NEW YORK UNIVERSITY
Stern School of Business

Advanced Accounting Concepts — Summer 2018

jbilders@stern.nyu.edu

Prof. John Bildersee — Office hours T, H 9:00 – 9:30 & 4:00 – 4:15

Tel. 212-998-0027 — KMC 10-79 — Class web site: NYU Classes

Text: Advanced Accounting (**Custom Text** from [13th edition] Hoyle, Schaefer & Doupnik)

Course Content: This course concentrates on events causing material discontinuities in financial statements thereby complicating analyses and projections. These include mergers and acquisitions, the development of consolidated financial statements, related analytical issues such as taxes and selected reorganization issues such as spinoffs, splitoffs, IPOs, LBOs and Fresh Starts. It also covers accounting for companies that operate in multiple currencies and selected financial instruments.

Warning: **The topics in this course are detailed and build on materials presented earlier in the semester. Difficulties faced early in the semester should be dealt with promptly.**

Some representative questions for discussion include:

How are acquisitions, LBOs and Fresh Starts related?
What are some analysis problems associated with consolidated statements?
How can management 'manipulate' consolidated statements?
Can the acquirer and the acquired both show gains in a partial acquisition?
How does increasing an already majority ownership affect financial reporting?
What is the impact of a bidding war on shareholders, leverage, goodwill and the future?
Are internal profits relevant to the analysis of the entire firm?
Can a subsidiary report a profit and the parent suffer a loss on its investment in the subsidiary (or vice versa)?
Can the parent and the noncontrolling interest have different rates of return on the same investment?
Does a company have 100%control of all the assets on its consolidated statements?
Can a company avoid consolidation even if it owns a majority of a company?
Can a company be required to consolidate even if it has a minority position in a company?
How do consolidations impact reported cash flows?
What are the restrictions keeping companies from using fully consolidated tax statements?
Can one company have a gain and another a loss (and a third have no gain or loss) from the same currency movements?
How does a firm hedge future transactions in foreign currencies?

Attendance: You should **attend every class** to assure a good understanding of the course materials.

Exams: There are two exams. Exams are open book and open notes but no computers or cell phones. There are **<u>no make-up exams</u>**. If you cannot take an exam at the scheduled time you are expected to take it **early**. The exams will be given on the stated dates. The topics may change if the course falls behind schedule.

Suggested exercises: These exercises offer reviews of the primary topics in each chapter and may help you prepare for the quiz and exams. Do not spend too much time on any question. Instead, try to work the exercise in your own way and, if you are stuck, try to understand the answer that is on NYU Classes and/or ask related questions in class. Homework suggestions are listed on the first date of the following chapter to assure some classroom discussion prior to doing the exercises.

Classroom performance and In-class Handouts: **You are expected to be able to contribute to discussions about the exercises as well as other classroom discussions.** Read the text and review the classroom exercises before class. Positive contributions include questions and well-intended responses irrespective of their accuracy and are worth extra credit

Support materials: Visit NYU Classes early and often. It has announcements, class notes, slide shows, spreadsheets, sample exams and more.

We follow the undergraduate code of conduct and the graduate honor code throughout the semester. We follow Stern's default policies for anything not covered here.

Tentative Grading:

Best Exam	60 points
Poorest Exam	35 points
Classroom attendance	5 points
Classroom participation	Extra Credit

Schedule:

