Monyetla Project – Accounting Gr 11

Lesson 2: Asset disposal and Fixed assets notes

FIXED ASSETS

Of the most valuable assets that a business can own are its Fixed (Tangible) assets. These assets have a reasonably long lifespan and are not purchased with the intention of reselling them, but rather to produce an income for the business.

- Land and buildings
- Vehicles
- Equipment (including furniture and fittings)
- Computers

Business owners must keep an accurate record of the purchase price and carrying value of their fixed assets. These records are kept in the Fixed Asset Register.

They have to keep these records:

- For Financial Statement purposes
- To assist in the tax return process
- As record if the business wants to sell the asset at a later stage
- For proper internal control purposes.

<u>Fixed Asset Management</u>

Fixed Asset Management is the accounting process of keeping track of all the business's fixed assets. The management process is essential for the following reasons:

- For financial accounting purposes
  The correct bank entries for the purchase and sale of the fixed asset, recording depreciation and carrying the asset at the correct value in the books of the business.

- To determine the maintenance cycle of an asset
  Fixed asset stock needs to be maintained regularly and on time in order to extend the lifespan and to ensure the efficient use of the asset in order to generate maximum profits.

- To prevent the theft and misuse of the asset
  Fixed assets need to be looked after and must be used responsibly – management must formulate policies and put control measures in place to ensure that fixed assets are used responsibly. It must be used for the purpose for which it was and the employees who mismanage or abuse the fixed assets must be disciplined.

<u>Acquisition of fixed assets</u>

Fixed assets can be purchases in one of three ways:

- For cash
- On credit
- As a trade-in

Fixed assets such as land and buildings (property) and vehicles are, in most cases, purchased on credit. When property is purchased on credit, the business will secure a loan, referred to as a mortgage bond. This type of loan is usually repaid within 20 years and interest is accrued to the loan for as long as the bond is being repaid.

Vehicles purchased on credit are, in most cases, subject to vehicle finance. All banks have a vehicle finance division. The bank will pay the car dealer the full purchase price and the client will repay the bank, including interest. The loan on a vehicle is repaid within 5 years.

Lifespan versus Useful life

'Lifespan' means the actual physical life of the asset, until it is really worthless or worth nothing. Such an asset will then be simply written off or sold for a very low amount. The **'useful life'** of an asset refers to the period that the asset will be useful for the enterprise.

The Fixed Asset Register

This register contains all the relevant information pertaining to every fixed asset owned by the business. The acquisition of each asset will be entered into this register. Each asset will be recorded on a separate page in the Fixed Asset Register and updates will take place regularly.

The format:

Fixed Asset Register of Alma Traders

Make: Toyota truck (MXB 234 GP)
Model: 2003
Date of purchase: 1 March 2014 Date of sale: …
Purchased from: Maxi Motors
Cost: R80 000
Depreciation: 25% p.a. on the cost price / diminishing balance method

Date	Depreciation	Accumulated depreciation	Carrying value
28 Feb 2015			
28 Feb 2016			
28 Feb 2017			

Depreciation

Depreciation is the cost of using the asset. Because the asset adds economic benefit to the business by way of generating a profit, there is a cost involved in using the asset.

Depreciation is calculated at the end of the financial year and is written off against the asset as an expense.

There are two methods of depreciating assets:

- **Straight-line method / Cost price method** where a certain percentage of the cost price is depreciated every year.

- **Diminishing balance method / Carrying value method** where a certain percentage of the carrying value (Cost price minus Accumulated depreciation) is depreciated every year.

Updating the Fixed Asset Register with depreciation and accumulated depreciation.

