Tutorial 6 – <u>Accounting for Non-current assets</u>

Section A:

1   (a) Describe capital expenditure and revenue expenditure. How are they to be treated in the accounts?

Capital expenditures are expenses spent to acquire non-current assets, which are to be used for more than one year and to increase the value of existing non-current assets. Capital expenditure is all the cost/expense incurred to bring the non-current asset to its current location and current condition in order to be used in business.

Revenue expenditures must be expensed off in the period it is incurred. It is charged as an expense in the statement of profit or loss in the year it is incurred. It is used in running the business on a day to day basis (maintenance) which maintains the same value. It's not used for increasing the value of non-current assets.

    (b) What is depreciation? Explain.

The **cost** (capital expenditure) of the non-current asset is **divided** over a few years where it is used to help generate business income. The number of years is called the asset's **useful life (economic useful life)**, which is usually an estimate. The **shared portion of the original cost** of the non-current asset is called **depreciation**. Therefore, **depreciation is part of the original cost** of the non-current assets that are being consumed during its period of use by the business. It represents the **loss/reduction in value** of the non-current asset as it is used over time. Depreciation is charged as an **<u>expense</u>** in the **Statement of Profit or Loss**.

2   (a) What are the common methods of depreciation? Explain.

    Straight line method - The total cost on the non-current asset is spread over its useful life at an <u>equal amount</u> and charged to the Statement of Profit or Loss every year

Reducing balance method - A fixed percentage for depreciation is deducted from the cost in the first year. In the following years, the fixed percentage is applied on the net book value, i.e. after deducting previous years' depreciation charges.

(b) Compare depreciation with accumulated depreciation. Explain how they are treated in the accounts.

Depreciation (Dr) is an expense. Therefore, it is deducted from the revenue to arrive at the net profit for the year. It is a debit item in the ledger. There is no balance to be carried forward to the next year.

Accumulated depreciation (Cr) is the total of all the depreciation that have been charged since the non current asset was acquired up to date. It is recorded as a credit item in the ledger and its balance is carried forward to the next period. The accumulated depreciation is net off from the cost of the non current asset to arrive at the net book value in the statement of financial position. Please note that the cost of the non current asset and accumulated depreciation of the same asset are recorded in different accounts.

3.   State whether each of the following statements is **True** or **False**:

a. When a business has an accumulated depreciation account of RM4,000 for a particular non-current asset, it means the business has accumulated, or set aside this amount of cash for replacement later.

    Replacement of assets the purpose of Accum Depreciation? History, **<u>True</u>**

b. Depreciation is the fall in value of non-current assets.
   True

c. The straight line method is the depreciation method where <u>decreasing amounts of depreciation</u> (it should be reducing balance method) are being charged to the Statement of Profit or Loss over the years.
   Straight-line method's pattern, it does not decrease/reduce/decline. Instead, the total cost of the non-current asset is spread over its useful life at an equal amount.
   False

d. Net book value is the estimated value of non-current assets after deducting accumulated depreciation.
   Net book value = Cost – Accumulated Depreciation
   True

e. Capital expenditure is incurred when a business spends money to buy or increase the value of a non-current asset.
   Capital expenditure: buying a new non-current asset or increasing the value an existing non-current asset : **True**

Question 4
revenue expenditure = re
capital expenditure = ce

Bryan operates a candy factory in Rawang. The machines in his factory are purchased overseas. On 1 Jan 2016, he purchased a machine from Korea costing *RM120,000 (ce)*. The machine was delivered to Malaysia on freight. The *transportation cost of RM3,000* (ce) and *freight insurance of RM1,200 (ce)* was borne (承担) by Bryan. When the machine landed in Malaysia, Bryan paid *custom duty of RM3,000 (ce)*.

Bryan hired an engineer to install the machine within the factory. The engineer told Bryan that in the event Bryan wishes to dismantle the machine in the future, it would cost him *RM700 (ce)*. After the installation was completed, the engineer billed him at RM1000 (ce).

Bryan plans to use the machine for 6 years. Every year, the machine would be maintained at a cost of RM350 (re). In year 7, the machine will be dismantled and sold off as **scrap for RM5,000**.

For every of his assets, Bryan adopts the policy to make full year depreciation in the year of purchase.

Capital expenditure includes all the cost/expenses that are incurred to bring the non-current assets to its ==current location (Bryan's factory in Malaysia)== and ==current condition== so that it can be used for the business.

