

- 1.** Major uncertainties that can cause long-lived assets to earn an abnormal positive or negative rate of return include unexpected good or bad news about: 1) the demand for an organization's products and services, 2) the prices of important inputs that must be used in combination with the long-lived assets, and 3) the invention of better production methods or technologies, leading to obsolescence of the assets.
- 2.** Long-lived assets include land, buildings, equipment, automobiles, patents, copyrights, and intellectual property.
- 3.** Buildings and machinery must be depreciated to account for the effects of the inevitable decline in economic value associated with wear and tear.
- 4.** A liquidating dividend is a distribution to shareholders of the remaining assets of a business when it ceases operations.
- 5.** The economic value of a long-lived asset is the present value of the future cash flows that it will generate.
- 6.** Economic depreciation is computed by taking the difference between the asset's economic value at the beginning of the period and its economic value at the end of the period.
- 7.** Advertising and training costs create economic value, but they are not recognized as assets because there is too much uncertainty about that economic value and it is too difficult to measure the future benefit.
- 8.** Advertising costs and research and development costs are recorded as expenses in the period they are incurred.
- 9.** Included in the capitalized cost of a purchased asset are all reasonable and necessary costs required to get the asset ready for its intended use, e.g., transportation and testing.
- 10.** Interest costs are capitalized when they are related to the self-construction of a long-lived asset.
- 11.** The accounting definition of depreciation is the systematic allocation of the cost of an asset to the periods that it benefits.
- 12.** In practice, a company does not have precise knowledge of the pattern of cash flows from an asset; therefore, it is difficult to determine the economic value of the asset. GAAP only require that the asset be depreciated in a systematic and rational manner.
- 13.** Depreciable cost is the asset's cost less salvage value.
- 14.** Accelerated depreciation methods assign more depreciation to earlier years and less to later years.
- 15.** Two accelerated methods of depreciation are sum-of-years' digits and declining balance.
- 16.** Tangible long-lived assets are generally presented with the related accu-

mulated depreciation; intangible long-lived assets are generally presented net of accumulated amortization.

- 17.** Most businesses would use straight-line depreciation because it results in lower depreciation expense in the early years of an asset's life than accelerated methods. This will result in higher reported income. Because tax laws allow accelerated methods to be used on the tax return but do not require them to be used in financial statements, companies will experience the "best of both worlds," reporting higher income for financial statement purposes but lower taxable income for tax purposes.
- 18.** Economic values are often in excess of book values because GAAP depreciation methods reduce the book value of assets in a systematic and rational manner, without regard to the pattern of cash flows related to the assets. The economic value is based on the pattern of future cash flows, which generally fluctuates over the asset's life. Economic depreciation therefore tends to **increase** over some parts of the life of the asset. Economic depreciation tends to be less in the early years than GAAP depreciation, resulting in higher economic value relative to GAAP.
- 19.** When a long-lived asset is sold, its economic value (selling price) is compared to its accounting book value. If the asset is sold for more than its book value, a gain is recognized. If the asset is sold for less than its book value, a loss is recorded.
- 20.** Gains or losses appear in the income statement, generally in a category called "other gains and losses."
- 21.** An asset impairment takes place when the cash flows of an asset unexpectedly decline.
- 22.** Under GAAP, asset impairments must be recorded when the estimated undiscounted future cash flows from the asset are less than the asset's book value.
- 23.** An asset may be impaired when: 1) the market value of the asset has significantly decreased, 2) the company forecasts losses from the asset's continued use, or 3) adverse business conditions or legal matters have affected the asset.
- 24.** Once an impairment is recognized, the asset's remaining book value is depreciated over its remaining useful life.
- 25.** Companies may want to avoid asset impairment charges because they result in significant losses, which reduce the company's net income in the year the impairment charge is tak