**Weekly Questions for Week 6 (PP&E, depreciation, intangibles)**

**Joshua:**

1) Costa has asked you to complete the accounting relevant to their acquisition of a building previously owned by Starbucks. Given the following information, account for the total value of the building.

· Starbucks originally wanted to charge us $100 000 for the building

· Gave a 10% discount due to its poor condition

· Starbucks informed us the original value of the building was $500 000 and had depreciated over 4 years to a value of $200 000

· $1000 was paid to contractors to assess and recommend how to fix up the building

· Paid $5000 to fix the walls and doors

· Losses for opening day promotions estimated to be $600

· $400 dollars incurred adding a new line of sweeter drinks to cater to the clientele

Answer:

|  |  |
| --- | --- |
| Purchase price – Building (after discount) | 90 000 |
| Related costs: |  |
| Assessment fee | 1000 |
| Repair expenses | 5000 |
| Total cost of building | **84 000** |

2) Costa wishes to purchase a property (land, building and equipment included), for $10 000 000. Using these estimates from the market, record the value of the acquired land, building and equipment.

· Land: $9 000 000

· Building: $3 000 000

· Equipment: $1 000 000

Answer:

Land: 9/15 X 10 000 000 = 6 000 000

Building: 3/15 X 10 000 000 = 2 000 000

Equipment: 1/15 X 10 000 000 = 2 000 000

3) Costa estimated that a coffee machine could be salvaged for $500 but had to scrap it. The machine was purchased for $2000, had an estimated life span of 3 years and had been used for 2 years. Record its disposal, assuming straight-line depreciation.

Answer:

|  |  |
| --- | --- |
| Accumulated depreciation (Equipment) | 1000 |
| Loss on disposal | 1000 |
| Equipment | 2000 |

4) Costa decides to exchange a coffee machine for a refrigerator from Starbucks. Starbucks will pay an additional $1000, of which 20% will be paid in cash. Costa’s machine has been used for a year, was purchased for $2000, has an estimated lifespan of 10 years with no salvage value. Starbucks’ refrigerator is estimated to be currently worth $1000. Use straight line depreciation.

|  |  |  |
| --- | --- | --- |
| Refrigerator | 1000 |  |
| Accumulated depreciation (Coffee machine) | 200 |  |
| Cash | 200 |  |
| Accounts receivable | 800 |  |
| Coffee machine |  | 2000 |
| Gain on exchange |  | 200 |

**Mei Hui:**

5) An oil lease will cost BeeNGold $1,000,000. It contains an estimated total of 50,000 barrels of oil. Calculate the depletion entry when 15,000 barrels are extracted.

Answer:

Depletion rate per unit = 1,000,000 / 50,000 = $20 per barrel

Depletion expense = $20 per barrel x 15,000 = $300,000

|  |  |  |
| --- | --- | --- |
| Account Name | Debit | Credit |
| Depletion Expense  Accumulated Depletion - Oil | 300,000 | 300,000 |

6) Sunflower Land purchased a plot of land, a building and a sunflower machine in China. They purchased them in a bundle and the total combined purchase price is $5,800,00. However, the current market value for the land, building and machinery are 2,890,000, 2,990,000 and 999,000 respectively. As it was a cash purchase, journalise the purchase of the three assets.

**Answer:**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Asset** | **Land** | **Building** | **Machinery** |  |
| **Market Value** | $2,890,000 | $2,990,000 | $999,000 | Total : $**6,879,000** |
| **% of Total Market Value** | 42% | 43.5% | 14.5% |  |
| **Total Cost** | $5,800,000 | | | |
| **Cost of each asset** | 2,436,000 | 2,523,000 | 841,000 | Total : $5,800,000 |

*Journalizing:*

|  |  |  |
| --- | --- | --- |
| Account Name | Debit | Credit |
| Land  Building  Machinery  Cash | 2,436,000  2,523,000  841,000 | 5,800,000 |

