Question #1 (AICPA.970510FAR-FA)

Ichor Co. reported equipment with an original cost of $379,000 and $344,000 and accumulated depreciation of $153,000 and $128,000, respectively, in its comparative financial statements for the years ended December 31, 2005 and 2004.
During 2005, Ichor purchased equipment costing $50,000 and sold equipment with a carrying value of $9,000.

What amount should Ichor report as depreciation expense for 2005?

- [ ] A. $19,000
- [ ] B. $25,000
- [x] C. $31,000

Net equipment at end of 2004: $344,000-$128,000 =	$216,000
Equipment purchase	50,000
Book value of equipment sold	(9,000)
Depreciation in 2005	?
Equals net equipment at end of 2005: $379,000-$153,000 =	$226,000

Solving for depreciation yields $31,000 depreciation for 2005.

- [ ] D. $34,000

Question #2 (AICPA.900521FAR-TH-FA)

Net income is understated if, in the first year, estimated salvage value is excluded from the depreciation computation when using the

	Straight-line method	Production or use method
[ ]	Yes	No
[x]	Yes	Yes

When salvage value is excluded from the computation of depreciation, excessive depreciation is recognized each year under BOTH methods. Therefore, income is understated for both methods.

Annual depreciation under straight-line is:
(1/n)(cost-salvage)
where n is the number of years in the useful life.
Annual depreciation under the production method is:
(current year production/tot.est.production)(cost-salvage)

In both cases, if salvage value is excluded from the computation, depreciation is overstated because cost, rather than depreciable cost, is used as the basis for depreciation.

	Straight-line method	Production or use method
[ ]	No	No
[ ]	No	Yes

Question #3 (AICPA.940545FAR-FA)

On January 2, 2005, Lem Corp. bought machinery under a contract that required a down payment of $10,000, plus 24 monthly payments of $5,000 each, for total cash payments of $130,000.

The cash-equivalent price of the machinery was $110,000. The machinery has an estimated useful life of 10 years and estimated salvage value of $5,000. Lem uses straight-line depreciation.

In its 2005 Income Statement, what amount should Lem report as depreciation for this machinery?

- [x] A. $10,500

    The capitalized cost of the equipment is $110,000, not the total of the cash payments to be made. The latter amount includes interest.

    Thus, annual depreciation is $10,500: ($110,000-$5,000)/10.

- [ ] B. $11,000
- [ ] C. $12,500
- [ ] D. $13,000

Question #4 (AICPA.0821124FAR-II.D)

A manufacturing firm purchased used equipment for $135,000. The original owners estimated that the residual value of the equipment was $10,000. The carrying amount of the equipment was $120,000 when ownership transferred. The new owners estimate that the expected remaining useful life of the equipment was 10 years, with a salvage value of $15,000. What amount represents the depreciable base used by the new owners?

- [ ] A. $105,000
- [ ] B. $110,000
- [x] C. $120,000

    The purchase price of the asset acquired less its salvage value is the asset's depreciable cost. In this case, total depreciation on the asset is limited to $120,000 ($135,000 purchase price-$15,000 salvage value). The cost to the seller and the previous salvage value are not relevant to the new owner.

- [ ] D. $125,000

Question #5 (AICPA.931134FAR-TH-FA)

In which of the following situations is the units of production method of depreciation most appropriate?

- [x] A. An asset's service potential declines with use.

    This method is most appropriate when the service potential of an asset can be estimated reliably in terms of a physical variable, such as miles to be driven, or number of units of output that can be produced by the asset.

    Over time, as more units are produced, the service potential of the asset declines because the total number of units that can be produced is finite. Over time, the number of units that can be produced by the asset in the future declines. The primary

causative agent for depreciation under the units of production method is, thus, the actual use of the asset in production.

- [ ] B. An asset's service potential declines with the passage of time.
- [ ] C. An asset is subject to rapid obsolescence.
- [ ] D. An asset incurs increasing repairs and maintenance with use.

Question #6 (AICPA.920517FAR-TH-FA)

On January 1, 2005, Brecon Co. installed cabinets to display its merchandise in customers' stores. Brecon expects to use these cabinets for five years.

Brecon's 2005 multi-step Income Statement should include:

- [ ] A. One-fifth of the cabinet costs in cost of goods sold.
- [x] B. One-fifth of the cabinet costs in selling, general, and administrative expenses.

With a five year life, 1/5 of the cost of the cabinets is expensed as depreciation. The cabinets are not involved in the manufacturing of the goods. Rather, they are used to help sell the merchandise.

Thus, the depreciation is not included in cost of goods sold; rather, it is included in selling, general, and administrative expenses.

- [ ] C. All of the cabinet costs in cost of goods sold.
- [ ] D. All of the cabinet costs in selling, general, and administrative expenses.

Question #7 (AICPA.920515FAR-TH-FA)

What factor must be present to use the units of production (activity) method of depreciation?

- [x] A. Total units to be produced can be estimated.

Without an estimate for total units to be produced, depreciation could not be computed. Annual depreciation under this method is:

[(Cost-salvage value)/(Total estimated production)](units produced year).

The quantity in square brackets is the rate of depreciation per unit.

- [ ] B. Production is constant over the life of the asset.
- [ ] C. Repair costs increase with use.
- [ ] D. Obsolescence is expected.

Question #8 (AICPA.901112FAR-P2-FA)

Zahn Corp.'s comprehensive Balance Sheet at December 31, 2005 and 2004 reported accumulated depreciation balances of $800,000 and $600,000, respectively. Property with a cost of $50,000 and a carrying amount of $40,000 was the only property sold in 2005.

Depreciation charged to operations in 2005 was:

- [ ] A. $190,000
- [ ] B. $200,000
- [x] C. $210,000

The accumulated depreciation on the property sold was $10,000 ($50,000 cost less $40,000 carrying value). The sale of property requires that the accumulated depreciation on the property be removed from the accounts.

Thus, the $10,000 amount is a decrease in accumulated depreciation. With an overall increase of $200,000 in accumulated depreciation during the period ($800,000-$600,000), depreciation must have been $210,000 ($200,000 + $10,000).

- [ ] D. $220,000

Question #9 (AICPA.08211231FAR-II.D)

In 2002, Spirit, Inc. determined that the 12-year estimated useful life of a machine purchased for $48,000 in January 1997 should be extended by three years. The machine is being depreciated using the straight-line method and has no salvage value. What amount of depreciation expense should Spirit report in its financial statements for the year ending December 31, 2002?

- [x] A. $2,800

This is a change in estimate and is handled currently and prospectively by allocating the remaining book value at the beginning of 2002 over the revised estimate of remaining years at that point. Through the beginning of 2002, the asset has been used five years. Therefore, seven years remain in the original book value. The book value at the beginning of 2002 is 7/12 x $48,000 or $28,000. The remaining useful life of seven years is extended to 10. Therefore, depreciation expense for 2002 is $28,000 x 1/10 or $2,800.

- [ ] B. $3,200
- [ ] C. $43,200
- [ ] D. $4,800