

Solution 9.1

a) Capital expenditure is expenditure on the purchase or improvement of fixed assets. A fixed asset relates to items purchased (not for resale at a profit) that will be used in the business for more than one accounting year and is of significant monetary value. It can also include money spent to add value to fixed assets and can include any costs in bringing the assets to their present location and condition. Capital expenditure can include the purchase cost of an asset as well as legal costs, transportation costs and installation costs relating to the asset. An example of capital expenditure is the purchase and installation of refrigeration equipment in a supermarket.

Revenue expenditure is expenditure which does not increase the value of fixed assets but relates to the operating costs of the business. Revenue expenditure relates to the day to day running costs of a business. Examples of revenue expenditure include; rent, insurance, wages and electricity.

- b) Key questions to address when classifying items as 'capital' are:
1. Is the item bought for use in the organisation and not for resale at a profit?
 2. Will it be of use in the organisation, or add benefit, for more than one accounting year?
 3. Is it of significant value?

Solution 9.2

1. Purchase of new van	Capital
2. Cost of road tax for new van.	Capital
3. Cost of painting firms name on new van	Revenue
4. Purchase of stock for re-sale	Revenue
5. Carriage inwards on stock for re-sale	Revenue
6. Carriage costs on sales	Revenue
7. Legal costs of collecting debts	Revenue
8. Legal costs in relation to acquiring a new office premises	Capital
9. Costs of installing new machine	Capital
10. Installing security equipment	Capital
11. Roof repairs	Revenue
12. Fitting partitions in the shop	Capital
13. Installing a security hut	Capital
14. Wages	Revenue
15. Fire insurance premium	Revenue
16. Carriage costs on bricks for security hut	Capital
17. Cost of altering the interior of new van to increase capacity	Capital
18. Purchase of replacement engine for existing van.	Revenue

Solution 9.3

- a) Treating a fixed asset as an expense in the profit and loss account will result in profit being understated by the €25,000. In the balance sheet both fixed assets and capital will be understated by €25,000.

- b) Treating repairs as capital expenditure will result in the profit being overstated by €5,000 in the profit and loss account. In the balance sheet both fixed assets and capital will be overstated by €5,000.

Solution 9.4

The capital cost for the Hilda Hotel will amount to:

Purchase cost	€22,000
Installation and testing	€ 2,000
Training	€ 1,000
Total capital cost	<u>€25,000</u>

Solution 9.5

- a) Depreciation is a measure of the wear and tear or loss in value of an asset over its life. It is the difference between the cost of a fixed assets and the amount received when it is sold. Assets such as plant, equipment, motor vehicles and furniture are all assets that lose value over time due to either wear and tear or, economic factors such as inadequacy and obsolescence or, the simple passing of time.
- b) The purpose of depreciation charge in the accounts is to ensure that the value of fixed assets in the balance sheet is reflective of the current value of the assets. Fixed assets must be depreciated in accordance with the accruals and prudence concepts, except non depreciable land which under normal economic conditions appreciates in value. Each year the asset will appear in the balance sheet at its reduced book value (net book value), while the reduction, called depreciation, is treated as an expense in the profit and loss account.
- c) Capital costs relating to fixed assets
- | | |
|---|---|
| Original cost of the asset. | ✓ Capital |
| Delivery costs of the asset. | ✓ Capital |
| The legal costs in acquiring the asset. | ✓ Capital |
| Repairs to the asset. | ✗ Revenue |
| Installation costs of the asset. | ✓ Capital |
| VAT on the cost of the asset. | ? Capital only if company exempt
VAT |
| Wages of maintenance | ? Capital only if they worked on
installation |

Solution 9.6

Straight line approach

$$\frac{\text{Cost } \text{€}20,000 - \text{scrap } \text{€}4,800}{4 \text{ years}} = \text{€}3,800 \text{ per annum}$$

