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LONG-LIVED ASSETS

1. 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) 31.1%.
 (B) 38.9%.
 (C) 35.6%.
2. U.S. GAAP least likely requires property, plant, and equipment to be tested for impairment:
- (A) at least annually.
 (B) when an asset is reclassified as held-for-sale.
 (C) when events indicate the firm may not recover the asset's carrying value.

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3. 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) IFRS.
 - (C) U.S. GAAP.

4. 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 and recognized the entire purchase price as an expense. If Train had instead elected to amortize the cost of the franchise over its estimated life, 20X8 cash flow from operations (CFO) would have been:
 - (A) \$6 million.
 - (B) \$22 million.
 - (C) \$14 million.

5. The most likely result of increasing the estimated useful life of a depreciable asset is that:
 - (A) asset turnover will increase.
 - (B) net profit margin will increase.
 - (C) return on assets will decrease.

6. 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) capitalize all costs of this project.
 - (B) expense all costs of this project in the periods incurred.
 - (C) expense all costs of this project until technological feasibility has been established.

7. 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) \$400,000.
 - (C) \$800,000.

8. 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) Only one of these items is required to be disclosed.
 (C) Both of these items are required to be disclosed.
9. After acquiring a subsidiary, Lafleur Company adds to its balance sheet a patent that expires in five years and a trademark that can be renewed every three years. Lafleur should amortize:
- (A) the patent over five years and the trademark over three years.
 (B) the patent over five years, but should not amortize the trademark.
 (C) neither the patent nor the trademark, but must test them for impairment annually.
10. 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) \$1,600.
 (B) \$6,910.
 (C) \$8,640.
11. Capitalized interest costs are typically reported in the cash flow statement as an outflow from:
- (A) financing.
 (B) investing.
 (C) operating.
12. Three years ago, Rancho Corporation purchased equipment for a process used in production, for 3 million. At the end of last year, Rancho determined the fair value of the equipment was greater than its book value. No impairment losses have been recognized on the equipment. Assuming Rancho 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) Both will increase.
 (B) Both will decrease.
 (C) Only one will increase.
13. Granite, Inc., owns a machine with a carrying value of \$3.0 million and a salvage value of \$2.0 million. The present value of the machine's future cash flows is \$1.7 million. The asset is permanently impaired. Granite should:
- (A) immediately write down the machine to its salvage value.
 (B) write down the machine to its recoverable amount as soon as it is depreciated down to salvage value.
 (C) immediately write down the machine to its recoverable amount.

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14. The revaluation model for investment property is permitted under:
 - (A) neither IFRS nor U.S. GAAP.
 - (B) both IFRS and U.S. GAAP.
 - (C) IFRS, but not U.S. GAAP.

15. When comparing the financial statement effects of expensing versus capitalizing an expenditure, capitalizing will most likely result in which of the following effects in the years after the expenditure is incurred?
 - (A) Lower net income and higher return on assets.
 - (B) Higher net income and lower return on assets.
 - (C) Lower net income and lower return on assets.

16. 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) \$2.2 million.
 - (B) \$2.1 million.
 - (C) \$2.0 million.

17. Under U.S. GAAP, an asset is considered impaired if its book value is:
 - (A) greater than the sum of its undiscounted expected cash flows.
 - (B) less than its market value.
 - (C) greater than the present value of its expected future cash flows.

18. 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) exchanging an asset.
 - (C) selling an asset.

19. Under normal circumstances, intangible assets with indefinite lives are:
 - (A) amortized over a period specified in the accounting standards.
 - (B) not amortized.
 - (C) amortized over a period chosen by management.

20. An impairment write-down is least likely to decrease a company's:
 - (A) future depreciation expense.
 - (B) debt-to-equity ratio.
 - (C) assets.

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21. Clampet Ltd. reports under IFRS and reports certain assets on its balance sheet using the revaluation model. Machinery purchased in 20X1 for £22,000 is revalued to £20,000 at the end of 20X2. At the end of 20X3, the fair value of the asset is £23,000. The most likely effect of the change in value to £23,000 is to:
- (A) increase EBIT by £3,000.
 - (B) increase EBIT by £2,000.
 - (C) leave EBIT unchanged.
22. Which of the following is best estimated by the ratio of net PP & E to annual depreciation expense?
- (A) Remaining useful life.
 - (B) Total useful life.
 - (C) Average age.
23. An analyst will most likely use the average age of depreciable assets to estimate the company's:
- (A) cash flows.
 - (B) earnings potential.
 - (C) near-term financing requirements.
24. In accounting for PP&E using the cost model, companies are required to disclose both gross asset value and accumulated depreciation under:
- (A) both IFRS and U.S. GAAP.
 - (B) IFRS but not U.S. GAAP.
 - (C) U.S. GAAP but not IFRS.
25. 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 first year will be one-seventh of \$60,000.
 - (B) amortization expense in the sixth year will be zero.
 - (C) an accelerated amortization method is more appropriate than the straight-line method.
26. 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) either IFRS or U.S. GAAP.
 - (B) IFRS, but not U.S. GAAP.
 - (C) neither IFRS nor U.S. GAAP.

