      a. For cost or partial equity method

To recognize unrealized profit in beginning inventory		
Beginning Retained Earnings – P		
Beginning Inventory (Income statement - COS)		

         i. In this entry, we are decreasing consolidated retained earnings (P's) for the profit that last year's eliminating entry removed. Since it was never recorded, we have to account for it again.

ii. This entry also decreases beginning inventory, which decreases goods available for sale and cost of sales. Therefore, the profit not recognized last year will be realized this year!

b. For the complete equity method, we will actually record unrealized profit on P's books, so we do the elimination entry to adjust the investment account to simplify its elimination later.

To recognize unrealized profit in beginning inventory		
Investment in S		
Beginning Inventory – (income statement - COS)		

E. Determination of amount of intercompany profit
1. Usually, the selling affiliate's gross profit rate is stated as a percent of its cost.
2. Sometimes the gross profit rate is given as a percent of sales instead. Remember that this is the selling affiliate's sales (also the buying affiliate's cost).
3. If you remember to use the formula right, you will have no problem:

   Cost + Markup = Selling Price

   a. Markup can be a percent of cost: C + %C = S
   b. Markup can be a percent of selling price: C + %S = S

F. Inventory pricing adjustments
1. After P sells merchandise to S, it is possible that S will write down its cost of ending inventory, often by following lower of cost or market rules.
2. If that happens, then the unrealized profit to be eliminated on the workpaper should be decreased by the write down. In other words, unrealized profit in ending inventory equals S's inventory valuation less P's cost.

G. Determination of proportion of intercompany profit to be eliminated
1. The GAAP rule is that 100 percent of the unrealized profit be eliminated. IFRS is silent on this issue.
2. Eliminating 100% is consistent with the "entity" rather than the "parent" concept, which is consistent with both U.S. GAAP and IFRS.

H. Determination of noncontrolling interest in consolidated income – upstream or horizontal sales
1. Thus far, we've assumed that P was the seller and S the buyer. However, often S is the seller and P is the buyer, or one subsidiary could sell to another subsidiary.
2. If S is the seller and P is the buyer (upstream sale) and we eliminate 100 percent of unrealized intercompany profit, some of that belongs to the noncontrolling interest stockholders.
3. The adjustment to consolidated income for noncontrolling interest in consolidated unrealized profit in beginning inventory recognized:

   S's reported income

- Unrealized profit in ending inventory
+ Unrealized profit in beginning inventory
= S's adjusted income
× Noncontrolling interest %
= Noncontrolling interest in consolidated income

6.2 Cost Method: Consolidated Statements Workpaper – Upstream Sales

A. Eliminating entries – year of acquisition (Remember, we're not including the entries we learned in Chapter 5)

To eliminate intercompany sales		
Sales (S)		
Purchases (P)		
To eliminate unrealized profit in ending inventory		
Ending Inventory (income statement - COS)		
Inventory (balance sheet)		
To eliminate P's share of S's Dividends		
Dividend Income – P		
Dividends Declared – S		
To eliminate P's investment in S		
Common Stock – S		
Retained Earnings – S		
Investment in S		
Noncontrolling Interest		

B. New eliminating entries – subsequent to year of acquisition (year of acquisition are the same for upstream and downstream)

To establish reciprocity		
Investment in S		
Beginning Retained Earnings – P		
To recognize unrealized profit in beginning inventory		
Beginning Retained Earnings – P (P's %)		
Noncontrolling Interest (noncontrolling interest %)		
Beginning Inventory (COS)		

1. Beginning retained earnings – P is our substitute for consolidated retained earnings
2. Noncontrolling interest is the noncontrolling interest, which is adjusted for the noncontrolling interest's share of unrealized profit on upstream sales

C. A comprehensive example of a consolidated statements workpaper can be found on pages 314-315 of your book

6.3 Cost Method – Analysis of Controlling Interest in Consolidated Net Income and Consolidated Retained Earnings

A. Controlling interest in consolidated net income

P's reported income
+ Profit from downstream sales realized in beginning inventory
- Unrealized profit from downstream sales in ending inventory
- Amortization and depreciation of the difference between implied and book value
+ P's share of S's income from third parties (as above)
= Controlling Interest in Consolidated Net Income

B. Consolidated retained earnings

P's retained earnings
+ P's share of change in S's retained earnings since acquisition
- P's share of unrealized gross profit on upstream sales from S (in P's ending inventory)
- Unrealized profit on downstream sales to S (in S's ending inventory)
+ Cumulative adjustment of amortization of difference between implied and book value
= Consolidated retained earnings

6.4 Consolidated Statements Workpaper – Partial Equity Method

A. There is no difference between cost and partial equity in the year of acquisition
B. In subsequent years
   1. Use the elimination entry for equity in S income we learned in Chapter 5
   2. There is no reciprocity entry
   3. The entries for Chapter 6 are the same as the cost method
C. See the comprehensive workpaper on pages 323 – 324 of your text

6.5 Partial Equity Method – Analysis of Controlling Interest in Consolidated Net Income and Consolidated Retained Earnings

A. Controlling interest in consolidated net income

P's reported income
+ Profit from downstream sales realized in beginning inventory
- Unrealized profit from downstream sales in ending inventory
- Amortization and depreciation of the difference between implied and book value
+ P's share of S's income from third parties*
= Controlling Interest in Consolidated Net Income

* S's income from third parties

S's reported income
\+ Profit from upstream sales realized in beginning inventory
\- Unrealized profit from upstream sales in ending inventory
= S's income from third parties

B. Consolidated retained earnings
P's retained earnings
\- P's share of unrealized gross profit on upstream sales from S (in P's ending inventory)
\- Unrealized profit on downstream sales to S (in S's ending inventory)
\+ Cumulative adjustment of amortization of difference between implied and book value
= Consolidated retained earnings

6.6 Consolidated Statements Workpaper – Complete Equity Method

A. A new elimination entries will differ under the complete equity method because P has recorded the effects of the combination on its books, but most will be just the same.

To eliminate intercompany sales		
Sales		
Purchases		
To eliminate unrealized profit in ending inventory		
Ending Inventory (income statement - COS)		
Inventory (balance sheet)		
To eliminate equity in S income		
Equity in S Income		
Dividends Declared – S		
Investment in S		
To eliminate P's investment in S		
Common Stock – S		
Retained Earnings – S		
Investment in S		
Noncontrolling Interest		

B. The only entry that is different is the one to recognize unrealized profit in beginning inventory. Since P has already recorded that amount, we don't want to adjust P's retained earnings, so we adjust P's investment account, which makes it easier to eliminate the investment account later.

To recognize unrealized profit in beginning inventory		
Investment in S (P's %)		
Noncontrolling Interest (noncontrolling %)		
Beginning Inventory (income statement -		

COS)		

6.7 Complete Equity Method – Analysis of Controlling Interest in Consolidated Net Income and Consolidated Retained Earnings

A. Controlling interest in consolidated net income equals P's net income. We don't need to calculate anything else, because the effects of all intercompany transactions have been recorded on P's books.

B. Consolidated retained earnings equals P's retained earnings

6.8 Summary of Workpaper Entries Relating to Intercompany Sales of Inventory

Downstream Sales			Upstream Sales		
To eliminate intercompany sales					
Sales			Sales		
Purchases (COS)			Purchases (COS)		
To eliminate unrealized profit in ending inventory					
12/31/Inv. (is – COS)			12/31 Inv. (is – COS)		
Inventory (bs)			Inventory (bs)		

To recognize unrealized profit in beginning – cost or partial equity methods					
1/1 Ret. Earn – P			1/1 Ret. Earn - P		
1/1 Inventory (is)			1/1 Noncontrolling Interest		
			1/1 Inventory – IS		
To recognize unrealized profit in beginning inventory – complete equity method					
Investment in S			Investment in S		
1/1 Inventory (is)			1/1 Noncontrolling interest		
			1/1 Inventory (is)		

6.9 Intercompany Profit Prior to Parent-Subsidiary Affiliation

A. GAAP does not address profit made on sales between two companies that combine later in the year

B. Logically, the income earned by S prior to the affiliation has been taken into account when P determined the appropriate cost for the subsidiary. Therefore, if the profit is recorded again it would effectively reduce income twice, once with the investment account and again in the profit entry.

C. Income earned by P prior to the affiliation will be included in P's retained earnings. If it is eliminated and later added back, it would effectively increase income twice – once before affiliation, and again after.

6.10 Appendix describes how to account for Deferred Tax Consequences Arising Because of Unrealized Intercompany Profit

MULTIPLE CHOICE QUESTIONS

Choose the BEST answer for the following questions.

_____ 1. Which of the following is an example of unrealized profit on intercompany sales of inventory?

a. The difference between what P pays for merchandise and what it sells that merchandise to S for
b. The profit that P has recorded from the sale of merchandise to S
c. The profit still in S's inventory which is from merchandise sold to S by P
d. The profit made by S selling inventory it bought from P to outsiders

_____ 2. What should consolidated inventory reflect?

a. The profit made by all the affiliated companies for any sales they have made
b. The profit made by all the affiliated companies for sales they have made to third parties
c. The selling price as recorded by the last entity who bought the merchandise
d. The cost as recorded by the first entity who bought the merchandise

_____ 3. What is the essence of the unrealized profit in ending/beginning inventory?

a. It is an issue of timing – when the consolidated entity, rather than the individual affiliate, earns the profit
b. It is an issue of materiality – the affiliated companies in the consolidated entity cannot record sales to each other
c. It is an issue of transfer pricing – the affiliated companies must pass merchandise on at its original price with no markup
d. It is an issue of taxation – the consolidated entity must avoid double taxation

_____ 4. If the sale of merchandise is upstream, where should the workpaper entry for unrealized profit

in beginning inventory be accounted for?

a. In P's beginning retained earnings only
b. In S's beginning retained earnings only
c. In both P's and S's beginning retained earnings
d. In equity in subsidiary income

_____ 5. What are the GAAP arguments for eliminating 100 percent of intercompany profit?

a. Consistent with the "entity" concept
b. The noncontrolling interest in intercompany profit is not part of consolidated income so it should be eliminated
c. both of the above are reasons
d. neither of the above are reasons

_____ 6. Using the cost method, what entries are made on P's books to eliminate unrealized profit in ending inventory from a downstream sale of merchandise? P should decrease

a. its sales and cost of goods sold.
b. its equity in S income and ending inventory.

c. its investment in S and its equity in S income.
d. nothing.

______ 7. How does the equity method of accounting for unrealized profit in ending inventory differ from the cost method? P must
a. eliminate unrealized profit in its ending inventory by debiting equity in S income and crediting investment in S.
b. eliminate unrealized profit in its ending inventory by crediting equity in S income and crediting investment in S.
c. eliminate unrealized profit in its ending inventory by decreasing inventory and cost of goods sold.
d. not record any entry to account for unrealized profit in ending inventory.

______ 8. What is a horizontal sale?
a. P sells merchandise to S
b. S sells merchandise to P
c. S sells merchandise to another affiliate, R
d. All of the above are horizontal sales

______ 9. What is unrealized profit in beginning inventory?
a. Profit on an intercompany sale made this year on merchandise bought by the selling company last year
b. Profit on an intercompany sale made last year where the merchandise was not sold to third parties until this year
c. any profit made on last year's intercompany sales
d. Any adjustment to inventory valuation because of the lower of cost or market rule

______10. How are intercompany sales eliminated?
a. Decrease sales and inventory
b. Decrease cost of sales and inventory
c. Decrease sales and cost of sales
d. Decrease P's inventory and S's inventory

______11. What are upstream sales?
a. Sales made by a subsidiary to a parent
b. Sales made by a subsidiary to another subsidiary
c. Sales made by a parent to a subsidiary
d. Any sales made from one affiliated company to another

______12. How should the eliminating entry handle unrealized profit in P's sales to S if S has written down the value of the inventory?
a. Unrealized profit in ending inventory always is S's cost less P's cost
b. Unrealized profit in ending inventory is S's inventory valuation less P's cost
c. Unrealized profit in ending inventory is S's selling price less P's cost
d. S's value is irrelevant, so it should do it the same as it would is S had not written down the value of the inventory

_____13. When there has been an upstream sale of merchandise, how is the noncontrolling interest in consolidated income determined?
   a. The noncontrolling interest's share of S's income is always smaller when there is an upstream sale of merchandise
   b. The noncontrolling interest's share of S's income is always larger when there is an upstream sale of merchandise
   c. S's income must be adjusted by the unrealized profits in beginning and ending inventories before the noncontrolling interest's share can be computed
   d. Upstream sales of merchandise do not affect the noncontrolling interest's interest in consolidated income

_____14. What is the only difference between the cost and complete equity methods in the eliminating entries for intercompany sales of inventory?
   a. With the cost method, we don't need to decrease S's retained earnings for unrealized profit in beginning inventory for upstream sales
   b. With the cost method, we don't need to divide the unrealized profit between the consolidated entity and the noncontrolling interest
   c. With the equity method, we don't need to divide the unrealized profit between the consolidated entity and the noncontrolling interest
   d. With the complete equity method, we have to increase the investment account (instead of debiting P's beginning retained earnings) for unrealized profit in beginning inventory

_____15. Consolidated retained earnings are:
   a. adjusted for unrealized profit, both upstream and downstream.
   b. only adjusted for downstream unrealized profit.
   c. only adjusted for unrealized profit in beginning inventory.
   d. only adjusted for unrealized profit in ending inventory.

