Reading 29: Long-lived Assets

Question #1 of 70

Question ID: 496422

An IFRS-reporting firm reclassifies a building it owns from "owner-occupied" to "investment property." The fair value of the building is greater than its carrying value. Under the fair value model for investment property, the firm will recognize a gain:

- ✗ **A)** in other comprehensive income but not on the income statement.
- ✗ **B)** equal to the difference between fair value and carrying value.
- ✓ **C)** only if it reverses a previously recognized loss.

Explanation

When reclassifying a property from owner-occupied to investment property and using the fair value model for valuation of investment property, IFRS specifies that the firm should treat the event as a revaluation, recognizing a gain only if it reverses a previously recognized loss.

References

Question From: Session 8 > Reading 29 > LOS n

Related Material:

- Key Concepts by LOS

Question #2 of 70

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)** a $90 million gain in other comprehensive income.
- ✗ **B)** an $80 million gain on income statement and $10 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.

References

Question From: Session 8 > Reading 29 > LOS k

Related Material:

- Key Concepts by LOS

Question #3 of 70

Question ID: 598969

Accelerated depreciation methods for financial reporting are *most likely* to have which of the following effects on a company's financial ratios during the early years of an asset's life?

- ✗ **A)** Lower debt-to-equity ratio.
- ✓ **B)** Higher asset turnover ratio.
- ✗ **C)** Lower current ratio.

Explanation

Given the higher depreciation expense recorded in the early years under accelerated depreciation methods, total assets will be lower, causing a higher asset turnover ratio versus straight-line.

References

Question From: Session 8 > Reading 29 > LOS e

Related Material:

- Key Concepts by LOS

Question #4 of 70

Question ID: 683865

Train, Inc.'s cash flow from operations (CFO) in 20X8 was $14 million. Train paid $8 million cash to acquire a franchise at the beginning of 20X8 that was expensed in 20X8. If Train had elected to amortize the cost of the franchise over eight years, 20X8 cash flow from operations (CFO) would have been:

- ✗ **A)** $21 million.
- ✗ **B)** $14 million.
- ✓ **C)** $22 million.

Explanation

If Train decided to amortize the cost, the franchise would be capitalized as a balance sheet asset and the cash outflow would have been classified as CFI. As a result CFO would have been $8 million higher, or $14 million + $8 million = $22 million. Amortization would be a non-cash expense.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS

Question #5 of 70

Question ID: 498760

In accounting for PP&E using the cost model, companies are required to disclose both gross asset value and accumulated depreciation under:

- ✗ **A)** IFRS but not U.S. GAAP.
- ✗ **B)** U.S. GAAP but not IFRS.
- ✓ **C)** both IFRS and U.S. GAAP.

Explanation

Both IFRS and US GAAP require disclosure of gross asset values and accumulated depreciation.

References

Question From: Session 8 > Reading 29 > LOS l

Related Material:

- Key Concepts by LOS

Question #6 of 70

Question ID: 414502

Novak, Inc. owns equipment with a historical cost of $20,000, a useful life of 5 years, and an estimated salvage value of $5,000. Using the double declining balance method, depreciation expense in Year 3 for this equipment is:

- ✗ **A)** $3,000.
- ✓ **B)** $2,200.
- ✗ **C)** $2,880.

Explanation

DDB depreciation in each year is 2/5 of the carrying value at the beginning of the year, until the carrying value reaches the estimated salvage value.

Year 1 DDB depreciation = $20,000 × 2/5 = $8,000
Carrying value = $20,000 - $8,000 = $12,000

Year 2 DDB depreciation = $12,000 × 2/5 = $4,800
Carrying value = $12,000 - $4,800 = $7,200

Year 3 DDB depreciation = $7,200 × 2/5 = $2,880
Because $7,200 - $2,880 = $4,320 would depreciate the equipment below its salvage value, depreciation in Year 3 is limited to $7,200 - $5,000 = $2,200.

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS

Question #7 of 70

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.

References

Question From: Session 8 > Reading 29 > LOS i

Related Material:

- Key Concepts by LOS

Question #8 of 70

Question ID: 414487

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

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

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.

References

Question From: Session 8 > Reading 29 > LOS a

Related Material:

- Key Concepts by LOS

Question #9 of 70

Question ID: 414525

Felker Inc. owns a piece of specialized machinery. The original cost of the machinery was $500,000 and to date there is an accumulated depreciation balance of $140,000. Which of the following will Felker recognize on its income statement if it sells the machinery for $400,000?

- ✗ **A)** Loss of $360,000.
- ✓ **B)** Gain of $40,000.
- ✗ **C)** Loss of $100,000.