Readings	Readings	In Class Discussion	Extra Exercises
Introduction		GE-Annual Report	
Mergers and Acquisitions/ *Consolidations at acquisition**	Ch 2	Biovail-Valeant – Who acquired who?	
Consolidations at acquisition	Ch 2	(2-9,2-10)	(2-11,2-12,2-17,2-19))
Consolidations at acquisition/ *Consolidations after acquisition*	Ch 2	(2-26,2-33)	(2-16,,2-23)
Consolidations after acquisition (Cost & Equity methods)	Ch 3	(3-4,3-7)	
Consolidations after acquisition/ *Partial acquisitions*	Ch 3	(3-9 thru 3-11,3-15)	(3-17,3-18,3-21)
Partial acquisitions	Ch 4	(4-2,4-4,4-12 thru 4-14)	
Partial acquisitions	Ch 4	(4-15 thru 4-19)	
Consolidations – Intercompany Transactions – Land	Ch 5 (pp 203 – 204, 224- – 226)	(5-2, 5-5, 5-10 thru 15)	(5-7, 5-20ab)
Consolidations – Intercompany Transactions – Sales	Ch 5 (pp 203 – 224)	(5-23, 5-24)	(5-20c)
Review	Ch 5 (pp 203 - 224)	(4-26)	(4-22, 4-27)
Taxes	Ch 7 (321-330)		
First Exam – through partial acquisitions		(Chapters 1-4)	
Alternate restructurings	Notes		
Conversions (Current Method)	Ch 10	(10-4, 10-5,10-6 thru 10-9)	
Conversions (Temporal Method)	Ch 10	(10-10,10-11)	(10-15,10-28)
Transactions-Forwards, Fair Value & Cash Flow Hedges	Ch 9 (393-421)	(9-1, 9-4)	
Transactions-Commitments & forecasted Events	Ch 9 (421-430)	(9-9,9-11, 9-12)	(9-11 thru 9-13, 9-29)
Review			
Second Exam (Intercompany transactions & Foreign operations) (Chapters 5, 9-10)			

*Topics in *italics* refer to basic introductory remarks (no immediate assigned reading) offering insights to the primary materials in the next class.

Homework related notes

Several problems and questions include parts about three different accounting methods associated with investments (**prior to consolidation**) – the equity method, the partial equity method and the cost method. The equity methods are typically identical for subsidiary income and dividend flows. The partial equity method and the cost method are typically identical when the focus is on intra-entity transactions.

Additional comments:

Investment Accounting

Ownership	<20%	20-50%	>50%
Available for Sale*	X		
Trading*	X		
Equity Method		X	
Equity Method			X- prior to consolidation
Cost Method			X- prior to consolidation

*Similar to accounting for foreign exchange

Three **consolidation** methods have been used at various times this century. Pooling has been disallowed for new acquisitions since 2001. The purchase method has been disallowed for new acquisitions since December 2008. **The acquisition method is the only acceptable method for new acquisitions today.** We focus on the acquisition method. Many details of the purchase and acquisition methods overlap.

Summary of Consolidation Methods	**Acquisition Method**	**Purchase Method**	**Pooling**
Values of Acquired Assets and Liabilities	**Fair Value**	Mix	Book Value
Type of financial consideration	**Any**	Any	Stock primarily
Amount of financial consideration	**Fair value**	Adjusted fair value	Book Value
Valuation adjustments - 100% acquisition	**100% adjustment**	100% adjustment	None
Valuation adjustments - partial acquisition	**100% adjustment**	Acquired portion only	None
Assets discovered	**More new intangibles**	New intangibles	None
Goodwill	**Possible**	Possible	None
Valuation	**As of change in control**	As of agreement	No change
Consolidation of the subsidiary	**Include only events after the acquisition**	Include only events after the acquisition	Treated as having been together forever

Foreign Currency Activity	Conversions to Dollars for Reporting			Transactions	
	Conversions before Consolidation				Hedging
	Current Method - Translation	**Temporal Method- Remeasurement**	Consolidation In dollars	Spot Market Risk	Forward Markets Neutralizes Risk
	Major Op	Minor Operations			
	Net Assets	Net Monetary Assets			Commitments
	Comp Inc	Income			Forecasted Events

<u>Options and Primary Accounting Impacts</u>

	Minority Investments	Currency Conversions	Hedged Transactions
Income (Gains & Losses)	Trading Securities	Temporal Method	Fair Value Hedges
Accumulated Other Comprehensive Income (AOCI)	Available for Sale Securities	Current Method	Cash Flow Hedges

<u>Dollar Impacts for Changes in Foreign Currency Values</u>

	Foreign Currency Strengthened	Foreign Currency Weakened
Asset	$+ (Gain)	$- (Loss)
Liability	$- (Loss)	$+ (Gain)

	Foreign Currency Hedges Strengthened	Foreign Currency Hedges Weakened
Asset	+ / -	- / +
Liability	- / +	+ / -

Item / Hedge

Do you know the **differences** between and among the following?

