CHAPTER 22

LONG-LIVED ASSETS

1. (A) 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%.

(Study Session 7, Module 22.1, LOS 22.c)

Related Material

Schweser Notes - Book 2

2. (A) 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.

(Study Session 7, Module 22.3, LOS 22.i)

Related Material

Schweser Notes - Book 2

3. (C) U.S. GAAP.

Explanation

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

(Study Session 7, Module 22.4, LOS 22.l)

Related Material

Schweser Notes - Book 2

4. (B) $22 million.

Explanation

Because Train recognized the purchase as an expense in the current period, the cash outflow was classified as CFO. If Train had decided to amortize the purchase, 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, while CFI would have been $8 million lower.

(Study Session 7, Module 22.1, LOS 22.c)

Related Material

Schweser Notes - Book 2

5. (B) 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.

(Study Session 7, Module 22.2, LOS 22.g)

Related Material

Schweser Notes - Book 2

6. (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.

(Study Session 7, Module 22.1, LOS 22.b)

Related Material

Schweser Notes - Book 2

7. (B) $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.

(Study Session 7, Module 22.2, LOS 22.f)

Related Material

Schweser Notes - Book 2

8. (C) Both of these items are 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.

(Study Session 7, Module 22.4, LOS 22.l)

Related Material

Schweser Notes - Book 2

9. (B) the patent over five years, but should not amortize the trademark.

Explanation

Because the trademark can be renewed, it should be considered to have an indefinite life and therefore should not be amortized. The patent has an expiration date and should be amortized over its remaining life.

For Further Reference:

(Study Session 7, Module 22.2, LOS 22.f)

CFA® Program Curriculum, Volume 3, page 351

Related Material

Schweser Notes - Book 2

10. (A) $1,600.

Explanation

Net book value at the end of year 3 is $100,000 x 3/5 x 3/5 x 3/5 = $21,600. DDB amortization in year 4 of 2/5 x $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.

(Study Session 7, Module 22.2, LOS 22.f)

Related Material

Schweser Notes - Book 2

11. (B) 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.

(Study Session 7, Module 22.1, LOS 22.c)

Related Material

Schweser Notes - Book 2

12. (B) **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.

(Study Session 7, Module 22.3, LOS 22.k)

Related Material

SchweserNotes - Book 2

13. (C) **immediately write down the machine to its recoverable amount.**

Explanation

Under IFRS, when an asset is permanently impaired, it must be written down to its recoverable amount (greater of value in use or fair value less selling costs) in the period in which the impairment is recognized.

For Further Reference:

(Study Session 7, Module 22.3, LOS 22.i)

CFA® Program Curriculum, Volume 3, page 356

Related Material

Schweser Notes - Book 2

14. (A) **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.

(Study Session 7, Module 22.4, LOS 22.n)

Related Material

Schweser Notes - Book 2

15. (C) **Lower net income and lower return on assets.**

Explanation

In the years following the expenditures, capitalizing will result in depreciation being deducted against net income, thereby resulting in a lower net income than expensing. Furthermore, capitalizing will increase total assets and cause ROA (net income / assets) to be lower.

For Further Reference:

(Study Session 7, Module 22.1, LOS 22.b)

CFA® Program Curriculum, Volume 3, page 326

Related Material

Schweser Notes - Book 2

16. (C) **$2.0 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 x $5 million = $2 million.

(Study Session 7, Module 22.2, LOS 22.f)

Related Material

Schweser Notes - Book 2

17. (A) **greater than the sum of its undiscounted expected cash flows.**

Explanation

Under U.S. GAAP, an asset is considered impaired when its book value is greater than the sum of the estimated undiscounted future cash flows from its use and disposal.

For Further Reference:

(Study Session 7, Module 22.3, LOS 22.i)

CFA® Program Curriculum, Volume 3, page 356

Related Material

Schweser Notes - Book 2

18. (B) **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.

(Study Session 7, Module 22.3, LOS 22.j)

Related Material

Schweser Notes - Book 2

19. (B) not amortized.

Explanation

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

(Study Session 7, Module 22.2, LOS 22.f)

Related Material

Schweser Notes - Book 2

20. (B) 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.

