

Quick Questions On Depreciation Methods And Capitalization

1. An asset costs \$33,000, has a residual value of \$3,000, and is expected to last 4 years. In the space provided, complete the names of the three depreciation methods. Calculate all 4 years of annual depreciation using each method.

 Straight- Line Method Double Declining Balance Method

$$D = \frac{\text{Cost} - \text{Residual Value}}{\text{Useful Life}}$$

$$= \frac{\$33,000 - \$3,000}{4 \text{ years}}$$

$$= \$7,500 \text{ per year for four years}$$

$$D1 = (2/n) (\text{Cost} - \text{Accumulated Depreciation})$$

$$= (2/4) (\$33,000 - 0)$$

$$= .5(\$33,000) = \$16,500$$

$$D2 = .5(\$33,000 - \$16,500) = \$8,250$$

$$D3 = .5(\$33,000 - \$24,750) = \$4,125$$

$$D4 = \$30,000 - (\$24,750 + \$4,125) = \underline{\$1,125}$$

Note that in year 4, the balance of allowable depreciation (\$33,000 - \$3,000) is taken

 Sum-of-the-Year's- Digits Method

$$D = (nth/\sum n) (\text{Cost} - \text{Residual Value})$$

$$\sum n = 1 + 2 + 3 + 4 = 10$$

$$D1 = 4/10(\$33,000 - \$3,000) = \$12,000$$

$$D2 = 3/10(\$33,000 - \$3,000) = \$9,000$$

$$D3 = 2/10(\$33,000 - \$3,000) = \$6,000$$

$$D4 = 1/10(\$33,000 - \$3,000) = \underline{\$3,000}$$

\$30,000

Note: $4/10 + 3/10 + 2/10 + 1/10 = 1$

2. Which of the following is not capitalized as part of the cost of equipment? Freight, transit insurance, alterations to a platform required to make the equipment stable, installation costs, cost to repair damage incurred during installation, or materials consumed during the initial adjustment of the equipment.

The only cost listed that is not ordinarily required to put the equipment in position and condition for use is the repair damage incurred during installation. Therefore, it is not capitalized.

3. ABC Company paid \$700,000 plus an additional \$35,000 in closing costs for real estate appraised as follows: Land \$280,000, Land Improvements \$120,000, and Building \$600,000. At what dollar value should these assets be recorded?

Total Capitalization = \$700,000 + \$35,000 = \$735,000

Total Appraised Value = \$280,000 + \$120,000 + \$600,000 = \$1,000,000

Costs should be allocated proportionately:

Land	Land Improvements	Building
$\frac{\$280,000}{\$1,000,000} \times (\$735,000)$	$\frac{\$120,000}{\$1,000,000} \times (\$735,000)$	$\frac{\$600,000}{\$1,000,000} \times (\$735,000)$
= \$205,800	= \$88,200	= \$441,000

$$\$205,800 + \$88,200 + \$441,000 = \$735,000$$