CHAPTER 12: ACCOUNTING FOR NON-CURRENT ASSETS

Cost Of Non-current assets:

Purchase price plus capital expenditures (e.g installation cost, carriage cost and improvement expenditures) less any discount at time of purchase.

Depreciation:
The decrease in value of non-current assets with the passage of time and its usage.

Scrap value (residual value): Resale value of assets after their useful life.

Useful life: Number of years in which an asset remains useful for a business.

Causes of depreciation:

1. Wear and tear
2. Effusion of time
3. Depletion
4. Environmental factors
5. Economic factors
6. Obsolescence
7. Accidents

Methods of Depreciation:

Straight line method: Depreciation is charged on cost of non current assets. Every year same amount of depreciation is charged as expense. This method is applied on property & building.
Reducing balance method (diminishing balance**):** Charge depreciation on net book value of assets (NBV=cost-total previous depreciation). Depreciation charge will reduce gradually year to year. This method is normally applied on motor vehicles.
Revaluation method: Check market value of assets each year and any fall in value of assets will record as depreciation in relevant year. This method is applied on loose tools

What are the accounting concepts (or convention) involved in depreciation process?

- **Historic cost:** Depreciation expense is based on historic cost of asset (not replacement value or current market value).
- **Matching principle:** This principle requires that the asset's cost be allocated to Depreciation Expense over the life of the asset.

Choice of depreciation method:
The following factors are considered for selection of depreciation method.

1. **Nature of asset.** (Cost of asset, repair cost)
2. **Price fluctuation.** (high fluctuation then revaluation method)
3. **Obsolescence.** (technology base item them maximum depreciation charge in early years)
4. **Management choice.** (similar business practices, personal choice)

5. **Life of asset.**
6. **Legal requirement.**

ACCOUNTS & JOURNAL ENTRIES:

Straight line method (on cost):

- Formula for depreciation
  Annual depreciation= cost-scrap value/useful life (no. of years)
- If %age is given then annual depreciation= %age ×cost

Reducing balance method or diminishing balance method (on book value):

Annual depreciation= %age × net book value

Net book value=cost- total provision for depreciation given

Double entry of Depreciation:

Income statement (Dr)	XXX	
Provision for depreciation (Cr)		XXX

Ledger accounts of Depreciation:

Provision for depreciation

	$		$
Disposal A/c	XX	Balance B/F	XX
Balance C/F	XX	Income statement (depreciation for the year)	XX
	XX		XX
		Balance B/F	XX

Disposal a/c

	$		$
Non current asset (cost of asset sold)	XX	Provision for depreciation	XX
Income statement (profit on disposal)	XX	Bank (sold value)	XX
		Income statement (loss on disposal)	XX
	XX		XX

Total depreciation of sold Non current asset till that date.

Journal entries for Disposal:

If profit on disposal

Provision For Depreciation(Dr)	XX	
Bank(Dr)	XX	
Non current asset(Cr)		XX
Income statement(Cr) (profit)		XX

If loss on disposal

Provision for depreciation(Dr)	XX	
Bank(Dr)	XX	

Income statement (Dr) (Loss)	XX	
Non current asset(Cr)		XX

Practice Questions:

Q1: PQR company bought a machine for $20,000 on January 1, 2015. The company uses straight line method of depreciation and estimates that the machine will have a useful life of 6 years and leave a scrap value of $ $2,000.

Required:
Show the relevant ledger accounts for the year 2016, 2017 and 2018.

Q2: The following balances were recorded in the books of Hajra on 1 March 2015.

	$
Motor vehicles account (at cost)	50 000
Motor vehicles – provision for depreciation account	18 400

Additional information

1 On 31 May 2015 a motor vehicle costing $16 000 and with an accumulated depreciation of $7000 was sold for $8400.

2 On 30 June 2015 a motor vehicle costing $20 000 was purchased on credit.

3 The depreciation policy of Hajra is as follows:

Motor vehicles are depreciated at the rate of 25% per annum using the diminishing (reducing) balance method.

A full year's depreciation is charged in the year of purchase. No depreciation is charged in the year of sale.

Required:
Prepare following accounts.

(a) Motor vehicle
(b) Provision for depreciation
(c) Disposal

Q3: On 1st January 2013, Tony Brown paid $92,000 for furniture and equipment for his office. He depreciated these assets using the straight-line method. He estimated that, at the end of the 8th year, their scrap value would be $14,000.

On 1st July 2013, he purchased a motor van costing $150,000 for his business. He depreciated the van at the rate of 40% per annum using the reducing balance method.
Charge depreciation for each month of ownership.