Explanation

With a sale of an asset to a third party, the difference between the proceeds and carrying value is reported as a gain or loss on the income statement. The carrying value is $360,000, which equals the original cost ($500,000) less the accumulated depreciation ($140,000). Therefore, the gain is equal to $40,000 ($400,000 proceeds less $360,000 carrying value).

References

Question From: Session 8 > Reading 29 > LOS j

Related Material:

- Key Concepts by LOS

Question #10 of 70

Question ID: 414506

Slovac Company purchased a machine that has an estimated useful life of eight years for $7,500. Its salvage value is estimated at $500.

What is the depreciation expense for the second year, assuming Slovac uses the double-declining balance method of depreciation?

✓ **A)** $1,406.

✗ **B)** $1,875.

✗ **C)** $1,438.

Explanation

double-declining balance depreciation rate = 2 × 1/8 = ¼ or 25%

first year deprecation will be $7,500 × 0.25 = $1,875

second year deprecation will be ($7,500 − $1,875) × 0.25 = $1,406

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS

Question #11 of 70

Question ID: 598971

Which of the following is *best* estimated by the ratio of net PP&E to annual depreciation expense?

✓ **A)** Remaining useful life.

✗ **B)** Average age.

✗ **C)** Total useful life.

Explanation

Remaining useful life = ending net PP&E / annual depreciation expense.

References

Question From: Session 8 > Reading 29 > LOS m

Related Material:

- Key Concepts by LOS

Question #12 of 70

Question ID: 414501

Walsh Furniture has purchased a machine with a 7-year useful life for $250,000. At the end of its life it will have an estimated salvage value of $15,000. Using the double-declining balance (DDB) method, depreciation expense in year 2 is *closest* to:

✗ **A)** $71,430.

✗ **B)** $58,750.

✓ **C)** $51,020.

Explanation

Year	*2 / Depreciable Life*	*× Book Value at Beginning of the Year*	*= Depreciation*
1	0.2857	250,000	71,429
2	0.2857	178,571	51,020

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS

Question #13 of 70

Question ID: 414524

Spenser Inc. owns a piece of specialized machinery with a current fair value of $400,000. The original cost of the machinery was $500,000 and to date has generated accumulated depreciation of $140,000. Which of the following must Spenser record on the income statement if it decides to abandon the asset?

✗ **A)** Loss of $100,000.

✗ **B)** Gain of $40,000.

✓ **C)** Loss of $360,000.

Explanation

With an abandonment of an asset, the carrying value of the machinery is removed from the balance sheet and a loss of that amount is recognized in the income statement. The carrying value is $360,000, which equals the original cost ($500,000) less the accumulated depreciation ($140,000).

References

Question From: Session 8 > Reading 29 > LOS j

Related Material:

- Key Concepts by LOS

Question #14 of 70

Question ID: 414520

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

- ✗ **A)** accumulated depreciation plus salvage value exceeds acquisition costs.
- ✓ **B)** the firm can no longer fully recover the carrying amount of the asset.
- ✗ **C)** the present value of future cash flows exceeds the carrying amount of the asset.

Explanation

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

References

Question From: Session 8 > Reading 29 > LOS i

Related Material:

- Key Concepts by LOS

Question #15 of 70

Question ID: 683863

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 and 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 will be higher when costs are capitalized and lower when expensed. On the other hand, cash flows from investing 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.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS

Question #16 of 70

Question ID: 598970

The average age of a firm's property, plant, and equipment can be estimated by dividing:

- ✓ **A)** accumulated depreciation by depreciation expense.

- ✗ **B)** net PP&E by depreciation expense.
- ✗ **C)** gross PP&E by depreciation expense.

Explanation

Average age = accumulated depreciation / annual depreciation expense.

References

Question From: Session 8 > Reading 29 > LOS m

Related Material:

- Key Concepts by LOS

Question #17 of 70

Question ID: 414449

Blocher Company is evaluating the following methods of accounting for depreciation of long-lived assets and inventory:

- Depreciation: straight-line; double-declining balance (DDB)
- Inventory: first in, first out (FIFO); last in, first out (LIFO)

Assuming a deflationary environment (prices are falling), which of the following combinations will result in the highest net income in year 1?

- ✓ **A)** Straight-line; LIFO.
- ✗ **B)** DDB; FIFO.
- ✗ **C)** Straight-line; FIFO.

Explanation

For year 1, straight-line depreciation will be lower than DDB. During deflationary periods, LIFO will result in lower cost of goods sold and hence higher income.

References

Question From: Session 8 > Reading 29 > LOS e

Related Material:

- Key Concepts by LOS

Question #18 of 70

Question ID: 496421

Under IFRS, if a firm reports investment property using the fair value model, unrealized gains and losses on investment property are:

- ✗ **A)** recognized in other comprehensive income.
- ✓ **B)** recognized on the income statement.
- ✗ **C)** disclosed in the financial statement notes.

