

Review

What are “long-term” assets?

- If an asset is not “short-term” (i.e., a current asset) it is “long-term”

General types of long-term asset

- Tangible long-term assets (e.g., equipment, land, buildings)
- Intangible long-term assets (e.g., patents, goodwill, brand names)

Capitalize all costs needed to get the asset ready for its intended use, such as...

- Purchase price, demolition costs, transaction costs, interest on loan used to buy asset (capitalized interest)

Post-Acquisition Expenditures

- Expense the cost if it only helps maintain the productive capacity of the asset during the current accounting period
- Capitalize the cost if it increases the productive life, operating efficiency or capacity of the asset

Cost allocation terms

- Depreciation: Allocation of a long-term **tangible** asset’s cost to an expense over time
- Amortization: Allocation of a long-term **intangible** asset’s cost to an expense over time
- Depletion: Allocation of a long-term **natural resource** asset’s cost to an expense over time

Cost allocation assumptions

- Useful life
- Residual Value

Cost allocation methods

	Computation	Depreciation Expense
Straight-line	$(\text{Cost} - \text{Salvage value}) / \text{Useful life}$	Equal amounts each year
Units of production	$[(\text{Cost} - \text{Salvage value}) / \text{Estimated total production}] \times \text{Annual production}$	Varying amounts based on production level
Double declining balance (accelerated method)	$[(\text{Cost} - \text{Accumulated depreciation}) / \text{Useful life}] \times 2$	Declining amounts over time

Impairment testing

1. Test for impairment: if net book value > estimated future cash flows → asset is impaired
2. Compute impairment loss: Impairment loss = Net book value – Fair value

Disposal of long-term assets

1. Adjusting entry to update the depreciation expense and accumulated depreciation accounts
2. Record the disposal – cost of the asset and any accumulated depreciation at the date of the disposal must be removed from the accounts → difference between the resources received on disposal and the net book value is treated as a gain or loss

E.g., Loss on sale

Cash (A+)	500,000	
Loss on sale of assets (Loss/E+/SE-)	50,000	
Accumulated Depreciation (XA-)	200,000	
Equipment (A-)		750,000

Intangible assets

- Definite-lived – cost is allocated on a straight-line basis each period over its useful life in a process called amortization
- Indefinite-lived – not amortized but tested at least annually for impairment

Goodwill

- Only recorded when another business is purchased –
 - Goodwill = Purchase price – Net assets (at fair value)

Key ratio from Chapter 8

Fixed Asset Turnover = Net Sales/Average Net Fixed Assets

Problem 1

Stillwater Youth Programs (SYP) purchased a used school bus to use in transporting children for its after-school programs. SYP incurred the following expenses related to the bus in 2013:

1. Painted the SYP logo on the bus for \$3,000 to help promote the after-school program.
2. Installed new seats on the bus at a cost of \$5,000.
3. Installed a DVD player and sound system in the bus to entertain the children in-transit and announce upcoming events at a cost of \$1,000.
4. Paid insurance on the bus for 2010, which increased 10% over the prior year to an annual premium of \$2,800.
5. Performed annual maintenance and repairs for \$1,400.
6. Overhauled the engine at a cost of \$6,500, increasing the service life of the bus by an estimated three years.

Required:

1. Indicate whether SYP should capitalize or expense each of these expenditures.
2. How could SYP use expenditures like these to increase reported earnings?

Problem 2

The following information relates to the intangible assets of Lettuce Express:

1. On 1/1/10, Lettuce Express completed the purchase of Farmers Produce, Inc., for \$1,500,000 in cash. The fair value of the identifiable net assets of Farmers Produce was \$1,350,000.
2. Included in the assets purchased from Farmers Produce was a patent for a method of processing lettuce valued at \$45,000. The original legal life of the patent was 20 years. There are still 17 years left on the patent, but Lettuce Express estimates the patent will be useful for only 10 more years.
3. Lettuce Express acquired a franchise on 7/1/10 by paying an initial franchise fee of \$175,000. The contractual life of the franchise is seven years.

Required

1. Record the amortization expense for the intangible assets at 12/31/10.
2. Prepare the intangible asset section of the 12/31/10 balance sheet.