Asset writeups and asset valuations at the time of acquisition
Complete and partial acquisitions
Equity, partial equity and cost methods of accounting for majority investments
Accounting for the unconsolidated parent and for the full consolidation
Assets acquired in the initial acquisition and assets acquired through intra-entity transactions thereafter

Upstream transactions and downstream transactions
Adjustments to equity in income of the subsidiary and eliminations
Intangibles and goodwill
Amortization and impairment
Translations and remeasurements
Conversions and transactions
Hedging and speculation
Fair value hedges and Cash Flow Hedges
Commitments and Forecasted Events

Basic Goals and Issues of Each Topic

Topic: **Introduction**

Goal: Course organization, examples of some of the issues

Basic issues: What is a restructuring? What is an acquisition? What is a consolidation?

Question:
Are published financial statements actually consolidated statements?
Classroom discussion case: General Electric financial statements

Expected time: 1 period

Topic: **Consolidations on Acquisition – Acquisition Method – Balance Sheet**

Goal: Understand the fundamental issues of consolidation and financial integration for 100% acquisitions

Basic issues include: Types of acquisitions, cost of acquisitions, valuation of acquired assets, consolidation process

Questions:
How does a parent company's financial statement change as it undergoes the consolidation process?
How does the appraisal value of acquired assets impact the consolidation?
How is the cash flow statement affected by the method of acquisition?

Read: Chapter 2 of text and notes (including representative results based on interactive spreadsheets available on NYU Classes and used in class)

Representative textbook exercises (some may be done in class): 2-9 – 2-18, 2-26, 2-33

Expected time: 3 periods

Topic: **Consolidations – After Date of Acquisition – Income Statement**

Goal: Understand the cost and equity investment methods used by the preconsolidation parent. Understand the impact of time and subsequent events on consolidations of 100% owned subsidiaries. (The cost and equity methods are introduced as investment options in chapter 1)

Basic issues include: Tracking the performance of subsidiaries and income statements, Impact of book value versus fair value valuations (including impairments)

Questions:
Is the subsidiary's income the same as the parent's income earned from the 100% owned subsidiary?
What is the impact of the parent's pre consolidation accounting method on the consolidation?
What is the impact on the cash flow statement?

Read: Chapter 3 and pgs. 270-274 (Cash Flows) of text and notes (including representative results based on interactive spreadsheets available on NYU Classes and used in class)

Representative textbook exercises (some may be done in class): 3-4, 3-7, 3-11 through 3-13, 6-6, 6-7

Expected time: 1-2 periods

Topic: Consolidations – **Partial Acquisitions**

Goal: Understand the impact of partial acquisitions and the presence of noncontrolling interests; Analyze the impact on acquisition and thereafter.

Basic issues include: The difference between consolidated income, noncontrolling interest and the parent's income; the impact of assets and liabilities being reported as wholly owned, but only have partial ownership

Questions:

What is the impact on financial ratios and analysis?
Why would a company acquire only part of a company if they feel it Is a good investment?
Will all owners have the same interests?
Why are some Variable Interest Entities (VIEs) consolidated despite a minority interest?

