1981

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E.C.R.S.B. 81-3

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ABSTRACT

Although the consolidation process is a series of interrelated adjustments and eliminations, it is rarely pictured as an integrated whole. The flow chart approach presented herein accomplishes this objective and can serve as a model for the solution of consolidation problems. Following this conceptual approach allows the user to see the place of each adjustment and elimination in the overall perspective of the consolidation process.

A FLOW CHART APPROACH TO CONSOLIDATIONS

The teaching of consolidations often follows a segmented approach in which selected topics and the related eliminations are examined somewhat independently of each other and of the effect on the overall consolidation. In the flow chart approach presented in this paper, the emphasis is on the complete sequential development of the consolidation process through a series of interrelated steps and eliminations. The flow chart, augmented by the development of the elimination entries identified in the flow diagram, is presented in Figure 1.

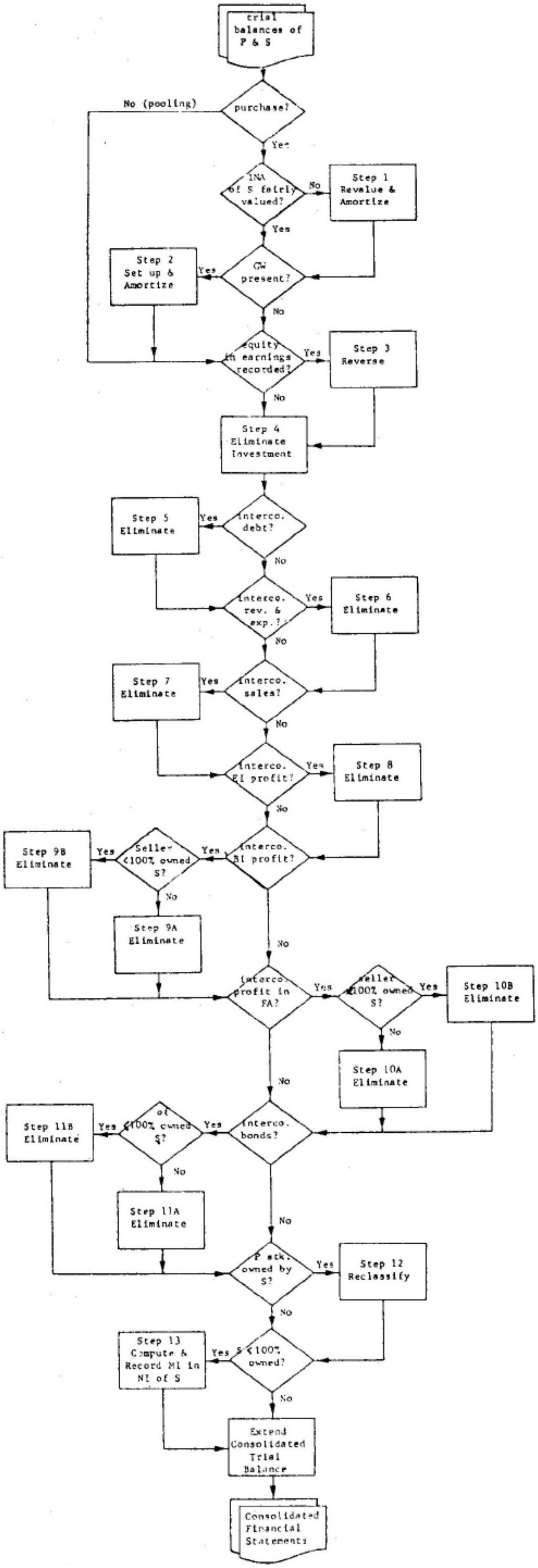
In conformity with Modern Advanced Accounting Meigs, Mosich and Larsen, 1975 Figure 1 utilizes entity theory for the calculation of goodwill, parent theory for the computation of minority interest, and the treasury stock method for dealing with parent company stock owned by a subsidiary. Income taxes are omitted from consideration and proper use of the equity method by the parent in accounting for the investment in the subsidiary is assumed. However, it is further assumed that the parent recorded its share of the subsidiary's net income as reported without adjustment for items of intercompany profit or loss included in the net income of the subsidiary. Abbreviations used are as follows:

