

Lesson 6 – Accounting for the Acquisition, Depreciation and Disposal of Fixed Assets

Question 6.1

Which **one** of the following types of expenditure has a long-term effect on the profit making capacity of a business?

	✓
Capital expenditure	✓
Revenue expenditure	

Question 6.2

The financial records of a business show the following items of expenditure. You are required to complete the following table, thereby classifying each item as being either capital or revenue expenditure.

Item	Expenditure	
	Capital	Revenue
	✓	✓
Wages and salaries		✓
Office furniture (business use)	✓	
Insurances		✓
Machinery (business use)	✓	
Heat and light		✓
Vehicle running costs		✓
Drinks vending machine (canteen)	✓	
Ingredients for vending machine		✓
Bank charges (Current Account)		✓
Repairs and maintenance		✓

Question 6.3

The Bistro restaurant is registered for VAT. Provided below is an invoice they received recently from Catering & Bar Supplies:

Invoice No: 1265	
CATERING & BAR SUPPLIES	
To: The Bistro	Date: 1 May 201Y
Details	£
Sharp commercial micro-wave oven	600.00
12 Cases of wine - Echo Falls (white 1L) 6 per case	300.00
Sub-total	900.00
VAT @ 20%	180.00
Invoice total	1,080.00
Terms: Net 30 days	VAT Reg No. 321 7654 98

Provided below is an extract from the ledger of The Bistro. Using the invoice date and the accounts provided, record the invoice in the ledger.

The Bistro - Ledger (extract)

DR		Kitchen Equipment (cost)		CR	
201Y	Details	£	201Y	Details	£
1 May	Catering & Bar Supplies	600			

DR **Purchases** **CR**

201Y	Details	£	201Y	Details	£
1 May	Catering & Bar Supplies	300			

DR **VAT Control** **CR**

201Y	Details	£	201Y	Details	£
1 May	Catering & Bar Supplies	180			

DR **Catering & Bar Supplies** **CR**

201Y	Details	£	201Y	Details	£
			1 May	Catering equipment and VAT	1,080

Question 6.4

The bookkeeper of Allendale Engineering recently incorrectly classified an expenditure transaction. As a result, the acquisition of a lathe for use in the workshop at a cost of £2,000 (ignore VAT) was debited to the purchases account instead of the machinery and equipment account.

Given the above information, and provided the error is not found and corrected prior to the preparation of financial statements at the year-end, which **one** of the following statements is true?

	✓
The net profit for the year will be overstated and the value of machinery and equipment on the balance sheet will be overstated	
The net profit for the year will be understated and the value of machinery and equipment on the balance sheet will be understated	✓
The net profit for the year will be overstated and the value of machinery and equipment on the balance sheet will be understated	

Question 6.5

The management of a business is required to select a method of depreciation which is the most appropriate to the type of asset and the operating circumstances of the business, and to apply the chosen method from accounting period to accounting period.

Which **one** of the following accounting concepts is being applied by observing the above requirement?

	✓
Going concern	
Accruals	
Consistency	✓

Question 6.6

A business purchases an item of office equipment for use in the business. It is estimated that the item will have an economic life of 10 years, and that the business will get the same amount of use from the item each year.

Given the above information, which **one** of the following methods of depreciation would be most appropriate for the purpose of accounting for depreciation of the item of office equipment over the period of its economic life?

	✓
Diminishing balance	
Straight line	✓

Question 6.7

The value of which **one** of the following assets is most likely to be subject to technological change?

	✓
Desktop computer	✓
Delivery van	
Filing cabinet	

Question 6.8

A business has annual sales of £8 million.

The business recently purchased a sack barrow for use in moving heavy parcels delivered to the office. The sack barrow cost £75 and was classified as revenue expenditure by the bookkeeper.

Which **one** of the following accounting concepts has the bookkeeper applied by treating the purchase of the sack barrow as revenue expenditure?

