

Depreciation



Accounting for non-current assets

Candidates will look at the classification of business expenditure with particular reference to the treatment of assets used in the longer term in a business. Candidates will also consider the purpose and methods of recording the cost of using those assets over time and the subsequent change in value.

Changing asset values

Candidates should have an understanding of:

- factors that cause the value of non-current assets to depreciate
- the purpose of accounting for depreciation of non-current assets and the associated application of relevant accounting concepts
- how to calculate depreciation using the reducing balance and straight-line methods
- the most appropriate method of calculating depreciation
- how to measure the value of non-current assets by the cost model or the revaluation model
- how to prepare ledger accounts and journal entries for:
 - non-current assets (acquisition and revaluation)
 - depreciation and disposal (including entries for part exchange)
- how to calculate profit or loss on disposal of a non-current asset
- how to record the effect of a charge for depreciation in the statement of profit or loss and statement of financial position

Additional information

On 1 March 2020, Vehicle A was sold in part exchange for Vehicle D. Vehicle D cost \$42 000 of which \$29 200 was paid by cheque.

REQUIRED

(b) Prepare the vehicle disposal account.

Vehicle disposal account

	\$		\$

[5]

- (c) Prepare the provision for depreciation of vehicles account for the year ended 31 December 2020.

Provision for depreciation of vehicles account

	\$		\$

[3]

Additional information

Businesses may use the revaluation method of depreciation for some of their non-current assets.

REQUIRED

(d) Explain **one** reason why some businesses may use the revaluation method of depreciation.

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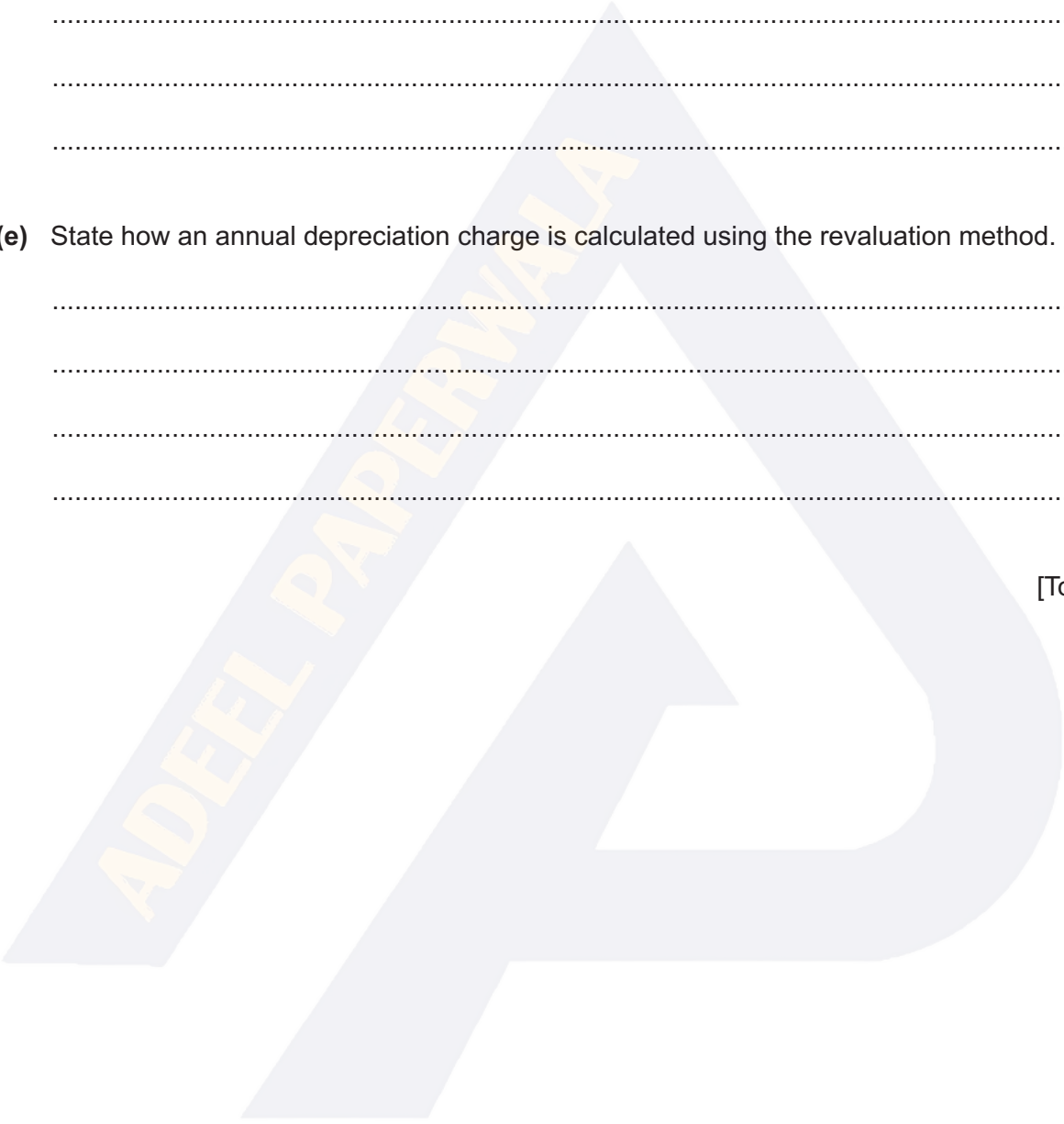
[2]