<u>EXERCISE</u>

1. **Workpaper Entries, Downstream Sales**

   Perkins Company own 85% of Sheraton Company. Perkins Company sells merchandise to Sheraton Company at 20% above cost. During 2011 and 2012, such sales amounted to $450,000 and $486,000, respectively. At the end of each years, Sheraton had in its inventory one third of the amount of good purchased form Perkins during that year.

   Required :

   Prepare the workpaper entries necessary to eliminate the effect of the intercompany sales for 2011 and 2012.

2. **Workpaper Entries, Upstream Sales**

   Refer to Exercise above. Using the same figures, assume that the sales were upstream instead of downstream

Required :

Prepare the workpaper entries necessary to eliminate the effect of the intercompany sales for 2011 and 2012.

3. **Upstream Workpaper-Partial Equity Method**

Paque Corporation own 90% of the common stock of Segal Company. The stock was purchased for $810,000 on January 1,2009, when Segal Company's retained earnings were Financial data for 2013 are presented here :

	Paque Corporation	Segal Company
Sales	$1,650,000	$795,000
Equity in Subsidiary Income	$64,125	
Total revenue	$1,714,125	$795,000
Cost of Goods Sold		
Beginning Inventory	$225,000	$165,000
Purchases	$1,275,000	$525,000
Cost of Goods Available	$1,500,000	$690,000
Less : Ending Inventory	$210,000	$172,500
Cost of Goods Sold	$1,290,000	$517,500
Other expenses	$310,500	$206,250
Total Cost and Expenses	$1,600,000	$723,750
Net Income	$113,625	71,250
1/1 Retained Earnings	$838,500	$180,000
Net Income	$113,625	$71,250
Dividend Declared	($150,000)	($60,000)
31/12 Retained Earnings	$802,125	$191,250
Cash	$93,000	$75,000
Account Receivable	$319,500	$168,750
Inventory	$210,000	$172,500
Investment in Segal Company	$847,125	
Other Assets	$750,000	$630,000
Total Assets	$2,219,625	$1,046,250
Account Payable	$105,000	$45,000
Other Current Liabilities	$112,500	$60,000
Capital Stock	$1,200,000	$750,000
Retained Earnings	$802,125	$191,250
Total Liabilities and Equity	$2,219,625	$1,046,250

The January 1,2015, inventory of Paque Corporation includes $45,000 of profit recorded by Segal Company on 2012 sales. During 2013, Segal Company made intercompany sales of $300,000 wirh markup of 20% of selling price. The ending inventory of Paque Corporation includes good purchased in 2013 from Segal Company for $75,000. Paque Corporation uses the partial equity method to record its investment in Segal Company.

Required :

A. Prepare the consolidated statements workpaper for the year ended December 31,2013.
B. Calculate consolidated retained earnings on December 31,2013, using the analytical or t-account approach.

4. **Complete Equity with Upstream Sales**

Paque Corporation own 90% of common stock of Segal Company. The stock wa purchased for $810,000 on January 1,2009, when Segal Company's retained earnings were $150,000. Financial data for 2013 are presented here :

	Paque Corporation	Segal Company
Sales	$1,650,000	$795,000
Equity in Subsidiary Income	$691,125	
Total revenue	$1,741,125	$795,000
Cost of Goods Sold		
Beginning Inventory	$225,000	$165,000
Purchases	$1,275,000	$525,000
Cost of Goods Available	$1,500,000	$690,000
Less : Ending Inventory	$210,000	$172,500
Cost of Goods Sold	$1,290,000	$517,500
Other expenses	$310,500	$206,250
Total Cost and Expenses	$1,600,000	$723,750
Net Income	$140,625	$71,250
1/1 Retained Earnings	$798,000	$180,000
Net Income	$140,625	$71,250
Dividend Declared	($150,000)	($60,000)
31/12 Retained Earnings	$788,625	$191,250
Cash	$93,000	$75,000
Account Receivable	$319,500	$168,750
Inventory	$210,000	$172,500
Investment in Segal Company	$833,625	
Other Assets	$750,000	$630,000
Total Assets	$2,206,125	$1,046,250
Account Payable	$105,000	$45,000
Other Current Liabilities	$112,500	$60,000
Capital Stock	$1,200,000	$750,000
Retained Earnings	$788,625	$191,250
Total Liabilities and Equity	$2,206,125	$1,046,250

The January 1, 2013, Inventory of Paque Corporation includes $45,000 of profit recorded by Segal Company on 2012 sales. During 2013, Segal Company made intercompany sales of $300,000 with a markup of 20% of selling price. The ending inventory of Paque Corporation includes goods purchased in 2013 from Segal

Company for $75,000. Paque Corporation uses the complete equity method to record its investment in Segal Company.

Required :

A. Prepare the consolidated statements workpaper for the year ended December 31,2015.
B. Calculate consolidated retained earnings on December 31, 2013, using the analytical or t-account approach

Elimination of Unrealized Gains or Losses on Intercompany Sales of Property and Equipment

Learning Objectives :

1. Understand the financial reporting objectives in accounting for intercompany sales of *nondepreciable* assets on the consolidated financial statements.
2. Explain the additional financial reporting objectives in accounting for intercompany sales of *depreciable* assets on the consolidated financial statements.
3. Explain when gains or losses on intercompany sales of depreciable assets should be recognized on a consolidated basis.
4. Explain the term "realized through usage."
5. Describe the differences between upstream and downstream sales in determining consolidated net income and the controlling and noncontrolling interests in consolidated income.
6. Compare the eliminating entries when the selling affiliate is a subsidiary (less than wholly owned) versus when the selling affiliate is the parent company.
7. Compute the noncontrolling interest in consolidated net income when the selling affiliate is a subsidiary.
8. Compute consolidated net income considering the effects of intercompany sales of depreciable assets.
9. Describe the eliminating entry needed to adjust the consolidated financial statements when the purchasing affiliate sells a depreciable asset that was acquired from another affiliate.
10. Explain the basic principles used to record or eliminate intercompany interest, rent, and service fees.

Referensi

Debra C. Jetter, Advance Accounting, International Student Version, 5th edition, John Wiley, 2012.

<u>INTRODUCTION</u>

In the last chapter we looked at intercompany sales of merchandise. In this chapter, we'll look at the other things that one affiliate might sell to another, most principally property and equipment. The same general technique that you studied in Chapter 6 is used for these intercompany sales, too – we're going to eliminate intercompany sales and unrealized gains. We'll focus on gains, which are far more common, but the techniques we use can be applied to losses, too (the entries will just be the other way around!). There's only one significant difference between inventory and capital assets – capital assets have longer lives, so they affect the consolidated statements over a longer time period.

<u>CHAPTER OUTLINE</u>

7.1 Intercompany Sales of Land (Nondepreciable Property)

A. Definition

1. If one affiliate sells land to another (P to S, or S to P), the selling affiliate will most likely record a gain on the sale
2. In the year of the sale, the selling affiliate's income is too high – we cannot make a profit selling anything to ourselves
3. As long as the land is owned by the second affiliate, it would be overstated on that buying affiliate's books, as far as the consolidated entity is concerned

B. The concept
1. Just like intercompany sales of merchandise, any unrealized gain shows up on the affiliated company's books, but has to be eliminated for the consolidated statements
2. The gain on the intercompany sale of land must be deferred until that land is sold to outsiders – a third party, not part of the consolidated entity
3. This is also a timing issue, but it generally takes more than one year to finish the entire transaction

C. Entries
1. On the selling affiliate's books

To record the sale of land to affiliated company		
Cash		
Land		
Gain on Sale of Land		

2. On the buying affiliate's books

To record the purchase of land from affiliated company		
Land		
Cash		

3. On the workpaper
a. Year of sale

To eliminate unrealized gain on the intercompany sale of land		
Gain on Sale of Land		
Land		

b. Subsequent years

To eliminate unrealized gain on the intercompany sale of land in a prior year					
Downstream					
Cost or Partial Equity Methods			**Complete Equity Method**		
Beginning RE – P			Investment in S		
Land			Land		
Upstream					
Cost or Partial Equity Methods			**Complete Equity Method**		
Beginning RE – P			Investment in S		

Beginning NCI			Beginning NCI		
Land			Land		

4. If these entries look pretty familiar, you're on track – the entries are very similar to the ones we did in the last chapter. It's just that, when the asset is land, we'll do the appropriate entry from above every year the land is owned by the buying affiliate.

D. Land sold to outsiders
1. In the year the land is sold to a third party, the unrealized gain will be recognized.
2. To recognize the unrealized gain, just change the credit to land in the entries above to a credit to Gain on sale of land.
3. Essentially, you're adding the unrealized gain to the current gain, recognizing:

    Current selling price
  - Cost to the consolidated entity (earliest cost to any affiliate)
  = Consolidated gain on sale of land

7.2 Intercompany Sales of Depreciable Property (Machinery, Equipment, Buildings)

A. Realization through usage
1. Generally, when a company buys a depreciable asset, it intends to use that asset
   a. Each year's recorded depreciation expense is higher than the consolidated entity's depreciation expense
   b. Each year until it is fully depreciated, the recorded cost of the asset is higher than the consolidated entity's cost
2. The intercompany gain is spread out over the estimated useful life of the asset
   a. We can get more income in two ways – by increasing revenues or be decreasing expenses. In this case, we'll decrease depreciation expense in order to recognize that unrealized gain.
   b. We divide the unrealized gain by the remaining estimated useful life of the asset to arrive at the amount of that unrealized gain which will be recognized each year.
   c. We then decrease depreciation expense by that amount – realization through usage.

B. Illustration of basic workpaper elimination entries
1. Downstream sales
   a. To calculate unrealized gain and depreciation

P's original cost	P's selling price (S's cost)
- P's accumulated depreciation	- P's book value
= P's book value	= Unrealized gain

   Unrealized gain/remaining EUL = excess depreciation per year
   b. Year of the intercompany sale – this restates the asset to its original cost to P, restores accumulated depreciation to the point of the intercompany sale, and eliminates the unrealized gain

To eliminate unrealized gain from intercompany sale of equipment		
Equipment		
Gain on Sale of Equipment		
Accumulated Depreciation		

c. Years subsequent to the year of the intercompany sale – this also restates the asset to its original cost and restores accumulated depreciation, it eliminates the unrealized gain from the prior year. The second entry, by crediting either retained earnings or investment in S, recognizes the unrealized gain that has been recognized in prior years, In other words, the second entry offsets the first entry. The credits to retained earnings or investment in S will get bigger every year, as will the debit to accumulated depreciation.

Downstream					
To eliminate unrealized gain on the intercompany sale of equipment in a prior year					
Cost or Partial Equity Methods			**Complete Equity Method**		
Equipment			Equipment		
Beginning RE – P			Investment in S		
Accumulated Depreciation			Accumulated Depreciation		
To recognize unrealized gain by adjusting depreciation expense					
Accumulated Depreciation			Accumulated Depreciation		
Depreciation Expense			Depreciation Expense		
Beginning RE - P			Investment in S		

2. Upstream sales
   a. In upstream sales, we have unrealized gain which is attributable to the noncontrolling interest as well as to the parent company. For consolidated financial statement purposes, that changes the noncontrolling interest in consolidated income.