	✓
Going concern	
Objectivity	
Materiality	✓

Question 6.9

Using appropriate words from the list provided below, complete the gaps in each of the four sentences which follow the list:

- residual value
- straight line
- capitalised cost
- net book value
- diminishing balance

1. The method of accounting for depreciation which results in the annual depreciation charge being higher in earlier years of an assets economic life than in later years is known as the **diminishing balance** method.
2. The method of accounting for loss in value of a fixed asset (depreciation) evenly over the period of an assets economic life to the business is known as the **straight line** method.
3. The amount a business which owns a fixed asset expects to receive when the asset is disposed of is known as its **residual value**.
4. The cost of a fixed asset less its accumulated depreciation is known as its **net book value**.

Question 6.10

Which **one** of the following statements describes tangible assets?

	✓
Non-physical assets that have no substance or form	
Physical assets with substance and form	✓

Question 6.11

Indicate which **two** of the following are examples of intangible assets:

	✓
Goodwill	✓
Land and buildings	
Furniture and fittings	
Patents	✓
Plant and equipment	

Question 6.12

You have been asked to record the opening balances brought down on several fixed asset cost accounts and fixed asset provision for depreciation accounts in the ledger of a business at the beginning of its financial year.

Which **two** of the statements below correctly describe how the opening balances brought down on the fixed asset cost accounts and fixed asset provision for depreciation accounts would be recorded in the ledger?

	✓
The opening balance on a fixed asset cost account would be recorded in the account as a debit balance brought	✓
The opening balance on a fixed asset provision for depreciation account would be recorded as a debit balance brought down	
The opening balance on a fixed asset cost account would be recorded in the account as a credit balance brought down	
The opening balance on a fixed asset provision for depreciation account would be recorded as a credit balance brought down	✓

Question 6.13

A business depreciates its fixtures and fittings by 10% each year. When calculating depreciation at the year-end the business applies the percentage rate to the cost of the fixtures and fittings.

Depreciation is charged each year for a full twelve months, irrespective of when within the financial year items of fixtures and fittings are acquired. The business does not depreciate fixtures and fittings in the year they are disposed of.

Given the above information which one of the following statements describes the policy of the business for depreciating its fixtures and fittings?

	✓
The business is using the diminishing balance method of depreciation applied on a month for month basis	
The business is using the diminishing balance method of depreciation applied on a full year basis	
The business is using the straight line method of depreciation applied on a full year basis	✓
The business is using the straight line method of depreciation applied on a month for month basis	

Question 6.14

The financial year of a business ends on 31 December.

On 1 March 201X the business purchased an item of machinery for use in its factory, which it capitalised as at a cost of £15,000 (ignore VAT).

The business depreciates machinery at the rate of 40% each year using the reducing balance method of depreciation. The business charges a full year's depreciation in the year of acquisition of fixed assets, with no depreciation being charged in the year of disposal.

Given the above information make the following calculations:

- a) Calculate the depreciation on the machine for each of the first two years of its economic life to the business. Enter the figures you calculate in the boxes provided below:

Depreciation year ended 31 December 201X £6,000

Depreciation year ended 31 December 201Y £3,600

- b) Calculate the net book value of the machine at the year-end 31 December 201Y. Enter the figure you calculate in the box provided below:

Net book value of machine at 31 December 201Y £5,400

Question 6.15

The financial year of a business ends on 31 March.

On 1 July 201X the business purchased an item of office equipment for use in the business at a cost of £1,200

The business depreciates office equipment at the rate of 25% each year using the straight line method of depreciation. The business charges depreciation at the end of each financial year based on the number of months in the year that fixed assets have been owned at the end of that financial year.

Given the above information make the following calculations:

- a) Calculate the depreciation on the item of office equipment for each of the first two years of its economic life to the business. Enter the figures you calculate in the boxes provided below:

Depreciation year ended 31 March 201Y £225

Depreciation year ended 31 March 201Z £300

- b) Calculate the net book value of the item of office equipment at the year-end 31 March 201Z. Enter the figure you calculate in the box provided below:

Net book value of machine at 31 March 201Z £675

Question 6.16

A business owns several vehicles and keeps the following accounts in its ledger.

- vehicles cost account
- vehicles provision for depreciation account
- Depreciation expense account

The business has a year-end of 31 December.