(e) State how an annual depreciation charge is calculated using the revaluation method.

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[1]

[Total: 15]



- 3 Petra owns a small manufacturing business. Her depreciation policy is as follows:

Non-current asset	Depreciation policy
Plant and machinery	20% per annum reducing balance method
A full year's depreciation is charged in the year of purchase but none in the year of sale.	

The following information in respect of plant and machinery has been extracted from the books of account for the year ended 31 July 2021.

Date	Details
1 August 2020	Cost, \$26 800; Provision for Depreciation, \$12 200.
1 January 2021	Purchased new machinery, cost \$4200. This was settled by a cheque payment of \$2450 and part exchange of machinery that had originally cost \$2500 in September 2018.
31 July 2021	Machinery with an original cost of \$850 and a net book value of \$60 was scrapped with no proceeds.

REQUIRED

- (a) Prepare the provision for depreciation account for plant and machinery for the year ended 31 July 2021.

Provision for Depreciation – Plant and Machinery

Date	Details	\$	Date	Details	\$
			2020 Aug 1	Balance b/d	12 200

[5]

Workings:

(b) Prepare the disposal account for the year ended 31 July 2021.

Disposal Account

Date	Details	\$	Date	Details	\$

[7]

(c) Discuss the reasons why a business may choose to depreciate plant and machinery using the reducing balance method.

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[Total: 15]

2 Depreciation is provided for by a business when accounting for non-current assets.

(a) (i) State **three** possible causes of depreciation.

- 1
- 2
- 3 [3]

(ii) Explain **two** accounting concepts which are applied when providing for depreciation.

