

True-False

1. The method of measuring long-lived assets at their estimated value in an output market is the expected benefit approach.
2. Current cost is an example of the economic sacrifice approach for valuing long-lived assets.
3. A primary concern of auditors and analysts is that numbers on the financial statements be verifiable, which means that the numbers should arise from readily observable corroborable facts.
4. Expenditures included in the cost of a long-lived asset are capitalized.
5. Salvage value of material from razing a building is considered a reduction in the cost of the building.
6. Capitalization of interest for the construction of long-lived assets is limited to interest arising from actual borrowings from third parties.
7. GAAP calls for capitalization of an expenditure on a long-lived asset when the capacity of the asset is decreased.
8. An expenditure that increases a long-lived asset's useful life should be capitalized.
9. A relatively new asset base makes it difficult for financial analysts to use trend analysis.
10. The FASB requires that virtually all costs incurred for research and development of an internally generated patent be capitalized.
11. The balance sheet carrying value for internally generated intangibles is often below the value of the property rights.
12. For U. S. GAAP, software development costs are capitalized as intangible assets once the technological feasibility of the product is established.
13. Research findings almost uniformly indicate that existing GAAP for both R&D and software development is too conservative.
14. United Kingdom accounting rules allow companies to write long-lived assets up to new carrying values when market value exceeds cost.
15. The method used to account for oil and gas exploration costs that capitalizes all exploration costs is the successful efforts approach.
16. If a long-lived asset's remaining expected future value falls below its net book value, the asset is considered to be an impaired asset.
17. An impairment loss is the difference between the carrying value of the asset and the future value of the asset.
18. Depreciation is the apportionment of the cost of a wasting asset to future periods under the matching principle.
19. Depreciation is **not** intended to track the asset's declining market value.
20. The depreciation rate for the double declining balance method is double the straight line rate.

21. When firms dispose of a long-lived asset before the end of its useful life, the difference between the net book value of the asset and the sale proceeds is a gain or loss from a discontinued item.
22. When the differences in useful lives of long-lived assets reflect real economic variables, the attempt on the part of financial analysts to undo the differences in useful lives may impede profit and loss comparisons.
23. In the United Kingdom when assets are written up to market value, a revaluation account is credited.
24. In an exchange of assets, when the fair value of the asset received is more clearly evident than the fair value of the asset given up, the fair value of the asset received is used as the new cost base.
25. To preclude firms from engaging in "sham" exchanges in order to generate artificial gains, the FASB requires that the transaction must possess commercial substance.

Multiple-Choice Questions

Select the best answer from those provided.

26. Long-lived assets are
 - a. non-operating assets expected to yield their economic benefits (or service potential) over a period longer than one year.
 - b. operating assets expected to yield their economic benefits (or service potential) over a period longer than one year.
 - c. non-operating assets expected to yield their economic benefits (or service potential) over a period longer than five years.
 - d. operating assets expected to yield their economic benefits (or service potential) over a period longer than two years.
27. Which one of the following is an example of the expected benefit approach for valuing long-lived assets?
 - a. Historical cost
 - b. Current replacement value
 - c. Current cost
 - d. Discounted present value
28. The method of measuring long-lived assets at their estimated value in an input market is the
 - a. expected benefit approach.
 - b. economic sacrifice approach.
 - c. discounted present value approach.
 - d. net realizable value approach.

- 29.** The dominant method under GAAP for measuring long-lived assets is the
- expected benefit approach.
 - discounted present value approach.
 - historical cost approach.
 - replacement cost approach.
- 30.** Expected benefit approaches for valuing long-lived assets were discarded because the numbers generated under these methods were unreliable and
- fictitious.
 - objective.
 - unverifiable.
 - estimates.
- 31.** Expenditures included in the cost of a long-lived asset are
- charged off.
 - expensed.
 - intangible.
 - capitalized.
- 32.** Which one of the following items would be charged to the cost of a building rather than the cost of the land?
- Architectural fees
 - Grading of land
 - Demolition of existing structure
 - Cost of hauling material from demolished structure
- 33.** Which one of the following items would be charged to the cost of land rather than the cost of the building?
- Demolition of existing structure
 - Capitalization of interest
 - Architectural fees
 - Cost of foundation
- 34.** Capitalization of interest for the construction of long-lived assets is limited to interest arising from actual borrowings from
- owners.
 - stockholders.
 - outsiders.
 - the board of directors.

Table 10-1

The Reid Co. acquired a piece of land for a new factory paying \$100,000. Reid removed the old building at a cost of \$20,000, and sold scrapped material salvaged from the old building for \$5,000. The architect's fees were \$25,000, and the title insurance on the land was \$1,000. The construction period interest was \$8,000, and the contractor received \$300,000 for the building. A pavement assessment made by the city cost Reid \$2,000.