	Year of Intercompany Sale		Subsequent Years
	S's reported income		S's reported income
-	Unrealized gain on upstream sale of asset		
+	Depreciation adjustment	+	Depreciation adjustment
=	S's adjusted income	=	S's adjusted income
×	Noncontrolling interest %	×	Noncontrolling interest %
=	Noncontrolling interest in consolidated income	=	Noncontrolling interest in consolidated income

b. Eliminating entries
   i. In the year of the intercompany sale, the entries will be the same for upstream as they were for downstream
   ii. In subsequent years

Upstream					
To eliminate unrealized gain on the intercompany sale of equipment in a prior year					
Cost or Partial Equity Methods			**Complete Equity Method**		
Equipment			Equipment		
Beginning RE – P			Investment in S		
Noncontrolling Interest			Noncontrolling interest		
Accumulated Depreciation			Accumulated Depreciation		
Beginning RE – P			Investment in S		

Upstream					
Cost or Partial Equity Methods			**Complete Equity Methods**		
To recognize unrealized gain by adjusting depreciation expense					
Accumulated Depreciation			Accumulated Depreciation		
Depreciation Expense			Depreciation Expense		
Beginning RE - P			Investment in S		
Noncontrolling Interest			Noncontrolling Interest		

3. The only difference between downstream and upstream intercompany sales of property and equipment are the same things we say in the unrealized profit in inventory transactions – on the upstream sales, we split the prior years' gains realized between the parent and the noncontrolling interest.

7.3 Consolidated Statements Workpaper – Cost and Partial Equity Method

A. A comprehensive example showing a series of completed worksheets is found in your book. Study these examples carefully.
B. The entries we've learned in this chapter can be added to the entries we learned in all the previous chapters – they don't replace any other entries.
C. Disposal of property and equipment by the purchasing affiliate
   1. The technique we use is much the same as the one we discussed earlier in the chapter when land from an intercompany transaction is sold to outsiders
   2. The big difference here is that there has been intermediate recognition of the unrealized gain by the depreciation adjustment

3. We still want to recognize any remaining unrealized gain at the time the plant or equipment is sold to third parties
4. Calculation of book value on the date of sale to third parties

On Books of the Buying Company	For Consolidated Statements
Cost (selling affiliate's selling price)	Original cost to selling affiliate
- Acc. depr. taken since purchase	- Acc. depr (orig. amount + net depr. expense since intercompany sale
= Book value	= Consolidated book value

5. Consolidated gain on the sale
   a. Selling price to a third party – consolidated book value = consolidated gain
   b. Also, recorded gain plus remaining unrealized gain
   c. Eliminating entry

To eliminate remaining unrealized gain and restate selling affiliate's gain on sale of equipment to third parties to consolidated gain – upstream and cost method		
Beginning RE – P		
Noncontrolling Interest		
Gain on Sale of Equipment		

7.4 Calculation of Controlling Interest in Consolidated Net Income and Consolidated Retained Earnings

A. Controlling interest in consolidated net income

P's reported income
- Unrealized gain on intercompany sale (downstream) [only year of sale]
+ Depreciation adjustment for gain recognized (downstream)
- Unrealized profit in ending inventory (downstream)
+ Unrealized profit in beginning inventory (downstream)
- Amortization/depreciation of difference between implied and book value
+ P's share of S's adjusted income *
= Controlling Interest in Consolidated Net Income

*P's share of S's adjusted income

S's reported income
- Unrealized gain on intercompany sale (upstream) [only year of sale]
+ Depreciation adjustment for gain recognized (upstream)
- Unrealized profit in ending inventory (upstream)
+ Unrealized profit in beginning inventory (upstream)
= S's adjusted income
× P's percentage
= P's share of S's adjusted income

Noncontrolling interest's share

S's adjusted income

× Noncontrolling interest's percent
= Noncontrolling interest's share of S's adjusted income

B. Consolidated retained earnings

P's retained earnings
+ P's share of the increase in S's retained earnings since acquisition
- Cumulative amount of amort./depr. of the difference between implied value and book value
- P's share of unrealized profit in ending inventory (upstream)
- Unrealized profit in ending inventory (downstream)
- P's share of unrealized gain of sale of equipment (upstream)
- Unrealized gain on sale of equipment (downstream)
= Consolidated retained earnings

7.5 Consolidated Statements Workpaper – Complete Equity Method

A. Your book has a comprehensive example – study it carefully.

B. To review the differences between the complete equity method and the cost of partial equity methods just studied:

1. P's book entries

To record P's share of S's income		
Investment in S		
Equity in S Income		
To record P's share of unrealized gain on upstream sale of plant and equipment		
Equity in S income		
Investment in S		
To record P's share of unrealized gain recognized by usage (depreciation adjustment)		
Investment in S		
Equity in S Income		

2. Workpaper entries
   a. In the year of sale, they're the same as the cost and partial equity methods
   b. In the years subsequent, the modified entries are

To eliminate unrealized gain from intercompany sale of equipment – upstream		
Investment in S		
Beginning NCI		
Plant and Equipment		
Accumulated Depreciation		
To recognize unrealized gain for this and prior years by adjusting depreciation expense and accumulated depreciation		
Accumulated Depreciation		

Depreciation Expense		
Investment in S		
Noncontrolling Interest		

3. Premature disposal
   a. The technique used to calculate consolidated entity book value is the same.
   b. P has recorded the adjustment to Equity in S income for the gains since the original intercompany sale
   c. P must now account for the remaining unrealized gain

To eliminate remaining unrealized gain and restate selling affiliate's gain on sale of equipment to third parties to consolidated gain – upstream and complete equity method		
Investment in S		
Beginning NCI		
Gain on Sale of Equipment		

7.6 Calculation of Controlling Interest in Consolidated Net Income and Consolidated Retained Earnings: Complete Equity Method

A. Controlling interest in consolidated net income equals P's net income

B. Consolidated retained earnings equals P's retained earnings

7.7 Summary of Workpaper Entries Relating to Intercompany Sales of Equipment

A. You will find a detailed summary of the entries in your book – you should study these entries very carefully!

B. Some simplifications
1. The difference between downstream and upstream is in years subsequent to the intercompany sale of plant and equipment – the remaining unrealized gain is divided between the controlling and noncontrolling interest.
2. The difference between cost/partial equity and complete equity is that P's retained earnings becomes the controlling interest in the cost models, while Investment in S is the controlling interest in the complete equity method

7.8 Intercompany Interest, Rents, and Service Fees

A. Intercompany interest
1. If interest is charged on intercompany loans the lender records interest income and the borrower records interest expense. We cannot pay interest to ourselves.
2. The elimination entry for intercompany interest

To eliminate interest income/expense		
Interest Income		
Interest Expense		

B. Intercompany rents
1. We must eliminate the reciprocal accounts of rent income/rent expense
2. The elimination entry

To eliminate intercompany rents		
Rent Income		
Rent Expense		

C. Intercompany service fees

1. Sometimes one affiliate performs a service for another affiliate; any income or expense transferred between the two must be eliminated.
2. Sometimes one affiliate treats the intercompany transaction as income, while the other treats it as a capital expenditure (asset). For instance, if a company which writes software programs sells a software system to its subsidiary, then P treats the sale as revenue with related expenses, and S treats the sale as the purchase of a capital asset.
   a. The eliminating entry must decrease not only the revenue but also the related expenses and the remainder (the net income from the service) must be eliminated.

To eliminate intercompany revenue and expense with the overstatement of capital asset		
Revenue		
Expenses Relating to Revenue		
Capital Asset		

   b. The unrealized income is then amortized over the life of the asset

Downstream					
To eliminate unrealized profit on the intercompany sale of services which are recorded as capital assets					
Cost and Partial Equity Methods			**Complete Equity Method**		
Beginning Retained Earnings - P			Investment in S		
Accumulated Depreciation			Accumulated Depreciation		
Asset			Asset		
To realize intercompany profit with depreciation adjustment					
Accumulated Depreciation			Accumulated Depreciation		
Depreciation Expense			Depreciation Expense		

   c. Essentially, after the first year, the eliminating entries are similar to those used to eliminate the unrealized gain from the intercompany sale of equipment
   d. The reporting objectives of these entries are to:
      i. Include in revenue only those revenues earned from outsiders
      ii. Present property at its cost to the consolidated entity

iii. Present accumulated depreciation based on cost to the consolidated entity
iv. Present depreciation expense based on cost to the consolidated entity

MULTIPLE CHOICE QUESTIONS

Choose the BEST answer for the following questions.

_____ 1. What of the following is an example of an unrealized gain or loss on intercompany sale of equipment?
  a. A gain recorded only by P which should also be recorded by S
  b. A difference between P's cost and the price for which it sells the equipment to S
  c. S's gain or loss on the sale of equipment bought from P and now sold to an outsider
  d. Any gain or loss on the sale of equipment recorded by either P or S

_____ 2. How does unrealized gain or loss on the intercompany sale of equipment affect the consolidated statements workpaper?
  a. The gain or loss is permanently removed from the consolidated statements.
  b. The gain or loss is recognized in the next year, just like we recognized unrealized profit in beginning inventory.
  c. The gain or loss is allocated over the useful life of the equipment.
  d. The gain or loss is amortized over some time period not to exceed 20 years.

_____ 3. What is the workpaper entry to eliminate the unrealized gain, assuming an upstream sale of land, in years subsequent to the sale when P uses the complete equity method?
  a. Debit land; credit gain on sale of land
  b. Debit beginning retained earnings – P and retained earnings – S; credit land
  c. Debit investment in S; credit land
  d. Debit investment in S and retained earnings – S; credit land

_____ 4. What is realization through usage?
  a. By decreasing depreciation expense, we increase income and thus realize the unrealized gain
  b. By increasing depreciation expense, we decrease the cost of the asset to its original cost
  c. By decreasing depreciation expense, we increase cost of goods sold
  d. By increasing the asset, we realize the gain because the asset is worth more than it was originally

_____ 5. Why is accumulated depreciation credited in the elimination entry?
  a. To eliminate the accumulated depreciation previously recorded by the selling company
  b. To eliminate the accumulated depreciation previously recorded by the buying affiliate
  c. To eliminate the accumulated depreciation recorded during the current year by the selling affiliate

d. It is part of the entry to restate the asset to its original state to the consolidated entity

_____ 6. How is the entry to recognize unrealized gain different between the cost and the complete equity method?

a. The cost method debits beginning retained earnings – P and the equity method debits investment in S
b. The cost method credits beginning retained earnings – P and the equity method credits investment in S
c. The equity method does not have to do an elimination entry because it is recorded on P's books
d. The cost method does not have to do an elimination entry because it is recorded on S's books

_____ 7. If S sells equipment previously purchased from P before that equipment is fully depreciated, how does that affect the consolidated entity?

a. The consolidated statements must realize the remainder of the unrealized gain that has been deferred
b. The book value of the equipment must reflect the consolidated entity's book value rather than S's book value
c. Generally, the gain recorded by S will be increased in order to reflect the consolidated entity's gain
d. All of the above

_____ 8. How does unrealized gain on intercompany sales of equipment affect controlling interest in consolidated net income?

a. P's reported income is increased by downstream intercompany gains in the year of the sale and decreased during the useful life of the asset.
b. P's reported income is decreased by downstream intercompany gains in the year of the sale and increased during the useful life of the asset.
c. Upstream sales do not affect consolidated income in the year of the sale.
d. Upstream sales decrease P's reported income, but don't decrease the noncontrolling income in the year of the sale.

_____ 9. If S sells equipment to P, what entries are included in P's books if it uses the equity method?

a. P decreases its equity in S income for its share of unrealized gain on the sale.
b. P increases its equity in S income for the depreciation adjustment.
c. P does both A and B.
d. P does neither A nor B.