1 Concept

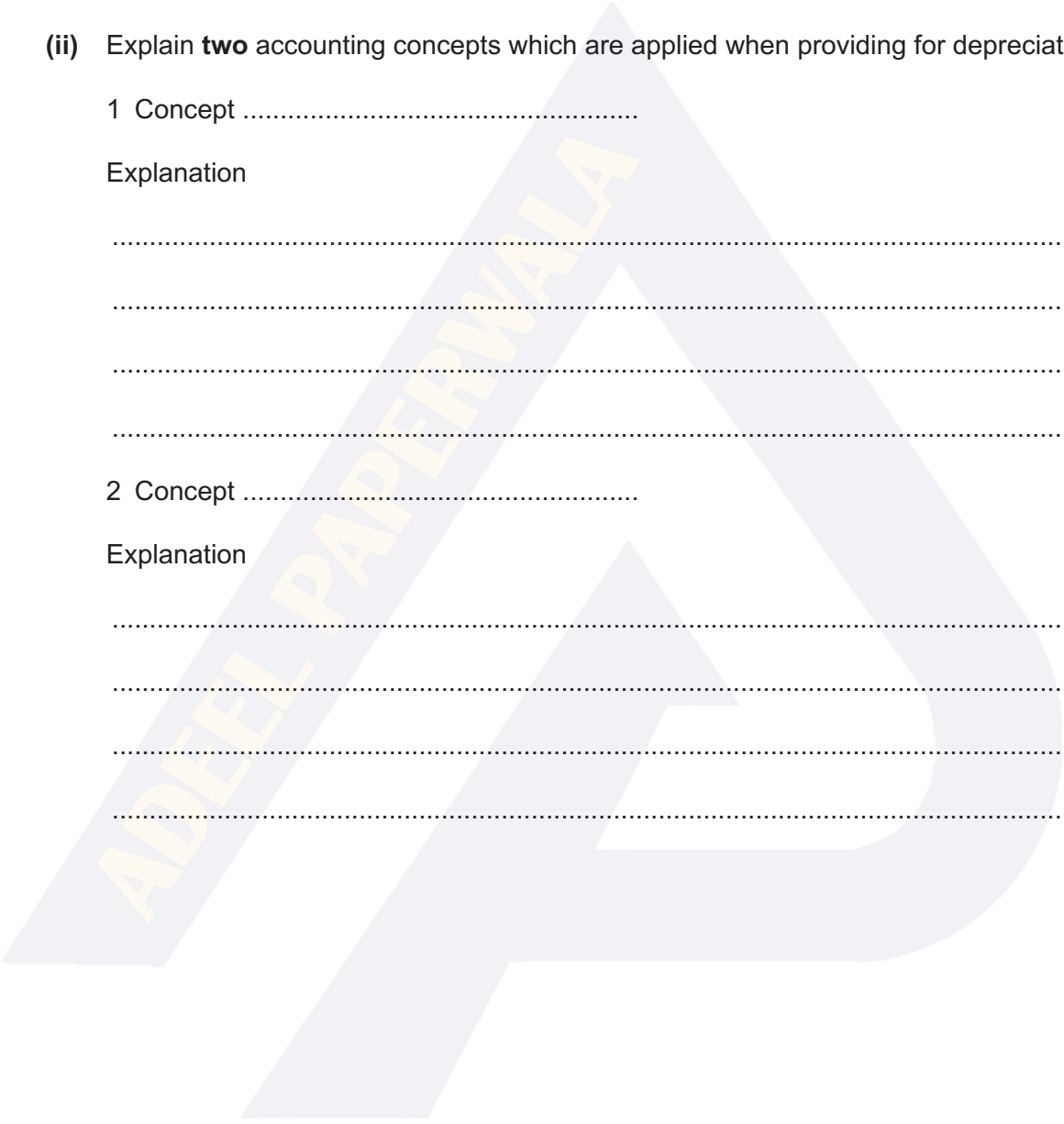
Explanation

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2 Concept

Explanation

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- [4]



The directors of K Limited prepare financial statements to 31 December. They have provided the following information.

Balances at 1 January 2019

	\$
Motor vehicles cost	180 000
Motor vehicles provision for depreciation	105 000

During the year ended 31 December 2019

- 1 A new motor vehicle was acquired for \$50 000.
- 2 A motor vehicle which had cost \$40 000 and been depreciated by \$17 500 was sold for \$16 500.

The company policy is to depreciate motor vehicles at 25% per annum using the reducing balance method.

A full year's depreciation is charged in the year of acquisition and none in the year of disposal.

