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Università Cattaneo

Management & Principles of Accounting
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Recording long-lived assets and other investments

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E-Book

After this lesson you should be able to:

- Explain the recording of long-lived assets

Long-lived assets: a definition

There are three main categories of long-lived assets:

1 Long-term investments

Long-term investments are generally: (1) investments in stocks and bonds of other corporations that are held for more than one year, (2) long-term assets such as land or buildings that a company is not currently using in its operating activities, and (3) long-term notes receivable. In Illustration 1:, Franklin Corporation reported total long-term investments of $ 7,200 on its balance sheet.

In Illustration 2: Yahoo! Inc. reported long-term investments of $ 90.266 on its balance sheet in a recent year

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Illustration 1: Classified balance sheet

FRANKLIN CORPORATION
Balance Sheet
October 31, 2014

Assets			
Current assets			
Cash		$ 6,600	
Debt investments		2,000	
Accounts receivable		7,000	
Notes receivable		1,000	
Inventory		3,000	
Supplies		2,100	
Prepaid insurance		400	
Total current assets			$22,100
Long-term investments			
Stock investments		5,200	
Investment in real estate		2,000	7,200
Property, plant, and equipment			
Land		10,000	
Equipment	$24,000		
Less: Accumulated depreciation—equipment	5,000	19,000	29,000
Intangible assets			
Patents			3,100
Total assets			$61,400

Illustration 2: Long-term investment section

Real World	YAHOO! INC. Balance Sheet (partial) (in thousands)
Long-term investments	
Investments in securities	$90,266

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2. Long-term investments

Property, plant, and equipment are assets with relatively long useful lives that are currently used in operating the business. This category includes, land, buildings, equipment, delivery vehicles, and furniture. In Illustration 1 Franklin Corporation reported property, plant and equipment of $ 29,000.

Depreciation is the allocation of the cost of an asset to a number of years. Companies do this by systematically assigning a portion of an asset's cost as an expense each year (rather than expensing the full purchase price in the year of purchase). The asset that the company depreciates are reported on the balance sheet at cost less accumulated depreciation. The accumulated depreciation account shows the total amount of depreciation that the company has expensed thus far in the asset's life. In Illustration 1 Franklin Corporation reported accumulated depreciation of $ 5,000.

Illustration 3 presents the property, plant, and equipment of Cooper Tire & Rubber Company in a recent year.

Illustration 3: Property, plant and equipment

Real World

COOPER TIRE & RUBBER COMPANY
Balance Sheet (partial)
(in thousands)

Property, plant, and equipment		
Land and land improvements	$ 41,553	
Buildings	298,706	
Machinery and equipment	1,636,091	
Molds, cores, and rings	268,158	$2,244,508
Less: Accumulated depreciation		1,252,692
		$ 991,816

3. Intangible Assets

Many companies have assets that do not have physical substance and yet often are very valuable.

We call these assets intangible assets.

One common intangible is goodwill. Others include patents copyrights, and trademarks or trade names that give the company exclusive right of use for a specified period of time. Franklin Corporation reported intangible assets of $ 3,100.

Illustration 4 shows the intangible assets of media giant Time Warner, Inc. I a recent year.

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Illustration 4: Intangible asset

Real World

TIME WARNER, INC.
Balance Sheet (partial)
(in millions)

Intangible assets	
Goodwill	$40,953
Film library	2,690
Customer lists	2,540
Cable television franchises	38,048
Sports franchises	262
Brands, trademarks, and other intangible assets	8,313
	$92,806

Long-lived assets: summary

In summary the three main categories of long-lived assets are:

tangible assets (fixed assets)

- long-term investments
- Property, Plant and Equipment

Intangible assets (which have no physical substance, but represent special rights)

- patents, copyrights, brands, trademarks etc

Accounting is similar for these categories. There are some differences as far as valuation issues are concerned, as we will talk later about in the course.

Recording purchase of long-lived assets

When we buy a long-lived asset, as shown in previous sessions, we make the following entry:

Land (A)		2.000	
	Cash (A)		2.000

……………………. *Please note that sometimes we skip the description, but remember that the companies always put it after each accounting entry !*

We record the asset at purchase cost. This cost includes purchase commissions, applicable taxes, legal fees, transportation charges, installation costs and all other amounts paid to acquire the asset and to make it ready for its intended use.

So, for example, if after a while we pay brokerage commissions for a 200 Euros related to the land acquired, we record

Land (A)		200	
	Cash (A)		200

Long-lived assets: Coca-Cola Company

Real World

THE COCA-COLA COMPANY
Balance Sheet (partial)
(in millions)

Property, plant, and equipment	
Land	$ 699
Buildings and improvements	3,816
Machinery and equipment	10,355
Containers and other	1,597
	16,467
Less: Accumulated depreciation	6,906
	9,561
Intangible assets	
Trademarks with indefinite lives	6,183
Goodwill	4,224
Other intangible assets	2,421
	$12,828

Recording operating leasing

Instead of buying a long-lived asset, a company may lease it. A lease is a rental agreement in which the tenant (lessee) agrees to make rent payments to the property owner (lessor) in exchange for the use of the asset.

There are two types of leases: operating and capital leases.

Operating lease is often short-term. Risks and rewards remain on the lessor. The lessee has the right to use the asset but has no continuing rights to the asset.

To account for an operating lease:

Rent (Lease) expense (E)	2.000	
Cash (A)		2.000

Accounting for **capital lease** is far more complicated. For some details see “Financing operations”.