Explanation

Under the fair value model for investment property, unrealized gains and losses are recognized on the income statement.

References

Question From: Session 8 > Reading 29 > LOS n

Related Material:

- Key Concepts by LOS

Question #19 of 70

Question ID: 598976

With a finance lease, which party recognizes depreciation expense on the leased asset?

✗ **A)** Both the lessor and the lessee.

✓ **B)** The lessee.

✗ **C)** The lessor.

Explanation

On the lessee's financial statements, a finance lease is treated like a purchase with debt. The lessee adds the asset to its balance sheet along with a liability for the lease obligation and recognizes depreciation expense on the leased asset. The lessor removes the leased asset from its balance sheet and recognizes a lease receivable.

References

Question From: Session 8 > Reading 29 > LOS p

Related Material:

- Key Concepts by LOS

Question #20 of 70

Question ID: 414521

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

✗ **A)** assets.

✗ **B)** future depreciation expense.

✓ **C)** debt-to-equity ratio.

Explanation

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

References

Question From: Session 8 > Reading 29 > LOS k

Related Material:

- Key Concepts by LOS

Question #21 of 70

Question ID: 414485

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

- ✗ **A)** Capitalizing costs creates lower cash flows from operations and higher cash flows from investing.
- ✗ **B)** Expensing costs creates lower cash flows from operations and lower cash flows from investing.
- ✓ **C)** Capitalizing costs creates higher 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.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS

Question #22 of 70

Question ID: 598974

Under IFRS, the principal portion of a finance lease payment:

- ✗ **A)** is recognized as CFI by both the lessor and the lessee.
- ✗ **B)** may be recognized as CFO by either the lessor or the lessee.
- ✓ **C)** is recognized as CFF by the lessee and CFI by the lessor.

Explanation

The principal portion of a finance lease is treated like an amortizing loan and classified as a CFF outflow by the lessee (i.e., the borrower) and a CFI inflow by the lessor (i.e., the lender). Under IFRS the interest portion (not the principal portion) of a finance lease payment may be classified as CFO or CFF by the lessee and as CFO or CFI by the lessor.

References

Question From: Session 8 > Reading 29 > LOS p

Related Material:

- Key Concepts by LOS

Question #23 of 70

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

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

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.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS

Question #24 of 70

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 its carrying value exceeds expected future cash flows.

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

✗ **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.

References

Question From: Session 8 > Reading 29 > LOS i

Related Material:

- Key Concepts by LOS

Question #25 of 70

Question ID: 414508

Intangible assets with finite useful lives are:

✗ **A)** not amortized, but are tested for impairment at least annually.

✓ **B)** amortized over their expected useful lives.

✗ **C)** amortized over their actual lives.

Explanation

Intangible assets with finite lives are amortized over their expected useful lives, which is an estimate. Actual lives of intangible assets are often not known in advance. Intangible assets with infinite lives are not amortized, but are tested for impairment at least annually.

References

Question From: Session 8 > Reading 29 > LOS f

Related Material:

- Key Concepts by LOS

Question #26 of 70

Question ID: 683864

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

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

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.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS

Question #27 of 70

Question ID: 434298

Three years ago, Ranchero Corporation purchased equipment for a process used in production, for £3 million. At the end of last year, Ranchero determined the fair value of the equipment was greater than its book value. No impairment losses have been recognized on the equipment. Assuming Ranchero follows International Financial Reporting Standards, what is the impact on its total asset turnover ratio and return on equity of reporting the value of the equipment on the balance sheet at fair value?

- ✗ **A)** Only one will increase.
- ✗ **B)** Both will increase.
- ✓ **C)** Both will decrease.

Explanation

Increasing the value of the equipment on the balance sheet will increase assets and thus decrease the total asset turnover ratio (higher denominator). Increasing the value of the equipment will also increase equity, otherwise, the balance sheet equation would not balance. Increasing equity will result in lower ROE (higher denominator). The increase in the value of the equipment is not recognized in the income statement unless it is reversing a previously recognized write-down.

References

Question From: Session 8 > Reading 29 > LOS k

Related Material:

- Key Concepts by LOS

Question #28 of 70

Question ID: 598972

Compared to a firm that purchases a PP&E asset for cash and capitalizes the asset, a firm that leases the same asset with an operating lease will have lower:

- ✓ **A)** long-lived assets.
- ✗ **B)** long-term liabilities.
- ✗ **C)** current liabilities.

Explanation

With an operating lease, the lessee does not recognize a long-lived asset on its balance sheet. Neither an operating lease nor a capitalized purchase for cash involves a balance sheet liability.