**Trenna:**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Method A: Straight-line** | | | **Method B: Double declining-Balance** | | |
| **FY** | **Annual Depreciation Expense** | **Accumulated Depreciation** | **Book Value** | **Annual Depreciation Expense** | **Accumulated Depreciation** | **Book Value** |
| Start |  |  | $44,000 |  |  | $44,000 |
| 20X5 | $4,000 | $4,000 | $40,000 | $8,800 | $8,800 | $35,200 |
| 20X6 | $4,000 | $8,000 | $36,000 | $7,040 | $15,840 | $28,160 |
| 20X7 | $4,000 | $12,000 | $32,000 | $5,632 | $21,472 | $22,528 |

7a. Suppose the income tax authorities permitted a choice between these two depreciation methods. Which method would Dairy Farm select for income-tax purposes? Why?

**Answer: For tax purposes, most companies select the accelerated method because it results in the greatest depreciation in the earliest years of the asset's life. Accelerated depreciation minimizes income tax payments in the early years of the asset's life. That allows the business to maximise its cash level in the earliest possible time.**

7b. Suppose Dairy Farm purchased the equipment described earlier ($44,000 cost, $4,000 residual value and 10 years' useful life) on january l, 20X4. Management has depreciated the equipment by using the double-declining-balance method. On June 30, 20X7, Lenovo sold the equipment for $27,000 cash.

Record depreciation for 20X7 and the sale of the equipment on june 30, 20X7.

**Answer:**

|  |  |  |  |
| --- | --- | --- | --- |
| **20X7** | **Particulars** | **DR** | **CR** |
| **Oct 1** | **Depreciation Expense - Equipment  ($5,632 x1/2 year)** | **$2,816** |  |
|  | **Accumulated Depreciation - Equipment** |  | **$2,816** |
|  |  |  |  |
| **Oct 1** | **Accumulated Depreciation - Equipment ($15,840 + $2,816)** | **$18,656** |  |
|  | **Cash** | **$27,000** |  |
|  | **Equipment** |  | **$44,000** |
|  | **Gain on Sale of Equipment** |  | **$1,656** |

8. Dairy Farm operates in many countries across Asia. Suppose DWP acquires KMG Company at a cost of $10 million. KMG's assets have a market value of $9 million, and its liabilities total $2 million so KMG's net assets total $7 million at current market value. Note that the assets and liabilities may include new identifiable intangible assets that were previously not recorded in KMG's books, for example brand names, trademarks, customer relationships, etc. In this case, DWP paid $3 million for goodwill, computed as follows:

Purchase price paid for KMG Company $10 million

Sum of the fair values of KMG Company’s assets $9 million

Less: KMG’s Company’s liabilities $ (2 million)

Market value of KMG’s company’s net assets $7 million

Excess is called goodwill $3 million

8a. DWP’s entry to record the acquisition of KMG company, including its good-will would be:

**Answer:**

|  |  |  |
| --- | --- | --- |
| **Assets (Cash, receivables, PPE, inventories all at fair value)** | **$9,000,000** |  |
| **Goodwill** | **$3,000,000** |  |
| **Liabilities** |  | **$2,000,000** |
| **Cash** |  | **$10,000,000** |

8b. Several months later, DWP realized that the goodwill they have paid for in the acquisition of KMG actually had no value at all. DWP also realized that they have overpaid for KMG’s machinery by $500,000. Write the entry to record this adjustment.

**Answer:**

|  |  |  |
| --- | --- | --- |
| **Impairment expense** | **$3,000,000** |  |
| **Goodwill** |  | **$3,000,000** |

|  |  |  |
| --- | --- | --- |
| **Impairment expense** | **$500,000** |  |
| **Machinery** |  | **$500,000** |

8c. DWP bought a patent for $1 million in the year 20X6 and it has 10 years of life. Record the adjustment entry after 2 years of obtaining the patent.

**Answer:**

|  |  |  |  |
| --- | --- | --- | --- |
| **20X7** | **Amortization expense** | **$100,000** |  |
|  | **Accumulated amortization - patents** |  | **$100,000** |
| **20X8** | **Amortization expense** | **$100,000** |  |
|  | **Accumulated amortization - patents** |  | **$100,000** |