- 35.** Refer to Table 10-1. The cost of the land recorded by Reid Co. is
- \$100,000.
 - \$115,000.
 - \$116,000.
 - \$118,000.
- 36.** Refer to Table 10-1. The cost of the building recorded by Reid Co. is
- \$300,000.
 - \$326,000.
 - \$333,000.
 - \$335,000.
- 37.** Staley Enterprises purchased a machine for \$260,000. The seller paid \$900 freight to deliver the machine. Staley used \$4,600 of staff mechanics' time to install the machine and employee training cost \$7,000. The state charged a 5% sales tax on the invoice price. What is the capitalized cost of the machine?
- \$260,000
 - \$264,600
 - \$271,600
 - \$284,600
- 38.** An expenditure that increases a long-lived asset's useful life should be
- capitalized.
 - expensed.
 - ignored.
 - written off immediately.
- 39.** Which one of the following factors makes it difficult for financial analysts to use trend analysis?
- Decreasing costs and prices
 - Deflation
 - An aging asset base
 - A relatively new asset base
- 40.** The FASB requires that virtually all costs incurred for research and development of an internally generated patent be
- capitalized.

- b. expensed.
- c. amortized over 40 years.
- d. ignored.

41. For U. S. GAAP, software development costs are capitalized as intangible assets

- a. from the beginning of development.
- b. after a copyright is obtained.
- c. once the product is introduced into the marketplace.
- d. once the technological feasibility of the product is established.

42. Research findings almost uniformly indicate that existing GAAP for both R&D and software development is

- a. satisfactory as written.
- b. too objective.
- c. too conservative.
- d. too liberal.

43. The method used to account for oil and gas exploration costs that capitalizes all exploration costs is the

- a. full-cost approach.
- b. successful efforts approach.
- c. reserve recognition accounting.
- d. tax-method accounting.

44. The method used to account for oil and gas exploration costs that capitalizes the exploration costs of productive wells is the

- a. full-cost approach.
- b. successful efforts approach.
- c. reserve recognition accounting.
- d. tax-method accounting.

45. If a long-lived asset's remaining expected future value falls below its net book value, the asset is considered to be a/an

- a. extraordinary item.
- b. discontinued operation.
- c. valuable asset.
- d. impaired asset.

46. An impairment loss is the difference between the carrying value of the asset and the

- a. historical cost of the asset.
- b. fair value of an asset.

- c. future value of the asset.
- d. price-level adjusted value of the asset.

47. An impairment loss is reported on the income statement as a/an

- a. ordinary item.
- b. extraordinary item.
- c. discontinued item.
- d. accounting change.

48. The FASB has been able to guard against management manipulation of earnings as a result of asset impairments by

- a. fining any managers found guilty of such manipulation.
- b. requiring restoration of previously recognized impairment losses.
- c. prohibiting restoration of previously recognized impairment losses.
- d. relying on State Boards of Public Accountancy to police the transactions.

49. The Simon Company acquired a long-lived asset three years ago at a cost of \$125,000. Two years later the asset sustained impairment in value. At the time of the impairment the fair value of the asset was \$25,000 and the carrying value was \$50,000. The entry to record the impairment would be

a. Retained earnings	25,000	
Accumulated depreciation		25,000
b. Loss on equipment impairment	25,000	
Long-lived asset		25,000
c. Retained earnings	25,000	
Extraordinary loss		25,000
d. Extraordinary loss	25,000	
Long-lived asset		25,000

50. The apportionment of the cost of equipment to future periods under the matching principle is

- a. depletion.
- b. amortization.
- c. depreciation.
- d. allocation.

51. The apportionment of the cost of a copyright to future periods under the matching principle is

- a. depletion.

- b. amortization.
- c. depreciation.
- d. allocation.

52. The apportionment of the cost of a wasting asset to future periods under the matching principle is

- a. depletion.
- b. amortization.
- c. depreciation.
- d. allocation.

Table 10-2

Deuce Company purchased a truck for \$50,000 on January 2, 2005. The asset has an expected salvage value of \$5,000 at the end of its five-year useful life.