At 1 January 201X the vehicles cost account carried a balance brought down of £84,000. At the same date the vehicles provision for depreciation account carried a balance brought down of £36,400.

Required - record the balances above as balances brought down at 1 January 201X in the ledger. The following ledger extract is provided for your use in completing this task.

Ledger (extract)					
DR			CR		
Vehicles (Cost)					
201X	Details	£	201X	Details	£
1 Jan	Balance b/d	84,000	31 Dec	Balance c/d	108,000
1 May	Bank	24,000			
		108,000			108,000
201Y	Details	£	201Y	Details	£
1 Jan	Balance b/d	108,000			

DR			Vehicles (Provision for Depreciation)			CR		
201X	Details	£	201X	Details	£			
31 Dec	Balance c/d	54,300	1 Jan	Balance b/d	36,400			
			31 Dec	Depreciation expense	17,900			
		54,300			54,300			
201Y	Details	£	201Y	Details	£			
			1 Jan	Balance b/d	54,300			

DR			Depreciation Expense			CR		
201X	Details	£	201X	Details	£			
31 Dec	Vehicles provision for depreciation	17,900	31 Dec	Profit and loss	17,900			
		17,900			17,900			

On 1 May 201X the business purchased a new vehicle for use in the business at a cost of £24,000 (ignore VAT), making payment directly from its bank account.

Required – record the acquisition of the vehicle on 1 May 201X in the ledger above.

At the year-end 31 December 201X vehicles are to be depreciated by £17,900.

Required - using the journal provided below complete the journal entry to account for depreciation at the year-end 31 December 201X, and record from the journal entry record the depreciation in the ledger.

Journal

201X	Account name	DR £	CR £
31 Dec	Depreciation expense	17,900	
	Vehicles provision for depreciation		17,900
	Depreciation of vehicles at the year-end 31 December 201X		

Required – having recorded the entries from the journal above in the ledger, balance off the vehicles cost account and vehicles provision for depreciation account at the year-end. Show the closing account balances carried down (Balance c/d) at 31 December 201X and brought down (Balance b/d) at 1 January 201Y.

Required - using the journal provided below complete the journal at the year-end 31 December 201X, to transfer the depreciation expense for the year to the profit and loss account and record the transfer in the depreciation account. Having made the transfer, close off the depreciation expense account.

Journal

201X	Account name	DR £	CR £
31 Dec	Profit and loss account	17,900	
	Depreciation expense		17,900
	Transfer of depreciation at the year-end 31 December 201X to the profit and loss account		

Required – having balanced off the vehicles cost account and the vehicles provision for depreciation account, and closed off the depreciation expense account complete each of the following extracts taken from the financial statements to be prepared at 31 December 201X.

**Trading and Profit and Loss Account (extract)
for the Year Ended 31 December 201X**

	£	£	£
Sales			XXXX
Less Cost of Goods Sold			
Opening Stock	XXXX		
Add Purchases	XXXX		
		XXXX	
Less Closing Stock		XXXX	
Cost of Sales			XXXX
Gross Profit			XXXX
Less Expenses			
Depreciation charge		17,900	

Balance Sheet (extract) at 31 December 201X

	£	£	£
	Cost	Less Depreciation to Date	Net Book Value
Fixed Assets			
Vehicles	108,000	54,300	53,700

Question 6.17

A business keeps the following accounts in its ledger.

Machinery cost account

- Machinery provision for depreciation account
- Depreciation expense account

The business has a year-end of 31 December.

At 1 January 201X the machinery cost account carried a balance brought down of £61,500. At the same date the machinery provision for depreciation account carried a balance brought down of £12,300.

Required - record the balances above as balances brought down at 1 January 201X in the ledger. The following ledger extract is provided for your use in completing this task.