REQUIRED

(b) Prepare for the year ended 31 December 2019:

- (i) motor vehicles provision for depreciation account

Motor vehicles provision for depreciation account

	\$		\$

[6]

(ii) disposal account

Disposal account

		\$			\$

[2]

[Total: 15]

- 2 Q Limited is a small wholesale business. It uses the reducing balance method of depreciation to depreciate delivery vehicles.

REQUIRED

- (a) Explain **one** advantage and **one** disadvantage to a business of using the reducing balance method of depreciation.

Advantage

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Disadvantage

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Additional information

Delivery vehicle A was purchased on 1 January 2018 for \$36 000.
Delivery vehicle B was purchased on 1 April 2018 for \$40 000.
Depreciation of 20% per annum has been provided annually using the reducing balance method.
A full year's depreciation is charged in the year of acquisition and none in the year of disposal.
The business's financial year end is 31 December.

Additional information

Delivery vehicles are depreciated because they are subject to wear and tear.

REQUIRED

(d) State **two** reasons, other than wear and tear, for depreciating non-current assets.

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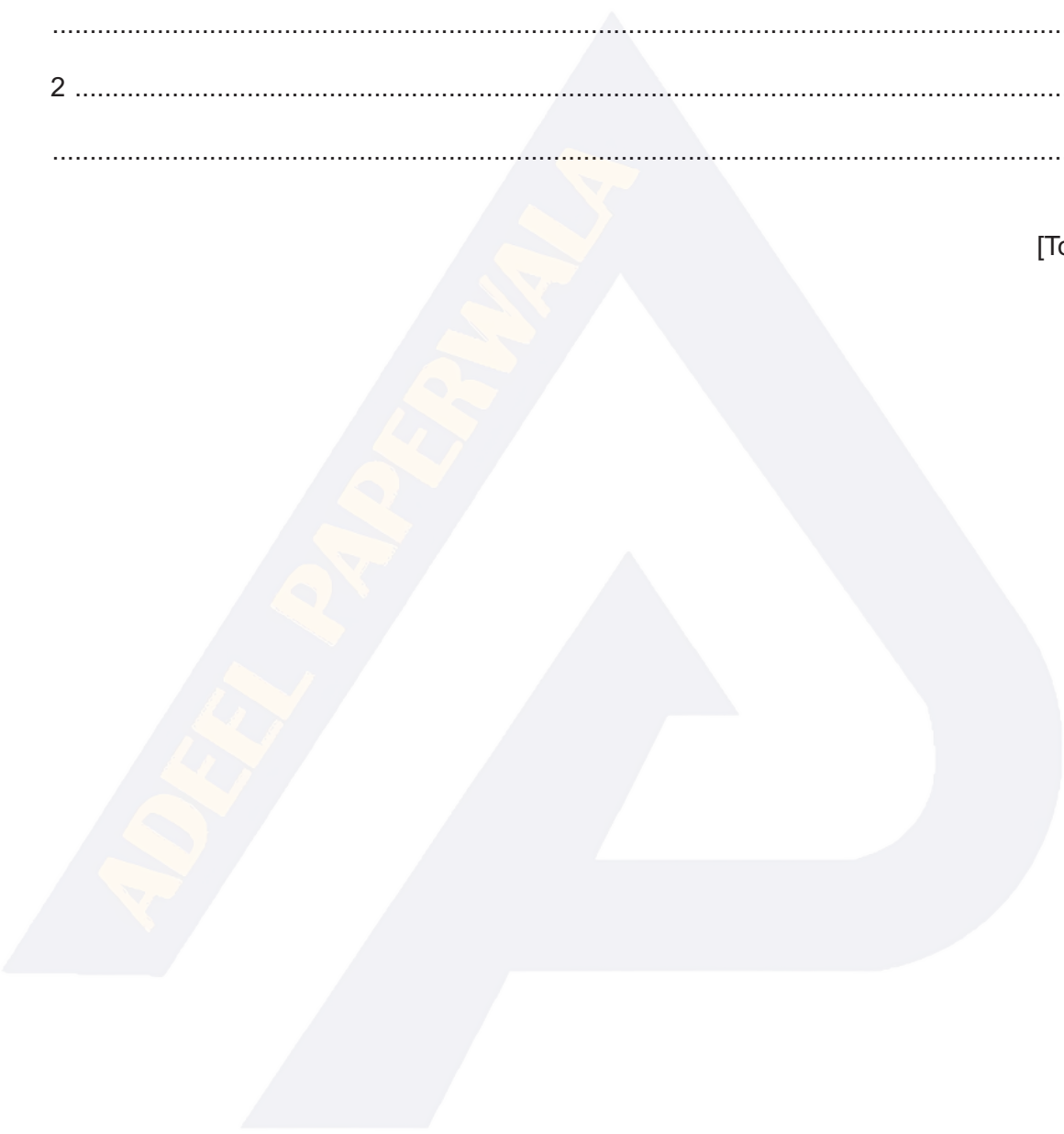
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[2]

