

FA Module 10: Accounting for long-lived assets (overview 4<sup>th</sup> edition)

(The attached PDF file has better formatting.)

(Readings from the fourth 4<sup>th</sup> edition of the Robinson text.)

Reading: chapter 8 long-lived assets

- ! § 2 acquisition of long-lived assets, *excluding*
  - " Exhibit 1 (Anheuser-Busch InBev)
  - " §2.2.2. Intangible Assets Developed Internally and Example 3 Software Development Costs
  - " Example 6 (Effect of Capitalized Interest Costs on Coverage Ratios and Cash Flow) and Exhibit 3 (Melco Resorts)
  - " § 2.5 Capitalization of internal development costs and Exhibit 4 Disclosure on Software Development Costs and Example 7 Software Development Costs
- ! § 3 depreciation and amortization of long-lived assets, *excluding*
  - " Example 9 Illustration of Depreciating Components of an Asset
- ! § 4 the revaluation model, *excluding*
  - " Exhibit 6 (Impact of revaluation – KPN)

§5 impairment of assets, §6 de-recognition, §7 Presentation and Disclosures, and §8 Investment Property are not on the syllabus for this course.

Statutory accounting in some countries, such as in the United States, differs from financial accounting; some costs that are capitalized or use long depreciation schedules for financial accounting are expensed or use short depreciation schedules for statutory accounting. This course covers financial accounting only.

§2 explains the types of long-lived assets; the final exam does not test the details in this section. For example, know what capitalized interest refers to and how it is computed, shown in Examples 1, 2, 4, and 5; the final exam does not test the additional material in Example 6 (Effect of Capitalized Interest Costs on Coverage Ratios and Cash Flow) and Exhibit 3 (Melco Resorts).

2.2.3. Intangible Assets Acquired in a Business Combination discusses goodwill. You must know how to compute full goodwill, partial goodwill, and the non-controlling (minority) interest associated with each, as explained in a later module. You cannot figure this out from Exhibit 1 Acquisition of Intangible Assets through a Business Combination; later sections of the textbook have clearer explanation.

Example 4 General Financial Statement Impact of Capitalizing Versus Expensing shows how capitalization affects other financial ratios. Given the financial ratio (such as ROE) under expensing and other relevant data, you should be able to compute the financial ratio with capitalization. Note that you must work out both income statement (net income) and balance sheet (equity) items under each scenario. Be sure you understand the logic: capitalizing expenditures shifts profits from later years to current years, whereas expensing expenditures shifts profits from current years to later years.

Know two depreciation methods: straight line depreciation and double declining balance depreciation. In the United States, one method may be used for financial statements and the other method for taxable income, leading to a deferred tax asset or liability. Other countries may require the same method for taxable income as for financial statements.

Know Example 8 Alternative Depreciation Methods and be able to fill in the template given the input values.

§7 (Presentation and Disclosures) is not on the syllabus, but it has a nice matrix showing the definitions of various terms:

- ! Estimated total useful life = Time elapsed since purchase (Age) + Estimated remaining life

!  $\text{Historical cost} \div \text{annual depreciation expense} = \text{Estimated total useful life}$

!  $\text{Historical cost} = \text{Accumulated depreciation} + \text{Net PPE}$

!  $\text{Estimated total useful life} = \text{Estimated age of equipment} + \text{Estimated remaining life}$

!  $\text{Historical cost} \div \text{annual depreciation expense} = \text{Accumulated depreciation} \div \text{annual depreciation expense} + \text{Net PPE} \div \text{annual depreciation expense}$ .

Understand the relations above. In particular, do not confuse depreciation (an expense) with accumulated depreciation (a balance sheet offset). Review end of chapter questions 10, 21, 22, 26, and 27.

If the asset has zero salvage value, the purchase price and the estimated useful life determine both straight line depreciation and double declining balance depreciation. Given the depreciation expense in any year from the two methods, one can derive the purchase price and the estimated useful life. A final exam problem might give straight line depreciation in the second year and double declining balance depreciation in the third year and ask for the double declining balance depreciation in the fifth year.

Acquisition expenditures (including interest costs) for long-lived fixed assets are often capitalized. A final exam problem may give the cost of constructing a building and the interest rate on a loan taken to pay a contractor, and ask for the carrying value of the building and the annual depreciation expense. GAAP and IFRS differ in one item: whether to deduct interest income on the unused cash from the capitalized interest.

Know Example 15 Calculation of Gain or Loss on the Sale of Long-Lived Assets. The computation is simple, but it seems confusing at first. Keep in mind that the gain is the excess of the sale price over the carrying value, not the excess of the sale price over the purchase price.

This module has much accounting detail. For the final exam, focus on depreciation schedules, amortization, and the calculation of gain or loss on the sale of long-lived assets.