Long-lived Assets: Implications for Financial Statements and Ratios

Test ID: 7440403

Question #1 of 82

Question ID: 462104

In industries where there are rapid changes in technology related to production processes, which of the following characteristics will *most likely* indicate that a firm has a competitive advantage?

✗ **A)** **Low capital expenditures.**

✗ **B)** High earnings per share.

✓ **C)** Low average age of equipment.

Explanation

Average age of depreciable assets is useful for two reasons:

1. To assess how competitive the corporation will be going forward (older assets are less efficient).
2. Estimate financing required for major capital expenditures to replace depreciated assets.

While low capital expenditures may result in higher earnings in the short run, in the long run, the company may find itself at a comparative disadvantage if technological changes are rapidly increasing. EPS is not comparable between companies.

Question #2 of 82

Question ID: 414641

The Mader Corporation leases an asset for five years with lease payments of $10,000 per year. If Mader classifies the lease as a finance lease, which financial statements are affected at the end of the first year?

✗ **A)** **Income statement only.**

✓ **B)** Statement of cash flows, income statement, and balance sheet.

✗ **C)** Income statement and balance sheet only.

Explanation

The classification of a lease as a finance lease creates an asset, a debt obligation, financing cash flows (amortization of the loan), and operating cash flows (interest expense).

Question #3 of 82

Question ID: 462092

Which of the following statements about depreciation is *least accurate*?

✗ **A)** **Return on assets is initially higher using straight-line depreciation than it is using accelerated depreciation.**

✗ **B)** If an asset produces a constant stream of net income over its useful life and is depreciated using the straight-line method, the rate of return on the asset increases over its life.

✓ **C)** For a firm with increasing capital expenditures, accelerated depreciation methods tend to increase both net income and stockholders' equity when compared to straight-line depreciation.

Explanation

For a firm with increasing capital expenditures, accelerated depreciation methods tend to *decrease* both net income and stockholders' equity when compared to straight-line depreciation.

Assuming the firm continues to invest in new assets, the following relationships hold. These relationships will eventually reverse if the firm's capital expenditures decline.

	Straight Line	*Accelerated (DDB & SDY)*
Depreciation Expense	Lower	Higher
Net Income	Higher	Lower
Assets	Higher	Lower
Equity	Higher	Lower
Return on Assets	Higher	Lower
Return on Equity	Higher	Lower

Question #4 of 82

Question ID: 414521

An impairment write-down is *least likely* to decrease a company's:

✗ **A) future depreciation expense.**

✓ **B)** debt-to-equity ratio.

✗ **C)** assets.

Explanation

An impairment write-down reduces equity and has no effect on debt. The debt-to- equity ratio would therefore increase.

Question #5 of 82

Question ID: 414519

Marcel Inc. is a large manufacturing company based in the U.S. but also operating in several European countries. Marcel has long-lived assets currently in use that are valued on the balance sheet at $600 million. This includes previously recognized impairment losses of $80 million. The original cost of the assets was $750 million. The fair value of the assets was determined in a professional appraisal to be $690 million. Assuming that Marcel reports under U.S. GAAP, the new appraisal of the assets' value most likely results in:

✗ **A) an $80 million gain on income statement and $10 million gain in other comprehensive income.**

✗ **B)** a $90 million gain in other comprehensive income.

✓ **C)** no change to Marcel's financial statements.

Explanation

Under U.S. GAAP, long-lived assets are reported on the balance sheet at depreciated cost less any impairment losses ($750 million original cost less $70 million accumulated depreciation and less $80 million impairment loss, for a net amount of $600 million). Increases are generally prohibited with the exception of assets held for sale. Since these assets are currently in use, this exception does not apply. Therefore, Marcel may not revalue the assets upward.

Question #6 of 82

Question ID: 462109

In a sales-type lease, a lessor recognizes a gross profit at the inception of the lease equaling the:

✗ **A)** **sale price of the leased asset plus the present value of the minimum lease payments.**

✓ **B)** present value of the minimum lease payments less the cost of the leased asset.

✗ **C)** sale price of the leased asset less the present value of the minimum lease payments.

Explanation

In a sales-type lease, the implicit interest rate is such that the present value of MLP is the selling price of the asset. At the time of the lease inception, the lessor will recognize a gain equaling the present value of the MLPs, less the cost of the leased asset.

Question #7 of 82

Question ID: 414627

Which of the following statements that classify a lease as a finance lease under U.S. GAAP is *least* accurate?

✗ **A)** **Title is transferred at the end of the lease period.**

✓ **B)** The present value of the lease payments is at least 80% of the fair market value of the asset.

✗ **C)** A bargain purchase option exists.

Explanation

For a lease to be classified as a finance (capital) lease the present value of the lease payments must be at least 90% of the fair market value of the asset.

Question #8 of 82

Question ID: 414513

A firm revalues its long-lived assets upward. All other things equal, which of the following financial impacts is *least likely* to occur?

✓ **A)** **Higher profitability in the periods after revaluation.**

✗ **B)** Lower solvency ratios.

✗ **C)** Higher earnings in the revaluation period.

Explanation

Because the asset has now been increased to a higher depreciable base, there will now be higher depreciation expense and therefore, lower profitability in the periods after revaluation. There could be higher earnings in the revaluation period because there may be impairment losses that can be reversed on the income statement. Otherwise, there will be an adjustment to earnings through other comprehensive income. Solvency ratios (i.e. debt to equity) will decrease since the increase in assets will be balanced by an increase in equity. Higher denominators and unchanged numerators will result in lower solvency ratios.

Question #9 of 82

Question ID: 414489

Capitalized interest costs are typically reported in the cash flow statement as an outflow from:

✗ **A)** **operating.**

✗ **B)** financing.

✓ **C)** investing.

Explanation

Capitalized interest costs are reported as CFI on the statement of cash flows, as they are treated as part of the cost of the constructed capital asset.

Question #10 of 82

Question ID: 414634

Under a finance lease (versus an operating lease) which of the lessee's financial ratios will be higher?

✗ **A)** **Asset turnover.**

✗ **B)** Return on equity.

✓ **C)** Debt/equity.

Explanation

The debt/equity ratio will be higher because the finance lease requires the creation of a long-term liability on the balance sheet.

Question #11 of 82

Question ID: 462074

Statement of Financial Accounting Standard (SFAS) 86 requires that costs incurred to establish the feasibility of computer software must be:

✗ **A)** **capitalized only after the software is completely developed.**

✗ **B)** expensed once the economic feasibility is established.

