



CHAPTER 8

ACCOUNTING FOR PLANT ASSETS

Section 8.2

Calculating and Journalizing Depreciation Expense

Why may we need to “get rid of” a plant asset?

- Worn out
- No longer needed or useful
- Outdated / new models

Concept: Matching Expenses with Revenue

To match revenue with the expenses incurred to earn it, the cost of a plant asset should be allocated to an expense account over the useful life of the plant asset.

Calculating and Journalizing Depreciation Expense

What do we call the portion of the plant asset's cost that is transferred to an expense account in each fiscal period during a plant asset's useful life?

Answer: Depreciation Expense

Factors Used to Calculate Depreciation:

1. Original Cost
2. Estimated Salvage Value
3. Estimated Useful Life

Calculating and Journalizing Depreciation Expense

Is land subject to depreciation? Why?

Answer: No, because of its permanent nature.

When are the increases or decreases in land value recognized?

Answer: when the land is sold or otherwise disposed of.

Factors used to calculate depreciation

Original Cost:

All costs paid to make the asset usable to a business.

What may be included in original cost?

- Purchase price
- Delivery cost
- Installation cost

Historical Cost – The actual amount paid for merchandise or other items bought is recorded.

Factors used to calculate depreciation

Estimated Salvage Value:

- When a plant asset is disposed of, some part of its original value may remain.
- When a plant asset is bought, its final value can only be estimated.

The amount an owner expects to receive when a plant asset is removed from use is called ____.

Answer: Estimated Salvage Value

Factors used to calculate depreciation

Estimated Salvage Value Continued:

Salvage value can also be referred to:

- Residual value
- Scrap value
- Trade-in value

Because businesses have difficulty determining the exact salvage value, a business must estimate this amount.

Factors used to calculate depreciation

Estimated Salvage Value Continued:

Because salvage value is used in calculating a plant asset's annual depreciation, the most accurate estimate must be made.

Factors used to calculate depreciation

Estimated Useful Life:

- Number of years it is expected to be useful to the business
- Differs from one situation to another

What do most businesses use to determine a plant asset's useful life?

1. Past experience
2. Industry standard
3. Internal revenue service's guidelines

Depreciation Method

A business should select a depreciation method that provides the best financial information.

A business uses the same depreciation method for all assets within a plant asset category.

Straight-Line Depreciation

Charging an equal amount of depreciation expense for a plant asset in each year of the useful life is called _____.

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$$\begin{array}{r} \text{Original Cost} \\ - \quad \underline{\text{Estimated salvage value}} \\ = \quad \text{Estimated total depreciation expense} \\ / \quad \underline{\text{Years}} \\ = \quad \text{Annual Depreciation Expense} \end{array}$$

Straight-Line Depreciation

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$$\begin{aligned} & \text{Original Cost} \\ - & \text{ Estimated salvage value } \\ = & \text{ Estimated total depreciation expense} \\ / & \text{ Years } \\ = & \text{ Annual Depreciation Expense} \end{aligned}$$

Straight-Line Depreciation

Ending Book Value

$$\text{Beg. Book Value} - \text{Annual Depreciation} = \text{Ending Book Value}$$

Straight-Line Depreciation

Ending Book Value

$$\text{Beg. Book Value} - \text{Annual Depreciation} = \text{Ending Book Value}$$

Recording Depreciation on Plant Asset Record

Annual Depreciation will be recorded in two places:

1. On the plant asset record
2. As part of adjusting entries that are posted to the general ledger accounts

Accumulated Depreciation:

Sum of the previous years' accumulated depreciation

Book Value of a Plant Asset:

Original cost minus accumulated depreciation

Recording Depreciation on Plant Asset Record

How to calculate for part of a year:

Annual Depreciation Expense
Divided by Months in a year

Equals Monthly depreciation expense
Multiply Number of months Asset in Use

Equals Partial Year's Depreciation Expense

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Audit your understanding

To match revenue with the expenses incurred to earn it, the cost of a plant asset should be allocated to an expense account over what period of time?

Answer: Over the useful life of the plant asset.

Audit your understanding

Which accounting concept is being applied when depreciation expense is recorded for plant assets?

Answer: Matching expenses with revenue

Audit your understanding

Why is annual depreciation for land not recorded?

Answer: because it is permanent in nature

Audit your understanding

What three factors are used to calculate a plant asset's annual depreciation expense?

Answer:

1. Original Cost
2. Estimated Salvage Value
3. Estimated Useful Life

Audit your understanding

What is the smallest unit of time used to calculate depreciation?

Answer:

A calendar month