_____10. What is the general format of the elimination entries to reflect intercompany interest or rent?

a. Debit expense, credit income
b. Debit payable, credit receivable

c. Debit income, credit expense
d. Debit receivable, credit payable

_____11. What is often the result of intercompany service fees?
a. One affiliate records the transaction as revenue and the other records it as a contra revenue
b. One affiliate records the transaction as revenue and the other records it as an expense or asset
c. Both affiliates record income and receivables
d. The selling affiliate does not receive any income

_____12. What are the reporting objectives of intercompany transactions in capital assets?
a. To include in revenue only those revenues from outsiders
b. To present property at its cost to the consolidated entity
c. To present depreciation expense based on cost to the consolidated entity
d. All of the above

_____13. When land involved in an intercompany sale is sold to outsiders, the gain on the sale of that land is
a. decreased by the total unrealized gain from the original sale
b. decreased by the remaining unrealized gain from the original sale
c. increased by the remaining unrealized gain from the original sale
d. increased by the total unrealized gain from the original sale

EXERCISE

1. **Upstream and Downstream Sale**

   Patterson Company own 80% of the outstanding common stock of Stevens Company. On June 30,2010, land costing $500,000 is sold by one affiliate to the other for $800,000.

   Required :

   Prepare in general journal form the workpaper entries necessary because of the intercompany sale of land in the consolidated financial statements workpaper for the year ended December 31,2011, assuming that :

   A. Patterson Company purchased the land form Stevens Company
   B. Stevens Company purchased the land from Patterson Company.

2. **Entries – Intercompany Sale of Inventory and Equipment**

   On January 1,2010, Price Company acquired an 80% interest in the common stock of Smith Company on the open market for $750,000, the book value at that date.

   On January 1,2011, Price Company purchased new equipment for $14,500 from Smith Company. The equipment cost $9,000 and had an estimated lif of five years as of January 1,2011.

   During 2012, Price Company had merchandise sale to Smith Company of $100,000; the merchandise was priced at 25% above Pricce Company's cost. Smith Company

still owes Price Company $17,500 on open account and has 20% of this merchandise in inventory at December 31,2012. At the beginning of 2012, Smith Company had in inventory $25,000 of merchandise purchased in the previous period from Price Company.

Required :

A. Prepare all workpaper entries necessary to eliminate the effect of the intercompany sales on the consolidated financial statements for the year ended December 31,2003.
B. Assume that Smith Company reports net income of $40,000 for the year ended December 31,2011. Calculate the amount of noncontrolling interest to be deducted form consolidated income in the consolidated income statement fo the year ended December 31,2012.

3. **Workpaper- Journal Entries**

Pico Company, a truck manufacture own 90% of the voting stock of Steward Company. On January, 1,2011, Pico Company sold trucks to Steward Company for $350,000. The trucks which represented inventory to Pico Company, had a cost to Pico Company of $260,000. The management of Steward Company estimated that the trucks had a useful life of six years form the date of purchase. Steward Company uses the straight line method to depreciate its capital assets.

In 2011, Pico company reported $600,000 in net income from its independent operations (including sales to affiliates but excluding dividend or equity income from subsidiary), and Steward Company reported $200,000 in net income form its operations.

Required :

A. Prepare in general journal form the workpaper entries necessary because of a inter company sales in :
   (1) The consolidated financial statements workpaper for the year ended December 31, 2011.
   (2) The consolidated financial statements workpaper for the year ended December 31, 2012.
B. Calculate controlling interest in consolidated net income for the year ended December 31,2011.

4. **Workpaper- Partial Equity Method**

Prather Company own 80% of the common stock of Stone Company. The stock was purchased for $960,000 on January 1,2009, when Stone Company's retained earnings were $675,000. On January 1,2011, Stone Company sold fixed assets to Prather Company for $960,000, Stone Company had purchased these assets for $1,350,000 on January 1,2001, at which time their estimated useful life was 25 years. The estimated remaining useful life to Prather Company on 1/1/11 is 10 years. Both companies

employ the straight line method of depreciation. The Financial data for 2012 are presented here :

	Prather Company	Stone Company
Sales	$1,950,000	$1,350,000
Equity in Subsidiary Income	$240,000	
Total revenue	$2,190,000	$1,350,000
Cost of Goods Sold	$1,350,000	$900,000
Other expenses	$225,000	$150,000
Total Cost and Expenses	$1,575,000	$1,050,000
Net Income	$615,000	$300,000
1/1 Retained Earnings	$1,505,400	$1,308,000
Net Income	$615,000	$300,000
Dividend Declared	($150,000)	($75,000)
31/12 Retained Earnings	$1,970,000	$1,263,000
Inventory	$498,000	$225,000
Investment in Stone Company	$1,430,300	
Fixed Assets	$2,168,100	$2,625,000
Accumulated Depreciation – Fixed Assets	($900,000)	($612,000)
Total Assets	$3,196,500	$2,238,000
Liabilities	$465,600	$450,000
Common Stock	$760,500	$525,000
Retained Earnings	$1,970,400	$1,263,000
Total Liabilities and Equity	$3,196,500	$2,238,000

Required :

A. Prepare a consolidated statements workpaper for the year ended December 31,2012.
B. Calculate consolidated retained earnings on December 31, 2012, using an analytical or t-account approach.

5. **Workpaper – Partial Equity Method, Comprehensive Problem**

Padita Company acquired 90% of the outstanding common stock of Sanchez Company on June 30, 2011, for $426,000. On that date, Sanchez Company had retained earnings in the amount of $60,000, and the fair value of its recorded assets and liabilities was equal to their book value. The excess of implied over fair value of the recorded net assets was attributed to an unrecorded manufacturing formula held by Sanchez Companya, which had an expected remaining useful life of five years from June 30, 2011.

Financial data for 2013 are presented here :

	Padilla	Sanchez

	Company	Company
Sales	$2,555,500	$1,120,000
Equity in Subsidiary Income	$168,650	
Total revenue	$2,716,150	$1,120,000
Cost of Goods Sold	$1,730,000	$690,500
Expenses	$654,500	$251,000
Total Cost and Expenses	$2,384,500	$941,500
Net Income	$331,650	$178,500
1/1 Retained Earnings	$666,550	$139,500
Net Income	$331,650	$178,500
Dividend Declared	($100,000)	($60,000)
31/12 Retained Earnings	$898,200	$258,000
Cash	$119,500	$132,500
Account Receivable	$342,000	$125,000
Inventory	$362,000	$201,000
Other Current Assets	$40,500	$13,000
Land	$150,000	
Investment in Sanchez Company	$604,200	
Property and Equipment	$825,000	$241,000
Accumulated Depreciation	($207,000)	($53,500)
Total Assets	$2,236,200	$659,000
Liabilities	$295,000	$32,000
Other Liablilities	$43,000	$19,000
Capital Stock	$1,000,000	$300,000
Additional Paid in Capital		$50,000
Retained Earnings	$898,200	$258,000
Total Liabilities and Equity	$2,236,200	$659,000

On December 31, 2011, Padilla Company sold equipment (with an orginal cost of $100,000 and accumulated depreciation of $50,000) to Sanchez Company for $ 97,500. This equipment had been depreciated at annual rate of 20% of the purchase price. During 2012, Sanchez Company sold land to Padilla Company at a profit of $15,000.

The inventory of Padilla Company on December 31,2012, included goods purchased form Sanchez Company on which Sanchez Company recognized a profit $7,500. During 2013, Sanchez Company sold goods to Padilla Company for $375,000, of which $60,000 was unpaid on December 31,2013. The December 31, 2013, inventory of Padilla Company included goods acquired form Sanchez Company on which Sanchez Company recognized a profit of $10,500.

Required :

A. Prepare a consolidated financial statements workpaper for the year ended December 31, 2013.
B. Prepare a schedule to calculate consolidated retained earnings on December 31, 2013, using an analytical or t-account approach.

6. **Workpaper- Complete Equity Method**

Prather Company own 80% of the common stock of Stone Company. The stock was purchased for $960,000 on January 1,2009, when Stone Company's retained earnings were $675,000. On January 1,2011, Stone Company sold fixed assets to Prather Company for $960,000, Stone Company had purchased these assets for $1,350,000 on January 1,2001, at which time their estimated useful life was 25 years. The estimated remaining useful life to Prather Company on 1/1/11 is 10 years. Both companies employ the straight line method of depreciation. The Financial data for 2012 are presented here :

	Prather Company	Stone Company
Sales	$1,950,000	$1,350,000
Equity in Subsidiary Income	$252,000	
Total revenue	$2,202,000	$1,350,000
Cost of Goods Sold	$1,350,000	$900,000
Other expenses	$225,000	$150,000
Total Cost and Expenses	$1,575,000	$1,050,000
Net Income	$627,000	$300,000
1/1 Retained Earnings	$1,397,400	$1,308,000
Net Income	$627,000	$300,000
Dividend Declared	($150,000)	($75,000)
31/12 Retained Earnings	$1,874,000	$1,263,000
Inventory	$498,000	$225,000
Investment in Stone Company	$1,334,400	
Fixed Assets	$2,168,100	$2,625,000
Accumulated Depreciation – Fixed Assets	($900,000)	($612,000)
Total Assets	$3,100,500	$2,238,000
Liabilities	$465,600	$450,000
Common Stock	$760,500	$525,000
Retained Earnings	$1,874,500	$1,263,000
Total Liabilities and Equity	$3,100,500	$2,238,000

Required :

C. Prepare a consolidated statements workpaper for the year ended December 31,2012.

D. Calculate consolidated retained earnings on December 31, 2012, using an analytical or t-account approach.

Changes in Ownership Interest

Learning Objectives :

1. Identify the types of transactions that change the parent company's ownership interest in a subsidiary.
2. Describe the process needed when the parent acquires subsidiary shares through multiple open market purchases.
3. Explain how the parent reports the difference between selling price and book value when shares are sold subsequent to acquisition.
4. Compute the controlling interest in income after the parent sells some shares of the subsidiary company.
5. Describe the effect on the eliminating process when the subsidiary issues new shares entirely to the parent, and the parent pays either more or less than the book value of the subsidiary shares.
6. Describe the impact on the parent's investment account when the subsidiary issues new shares and either the new shares are purchased ratably by the parent and noncontrolling shareholders or entirely by the noncontrolling shareholders.

Referensi

Debra C. Jetter, Advance Accounting, International Student Version, 5th edition, John Wiley, 2012.

<u>INTRODUCTION</u>

This chapter takes away another simplifying assumption that we've made previously. Many times P doesn't buy a controlling interest in S all at once – it's done over time. Until P has actually achieved control, its investment in S is treated as a simple investment. No consolidated statements are made. Now we're going to look at how P changes its books into a parent-subsidiary relationship when it achieves control of S, and at how other S equity transactions affect the consolidated entity and its workpapers.

<u>CHAPTER OUTLINE</u>

8.1 Transactions with Third Parties

- A. Preliminary assumptions – we've used two simplifying assumptions
  1. P's interest in S was obtained through a single open-market transaction
  2. P's interest in S hasn't changed
- B. More realistic events might include:
  1. P might buy its interest over a period of time before it achieves control (over 50 percent ownership)
  2. After P achieves control, the percentage of ownership might change
     - a. P buys S stock from outsiders
     - b. P sells S stock to outsiders
     - c. S buys or sells its stock to outsiders
  3. Accounting treatment of each of the following events is listed in your book. All of the issues relate to the substance over form argument discussed in Chapter 2.

C. Changes in GAAP:
   1. Under past GAAP:
      a. Acquisitions of additional shares in an investee are handled in a step-by-step manner, with CAD schedules prepared for each portion purchased.
      b. On disposal of shares: the difference between the selling price and the basis of the shares sold is shown as a gain or loss in income. Shares retained are not adjusted.
   2. Under current GAAP [FASB ASC Topics 805 and 810]:
      a. Measure and recognize the acquiree's identifiable assets and liabilities at 100% of their fair values on the date the acquirer obtains control
      b. Recognize all the acquiree's goodwill (not just the parent's share)
      c. Any previously held noncontrolling equity interests should be remeasured to fair value, with the resulting adjustment recognized in income.
      d. After control is achieved, subsequent adjustments due to increased ownership are shown as Additional Contributed Capital, not as income.
      e. If a parent loses control, the retained investment should be remeasured to fair value and the adjustments recognized in net income.