✓ **C)** viewed like Research & Development (R&D) costs and expensed as incurred.

Explanation

SFAS 86 requires that all the costs incurred in establishing software feasibility be viewed as R&D costs and expensed as incurred. Once technological feasibility has been established, subsequent costs (for software to be sold or leased to others) can be capitalized as part of product inventory.

Question #12 of 82

Question ID: 448956

Lakeside Co. recently determined that one of its processing machines has become obsolete after 7 years of use and, unexpectedly, has no salvage value. The machine was being depreciated over a useful economic life of 10 years. Which of the following statements is *most* consistent with this discovery?

- ✗ **A) Lakeside Co. will owe back taxes.**
- ✗ **B)** Historically, economic depreciation was overstated in the financial statements.
- ✓ **C)** Historically, economic depreciation was understated in the financial statements.

Explanation

Historically, economic depreciation was understated. If an asset becomes obsolete and its useful life is less than expected, accounting methods for depreciation have understated the economic depreciation. In addition, if there is no salvage value when positive salvage value was expected, the understatement problem is compounded.

Question #13 of 82

Question ID: 462065

Train, Inc.'s cash flow from operations (CFO) in 2004 was $14 million. Train paid $8 million cash to acquire a franchise at the beginning of 2004 that was expensed in 2004. If Train had elected to amortize the cost of the franchise over eight years, 2004 cash flow from operations (CFO) would have been:

- ✗ **A) $21 million.**
- ✓ **B)** $22 million.
- ✗ **C)** unchanged.

Explanation

If Train decided to amortize the franchise cost, it would be capitalized and none of the cash expended would flow though CFO, and all of the $8 million would be added back to CFO. Subsequent amortization would be a non-cash expense and would be added back to NI to arrive at CFO.

Questions #14-19 of 82

Management of the Beef, Etc. corporation has changed certain accounting assumptions in hopes of improving the public perception of the company's prospects. These accounting assumptions relate primarily to the treatment of capitalized expenses and long-term leases. Lisa Kelps, CFA, wants to adjust the financial statements to make them more comparable across years and to similar firms in the same industry.

Question #14 of 82

Question ID: 462078

When comparing a company that expenses with a company that capitalizes the same expense, an analyst can adjust the cash flow statement of the company that capitalizes by:

- ✓ **A) increasing cash flow from investing activities and reducing cash flow from operations.**

✗ **B)** increasing cash flow from investing activities and increasing cash flow from operations.

✗ **C)** reducing cash flow from investing activities and reducing cash flow from operations.

Explanation

When adjusting cash flow statement, we want to reverse capitalizing of expenses. For that we reduce cash flow from operations (due to lower net income as expenses are recognized), and reduce cash outflow from investing activities. Reducing cash outflow is the same as increasing cash flow. (LOS 18.a)

Question #15 of 82

Question ID: 462079

When comparing a company that expenses with a company that capitalizes the same expense, an analyst can adjust the earnings before tax of the company that capitalizes by:

✓ **A) subtracting the capitalized expenses and adding back amortization of capitalized expenses.**

✗ **B)** adding the capitalized expenses and adding back amortization of capitalized expenses.

✗ **C)** subtracting the capitalized expenses and subtracting amortization of capitalized expenses.

Explanation

When adjusting the earnings before tax, we want to reverse capitalizing of expenses.

For that we use:

Adj. EBT = EBT − Capitalized exp. + Amortization of Capitalized exp.

(LOS 18.a)

Question #16 of 82

Question ID: 462080

When comparing a company that reports a lease as an operating lease with a company that reports that same lease as a financial lease, the company that reports a lease as an operating lease will *most likely*:

✓ **A) report higher profits, higher return measures and higher solvency in earlier years.**

✗ **B)** report lower profits, higher return measures and lower solvency in earlier years.

✗ **C)** report higher profits, lower return measures and lower solvency in earlier years.

Explanation

Companies that report a lease as an operating lease instead of a finance lease will usually have higher profits in early years due to lower lease expense as compared to sum of depreciation and interest expense under a finance lease. Due to higher reported profits, return measures (Profit Margin, ROA, ROE etc. will be higher). Also, since operating lease does not recognize a liability, solvency measures are higher. (LOS 18.f)

Question #17 of 82

Question ID: 462081

When comparing a company that capitalizes interest costs associated with construction of a new factory, with a company that expenses these costs, the company that capitalizes interest cost is *most likely* to report a:

- ✗ **A) lower interest coverage ratio and lower fixed asset turnover ratio.**
- ✓ **B)** higher interest coverage ratio and lower fixed asset turnover ratio.
- ✗ **C)** higher interest coverage ratio and higher fixed asset turnover ratio.

Explanation

Companies that capitalize interest cost will report lower interest expense (and higher interest coverage ratio) and higher fixed assets (lower fixed asset turnover ratio). (LOS 18.a)

Question #18 of 82

Question ID: 462082

Which of the following statements about fixed assets is *most* accurate?

- ✗ **A) Average remaining life can be estimated as average age minus average useful life.**
- ✗ **B)** Average age can be estimated as sum of average useful life and average remaining life.
- ✓ **C)** Average useful life can be estimated as the sum of average age and average remaining life.

Explanation

Average useful life can be estimated as the sum of average age and average remaining life. (LOS 18.d)

Question #19 of 82

Question ID: 462083

Compared to a company that uses straight line depreciation, a company that uses accelerated depreciation is *most likely* to have:

- ✗ **A) higher activity ratios and stronger solvency ratios.**
- ✗ **B)** lower activity ratios and weaker solvency ratios.
- ✓ **C)** higher activity ratios and weaker solvency ratios.

Explanation

Accelerated depreciation will lead to lower reported income and asset values in early years. The lower income will reduce reported equity (hence weaker solvency ratios) and lower asset values will increase the fixed-asset turnover (activity) ratios. (LOS 18.d)

Question #20 of 82

Question ID: 462108

A firm using straight-line depreciation reports the following financial information:

- Gross investment in fixed assets of $89,167,205.
- Accumulated depreciation of $35,341,773.
- Annual depreciation expense of $3,885,398.

The approximate age of the fixed assets is:

✓ **A) 9.10 years.**

✗ **B)** 22.95 years.

✗ **C)** 2.52 years.

Explanation

Average age of fixed assets = accumulated depreciation / annual depreciation = $35,341,773 / $3,885,398 = 9.10.

Question #21 of 82

Question ID: 462066

Which of the following is *least likely* to be a problem with accounting for internally generated intangible assets?

