**Fixed Assets – Part 1 Script**

Slide 1: In this presentation, we’re going to discuss how we account for some of the more common transactions associated with fixed assets. Since there’s a lot to talk about, we’ll split this into two parts.

Slide 2: When we mention fixed assets, what are we talking about? Remember, Current Assets are those assets that will be used up or converted to cash within one year or less. Fixed assets are part of non-current assets – those assets expected to be used up over a period of greater than one year. These assets are also known as Property, Plant & Equipment (PP&E) or Plant Assets.

Some of the PP&E items include Land, Buildings, Equipment, Vehicles, Computers, Furniture & Fixtures and Machinery to name a few.

Slice 3: We’re going to look at 4 main considerations when working with Fixed Assets. Those are: Valuation, Cost Allocation, Improvements and Disposal. In part 1, we will cover Valuation and Cost Allocation. Improvements and Disposal will be covered in the Part 2 presentation.

Slide 4: When we are talking about valuation of PP&E, one thing I like to remember is that “all normal and reasonable” expenditures necessary to make the asset ready to generate revenues can be included in the cost of the asset. Those of you who viewed the Merchandising, Part 2 video might remember that we could add in-bound shipping to the cost of Inventory – this is quite similar.

Let’s assume a new asset cost 24,000. In addition, it took another 1,000 to ship it to your place of business; an electrician charged 1,500 to connect it to the power source and the city required a 2,000 permit before the asset could be used. All of these expenditures are normal and reasonable, and are necessary to make the asset ready to generate revenues. Therefore, we’d put 28,500 on the books for the cost of this asset.

Slide 5: Sometimes, a person can negotiate a purchase of several assets for a single price. When happens, the question becomes “how much do we assign to each asset?” The easiest way to do this is to get appraised values for the assets and use them to allocate the purchase price.

If we add together all the appraised values and develop percentages of the totals, we can use those to pro-rate the purchase price. In this example, Equipment represents 10% of the appraised values, Building represents 40% and Land represents the remaining 50%. With this information, we can multiply the purchase price by these percentages to arrive at the values we’d use to record the purchase. The resulting journal entry is shown at the bottom of the slide.

Slide 6: Next on our list of four is Cost Allocation. For PP&E, this process is known as depreciation. This process allocates the cost of the asset, according to the Matching Principle, over the asset’s useful life.

We will look at three of the common Accounting approaches. Please be aware that tax treatment for depreciation is different and a tax professional should be consulted for your best results. We will look at Straight Line Method, Units of Production Method, and Double Declining Balance Method, which is an accelerated approach – more on that later.

Straight Line and Units of Production both start at the same place – computing the Depreciable Basis, which is equal to the Asset Cost less Salvage Value. Asset Cost is as we discussed in slides 3 and 4; Salvage Value is what we expect to receive for the asset at disposal – when we sell or otherwise “get rid of” the asset. We take this numerator and use the Expected Useful Life as the denominator, which can be in years or months for Straight Line Method. Or we use Expected Units of Production, if we’re using that method.

Straight line is used when the asset is used regularly from period to period – think of a security system for an office building. Units of Production is used with more seasonal businesses – think of machinery used to make Halloween masks -- which won’t be used the same each month.

Slide 7: Here, we look at an example figuring Straight Line Depreciation. This asset has a cost of 27,000 with a salvage value of 2,000, making the depreciable basis 25,000. If we further assume a life of 5 years, our depreciation expense is 5,000 per year. I created a depreciation schedule that shows at the end of 5 years, we have depreciated down to the salvage value. Although we may still be using the asset, at that point, we can no longer depreciate.

The journal entry for one year’s expense is shown below the schedule.

Slide 8: In this slide, I have assumed the same asset cost and salvage value; the difference here is that we will use the Units of Production method. This asset is expected to produce 5,000 units and the volumes per year are shown on the schedule. We can see that the yearly depreciation amounts change. I have prepared the year 2 entry below the schedule.

Slide 9: Some people choose accelerated depreciation methods, such as the Double-Declining Balance method shown here. The reason given for using such an approach is that early on in the life of the machine, repairs and maintenance expenses are low; later on, those expenses rise. Therefore, we recognize more depreciation expense early and less later; this way the two combined expenses are fairly stable over the life of the asset.