27. 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.
28. Slovak 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 Slovak uses the double-declining balance method of depreciation?
- (A) \$1,406.
 - (B) \$1,438.
 - (C) \$1,875.
29. Which of the following statements comparing straight-line depreciation methods to alternative depreciation methods is least accurate? Companies that use:
- (A) accelerated depreciation methods for tax purposes will decrease the amount of taxes paid in early years.
 - (B) accelerated depreciation methods will have lower asset turnover ratios than if they used straight line depreciation.
 - (C) straight-line depreciation methods will have higher book values for the assets on the balance sheet than companies that use accelerated depreciation.
30. Dubois Company bought land for company use five years ago for €2 million and presents its balance sheet value as €2.2 million. If the fair value of the land decreases to €1.8 million, Dubois will:
- (A) recognize a loss of €400,000 and decrease shareholders' equity by €200,000.
 - (B) decrease shareholders' equity by €400,000 but will not recognize a loss.
 - (C) recognize a loss of €200,000 and decrease shareholders' equity by €400,000.
31. 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.

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32. 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) \$2,200.00
 - (B) \$2,880.00
 - (C) \$3,000.00
33. 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) only if it reverses a previously recognized loss.
 - (C) equal to the difference between fair value and carrying value.
34. Rossdale, Inc., buys a small manufacturing plant with an estimated useful life of 12 years. The building includes two built-in machines that are expected to be replaced after four years and six years. Under International Financial Reporting Standards, Rossdale:
- (A) must have a single depreciation schedule for the plant.
 - (B) must have separate depreciation schedules for the machines and the building.
 - (C) may have separate depreciation schedules for the machines and the building.
35. For a firm to use the revaluation model for balance sheet reporting of long-lived assets:
- (A) an active market must exist for the assets.
 - (B) the firm must report under U.S. GAAP.
 - (C) the firm must choose which assets of each type to revalue, and which to report at cost.
36. 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) \$1,600.
 - (C) \$5,200.
37. 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) DDB; FIFO.
- (B) Straight-line; FIFO.
- (C) Straight-line; LIFO.

38. 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.

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

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

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

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

41. 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 net income and lower equity.
- (B) higher return on equity and higher return on assets.
- (C) lower depreciation expense and lower turnover ratios.

42. 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) not impaired.
- (B) impaired because expected salvage value has declined.
- (C) impaired because its carrying value exceeds expected future cash flows.

43. 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 /east accurate?

- (A) During the year of the write-downs, retained earnings and deferred taxes will decrease.
- (B) The write-downs are reported as a component of income from continuing operations.
- (C) Write-downs taken on asset values can be reversed in later years if market conditions improve.

44. Czerneyk Company buys a delivery vehicle for €60,000. Czerneyk 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 Czerneyk depreciates the vehicle by the units of production method, its carrying value at the end of Year 2 is:

- (A) €15,000.
- (B) €28,750.
- (C) €31,250.

45. 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) \$15,000.
- (B) \$6,000.
- (C) \$12,000.

46. A manufacturing firm shuts down production at one of its plants and offers the facility for rent. Based on the market for similar properties, the firm determines that the fair value of the plant is €500,000 more than its carrying value. If this firm uses the cost model for plant and equipment and the fair value model for investment property, should it recognize a gain on its income statement?

- (A) Yes, because the plant will be reclassified as investment property.
- (B) No, because the increase in value does not reverse a previously recognized loss.
- (C) No, because the firm must continue to use the cost model for valuation of this asset.
48. Component depreciation is required under:
- (A) U.S. GAAP, but not IFRS.
- (B) both IFRS and U.S. GAAP.
- (C) IFRS, but not U.S. GAAP.
48. The average age of a firm's property, plant, and equipment can be estimated by dividing:
- (A) accumulated depreciation by depreciation expense.
- (B) gross PP&E by depreciation expense.
- (C) net PP&E by depreciation expense.
49. 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) \$3,456.
- (B) \$4,000.
- (C) \$5,760.
50. 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) \$51,020.
- (B) \$58,750.
- (C) \$71,430.
51. 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) U.S. GAAP only.
- (C) IFRS only.