A. On the Straight-line method:

Fixed Asset Register of Alma Traders

Make: Toyota truck (MXB 234 GP)
Model: 2003
Date of purchase: 1 March 2014 Date of sale: 28 February 2017
Purchased from: Maxi Motors
Cost: R80 000
Depreciation: 25% p.a. on the cost price

Date	Depreciation	Accumulated depreciation	Carrying value
28 Feb 2015	25/100 x 80 000 = R20 000	R20 000	R60 000
28 Feb 2016	25/100 x 80 000 = R20 000	R40 000	R40 000
28 Feb 2017	25/100 x 80 000 = R20 000	R60 000	R20 000

At the end of the 3rd year, the vehicle is worth R20 000.

BUT: If the vehicle is sold on 28 February 2018, the vehicle will be depreciated in full. It means that the depreciation period of the vehicle (25% = 4 years) is over. It is generally practice that in the last year the asset will be reflected in the books at R1, and will not be depreciated any further. Consequently, depreciation in the 4th year would be R19 999 and not R20 000.

Fixed Asset Register of Alma Traders

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28 Feb 2015	25/100 x 80 000 = R20 000	R20 000	R60 000
28 Feb 2016	25/100 x 80 000 = R20 000	R40 000	R40 000
28 Feb 2017	25/100 x 80 000 = R20 000	R60 000	R20 000
28 Feb 2017	25/100 x 80 000 = R19 999	R79 999	**R1**

After the vehicle is depreciated in full and is still useful for the business, they can still use it but no depreciation will be written off any more. If the vehicle is no longer useful for the enterprise, they can sell it.

A. On the Diminishing balance method:

Round amounts off to the nearest rand.

Fixed Asset Register of Alma Traders			
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Date	**Depreciation**	**Accumulated depreciation**	**Carrying value**
28 Feb 2015	25/100 x 80 000 = R20 000	R20 000	R60 000
28 Feb 2016	25/100 x (80 000 – 20 000) = R15 000	R35 000	R45 000
28 Feb 2017	25/100 x (80 000 – 35 000) = R11 250	R46 250	R33 750
28 Feb 2018	25/100 x (80 000 – 46 250) = R8 438	R54 688	R25 312

The value of the vehicle decreased more slowly when using the diminishing balance method of depreciation.

RECORDING DISPOSAL OF FIXED ASSETS

When a fixed asset is no longer needed by the business or needs to be replaced, the business will dispose (sell) it. Machines and computers often need to be replaced or upgraded because of technological advances in the industry. Vehicles often need to be replaced because of wear and tear which makes them very expensive to maintain.

When this happens, the business will sell its old fixed assets and replace them with new ones. This process is called **Asset disposal**.

Journal → General Journal (GJ)
All the transactions of Asset disposal, except for the cash amount received when the asset are sold for cash (step 4 → CRJ), will be recorded in the GJ.

When a fixed asset is sold, it must be removed from the records of the business. The price received for that asset is the **selling price**.

STEPS TO FOLLOW WHEN DOING ASSET DISPOSAL

MAKE SURE ABOUT:

- **The current accounting period**
- **The date of selling the asset**
- **The method and percentage of depreciation**

STEP 1: COST PRICE

The cost price of the asset sold, will be given to you.

Remove the cost price of the vehicles being sold from the Vehicles account.

Date: Date of selling

General Journal/Ledger: Dt Asset disposal (N)
Ct Vehicles (B)

STEP 2: ADDITIONAL DEPRECIATION

When selling the asset on the first day of the financial year, there will be no Step 2.

When selling the asset during the financial year or on the last day of the financial year, you must do Step 2.

The depreciation on the asset sold must be calculated **for this year only** → sometimes it is for the whole year (12 months) and sometimes it is only for a few months.

Calculate the depreciation on the asset being sold from the beginning of the year to date of sale. ***Only this amount must still be recorded.***

Date: Date of selling

General Journal/Ledger: Dt Depreciation (N)
Ct Accumulated dep on vehicles (B)

STEP 3: ACCUMULATED DEPRECIATION

If the accumulated depreciation on the specific asset on the first day of the accounting period is not given, you must calculate it first. This amount (given or not) will be included in the credit balance of the Accumulated depreciation on vehicles account.

