

Lecture 1: Non-current Assets

Describe non-current assets and how they are recorded, expensed and reported.

Asset: a resource controlled by an entity as a result of past events and from which future economic benefits are expected to arise. They are presented on the balance sheet.

Non-current asset: any tangible resource that is expected to be used in the normal course of operations for more than one year and is not intended for resale. E.g. Lands, Building, equipment

There are three primary activities for PPE (main non-current assets):

- Acquisition of non-current assets
- Depreciation over their useful life
- Disposal of non-current assets

Recording non-current assets:

- Should be recorded at their historical cost, that is the cost of acquiring them
- This includes **all necessary costs** incurred to get the asset delivered, installed and ready to use e.g. if you must pay for shipping, it is included in the value
- These extra costs include:
 - Purchase price
 - Taxes
 - Delivery
 - Insurance during transit
 - Installation costs

Suppose Azzi Computers buys a delivery truck for \$63,000. In addition to this, they pay stamp duty \$3600, fees of \$400, GPS system \$2000, non-compulsory insurance. All of these costs are included in the cost of the truck except non-compulsory insurance, as it was not necessary. Therefore, the journal entry is:

Delivery Truck	69000	
Cash		69000

Expensing non-current assets: Depreciation

- A non-current asset becomes an expense when used. This expense is depreciation.
- **Depreciation** is the process of allocating the cost of a non-current asset over its useful life. It is an application of the **matching principle**.
- When depreciating, we are not trying to determine a market value, but allocating its cost over time. eg. you buy a pair of shoes for \$200 expecting to wear them 200 times, meaning each time you wear them it depreciates by a dollar. After you wear them once, they might have a market value of \$100, but depreciation might only be \$1 if it's based on "use"!
- Journal entry for depreciation is:

Dr Depreciation Expense

Cr Accumulated Depreciation (contra asset – sits just below the asset)

Note: Accumulated depreciation is a contra asset! It is subtracted from the corresponding asset account to yield a book value over time.

How to Calculate Depreciation Expense

When you own depreciable assets, it must calculate depreciation each period. To do this, you need to know some info about the asset, including cost of asset, salvage value/residual value (estimated value of the asset at the end of its life), useful life, depreciation method used.

Three methods:

1. Straight Line Method

Straight-line depreciation spreads depreciation evenly over the useful life of an asset. Via this method, depreciation will be the same for every year for the life of the asset.

$$\text{Depreciation expense} = \frac{\text{Initial cost} - \text{Salvage Value}}{\text{Useful Life}}$$

Remember! Carrying amount (Book value) = Cost – Accumulated Depreciation

Things to notice:

- Same depreciation every year
- Accumulated depreciation will grow by the same amount every year until it reaches the depreciable cost of the asset
- Carrying amount decreases by the same amount per year until it equals salvage value

2. Reducing Balance Method

The reducing balance method is an accelerated method that results in more depreciation expense in the early years of an assets life, and less depreciation in later years. This is based on the idea that more depreciation expense is recorded when it is considered more useful in early years. This method is thought to more accurately represent depreciation, and may match revenues to expenses better than straight line.

$$\text{Depreciation expense} = 2 \cdot \frac{1}{\text{Useful Life}} \cdot \text{Carrying Amount}$$

OR

$$\text{Depreciation expense} = (2 \times \text{straight line rate}) \times (\text{Cost} - \text{accumulated depreciation})$$

Things to notice:

- We sometimes use 1.5 times the straight line rate
- The depreciation amount is multiplied by the carrying amount, which goes down each period. Therefore, depreciation expense will become smaller and smaller as it the depreciation rate is applied to a smaller amount each period.

Suppose we know that Azzi bought a truck (INCL. ALL EXPENSES) for \$65000, useful life of 5 years, with estimated salvage value \$15000. Using the straight line method, depreciation each year is 20% per year at \$10,000.

Using reducing balance method, first year depreciation is $(1.5 \times 20\%) \times (65000 - 0) = \19500 . This gives a carrying amount of \$45500.

Second year depreciation is $(1.5 \times 20\%) \times (65000 - 19500) = \13950 .