

CFA LEARNING OUTCOMES DECODED

In our series *Learning Outcomes Decoded* we break down a single Learning Outcome Statement (LOS) from the CFA level 1 curriculum. Cheryl Wu, CFA, CPA, is the author of this article and a Content Developer of the CFA team. She works as a corporate development manager in the Energy and Utilities industry.

FINANCIAL STATEMENT ANALYSIS: LONG-LIVED ASSETS

LOS 1: Explain the derecognition of property, plant, and equipment and intangible assets

LOS 2: Explain and evaluate how impairment, revaluation, and derecognition of property, plant, and equipment and intangible assets affect financial statements and ratios

This learning module describes the different types of long-lived assets and how the choice of depreciation method affects financial statements and ratios. It also lays out how to derecognize a long-lived asset and calculate the gain and loss resulting from the disposal. The process may be complicated and is highly testable.

Derecognition

A company derecognizes an asset when the asset is disposed of or is expected to provide no future benefits from use. Assets are usually disposed of through sale. Other means of disposal include retirement/abandonment, exchange, or distribution to shareholders- often called a spin-off.

Disposal by sale

When an asset is sold, the gain or loss is calculated as the proceeds minus the carrying value of the asset. The carrying value is defined as net book value, or historical cost less accumulated depreciation or impairment. The gain/loss is typically disclosed on the income statement either as a separate line item as a component of other gains and losses, depending on its size.

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Disposal by means other than sale

- If an asset is *retired* or *abandoned*, then its carrying value on the balance sheet is reduced to zero. If the asset was listed as having any remaining value prior to the retirement, then that amount is recorded as a loss on the income statement.
- If an asset is *exchanged*, then the fair value of the asset is removed from the balance sheet and the fair value of the acquired asset is added. Any difference between the two is reported as a gain or loss on the income statement. If the fair value of the acquired asset is unknown, then the fair value of the disposed asset is used in its place with no gain or loss reported.
- A *distribution* or *spin-off* applies to the disposal of a business unit rather than that of a single asset. This action distributes the value of the unit to existing shareholders and does not recognize a gain or loss. When the company decides to conduct the spin-off, it must restate the business unit on its balance sheet to list its assets and liabilities as “held for distribution.” After the spin-off, the unit is listed as a “discontinued operation.”

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PRACTICE QUESTION

West Pender Sewage sold one of its piping machines. At the time of the sale the machine had carrying value of \$1.2 million with an original cost of \$2.0 million and accumulated depreciation of \$0.8 million. The company recorded a loss of \$0.3 million from the transaction. At what price was the equipment sold?

- A. \$0.9 million
- B. \$1.3 million
- C. \$1.5 million

A is correct. The equipment had a carrying amount of \$1.2 million, and the company recorded a loss of \$0.3 million. The fair value or selling price is $\$1.2 - \$0.3 = \$0.9$ million.