You must calculate the total accumulated depreciation for the previous years.
Find out:
- When was the asset purchased?
- What is the current financial year (this year)?
- What method and percentage of depreciation is used?

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Add the amount as calculated in Step 2 to the accumulated depreciation on the asset being sold as on the first day of the financial year.

You will then have the **TOTAL** accumulated depreciation on the asset sold, therefore the accumulated depreciation on the first day of the year (previous years) + the depreciation as calculated in step 2.

Remove the accumulated depreciation to date of sale of the vehicle being sold from the Accumulated depreciation on vehicles account.

Date: Date of selling

General Journal/Ledger: Dt Accumulated dep on vehicles (B)
Ct Asset disposal (N)

STEP 4: SELLING PRICE

The asset can be sold in one of the following ways:

- sold for cash (Bank)
- sold on credit (Debtors control)
- traded in on a new vehicle (Creditors control)
- taken by the owner (Drawings)

Enter the selling price on the credit side of the Asset disposal account.

Date: Date of selling

Sold for cash:
Cash Receipts Journal/General Ledger:
Dt Bank (B)
Ct Asset disposal (N)

Sold on credit / Traded in / Taken by the owner
General Journal/Ledger:
Dt Debtors control / Creditors control / Drawings (B)
Ct Asset disposal (N)

STEP 5: PROFIT/LOSS

Calculate the profit or loss on the sale of the vehicle by closing off the Asset disposal account.

The business will make a **PROFIT** when the credit side of the Asset disposal account is more than the debit side.
→ thus, when the value that you get out of the asset (usage and money) is more than the amount you paid for it (cost price).

You will make a profit when the selling price is more than what it is worth / carrying value (Cost price – Accumulated depreciation). **Step 1 – 3**

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Date: Date of selling

General journal/ledger: Dt Asset disposal (N)
Ct Profit on sale of asset (N)

The business will make a **LOSS** when the debit side of the Asset disposal account is more than the credit side.
→ thus, when the amount we paid for it (cost price) is more than the value that you get out of the asset (usage and money).

You will make a loss when the selling price is less than what it is worth / carrying value (Cost price – Accumulated depreciation). **Step 1 – 3**

Date: Date of selling

General Journal/Ledger: Dt Loss on sale of asset (N)
Ct Asset disposal (N)

STEP 6: DEPRECIATION ON THE REMAINING ASSETS AT THE END OF THE YEAR

Calculate: Cost price of the remaining **old vehicles**
Accumulated depreciation of the remaining **old vehicles**

To calculate this amount, use the Accumulated depreciation account:

Calculate a temporary balance in the Accumulated depreciation account
→ Balance + step 2 – step 3

NOW: Depreciation must be calculated separately on the old and new vehicles.

NOTE! New vehicles do not have any accumulated depreciation that must be subtracted from the cost price (diminishing balance method), because it is new!

Date: Last day of the year!

General Journal/Ledger: Dt Depreciation (N)
Ct Accumulated dep on vehicles (B)

NOTE:

Depreciation on the OLD VEHICLE SOLD **(step 2)**
\+ Depreciation on the REMAINING OLD VEHICLES and NEW VEHICLES **(step 6)**
= **TOTAL DEPRECIATION** FOR THIS YEAR on vehicles

Thus, total depreciation for the financial year = Step 2 + Step 6

In the Financial Statements, all transactions according to Fixed Assets will be recorded in **Note 3**.

	Asset
Carrying value at beginning of the year	**A – B = C**
Cost	A
Accumulated depreciation	(B)
Movements:	
Additions at cost	D
Disposal at carrying value (step 1 – step 3)	(E)
Depreciation for the year (step 2 + step 6)	(F)
Carrying value at end of the year	**C + D – E – F = G** *Check:* **H – J = G**
Cost (A + D – step1)	H
AccumuHlated depreciation (B + F – step 3)	(J)

Summary according to Depreciation when selling an asset:

1. Selling on the first day of the financial year

Step 2: **No step 2**, because there is no additional depreciation to calculate on the asset (vehicle/equipment) sold.