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52. 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.
53. Varin, Inc. purchases franchise rights with an estimated useful life of ten years and a trademark that can be renewed every five years for a nominal fee. Under IFRS, Varin will recognize amortization expense on:
- (A) only one of these assets.
 - (B) neither of these assets.
 - (C) both of these assets.
54. Taking an impairment of long-lived assets will result in:
- (A) higher deferred tax liabilities.
 - (B) a lower debt-to-equity ratio.
 - (C) higher future return on assets.
55. A reconciliation of beginning and ending carrying values for each class of property, plant, and equipment is required for firms reporting under:
- (A) U.S. GAAP.
 - (B) both U.S. GAAP and IFRS.
 - (C) IFRS.
56. Under the fair value model for investment property, unrealized gains and losses are recognized on the income statement.
- (A) disclosed in the financial statement notes.
 - (B) recognized in other comprehensive income.
 - (C) recognized on the income statement.
57. Which of the following statements about the role of depreciable lives and salvage values in the computation of depreciation expenses for financial reporting is most accurate?
- (A) Companies are specifically required to disclose data about estimated salvage values in the footnotes to the financial statements.
 - (B) Depreciable lives and salvage values are chosen by management and allow for the possibility of income manipulation.
 - (C) The estimated useful life of the same depreciable asset should be the same regardless of which company owns the asset.

58. Vasco Ltd. purchased a unit of heavy equipment one year ago for £500,000 and capitalized it as a long-lived asset. Because demand for equipment of this type has grown significantly, Vasco believes the fair value of its equipment has increased to £600,000. If Vasco revalues its equipment to £600,000, what will be the most likely effect on Vasco's financial results, compared to not revaluing the equipment?
- (A) Net income will be higher in the period of the revaluation.
 - (B) The debt-to-equity ratio will be unaffected by the revaluation.
 - (C) Net income will be lower in the periods following the revaluation.
59. For impaired long-lived assets, a firm reporting under IFRS is least likely required to disclose the:
- (A) circumstances that caused the impairment losses or reversals.
 - (B) estimated probabilities of reversing impairment losses.
 - (C) amounts of impairment losses and reversals by asset class.
60. 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.
61. 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) total assets on the balance sheet.
 - (C) fixed asset turnover ratio.
62. Which of these intangible assets is most likely to be amortized? Question ID: 1378375
- (A) Internally developed trademark with a useful life of 20 years.
 - (B) Purchased franchise right with a useful life of two years.
 - (C) Purchased patent that will expire in the current period.
63. 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 cash flows from operations and lower cash flow from investing.
 - (B) higher debt/equity ratio and higher debt/assets ratio.
 - (C) lower profitability (ROA and ROE) in early years and higher in later years.

64. Which of the following items is least likely an example of an intangible asset with an indefinite life?
- (A) Acquired patents.
 - (B) Goodwill.
 - (C) Trademarks that can be renewed at minimal cost.
65. 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 earnings in the revaluation period.
 - (B) Higher profitability in the periods after revaluation.
 - (C) Lower solvency ratios.
66. A company that capitalizes costs instead of expensing them will have:
- (A) higher income variability and higher cash flows from operations.
 - (B) lower cash flows from investing and lower income variability.
 - (C) lower cash flows from operations and higher profitability in early years.
67. Which of the following statements regarding capitalizing versus expensing costs is least accurate?
- (A) Capitalization results in higher profitability initially.
 - (B) Cash flow from investing is higher with expensing than with capitalization.
 - (C) Total cash flow is higher with capitalization than expensing.
68. 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.
69. Intangible assets with finite useful lives are:
- (A) amortized over their actual lives.
 - (B) amortized over their expected useful lives.
 - (C) not amortized, but are tested for impairment at least annually.

70. Felker Inc. owns a piece of specialized machinery. The original cost of the machinery was \$500,000 and to date it has accumulated depreciation 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) Loss of \$100,000.
 - (C) Gain of \$40,000.
71. 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) Gain of \$40,000.
 - (B) Loss of \$100,000.
 - (C) Loss of \$360,000.
72. Compared to firms that expense costs, firms that capitalize expenses will have:
- (A) higher leverage ratios.
 - (B) lower cash flow from operations.
 - (C) lower variability of income.
73. Stone Development Company owns four office buildings and a tract of raw land. Stone occupies one of the buildings, collects rental income from the other three buildings, and is holding the land for capital appreciation. Under IFRS, which of these assets should Stone classify as investment property on its balance sheet?
- (A) Only the land held for capital appreciation.
 - (B) The land and the buildings that generate rental income.
 - (C) All of these assets.
74. A building owned by a firm is most likely to be classified as investment property if:
- (A) the firm uses the building for its corporate headquarters.
 - (B) the building is a manufacturing plant or distribution center.
 - (C) space in the building is rented to other firms.