✗ **A) Costs of developing these assets may not be easily separable.**

✓ **B)** The potential benefits are spread over a long time period.

✗ **C)** Determining the economic life.

Explanation

The problems with accounting for internally generated intangible assets are: determination of economic life and separation of the cost for development.

Question #22 of 82

Question ID: 462073

Income statement information for Quick Corp. for the years ended December 31, 20X0 and 20X1 was as follows (in $ millions):

	20X0	*20X1*
Sales	30,000,000	32,000,000
Cost of Goods Sold	(16,000,000)	(17,000,000)
Gross Profit	14,000,000	15,000,000
Amortization of Franchise	(1,500,000)	(1,500,000)
Other Expenses	(7,000,000)	(7,000,000)
Net Income	5,500,000	6,500,000

Quick acquired a franchise in 20X0 for $15,000,000 and elected to amortize the cost over 10 years. Ignoring taxes, if Quick had expensed the franchise cost in 20X0 instead of amortizing it, net income for 20X0 and 20X1 would be:

	20X0	20X1
✓ **A)**	**-$8,000,000**	**$8,000,000**
✗ **B)**	-$8,000,000	$6,500,000
✗ **C)**	-$9,500,000	$8,000,000

Explanation

If the franchise cost were expensed, amortization would be eliminated and franchise expense would be fully taken in 20X0. 20X0 net income would be $5,500,000 + 1,500,000 - $15,000,000= -$8,000,000, and 20X1 net income would be $6,500,000 + $1,500,000= $8,000,000.

Questions #23-28 of 82

Doug Dalby, CFA and Luke Brown, CFA are consulting to the executive board of Housekeeping Enterprises (Housekeeping) concerning strategic changes to the company's balance sheet.

Housekeeping is considering changing its inventory accounting method to FIFO from LIFO. Dalby briefs the board on the effect of falling/rising prices and stable or increasing inventory quantities, on cost of goods sold and cash flows, depending on inventory accounting method.

Housekeeping would like to capitalize various costs it had previously been expensed, but is worried about the change being refused by its auditors. The board asks Brown which costs are most likely to be capitalized under U.S. GAAP.

Question #23 of 82

Question ID: 462085

If Housekeeping uses last in, first out (LIFO) reports an inventory balance of $44,000 and a LIFO reserve of $8,000 (assume a 40% effective tax rate), the estimated value for the inventory on a first in, first out (FIFO) basis would be closest to:

✗ **A)** **$36,000.**

✗ **B)** $48,800.

✓ **C)** $52,000.

Explanation

FIFO INV = LIFO INV + LIFO Reserve
X = 44,000 + 8,000
X = 52,000

The effective tax rate is not used in this calculation.

(Study Session 5, LOS 17.b)

Question #24 of 82

Question ID: 462086

In periods of rising prices and stable or increasing inventory quantities, a company using LIFO rather than FIFO will report cost of goods sold which is:

✓ **A)** **higher.**

✗ **B)** lower.

✗ **C)** the same.

Explanation

In this situation, LIFO results in higher cost of goods sold because it uses the more recent and higher costs than FIFO. (Study Session 5, LOS 17.a)

Question #25 of 82

Question ID: 462087

In periods of rising prices and stable or increasing inventory quantities, a company using LIFO rather than FIFO will report cash flows which are:

✗ **A)** **lower.**

✗ **B)** the same.

✓ **C)** higher.

Explanation

LIFO results in higher cash flows because with lower reported income, income tax will be lower. (Study Session 5, LOS 17.a)

Question #26 of 82

Question ID: 462088

If Housekeeping changed policy and capitalizes some costs instead of expensing them, the company will:

✗ **A)** **have a higher reported income initially, with lower income levels to follow invariably.**

✓ **B)** have a higher reported income as long as capitalized expenditures exceed depreciation on them.

✗ **C)** have a lower reported income initially, with higher income levels to follow invariably.

Explanation

If management decides to capitalize costs instead of expensing them, it will report higher income as long as such capitalized expenses exceed the depreciation of such expenses in later periods. (Study Session 5, LOS 18.a)

Question #27 of 82

Question ID: 462089

Compared to capitalizing, expensing these costs will result in:

✗ **A)** **lower asset levels and higher equity levels.**

✓ **B)** lower asset levels and lower equity levels.

✗ **C)** lower asset levels and lower liability levels.

Explanation

Expensing instead of capitalizing results in lower assets. Since the entire expense is recognized in the current period (whereas only a portion of the expenditure is amortized when capitalizing), net income (and therefore equity, via retained earnings) is lower with expensing than with capitalizing. Liabilities are unaffected. (Study Session 5, LOS 18.a)

Question #28 of 82

Question ID: 462090

Under U.S. Generally Accepted Accounting Principles (GAAP), which of the following costs associated with intangible assets is *most likely* to be capitalized?

✗ **A)** **Research and development costs associated with software development.**

✗ **B)** The costs associated with an internally created trademark.

✓ **C)** The cost of an acquisition of a patent from an outside entity.

Explanation

The cost of an acquisition of a patent from an outside entity is correct because this cost may be capitalized. When patents and copyrights are internally developed, only the legal fees incurred for registration can be capitalized. However, if the patents and copyrights are purchased from other entities, full acquisition cost can be capitalized. (Study Session 5, LOS 18.a)

Question #29 of 82

Question ID: 462076

Under U.S. generally accepted accounting principles (GAAP), which of the following costs associated with intangible assets is *most likely* to be capitalized?

✓ **A)** **The cost of an acquisition of a patent from an outside entity.**

✗ **B)** The costs associated with an internally created trademark.

✗ **C)** Research and development costs associated with software development.

Explanation

The cost of an acquisition of a patent from an outside entity is correct because this cost may be capitalized.

Question #30 of 82

Question ID: 414635

On the lessee's cash flow statement, the principal portion of a finance lease payment is a:

✗ **A)** **operating cash flow.**

✓ **B)** financing cash flow.

✗ **C)** investing cash flow.

Explanation

The principal portion of a finance lease payment is a financing cash outflow for the lessee. The interest portion is an operating cash outflow.

Question #31 of 82

Question ID: 462094

Meyer Investment Advisory and Smith Brothers Investments are operationally identical except that Meyer capitalizes some costs that Smith expenses. Compared to Smith, Meyer is likely to have:

✗ **A)** **higher debt/equity ratio and higher debt/assets ratio.**

✓ **B)** higher cash flows from operations and lower cash flow from investing.