Step 6: Calculate the depreciation on the remaining assets, without the asset sold on the first day of the year.

2. Selling on the last day of the financial year

Step 2: Calculate the additional depreciation on the asset sold **for the entire year**.
Add this amount (step 2) to the accumulated depreciation of the previous years to calculate the **total accumulated depreciation** written off on the asset sold (step 3).
Do not record step 2. On the last day of the year you calculate the depreciation on all the assets (step 6) for the entire year.

Step 6: Calculate the **depreciation on ALL the assets for the entire year**, because we've got all the assets the entire year. This will include the depreciation on the asset sold (on the last day of the year).

3. Selling during the financial year

Step 2: Calculate the additional depreciation on the asset sold **for the months of this year** – from the first day of the year until the date of selling.
Add this amount (step 2) to the accumulated depreciation of the previous years to calculate the **total accumulated depreciation** written off on the asset sold (step 3).
Record this amount as the depreciation on the date of selling.

Step 6: Calculate the depreciation on the **remaining assets**, without the asset sold during the year.
Record this amount as the depreciation at the end of the year.

MAKE SURE ABOUT:
- the depreciation method (on cost / on carrying value/diminishing balance),
- the depreciation percentage, and
- the months before selling an asset or after buying a new asset.

Calculate the depreciation on the remaining old assets (vehicles/ equipment) and new assets separately.

Completing the note for fixed assets in the Financial Statements

When selling an asset, make sure of the amounts when preparing the note for fixed assets.

Example 1: (Study & Master, Act 5.21 – pg 162)

Required:
Use the information given to complete the note for fixed assets in the financial statements of Super Sport Store on 30 June 2018, the last day of the financial year.

Information:

Balances on 1 July 2017:	
Land and buildings	R120 000
Vehicles	R75 000
Equipment	R19 000
Accumulated depreciation on vehicles	R15 500
Accumulated depreciation on equipment	R2 800

Transactions from 1 July 2017 to 30 June 2018:

2017

31 Oct	Bought new equipment on credit from LTD Traders for R6 200.

2018

01 Jan	Bought a delivery van on credit from Cleo's Cars for R65 000.
28 Feb	The extensions to the building was completed and a cheque for R50 000 was handed over to the building contractor.
30 Jun	Sold old office equipment for R3 000. The office equipment originally cost R5 100 and the accumulated depreciation on 1 July 2017 amounted to R1 230.

Depreciation is calculated on vehicles at 20% p.a. on the carrying value and on equipment at 15% p.a. on the cost price.

Memo:

	Land and buildings	Vehicles	Equipment
Carrying value at beginning of the year	**120 000**	**59 500**	**16 200**
Cost	120 000	75 000	19 000
Accumulated depreciation	-	(15 500)	(2 800)
Movements:			
Additions at cost	50 000	65 000	6 200
Disposal at carrying value (1 – 3)	-	-	(3 105) *
Depreciation for the year (2 + 6)	-	(18 400)	(3 470) **
Carrying value at end of the year	**170 000**	**106 100**	**15 825**
Cost	170 000	140 000	20 100 #
Accumulated depreciation	-	(33 900)	(4 275) @

<u>Calculations when an asset was sold</u>:

* Cost price (1) *minus* Accum depreciation (3): R5 100 **–** 1 995 = **R3 105**

** Depreciation for the year (step 2 + 6): R765 + 2 705 = **R3 470**

Cost (Balance + new – step 1): R19 000 + 6 200 – 5 100 = **R20 100**

@ Accumulated depreciation (Balance + [step 2 + step 6] – step 3):
R2 800 + R3 470 – R1 995 = **R4 275**