(Study Session 7, Module 22.3, LOS 22.k)

Related Material

Schweser Notes - Book 2

21. (B) increase EBIT by £2,000.

Explanation

Clampet may only recognize a gain on revaluation to the extent that it reverses the previously recognized £2,000 loss. The increase in asset value in excess of the previously recognized loss will be recognized in equity as revaluation surplus.

For Further Reference:

(Study Session 7, Module 22.3, LOS 22.h)

CFA® Program Curriculum, Volume 3, page 352

Related Material

Schweser Notes - Book 2

22. (A) Remaining useful life.

Explanation

Remaining useful life = ending net PP&E / annual depreciation expense. (Study Session 7, Module 22.4, LOS 22.m)

Related Material

Schweser Notes - Book 2

23. (C) near-term financing requirements.

Explanation

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

(Study Session 7, Module 22.4, LOS 22.m)

Related Material

Schweser Notes - Book 2

24. (A) both IFRS and U.S. GAAP.

Explanation

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

(Study Session 7, Module 22.4, LOS 22.1)

Related Material

Schweser Notes - Book 2

25. (B) amortization expense in the sixth year will be zero.

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.

(Study Session 7, Module 22.2, LOS 22.f)

Related Material

Schweser Notes - Book 2

26. (B) IFRS, but not 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.

(Study Session 7, Module 22.3, LOS 22.h)

Related Material

Schweser Notes - Book 2

27. (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.

(Study Session 7, Module 22.3, LOS 22.k)

Related Material

SchweserNotes - Book 2

28. (A) $1,406.

Explanation

double-declining balance depreciation rate = 2 x 1/8 =1/4 or 25% first year deprecation will be $7,500 x 0.25 = $1,875

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

(Study Session 7, Module 22.2, LOS 22.d)

Related Material

Schweser Notes - Book 2

29. (B) accelerated depreciation methods will have lower asset turnover ratios than if they used straight line depreciation.

Explanation

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

(Study Session 7, Module 22.2, LOS 22.e)

Related Material

Schweser Notes - Book 2

30. (C) recognize a loss of €200,000 and decrease shareholders' equity by €400,000.

Explanation

Because the land is valued above its historical cost on the balance sheet, Dubois is using the revaluation model. The land's revaluation up to €2.2 million would have been reflected in shareholders' equity with a revaluation surplus of €200,000. The decrease in fair value to €1.8 million will reduce the revaluation surplus to zero, and the amount of the write down below historical cost (€2 million - €1.8 million = €200,000) will be recognized as a loss on Dubois's income statement. This loss, combined with the removal of the revaluation surplus, will decrease shareholders'

equity by €400,000. Note that the land was purchased for company use and therefore would not be classified as investment property.

(Study Session 7, Module 22.3, LOS 22.h)

Related Material

Schweser Notes - Book 2

31. (B) **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.

(Study Session 7, Module 22.3, LOS 22.i)

Related Material

Schweser Notes - Book 2

32. (A) **$2,200.00**

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 x 2/5 = $8,000

Carrying value = $20,000 - $8,000 = $12,000

Year 2 DDB depreciation = $12,000 x 2/5 = $4,800

Carrying value = $12,000 - $4,800 = $7,200

Year 3 DDB depreciation = $7,200 x 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.

(Study Session 7, Module 22.2, LOS 22.d)

Related Material

Schweser Notes - Book 2

33. (B) **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.

(Study Session 7, Module 22.4, LOS 22.n)

Related Material

Schweser Notes - Book 2

34. (B) must have separate depreciation schedules for the machines and the building.

Explanation

IFRS requires firms to use component depreciation. Each component of an asset is depreciated separately based on its estimated useful life. U.S. GAAP permits component depreciation but does not require firms to use it.

(Study Session 7, Module 22.2, LOS 22.d)

Related Material

Schweser Notes - Book 2

35. (A) 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.

(Study Session 7, Module 22.3, LOS 22.h)

Related Material

Schweser Notes - Book 2

36. (A) $4,800.

Explanation

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

(Study Session 7, Module 22.2, LOS 22.d)

Related Material

Schweser Notes - Book 2

37. (C) Straight-line; LIFO.