References

Question From: Session 8 > Reading 29 > LOS o

Related Material:

- Key Concepts by LOS

Question #29 of 70

Question ID: 414492

Which of the following items is *least likely* an example of an intangible asset with an indefinite life?

- ✗ **A)** Trademarks that can be renewed at minimal cost.
- ✗ **B)** Goodwill.
- ✓ **C)** Acquired patents.

Explanation

Acquired patents are most likely purchased with the intent to use over a specific period of time and therefore would be an example of an intangible asset with a finite life. Goodwill, by definition, is an intangible asset with an indefinite life. Trademarks that can be renewed at minimal cost are also considered to be intangible assets with infinite lives.

References

Question From: Session 8 > Reading 29 > LOS b

Related Material:

- Key Concepts by LOS

Question #30 of 70

Question ID: 498759

For impaired long-lived assets, a firm reporting under IFRS is *least likely* required to disclose the:

- ✗ **A)** amounts of impairment losses and reversals by asset class.
- ✗ **B)** circumstances that caused the impairment losses or reversals.
- ✓ **C)** estimated probabilities of reversing impairment losses.

Explanation

Under IFRS, firms with impaired assets must disclose the amounts of impairment losses and reversals by asset class, the circumstances that caused the impairment losses or reversals, and where the losses or reversals are recognized on the income statement.

References

Question From: Session 8 > Reading 29 > LOS l

Related Material:

- Key Concepts by LOS

Question #31 of 70

Question ID: 652915

On January 1, 20X4, Cayman Corporation bought manufacturing equipment for $30 million. On December 31, 20X6, Cayman determined the equipment was impaired and recognized a $5 million impairment loss in its income statement. As of December 31, 20X7, the fair value of the equipment exceeded the book value by $7 million. Cayman may recognize a gain in its 20X7 income statement if it reports under:

- ✗ **A)** neither IFRS nor U.S. GAAP.
- ✓ **B)** IFRS, but not U.S. GAAP.
- ✗ **C)** either IFRS or U.S. GAAP.

Explanation

U.S. GAAP does not permit upward valuations of plant and equipment. Under IFRS, the recovery is reported in the income statement to the extent that the previous downward adjustment (loss) was reported in net income. Any further increase in value is reported as revaluation surplus in shareholders' equity.

References

Question From: Session 8 > Reading 29 > LOS h

Related Material:

- Key Concepts by LOS

Question #32 of 70

Question ID: 414488

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

- ✗ **A)** IFRS only.
- ✗ **B)** U.S. GAAP only.
- ✓ **C)** both IFRS and U.S. GAAP.

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.

References

Question From: Session 8 > Reading 29 > LOS a

Related Material:

- Key Concepts by LOS

Question #33 of 70

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

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.

References

Question From: Session 8 > Reading 29 > LOS g

Related Material:

- Key Concepts by LOS

Question #34 of 70

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 equity levels.
- ✗ **B)** lower asset levels and lower liability levels.
- ✗ **C)** lower asset levels and higher 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.

References

Question From: Session 8 > Reading 29 > LOS a

Related Material:

- Key Concepts by LOS

Question #35 of 70

Question ID: 414529

A firm acquires investment property for □3 million and chooses the fair value model for financial reporting. In Year 1 the market value of the investment property decreases by □150,000. In Year 2 the market value of the investment property increases by □200,000. On its financial statements for Year 2, the firm will recognize a:

✓ **A)** □200,000 gain on its income statement.

✗ **B)** □150,000 gain on its income statement and a □50,000 revaluation surplus in shareholders' equity.

✗ **C)** □150,000 increase in shareholders' equity.

Explanation

Under the fair value model, all gains and losses from changes in the value of investment property are recognized on the income statement. The firm will recognize a loss of □150,000 in Year 1 and a gain of □200,000 in Year 2.

References

Question From: Session 8 > Reading 29 > LOS n

Related Material:

- Key Concepts by LOS

Question #36 of 70

Question ID: 414523

U.S. GAAP *least likely* requires property, plant, and equipment to be tested for impairment:

✗ **A)** when events indicate the firm may not recover the asset's carrying value.

✗ **B)** when an asset is reclassified as held-for-sale.

✓ **C)** at least annually.

Explanation

Under U.S. GAAP, a PP&E asset is tested for impairment when events and circumstances indicate the firm may not recover its carrying value through future use, or if the asset is reclassified from held-for-use to held-for-sale. Under IFRS, firms are also required to assess at least annually whether events and circumstances indicate impairment may have occurred.

References

Question From: Session 8 > Reading 29 > LOS i

Related Material:

- Key Concepts by LOS

Question #37 of 70

Question ID: 460646

In the early years of an asset's life, a firm that chooses an accelerated depreciation method instead of using straight-line depreciation will tend to have:

- ✗ **A)** lower depreciation expense and lower turnover ratios.
- ✓ **B)** lower net income and lower equity.
- ✗ **C)** higher return on equity and higher return on assets.