Required:

a) Prepare for the years ended 31st December 2013, 2014, 2015 and 2016:

I. Furniture and equipment account
II. Provision for depreciation of furniture and equipment account
III. Motor van account
IV. Provision for depreciation of motor van account

b) Show the balance sheet (extract) as at 31 December 2016 for both furniture and equipment as well as motor van.

Q4: The cost of machinery in use with a firm on 1st April, 2011 was $250,000 against which the depreciation provision stood at $105,000 on that date; the firm provided depreciation at 10% of the diminishing value according to ownership.
On 31st December, 2011 two machines costing $15,000 and $12,000 respectively, both purchased on 1st October, 2008, had to be discarded because of damage and had to be replaced by two new machines costing $20,000 and $15,000 respectively.
One of the discarded machines was sold for $8,000; against the other it was expected that $3,000 would be realisable.

Required:
Show the relevant accounts in the ledger on the firm for the year ended 31st March, 2012.

Q5: A company depreciates its plant at the rate of 20 per cent per annum, straight line method, for each month of ownership.

2014	Bought plant costing $12,000 on 1 January.
	Bought plant costing $16,000 on 1 October.
2016	Bought plant costing $24,000 on 1 April.
2017	Sold plant which had been bought for $12,000 on 1 January 2014 for the sum of $8,100 on 30 June 2017.

Required:
From the above details draw up the plant account, the provision for depreciation account and disposal account for each of the years 2014, 2015, 2016 and 2017.

Q6: A motor vehicle purchased by Saira Mir on 1 May 2004 for $8000 was sold on 30 April 2008 for $400. She uses the diminishing (reducing) balance method at 50 % per annum. The motor vehicle had been depreciated by $7000 by 30 April 2007.
Required:

a) Explain the term depreciation.
b) Calculate depreciation for the motor vehicle for the year ended 30 April 2008.
c) Show the journal entry for the provision for depreciation at 30 April 2008.
d) Prepare the disposal account for the motor vehicle.

Q7: Sparky Ltd set up business on 1 May 2008 with the following assets:

	$
Property (Land and buildings)	150 000
Computer equipment	40 000
Inventory (stock in trade)	70 000

Sparky Ltd decided on the following policy for depreciation:

1 Land costing $80 000 was not to be depreciated.

2 Buildings are to be depreciated at 2% per annum on cost using the straight line method.

3 Computer equipment is to be depreciated at 25% per annum using the diminishing (reducing) balance method.

REQUIRED

(a) State two causes of depreciation.

(b) On 30 April 2010 Sparky Ltd sold some of the computer equipment for $7000. The computer equipment had cost $12 000 on 1 May 2008. Sparky Ltd charges a full year's depreciation in the year of disposal. Prepare the disposal account on 30 April 2010 recording the disposal of the computer equipment.

Q8: Amayi owns a manufacturing business. Her financial year ends on 30 April.
She has the following depreciation policy:
Machinery is depreciated at the rate of 25% per annum using the diminishing (reducing) balance method. Office furniture is depreciated at the rate of 10% per annum using the straight-line method. Loose tools are depreciated using the revaluation method.
A full year's depreciation is charged on assets in the year of purchase but no depreciation is charged in the year of sale.
The following information is available for the year ended 30 April 2011,

1 Balances 1 May 2010

	$
Non-current assets at cost	
Machinery	80 000
Office furniture	15 000
Provisions for depreciation	
Machinery	60 000
Office furniture	5 000

2 On 31 July 2010, additional machinery, $18 000, was purchased.

3 On 20 February 2011, office furniture, which had cost $1 000 on 1 May 2008, was sold for $550 cash.

4 On 1 May 2010, loose tools, cost price $1600, were valued at $1050. Additional loose tools were purchased during the year for $630. On 30 April 2011 loose tools were valued at $1400.

REQUIRED:

a) Calculate the depreciation to be charged on each of three Assets for the year ended 30 April 2011.
b) Calculate the profit or loss on the office furniture sold on 20 February 2011.
c) Calculate the net book value on 30 April 2011 of Machinery and Office furniture.

Q9: Habib provides the following information.

Non-current Asset	Cost $	Depreciation method
Computer	2000	Diminishing (reducing) balance – 60% per annum
Office furniture	3000	Straight-line – 10% per annum
Loose tools	800	Revaluation

REQUIRED

(a) Explain the following methods of depreciation.

