

Accounting for Business Decisions B

ACCT Financial: Chapter 8 – Non-Current Assets and Intangible Assets

Non-current assets

A non-current asset refers to a **tangible resource** that is expected to be used in business operations for a **period greater than one year**, and is **not intended for resale** – Ie: land, builds, equipment

Recording non-current assets

Non-current assets should be recorded at the **cost incurred to acquire them**

This **includes any expenses on top of the original purchase price**. Therefore when recording a non-current asset, their cost should include:

- Purchase price
- Taxes and duties
- Delivery costs
- Insurance cost during transit
- Installation costs

Example: Tran paper Supply purchases a delivery truck and pays the following:

Purchase price - \$60 000
Import Duty - \$3600
Stamp Duty - \$400
GPS System (compulsory for the business) - \$1000
Non-compulsory insurance - \$1400

The non-current asset would be recorded at a price of $\$65\,000 = \$60\,000 + \$3600 + \$400 + \$1000$

Therefore the journal entry would be as follows:

| General Journal | | | |
|-----------------|----------------|--------|--------|
| Date | Description | Debit | Credit |
| (Date) | Delivery truck | 65 000 | |
| | Cash | | 65 000 |

Expensing non-current assets

A non-current asset **converts to an expense as it is used or consumed**. Therefore, the expensing of a non-current asset is accomplished through **depreciation**.

Depreciation refers to the **process of allocating the cost of a non-current asset over its useful life**

Depreciation is an application of the matching principal → this is because a non-current asset is used to generate revenues period after period, and thus some of its costs should be expensed (matched) to each of those periods

Depreciation expense is normally calculated at the end of an accounting period and recorded with an adjusting journal entry.

The general form of the entry to record depreciation is:

- Debit depreciation expense
- Credit accumulated depreciation

Depreciation expense is recorded on the statement of comprehensive income.

Accumulated depreciation is a contra-asset account, and is subtracted from non-current assets to yield the carrying amount (net book value) of the non-current assets (carrying amount gets lower over time).

Reporting non-current assets

Non-current assets are reported on the statement of financial position

Depreciation

Calculating depreciation expense

Depreciation expense is calculated each period. In order to calculate depreciation expense, the business must know the following information about the asset: cost, residual/salvage value, useful life, and depreciation method

Key terms

1. Cost – refers to the historical cost of a non-current asset being depreciated – I.e: what you paid for an asset
2. Residual value – refers to an estimate of the value of a non-current asset at the end of its useful life
3. Depreciable amount – refers to the difference between an asset's cost and its residual value
4. Useful life – refers to the length of time a non-current asset is expected to be used in operations
5. Carrying amount – refers to the unexpired cost of a non-current asset, calculating by subtracting accumulated depreciation from the cost of the non-current asset

Depreciation methods

Depreciation method refers to the **method used to calculate depreciation**. There are many different depreciation methods including: **the straight-line method, the reducing-balance method and the units-of-activity method**

1. Straight line depreciation method

The straight-line depreciation method **spreads depreciation expense evenly** over each year of an **asset's useful life**

$$\text{Depreciation Expense} = \frac{\text{Cost} - \text{Residual Value}}{\text{Useful Life}}$$

Example:

Cost of delivery truck = \$65,000
Residual value of delivery truck = \$15,000
Useful Life (years) = 5

Therefore:

$$\text{Depreciation Expense} = \frac{\$65\,000 - \$15\,000}{5} = \$10\,000$$

And then the journal entry would be:

| | | | | | |
|---------|--------------------------|---|-------------|--------|---------|
| 31 Dec. | Depreciation Expense | | 10 000 | | |
| 2013 | Accumulated Depreciation | | | 10 000 | |
| | Assets | = | Liabilities | + | Equity |
| | -10 000 | | | | -10 000 |

Therefore after 1 year, the carrying amount of the truck would be \$55,000

2. Reducing-balance depreciation method

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 of an asset's life**

*N = Number Of
Periods or Useful
Life*

$$1 - n \sqrt{\frac{\text{Residual value}}{\text{Cost}}}$$

*Or Depreciation Expense = Depreciation Rate x Carrying Amount
= (Straight-Line Rate x 2) x (Cost - Accumulated Depreciation)*

Example:

Cost of delivery truck = \$65,000
Residual value of delivery truck = \$15,000
Useful Life (years) = 5

Therefore:

Depreciation Expense 1st year = $(20\% \times 2) \times (\$65,000 - \$0)$
= \$26,000

Depreciation Expense 2nd year = $(20\% \times 2) \times (\$39,000)$
= \$15,600

3. Units-of-activity depreciation method

The units of depreciation method refers to when depreciation expense is a function of the actual usage of the asset

Because the units-of-activity method relies on an estimate of an asset's lifetime activity, the method is limited to assets whose units-of-activity can be in some way determined

Depreciation per unit of expected activity is the depreciable cost of the asset divided by the estimated units-of-activity over the life of the asset

Key formula 8.3: Units-of-activity method

$$\text{Depreciation Expense per Unit} = \frac{\text{Cost} - \text{Salvage Value}}{\text{Useful Life in Units}}$$

Key formula 8.4: Units-of-activity method

$$\text{Depreciation Expense} = \text{Depreciation Expense per Unit} \times \text{Actual Units of Activity}$$

Note: Regardless of how much depreciation expense is calculated to be, an asset's accumulated depreciation balance should never exceed the asset's depreciable amount (cost - residual value)

Example:

Cost (of a truck) = \$65,000
Residual value = \$15,000
Estimated number of kilometers in life = 100 000km

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