Explanation

These relationships are reversed in the later years of the asset's life if the firm's capital expenditures decline.

References

Question From: Session 8 > Reading 29 > LOS e

Related Material:

- Key Concepts by LOS

Question #38 of 70

Question ID: 414491

A firm that capitalizes rather than expensing costs will have:

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

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS

Question #39 of 70

Question ID: 462071

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

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

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS

Question #40 of 70

Question ID: 414500

JME acquired an asset on January 1, 2004, for $60,000 cash. At that time JME estimated the asset would last 10 years and have no salvage. During 2006 JME estimated the remaining life of the asset to be only three more years with a salvage value of $3,000. If JME uses straight line depreciation, what is the depreciation expense for 2006?

- ✗ **A)** $6,000.
- ✗ **B)** $12,000.
- ✓ **C)** $15,000.

Explanation

first two years = (60,000 − 0) / 10 = 6,000 per year

yr. 2006 = (60,000 − 12,000 − 3,000) / 3 = 15,000

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS

Question #41 of 70

Question ID: 414517

For a firm to use the revaluation model for balance sheet reporting of long-lived assets:

- ✗ **A)** the firm must choose which assets of each type to revalue, and which to report at cost.
- ✗ **B)** the firm must report under U.S. GAAP.
- ✓ **C)** an active market must exist for the assets.

Explanation

Under IFRS, a firm may use the revaluation model for long-lived assets that have an active market which can be used to determine the fair value of the assets. The firm must use the same model for all assets of a similar type. U.S. GAAP reporting firms must use the cost model for long-lived assets.

References

Question From: Session 8 > Reading 29 > LOS h

Related Material:

- Key Concepts by LOS

Question #42 of 70

Question ID: 485778

The *most likely* result of increasing the estimated useful life of a depreciable asset is that:

- ✗ **A)** asset turnover will increase.
- ✗ **B)** return on assets will decrease.
- ✓ **C)** net profit margin will increase.

Explanation

The longer the estimated useful life of an asset, the lower the annual depreciation expense charged to operations. Lower depreciation expense results in higher net income, profit margins, and contributions to shareholder's equity.

References

Question From: Session 8 > Reading 29 > LOS g

Related Material:

- Key Concepts by LOS

Question #43 of 70

Question ID: 498758

A company acquires an intangible asset for $100,000 and expects it to have a value of $20,000 at the end of its 5-year useful life. If the company amortizes the asset using the double-declining balance method, amortization expense in year 4 of the asset's useful life is *closest* to:

- ✗ **A)** $6,910.
- ✓ **B)** $1,600.
- ✗ **C)** $8,640.

Explanation

Net book value at the end of year 3 is $100,000 × 3/5 × 3/5 × 3/5 = $21,600. DDB amortization in year 4 of 2/5 × $21,600 = $8,640 would amortize the asset below its salvage value, so amortization expense is the remaining $1,600 that will amortize net book value to $20,000.

References

Question From: Session 8 > Reading 29 > LOS f

Related Material:

- Key Concepts by LOS

Question #44 of 70

Question ID: 414507

Allocating an intangible asset's cost to the income statement over time is known as:

✓ **A)** amortization.

✗ **B)** depletion.

✗ **C)** depreciation.

Explanation

Allocating an intangible asset's cost to the income statement over time is known as amortization. The same process is known as depreciation for tangible assets. For natural resources, allocation of cost to the income statement over time is commonly referred to as depletion.

References

Question From: Session 8 > Reading 29 > LOS f

Related Material:

- Key Concepts by LOS

Question #45 of 70

Question ID: 414510

Schubert, Inc. acquires 100% of another firm. As a result of the acquisition, Schubert reports on its balance sheet 1) a patent with five years remaining and a carrying value of $2 million and 2) goodwill with a carrying value of $4 million. Using the straight-line method, total amortization expense in the first year for these two intangible assets is:

✗ **A)** $1,200,000.

✗ **B)** $800,000.

✓ **C)** $400,000.

Explanation

Amortization expense for the patent is $2 million / 5 = $400,000. Goodwill is an intangible asset with an indefinite life and is not amortized.

References

Question From: Session 8 > Reading 29 > LOS f

Related Material:

- Key Concepts by LOS

Question #46 of 70

Question ID: 598975

Cash flows from an operating lease are recognized as:

- ✗ **A)** CFF by the lessee and CFO by the lessor.
- ✗ **B)** CFO by the lessee and CFI by the lessor.
- ✓ **C)** CFO by both the lessor and the lessee.