✗ **C)** lower profitability (ROA & ROE) in early years and higher in later years.

Explanation

The net cash flow remains the same regardless of which accounting method is used. But components of cash flows change and cash flows from operations (CFO) will be higher when costs are capitalized and lower when expensed. On the other hand, cash flows from investing (CFI) will be lower when costs are capitalized and higher when expensed. Compared to firms expensing costs, firms that capitalize costs will have smaller debt to equity ratios and higher initial ROAs, but lower ROAs in the future.

Question #32 of 82

Question ID: 414632

For a finance lease, the amount recorded initially by the lessee as a liability will *most likely*:

✓ **A)** **equal the present value of the minimum lease payments at the beginning of the lease.**

✗ **B)** be less than the fair value of the leased asset.

✗ **C)** equal the total of the minimum lease payments.

Explanation

With a finance lease, both an asset and liability are reported on the lessee's balance sheet, with lease payments divided between interest and principal components. The future payments on principal and interest must be discounted to present value at the beginning of the lease.

Question #33 of 82

Question ID: 414639

If a lessee enters into a finance lease rather than an operating lease, it can expect to have a:

✗ **A)** **higher return on assets.**

✗ **B)** lower debt-to-equity ratio.

✓ **C)** higher debt-to-equity ratio.

Explanation

Leasing the asset with an operating lease avoids recognition of the debt on the lessee's balance sheet. Having fewer assets and liabilities on the balance sheet than would exist if the assets were purchased increases profitability ratios (e.g., return on assets) and decreases leverage ratios (e.g., debt-to-equity ratio). In the case of a finance lease, the assets are reported on the balance sheet and are depreciated.

Question #34 of 82

Question ID: 462093

For firms that expense rather than capitalize costs, which of the following statements is *least* accurate?

✗ **A)** **Net cash flows are the same regardless of which method is used.**

✗ **B)** Higher debt/equity and debt/assets will occur because of lower asset and equity levels.

✓ **C)** Lower ROA and ROE will occur because of higher asset and equity levels in the early years.

Explanation

Firms that expense costs rather than capitalize costs will have lower ROE and lower ROA in early years. This occurs because of lower profits and not because of higher assets and equity levels. Actually, the assets and equity are lower due to expensing the costs.

Question #35 of 82

Question ID: 414522

An analyst determined the following information concerning Franklin, Inc.'s stamping machine:

- Acquired seven years ago for $22 million
- Straight line method used for depreciation
- Useful life estimated to be 12 years
- Salvage value originally estimated to be $4 million

The stamping machine is expected to generate $1,500,000 per year for five more years and will then be sold for $1,000,000. Under U.S. GAAP, the stamping machine is:

✗ **A)** **impaired because expected salvage value has declined.**

✓ **B)** impaired because its carrying value exceeds expected future cash flows.

✗ **C)** not impaired.

Explanation

The carrying value of the stamping machine is its cost less accumulated depreciation. Depreciation taken through 7 years was ($22,000,000 - $4,000,000) / 12 × 7 = $10,500,000, so carrying value is $22,000,000 - $10,500,000 = $11,500,000. Because the $11,500,000 carrying value is more than expected future cash flows of (5 × $1,500,000) + $1,000,000 = $8,500,000, the stamping machine is impaired.

Question #36 of 82

Question ID: 462106

Two companies in the same industry are similar in all aspects except that the average age of the depreciable assets for Company B is 10 times greater than the average age of the depreciable assets for Company A. Which of the following statements is *least likely* accurate? Company B will have:

✗ **A)** **higher taxes.**

✗ **B)** lower depreciation expense.

✓ **C)** a competitive advantage in the future.

Explanation

Company A will most likely have a competitive advantage from using newer equipment on average. Company B's assets are mostly depreciated. Therefore, depreciation expense will be lower and if all other aspects are similar, the earnings and taxes for Company B will be higher.

Question #37 of 82

Question ID: 462091

Roger Margotta, the CFO of Brainchild, Inc., is considering several alternative methods of depreciation for long-term assets. With respect to double-declining method of depreciation, which of the following statements is the *most* accurate?

- ✗ **A)** **Asset turnover ratio will decrease over the life of the asset.**
- ✗ **B)** Current ratio will increase over the life of the asset.
- ✓ **C)** Return on Investment will increase over the life of the asset.

Explanation

With the use of any accelerated method of depreciation, the deductions in assets and net income are greatest in the early years. For DDB, the greatest impact is year 1. After year 1, net income will increase, increasing ROI.

Question #38 of 82

Question ID: 414645

Classifying a lease as an operating lease for a lessee, as opposed to a finance lease, will result in:

	Current Ratio	Debt/Equity Ratio	Asset Turnover Ratio
✗ **A)**	**Higher**	**Lower**	**Lower**
✗ **B)**	Lower	Lower	Higher
✓ **C)**	Higher	Lower	Higher

Explanation

For a lessee using operating leases, the current ratio will be higher, the debt/equity ratio will be lower, and the asset turnover will be higher than they would be with finance leases. With operating leases, assets and liabilities are lower.

Question #39 of 82

Question ID: 462105

An analyst will *most likely* use the average age of depreciable assets to estimate the company's:

- ✓ **A)** **near-term financing requirements.**
- ✗ **B)** earnings potential.
- ✗ **C)** cash flows.

Explanation

Average age of depreciable assets is useful for two reasons:

1. To assess how competitive the corporation will be going forward (older assets are less efficient).
2. To estimate financing required for major capital expenditures in the near-term to replace depreciated assets.

Question #40 of 82

Question ID: 462110

Which of the following statements about leasing is *least* accurate?

✗ **A)** **Firms that capitalize their leases will have lower current ratios and higher debt to equity ratios than firms that structure their leases as operating leases.**

✓ **B)** If the lessor is only financing the purchase of an asset, the lease is considered to be a direct financing lease and gross profits are recognized at the inception of the lease.

✗ **C)** The interest rate implicit in a lease is the discount rate that the lessor used to determine the lease payments.

Explanation

With a direct financing lease, the lessor recognizes profit as interest revenue over the life of the lease. A sales-type lease allows the lessor to recognize profits at the lease inception.

Question #41 of 82

Question ID: 462107

Ending gross investment/depreciation expense is used to estimate the average:

✗ **A)** **age as a percent of depreciable life.**

✓ **B)** depreciable life.

✗ **C)** age.

Explanation

Average depreciable life is approximated by: ending gross investment / depreciation expense

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Question #42 of 82

Question ID: 414485

When comparing capitalizing versus expensing costs which of the following statements is *most* accurate?

