Module 1: Non-Current Assets

Final examination: Practical questions worth 6 marks (6 out of 50 short answer marks, 6 out of 55 marks total).

LO1: Describe non-current assets and how they are recorded, expensed, and reported.

A **non-current asset (NCA)** is 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. Assets are presented on the Balance Sheet.

1. **Recording the purchase of an NCA: Dr. Non-Current Asset (↑A) , Cr. Cash (↓A).**
    - NCAs should be recorded at the **cost of acquisition** (historic cost). All necessary costs incurred to get the asset delivered, installed and ready to use should be included, e.g. purchase price, taxes/duties, delivery and insurance, etc.
    - Any costs specific to the asset provides future value are also included. Example: A laptop case for a laptop.
2. **Expensing an NCA:** A non-current asset converts to an expense as it is used or consumed. The expensing of non-current assets is called depreciation. **Depreciation** is the process of allocating the cost of a non-current asset over its useful life.
    - Depreciation is an application of the matching principle; because a non-current asset is used to generate revenues period after period, some of its cost should be expensed in, or matched to, those same periods.
    - Process of allocating an asset's cost , not a method of determining an asset's market value.
3. **Recording and reporting depreciation:** Depreciation expense is calculated at the end of an accounting period and recorded with an adjusting journal entry. To record depreciation: **Dr. Depreciation Expense (↑E), Cr. Accumulated Depreciation (↑*A)**
    - **Accumulated depreciation** is a contra-asset account (*A), meaning that it sits just below assets, and its accumulating balance is subtracted from the asset account to yield the carrying amount (net book value) of the non-current asset.
    - Contra-asset accounts begin with a credit balance (vs. asset debit balance), hence why credit increases it.
    - Depr. expense reported on the statement of comprehensive income (Profit and Loss/Income statement). Accumulated Depreciation (NCA only) reported on the statement of financial position (Balance Sheet).

LO2: Calculate and compare depreciation expense using straight-line, reducing-balance and units-of-activity methods.

Calculating depreciation expense: When a company owns depreciable assets, it must calculate depreciation expenses each period. Calculating depreciation at the end of each accounting period requires information about the asset:

1. **Cost:** the historical cost of the NC asset being depreciated.
2. **Residual/salvage value:** an estimate of the value of a NC asset at the end of its useful life.
3. **Useful life:** the length of time a NC asset is expected to be used in operations.
4. **Depreciable amount:** the difference between an asset's cost and it's residual value (Cost - RV).

Depreciation methods include: (1) straight-line depreciation, (2) reducing-balance depreciation and (3) units-of-activity depreciation.

1. **Straight-line depreciation** spreads depreciation evenly over the useful life of an asset - same entry format each year.
2. The **reducing-balance method** of depreciation is an accelerated method that results in more depreciation expense in the early years of an asset's life and less depreciation expense in the later years.
    - Accelerated depreciation methods may match expenses to revenues better than the straight-line method. Provide larger expenses (for tax purposes, larger tax-deductible expenses) in earlier years of an NCA's life.
    - Use the same formula until the depreciation expense is larger than the difference between carrying and residual. We cannot record the asset as less than the residual value.
3. The **units-of-activity method** of depreciation calculates depreciation based on use. The method is limited to assets whose units-of-activity can be measured.

Carrying amount/Book Value = Cost – Accumulated Depreciation → Beginning amount for each new adjusting entry.

Straight-line depreciation

$$Depreciation\ expense\ = \frac{Acquisition\ Cost - Residual\ value}{Useful\ life}$$

Reducing-balance depreciation

$$Depreciation\ expense\ = 2\ (or\ 1.5) \times \frac{1}{Useful\ life} \times Carrying\ amount$$ OR

$$(Straight - line\ rate \times 2\ or\ 1.5) \times (Cost - Accumulated\ Depreciation)$$

Units-of-activity method

$$Depreciation\ expense\ per\ unit\ = (Cost - Salvage/Residual\ value) \div Useful\ life$$

$$Depreciation\ expense\ = Depreciation\ expense\ per\ unit \times Actual\ units\ of\ activi$$

LO3: Understand the effects of adjustments that may be made during a non-current asset's useful life.