Explanation

Rental payments on an operating lease are an operating cash outflow for the lessee and an operating cash inflow for the lessor.

References

Question From: Session 8 > Reading 29 > LOS p

Related Material:

- Key Concepts by LOS

Question #47 of 70

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)** total assets on the balance sheet.
- ✓ **B)** fixed asset turnover ratio.
- ✗ **C)** net income/sales ratio.

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.

References

Question From: Session 8 > Reading 29 > LOS e

Related Material:

- Key Concepts by LOS

Question #48 of 70

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)** accelerated depreciation methods for tax purposes will decrease the amount of taxes paid in early years.
- ✗ **C)** straight-line depreciation methods will have higher book values for the assets on the balance sheet than companies that use accelerated depreciation.

Explanation

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

References

Question From: Session 8 > Reading 29 > LOS e

Related Material:

- Key Concepts by LOS

Question #49 of 70

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.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS

Question #50 of 70

Question ID: 496420

The revaluation model for investment property is permitted under:

- ✗ **A)** both IFRS and U.S. GAAP.
- ✗ **B)** IFRS, but not U.S. GAAP.
- ✓ **C)** neither IFRS nor U.S. GAAP.

Explanation

For long-lived assets classified as investment property, IFRS allows either the cost model or the fair value model. The revaluation model is permitted for long-lived assets that are not classified as investment property. U.S. GAAP only permits the cost model for valuation of long-lived assets and does not identify investment property as a specific subset of long-lived assets.

References

Question From: Session 8 > Reading 29 > LOS n

Related Material:

- Key Concepts by LOS

Question #51 of 70

Question ID: 414499

On January 1, 2004, JME purchased a truck that cost $24,000. The truck had an estimated useful life of 5 years and $4,000 salvage value. The amount of depreciation expense recognized in 2006 assuming that JME uses the double declining balance method is:

- ✗ **A)** $4,000.
- ✗ **B)** $5,760.
- ✓ **C)** $3,456.

Explanation

yr. 2004 = 24,000 × 2/5 = 9,600

yr. 2005 = (24,000 − 9,600) × 2/5 = 5,760

yr. 2006 = (24,000 − 9,600 − 5,760) × 2/5 = 3,456

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS

Question #52 of 70

Question ID: 498757

La Crosse Partners LLC has a franchise agreement with Arnolds Crispy Fry that expires in seven years, but is renewable at each expiration date for a nominal fee. If the franchise agreement is initially valued at $60,000:

- ✓ **A)** amortization expense in the sixth year will be zero.
- ✗ **B)** amortization expense in the first year will be one-seventh of $60,000.
- ✗ **C)** an accelerated amortization method is more appropriate than the straight-line method.

Explanation

Because the franchise agreement is renewable for a nominal fee, it is treated as an intangible asset with an indefinite life and therefore not amortized but tested for impairment regularly.

References

Question From: Session 8 > Reading 29 > LOS f

Related Material:

- Key Concepts by LOS

Question #53 of 70

Question ID: 414505

This information pertains to equipment owned by Brigade Company.

- Cost of equipment: $10,000.

- Estimated residual value: $2,000.
- Estimated useful life: 5 years.
- Depreciation method: straight-line.

The accumulated depreciation at the end of year 3 is:

✓ **A)** $4,800.
✗ **B)** $5,200.
✗ **C)** $1,600.

Explanation

Accumulated depreciation at the end of year 3 = [($10,000 − $2,000) / 5] × 3 = $4,800

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS

Question #54 of 70

Question ID: 414509

Under normal circumstances, intangible assets with indefinite lives are:

✗ **A)** amortized over a reasonable period and subject to impairment.
✗ **B)** amortized over a reasonable period but not subject to impairment.
✓ **C)** not amortized but subject to impairment.

Explanation

Intangible assets with indefinite lives are not amortized but are subject to impairment charges. Under such situations, there may be in impairment in the asset value where events and circumstances indicate that the firm may not be able to recover the carrying value through future use. Examples include significant declines in market value of the asset or significant deterioration in the asset's physical condition.

References

Question From: Session 8 > Reading 29 > LOS f

Related Material:

- Key Concepts by LOS

Question #55 of 70

Question ID: 414511

Stannum Records obtains two intangible assets in a business acquisition: legal rights to reproduce songs, valued at $5 million, and a trademark valued at $1 million. The trademark expires in 10 years and can be renewed at a minimal cost. Stannum estimates a 5-year useful life for the song rights. Because much of the songs' economic value is realized in their early years, Stannum uses double-declining balance amortization. Amortization expense in the first year after the acquisition is *closest to*:

✓ **A)** $2.0 million.

✗ **B)** $2.1 million.

✗ **C)** $2.2 million.