✓ **A)** **Capitalizing costs creates higher cash flows from operations and lower cash flows from investing.**

✗ **B)** Capitalizing costs creates lower cash flows from operations and higher cash flows from investing.

✗ **C)** Expensing costs creates lower cash flows from operations and lower cash flows from investing.

Explanation

Although net cash flows are not affected by the choice of capitalization or expensing, the components of cash flow are affected. Because, a firm that capitalizes classifies the expenditure as investing (not operations), cash flow from operations will be higher for firms that capitalize and investing cash flows will be lower than that of an expensing firm.

Question #43 of 82

Question ID: 414633

Compared to an operating lease, a lessee using a finance lease is *least likely* to have:

✗ **A)** **lower net income in the earlier years of the lease.**

✗ **B)** a lower current ratio.

✓ **C)** higher cash flow from financing during the lease period.

Explanation

Since a portion of the lease payment is treated as repayment of principal under a finance lease, cash flow from financing will be lower.

Question #44 of 82

Question ID: 414497

A company is switching from straight-line depreciation to an accelerated method of depreciation. Assuming all other revenue and expenses are at the same levels for the next period, switching to an accelerated method will *most likely* increase the company's:

✗ **A)** **net income/sales ratio.**

✓ **B)** fixed asset turnover ratio.

✗ **C)** total assets on the balance sheet.

Explanation

The use of an accelerated depreciation method will increase depreciation expenses early in the asset's life. The book value of the asset will be lower. Fixed asset turnover ratio (sales/fixed assets) will increase, because the book value of the fixed assets will be lower.

Question #45 of 82

Question ID: 462071

Compared with firms that expense costs, firms that capitalize costs can be expected to report:

✗ **A)** **lower asset levels and higher equity levels in the early years of the asset's life.**

✗ **B)** higher asset levels and lower equity levels in the early years of the asset's life.

✓ **C)** higher asset levels and higher equity levels in the early years of the asset's life.

Explanation

The capitalized cost is recorded as an asset, which is then expensed in the form of depreciation over future years. Spreading the depreciation out over future years causes net income to increase along with retained earnings and equity in the early years of the asset's life.

Question #46 of 82

Question ID: 414486

Which of the following statements regarding capitalizing versus expensing costs is *least* accurate?

✓ **A)** **Total cash flow is higher with capitalization than expensing.**

✗ **B)** Capitalization results in higher profitability initially.

✗ **C)** Cash flow from investing is higher with expensing than with capitalization.

Explanation

Total cash flow is higher with capitalization than expensing is least accurate because total cash flow would be the same under both methods, not considering tax implications.

Question #47 of 82

Question ID: 414631

In a direct-financing lease, the implicit rate is such that the present value of the minimum lease payments:

✓ **A) equals the cost of the leased asset.**

✗ **B)** is lower than the cost of the leased asset.

✗ **C)** equals the sale price of the leased asset.

Explanation

In a direct-financing lease, the implicit rate is such that the present value of the MLPs equals the cost of the leased asset. Thus, at lease inception the total assets do not change and no gain is recognized.

Question #48 of 82

Question ID: 414488

Capitalizing interest costs related to a company's construction of assets for its own use is *required* by:

✓ **A) both IFRS and U.S. GAAP.**

✗ **B)** IFRS only.

✗ **C)** U.S. GAAP only.

Explanation

Both U.S. GAAP and IFRS require companies to capitalize the interest that accrues during a the construction of capital assets for their own use.

Question #49 of 82

Question ID: 414638

Which of the following statements about leases is *least* accurate?

✗ **A) In the first years of a finance lease, the lessee's debt to equity ratio is greater than it would have been if the firm had used an operating lease.**

✗ **B)** All else equal, when a lease is capitalized the lessee's income will rise over the term of the lease.

✓ **C)** In the first years of a finance lease, the lessee's current ratio is greater than it would have been had the firm used an operating lease.

Explanation

From the lessee's perspective, if a lease is considered to be a *finance lease* instead of an operating lease, then the lessee's *current liabilities will be greater* until the lease has expired. This will result in a *lower current ratio* (larger denominator).

In the early years, the *capitalized lease expense* (interest plus depreciation) is greater than in the later years because interest expense decreases over time. Less expenses = more income.

In the first years of a finance lease the lessee's debt to equity ratio will be greater than if the firm had used an operating lease because in the case of the finance lease, the numerator is comprised of (debt + lease), while the numerator in the case of the operating lease is (debt) only. In addition, the greater capitalized lease expense flows through to decrease shareholder's equity (the denominator).

Question #50 of 82

Question ID: 414491

A firm that capitalizes rather than expensing costs will have:

- ✗ **A)** **lower profitability in the earlier years.**
- ✗ **B)** lower cash flows from operations.
- ✓ **C)** lower cash flows from investing.

Explanation

A firm that capitalizes costs classifies them as an investing cash flow rather than an operating cash flow. Investing cash flows will be lower and cash flow from operations will be higher when costs are capitalized.

Question #51 of 82

Question ID: 414487

Which of the following statements regarding the capitalization of an expense is *least accurate*?

- ✗ **A)** **Capitalized expenses increases equity.**
- ✓ **B)** Capitalizing an expense lowers current period net income.
- ✗ **C)** Capitalizing an expense creates an asset.

Explanation

Capitalizing expenses reduces current period expenses by the amount capitalized. The amount capitalized is added to assets which increases equity by increasing net income and retained earnings in the current period.

Question #52 of 82

Question ID: 462069

Selected information from Yorktown Corp.'s financial statements for the year ended December 31, 2004 was as follows (in $ millions):

Accounts Payable	8
Long-term Debt	9
Common Stock	17
Retained Earnings	23
Total Liabilities & Equity	57

In 2004, Yorktown paid $10 million cash to purchase a franchise. The franchise cost was fully expensed in 2004. If the company had elected to amortize the franchise cost over 5 years instead of expensing it, Yorktown's debt ratio would (ignoring taxes):

✗ **A)** **increase from 0.158 to 0.184.**

✗ **B)** decrease from 0.184 to 0.138.

✓ **C)** decrease from 0.158 to 0.138.

Explanation

The debt ratio is the ratio of total debt (which excludes accounts payable) to total assets. Total assets must equal total liabilities and equity. Yorktown's total debt ratio was Total debt / Total assets = $9 / $57 = 0.158. If the franchise cost were amortized, retained earnings would increase by $8 million ($10 cost, less $10/5 = $2 million of amortization.) The debt ratio would decrease to $9 / ($57 + $8) = 0.138.