8.2 Parent Acquires Subsidiary Stock through Several Open Market Purchases – Cost Method

A. When P's control of S is achieved in a single open market purchase, the date of acquisition is
   the date that purchase was made
B. When control is achieved only after one or more smaller open market purchases, the acquisition date is the date when control is achieved. According to FASB ASC 805-10-25-9:
   1. The previously held noncontrolling equity interest should be remeasured to fair value when control is achieved, and the resulting adjustment should be recognized in net income
   2. If a parent loses control but retains a noncontrolling interest, the portion retained should be remeasured to fair value on the date control is surrendered and the adjustment reflected in the income statement
C. In the first year of control, there must be a workpaper entry to establish reciprocity for all of
   S's increase in retained earnings that have been earned since P's initial purchase of S's stock
   1. P bought its share of S's retained earnings each time it bought S's stock
   2. Any earnings made by S after the date of each stock purchased is actually part of consolidated earnings when P finally achieves control
   3. The entry to establish reciprocity essentially takes the date of consolidation back to the date of P's first purchase of S stock

4. After the year where control was established, the reciprocity entry takes P’s share of S’s retained earnings from the date of control to the beginning of the current year, then adds the reciprocity amount found above

D. After reciprocity is established, the initial noncontrolling interest of the parent must be adjusted to its current fair value

E. The noncontrolling interest percent is based on end of year percentages

8.3 Parent Sells Subsidiary Stock Investment on the Open Market – Cost Method

A. The treatment of the sale of a portion of investment depends on whether the sale results in the loss of control of the subsidiary

1. If control is maintained, no gain or loss is recognized in the income statement. Instead, all shares are adjusted to fair value, and an adjustment is made to additional contributed capital of the controlling interest
2. If control is lost, the entire interest should be adjusted to fair value, and a gain or loss recorded in income on all shares owned prior to sale

B. When P sells part of its investment in S and retains control:

1. Selling price is readily determined by the market transaction
2. Cost is more complex. The original cost of the shares must be adjusted for the change in S’s retained earnings

   Cost of S’s shares
   \+ P’s share of the change in S’s retained earnings from the date of acquisition to the beginning of the year
   \+ P’s share of S’s current earnings to date
   = P’s adjusted cost of shares sold

3. In its books, Parent records the sale of the shares

To record sale of shares		
Cash		
Investment in S Company (% of shares sold × adjusted cost)		
Additional Contributed Capital		

C. The workpaper entries

1. The workpaper entries must eliminate some of the additional contributed capital as income purchased

To eliminate a portion of P’s recorded additional contributed capital on the sale of S’s stock		
Additional Contributed Capital-P		
Beginning Retained Earnings – P		

2. The consolidated statement elimination entries should also include an entry to recognize P’s share of S’s current year earnings which was sold

To eliminate a portion of P’s earnings from S sold with S’s stock sold		
Additional Contributed Capital-P		

Subsidiary Income Sold		

3. The third workpaper entry must include the traditional entry to establish reciprocity for the shares of S stock still owned by P

To establish reciprocity		
Investment in S		
Beginning Retained Earnings – P		

D. The noncontrolling interest in consolidated income will include two amounts:
   1. The percentage for the income earned before P sold some of S's stock
   2. The larger percentage for income earned after that sale

8.4 Equity Method – Purchases and Sales of Subsidiary Stock by the Parent

A. This chapter again simplifies the workpaper so there is no difference between the complete
and partial equity method

B. When P achieves control of S Company, it revalues its initial investment to fair value

To revalue initial investment		
Investment in S		
Gain on Revaluation		

C. As with the cost method, when P finally achieves control of S Company, it must account for its share of S's income earned after P's initial purchase of S's stock
   1. Under the equity method, when it finally achieves a controlling interest, P must record its share of S's interim earnings as an adjustment to the investment account and as equity in S income

To record P's share of S's income since initial acquisition of S's stock		
Investment in S		
Equity in S Income		

   2. After control is achieved, P will record its new share of S's income as we've done before

D. P sells some of its investment in S
   1. P must first record its share of S's income since the beginning of the current year
   2. The investment in S account will include all adjustments for S's income in prior years
   3. P's cost for the S stock sold can then be easily calculated

      Cost of first purchase, adjusted
      \+ Cost of second purchase (identified by purchase date)
      \+ <u>P's share of S's retained income since acquisition</u>
      Cost of acquisition of stock sold
      × <u>Percent of total purchase sold</u>
      = <u>Carrying value of investment sold</u>

   4. The adjustment to the Additional Contributed Capital on P's sale of part of its investment is recorded on P's books

To record gain on the sale of S stock		
Cash		
Investment in S [from above]		
Additional Contributed Capital		

5. As usual, in the equity method, consolidated Additional Contributed Capital is the same as P's Additional Contributed Capital

8.5 Subsidiary Issues Stock

A. P's equity interest can decrease if S issues more stock

B. Issuance of additional shares by a subsidiary

1. If S issues new shares, P can purchase all, some, or none of the new stock issued
2. If some or all of the shares are purchased by outsiders, P loses part of its equity interest just like it does when it sells some of its investment
   a. If the stock is sold at more than S's book value, P gets an increase in the additional contributed capital
   b. If the stock is sold at less than S's book value, P suffers a decrease in the additional contributed capital
3. 100 percent of new shares purchased by P
   a. Unless P originally owned 100 percent of S's outstanding shares, its ownership interest will increase, while the noncontrolling interest will decline
   b. P's share of S's equity must be recalculated, since S's equity accounts will change
   c. New shares issued above existing book value per share
      i. P must calculate the book value per share of S's equity

S's Equity – Book Value per Share			
	Before	New Issue	After
Common stock			
Other contributed capital			
Retained earnings	____________	______________	____________
Total			
Common shares			
Book value per share			

      ii. Then it must calculate its new book value

Book Value of P's Share of S's Equity			
	Old Percentage	New Percentage	Book Value of Interest Acquired
Common stock			
Other contributed capital			
Retained earnings	__________	___________	___________

	__	_	___
Total equity acquired			
Plus: Goodwill acquired	__________ __	___________ __	___________ ___
Total interest acquired			

iii. Finally, P must determine the amount and allocation of the revised difference between implied and book value

Computation and Allocation of Difference between Implied and Book Value			
	Parent share	Noncontrolling share	Implied value
Purchase price and implied value			
Equity acquired: Common stock Other contributed capital Retained earnings Total	(__________)	(___________)	(___________)
Difference between implied value and book value			

iv. When S's new shares are sold at greater than book value, that excess increases the noncontrolling interest in book value per share, even though the total percent of the noncontrolling interest decreased

v. The book value increase in noncontrolling interest equals the amount debited to the parent's additional capital

vi. The controlling interest stockholders paid more than existing book value per share, which increased the noncontrolling interest shareholders' book value

c. New shares issued at or below existing book value per share
   i. If new shares are issued at their book value, the parent's additional contributed capital will change only by the amount of goodwill purchased. The noncontrolling interest percent decreases and its share of net assets decreases only by the sold goodwill
   ii. If the new shares are issued below book value, total noncontrolling book value interest decreases, and the controlling book value interest increases by more than the amount of goodwill purchased.

d. New shares purchased ratably by parent and noncontrolling stockholders

i. If the noncontrolling stockholders exercise their preemptive right and buy their share of the new stock issue, both P and the noncontrolling interest will maintain their percent interest in S's equity
ii. There will be no need to adjust the parent's additional contributed capital

e. New shares purchased entirely by noncontrolling stockholders
i. Sometimes S issues new shares which are all purchased by outsiders
ii. Stock options or employees stock option plans issue new shares to noncontrolling interest stockholders
iii. Stock sold to outsiders generates capital for the consolidated entity
iv. This reduces P's percentage of ownership, equivalent to P selling part of its interest
v. P's book value can increase, decrease, or remain the same, depending upon the issue price of the new stock
vi. If issue price is greater than book value, P's share of S's net assets increases
vii. If issue price is less, P's share of S's net assets decreases
viii. If issue price equals book value, P's share of S's net assets stays the same

C. Important differences between IFRS and U.S. GAAP with regard to step acquisitions
1. Choice between measuring noncontrolling interests at proportionate interest in net identifiable assets or fair value (required by U.S. GAAP)
2. Acquisition accounting is applied only at the date control is achieved
3. After control is attained, any subsequent transactions between parent and noncontrolling interests are accounted for as equity transactions
4. Additional goodwill is not recorded, no remeasurement of net assets to fair value, and no recognition of gain or loss on decrease in parent ownership percentage

MULTIPLE CHOICE QUESTIONS

Choose the BEST answer for the following questions

_____ 1. How can P achieve control over S?
- a. Only by buying more than 50 percent of the shares in a single open market transaction
- b. Only by buying more than 90 percent of the shares in a single open market transaction
- c. By buying more than 50 percent of S's outstanding shares in any number of transactions
- d. Only by buying more than 50 percent of S's stock directly from S company

_____ 2. How is the difference between implied and book value calculated with changes in ownership interest?
- a. P calculates the difference between implied and book value by comparing the total of its cost to the total of the equity of S on the date of control
- b. P calculates the difference between implied and book value on a step-by-step basis, depending upon the date of acquisition of the stock
- c. Once P buys a controlling interest in S, there can be no changes in ownership interest
- d. The same way we calculated it in Chapter 4

_____ 3. If P achieves control over a number of years, when is the first year to use a workpaper to establish reciprocity?

a. In the first year that P buys any stock in S, regardless of the control
b. In the second year that P buys stock in S, regardless of the control
c. In the first year that P achieves control of S
d. In the second year that P achieves control of S

_____ 4. How is noncontrolling interest percent determined?

a. As the weighted average of noncontrolling interest percentages during the current year
b. As a weighted average of noncontrolling interest percentages during the entire time P has owned stock in S
c. As of the beginning of the current year
d. As of the end of the current year

_____ 5. How does P determine the increase in its additional contributed capital on the sale of S's stock?

a. By using the original cost of the shares sold
b. By using the original cost of the shares sold, adjusted for P's share of the change in S's retained earnings and income since acquisition
c. P cannot record an increase in its additional contributed capital on the sale of S's shares, as it is an intercompany transaction
d. P uses the fair market value of the shares sold

_____ 6. If P sells some of its interest in S, how does that affect the noncontrolling interest in consolidated income?

a. The noncontrolling interest in consolidated income will include a percentage of the income earned before P sold the stock
b. The noncontrolling interest in consolidated income will include a larger percentage for income earned after that sale
c. Both of the above are included in noncontrolling interest in consolidated income
d. Noncontrolling interest in consolidated income in S's reported income × the noncontrolling interest's end of year percentage

_____ 7. How does the equity method change accounting for changes in ownership interest?

a. P actually records its share of S's income since the beginning of the year
b. The investment in S account will include all adjustments for S's income in prior years
c. P's cost for S's stock sold can be easily calculated
d. All of the above

_____ 8. If S sells more stock on the open market, P's equity

a. Increases if S sells the stock to outsiders at more than book value
b. Decreases if S sells the stock to outsiders at more than book value
c. Increases if P buys its proportional interest in the new shares
d. Decreases if P buys its proportional interest in the new shares

_____ 9. If S sells stock for more than book value, the noncontrolling interest will

a. Always decrease in percentage and in book value
b. Always increase in percentage and in book value
c. decrease in percentage but increase in book value
d. Have no change

_____10. If new shares are issued at or below existing book value per share
  a. There is a negative difference between implied and book value
  b. The parent's additional contributed capital will change only by the amount of goodwill purchased
  c. The excess of book value over implied value increases the noncontrolling interest
  d. The excess of book value over implied value must be amortized over 20 years

_____11. If new shares issued by S are purchased entirely by noncontrolling stockholders
  a. That indicates that S might have a stock option plan for employees
  b. The sale decreases P's percentage of ownership
  c. The sale generates new capital for the consolidated entity
  d. All of the above are true

_____12. What happens to P's book value of S's stock if noncontrolling stockholders buy all the newly issued shares?
  a. The book value always goes down
  b. The book value always goes up
  c. The book value can go down, up, or remain the same
  d. Cannot be determined

EXERCISE

1. **Multiple Stock Purchases – Journal Entries**

Perk Company purchased Sanno Company common stock in a series of open market cash purchases from 2009 through 2011 as follows :

Date	Shares Acquired	Cost
January 1, 2009	1,800	$46,000
January 1, 2010	4,500	$95,000
January 1, 2011	9,900	$262,350

Sanno Company had 18,000 shares of $20 par value common stock outstanding during the entire period. Retained earnings balances for Sanno Company on relevant dates were :

January 1, 2009	$20,000
January 1, 2010	($30,000)
January 1, 2011	$85,000
December 31,2011	$170,000

Dividends in the amount of $50,000 were distributed by Sanno Company only in 2011. Any difference between implied and book values is assigned to goodwill. Peck Company uses the cost method to account for its investment in Sanno Company.