Explanation

Because the trademark can be renewed at minimal cost, it should be treated as an intangible asset with an indefinite life: the asset is not amortized but is tested for impairment at least annually. For the song rights, DDB depreciation in the first year = 2/5 × $5 million = $2 million.

References

Question From: Session 8 > Reading 29 > LOS f

Related Material:

- Key Concepts by LOS

Question #56 of 70

Question ID: 414503

Czernezyk Company buys a delivery vehicle for □60,000. Czernezyk expects to drive the vehicle 400,000 kilometers over 4 years, at the end of which the firm expects to be able to sell the vehicle for □10,000. At the end of Year 2, the vehicle has been driven 250,000 kilometers. If Czernezyk depreciates the vehicle by the units of production method, its carrying value at the end of Year 2 is:

✓ **A)** □28,750.

✗ **B)** □31,250.

✗ **C)** □15,000.

Explanation

Depreciation per unit of production = (□60,000 - □10,000) / 400,000 km = □0.125 per kilometer. Through year 2, depreciation expense = □0.125 × 250,000 = □31,250. Carrying value at the end of Year 2 = □60,000 - □31,250 = □28,750.

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS

Question #57 of 70

Question ID: 414527

Lucille Edgewater, CFA, is analyzing Pfaff Company, which reports its long-lived assets using the revaluation model. Edgewater needs to determine 1) what Pfaff's carrying value of property, plant and equipment would be under the historical cost model, and 2) which of Pfaff's intangible assets have finite useful lives. Will these items be disclosed in Pfaff's financial statements?

✗ **A)** Neither of these items is required to be disclosed.

✓ **B)** Both of these items are required to be disclosed.

✗ **C)** Only one of these items is required to be disclosed.

Explanation

Under IFRS, firms that use the revaluation model for PP&E must disclose its carrying value under the historical cost model. Firms must also disclose whether the useful lives of intangible assets are finite or indefinite.

References

Question From: Session 8 > Reading 29 > LOS l

Related Material:

- Key Concepts by LOS

Question #58 of 70

Question ID: 683867

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

- ✗ **A)** a lower debt-to-equity ratio.
- ✓ **B)** higher future return on assets.
- ✗ **C)** higher deferred tax liabilities.

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-to-equity ratio increases because equity decreases while debt is unchanged.

References

Question From: Session 8 > Reading 29 > LOS k

Related Material:

- Key Concepts by LOS

Question #59 of 70

Question ID: 598977

With an operating lease, the leased asset appears on the balance sheet of:

- ✗ **A)** neither the lessor nor the lessee.
- ✗ **B)** the lessee.
- ✓ **C)** the lessor.

Explanation

With an operating lease, the leased asset remains on the lessor's balance sheet and the lessor recognizes depreciation expense on the asset.

References

Question From: Session 8 > Reading 29 > LOS p

Related Material:

- Key Concepts by LOS

Question #60 of 70

Question ID: 414528

A building owned by a firm is *most likely* to be classified as investment property if:

✓ **A)** space in the building is rented to other firms.

✗ **B)** the firm uses the building for its corporate headquarters.

✗ **C)** the building is a manufacturing plant or distribution center.

Explanation

Under IFRS, investment property is an asset that is owned for the purpose of earning income from rentals, capital appreciation, or both.

References

Question From: Session 8 > Reading 29 > LOS n

Related Material:

- Key Concepts by LOS

Question #61 of 70

Question ID: 598973

Compared to a firm that purchases a long-lived asset for cash and capitalizes the asset, a firm that leases the same asset with a finance lease will have:

✗ **A)** higher long-lived assets.

✓ **B)** higher liabilities.

✗ **C)** lower expenses in the period the asset is acquired.

Explanation

With a finance lease, the lessee recognizes both an asset and a liability on its balance sheet. When capitalizing a purchase, the buyer recognizes an asset but not a liability. In either case the firm will recognize depreciation expense on the asset, but with a finance lease the firm will also recognize interest expense on the liability.

References

Question From: Session 8 > Reading 29 > LOS o

Related Material:

- Key Concepts by LOS

Question #62 of 70

Question ID: 683868

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

✓ **A)** near-term financing requirements.

- ✗ **B)** cash flows.
- ✗ **C)** earnings potential.

Explanation

Average age of depreciable assets is useful for estimating financing required for major capital expenditures in the near term to replace depreciated assets.

References

Question From: Session 8 > Reading 29 > LOS m

Related Material:

- Key Concepts by LOS

Question #63 of 70

Question ID: 496419

For a firm that uses the cost basis for valuing its long-lived assets, fair value is a consideration when calculating a gain or loss on:

- ✗ **A)** abandoning an asset.
- ✗ **B)** selling an asset.
- ✓ **C)** exchanging an asset.