[Total: 15]



2 Khalid runs a business. His non-current assets with a total value of \$200 000 consist of a motor vehicle and a machine with a life expectancy of 5 years. He anticipates that the machine will make products at a steady rate during that period.

REQUIRED

(a) State **three** methods of depreciation which may be used by a business.

- 1
- 2
- 3 [3]

(b) Advise Khalid which method of depreciation he should use for **each** asset. Justify your advice.

Motor vehicle

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Machine

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2 Moser has provided the following information about his non-current assets for the year ended 30 November 2018.

1	Motor vehicles		\$
	Cost at 1 December 2017		185 000
	Accumulated depreciation at 1 December 2017		64 750
	Purchased during the year		27 745

2 A motor vehicle was sold during the year for \$12 450. It had originally cost \$18 500 and had a net book value of \$13 875.

3 The motor vehicles depreciation policy is as follows:

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

A full year's depreciation is charged in the year of purchase and no depreciation is charged in the year of disposal.

REQUIRED

(a) State how a disposal of a non-current asset would affect the income statement and the statement of financial position. Calculations are **not** required.

Income statement

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Statement of financial position

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[3]

- (b) Prepare the non-current assets section of Moser's statement of financial position at 30 November 2018.

	Cost \$	Accumulated depreciation \$	Net book value \$

Workings:

[6]

- 2 The following information has been extracted from the books of account of FA Limited at 1 January 2016.

	\$
Motor vehicles at cost	124 000
Motor vehicles provision for depreciation	54 250

The following information is also available.

- All the company's motor vehicles had been purchased on 1 January 2014.
- On 1 July 2016, a new motor vehicle was purchased for \$48 000. The cost was settled by a cheque payment of \$28 000, the balance by the part exchange of an old motor vehicle.

The vehicle that was part-exchanged had cost \$36 000.

- The company policy is to depreciate motor vehicles at 25% per annum using the reducing balance method.

A full year's depreciation is charged in the year of purchase, but none in the year of sale.

REQUIRED

- (a) Prepare the following ledger accounts for the year ended 31 December 2016. (Dates are not required.)

Motor vehicles at cost

	\$		\$

Motor vehicles provision for depreciation

	\$		\$

Disposal of non-current assets

	\$		\$

Workings

[6]

3 Butler operates a small business.

He has provided the following information for non-current assets at 31 July 2016.

	\$
Plant and machinery	
Cost	195 000
Provision for depreciation	68 250

During the year ended 31 July 2017, the following transactions took place.

- 1 A machine was sold for \$25 000. There was a loss on disposal of \$3000. The machine had been purchased on 28 May 2016.
- 2 A machine was purchased by cheque at a cost of \$37 500. The following costs were also incurred for the new machine:

	\$
Annual insurance	2825
Installation expenses	4500

Plant and machinery is depreciated using the reducing balance method at a rate of 20% per annum.

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

REQUIRED

- (a)** Prepare the following ledger accounts for the year ended 31 July 2017. Dates are **not** required.

