Question #1 of 76

Question ID: 1457754

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 $100,000.

B) Gain of $40,000.

C) Loss of $360,000.

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).

(Module 23.3, LOS 23.k)

Question #2 of 76

Question ID: 1457701

Capitalizing interest costs related to a company's construction of assets for its own use is *required* by:

A) U.S. GAAP only.

B) both IFRS and U.S. GAAP.

C) IFRS only.

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.

(Module 23.1, LOS 23.a)

Question #3 of 76

Question ID: 1457736

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) an accelerated amortization method is more appropriate than the straight-line method.

C) 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.

(Module 23.2, LOS 23.g)

Question #4 of 76

Question ID: 1457744

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.

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 writedown 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.

(Module 23.3, LOS 23.i)

Question #5 of 76

Question ID: 1457771

Under IFRS, if a firm reports investment property using the fair value model, unrealized gains and losses on investment property are:

A) disclosed in the financial statement notes.

B) recognized in other comprehensive income.

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.

(Module 23.4, LOS 23.n)

Question #6 of 76

Question ID: 1457702

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.

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 23.1, LOS 23.b)

Question #7 of 76

Question ID: 1457711

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.

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.

(Module 23.1, LOS 23.c)

Question #8 of 76

Question ID: 1457729

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.

Explanation

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

(Module 23.2, LOS 23.e)

Question #9 of 76

Question ID: 1457735

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) $2.1 million.

B) $2.0 million.

C) \$2.2 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 × \$5 million = \$2 million.

(Module 23.2, LOS 23.g)

Question #10 of 76

Question ID: 1457740

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.

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.

(Module 23.2, LOS 23.h)

Question #11 of 76

Question ID: 1457747

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.

Explanation

An asset is impaired if its future cash flows (undiscounted) are less than its carrying value.

(Module 23.3, LOS 23.j)

Question #12 of 76

Question ID: 1457763

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.

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.

(Module 23.4, LOS 23.l)

Question #13 of 76

Question ID: 1457745

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) The debt-to-equity ratio will be unaffected by the revaluation.

B) Net income will be higher in the period of the revaluation.

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.

(Module 23.3, LOS 23.i)

Question #14 of 76

Question ID: 1457741

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.

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.

(Module 23.3, LOS 23.i)

Question #15 of 76

Question ID: 1457773

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 increase in shareholders' equity.

C) €150,000 gain on its income statement and a €50,000 revaluation surplus in shareholders' equity.

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.

(Module 23.4, LOS 23.n)

Question #16 of 76

Question ID: 1457767

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.

Explanation

Average age = accumulated depreciation / annual depreciation expense.

(Module 23.4, LOS 23.m)

Question #17 of 76

Question ID: 1462845

A company that capitalizes costs instead of expensing them will have:

A) lower cash flows from investing and lower income variability.

B) lower cash flows from operations and higher profitability in early years.

C) higher income variability and higher cash flows from operations.

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. (Module 23.1, LOS 23.c)

Question #18 of 76

Question ID: 1457742

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.

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.

(Module 23.3, LOS 23.i)

Question #19 of 76

Question ID: 1457760

An impairment write-down is *least likely* to decrease a company's:

A) future depreciation expense. ✗

B) debt-to-equity ratio. ✓

C) assets. ✗

Explanation

An impairment write-down reduces equity and has no effect on debt. The debt-to-equity ratio would therefore increase.

(Module 23.3, LOS 23.f)

Question #20 of 76

Question ID: 1457737

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. ✗

Explanation

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

(Module 23.2, LOS 23.g)

Question #21 of 76

Question ID: 1457719

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.

Explanation

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

(Module 23.2, LOS 23.d)

Question #22 of 76

Question ID: 1457756

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.

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).

(Module 23.3, LOS 23.k)

Question #23 of 76

Question ID: 1457762

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. ✓

Explanation

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

(Module 23.4, LOS 23.l)

Question #24 of 76

Question ID: 1457753

The *most likely* effects of taking an impairment charge in the current period on an intangible asset with a remaining life of five years would be to:

A) increase the debt-to-equity ratio and decrease the long-term asset turnover ratio. ✗

B) reduce net income in the current period and increase it in future periods. ✓

C) reduce pretax income and accumulated amortization in the current period. ✗

Explanation

The impairment charge is reported as a loss on the income statement, reducing net income. In subsequent periods, the asset's carrying value will be less, reducing amortization expense and increasing net income. The impairment charge reduces the value of long-term assets and increases the long-term asset turnover ratio. Accumulated amortization is unaffected by the impairment, which is recorded as an adjustment to the gross value of the intangible asset.

(Module 23.3, LOS 23.j)

Question #25 of 76

Question ID: 1457748

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. ✗

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.