Explanation

When exchanging one long-lived asset for another, a gain or loss is recorded as the difference between the old asset's carrying value and its fair value (or the fair value of the asset received in exchange, if that value is more evident). When selling an asset, the gain or loss is the difference between the carrying value and the cash received. When abandoning an asset, a firm records a loss equal to the carrying value of the asset.

References

Question From: Session 8 > Reading 29 > LOS j

Related Material:

- Key Concepts by LOS

Question #64 of 70

Question ID: 414526

Which set of accounting standards requires firms to disclose estimated amortization expense for the next five years on intangible assets?

- ✗ **A)** Both IFRS and U.S. GAAP.
- ✓ **B)** U.S. GAAP.
- ✗ **C)** IFRS.

Explanation

Estimated amortization expense for the next five years is required by U.S. GAAP but is not required by IFRS.

References

Question From: Session 8 > Reading 29 > LOS l

Related Material:

- Key Concepts by LOS

Question #65 of 70

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)** Lower solvency ratios.
- ✓ **B)** Higher profitability in the periods after revaluation.
- ✗ **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.

References

Question From: Session 8 > Reading 29 > LOS k

Related Material:

- Key Concepts by LOS

Question #66 of 70

Question ID: 414504

Component depreciation is required under:

- ✓ **A)** IFRS, but not U.S. GAAP.
- ✗ **B)** U.S. GAAP, but not IFRS.
- ✗ **C)** both IFRS and U.S. GAAP.

Explanation

IFRS requires firms to use component depreciation, which refers to depreciating the identifiable components of an asset separately. U.S. GAAP permits component depreciation but does not require it.

References

Question From: Session 8 > Reading 29 > LOS d

Related Material:

- Key Concepts by LOS

Question #67 of 70

Question ID: 434297

Mammoth, Inc. reports under U.S. GAAP. Mammoth has begun a long-term project to develop inventory control software for external sale. On its financial statements, Mammoth should:

- ✗ **A)** expense all costs of this project in the periods incurred.
- ✗ **B)** capitalize all costs of this project.
- ✓ **C)** expense all costs of this project until technological feasibility has been established.

Explanation

Under IFRS and U.S. GAAP, costs of developing software are expensed until technological feasibility is established, and capitalized after technological feasibility has been established.

References

Question From: Session 8 > Reading 29 > LOS b

Related Material:

- Key Concepts by LOS

Question #68 of 70

Question ID: 684024

Selected information from the financial statements of Salvo Company for the years ended December 31, 20X3 and 20X4 is as follows (in $ millions):

	20X3	20X4
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

If Salvo had amortized the cost of the franchise acquired in 20X3 over six years instead of expensing it, Salvo's return on average total equity for 20X4 would have been *closest* to:

✗ **A)** 35.6%.

✗ **B)** 38.9%.

✓ **C)** 31.1%.

Explanation

If the franchise cost had been amortized over six years beginning in 20X3, net income in 20X3 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 20X4 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 20X3 would have been $11 million ($5 million higher), and total equity for 20X3 would have been $8 + $11 = $19 million. Retained earnings for 20X4 would be the 20X3 retained earnings of $11 million increased by 20X4 net income of $7 million for a total of $18 million, and total equity for 20X4 would be $8 + $18 = $26 million. If the franchise cost were amortized, return on total equity for 20X4 would be $7 / ((19 + 26) / 2) = 31.1%.

References

Question From: Session 8 > Reading 29 > LOS c

Related Material:

- Key Concepts by LOS

Question #69 of 70

Question ID: 652914

Davis Inc. is a large manufacturing company operating in several European countries. Davis has long-lived assets that are valued on the balance sheet at $600 million. This includes previously recognized revaluation losses of $80 million. In the most recent accounting period, the fair value of these assets in an active market is $690 million. Which of the following entries will Davis record under the IFRS revaluation model?

✓ **A)** Gain on income statement and a revaluation surplus.

✗ **B)** Gain on income statement only.

✗ **C)** Revaluation surplus only.

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 and 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 loss that was previously recognized. The remaining $10 million is recorded as revaluation surplus in shareholders' equity.

References

Question From: Session 8 > Reading 29 > LOS h

Related Material:

- Key Concepts by LOS

Question #70 of 70

Question ID: 414494

The amortized cost of a trademark is *least likely* to appear on a firm's balance sheet if the trademark was:

- ✗ **A)** purchased from another firm.
- ✓ **B)** developed internally.
- ✗ **C)** obtained in the acquisition of another firm.

Explanation

Costs of developing a trademark are expensed in the period incurred. The value of a trademark can appear on the balance sheet if the trademark was purchased or obtained in a business acquisition.

References

Question From: Session 8 > Reading 29 > LOS b

Related Material:

- Key Concepts by LOS