(i)

Plant and machinery at cost

	\$		\$

[3]

(ii) Provision for depreciation on plant and machinery

	\$		\$

[3]

REQUIRED

(b) Explain why a business may use reducing balance method of depreciation for plant and machinery.

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[3]

Additional information

Butler also purchases loose tools for use in the business.

(c) Explain **two** accounting treatments for loose tools.

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(d) Explain **one** fundamental accounting concept relating to depreciation.

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[Total: 15]



Workings:

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Additional information

Rather than paying immediately, the company had the option to pay in full for the new machine 15 months from the date of purchase.

REQUIRED

(c) Explain the impact on the financial statements for the year ended 30 June 2018 of paying for the new machine 15 months from the date of purchase.

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3 King provided the following information for non-current assets at 1 April 2015.

	\$
Property plant and machinery	
Land and buildings – cost	252 000
Plant and machinery – cost	123 000
Accumulated depreciation	
Buildings	21 000
Plant and machinery	49 000

During the year ended 31 March 2016, the following took place:

- 1 Land was revalued to \$202 500. It had originally cost \$182 000.
- 2 A machine was sold on 30 November 2015. It had a net book value on 1 April 2015 of \$46 350 and an original cost of \$76 200.
- 3 A machine was purchased on 1 December 2015 at a cost of \$62 850.

The depreciation policy for non-current assets is as follows:

Buildings 2% per annum using the straight-line method

Plant and machinery 20% per annum using the reducing balance method

Depreciation is charged on a month-by-month basis.

REQUIRED

(a) Calculate the **total** depreciation charge for buildings for the year ended 31 March 2016.

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(b) Calculate the **total** depreciation charge for plant and machinery for the year ended 31 March 2016.

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(d) State **three** causes of depreciation.

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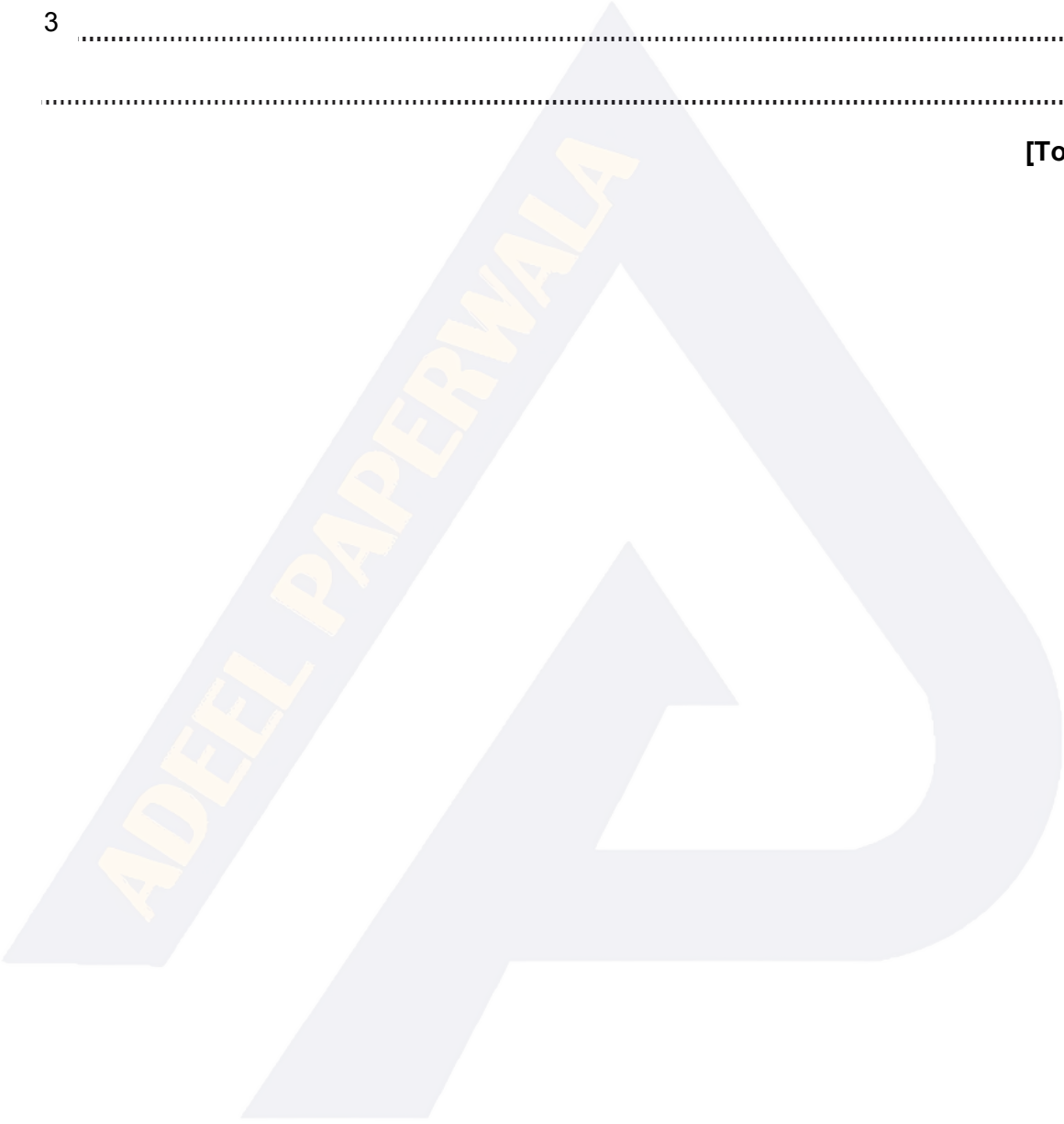
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[Total: 15]



