Chapter 7 (Week 9 lecture)

Tutorial question (P7-5A, P7-7A, P7-8A)

P7–5A University Car Wash built a deluxe car wash across the street from campus. The new machines cost $270,000 including installation. The company estimates that the equipment will have a residual value of $24,000. University Car Wash also estimates it will use the machine for six years or about 12,000 total hours. Required: **Prepare a depreciation schedule for six years using the following methods**:

1. Straight-line.

Year	Depreciable cost	x Depreciable Rate	= Depreciation Expense	Accumulated depreciation	Book value
1					
2					
3					
4					
5					
6					

2. Double-declining

Year	Depreciable cost	x Depreciable Rate	= Depreciation Expense	Accumulated depreciation	Book value
1					
2					
3					
4					
5					
6					

3. Activity-based - Actual use per year was as follows:

Year	Hours Used	x Depreciable Rate	= Depreciation Expense	Accumulated depreciation	Book value
1	3,100				
2	1,100				
3	1,200				
4	2,800				
5	2,600				
6	1,200				

P7–7A Solich Sandwich Shop had the following long-term asset balances as of December 31, 2024:

	Cost	**Accumulated Depreciation**	**Book Value**
Land	$ 95,000	–	$ 95,000
Building	460,000	$(165,600)	294,400
Equipment	235,000	(50,000)	185,000
Patent	250,000	(100,000)	150,000

Additional information:

1. Solich purchased all the assets at the beginning of 2022.
2. The building is depreciated over a 10-year service life using the double-declining-balance method and estimating no residual value
3. The equipment is depreciated over a nice-year service life using the straight-line method with an estimated residual value of $10,000.
4. The patent is estimated to have a five-year useful life with no residual value and is amortized using the straight-line method.
5. Depreciation and amortization have been recorded for 2022 and 2023 (first two years).

   Required:

   1. For the year ended December 31, 2024, record depreciation expense for buildings and equipment. Land is not depreciated.
   2. For the year ended December 31, 2024, record amortization expense for the patent.
   3. Calculate the book value for each of the four long-term assets at December 31, 2024.

P7–8A New Morning Bakery is in the process of closing its operations. It sold its two-year-old bakery ovens to Great Harvest Bakery for $700,000. The ovens originally cost $910,000, had an estimated service life of 10 years, had an estimated residual value of $60,000, and were depreciated using straight-line depreciation. Complete the requirements below for New Morning Bakery.

Required:

1. Calculate the balance in the Accumulated Depreciation account at the end of the second year.
2. Calculate the book value of the ovens at the end of the second year.
3. What is the gain or loss on the sale of the ovens at the end of the second year?
4. Record the sale of the ovens at the end of the second year.

Take-home question (P7-1A, P7-4A, P7-6A, RWP7-6)

P7–1A The Italian Bread Company purchased land as a factory site for $70,000. An old building on the property was demolished, and construction began on a new building. Costs incurred during the first year are listed as follows:

Demolition of old building	$ 9,000
Sale of salvaged materials	(1,100)
Architect fees (for new building)	20,000
Legal fees (for title investigation of land)	3,000
Property taxes on the land (for the first year)	4,000
Building construction costs	600,000
Interest costs related to the construction	23,000

Required:

Determine the amounts that the company should record in the Land and the Building accounts.

P7–4A Several years ago, Health Services acquired a helicopter for use in emergency situations. Health Services incurred the following expenditures related to the helicopter delivery operations in the current year:

1. Overhauled the engine at a cost of $7,500. Health Services estimated the work would increase the service life for an additional five years.
2. Cleaned, repacked, and sealed the bearings on the helicopter at a cost of $800. This repair is performed annually.
3. Added new emergency health equipment to the helicopter for $25,000.
4. Modified the helicopter to reduce cabin noise by installing new sound barrier technology at a cost of $15,000.
5. Paid insurance on the helicopter for the current year, which increased 15% over the prior year to $9,000.
6. Performed annual maintenance and repairs at a cost of $39,000.

Required:

Indicate whether Health Services should capitalize or expense each of these expenditures.

P7–6A The following information relates to the intangible assets of University Testing Services (UTS):

a. On January 1, 2024, UTS completed the purchase of Heinrich Corporation for $3,510,000 in cash. The fair value of the net identifiable assets of Heinrich was $3,200,000.

b. Included in the assets purchased from Heinrich was a patent valued at $82,250. The original legal life of the patent was 20 years; there are 12 years remaining, but UTS believes the patent will be useful for only 7 more years.

c. UTS acquired a franchise on July 1, 2024, by paying an initial franchise fee of $333,000. The contractual life of the franchise is 9 years.

Required:

1. Record amortization expense for the intangible assets at December 31, 2024.

2. Prepare the intangible asset section of the December 31, 2024, balance sheet.

RWP7–6 Companies often are under pressure to meet or beat Wall Street earnings projections in oder to increase stock price and also to increase the value of stock options. Such pressure may cause same managers to alter their estimates for depreciation to artificially create desired results.

Required:

1. Understand the reporting effect: Do estimates by managment affect the amount of depreciation in its company's financial statements?

2. Sepecify the options: To increase earnings in the initial years following the purchase of a depreciable asset, would management (a) choose straight-line or double-declining balance, (b) estimate a longer or shorter service life, and (c) estimate a higher or lower residual value?

3. Identify the impact: Are decisions of investors and creditors affected by accounting estimates?

4. Make a decision: Should a company alter depreciation estimates for the sole purpose of meeting expectations of Wall Street analysts?