Capital expenses
1. Machine cost (120000)
2. Transportation cost (3000)
3. Insurance cost (1200)

4. Custom cost (3000)
5. Installation cost (1000)
6. Dismantled cost (not happened yet, 700)

Revenue expenses
1. Maintenance cost (350)

Year 7 - Scrap value 5,000

Required:

(a) Calculate the cost of the machine.
hint: Add up all the capital expense
Cost of the machine:
machine	120,000
transport cost	3,000
insurance cost	1,200
custom duty	3,000
installation cost	1,000
future dismantling cost	700
total cost	**128,900**

(b) Compute the annual depreciation for the years ended 31 Dec 2016, 2017, 2018, 2019, 2020 and 2021 using the following depreciation basis:

   (i)   **Straight line** methods

$$\text{Depreciation} = \frac{\text{Acquisition cost} - \text{Scrap value (残值)}}{\text{Estimated useful life}}$$

= 128,900 - 5,000/ 6 years
= 20,650

(ii)   **reducing balance** basis at the rate of 42% per annum
Reducing balance method
Net book value = Cost – Accumulated Depreciation
Remainder net asset value/Net Book value x 42%

Year			RM
2016	Cost		128,900
	Less: Depreciation	x42%	(54,138)
			74,762
2017	Net Book Value		74,762
	Less: Depreciation	x42%	(31,400)
			43,362
2018	Net Book Value		43,362
	Less: Depreciation	x42%	(18,212)
			25,150
2019	Net Book Value		25,150
	Less: Depreciation	x42%	(10,563)
			14,587
2020	Net Book Value		14,587
	Less: Depreciation	x42%	(6,127)
			8,460
2021	Net Book Value		8,460
	Less: Depreciation	x42%	3(553)
			4,907
			(scrap value)

(c) With your answer in (b) (ii) above, prepare for the years ended 31 Dec 2018, 2019 and 2020:

    (i)   Machinery account
    (ii)   Depreciation account
    (iii)   Accumulated depreciation account - remember to add on the accumulated depreciation of 2016 and 2017 (RM 85538) as balance brought down (bal b/d) before start to continue the accump. depreciation for 2018, 2019 and 2020
    (iv)   Statement of Profit or Loss (extract) - includes depreciation
    (v)   Statement of Financial Position (extract) - includes accumulated depreciation

Section B: Extra exercise questions (for students' own practice)

Question 1

Genesis Trading currently has a problem in finalizing the depreciation charges for the non-current assets. The bookkeeper has provided the following information as at **1 Jan 2020**:

Non-current assets	Cost (RM)	Accum Dep (RM)	Deprecation policy
Land	800,000	-	-
Motor vehicles	250,000	25,000	10% on cost (straight-line)
Furniture Fittings	90,000	4,500	5% using reducing balance method

New purchases of non-current assets during the year 2020 and 2021:

	2020	2021
New Asset Purchased	Land at cost RM50,000 (Dr - Land, Cr Bank)	1. Furniture & fittings at cost RM8,000 (Dr - F&F, Cr - Bank) 2. Motor vehicles at cost RM45,000 (Dr - M.Vehicles, Cr - Bank)

Depreciation is to be calculated on assets in existence at the end of each year, giving full year's depreciation in the year of acquisition.

Required:

(a) Prepare the following accounts for the year ended 31 Dec 2020 and 2021:
    (i)   Land account

   (ii)   Motor vehicle account

   (iii)   Furniture & Fittings account

   (iv)   Accumulated depreciation – Motor vehicles account; and

   (v)   Accumulated depreciation – furniture & fittings accounts (no decimal, round up to the nearest RM)

(b) Prepare the Statement of Financial Position (extract) as at 31 December 2020 and 2021 showing the non-current assets.

Question 2:

A car costs RM96,000. It will be kept for 3 years, and then sold for an estimated value of RM24,000.

Required:

Calculate depreciation for each year using:

(c)   Straight line method

$$\text{Depreciation} = \frac{\text{Acquisition cost} - \text{Scrap value (残值)}}{\text{Estimated useful life}}$$

(96000 - 24000) / 3 = 24000

(d)   Reducing balance method, with depreciation rate of 37%

Year		RM
1	Cost Less: Depreciation x37%	96000

		(35520) *60480*
2	Net Book Value Less: Depreciation x37%	60480 (22378) *38102*
3	Net Book Value Less: Depreciation x37%	38102 (14098) *24004*

Question 3

If an asset cost RM100,000, reducing the balance rate was 54% for 6 years of useful life. The depreciation calculated would be RM53,584 in year 1. Show the journal entry to record depreciation charge at the end of year 1.

Particulars	Debit (DR)	Credit (CR)
Dr Depreciation	53584	
Cr Accumulated. depreciation		53584

Notes

Depreciation
slow expense
spread out effect
gradual
on net profit

expense (normal)

fast effect
on net profit