Reducing balance approach

	€
Original cost	20,000
Depreciation end of year 1 ($\text{€}20,000 \times 30\%$)	<u>6,000</u>
NBV end of year 1	14,000
Depreciation end of year 2 ($\text{€}14,000 \times 30\%$)	<u>4,200</u>
NBV end of year 2	9,800
Depreciation end of year 3 ($\text{€}9,800 \times 30\%$)	<u>2,940</u>
NBV end of year 3	6,860
Depreciation end of year 4 ($\text{€}6,860 \times 30\%$)	<u>2,058</u>
NBV end of year 4	4,802

Solution 9.7

DR		Office Equipment Account		CR	
		€			€
1/1/02	Bal b/d	100,000			
2002	Bank a/c	25,000			
2002	Bank a/c	35,000	31/12/02	Bal c/d	160,000
		<u>160,000</u>			<u>160,000</u>
1/1/03	Bal b/d	160,000			

DR		Provision for Depreciation of Equipment Account		CR	
		€			€
			1/1/02	Bal b/d	50,000
31/12/02	Bal c/d	<u>82,000</u>	31/12/02	P & L a/c	32,000
		<u>82,000</u>			<u>82,000</u>
			1/1/03	Bal b/d	82,000

Annual depreciation is
 $€160,000 \times 20\% = €32,000$

DR		Profit & Loss Account (Extract)		CR	
		€			€
31/12/02	Depreciation	32,000			

Balance Sheet (Extract)

	Cost	Accumulated Depreciation	Net Book Value
	€	€	€
Office equipment	160,000	(82,000)	78,000

Solution 9.8

DR		Equipment Account		CR	
		€			€
1/1/03	Bank a/c	22,000			
1/10/03	Bank a/c	10,000	31/12/03	Bal c/d	32,000
		<u>32,000</u>			<u>32,000</u>
1/1/04	Bal b/d	32,000	1/10/04	Disposal a/c	8,000
			31/12/04	Bal c/d	24,000
		<u>32,000</u>			<u>32,000</u>
1/1/05	Bal b/d	24,000			

DR		Provision for Depreciation of Equipment Account		CR	
		€			€
31/12/03	Bal c/d	3,200	31/12/03	P & L a/c	3,200
1/10/04	Disposal a/c	800	1/1/04	Bal b/d	3,200
31/12/04	Bal c/d	4,800	21/12/04	P & L a/c	2,400
		<u>5,600</u>			<u>5,600</u>
			1/1/05	Bal b/d	4,800

DR		Disposal Account		CR	
		€			€
1/10/04	Equipment a/c	8,000	1/10/04	Depreciation a/c	800
			1/10/04	Bank a/c	5,000
		<u>8,000</u>	1/10/04	P & L a/c	2,200
					<u>8,000</u>

DR		Fixtures Account		CR	
		€			€
1/1/03	Bank a/c	30,000	31/12/03	Bal c/d	30,000
1/1/04	Bal b/d	30,000			
1/7/02	Bank a/c	5,000	31/12/04	Bal c/d	35,000
		<u>35,000</u>			<u>35,000</u>
1/1/05	Bal b/d	35,000			

DR		Provision for Depreciation of Equipment Account		CR	
		€			€
31/12/03	Bal c/d	3,750	31/12/03	P & L a/c	3,750
			1/1/04	Bal b/d	3,750
31/12/04	Bal c/d	8,125	31/12/04	P & L a/c	4,375
		<u>8,125</u>			<u>8,125</u>
			1/1/05	Bal b/d	8,125

DR	Profit & Loss Account (Extract)		CR
		€	€
2003	Depreciation - equipment	3,200	
2003	Depreciation – fixtures	3,750	
2004	Disposal loss	2,200	
2004	Depreciation - equipment	2,400	
2004	Depreciation – fixtures	4,375	

Balance Sheet (Extract)

	Cost	Accumulated Depreciation	Net Book Value
	€	€	€
2003			
Equipment	32,000	(3,200)	28,800
Fixtures	30,000	(3,750)	26,250
2004			
Equipment	24,000	(4,800)	19,200
Fixtures	35,000	(8,125)	26,875