Question #53 of 82

Question ID: 414490

Dobkin Company decides to expense costs that it would have otherwise capitalized. Compared to capitalizing, expensing these costs will result in:

✗ **A)** **lower asset levels and lower liability levels.**

✗ **B)** lower asset levels and higher equity levels.

✓ **C)** lower asset levels and lower equity levels.

Explanation

Expensing instead of capitalizing results in lower assets. Since the entire expense is recognized in the current period (whereas only a portion of the expenditure is amortized when capitalizing), net income (and therefore equity, via retained earnings) is lower with expensing than with capitalizing. Liabilities are unaffected.

Question #54 of 82

Question ID: 414622

The lessee has an incentive to classify a lease as an operating lease, rather than as a finance lease, because an operating lease:

✗ **A)** **has no risk involved because the lessor assumes all risk.**

✗ **B)** has payments that are less than a capital lease's payments.

✓ **C)** does not appear on the balance sheet.

Explanation

Having less assets and liabilities on the balance sheet than would exist if the asset were purchased increases profitability ratios (e.g., return on assets) and decreases leverage ratios (e.g., the debt to equity ratio).

Question #55 of 82

Question ID: 462067

Under U.S. GAAP, which statement is CORRECT?

- ✗ **A) Goodwill cannot be recognized and capitalized in a purchase transaction.**
- ✗ **B)** Research and development costs are not expensed.
- ✓ **C)** Purchased patent and copyright costs are not expensed.

Explanation

Purchased patent and copyright costs are not expensed is correct because these costs are capitalized.

Questions #56-61 of 82

A manufacturing firm reports the following in its financial statements:

- Gross plant and equipment: $2,700,000.
- Depreciation expense: $235,000.
- Accumulated depreciation: $1,850,000.

Question #56 of 82

Question ID: 462098

The average useful life of plant and equipment is *closest to*:

- ✓ **A) 11.5 years.**
- ✗ **B)** 15.4 years.
- ✗ **C)** 19.4 years.

Explanation

The average useful life = gross investment / depreciation expense

$2,700,000 / $235,000 = 11.49.

(LOS 18.d)

Question #57 of 82

Question ID: 472477

The average age of plant and equipment is *closest to*:

- ✗ **A) 19.4 years.**
- ✗ **B)** 11.5 years.
- ✓ **C)** 7.9 years.

Explanation

The average age = accumulated depreciation / depreciation expense

$1,850,000 / $235,000 = 7.87

(LOS 18.d)

Question #58 of 82

Question ID: 462100

The average remaining life of plant and equipment is *closest to*:

- ✓ **A) 3.6 years.**
- ✗ **B)** 11.5 years.
- ✗ **C)** 7.9 years.

Explanation

The average remaining life = average useful life − average age = 11.49 − 7.87 = 3.62 years.

Average remaining life = Net PP&E / annual depreciation = (2,700,000 − 1,850,000) / 235,000 = 3.62. (LOS 18.d)

Question #59 of 82

Question ID: 462101

The impairment loss recognized under U.S. GAAP is *most likely* equal to the difference between the asset's carrying value and:

- ✗ **A) fair value minus selling cost, subject to a recoverability test.**
- ✗ **B)** value in use, subject to a recoverability test.
- ✓ **C)** fair value, subject to a recoverability test.

Explanation

U.S. GAAP impairment loss recognition is a 2-step process. Step 1: Recoverability test. Step 2: Loss measurement = carrying value − fair value or carrying value − PV of future cash flows. (LOS 18.c)

Question #60 of 82

Question ID: 462102

The impairment loss recognized under IFRS is *most accurately* described as the difference between carrying value and:

- ✗ **A) fair value.**
- ✗ **B)** value in use minus selling cost.
- ✓ **C)** fair value minus selling cost.

Explanation

IFRS impairment measurement = carrying value − (fair value − selling costs) or carrying value − value in use. (LOS 18.c)

Question #61 of 82

Question ID: 462103

Recognition of an impairment loss would improve which of the following ratios?

- ✗ **A) Current year net profit margin.**
- ✓ **B)** Future ROE.
- ✗ **C)** Current year ROA.

Explanation

An impairment loss would reduce the current year's net income but would lead to lower depreciation expense. This would lower current year net profit margin, ROA and ROE. However future ROE would improve due to lower depreciation expense in the future. (LOS 18.c)

Question #62 of 82

Question ID: 462075

Under U.S. Generally Accepted Accounting Principles (GAAP), development cost of patents and copyrights can be capitalized:

✗ **A)** **when developed internally.**

✓ **B)** when purchased from other entities.

✗ **C)** when purchased or developed internally but excluding registration costs.

Explanation

When patents and copyrights are internally developed, only the legal fees incurred for registration can be capitalized. However, if the patents and copyrights are purchased from other entities, full acquisition cost can be capitalized.

Question #63 of 82

Question ID: 462096

Taking an impairment of long-lived assets will result in:

✗ **A)** **increased deferred tax liabilities.**

✗ **B)** decreased debt/equity ratio.

✓ **C)** increased future ROA.

Explanation

In future years, less depreciation expense is recognized on the written-down asset resulting in higher net income and return on assets since ROA = NI/Total Assets. Deferred tax liabilities related to the asset decrease because the impairment cannot be deducted from taxable income until the asset is sold or disposed of. The debt/equity ratio increases because equity decreases while debt is unchanged.

Question #64 of 82

Question ID: 462095

Selected information from Ingot Company's financial statements for the year ended December 31, 20X4, was as follows prior to the consideration of its impaired asset write-down (in $):

Cash	120,000	Short-term Debt	290,000
Accounts Receivable	200,000	Long-term Debt	740,000
Inventory	300,000	Common Stock	800,000
Property Plant & Eq. (net)	1,700,000	Retained Earnings	490,000
	2,320,000		2,320,000

Ingot Company's excavation machine is permanently impaired. Its purchase price was $1,600,000 and its accumulated depreciation was $800,000 through 20X4. The present value of its future cash flows is $500,000.

The write-down of the excavation machine will cause Ingot's total debt ratio (total debt-to-total capital) to:

✓ **A) increase from 0.44 to 0.51.**

✗ **B)** decrease from 0.44 to 0.40.

✗ **C)** increase from 0.44 to 0.48.