53. Refer to Table 10-2. What depreciation method is used if depreciation expense is \$6,000 in 2008?

- a. Straight-line
- b. Sum of years' digits
- c. Double-declining balance
- d. Composite

54. Refer to Table 10-2. How much is the depreciation expense in 2006 if double-declining balance depreciation is used?

- a. \$ 6,000
- b. \$ 9,000
- c. \$ 12,000
- d. \$ 15,000

55. Refer to Table 10-2. How much is the depreciation expense in 2006 if sum-of-years digits depreciation is used?

- a. \$ 6,000
- b. \$ 9,000
- c. \$ 12,000
- d. \$ 15,000

56. Refer to Table 10-2. How much is the depreciation expense in 2009 if double-declining balance depreciation is used?

- a. \$ 1,480
- b. \$ 3,000
- c. \$ 9,000
- d. \$ 12,000

Table 10-3

Eagle Corporation acquired a new machine on January 2, 2006 at a cost of \$126,000. The machine has an expected 4 year life and a salvage value of \$6,000.

57. Refer to Table 10-3. If Eagle uses the sum-of-years' digits depreciation method, the depreciation expense in 2008 is

- a. \$16,000.
- b. \$24,000.
- c. \$32,000.
- d. \$40,000.

58. Refer to Table 10-3. If Eagle uses the straight-line depreciation method, the depreciation expense in 2009 is

- a. \$16,000.
- b. \$24,000.
- c. \$30,000.
- d. \$40,000.

59. Refer to Table 10-3. If Eagle uses the double-declining balance depreciation method, the depreciation expense in 2007 is

- a. \$16,000.
- b. \$24,000.
- c. \$31,500.
- d. \$40,000.

60. Refer to Table 10-3. If Eagle uses the double-declining balance depreciation method, the depreciation expense in 2008 is

- a. \$12,750.
- b. \$15,000.
- c. \$25,500.
- d. \$30,000.

61. According to the latest annual survey conducted by the AICPA quoted in the text, the method of depreciation that predominates for financial reporting purposes is

- a. declining-balance.
- b. sum-of-the-years' digits.
- c. straight-line.
- d. units-of-production.

62. When firms dispose of a long-lived asset before the end of its useful life, the difference between the net book value of the asset and the sale proceeds is a/an

- a. extraordinary gain or loss.
- b. ordinary gain or loss.
- c. gain or loss from a discontinued item.
- d. gain or loss from a prior period.

63. Devine Company sold a machine that originally cost \$34,000. The machine had accumulated depreciation of \$27,000 and sold for \$6,000. Devine had a/an

- a. ordinary gain of \$1,000.
- b. extraordinary gain of \$1,000.
- c. ordinary loss of \$1,000.
- d. extraordinary loss of \$1,000.

64. The Key Company sold a machine. The machine had accumulated depreciation of \$50,000 and a salvage value of \$6,000. If the machine sold for \$16,000 and a gain of \$4,000 is recognized, the original cost of the asset is

- a. \$54,000.
- b. \$62,000.
- c. \$66,000.
- d. \$70,000.

65. A major problem facing financial analysts who compare long-lived assets on balance sheets of various companies is that different companies often use different

- a. depreciation methods.
- b. estimated lives.
- c. salvage values.
- d. tax methods of depreciation.

66. When the differences in useful lives of long-lived assets reflect real economic variables, the attempt on the part of financial analysts to undo the differences in useful lives may

- a. impede profit and loss comparisons.
- b. enhance profit comparisons.
- c. enhance profit comparisons, but impede loss comparisons.
- d. enhance profit and loss comparisons.

67. Financial analysts can make comparisons between the long-lived assets of two companies both using straight-line depreciation by computing the average useful life of assets with which one of the following formulas?

- a. Net property, plant, and equipment/average useful life
- b. Gross property, plant, and equipment/average useful life
- c. Gross property, plant, and equipment minus salvage/straight-line depreciation

- d. Straight-line depreciation/net property, plant, and equipment

68. Provide in your own words the definition of an asset under GAAP.

69. Provide two controversial examples of expenditures that are not capitalized under GAAP, but that have been in cases of earnings management or that in your opinion should be.

70. What is the approach that GAAP generally takes for measuring the Carrying Amount of Long-Lived Assets? Why?

71. Provide an example in which capital structure of the company could strongly affect the comparability of the asset balance and income statement between companies.

72. On January 1st, 2000, ABC, Inc. purchases a long-lived asset for \$10 Million in cash. The company determined the appropriated depreciation method and rate would be straight line over 10 years.

- a. Show the balance sheet presentation of the asset as of June 30, 2004.
- b. When does GAAP require the company to test for impairment of long-lived assets?
- c. On June 30th, 2004 the company realized the asset is worth \$2 million.
 - i. What is the amount that needs to be recognized as impaired?
 - ii. Where will it appear in the income statement for the period ended December 2004?

