*3-3C: Long-Lived Asset Assignment (50 marks) – Answer Key

1. JKL Company purchased a group of assets together from one of their competitors whose owner had recently decided to retire and stop operations. JKL paid $400,000 for land, building, equipment, 5 trucks, and a patent. They also had the following costs: $10,000 lawyer's fee; replaced the company name signage on the building for $15,000; had the company name and logo painted on the trucks for $10,000; bought driver's licenses for $3,300; paid $5,000 for the regular maintenance of the equipment; repainted the interior of the building for $10,000.

   The independent appraisals indicated the following fair values for the assets: land $250,000; building $280,000; equipment $175,000; trucks $50,000; patent $40,000.

   a. Prepare the journal entry to record the capital purchase (not the expenses).

   (Application – 12 marks – 2 marks for each amount)

GENERAL JOURNAL			
Date	**Account Titles and Explanation**	**Debit**	**Credit**
Year			
Month	Land	$125,000	
	Building	147,500	
	Equipment	87,500	
	Trucks	30,000	
	Patent	20,000	
	Bank/Cash		$410,000
	(B=280000+15000; T=$50000+10000)		
	(paid $410000; FMV=250+280+15+175+50+10+40)		

2. CDE Company purchased a mine for $6.5M that is estimated to have 25M tonnes of ore and a residual value of $500,000. In the first year, 5 million tonnes of ore are extracted and 3 million tonnes are sold.

   a. Journalize the ore mined for CDE year-end on August 31, 2018.

(Application – 7 marks – 1 mark for each account, amount and explanation)

GENERAL JOURNAL			
Date	**Account Titles and Explanation**	**Debit**	**Credit**
2018			
Aug. 31	Inventory	$480,000	
	Depletion Expense	720,000	
	Accumulated Depletion – Mine		$1,200,000
	(I=$6M/25M*2M; DE=$6M/25M*3M)		

3. Several years ago, MM Company purchased a well-known trademark for $120,000. After using the trademark for 3 years, MM discontinued using it completely. The owner tells you to continue depreciating the patent $3000 per year for the remaining 36 years. Do you agree? Explain.

   (Thinking – 2 marks)

4. WXY Company purchased new equipment on January 3, 2000, at a cost of $240,000. The equipment had an estimated useful life of 8 years, with an estimated residual value of $24,000. Use full years of depreciation. Show your calculations.

   a. Compute the first two years depreciation using:

      i. Straight-line Method

      ii. Double Declining Balance Method

      (Application – 5 marks – 2 marks for Straight-line; 3 marks for Double Declining)

      SL: Year 1 = ($240,000-24000)/8 = $27,000 / Year 2 = $27,000

      DDB: Year 1 = $240,000*25% (2X12.5%) = $60,000 / Year 2 = ($240-60)*25% = $45,000

   b. At the beginning of the 3rd year, the remaining estimated life is 4 years, and the residual value is now expected to be $26,000. Using Straight-line Method, calculate the depreciation for year 3.

(Application – 3 marks)

SL: Year 3 = ($240,000-27000-27000-26000)/4 = $40,000

c. At the beginning of the 4th year, the equipment is traded-in for a new piece of equipment. The new equipment is being sold for $250,000 and the old equipment has a trade-in allowance of $140,000. Record the journal entry for the trade-in.

(Application – 10 marks – 1 mark for each account and amount)

GENERAL JOURNAL			
Date	**Account Titles and Explanation**	**Debit**	**Credit**
Year			
Month	Equipment (new)	$250,000	
	Accumulated Depreciation – Equipment	94,000	
	Loss on Trade-in of Assets	6,000	
	Equipment (old)		$240,000
	Bank/Cash		110,000
	(Accum=27+27+40) (Cash=250-140) (Loss=240-94-140)		

d. Recalculate the depreciation for years 1 & 2 using the ½ year convention.

(5 marks – 2 marks for Straight-line; 3 marks for Double Declining)

SL: Year 1 = ($240,000-24000)/8 ÷ 2= $13,500 / Year 2 = $27,000

DDB: Year 1 = $240,000*25% (2X12.5%) ÷ 2 = $30,000 / Year 2 = ($240-30)*25% = $52,500

5. Assume that A Corporation and B Corporation are in the same line of business, have similar plant assets and report the same amount of net income. In their financial statements, A Corp. uses straight-line depreciation and B Corp. uses an accelerated method.

a. Do you have any reason for considering one of these companies to be more profitable than the other? Explain.

(Thinking – 3 marks)

If it is the early years, B is more profitable because they are subtracting more depreciation (accelerated method) and still have the same Net Income.

If it is the later years, A is more profitable because straight-line subtracts more depreciation after 7 or 8 years.

b. If a capital expenditure is mistakenly treated as a revenue expenditure, will the Net Income of the current year be overstated or understated? Will this error have any effect upon the Net Income reported in future years? Explain.

(Thinking – 3 marks)

The error causes a one-time expense to be too high, therefore Net Income will be too low in this year. Future years will have no expense allocation to them, so Net Income will be too high in these years.