INA = identifiable net assets	FA = fixed assets
S = subsidiary company	MI = minority interest
P = parent company	APIC = additional paid in capital
GW = goodwill	BRE = beginning retained earnings
EI = ending inventory	FV = fair value
BI = beginning inventory	BV = book value

Although the flow chart does not cover every conceivable problem and situation which can arise in a consolidation, it will accomodate most consolidations. In fact, the three types of consolidation problems which have appeared in the practice part of the CPA examination in recent years can be solved by following the procedures outlined. The only necessary adaptation is to substitute "net income" for specific revenue and expense accounts in the eliminations if a retained earnings statement and a balance sheet are furnished instead of a pre-closing trial balance. If the problem involves only a balance sheet, "retained earnings" would be used in the eliminations in place of the nominal accounts. Figure 2 shows the use of the step-by-step procedures in solving these three types of consolidation problems. The CPA examination problems are identified but not reproduced and only the eliminations required by each problem are shown.

FIGURE 1

Consolidation Flow Chart and Elimination Steps



1. Adjust INA of S to FV as of date of P's purchase of S, and correct amortization, both past (from date of purchase to beginning of current year) and current (this year's)

If INA undervalued:	If INA overvalued:

INA
   APIC of S
	APIC of S
	   INA

Expense (current)
BRE (past)
   INA
	INA
	   Expense (current)
	   BRE (past)

2. Compute and record GW as of date of purchase, and reflect associated amortization, both past and current

GW = (Cost of Investment - (P's % ownership x FV of INA of S at date of purchase, less any preferred stock equity therein)) ÷ P's %

If positive GW:	If negative GW:

GW
   APIC of S
	APIC of S
	   Fixed Assets (or other appropriate account)

Expense (current)
BRE (past)
   GW
	Fixed Assets
	   Expense (current)
	   BRE (past)

3. Eliminate equity in earnings of S against investment in common stock of S

Equity in Earnings of S
   Investment in Common Stock of S

4. Eliminate P's investment account(s) against contributed capital accounts of S, BRE of S and current dividends of S, if any. (Note: If P's % ownership changed during the year, retained earnings of S at date of change should be used rather than BRE. MI in stockholders' equity of S, if any, is isolated in this process, with the exception of MI in current net income of S which is recorded in Step 13)

Preferred Stock of S (if any)
Common Stock of S
APIC of S
BRE of S
   Dividends of S
   Investment in Preferred Stock of S (if any)
   Investment in Common Stock of S
   MI

5. Eliminate intercompany indebtedness

Payables
   Receivables

6. Eliminate intercompany service revenue and expense

Service Revenue
   Service Expense

7. Eliminate intercompany sales

Sales
   Cost of Sales

8. Eliminate intercompany EI profit

Cost of Sales
   EI

9. Eliminate intercompany BI profit

A. If sold by P or 100% owned S:	B. If sold by less than 100% owned S:

BRE
   Cost of Sales
	BRE (P's % ownership x profit)
	MI (MI's % ownership x profit)
	   Cost of Sales

10. Eliminate intercompany profit in fixed assets and excess depreciation, that is, depreciation taken on the gain element

A. If sold by P or 100% owned S:	B. If sold by less than 100% owned S:

Gain (or BRE, if sale in prior year)
   Fixed Asset
	Gain (or BRE (P's % x gain) and MI (MI's % x gain) if sale in prior year)
	   Fixed Asset

Fixed Asset (or Accum. Depr.)
   Deprec. Expense (current)
   BRE (past)
	Fixed Asset (or Accum. Depr.)
	   Deprec. Expense (current)
	   BRE (P's % x past deprec. on gain element)
	   MI (MI's % x past deprec. on gain element)

Note: If intercompany sale of inventory or fixed assets made below cost, all entries in 8 to 10 above would be reversed as to debit and credit and "loss" substituted for "gain" in 10A and 10B.