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.

(Study Session 7, Module 22.2, LOS 22.e)

Related Material

Schweser Notes - Book 2

38. (A) €200,000 gain on its income statement.

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.

(Study Session 7, Module 22.4, LOS 22.n)

Related Material

Schweser Notes - Book 2

39. (A) 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.

(Study Session 7, Module 22.1, LOS 22.c)

Related Material

Schweser Notes - Book 2

40. (A) developed internally.

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.

(Study Session 7, Module 22.1, LOS 22.b)

Related Material

Schweser Notes - Book 2

41. (A) lower net income and lower equity.

Explanation

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

(Study Session 7, Module 22.2, LOS 22.e)

Related Material

SchweserNotes - Book 2

42. (C) impaired because its carrying value exceeds expected future cash flows.

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 x 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 x $1,500,000) + $1,000,000 = $8,500,000, the stamping machine is impaired.

(Study Session 7, Module 22.3, LOS 22.i)

Related Material

Schweser Notes - Book 2

43. (C) Write-downs taken on asset values can be reversed in later years if market conditions improve.

Explanation

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

(Study Session 7, Module 22.3, LOS 22.i)

Related Material

SchweserNotes - Book 2

44. (B) €28,750.

Explanation

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

(Study Session 7, Module 22.2, LOS 22.d)

Related Material

Schweser Notes - Book 2

45. (A) $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

(Study Session 7, Module 22.2, LOS 22.d)

Related Material

Schweser Notes - Book 2

46. (B) No, because the increase in value does not reverse a previously recognized loss.

Explanation

According to IFRS, property held for the purpose of earning rental income is classified as investment property. However, when a property is transferred from owner-occupied to investment property, a firm using the fair value model must treat any increase in the property's value as a revaluation. That is, the firm may only recognize a gain on the income statement to the extent that it reverses a previously recognized loss.

(Study Session 7, Module 22.4, LOS 22.n)

Related Material

Schweser Notes - Book 2

47. (C) IFRS, but not 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.

(Study Session 7, Module 22.2, LOS 22.d)

Related Material

Schweser Notes - Book 2

48. (A) accumulated depreciation by depreciation expense.

Explanation

Average age = accumulated depreciation / annual depreciation expense.

(Study Session 7, Module 22.4, LOS 22.m)

Related Material

Schweser Notes - Book 2

49. (A) $3,456.

Explanation

yr. 2004 = 24,000 x 2/5 = 9,600

yr. 2005 = (24,000 – 9,600) x 2/5 = 5,760

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

(Study Session 7, Module 22.2, LOS 22.d)

Related Material

Schweser Notes - Book 2

50. (A) $51,020.

Explanation

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

(Study Session 7, Module 22.2, LOS 22.d)

Related Material

Schweser Notes - Book 2

51. (A) both IFRS and U.S. GAAP.

Explanation

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

(Study Session 7, Module 22.1, LOS 22.a)

Related Material

Schweser Notes - Book 2

52. (B) Higher asset turnover 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.

(Study Session 7, Module 22.2, LOS 22.e)

Related Material

Schweser Notes - Book 2

53. (A) only one of these assets.

Explanation

Acquired intangible assets with finite expected useful lives are amortized. Intangible assets with indefinite lives are not amortized but are tested at least annually for impairment. Renewal at a nominal cost means the trademark should be treated as an asset with an indefinite life.

(Study Session 7, Module 22.1, LOS 22.b)

Related Material

Schweser Notes - Book 2

54. (C) higher future return on assets.

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.

(Study Session 7, Module 22.3, LOS 22.k)

Related Material

Schweser Notes - Book 2

55. (C) IFRS.

Explanation

The required disclosures for long-lived assets under IFRS are more extensive than they are under U.S. GAAP. IFRS requires a reconciliation of beginning and ending carrying values for classes of PP&E, while U.S. GAAP does not.

(Study Session 7, Module 22.4, LOS 22.1)

Related Material

Schweser Notes - Book 2

56. (C) recognized on the income statement.