Explanation

The write-down of the excavation machine in the amount of ((($1,600,000 − $800,000) − $500,000) =) $300,000 decreases retained earnings from $490,000 to $190,000. The total debt to total captital ratio increases from (($290,000 + $740,000) / ($290,000 + $740,000 + $800,000 + $490,000) =) 0.44 to (($290,000 + $740,000) / ($290,000 + $740,000 + $800,000 + $190,000) =) 0.51.

Question #65 of 82

Question ID: 414512

Davis Inc. is a large manufacturing company operating in several European countries. Davis has long-lived assets currently in use that are valued on the balance sheet at $600 million. This includes previously recognized impairment losses of $80 million. The original cost of the assets was $750 million. The fair value of the assets was determined by in independent appraisal to be $690 million. Which of the following entries may Davis record under IFRS?

✓ **A) $80 million gain on income statement and a $10 million revaluation surplus.**

✗ **B)** $90 million gain on income statement.

✗ **C)** $90 million revaluation surplus.

Explanation

Under IFRS, firms may choose to report long-lived assets at fair value. Upward revaluations are permitted and will result in a gain recognized on the income statement to the extent it reverses a previously recognized loss. Any excess is reported as a revaluation surplus, a direct adjustment to equity. In this case, the carrying value of the assets is $600 million ($750 million original cost less $70 million accumulated depreciation and less $80 million impairment loss). The fair value is $690 million. Of the $90 million excess of fair value over carrying value, $80 million is recognized as a gain on the income statement to reverse the $80 million impairment loss that was previously recognized. The remaining $10 million is recorded as a revaluation surplus in shareholders' equity.

Question #66 of 82

Question ID: 414626

Under an operating lease (versus a finance lease) which of the following is higher for the lessee?

✓ **A) Cash flow from financing.**

✗ **B)** Assets.

✗ **C)** Cash flow from operations.

Explanation

The lessee's cash flows from financing will be higher for an operating lease because the payments made for an operating lease are operating cash outflows, not financing cash outflows. The payments made under a finance lease are split between interest paid and principal. The latter is charged to cash flow from financing.

Question #67 of 82

Question ID: 414644

Which of the following statements regarding finance and operating leases is *least* accurate?

✓ **A)** **For financial reporting of finance and operating leases, no entry is required on the lessee's balance sheet at the inception of the lease.**

✗ **B)** Asset turnover is higher for the lessee with an operating lease than a finance lease.

✗ **C)** During the life of an operating lease, the rent expense equals the lease payment.

Explanation

If the lease is an operating lease there is no entry made on the balance sheet for the lessee. For finance leases, the leased asset and liability are recognized on the balance sheet by the amount equal to the present value of the minimum lease payments using as the discount rate the lower of the lessor's implicit rate or the lessee's incremental borrowing rate.

Question #68 of 82

Question ID: 414520

Under U.S. GAAP, an asset is impaired when:

✗ **A)** **accumulated depreciation plus salvage value exceeds acquisition costs.**

✗ **B)** the present value of future cash flows exceeds the carrying amount of the asset.

✓ **C)** the firm can no longer fully recover the carrying amount of the asset.

Explanation

An asset is impaired if its future cash flows (undiscounted) are less than its carrying value.

Question #69 of 82

Question ID: 462072

The management of Berger Investments has changed their policy and will capitalize some costs instead of expensing them. Due to the new policy, Berger will:

✗ **A)** **report a smooth income pattern initially, but income variability will increase over time.**

✓ **B)** have smoother reported income over time.

✗ **C)** have lower income variability as it grows, but the variability will increase as the firm matures.

Explanation

If management decides to capitalize costs instead of expensing them, it will report smoother reported income over time. If the firm decided to expense costs as incurred, it will have greater variability in reported income. This variability declines as the firm matures and is lower for larger firms.

Question #70 of 82

Question ID: 414629

Which of the following is *least likely* one of the criteria under U.S. GAAP for classifying a lease as a finance lease? The:

- ✗ **A)** **term of the lease is 75% or more of the estimated economic life of the leased property.**
- ✗ **B)** lease contains a bargain purchase option.
- ✓ **C)** lessor retains ownership of the property at the end of the lease term.

Explanation

If the lease transfers ownership of the property to the lessee at the end of the lease term, the lessee will classify the lease as a finance lease.

Question #71 of 82

Question ID: 414637

For a given lease payment and term, which of the following is *least accurate* regarding the effects of the classification of the lease as a finance lease as compared to an operating lease?

- ✗ **A)** **The lessee's asset turnover will be lower for a finance lease.**
- ✓ **B)** The lessee's current ratio will be higher for a finance lease.
- ✗ **C)** The lessee's debt-to-equity ratio will be higher for a finance lease.

Explanation

The lessee's current ratio will be lower because the current portion of the finance lease increases current liabilities, hence reducing the current ratio.

Question #72 of 82

Question ID: 414642

Which of the following statements regarding a direct financing lease is *least* accurate?

- ✗ **A)** **The lessor recognizes no gross profit at the inception of the lease.**
- ✓ **B)** Interest revenue on the lessor's income statement equals the implicit interest rate times the lease payment.
- ✗ **C)** The principal portion of the lease payment is a cash inflow from investing on the lessor's cash flow statement.

Explanation

Interest revenues are calculated by multiplying the implicit interest rate by net receivables at the beginning of the period.

Question #73 of 82

Question ID: 414623

Compared to a finance lease, an operating lease is *most likely* to be favored when:

✗ **A) at the end of the lease, the lessee may be better able to sell the asset than the lessor.**

✓ **B)** the lessee has bond covenants relating to financial policies.

✗ **C)** management compensation is not based on returns on invested capital.

Explanation

If the lessee has bond covenants (e.g., debt-to-equity ratio) relating to its financial policies that it must follow, it is best to have an operating lease due to the fact that the operating lease will keep the asset off of the balance sheet resulting in less liabilities.

Question #74 of 82

Question ID: 414518

As part of a major restructuring of business units, General Security (an industrial conglomerate operating solely in the U.S. and subject to U.S. GAAP) recognizes significant impairment losses. The Investor Relations group is preparing an informational packet for shareholders, employees, and the media. Which of the following statements is *least* accurate?

✗ **A) During the year of the write-downs, retained earnings and deferred taxes will decrease.**

✓ **B)** Write-downs taken on asset values can be reversed in later years if market conditions improve.

✗ **C)** The write-downs are reported as a component of income from continuing operations.

Explanation

Impairments cannot be restored under U.S. GAAP. Both remaining statements are correct.