Required :

A. Prepare the journal entries that Peck Company would record on its books during 2011 to account for its investment in Sanno Company.
B. Prepare the workpaper eliminating entries necessary to prepare a consolidated statements workpaper on December 31,2011.

2. **Parent Company Entries, Mutliple Stock Purchases, Equity Method**

   Use the data from Above, but assume use of either the complete or the partial equity method rather than the cost method.

   Required :

   C. Prepare the journal entries Peck Company will make on its books during 2010 and 2011 to account for its investment in Sanno Company.
   D. Prepare the workpaper eliminating entries necessary to prepare a consolidated statements workpaper on December 31,2011.

3. **Workpaper – Sale of Shares by Parent, Cost Method**

   The account of Pyle Company and its subsidiary, Stern Company, are summarized below as of December 31,2011 :

Debits	Pyle	Stern
Current Assets	$600,000	$320,000
Investment in Stern Company	$480,000	
Other Assets	$1,180,000	$668,000
Dividend Declared, 11/1	$80,000	$60,000
	$2,340,000	$1,048,000
Credits		
Liabilities	$190,000	$90,000
Common Stock, $5 par	$500,000	$300,000
Other Contributed Capital	$230,000	$180,000
1/1 Retained Earnings	$1,200,000	$292,000
Net Income	$220,000	$186,000
	$2,340,000	$1,048,000

   Pyle Company made the following open-market purchase and Sale of Stern Compay common stock : January 2, 2009, purchased 51,000 shares, cost $510,000, sold 3,000 shares, proceed, $100,000.

   The book value of Stern Company's net assets on January 2, 2009, $600.000, (including retained earnings of $120,000) approximated the fair value of those net assets. Subsequent changes in book value of the net assets are entirely attributable to earnings of Stern Company. Stern Company earns its income evenly throughout the year.

   Required :

   Prepare a consolidated financial statements workpaper as of December 31, 2011. Begin the income statement section of the workpaper with "Net Income Before Dividend Income" which is $172,000 for Pyle Company and Stern Company, respectively.

4. **Workpaper – Purchase and Sale of Shares, Cost Method**

Trial balance for Porter Company and its subsidiary, Splitz Company, as of December 31, 2011, follows :

Debits	Porter	Splitz
Cash	$90,000	$40,000
Account Receivable (net)	$62,000	$38,000
Inventory	$106,000	$64,000
Investment in Splitz Company	$121,500	
Plant Assets	$320,000	$149,000
Land	$69,000	$46,000
Dividends Declared, 10/1	$50,000	$30,000
Total	$818,500	$367,000
Credits	Porter	Splitz
Liabilities	$102,000	$61,000
Common Stock, $2 par value	$250,000	$100,000
Other Contributed Capital	$172,500	$20,000
1/1 Retained Earnings	$206,500	$126,000
Income Summary	$87,500	$60,000
Total	$818,500	$367,000

Porter Company made the following open-market purchase and sale of Splitz /Company common stock : January 1,2007, purchased 45,000 shares for $135,000 ; May 1, 2011, sold 4,500 shares for $28,000.

The book value of Splitz Company's net assets on January 1, 2007, was $140,000; the excess of cost over net assets acquired relates by land. Subsequent changes in the book value of Splitz Company's net assets are entirely attributable to earnings retained in the business, Splitz Company earns its income evenly throughout the year. Porter Company uses the cost method to account for its investment.

Required :

Prepare a consolidated financial statements workpaper as of December 31,2011. Begin the income statement section of the workpaper with "Net Income Before Dividens" which is $63,200 for Porter Company and $60,000 for Splitz Company.

Intercompany Bond Holdings and Miscellaneous Topics – Consolidated Financial Statements

Learning Objectives :

1. **Describe the term "constructive retirement of debt."**
2. **Describe how the gain or loss on constructive retirement of intercompany bond holdings is allocated between the purchasing and issuing companies.**
3. **Explain the impact on the consolidated financial statements when a company issues a note to an affiliated company, which then discounts the note with an outside company.**
4. **Determine the effect on the consolidated financial statements when a subsidiary issues a stock dividend.**
5. **Understand the difference in how stock dividends and cash dividends issued by a subsidiary company affect the consolidated financial statements.**
6. **Determine the impact on the investment account when a subsidiary issues a stock dividend from preacquisition earnings and from postacquisition earnings.**
7. **Explain how the purchase price is allocated when the subsidiary has both common and preferred stock outstanding.**
8. **Determine the controlling interest in income when the parent company owns both common and preferred stock of the subsidiary.**

Referensi

Debra C. Jetter, Advance Accounting, International Student Version, 5th edition, John Wiley, 2012.

INTRODUCTION

A number of different topics are covered in this chapter. The first has to do with intercompany bond holdings. Often one affiliate will buy the bonds of another affiliate – we will treat this as a *constructive retirement*. We will also discuss intercompany discounting of notes receivable, S's stock dividends, and S's preferred stock. You'll see a significant similarity with many of the intercompany transactions we've discussed in earlier chapters and you'll also see some totally new ideas.

CHAPTER OUTLINE

9.1 Intercompany Bond Holdings

- A. *Constructive retirement*
  1. One affiliate buys the bonds of another affiliate
  2. The consolidated entity cannot owe money to itself, so the bonds have in essence been bought back – constructive retirement
- B. Since this is early retirement of debt, there is a gain or loss on the constructive retirement that must be accounted for in the consolidated entity

9.2 Accounting for Bonds – A Review

- A. Basics
  1. Bonds can be sold at less (discount) or more (premium) than par value

2. Generally, bond price is determined by the relation between the coupon rate and the current market rate for similar investments

B. Premium or discount
   1. Amortized over the remaining life of the bond
   2. Premiums decrease interest expense to the issuer
   3. Discounts increase interest expense to the issuer

C. Entries
   1. The books of the investor company and issuing company are reciprocal – receivable against payable, revenue against expense
   2. For the issuing company

To issue bonds at a discount – date of issue		
Cash		
Discount on Bonds		
Bonds Payable		

To pay interest and amortize bond discount		
Interest Expense		
Cash		
Interest Expense		
Discount on Bonds		

   3. For the investor company

To buy bonds – date of issue		
Investment in Bonds		
Cash		
To record interest		
Cash		
Interest Revenue		
To record amortization of bond premium		
Investment in Bonds		
Interest Revenue		

9.3 Constructive Gain or Loss on Intercompany Bond Holdings

A. On the books of the affiliates, the bond transactions are recorded like any other bond transactions

B. The consolidated statements must show the constructive retirement of the bonds
   1. The constructive gain or loss on retirement shows up on the consolidated statements when the intercompany bond transaction occurs – before it is recorded in any books
   2. This is backwards from unrealized profit and unrealized gain, which are deferred and recognized later
   3. It's still an issue of timing

a. The consolidated entity recognizes the constructive gain or loss immediately
b. The issuer and investor companies record it over the life of the bonds

C. Allocation of constructive gain or loss
1. There are four techniques available for allocating the constructive gain or loss
   a. All to issuing company – the purchasing company acts as an agent for the issuing company
   b. All to purchasing company – the purchasing company initiates the transaction
   c. All to P – P's management controls all the affiliate's financing decisions
   d. Part to issuing company and part to purchasing company – gain or loss is part of both issuing and purchasing, so the gain or loss should be allocated to both and spread out over the life of the bond
2. Our book uses the fourth option
3. Computing the constructive gain or loss
   a. On the purchase date, the total constructive gain or loss is calculated by determining the difference between the book value of the bonds and their purchase price
   b. Allocation rules
      i. Issuing company gets the difference between book value and par value
         (a) If book value > par value, there is a gain
         (b) If book value < par value, there is a loss
      ii. Purchasing company gets the difference between par value and purchase price
         (a) If par value > purchase price, there's a gain
         (b) If par value < purchase price, there's a loss
   c. The total of the issuing company's gain or loss plus the purchasing company's gain or loss should equal the total constructive gain or loss as calculated in a. above

9.4 Accounting for intercompany bonds illustrated

A. Entries related to bond investment
1. Book entry

To record investment in affiliate's bonds		
Investment in bonds		
Cash		

2. Workpaper entries – year of transaction (assuming constructive loss)

To recognize constructive loss on intercompany bond investment (purchaser's share – par value-purchase price)		
Loss on Constructive Retirement		
Investment in Issuer's Bonds		
To recognize constructive loss on intercompany bond retirement		

(issuer's share – book value-par value)		
Loss on Constructive Retirement		
Discount on Bonds Payable		
To eliminate intercompany bonds		
Bonds Payable		
Investment in Bonds		

3. An alternative entry – combines all three entries above

To recognize constructive loss and allocate it between issuer and purchaser		
Loss on Constructive Retirement		
Bonds payable		
Discount on Bonds Payable		
Investment in Issuer's Bonds		

4. Entries – first year subsequent

Purchasing company's books		
To record intercompany interest revenue		
Cash		
Interest Revenue		
To record amortization of premium		
Interest revenue		
Investment in Issuing Company's Books		
Issuing company's books		
To record bond interest paid		
Interest Expense		
Cash		
To record amortization of bond discount		
Interest Expense		
Discount on Bonds Payable		

5. Workpaper entries – cost or partial equity and upstream

To establish reciprocity between investment and liability, and convert investment to equity		
Beginning Retained Earnings – P (total constructive loss)		
Investment in S Bonds		
To eliminate prior year's constructive loss – purchasing company (P)		
Beginning Retained Earnings – P		
Investment in S Bonds		

To eliminate prior year's constructive loss – issuing company (S)		
Beginning Retained Earnings – P (P's%)		
Noncontrolling Interest (noncontrolling interest %)		
Discount on Bonds Payable		

To eliminate amortization of bonds premium – P		
Investment in S Bonds		
Interest Revenue		
To eliminate amortization of bond discount – S		
Discount on Bonds Payable		
Interest Expense		
To eliminate intercompany bonds		
Bonds Payable – S		
Investment in Ponds – P		

6. An alternative to replace the entries above

To eliminate intercompany bond transactions		
Beginning Retained Earnings – P		
Noncontrolling Interest		
Interest Revenue		
Bonds Payable		
Interest Expense		
Discount on Bonds		
Investment in Bonds		

7. The complete equity method is the same as above except the debits to beginning retained earnings – P will change to investment in S

B. Workpaper entries – second year subsequent to intercompany transaction
   1. The first two entries above are the same
   2. The new entries

To reverse amortization of premium for current and prior year		
Investment in S Bonds		
Beginning Retained Earnings – P * (last year's)		
Interest Revenue (this year's)		
To reverse amortization of discount for current and prior year		
Discount on Bonds Payable		
Beginning Retained Earning – P * (last year's)		

Interest Expense (this year's)		
* if using the complete equity method, Investment in S		

9.5 There is a three-year comparison in your book. Review it carefully!

9.6 Interim Purchase of Intercompany Bonds

A. If bonds are not purchased at the end of the year, we must account for the part of the constructive loss already recorded by the companies

B. The entries to originally recognize the constructive loss will change

To record the loss on constructive retirement of bonds – P's books		
Loss on Constructive Retirement		
Interest Revenue (amount recorded as amortization of premium)		
Investment in Bonds		
To record the loss on constructive retirement of bonds – S's books		
Loss on Constructive Retirement		
Interest Expense (amount recorded as amortization of discount)		
Discount on Bonds Payable		

9.7 Notes Receivable Discounted

A. When a company that's loaned money to an affiliate later discounts that note (sells it to another party), what part is to be eliminated and what part should be included on the consolidated statements must be determined

1. A receivable on the consolidated balance sheet should only be from outsiders
2. A contingent liability should be disclosed for the discounted note

B. To discount an intercompany note receivable (ignoring interest!)

1. On the books

To discount an intercompany note receivable		
Cash		
Note Receivable		
-or-		
Cash		
Note Receivable Discounted		

2. Workpaper entries
   a. If the first entry above is used, there's no eliminating entry
   b. If the second entry is used, eliminate the extra note receivable against the note receivable discounted