Solution 9.9

DR		Vehicles Account		CR	
		€			€
1/1/03	Bal b/d	256,000	30/6/03	Disposal a/c	40,000
1/4/03	Bank a/c	56,000			
1/7/03	Bank a/c	25,000	31/12/03	Bal c/d	297,000
		<u>337,000</u>			<u>337,000</u>
1/1/04	Bal b/d	297,000			

DR		Provision for Depreciation of Vehicles Account		CR	
		€			€
30/6/03	Disposal a/c	31,360	1/1/03	Bal b/d	135,000
31/12/03	Bal c/d	180,984	31/12/03	P & L a/c	77,344
		<u>212,344</u>			<u>212,344</u>
			1/1/04	Bal b/d	180,984

€
40,000
(16,000) 40,000x40%
24,000
(9,600) 24,000x40%
14,400
(5,760) 14,400x40%
8,640
Depreciation to date is
16,000+9,600+5,760 =31,360

Cost €297,000 – net depreciation
 €103,640 (i.e.€135,000 - €31,360) =
 €193,360 x 40% = €77,344

DR		Disposal Account		CR	
		€			€
30/6/04	Vehicles a/c	40,000	30/6/03	Depreciation a/c	31,360
			30/6/03	Bank a/c	8,500
		<u>40,000</u>	30/6/03	P & L a/c	140
					<u>40,000</u>

DR		Profit & Loss Account 2003 (Extract)		CR	
		€			€
	Disposal loss	140			
	Depreciation – vehicles	77,344			

Balance Sheet 2003 (Extract)

	Cost	Accumulated Depreciation	Net Book Value
	€	€	€
Vehicles	297,000	(180,984)	116,016

Solution 9.10

DR		Machinery Account		CR	
		€			€
5/1/03	Bank a/c	100,000			
1/9/03	Bank a/c	220,000	31/12/03	Bal c/d	320,000
		<u>320,000</u>			<u>320,000</u>
1/1/04	Bal b/d	320,000	30/7/04	Disposal a/c	100,000
1/8/04	Bank a/c	130,000	31/12/04	Bal c/d	350,000
		<u>450,000</u>			<u>450,000</u>
1/1/05	Bal b/d	350,000			

DR		Provision for Depreciation of Machinery Account		CR	
		€			€
31/12/03	Bal c/d	52,000	31/12/03	P & L a/c	52,000
30/7/04	Disposal a/c	47,500	1/1/04	Bal b/d	52,000
31/12/04	Bal c/d	104,250	31/12/04	P & L a/c	99,750
		<u>151,750</u>			<u>151,750</u>
			1/1/05	Bal b/d	104,250

€30,000 +
€17,500

DR		Disposal Account		CR	
		€			€
30/7/04	Machinery a/c	100,000	30/7/04	Depreciation a/c	47,500
			30/7/04	Bank a/c	45,000
			30/7/04	P & L a/c	7,500
		<u>100,000</u>			<u>100,000</u>

DR		Profit & Loss Account (Extract)		CR	
		€			€
2003	Depreciation – machinery	52,000			
2004	Disposal loss	7,500			
2004	Depreciation – machinery	99,750			

Balance Sheet (Extract)

	Cost	Accumulated Depreciation	Net Book Value
	€	€	€
2003 Machinery	320,000	(52,000)	268,000
2003 Machinery	350,000	(104,250)	245,750

Depreciation calculations:

	2003		2004
Machine 1	100,000 x 30%	30,000	Machine 1 100,000 x 30% x ⁷ / ₁₂
Machine 2	220,000 x 30% x ⁴ / ₁₂	22,000	Machine 2 220,000 x 30%
			Machine 3 130,000 x 30% x ⁵ / ₁₂
		<u>52,000</u>	<u>16,250</u>
			99,750