2 The directors of W Limited have provided the following balances at 1 August 2016:

	Cost	Accumulated depreciation	Net book value
	\$	\$	\$
Motor vehicles	125 000	43 750	81 250

The company policy is to provide depreciation on motor vehicles at 20% per annum using the reducing balance method. Depreciation is charged on a month-by-month basis.

During the year ended 31 July 2017, the following transactions took place:

- 1 A motor vehicle was purchased on 31 January 2017 at a cost of \$28 230.
- 2 A motor vehicle was sold on 28 February 2017 for \$14 600. It had originally been purchased on 30 April 2015 at a cost of \$19 500.
- 3 There were no other additions or disposals of motor vehicles during the year.

REQUIRED

- (a) State the double entry required to record the disposal of a non-current asset **before** the profit or loss on disposal is transferred to the income statement (amounts are **not** required).

accounts to be debited	accounts to be credited

[6]

- 3 K Limited has been trading for many years and prepares financial statements annually to 30 April. It had the following balances at 1 May 2016:

	\$	\$
Plant and equipment at cost	84 695	
provision for depreciation		32 855

On 1 February 2017, the company bought new equipment, \$12 785, and the cost of installing this equipment was \$1595.

On 31 December 2016 the company sold a motor vehicle which had cost \$14 850 on 1 August 2015. The proceeds of \$8900 were paid by cheque.

The company's depreciation policy is as follows:

Plant and equipment	20% on cost per annum
Motor vehicles	25% reducing balance per annum

Depreciation is charged on a month-by-month basis.

REQUIRED

- (a) (i) Calculate the depreciation charge for plant and equipment for the year ended 30 April 2017. Workings **must** be shown.

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- (ii) Prepare the motor vehicle disposal account for the year ended 30 April 2017. Workings **must** be shown.

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(b) Explain **two** accounting concepts which are being applied when depreciation is provided.

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Additional information

K Limited is considering purchasing additional plant and equipment costing \$30 000. This could be financed by **one** of the following:

- Bank loan
- Issue of ordinary shares

REQUIRED

(c) Advise the directors which method of finance they should choose. Justify your answer.

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[Total: 15]