

Reading 35**ANALYSIS OF LONG-TERM ASSETS**

1. (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.

(Module 35.1, LOS 35.a)

2. (A) accumulated depreciation by depreciation expense.

Explanation

Average age = accumulated depreciation / annual depreciation expense.

(Module 35.3, LOS 35.c)

3. (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.

(Module 35.1, LOS 35.a)

4. (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.

(Module 35.2, LOS 35.b)

5. (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.

(Module 35.2, LOS 35.b)

CFA[®]**6. (A) Remaining useful life.****Explanation**

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

(Module 35.3, LOS 35.c)

7. (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.

(Module 35.3, LOS 35.c)

8. (A) 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.

(Module 35.1, LOS 35.a)

9. (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.

(Module 35.1, LOS 35.a)

10. (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.

(Module 35.2, LOS 35.b)

11. (C) 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.

(Module 35.1, LOS 35.a)

12. (A) 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.

(Module 35.2, LOS 35.b)

13. (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.

(Module 35.1, LOS 35.a)

14. (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.

(Module 35.2, LOS 35.b)