- **(i)** Diminishing (reducing) balance
- **(ii)** Straight-line
- **(iii)** Revaluation

(b) Using the above figures, calculate the depreciation in Years 1 and 2 for each asset. (Assume the value of loose tools at the end of Year 1 was $600 and was $350 at the end of Year 2)

(c) Comment on the suitability of each depreciation method for the three Non-current assets.

Q10: A motor vehicle purchased by Saira Mir on 1 May 2004 for $8000 was sold on 30 April 2008 for $400. She uses the diminishing (reducing) balance method at 50% per annum. The motor vehicle had been depreciated by $7000 by 30 April 2007.

Required:

(a) Calculate depreciation for the motor vehicle for the year ended 30 April 2008.
(b) Show the journal entry for the provision for depreciation at 30 April 2008. A narrative is not required.
(c) Prepare Disposal account.

Q11: Universal Industries provided the following information:

1 Purchased a machine for $8 000 on 1 October 2007.

2 Sold the machine for cash, $7000, on 31 March 2009.

3 The policy of Universal Industries is to charge depreciation at the rate of 10 % per annum on cost using the straight line method. Depreciation on machinery is charged from the date of purchase and up to the date of sale.

4 All sales of fixed assets are recorded in a disposal account.

5 Universal Industries prepares final accounts on 31 March each year.

Required:

(a) Prepare the journal entries to record the sale of the machine. Show the transfer of any profit or loss on the sale to the final accounts on 31 March 2009. Narratives are not required.
(b) Prepare provision for depreciation and disposal account for the year ended 31 March 2009.

Q12: On 31 August 2011 the following extract was taken from the balance sheet of Stavros.

	Non-current assets	Accumulated depreciation	NBV
	$	$	$
Equipment	60 000	24 000	36 000
Office Computers	8 000	5 600	2 400

The following transactions took place during the year ended 31 August 2012:

1 On 31 January 2012, equipment purchased on 1 April 2009, at a cost of $28 000, was sold for $10 000. Payment was received by cheque.

2 On 1 February 2012, new equipment was purchased at a cost of $35 000.

3 On 20 March 2012, office computers were purchased for $600.

Stavros has the following depreciation policy:
Equipment is depreciated at the rate of 20% per annum using the straight-line method.
Office computers are depreciated at the rate of 25% per annum using the diminishing (reducing) balance method.
A full year's depreciation is charged on equipment and office computers in the year of purchase.
No depreciation is charged on equipment in the year of sale.

REQUIRED:

(a) State one advantage of using the straight-line method of depreciation.
(b) Prepare provision for depreciation and disposal accounts for the year ended 31 august 2012.

(c) Complete the following statement of financial position (extract) for the non-current assets on 31 August 2012.

Non-current assets	Cost	Accumulated depreciation	NBV
	$	$	$
Equipment			
Office Computers			

Q13: Atto Electrical had the following non-current assets on 31 March 2013.

	Net book value
	$
Premises (cost $50 000)	48 000
Motor vehicles (cost $16 000)	12 000
Computers	6 000

Atto Electrical has the following depreciation policy.
Premises are depreciated at the rate of 2% per annum by straight-line method.
Motor vehicles are depreciated at the rate of 25% per annum by diminishing (reducing) balance method.
Computers are depreciated by revaluation method.
A full year's depreciation is charged on all non-current assets owned at the end of the financial year.
Additional information

1 There were no purchases or sales of non-current assets during the year ended 31 March 2014.

2 The following purchases of non-current assets were made during the year ended 31 March 2015. Payments were made by cheque.

	$
Premises	30 000
Motor vehicles	9 000
Computers	3 200

3 Computers were valued as follows:

	$
31 March 2014	4 200
31 March 2015	6 000

REQUIRED

(a) Complete the table to show the depreciation to be charged to the income statement for each of the years ended 31 March 2014 and 31 March 2015.

(b) Prepare the following ledger accounts of motor vehicles & provision for depreciation of motor vehicles for each of the years ended 31 March 2014 and 31 March 2015. Balance the accounts and bring down the balances on 1 April.

Q14: Ajib commenced business on 1 October 2014 delivering parcels to customers' homes. He purchased a motor van on that date, the details are as follows.

Purchase price	$9600
Life of motor van	3 years
Residual value	$1200

Ajib is undecided whether to use the straight-line method or diminishing (reducing) balance method to depreciate the motor van.

If Ajib uses the diminishing (reducing) balance method the annual rate of depreciation charged would be 50%.

REQUIRED

(a) Calculate Depreciation for three years using straight line method of depreciation.

(b) Calculate depreciation for three years using reducing balance method.