Explanation

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

(Study Session 7, Module 22.4, LOS 22.n)

Related Material

Schweser Notes - Book 2

57. (B) Depreciable lives and salvage values are chosen by management and allow for the possibility of income manipulation.

Explanation

Useful lives and salvage values of long-lived assets are management estimates that may vary among companies. Companies typically do not disclose data about estimated salvage values, except when estimates are changed.

(Study Session 7, Module 22.2, LOS 22.e)

Related Material

Schweser Notes - Book 2

58. (C) Net income will be lower in the periods following the revaluation.

Explanation

Revaluing the asset to £600,000 will increase future depreciation expense, and therefore reduce net income in subsequent periods. Because Vasco has not previously recognized a loss on this asset, the revaluation is not recognized as income but is recorded as an adjustment to equity. An increase in equity (with unchanged debt) will decrease the debt-to-equity ratio.

(Study Session 7, Module 22.3, LOS 22.h)

Related Material

Schweser Notes - Book 2

59. (B) 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.

(Study Session 7, Module 22.4, LOS 22.1)

Related Material

Schweser Notes - Book 2

60. (B) 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.

(Study Session 7, Module 22.2, LOS 22.g)

Related Material

Schweser Notes - Book 2

61. (C) fixed asset turnover 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.

(Study Session 7, Module 22.2, LOS 22.e)

Related Material

Schweser Notes - Book 2

62. (B) Purchased franchise right with a useful life of two years.

Explanation

A purchased, identifiable intangible asset with a finite life is amortized over its useful life. Costs incurred to develop an intangible asset such as a trademark are expensed when incurred. A patent that expires in the current period will not provide future benefits and therefore should not be recognized as an asset.

For Further Reference:

(Study Session 7, Module 22.1, LOS 22.b)

CFA® Program Curriculum, Volume 3, page 326

Related Material

Schweser Notes - Book 2

63. (A) higher cash flows from operations and lower cash flow from investing.

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.

(Study Session 7, Module 22.1, LOS 22.c)

Related Material

Schweser Notes - Book 2

64. (A) 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.

(Study Session 7, Module 22.1, LOS 22.b)

Related Material

Schweser Notes - Book 2

65. (B) Higher profitability in the periods after revaluation.

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.

(Study Session 7, Module 22.3, LOS 22.k)

Related Material

Schweser Notes - Book 2

66. (B) lower cash flows from investing and lower income variability.

Explanation

Capitalizing costs tends to smooth earnings and reduces investment cash flows. It will also increase cash flows from operations and increase profitability in the early years.

For Further Reference:

(Study Session 7, Module 22.1, LOS 22.c)

CFA® Program Curriculum, Volume 3, page 330

Related Material

Schweser Notes - Book 2

67. (C) Total cash flow is higher with capitalization than expensing.

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.

(Study Session 7, Module 22.1, LOS 22.c)

Related Material

Schweser Notes - Book 2

68. (A) Gain on income statement and a 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 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.

(Study Session 7, Module 22.3, LOS 22.h)

Related Material

SchweserNotes - Book 2

69. (B) amortized over their expected useful 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.

(Study Session 7, Module 22.2, LOS 22.f)

Related Material

Schweser Notes - Book 2

70. (C) Gain of $40,000.

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).

(Study Session 7, Module 22.3, LOS 22.j)

Related Material

Schweser Notes - Book 2

71. (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).

(Study Session 7, Module 22.3, LOS 22.j)

Related Material

Schweser Notes - Book 2

72. (C) lower variability of income.

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.

(Study Session 7, Module 22.1, LOS 22.c)

Related Material

SchweserNotes - Book 2

73. (B) The land and the buildings that generate rental income.

Explanation

Investment property is defined under IFRS as property held for the purpose of earning rental income, capital appreciation, or both. Owner-occupied property is not classified as investment property.

For Further Reference:

(Study Session 7, Module 22.4, LOS 22.n)

CFA® Program Curriculum, Volume 3, page 374

Related Material

Schweser Notes - Book 2

74. (C) space in the building is rented to other firms.

Explanation

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

(Study Session 7, Module 22.4, LOS 22.n)

Related Material

Schweser Notes - Book 2