(Module 23.3, LOS 23.j)

Question #26 of 76

Question ID: 1457761

Taking an impairment of long-lived assets will result in:

A) higher deferred tax liabilities. ✗

B) higher future return on assets. ✓

C) a lower debt-to-equity ratio. ✗

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 23.3, LOS 23.f)

Question #27 of 76

Question ID: 1457774

A building owned by a firm is *most likely* to be classified as investment property if:

A) space in the building is rented to other firms. ✓

B) the firm uses the building for its corporate headquarters. ✗

C) the building is a manufacturing plant or distribution center. ✗

Explanation

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

(Module 23.4, LOS 23.n)

Question #28 of 76

Question ID: 1457766

A reconciliation of beginning and ending carrying values for each class of property, plant, and equipment is required for firms reporting under:

A) both U.S. GAAP and IFRS. ✗

B) U.S. GAAP. ✗

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.

(Module 23.4, LOS 23.l)

Question #29 of 76

Question ID: 1462844

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.

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 23.1, LOS 23.b)

Question #30 of 76

Question ID: 1457765

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.

Explanation

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

(Module 23.4, LOS 23.l)

Question #31 of 76

Question ID: 1457732

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.

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.

(Module 23.2, LOS 23.g)

Question #32 of 76

Question ID: 1457758

Three years ago, Ranchero Corporation purchased equipment for a process used in production, for £3 million. At the end of last year, Ranchero determined the fair value of the equipment was greater than its book value. No impairment losses have been recognized on the equipment. Assuming Ranchero 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) Only one will increase.

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 23.3, LOS 23.f)

Question #33 of 76

Question ID: 1462849

Under U.S. GAAP, an asset is considered impaired if its book value is:

A) greater than the present value of its expected future cash flows.

B) less than its market value.

C) 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. (Module 23.3, LOS 23.j)

Question #34 of 76

Question ID: 1457772

The revaluation model for investment property is permitted under:

A) neither IFRS nor U.S. GAAP.

B) IFRS, but not U.S. GAAP.

C) both IFRS and 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.

(Module 23.4, LOS 23.n)

Question #35 of 76

Question ID: 1457704

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.

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 23.1, LOS 23.b)

Question #36 of 76

Question ID: 1462850

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) The land and the buildings that generate rental income. ✓

B) Only the land held for capital appreciation. ✗

C) All of these assets. ✗

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. (Module 23.4, LOS 23.n)

Question #37 of 76

Question ID: 1457728

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) total assets on the balance sheet. ✗

B) net income/sales ratio. ✗

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.

(Module 23.2, LOS 23.e)

Question #38 of 76

Question ID: 1457730

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) Higher asset turnover ratio.

B) Lower debt-to-equity ratio.

C) Lower current 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.

(Module 23.2, LOS 23.e)

Question #39 of 76

Question ID: 1462846

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.

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. (Module 23.2, LOS 23.g)

Question #40 of 76

Question ID: 1457749

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 its carrying value exceeds expected future cash flows.

C) impaired because expected salvage value has declined.

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

(Module 23.3, LOS 23.j)

Question #41 of 76

Question ID: 1457739

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.

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.

(Module 23.2, LOS 23.h)

Question #42 of 76

Question ID: 1457716

Compared to expensing, capitalizing costs will *most likely* result in:

A) lower returns on assets in the period of capitalization.

B) lower debt-to-equity ratios.

C) higher net cash flows.

Explanation

Capitalizing expenses will increase assets by the capitalized amount, compared with expensing. This will increase both assets and equity and decrease debt-to-equity ratios. If taxes are ignored, net cash flow is unaffected by whether the company expenses or capitalizes costs. If taxes are considered, net cash flow will be lower because capitalization of costs will increase both net income and taxes payable. Assuming that assets are greater than income, ROA will be higher in the period of capitalization, compared with expensing.

(Module 23.1, LOS 23.c)

Question #43 of 76

Question ID: 1462843

Which of these intangible assets is *most likely* to be amortized?

A) Purchased patent that will expire in the current period.

B) Internally developed trademark with a useful life of 20 years.

C) 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 23.1, LOS 23.b)

Question #44 of 76

Question ID: 1457743

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.

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.

(Module 23.3, LOS 23.i)

Question #45 of 76

Question ID: 1457712

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 debt/equity ratio and higher debt/assets ratio.

B) higher cash flows from operations and lower cash flow from investing.

C) lower profitability (ROA and ROE) in early years and higher in later years.

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.

(Module 23.1, LOS 23.c)

Question #46 of 76

Question ID: 1457757

Question #46 of 76

Question ID: 1457737

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. ✗

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 23.3, LOS 23.f)

Question #47 of 76

Question ID: 1457720

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) $3,000.00. ✗

B) $2,880.00. ✗

C) $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 × 2/5 = $8,000

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

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

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

Year 3 DDB depreciation = $7,200 × 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.

(Module 23.2, LOS 23.d)

Question #48 of 76

Question ID: 1457775

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) No, because the firm must continue to use the cost model for valuation of this asset.