Ledger (extract)

DR	Machinery (Cost)				CR
201X	Details	£	201X	Details	£
1 Jan	Balance b/d	61,500	31 Dec	Balance c/d	66,000
1 June	Bank	4,500			
		66,000			66,000
201Y	Details	£	201Y	Details	£
1 Jan	Balance b/d	66,000			

DR		Machinery (Provision for Depreciation)		CR	
201X	Details	£	201X	Details	£
31 Dec	Balance c/d	23,040	1 Jan	Balance b/d	12,300
			31 Dec	Depreciation expense	10,740
		23,040			23,040
201Y	Details	£	201Y	Details	£
			1 Jan	Balance b/d	23,040

DR		Depreciation Expense		CR	
201X	Details	£	201X	Details	£
31 Dec	Machinery provision for depreciation	10,740	31 Dec	Profit and loss	10,740
		10,740			10,740

On 1 June 201X the business purchased a machine for use in its workshop at a cost of £4,500 (ignore VAT), making payment directly from its bank account.

Required – record the acquisition of the machine on 1 June 201X in the ledger above.

At each year-end the business depreciates its machinery by 20% using the diminishing balance method of depreciation. A full year's depreciation is taken in the year and asset is purchased, with no depreciation taken in the year of an assets disposal.

Required – calculate depreciation on machinery at the year-end 31 December 201X and enter the figure you calculate in the box provided below:

Machinery depreciation year-end 31 December 201X £10,740

Required - using the journal provided below complete the journal entry to account for depreciation at the year-end 31 December 201X, and from the journal entry record the depreciation in the ledger.

Journal

201X	Account name	DR £	CR £
31 Dec	Depreciation expense	10,740	
	Machinery provision for depreciation		10,740
	Depreciation of machinery at the year-end 31 December 201X		

Required – having recorded the entries from the journal above in the ledger, balance off the machinery cost account and machinery provision for depreciation account at the year-end. Show the closing account balances carried down (Balance c/d) at 31 December 201X and brought down (Balance b/d) at 1 January 201Y.

Required - using the journal provided below complete the journal at the year-end 31 December 201X, to transfer the depreciation expense for the year to the profit and loss account and record the transfer in the depreciation expenses account. Having made the transfer, close off the depreciation expense account.

Journal

201X	Account name	DR £	CR £
31 Dec	Profit and loss account	10,740	
	Depreciation expense		10,740
	Transfer of depreciation at the year-end 31 December 201X to the profit and loss account		

Required – having balanced off the machinery cost account and the machinery provision for depreciation account, and closed off the depreciation expense account complete each of the following extracts taken from the financial statements to be prepared at 31 December 201X.

**Trading and Profit and Loss Account (extract)
for the Year Ended 31 December 201X**

	£	£	£
Sales			XXXX
Less Cost of Goods Sold			
Opening Stock	XXXX		
Add Purchases	XXXX		
		XXXX	
Less Closing Stock		XXXX	
Cost of Sales			XXXX
Gross Profit			XXXX
Less Expenses			
Depreciation charge		10,740	

Balance Sheet (extract) at 31 December 201X

	£	£	£
	Cost	Less Depreciation to Date	Net Book Value
Fixed Assets			
Machinery	66,000	23,040	42,960

Question 6.18

In the year ended 31 May 201Y a business disposed of a vehicle by part-exchanging it against a new vehicle. The business was given a part-exchange allowance of £6,000 against the new vehicle.

The vehicle disposed of originally cost the business £32,000 when it was purchased several years ago. At the time of its disposal the vehicle disposed had been depreciated by £28,000.

Given the information above, which one of the following statements is correct?

	✓
The business made a profit of £6,000 on disposal of the vehicle	
The business made a loss of £4,000 on disposal of the vehicle	
The business made a profit of £2,000 on disposal of the vehicle	✓

Question 6.19

The financial year of a business ends on 31 December.

In the year ended 31 December 201Y the business disposed of a profiling machine. The machine was sold by auction on 30 June 201Y. Following the auction, the auction company transferred £1,000, the net proceeds from sale of the machine, into the bank account of the business disposing of the machine.

The profiling machine originally cost the business disposing of it £12,500 when it was purchased several years ago. At the year-end 31 December 201X the machine had been depreciated by £9,000. The business charges a full year's depreciation on fixed assets in the year of acquisition, but charges no depreciation in the year of disposal.