To eliminate intercompany note		
Note Receivable Discounted		
Note Receivable		

C. P discounts a note receivable from a customer to S
   1. First method – no eliminating entry necessary
   2. Second method – 3 note receivable accounts, one note receivable discounted

To eliminate intercompany note discounted		
Note Receivable Discounted		
Note Receivable		

D. Then S discounts the note to C, an outsider
   1. First method – no elimination necessary
   2. Second method, 2 note receivable accounts, 2 notes receivable discounted

To eliminate intercompany note discounted		
Note Receivable Discounted		
Note Receivable		

9.8 Stock Dividends Issued by a Subsidiary Company

A. Definition – if S issues a stock dividend, P records it as a memorandum entry
   1. P's share of S's total equity is the same
   2. The stock dividend is assumed to be issued out of S's oldest retained earnings

B. On S's books, a transfer from retained earnings to common stock is recorded
   1. Large dividend (greater than 20-25%) – stock dividends are recorded at par value
   2. Small dividend (less than 20%) – stock dividends are recorded at market value, using
      other contributed capital as the balancing account

C. Workpaper entries
   1. Year of dividend

To eliminate stock dividend and restate common stock		
Common Stock – S		
Stock Dividend Declared – S (P's%)		
To eliminate P's investment in S		
Beginning Retained Earnings – S		
Common Stock – S		
Investment in S		
Noncontrolling Interest		

   2. Subsequent years

To eliminate P's investment in S		
Beginning Retained Earnings – S (has had dividend removed)		
Common Stock – S (original amount + dividend)		
Investment in S		
Noncontrolling Interest		

D. Stock dividends issued from postacquisition earnings

1. If the stock dividend issued exceeds S's retained earnings at acquisition, some of the stock dividends are from S's earnings since acquisition
2. The consolidated retained earnings then has some amount that is not available for dividends because it has been capitalized as a stock dividend
3. The amount must be disclosed in the consolidated financial statements, but doesn't have to be transferred to contributed capital

9.9 Dividends from Preacquisition Earnings

A. Bought by P as part of the acquisition, so if dividends are paid from those earnings they decrease the investment account instead of increasing an income account
   1. P's books – cost method

To record liquidating dividend		
Cash		
Dividend Income (from current income)		
Investment in S (from purchased income)		

   2. Eliminating entry – cost method

To eliminate P's share of S's dividends		
Dividend Income		
Investment in S		
Dividends Declared – S		

B. In subsequent years, the new investment in S (adjusted for the liquidating dividend) is used
for the eliminating entry

9.10 Subsidiary with Both Preferred and Common Stock Outstanding

A. Determining equity interest of each class of stockholders
   1. P's control is determined by its interest in S's voting stock. P might or might not own shares of S's preferred stock.
   2. All classes of S's stockholders have an interest in S's net assets
      a. S's equity must be allocated between preferred and common interests
      b. The preferred stock redemption and dividend provisions determine the amount of S's net assets associated with preferred – see Illustration 9-6 in your book for the details
         i. Preferred gets its share of dividends before common gets earnings
         ii. If there are dividends in arrears, a portion of accumulated retained earnings belongs to preferred stockholders

B. Allocation of difference between cost of preferred stock investment and book value of interest acquired
   1. The market price of preferred stock usually ties into its dividend rate as compared to the market returns of similar investments – much like premium or discount on bonds

2. The difference between cost and book value in the acquisition of preferred stock is essentially the constructive retirement of the stock – it should be used to decrease consolidated other contributed capital or consolidated retained earnings

9.11 Consolidating a Subsidiary with Preferred Stock Outstanding

A. Allocation of S's total equity

1. Division of equity

To Preferred Stock

Preferred's call price
\+ Dividends in arrears
= Preferred's share of S's total equity
× P's percent
= P's share of preferred's share

To Common Stock

Common stock, par value
\+ Other contributed capital
\+ Retained earnings less preferred's share
= Common's share of S's total equity
× P's percent
= P's share of common's share

2. P's entry

To record investment in S's common and preferred stock		
Investment in S – Preferred Stock		
Investment in S – Common Stock		
Cash		

3. Allocation of difference between implied and book value

P's cost of preferred stock
\- P's share of S preferred
= Difference between implied and book value

P's cost for common stock
\- P's share of S's common stock
= Difference between implied and book value

B. Consolidated statements workpaper entries – year of acquisition

To eliminate P's investment in S's preferred stock		
Beginning Retained Earnings – S ([preferred's share of S's equity – pfd stock] × P's %)		
Preferred Stock – S		
Difference Between Implied value and Book Value		
Investment in S – Preferred Stock		
Noncontrolling Interest		
Other Contributed Capital – P Company		
Noncontrolling Interest		
Difference Between Implied Value and		

Book Value		

To eliminate P's investment in S's common stock		
Beginning Retained Earnings – S		
Common Stock – S		
Other Contributed Capital – S		
Difference Between Implied Value and Book Value		
Investment in S – Common Stock		
Noncontrolling Interest		

C. Complete equity method
   1. Must recognize preferred dividends whether they've been paid or not
   2. Eliminating equity for income in preferred stock

To eliminate P's share of S's preferred stock dividend		
Equity in S Income – Preferred Stock		
Investment in S – Preferred Stock		

D. Accounting subsequent to the year of acquisition
   1. To establish reciprocity
      a. Preferred = (Pfd's share of S's ending RE – pfd's share of RE at acquisition × P's %)
      b. Common = (Common's share of S's ending RE – remaining RE at acq. × P's %)
   2. Eliminating entries

To establish reciprocity		
Investment in S – Preferred Stock		
Investment in S – Common Stock		
Beginning Retained Earnings – P		
To eliminate intercompany dividends		
Dividend Income		
Dividends Declared – S (Preferred stock)		
Dividends Declared – S (Common stock)		
To eliminate P's investment in S's preferred stock		
Beginning Retained Earnings – S		
Preferred Stock – S		
Difference Between Implied Value and Book Value		
Investment in S – Preferred Stock		
Noncontrolling Interest		

Other Contributed Capital – P Company		
Noncontrolling Interest		
Difference Between Implied Value and Book Value		

To eliminate P's investment in S's common stock		
Beginning Retained Earnings – S		
Common Stock – S		
Difference Between Implied Value and Book Value		
Investment in S		
Noncontrolling Interest		

E. Controlling interest in consolidated net income

  P's independent income
+ Other adjustments (from Chapters 5 & 6)
+ P's share of S's income assigned to preferred
+ <u>P's share of S's income assigned to common</u>
= <u>Controlling interest in consolidated net income</u>

<u>MULTIPLE CHOICE QUESTIONS</u>

Choose the BEST answer for the following questions.

_____ 1. Constructive retirement is when
  a. P retires shares of its own stock
  b. P retires bonds payable
  c. P buys S's bonds payable
  d. P buys S's common stock

_____ 2. The price of a bond is generally determined by
  a. the relation between the coupon rate and the current market rate of similar investments
  b. the stated interest rate of the bond
  c. how many bonds are issued
  d. who buys the bonds

_____ 3. How is the consolidated statements treatment of constructive gain or loss on intercompany bond investments different from the treatment of unrealized profit on intercompany sales of inventory?
  a. Constructive gain or loss is deferred until realized by transactions with outsiders.
  b. Unrealized profit s recognized immediately, before it has been recorded.

c. Constructive gain or loss is recognized immediately, before it has been recorded.
d. There is no difference in the treatment.

______ 4. Which of the following is NOT an acceptable technique for allocating constructive gain or loss?
a. All to issuing company
b. All to purchasing company
c. Part to issuing company and part to purchasing company
d. All to S

______ 5. How is constructive gain or loss divided?
a. Issuing company gets the difference between book value and purchase price
b. Issuing company gets the difference between par value and purchase price
c. Purchasing company gets the difference between book value and par value
d. Purchasing company gets the difference between par value and purchase price

______ 6. How is constructive loss recognized by the issuing company?
a. As a deduction to discount on bonds payable
b. As an increase to discount on bonds payable
c. As a decrease to investment in bonds
d. As an increase to investment in bonds

______ 7. How does the treatment of constructive gain or loss differ in the complete equity method from the cost method?
a. There is no difference
b. Use the investment account instead of P's beginning retained earnings
c. Use the equity in S income instead of interest income
d. Use the investment account instead of S's beginning retained earnings

______ 8. What is a note receivable discounted?
a. P sells a note it has received from S to a third party
b. P sells a note it has received from a third party to S
c. S sells a note it has received from a third party to P
d. All of the above are examples of a note receivable discounted

______ 9. What is the essence of accounting for discounted receivables on the consolidated statements?
a. They should all be eliminated
b. The consolidated balance sheet should never include a note receivable discounted
c. The consolidated balance sheet should include only notes receivable transactions with outsiders
d. There cannot be an intercompany note receivable transaction

______10. How does P handle a stock dividend from S?
a. With a memorandum entry only
b. With a debit to investment in S
c. With a credit to investment in S

d. With a credit to retained earnings

_____11. What is a liquidating dividend?

a. S pays dividends from income since acquisition
b. P pays dividends from consolidated income
c. S pays dividends from preacquisition income
d. P pays dividends from preacquisition income

_____12. How does S's preferred stock affect the consolidation?

a. Any preferred stock not held by P must be included in noncontrolling interest
b. P's % of ownership does not include preferred if the preferred doesn't have voting rights
c. Preferred stock will share in S's total equity
d. All of the above

_____13. If P invests in S's preferred stock, how is the difference between Implied Value and Book Value handled?

a. Allocated among S's noncurrent assets
b. Allocated among P's noncurrent assets
c. Deducted from P's other contributed capital, with an adjustment to NCI
d. Deducted from S's other contributed capital, with an adjustment to NCI

_____14. How is reciprocity established for preferred stock?

a. Preferred's share of S's ending RE – preferred's share of RE at acq. × P's % ownership
b. Preferred's share of S's ending RE – preferred's share of RE at acq. × noncontrolling %
c. Preferred's share of S's ending RE – total RE at acq. × P's % ownership
d. Preferred's share of S's ending RE – total RE at acq × S's % ownership

_____15. What is the controlling interest in consolidated net income?

a. P's independent income ± P's share of S' total income
b. P's independent income ± other adjustments + P's share of S's income assigned to preferred + P's share of S's income assigned to common
c. P's independent income ± other adjustments + P's share of S's income assigned to preferred + P's share of S's total income
d. P's independent income ± other adjustments + S's total income

EXERCISE

1. **Computing the Constructive Gain or Loss on Debt Retirement and Book Entries**
   Weber Company issued five year, 10% bonds on January 2, 2011, for 105. Par Value is $850,000. Interest paid semiannually on June 30 and December 31. Weber Company is a 90% owned subsidiary of Fairfield Company. On December 31,2011, Fairfield Company purchased $510,000 of Weber Company's par value bonds at 90 after the semiannual interest payment had been made. Weber Company declared dividends of

$60,000 in 2011 and $80,000 in 2012. Both companies use the straight line method to amortize bond discount and premium.

Required :

A. Compute the total gain or loss on the constructive retirement of the debt.
B. Allocate the total gain or loss between Weber Company and Fairfield Company
C. Prepare the book entries related to the bonds made by the individual companies in 2012.
D. Assume that the two companies reported net income as follows :

	Fairfield Company	Weber Company
2011	$275,000	$190,000
2012	$350,000	$225,000

Compute controlling interest in consolidated net income and the controlling interest in consolidated income for 2011 and 2012.

2. **Subsidiary Stock Dividend – Cost Method**

Perez, Inc, own 7,000 shares (70% interest) of Salata Company's $100 par value common stock. The stock was purchased for $1,250,000 on January 2,2010, when Salata reported a common stock balance of $1,000,000, a retained earning;s balance of $400,000, and other contributed capital balance of $100,000. Any difference between implied and book value interest acquired is attributable to the under or overvaluation of land. During 2011, Salata reported net income of $80,000. Because the company was short of liquid assets, dividend have been not padi since 2006. During 2011, however the company declared and issued a 15% stock dividend (market price of common stock on the date of issue, $160 per share). The retained earnings balance at beginning of 2011 was $500,000.