Adjustments are needed if there is a reassessment of the length of time the asset will remain useful or the value of the asset at the end of its useful life or because money is spent on the asset to maintain/improve operating capacity.

1. Changes in depreciation estimates: (1) Calculate carrying amount revision time, (2) Calculate depreciable cost for future depreciation, (3) Calculate revised depreciation expense.
2. Expenditures after the acquisition: Most NCAs require expenditures throughout useful lives. Treatment for expenditures made during the useful life of a non-current asset depends on whether they are classified as 'capital' or 'revenue' expenditures.
    - **Capital expenditure** increases the expected useful life or productivity of the asset. Increases the asset value.

- **Revenue expenditure** maintains expected useful life/productivity of the asset. Increase an expense account.
- **Changes in depreciation due to capital expenditure:** (1) Calculate net book value after capital expenditure, (2) Calculate depreciable expense for the new remaining useful life. **Journalise: Dr. NCA (↑A), Cr. Cash (↓A)**.
- Journalising a revenue expenditure includes: **Dr. Maintenance (Asset) Expense (↑E), Cr. Cash (↓A).**

3. Asset impairment (decline of net realisable value/NRV): When an NCA's recoverable amount falls below its carrying amount, the asset is considered **impaired**. An **impairment** is an expense that lowers the value of a non-current asset.
    - To journalise the asset impairment: **Dr. Impairment Expense - NCA (↑E), Cr. NCA (↓A)**.

LO4: Record the disposal of non-current assets.

Rule for calculating the gain or loss on disposal

1. Record necessary depreciation expense (possibly for partial period) to update accumulated depreciation account.
2. Calculate any gain or loss on the disposal by comparing the asset's carrying amount.
3. Prepare a journal entry that decreases the asset account and its related accumulated depreciation account.
4. Record any gain or loss on the disposal.

Disposal of a non-current asset: Once no longer needed by the business, if the asset is sold for more/less than its worth (carrying amount) then a gain/loss on sale is recognised. **Gain/Loss on sale** = Sales price – Carrying amount

- Journalise the disposal (gain on sale): **Dr. Cash (↑A), Dr. Accumulated Depreciation (↓*A), Cr. Gain on Sale, Cr. NCA (↓A).**
- Journalise the disposal (loss on sale): **Dr. Cash (↑A), Dr. Accumulated Depreciation (↓*A), Dr. Loss on Sale, Cr. NCA (↓A).**

LO5: Describe intangible assets and how they are recorded, expensed, and reported.

An **intangible asset** is a resource that is used in operations for more than one year but has no physical substance.

1. **Intellectual Property:** creative products of the human mind. Includes:
    - **Patents** - Inventions: a device, substance, method or process (Patents Act 1990)
    - **Trademarks** - A distinctive sign used to distinguish goods or services (Trade Marks Act 1995)
    - **Copyright** - Expression of an idea
    - **Designs** - visual features of shape, configuration, pattern or ornamentation (Designs Act 2003)

2. Accounting for these intangible NCAs:
    - **Patents:** Right to manufacture, sell or use a particular product or process exclusively for a limited period of time.
    - **Trademarks:** The right to use exclusively a name, or symbol, to identify the business.
    - **Copyright:** The right to reproduce or sell an artistic or published work.
    - **Designs:** The right to operate a business under the trade name of the franchisor.

Like tangible assets, intangibles are recorded at purchase price, then **amortised** (instead of depreciated) over time.

- Amortisation applies only to intangibles with limited lives, like patents. Assets with indefinite lives (i.e., trademarks, goodwill) are examined periodically to check for impairment.
- At the end of the period, to journalise the amortisation: **Dr. Amortisation Expense (↑E), Cr. Intangible NCA (↓A).**

Goodwill is created when one company buys another company and pays more than the value of the net assets of the purchased company. Premium paid for goodwill is usually due to the acquired company's customers, reputation, employees, market share, etc.

- To journalise the sale of a company: **Dr. Assets , Dr. Goodwill, Cr. Liabilities, Cr. Cash.**