73. Gil company, Inc., a medical laser treatment provider, purchased for \$130,000 an eye treatment laser. The company determined the appropriate depreciation method for the laser would be straight line over its expected useful life of 6 years with salvage value of \$10,000. Below are additional expenses incurred over the life of the laser:

- Annual replacement of lenses: \$1000
- 2nd year maintenance service: \$1,500
- Seminar training costs for company's technician: \$700
- At the beginning of the 5th year the company replaced the main power source of the laser. The cost was \$40,000. Following this replacement, the useful life was extended to a total of 8 years and salvage value is now estimated at \$14,000.

Answer the following questions:

- a. What is accounting treatment for each of the above events?
- b. Show the depreciation expense for the machine over its entire life.

1. E; True
2. E; False
3. E; True
4. E; True
5. E; False
6. E; True
7. M; False
8. M; True
9. M; False
10. M; False
11. M; False
12. M; True
13. M; True
14. M; True
15. M; False
16. M; True
17. M; False
18. M; False
19. M; True
20. M; True
21. M; False
22. M; True
23. M; True
24. M; True
25. M; True
26. E; (b)
27. E; (d)
28. E; (b)
29. E; (c)
30. E; (c)
31. E; (d)
32. E; (a)
33. E; (a)
34. E; (c)
35. M; (d)
36. M; (c)
37. M; (d)
38. M; (a)
39. M; (c)
40. M; (b)
41. M; (d)
42. M; (c)
43. M; (a)
44. M; (b)
45. M; (d)
46. M; (b)
47. M; (a)
48. M; (c)
49. M; (b)
50. M; (c)
51. M; (b)
52. M; (a)
53. M; (b)
54. M; (c)
55. M; (c)
56. D; (a)
57. M; (b)
58. M; (c)
59. M; (c)
60. M; (a)
61. M; (c)
62. M; (b)
63. M; (c)
64. M; (b)
65. M; (b)
66. M; (a)
67. M; (c)
68. Statement of Financial Accounting Concepts No. 6: "Assets are prob-

able future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.”

69. Advertising expenditures, Marketing expenditures (in 1994 AOL decided to capitalize current marketing costs and amortize them over 12 months), R&D expenditures and the feasibility issue.

70. Economic sacrifice (historical cost). Reasons: Reliability, subjectivity.

71. The extent of Interest Capitalization depends (among other things) on the amounts the company borrowed (avoidable interest, SFAS No. 34). An “all equity” company can not capitalize any interest. The effect of Interest Capitalization: Balance Sheet: PPE increases. Income Statement: greater depreciation expense over the life of the asset. Interest Expense decreases (higher Net Income during construction, lower Net Income during the useful life of the asset).

72. a. Balance sheet Representation : $10 - 4.5 = 5.5$
 b. Whenever events or changes in circumstances indicated an asset may be impaired
 c. Impairment
 i. $5.5 - 2 = 3.5$
 ii. Part of Income from continuing operations (possibly a special item)

73. a. Bulleted items 1–3 go to the income statement (not capitalized). Bulleted item 4 goes to the balance sheet and increases the asset's value.
 b. Depreciation:
 • Years 1–4: $(130,000 - 10,000)/6 = 20,000$
 • Years 5–8: $(130,000 - 80,000 + 40,000 - 14,000)/4 = 19,000$

	Building cost	<u>300,000</u>	
	Total building cost	<u>\$ 333,000</u>	
37.	Purchase cost		\$ 260,000
	Installation		4,600
	Training		7,000
	Tax		<u>13,000</u>
	Total machine cost		<u>\$ 284,600</u>
49.	Carrying value \$50,000 – fair value \$25,000 = impairment loss \$25,000		

53.	DDB	SYD	SL
2005	\$ 20,000	\$ 15,000	\$ 9,000
2006	12,000	12,000	9,000
2007	7,200	9,000	9,000
2008	4,320	6,000	9,000
2009	1,480	3,000	9,000
Total	\$ 45,000	\$ 45,000	\$ 45,000

Answer = Sum-of-the-years' digits

57.	DDB	SYD	SL
2006	\$ 63,000	\$ 48,000	\$ 30,000
2007	31,500	36,000	30,000
2008	12,750	24,000	30,000
2009	12,750	12,000	30,000
Total	\$ 120,000	\$ 120,000	\$ 120,000

63. Sales price \$6,000 – book value (\$34,000 – \$27,000) = ordinary loss \$1,000

- 64.** Sales price \$16,000 – book value (? – \$50,000) = ordinary gain \$4,000
 Book value = \$66,000 – \$4,000 = \$62,000

Explanation to Selected Multiple-Choice Questions

35.	Land	\$ 100,000
	Demolition	20,000
	Scrap value	(5,000)
	Title insurance	1,000
	Paving assessment	<u>2,000</u>
	Total land cost	<u>\$ 118,000</u>
36.	Architect fees	\$ 25,000
	Construction interest	8,000