Required :

A. Prepare the journal entries required in the books of Perez, Inc during 2011.
B. Prepare in general journal form the workpaper entries necessary in the consolidated statements workpaper for the year ended December 31,2011.
C. Prepare the workpaper entry to establish reciprocity to be made in the 2012 consolidated statements workpaper.

3. **Purchase Common and Preferred Stock**

On January 2,2011, Pasqual Corporation purchased 80% of the outstanding common stock an 30% of the outstanding cumulative, nonparticipating, preferred stock on Sung Company for $400,000 and $70,000 respectively. At this date, Sung Company reported account balances of $400,000 in common stock, $200,000 in preferred stock, and $100,000 in retained earnings. No other contributed capital account exist. The difference between implied and book value of the common stock is attributable to under or overvalued land. Dividends on the 12% cumulative preferred stock (par $10) were not paid during 2010.

Other information :

	Pasqual Corporation	Sung Company

1/2/2011 Retained Earnings	$45,000	$100,000
2011 Reported Net Income	$84,600	$90,000
2011 Dividends Declared	$25,000	$50,000

Required :

A. Prepare the journal entries made by Pasqual Corporation in 2011 to account for the investment assuming (1) the cost method is used, (2) the partial equity method is used, and (3) the complete equity method is used.

B. Compute the noncontrolling interest in Sung Company's net income.

C. Prepare the 2011 workpaper entries related to the forgoing investment assuming (1) the cost method is used to account for the investment, (2) the partial equity method is used to account for the investment,and (3) the complete equity method is used to account for the investment.

Translation of Financial Statemets of Foreign Affiliates

Learning Objectives :

1. Distinguish between the current exchange rate and the historical exchange rate.
2. Understand the objectives of financial statement translation.
3. Identify the functional currency of a foreign entity.
4. Compare the two methods used to convert the financial statements of a foreign entity into U.S. dollars.
5. Distinguish between the circumstances under which each of the two methods is appropriate under current GAAP.
6. Explain the factors involved in translating the statements of a foreign entity operating in a highly inflationary economy.
7. Translate the statements of a foreign entity when the functional currency is the local currency.
8. Translate the statements of a foreign entity when the functional currency is the U.S. dollar.
9. Understand the concept of comprehensive income in the context of foreign currency translation.
10. Identify the disclosure requirements for firms with foreign entities.

Referensi

Debra C. Jetter, Advance Accounting, International Student Version, 5th edition, John Wiley, 2012.

<u>EXERCISE</u>

1. **Translation – Local Currency Is the Functional Currency**

   On January 1,2008, a U.S. company purchased 100% of the outstanding stock on Ventana Grains, a company located in Latz City, New Zealand, Ventana Grains was organized on January 1,1994. All the propert, Plant, and Equipment held on January 1,2008, was acquired when the company was organized. The business combination was accounted for as a purchase transaction. The 2008 financial statements for Ventana Grains, prepared in its local currency the New Zealand dollar, are green here.

VENTANA GRAINS
Comparison Balance Sheets
January 1 and December 31, 2008

	Jan, 1	Dec, 31
Cash and Receivables	500,000	880,000
Inventories	600,000	500,000
Land	400,000	400,000
Building (net)	650,000	605,000
Equipment (net)	465,000	470,000
Totals	2,615,000	2,855,000
Short Term Account and Notes	295,000	210,000
Long Term, Notes (600,000 issued September 1, 2000,		

80,000 issued July 1, 2008)	600,000	680,000
Common stock	800,000	800,000
Additional Paid in Capital	200,000	200,000
Retained Earnings	720,000	965,000
Total	2,615,000	2,855,000

VENTANA GRAINS

Comparison Income and Retained Earnings Statement

For the Year Ended December 31, 2008

Revenues		3,225,000
Cost of Goods Sold :		
Beginning Inventory	600,000	
Purchases	2,100,000	
Good Available for Sale	2,700,000	
Less : Ending Balance	500,000	
Cost of Goods Sold		2,200,000
Gross Profit on Sales		1,025,000
Depreciation Expense	140,000	
Other Expenses	540,000	680,000
Net Income		345,000
Jan 1, Retained Earnings		720,000
Total		1,065,000
Less : Dividends Paid		100,000
Dec 31 Retained Earnings		965,000

The account balances are computed in conformity with U.S. generally accepted accounting standards.

Othe information is as follow :

1. Direct exchange rates for the New Zealand dollar on variation dates were :

Date	Exchange Rate
January 1, 1994	$,8011
September 1, 2004	$.5813
January 1,2008	$.7924
July 1, 2008	$.7412
December 31,2008	$.7298
Average for 2008	$.7480
Average for the last four months of 2008	$.7476

2. Ventana Grains purchased equipment for 100,000 New Zealand dollar on July 1,2008, by issuing a note for 80,000 New Zealand dollars and paying the balance in cash.
3. Sales were made and purchases and “Other Expenses” were incurred evenly throughout the year
4. Depreciation for the period in New Zealand dollars were computed as follows :

Building	45,000
Equipment – Purchase before 1/1/2008	85,000
Equipment – Purchase July 1,2008	10,000

5. The inventory is valued on a FIFO basis. The beginning inventory was acquired exchange rate was $.7480. The ending inventory was acquired during the last four months of 2008.
6. Dividends of 50,000New Zealand dollar were paid on July 1 and December 31.

Required :

A. Translate the financial statements into dollars assuming that the local currency of the foreign subsidiary was identified as its functional currency.
B. Prepare a schedule to verify the translation adjustment determined in requirement. A Describe how the translation adjustment would be reported in the financial statements.

7. **Translation – Local Currency Is the Functional Currency**

On January 2,2008, P Company, a U.S. based company, acquired for 2,000,000 francs an 80% interest in SFr Company, a Swiss Company. On January 2,2008, SFr Company reported a earnings balance of 480,000 francs. SFr's books are maintained in francs and are in conformity with U.S. genenerally accepted accounting principles. Trial balance of the two companies as of December 31, 2009, are presented here :

Debits	P Company (Dollars)	SFr Company (Francs)
Cash	500,200	962,500
Account Receivable	516,400	660,000
Inventories (FIFO cost)	627,800	1,037,500
Investment in SFr Company	300,000	
Land	450,000	500,000
Building (net)	610,000	550,000
Equipment (net)	290,000	405,000
Dividend Declared	200,000	375,000
Cost of Goods Sold	2,720,000	2,312,500
Depreciation Expense	210,000	125,000
Other Expense	914,000	818,750
Income Tax Expense	100,000	102,500
Totals	7,438,400	7,848,750
Credits	**P Company (Dollars)**	**SFr Company (Francs)**
Account Payable	540,000	800,000
Short-term Notes Payable	300,000	650,750
Bond Payable	700,000	850,000
Common Stock	800,000	960,000
Additional Paid in Capital	300,000	300,000
Retained Earnings, 1/1	544,400	513,000
Sales	4,200,000	3,775,000
Dividend Income	54,000	
Totals	7,438,400	7,848,750

Other information related to the subsidiary follows :

1. Beginning inventory of 830,000 francs was acquired when the exchange rate was $.165.
2. Purchases made uniformly throughout 2009 were 2,520,000 francs
3. The franc is identified as the subsidiary's functional currency.
4. The subsidiary's beginning (1/1/09), retained earnings and cumulative translation adjustment (credit) in dollar were $ 75,948 and $ 36,462, respectively.
5. All plant assets were acquired before the parent obtained a controlling interest in the subsidiary.
6. Sales are made and all expenses are incurred uniformly throughout the year.
7. The ending inventory was acquired during the last quarter.
8. The subsidiary declared and paid dividends of 375,00 francs on September2.
9. The following direct exchange rate quotation were available :

Date of subsidiary acquisition	$.15
Average for 2008	.156
January 1,2009	.17
September 2,2009	.18
December 31,2009	.19
Average for the 4th quarter, 2009	.185
Average for 2009	.176

Required :

A. Prepare a translated balance sheet and combined statement of income and retained earnings for the subsidiary.
B. Prepare a schedule to verify the translation adjustment.
C. Compute the following ratios based on the franc and the U.S. dollar financial statements.
   (1) Current Ratio
   (2) Debt to Equity
   (3) Gross profit percentage
   (4) Net income to sales

8. **Temporal Method**

Pasquale Company is a manufacturer of oil drilling equipment located in Canada. The company is 90% owned by a U.S. parent company. The accounting department of Pasquale Company accumulated the following 2008 information for the company's auditor.

Equipment :

1. The equipment account contained in following items :

Description	Cost (Can.$)	Useful life	Acquisition Date	Exchange Rate on Acquisition Date
Drill Press	30,000	5 years	July 15,2009	$.8430
Stamping Press	80,000	4 years	January, 2, 2006	$.7360

Fork lift	42,000	6 years	Septembe, 1,2007	$.6998

2. Pasquale Company depreciates assets by the straight line method and assumes a zero residual value.
3. Its policy is to take a full year's depreciation on all depreciable assets acquired before July 1 and no depreciation on all depreciable assets required after July 1.

Inventory :

1. The beginning inventory of 60,000 Canadian dollars was acquired during the last quarter of 2007.
2. Inventory purchases of 400,000 Canadian dollars were made uniformity during the year.
3. The ending inventory of 60,000 Canadian dollars was acquired during November and December, 2008.

Marketable Securities :

1. Marketable securities, carried at cost, were acquired for 30,000 Canadian dollars when the direct exchange rate was $.9320.
   Direct Exchange Rate
   Average for the last quarter of 2007, $.7322
   January 1, 2008, $.7080
   Average for November and December, 2008, $6845
   Average for 2008, $.7140
   December 31, 2008, $.6960

Required :

A. Compute the account balances that would be reported for equipment, inventory and marketable securities in the December 31, 2008, balance sheet expressed in U.S. dollars, assuming that the temporal method was used to translate the accounts.
B. Compute the depreciation expense and cost of goods sold for 2008 in U.S. dollars assuming that the temporal method was used to translate the account
C. Repeat requirements A and B, assuming the current rate method was used to translate the account.
D. Contrast the effect on income from using the current year method and the temporal method to translate cost of goods sold and depreciatin expense. Explain why net income is increased or decreased when the account were translated using the current year method.

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INDONESIA BANKING SCHOOL
Reaching The Future with Integrity
Jl. Kemang Raya No. 35, Bangka - Mampang Prapatan - Jakarta Selatan 12730
Telp. : 021-71791838, 71791979, 7195474, 7196535, 7196469 Fax. 021-7195486
website : www.ibs.ac.id e-mail : info@ibs.ac.id

SURAT TUGAS

No. : 053/ST-Dos/STIE IBS/X/2015

Sehubungan dengan Akreditasi masih terdapat kekurangan dalam hal ketersediaan modul praktikum pada Prodi Akuntansi dan Manajemen. Oleh karena itu, kami menugaskan Bapak dan Ibu untuk membuat modul praktikum dengan sistematika sebagai berikut:

1. Urutan bab disesuaikan dengan urutan bab pada silabus. Silabus terbaru akan diemail oleh staf prodi.
2. Untuk setiap bab terlebih dahulu diberikan ringkasan materi, baru dilanjutkan dengan soal latihan. Soal latihan dapat diambil dari *text book* acuan, tanpa di terjemahkan. Urutan pemilihan soal dimulai dari soal sederhana ke soal kompleks.
3. Untuk setiap bab, diberikan halaman untuk mahasiswa menulis jawaban.
4. Setiap modul dilengkapi dengan kata pengantar, daftar isi dan daftar pustaka.

Modul praktikum diemail kepada Kepala Prodi/Sekretaris Prodi dan staf prodi paling lambat tanggal 2 November 2015.

Prodi akan menyediakan workshop 1 (satu) hari untuk pengerjaan modul ini, yang akan diselenggarakan pada tanggal 28 Oktober 2015. Daftar penugasan pembuatan silabus dapat dilihat pada lampiran surat tugas ini. Setiap dosen yang membuat modul, berhak mendapatkan kompensasi sesuai ketentuan.

Demikianlah surat tugas ini dibuat untuk dapat dilaksanakan dengan penuh tanggung jawab.

Jakarta, 16 Oktober 2015

Sekolah Tinggi Ilmu Ekonomi
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Wakil Ketua I

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2	Manajemen Keuangan	Ossi Ferli
3	Statistik	Deni Wardani
4	Statistik I	Ossi Ferli
5	Statistik II	Erric Wijaya