You are provided below with a fixed asset disposals account in the ledger of the business which disposed of the machine.

Ledger (extract)

DR		Fixed Asset Disposals			CR	
201Y	Details	£	Date	Details	£	
30 June	Machine cost	12,500	30 June	Machine provision for depreciation	9,000	
			30 June	Bank	1,000	
			31 Dec	Profit and loss	2,500	
		12,500			12,500	

Required – using the journal provided below complete the journal entry to support the transfer of the cost of the machine disposed of on 30 June 201Y from the machinery cost account to the fixed assets disposals account:

Journal

201Y	Account name	DR £	CR £
30 June	Fixed asset disposals	12,500	
	Machinery cost		12,500
	Transfer of the cost of a machine disposed of to the fixed asset disposals account following its disposal		

Required – record the cost of the machine disposed of in the fixed asset disposals account provided in the ledger extract at 30 June 201Y.

Required – using the journal provided below complete the journal entry to support the transfer of the accumulated depreciation on the machine disposed of on 30 June 201Y, from the machinery provision for depreciation account to the fixed asset disposals account.

Journal

201Y	Account name	DR £	CR £
30 June	Machinery provision for depreciation	9,000	
	Fixed asset disposals		9,000
	Transfer of the accumulated depreciation of a machine disposed of to the fixed asset disposals account following its disposal		

Required – record accumulated depreciation on the machine disposed of in the fixed asset disposals account provided in the ledger extract at 30 June 201Y.

Required – record the proceeds of £1,000 from the sale of the machine received directly into the business bank account on 30 June 201Y in the fixed asset disposals account in the ledger extract.

Required – calculate whether the business disposing of the machine made a profit or loss on disposal, and enter the figure you calculate in the appropriate box provided below:

Profit on disposal of machine £

Loss on disposal of machine £2,500

Required – using the journal provided below complete the journal entry to support the transfer of the profit or loss on the machine disposed of from the fixed asset disposals account to the profit and loss account at the year-end 31 December 201Y.

Journal

201Y	Account name	DR £	CR £
31 Dec	Profit and loss account	2,500	
	Fixed asset disposals		2,500
	Transfer of the loss on disposal of a fixed asset to the profit and loss account at the year-end 31 December 201Y		

Required – record the journal entry above in the fixed asset disposals account in the ledger extract and in the profit and loss account section of the trading and profit and loss account (extract) provided below.

Trading and Profit and Loss Account (extract) for the Year Ended 31 December 201Y

	£	£	£
Sales			XXXX
Less Cost of Goods Sold			
Opening Stock	XXXX		
Add Purchases	XXXX		
		XXXX	
Less Closing Stock		XXXX	
Cost of Sales			XXXX
Gross Profit			XXXX
Less Expenses			
Loss on disposal of fixed asset		2,500	

Required – close off the fixed asset disposals account in the ledger extract.

Question 6.20

The financial year of J&R Construction ends on 31 December.

In the year ended 31 December 201Y the business disposed of an item of machinery (a mini-digger). The machine was sold on 30 September 201Y. J&R Construction received £3,500 from the buyer of the machine, which was transferred directly from the bank account of the buyer to the bank account of J&R Construction. The machine, which had originally cost J&R Construction £20,000 when it was purchased, had a net book value in their books of £2,500 at the year-end 31 December 201X.

J&R Construction charge a full year's depreciation on machinery in the year of acquisition, but charge no depreciation on machinery in the year of disposal.

You are provided below with a fixed asset disposals account in the ledger of J&R Construction.

J&R Construction - Ledger (extract)

DR		Fixed Asset Disposals				CR	
201Y	Details	£	Date	Details	£		
30 Sept	Machine cost	20,000	30 Sept	Machine provision for depreciation	17,500		
31 Dec	Profit and loss	1,000	30 Sept	Bank	3,500		
		21,000			21,000		

Required – using the journal provided below complete the journal entry to support the transfer of the cost of the machine disposed of on 30 September 201Y from the machinery cost account to the fixed assets disposals account:

Journal

201Y	Account name	DR £	CR £
30 Sept	Fixed asset disposals	20,000	
	Machinery cost		20,000
	Transfer of the cost of a machine disposed of to the fixed asset disposals account following its disposal		

Required – record the cost of the machine disposed of in the fixed asset disposals account provided in the ledger extract at 30 September 201Y.