11. Eliminate intercompany bondholdings

A. If bonds of P or 100% owned S:	B. If bonds of less than 100% owned S:

Bonds Payable (face amount owned)
   Investment in Bonds (BV)
Bond Premium (% owned x BV of premium)
   (or Bond Discount, if applicable)
Interest Revenue (on the bonds owned)
   Interest Expense (on the bonds owned)
Loss (or BRE, if purchased in prior year)
   (or Gain (or BRE), if applicable)
	The entry is the same except that any balancing debit or credit (to BRE) must be split between P and MI according to their relative % ownerships.

12. Set up any shares of parent company stock owned by S as treasury stock, and eliminate any dividends on such stock

Treasury Stock
   Investment in P Stock

Dividend Revenue
   Dividends

13. Record MI in the net income of S (after adjusting the reported net income for eliminations made in Steps 1, 2, 8B, 9B, 10B, and 11B)

	Reported Net Income of S
Steps 1 & 2	+(-) amortization expense correction
Step 8B	- profit in EI of P
Step 9B	+ profit in BI of P
Step 10B	- gain (if this year's transaction)
	+ depreciation (current year)
Step 11B	+ gain (- loss) if this year's transaction
	- positive (+ negative) difference between interest revenue and interest expense on bonds owned
	Adjusted Net Income of S (ANI)

then, the entry would be

MI in Net Income of S (MI's % x ANI)
   MI

CPA Examination Consolidation Eliminations Based on the Flow Chart

Step	Pre-closing Trial Balance (May 1975 Part II No. 5)			Retained Earnings Statement and Balance Sheet (November 1976 Part II No. 4)			Balance Sheet (November 1977 Part I No. 3)		
1.	Land	540,000					Prop., Pl. & Eq.	13,100,000	
	Mach. & Equip.	2,750,000					Long-term Debt	400,000	
	Other Assets		90,000				Other Assets		300,000
	Accum. Depr.: M & E		750,000				APIC of S		13,200,000
	Cost of Goods Sold		128,000						
	APIC of S		2,322,000				Other Assets	10,000	
							Ret. Earnings	4[illegible],000	
	Dep. Expense	236,250					Prop., Pl. & Eq.		500,000
	Accum. Dep.: M & E		236,250				Long-term Debt		5,000
2.	Goodwill	1,400,000					Goodwill	2,800,000	
	APIC of S		1,400,000				APIC of S		2,800,000
	Amort. Expense	52,500					Ret. Earnings	35,000	
	Goodwill		52,500				Goodwill		35,000
3.				Net Income	120,000		Ret. Earnings	1,250,000	
				Invest. in S		120,000	Invest. in S		1,250,000
4.	Pfd. Stock of S	150,000		Common Stk. of S	250,000		Common Stk. of S	1,000,000	
	Common Stk. of S	1,000,000		Cont. Cap. of S	50,000		APIC of S	16,400,000	
	APIC of S	3,844,000		Ret. Earnings of S			Ret. Earnings of		
	Ret. Earnings of			at 7/1/75	780,000		S at 6/30/76	1,600,000	
	S at 4/1/74	1,006,000		Dividends of S		100,000	Invest. in S		19,000,000
	Investment		6,000,000	Invest. in S		735,000			
				Minority Interest		245,000			
5.	Accounts Pay.	56,300					Accounts Pay.	500,000	
	Accounts Rec.		56,300				Accounts Rec.		500,000
7.	Sales	388,000							
	Cost of Goods Sold		388,000						
8.	Cost of Goods Sold	4,200		Net Income	4,000		Ret. Earnings	100,000	
	Inventory		4,200	Inventory		4,000	Inventory		100,000
9B.				Ret. Earnings(7/1/75)	9,000				
				Minority Interest	3,000				
				Net Income		12,000			
11.	Subord. Debent.	1,500,000		Bonds Payable	60,000				
	Interest Revenue	78,750		Invest. in Bonds		58,000			
	Investment		1,500,000	Bond Discount		1,200			
	Interest Expense		78,750	Net Income		800			
13.				**Minority Interest in Net Income of S (7/1 to 12/31/75)**	**43,200**				
				Minority Interest		**43,200**			

REFERENCE

[redacted], Walter B., A. N. Mosich, and E. John Larsen, Modern Advanced Accounting (McGraw-Hill, 1975), pp. 126 - 305.