Question #75 of 82

Question ID: 448955

Which of the following statements comparing straight-line depreciation methods to alternative depreciation methods is *least* accurate? Companies that use:

✓ **A) accelerated depreciation methods will have lower asset turnover ratios than if they used straight line depreciation.**

✗ **B)** straight-line depreciation methods will have higher book values for the assets on the balance sheet than companies that use accelerated depreciation.

✗ **C)** accelerated depreciation methods for tax purposes will decrease the amount of taxes paid in early years.

Explanation

Accelerated depreciation will lead to lower book values and hence a higher asset turnover ratio.

Question #76 of 82

Question ID: 414625

An analyst compares two companies that are identical except that Company X uses finance leases and Company Y uses operating leases. The analyst would expect Company X's debt-to-equity ratio, relative to Company Y's, to be:

✓ **A)** **higher.**

✗ **B)** lower.

✗ **C)** the same.

Explanation

Lease capitalization adds both current and noncurrent liabilities to debt, resulting in a corresponding increase in the debt-to-equity and other leverage ratios. Thus, Company X's (Debt + Lease)/Equity is greater than Company Y's Debt/Equity.

Question #77 of 82

Question ID: 462068

Selected information from Willingham Corp.'s financial statements for the year ended December 31 included the following (in $ millions):

Accounts Payable	12
Long-term Debt	32
Common Stock	10
Retained Earnings	16
Total Liabilities and Equity	70

During the year, Willingham paid $14 million cash to purchase a franchise and fully expensed the franchise cost. If the company had elected to amortize the franchise cost over 7 years instead of expensing it, Willingham's total asset-to-equity ratio would be *closest to:*

✗ **A)** **3.15.**

✓ **B)** 2.16.

✗ **C)** 1.84.

Explanation

Given that total assets must equal total liabilities and equity, Willingham's total asset-to-equity ratio was 70 / (10 + 16) = 2.69. If the franchise cost were amortized, retained earnings would be $12 million higher ($14 million cost less 14 / 7 = $2 million of amortization). The total asset-to-equity ratio would decrease to (70 + 12) / (10 + 16 + 12) = 2.16.

Question #78 of 82

Question ID: 414636

If a lease is treated as a finance lease, as compared to being treated as an operating lease, the effect on the lessee's current ratio and the debt/equity ratio will be an:

	Current Ratio	Debt/Equity Ratio
✗ **A)**	**Increase**	**Increase**
✓ **B)**	Decrease	Increase

✗ **C)** Increase Decrease

Explanation

With finance leases the lessee's assets, current liabilities, and long-term liabilities will be greater than if the lease was an operating lease. With the debt to equity ratio, the liability is in the numerator, which results in an increase in the ratio. With the current ratio, current liabilities are increased and are in the denominator which results in a decrease in the ratio.

Question #79 of 82

Question ID: 462070

Compared to firms that expense costs, firms that capitalize expenses will have:

- ✗ **A)** **higher leverage ratios.**
- ✗ **B)** lower cash flow from operations.
- ✓ **C)** lower income variablity.

Explanation

Firms that capitalize expenses have less variability of net income because the capitalized expense becomes an asset that is depreciated over years instead of all at once which happens when costs are expensed. Capitalizing expenses will result in higher cash flows from operations because capitalizing an expense becomes an investing cash flow instead of an operating cash flow which occurs when expenditures are expensed. Firms that capitalize expenses have lower leverage ratios because assets and equity are increased so any leverage ratio that have assets and equity in the denominator will decrease.

Question #80 of 82

Question ID: 462064

Selected information from the financial statements of Salvo Company for the years ended December 31, 2003 and 2004 is as follows (in $ millions):

	2003	*2004*
Sales	$21	$23
Cost of Goods Sold	(8)	(9)
Gross Profit	13	14
Cost of Franchise	(6)	0
Other Expenses	(6)	(6)
Net Income	$1	$8
Cash	$4	$5
Accounts Receivable	6	5
Inventory	9	7

Property, Plant & Equip. (net)	12	15
Total Assets	$31	$32
Accounts Payable	$7	$5
Long-term Debt	10	5
Common Stock	8	8
Retained Earnings	6	14
Total Liabilities and Equity	$31	$32

Salvo's return on average total equity for 2004 was ($8 / (($8 + $6) + ($8 + $14)) / 2 =) 44.4%.

If Salvo had amortized the cost of the franchise acquired in 2003 over six years instead of expensing it, Salvo's return on average total equity for 2004 would have decreased from 44.4% to:

✓ **A) 31.1%.**

✗ **B)** 35.6%.

✗ **C)** 38.9%.

Explanation

If the franchise cost had been amortized over six years beginning in 2003, net income in 2003 would have been $6 million instead of $1 million due to the cost of franchise expense of $6 million being eliminated and replaced by franchise amortization of $1 million. Net income in 2004 would have been reduced by the franchise amortization to $7 million instead of $8 million. On the equity side, retained earnings at the end of 2003 would have been $11 million ($5 million higher), and total equity for 2003 would have been ($8 + $11 =) $19 million. Retained earnings for 2004 would be the 2003 retained earnings of $11 million increased by 2004 net income of $7 million for a total of $18 million, and total equity for 2004 would be ($8 + $18 =) $26 million. If the franchise cost were amortized, return on total equity for 2004 would be ($7 / ((19 + 26) / 2 =) 31.1%.

Question #81 of 82

Question ID: 414640

Which of the following statements regarding the effect of a finance lease on the lessee's statement of cash flows is *least* accurate?

✗ **A) The change in the finance lease liability on the balance sheet is a cash flow from financing.**

✗ **B)** The interest expense portion of the lease payments reduces cash flow from operations.

✓ **C)** The rental expense serves to reduce the cash flow for financing because it is an investment expense.

Explanation

In finance leases, there is only interest expense and principal repayment. Rental expense is only charged when the lease is an operating lease.

Question #82 of 82

Question ID: 414628

Which of the following statements about the impact of leases on the financial statements of the lessee is *least* accurate?

✗ **A)** **A finance lease results in higher liabilities compared to an operating lease.**

✓ **B)** Cash flow from investing is higher for a finance lease than an operating lease.

✗ **C)** Net income is lower in the early years of a finance lease than an operating lease.

Explanation

Cash flow from investing is *not* affected by a lease being either a finance or an operating lease. Finance leases reduce cash flow from operations by only the portion of the lease payment attributed to interest expense. Cash flow from financing is reduced by the rest of the finance lease payment which is the principal part of the payment.