Question #1 of 14

Question ID: 1573610

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 35.1, LOS 35.a)

Question #2 of 14

Question ID: 1573619

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 35.3, LOS 35.c)

Question #3 of 14

Question ID: 1573608

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 35.1, LOS 35.a)

Question #4 of 14

Question ID: 1573617

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

A) assets.

B) debt-to-equity ratio.

C) future depreciation expense.

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)

Question #5 of 14

Question ID: 1573616

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 35.2, LOS 35.b)

Question #6 of 14

Question ID: 1573620

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 35.3, LOS 35.c)

Question #7 of 14

Question ID: 1573621

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 35.3, LOS 35.c)

Question #8 of 14

Question ID: 1573612

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

A) Purchased franchise right with a useful life of two years. ✓

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

C) Purchased patent that will expire in the current period. ✗

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)

Question #9 of 14

Question ID: 1573609

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 35.1, LOS 35.a)

Question #10 of 14

Question ID: 1573615

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) Only one will increase.

B) Both 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 35.2, LOS 35.b)

Question #11 of 14

Question ID: 1573611

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) both of these assets.

B) neither of these assets.

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)

Question #12 of 14

Question ID: 1573618

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

A) higher future return on assets.

B) a lower debt-to-equity ratio.

C) higher deferred tax liabilities.

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)

Question #13 of 14

Question ID: 1573613

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 35.1, LOS 35.a)

Question #14 of 14

Question ID: 1573614

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 35.2, LOS 35.b)