Required – using the journal provided below complete the journal entry to support the transfer of the accumulated depreciation on the machine disposed of on 30 September 201Y, from the machinery provision for depreciation account to the fixed asset disposals account.

Journal

201Y	Account name	DR £	CR £
30 Sept	Machinery provision for depreciation	17,500	
	Fixed asset disposals		17,500
	Transfer of the accumulated depreciation of a machine disposed of to the fixed asset disposals account following its disposal		

Required – record accumulated depreciation on the machine disposed of in the fixed asset disposals account provided in the ledger extract at 30 September 201Y.

Required – record the proceeds of £3,500 from the sale of the machine transferred into the bank account of J&R Construction on 30 September 201Y in the fixed asset disposals account in the ledger extract.

Required – calculate whether J&R Construction made a profit or loss on disposal of the machine, and enter the figure you calculate in the appropriate box provided below:

Profit on disposal of machine £1,000

Loss on disposal of machine £

Required – using the journal provided below complete the journal entry to support the transfer of the profit or loss on the machine disposed of from the fixed asset disposals account to the profit and loss account at the year-end 31 December 201Y.

Journal

201Y	Account name	DR £	CR £
31 Dec	Fixed asset disposals	1,000	
	Profit and loss account		1,000
	Transfer of the profit on disposal of a fixed asset to the profit and loss account at the year-end 31 December 201Y		

Required – record the journal entry above in the fixed asset disposals account in the ledger extract and in the profit and loss account section of the trading and profit and loss account (extract) provided below.

**Trading and Profit and Loss Account (extract)
for the Year Ended 31 December 201Y**

	£	£	£
Sales			XXXX
Less Cost of Goods Sold			
Opening Stock	XXXX		
Add Purchases	XXXX		
		XXXX	
Less Closing Stock		XXXX	
Cost of Sales			XXXX
Gross Profit			XXXX
Add Other income			
profit on disposal of fixed asset		1,000	

Required – close off the fixed asset disposals account in the ledger extract.

Question 6.21

The financial year of Riverdale Farm ends on 31 March. The farm owns several tractors.

During the financial year 1 April 201X to 31 March 201Y Riverdale Farm acquired a new tractor and disposed of an old tractor. Details of the acquisition and disposal transactions are shown below.

Acquisition of new tractor – a new tractor (John Deere 360) was purchased on 1 September 201X at a cost of £16,000 (ignore VAT). The tractor was paid for by cheque.

Disposal of old tractor – on 1 March 201Y Riverdale Farm sold an old tractor (Massey Ferguson 5455 originally purchased on 1 June 201V). The net proceeds for the sale of the tractor of £5,000 was received directly into the business bank account

The following is the depreciation policy of Riverdale Farm:

Depreciation policy

Tractors are depreciated at 20% per year using the straight line method. A full year's depreciation is charged in the year of acquisition of a tractor, but no depreciation is charged in the year of disposal of a tractor.

Note: The acquisition and disposal values given above exclude Value Added Tax (VAT) and for the purpose of this exercise VAT should be ignored.

Listed below are a number of tasks related to the acquisition and disposal of fixed assets and the keeping of a fixed asset register. You are provided with a fixed asset register, journal and all ledger accounts you will need to complete the required tasks.

Required:

- 1.** Enter the acquisition of the new tractor (John Deere 360) on 1 September 201X into the fixed asset register.
- 2.** Enter the disposal details of the old tractor (Massey Ferguson 5455) on 1 March 201Y into the fixed asset.
- 3.** Update the fixed asset register by depreciating tractors at 31 March 201Y in accordance with the depreciation policy of the business. Update also the columns 'accumulated depreciation' and 'net book value'.

The following is provided below for your use in completing the above tasks:

- Fixed asset register (extract – tractors section)

