

31.1 A drill to practise the different methods of estimating annual depreciation

Business 1

At the beginning of a year, a fixed asset is in the balance sheet of a business at cost £12 000, less depreciation £3 000.

At the end of the year, the fixed asset remains in the business.

Show a P&L Account extract for the year, and an extract from the closing balance sheet, as they would be under each of the following assumptions:

1. depreciation is charged at 25% per year on cost

<i>P&L</i>	
<i>depreciation</i>	3 000

BALANCE SHEET *extract*

fixed asset cost	12 000
provision for depreciation	(6 000)
Net Book Value	<u>£6 000</u>

2. depreciation is charged at 25% per year on the reducing balance

<i>P&L</i>	
<i>depreciation</i>	2 250

BALANCE SHEET *extract*

fixed asset cost	12 000
provision for depreciation	(5 250)
Net Book Value	<u>£6 750</u>

3. the fixed asset is valued at £7 500 at the end of the year

<i>P&L</i>	
<i>depreciation</i>	1 500

BALANCE SHEET *extract*

fixed asset cost	12 000
provision for depreciation	(4 500)
Net Book Value	<u>£7 500</u>

Business 2

At the beginning of a year, a fixed asset is in the balance sheet of a business at cost £16 000, less depreciation £5 000.

At the end of the year, the fixed asset remains in the business.

Show a P&L Account extract for the year, and an extract from the closing balance sheet, as they would be under each of the following assumptions:

1. depreciation is charged at 10% per year on the straight line method

<i>P&L</i>	
<i>depreciation</i>	1 600

BALANCE SHEET *extract*

fixed asset cost	16 000
provision for depreciation	<u>(6 600)</u>
Net Book Value	<u><u>£9 400</u></u>

2. depreciation is charged at 10% per year on the reducing balance

<i>P&L</i>	
<i>depreciation</i>	1 100

BALANCE SHEET *extract*

fixed asset cost	16 000
provision for depreciation	<u>(6 100)</u>
Net Book Value	<u><u>£9 900</u></u>

Business 3

A fixed asset with original cost £100 000 has been held by a business for three years.

Calculate the total depreciation charged to date (to the end of YEAR 3) and the net book value of the asset, under each of the following assumptions:

1. the policy of the firm has been to charge depreciation at 20% per year on the reducing balance
2. the policy of the firm has been to charge depreciation at 20% per year on cost

For each assumption, also calculate the profit or loss on disposal that would be reported if the fixed asset were sold for £45 000 at the start of YEAR 4.

1. if depreciation has been charged at 20% per year on the reducing balance

	£		
fixed asset cost	100 000	Summary of Depreciation	
less Year 1 depreciation 20%	(20 000)		£
remaining value	80 000	YEAR 1	20 000
less Year 2 depreciation 20%	(16 000)	YEAR 2	16 000
remaining value	64 000	YEAR 3	12 800
less Year 3 depreciation 20%	(12 800)	TOTAL	<u>£48 800</u>
remaining value	<u>£51 200</u>		

If sold for £45 000, loss on disposal would be £51 200 - £45 000 = £6 200

2. if depreciation has been charged at 20% per year on cost

	£		
fixed asset cost	100 000	Summary of Depreciation	
less Year 1 depreciation 20%	(20 000)		£
remaining value	80 000	YEAR 1	20 000
less Year 2 depreciation 20%	(20 000)	YEAR 2	20 000
remaining value	60 000	YEAR 3	20 000
less Year 3 depreciation 20%	(20 000)	TOTAL	<u>£60 000</u>
remaining value	<u>£40 000</u>		

If sold for £45 000, profit on disposal would be £45 000 - £40 000 = £5 000

NOTICE that in each case, the total of depreciation charged, plus loss on disposal/minus profit on disposal will be equal to the actual loss in value of £55 000