Read: Chapter 4 through pg. 170,pgs. (251-255) and notes (including representative results based on interactive spreadsheets available on NYU Classes and used in class)

Representative textbook exercises (some may be done in class): 4-2, 4-4, 4-12 through 4-19

Expected time: 3 periods

Topic: Consolidations – **Intercompany Transactions**

Goal: Understand the impact of internal transactions in an integrated firm

Basic issues include: The difference confirmed and unconfirmed transactions; internal pricing decisions; possible divergent interests between the parent and the noncontrolling interests

Questions:

Why do internal transactions have to be removed?
What is the impact of the removal?
Do these transactions still exist in parts of the company even if they are removed in consolidation?
How does internal pricing impact investment decisions and management compensation?

Read: Chapter 5 (pgs. 203-226) and notes (including representative results based on interactive spreadsheets available on NYU Classes and used in class)

Hand in discussion case: Henderson Co. (conflict between management groups)

Representative textbook exercises (some may be done in class): 5-23, 5-24

Expected time: 2 periods

Topic: Consolidations – **Taxes**

Goal: Understand the impact of tax policy on consolidation

Basic issues include: The relationship between tax reporting and financial statement reporting

Questions:

Does the type of acquisition impact the tax basis?
What majority investments cannot be consolidated for tax purposes?
How are internal dividends and unconfirmed internal sales taxed?
How are taxes allocated within the consolidation?

Read: Chapter 7 (pgs. 321-331) and notes (including representative results based on interactive spreadsheets available on NYU Classes and used in class)

Representative textbook exercises (some may be done in class): 5-23, 5-24

Expected time: 1 period

Topic: **Alternate Restructurings**

Goal: Describe restructurings that differ from typical acquisitions and their relationships to acquisitions

Basic issues include: The differences and similarities among spinoffs, splitoffs; IPOs, LBOs, bankruptcy liquidations and bankruptcy fresh starts.

Questions:

Why does one event often lead to another event?
Why are LBOs and Fresh Starts similar to a typical acquisition?
How does a spinoff (splitoff) differ from an acquisition even though it is a 'reversal' of an acquisition?

Read: Chapter 2 (pgs. 170-174) and notes (including representative results based on interactive spreadsheets available on NYU Classes and used in class)

Classroom discussion:

Facebook (IPO)
Sears Holdings (spinoff of Orchard Supply)
Hostess Brands (Chapter 7 liquidation)
General Motors (Chapter 11 Fresh Start)

Expected time: 1 period

Topic: Foreign operations – **Reporting**

Goal: Understand doing business using foreign currencies operating impacts financial statements

Basic issues include: The impact of changes in the exchange rates on company financial statements; the impact of a company's translation methodology decision (current versus temporal) on financial statements; the importance of volume flows; the distinction between monetary accounts and current accounts

Questions:

Are these flows real?
What is the impact of a company's monetary asset position on financial statements?
What rates should be used when converting from one currency to another?
What is the impact of hyperinflation?
How do reporting methodologies compare to those used for minority investments (described in chapter 1)?
How is the subsidiary recorded in the parent's statements preconsolidation?

Read: Chapter 10 (pgs. 457 - 481) and notes (including representative results based on interactive spreadsheets available on NYU Classes and used in class)

Representative textbook exercises (some may be done in class): 10-4 through 10-11

Expected time: 2 periods

Topic: Foreign operations – **Risk Management**

Goal: Understand doing business using foreign currencies tries to reduce financial risk so it can concentrate on its business

Basic issues include: The impact of changes in the exchange rates on the costs of doing business due to changes in rates during incomplete transactions company financial statements; the impact of a company's translation methodology decision (current versus temporal) on financial statements; the importance of volume flows; the distinction between monetary accounts and current accounts

Questions:

How does hedging ameliorate a company's financial risk?
Does a company hedge virtually every activity denominated in foreign currency?
Is hedging perfect?
How do hedging choices and accounting methodologies compare to those used for minority investments (described in chapter 1)?

Read: Chapter 9 and (pgs. 481 - 483) and notes (including representative results based on interactive spreadsheets available on NYU Classes and used in class)

Representative textbook exercises (some may be done in class): 9-1, 9-4, 9-9, 9-11 through 9-13, 9-29, 9-31, 9-32

Expected time: 2 periods