Recording sales of long-lived assets

When we sell a long-lived asset, we record a gain (loss) on the sale if the selling price is higher (lower) than the book value of the asset.

For example, if we sell the land we bought before for 1.300:

Cash (A)	1.300	
Land (A)		1.100
Gain on sale of land (R)		200

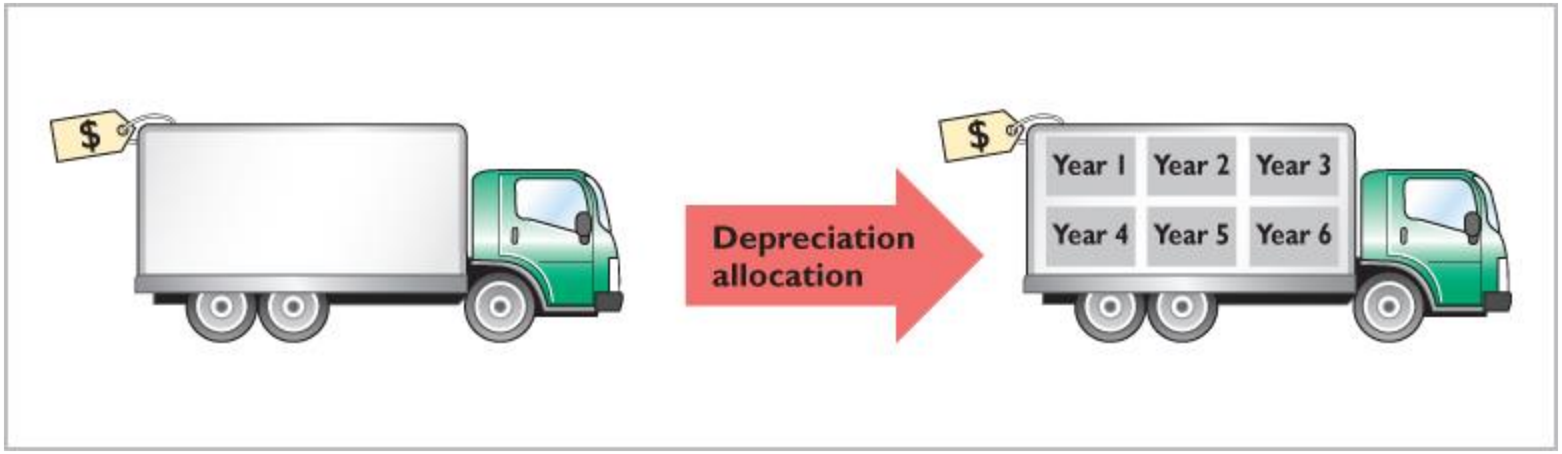
Or, if we sell the land for 900:

Cash (A)	900	
Loss on sale of land (E)	200	
Land (A)		1.100

Recording sales of long-lived assets

Only land has an unlimited life.

Most long-lived assets, after being used, loose at least partially their value. The loss of value due to physical deterioration or obsolescence is called “depreciation” or “amortization”. In this case, we have to consider the depreciated value when we book the sale of the asset. We’ll talk about this later in the course after seeing how depreciation is booked.



Exchange of long-lived assets

Businesses often trade in some of their assets for new ones. In these cases we record both the sale of the old asset and the purchase of the new one.

For example, we exchange our land for a new building whose price is 3.000. The book value of our land is 1.500 and we settle the difference by paying 1.100. In this case we record:

Buildings (A)	3.000	
Land (A)		1.500
Gain on sale of land (R)		400
Cash (A)		1.100

Recording investments

A company may invest part of its cash in short-term or long-term investments in securities, in order to earn a return until the cash is needed.

There are three categories of investments:

- trading **investments, expected to be sold in a short period of time;**
- held-to-maturity **investments, which the investor expect to hold until maturity;**
- available-for-sale **investments, including all other security investments.**

Held-to-maturity and available-for-sale investments can be either short or long-term investments. Trading investments are always short-term investments.

Recording investments

When we buy securities we make the following entry:

Short (Long)-term investments (A)	1.000	
Cash (A)		1.000

When we receive dividends or interests from the issuer of the securities:

Cash (A)	100	
Dividends (interest) revenues (R)		100

Recording investments

When we sell the securities we may have a gain or a loss.

When the selling price is higher than the book value of our investments:

Cash (A)	1.300	
Short (Long)-term investments (A)		1.000
Gain on sale of investments (R)		300

When the selling price is lower than the book value of our investments:

Cash (A)	800	
Loss on sale of investment (E)	200	
Short (Long) –term investments (A)		1.000

Recording investments

Some short-term investments are reported on the balance sheet at their current market value. Their accounting value, therefore, is updated periodically in order to record gains or losses.

We'll deal with this topic in the second module, when we'll talk about valuation of assets.

Method of Equipment Disposal

Long-lived assets: summary

A business that requires a large amount of long lived assets to conduct its operations usually has a large proportion of fixed costs in its cost structure, so it must earn a relatively large amount of gross profit before it can begin to earn a net profit. Thus, a reasonable strategic objective is to find a way to run a business with the smallest possible amount of long lived assets, thereby reducing the breakeven point of a business

Long-lived assets: summary

Changes in Long-Term Assets

Changes in long-term assets can be a sign of capital investment or liquidation. If a company is investing in its long-term health, it will likely use the capital for asset purchases designed to drive earnings in the long-term. However, investors must be aware that some companies sell their long-term assets to raise cash to meet short-term operational costs, or pay the debt, which can be a warning sign that a company is in financial difficulty.

Review Questions