B) Yes, because the plant will be reclassified as investment property.

C) 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.

(Module 23.4, LOS 23.n)

Question #49 of 76

Question ID: 1457724

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) $1,600.

B) $4,800.

C) $5,200.

Explanation

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

(Module 23.2, LOS 23.d)

Question #50 of 76

Question ID: 1462847

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.

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. (Module 23.3, LOS 23.i)

Question #51 of 76

Question ID: 1457713

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.

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.

(Module 23.1, LOS 23.c)

Question #52 of 76

Question ID: 1457733

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.

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.

(Module 23.2, LOS 23.g)

Question #53 of 76

Question ID: 1457731

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.

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.

(Module 23.2, LOS 23.e)

Question #54 of 76

Question ID: 1457764

For impaired long-lived assets, a firm reporting under IFRS is *least likely* required to disclose the:

A) estimated probabilities of reversing impairment losses.

B) amounts of impairment losses and reversals by asset class.

C) circumstances that caused the impairment losses or reversals.

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.

(Module 23.4, LOS 23.l)

Question #55 of 76

Question ID: 1457770

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) only if it reverses a previously recognized loss.

B) equal to the difference between fair value and carrying value.

C) in other comprehensive income but not on the income statement.

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.

(Module 23.4, LOS 23.n)

Question #56 of 76

Question ID: 1457705

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. ✗

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 23.1, LOS 23.b)

Question #57 of 76

Question ID: 1457717

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. ✗

Explanation

yr. 2004 = 24,000 × 2/5 = 9,600

yr. 2005 = (24,000 − 9,600) × 2/5 = 5,760

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

(Module 23.2, LOS 23.d)

Question #58 of 76

Question ID: 1457709

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) $14 million. ✗

B) $6 million. ✗

C) $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.

(Module 23.1, LOS 23.c)

Question #59 of 76

Question ID: 1457718

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) $6,000. ✗

B) $12,000. ✗

C) $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

(Module 23.2, LOS 23.d)

Question #60 of 76

Question ID: 1457769

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.

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 23.4, LOS 23.m)

Question #61 of 76

Question ID: 1457710

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.

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.

(Module 23.1, LOS 23.c)

Question #62 of 76

Question ID: 1457714

Capitalized interest costs are typically reported in the cash flow statement as an outflow from:

A) financing.

B) investing.

C) operating.

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.

(Module 23.1, LOS 23.c)

Question #63 of 76

Question ID: 1457727

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.

Explanation

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

(Module 23.2, LOS 23.e)

Question #64 of 76

Question ID: 1457722

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.

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.

(Module 23.2, LOS 23.d)

Question #65 of 76

Question ID: 1457726

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.

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.

(Module 23.2, LOS 23.e)

Question #66 of 76

Question ID: 1457734

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) $800,000.

B) $400,000.

C) $1,200,000.

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.

(Module 23.2, LOS 23.g)

Question #67 of 76

Question ID: 1457755

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.

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.

(Module 23.3, LOS 23.k)

Question #68 of 76

Question ID: 1457708

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) 35.6%.

B) 38.9%.

C) 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%.

(Module 23.1, LOS 23.c)

Question #69 of 76

Question ID: 1457759

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.

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 23.3, LOS 23.f)

Question #70 of 76

Question ID: 1457768

Which of the following is *best* estimated by the ratio of net PP&E to annual depreciation expense?

A) Remaining useful life. ✓

B) Average age. ✗

C) Total useful life. ✗

Explanation

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

(Module 23.4, LOS 23.m)

Question #71 of 76

Question ID: 1457725

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 separate depreciation schedules for the machines and the building. ✓

B) may have separate depreciation schedules for the machines and the building. ✗

C) must have a single depreciation schedule for the plant. ✗

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.

(Module 23.2, LOS 23.d)

Question #72 of 76

Question ID: 1457721

Czernezyk Company buys a delivery vehicle for €60,000. Czernezyk 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 Czernezyk 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.

Explanation

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

(Module 23.2, LOS 23.d)

Question #73 of 76

Question ID: 1457703

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.

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 23.1, LOS 23.b)

Question #74 of 76

Question ID: 1457723

Slovac 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 Slovac uses the double-declining balance method of depreciation?

A) $1,406.

B) $1,438.

C) $1,875.

Explanation

double-declining balance depreciation rate = 2 × 1/8 = ¼ or 25%

first year deprecation will be $7,500 × 0.25 = $1,875

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

(Module 23.2, LOS 23.d)

Question #75 of 76

Question ID: 1457750

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 *least* 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.

Explanation

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

(Module 23.3, LOS 23.j)

Question #76 of 76

Question ID: 1462848

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) write down the machine to its recoverable amount as soon as it is depreciated down to salvage value.

B) immediately write down the machine to its salvage value.

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. (Module 23.3, LOS 23.j)