

FA Module 6 Sale of equipment practice exam questions

covering historical cost, depreciation expense, accumulated depreciation, sales price, gain (loss) on sale

(The attached PDF file has better formatting.)

- ! Firms expense most items on the purchase date; buying an office chair for 100 is an expense of 100.
- ! Durable equipment is expensed over its expected life. An airline that buys a passenger aircraft with a 40 year expected life for 200 million may charges expenses of 5 million a year for 40 years.

This practice exam question shows how purchase prices, sales prices, depreciation expense, accumulated depreciation, and gain (loss) on sale inter-relate.

A firm reports the following financial statement figures:

	<i>Calendar Year 20X1</i>	<i>Calendar Year 20X2</i>
Depreciation expense (equipment)	17	19
Gain (loss) on sale of equipment	15	-19
	<i>December 31, 20X1</i>	<i>December 31, 20X2</i>
Equipment (historical cost)	434	479
Accumulated depreciation on equipment	218	231

On December 31, 20X2, the firm paid 139 to buy new equipment.

Question 6.2: Historical cost of equipment

What is the change in the historical cost of equipment in 20X2?

Answer 6.2: $479 - 434 = 45$

the historical cost of equipment increases when equipment is bought and decreases when equipment is sold.

Question 6.3: Historical cost of equipment sold

What is the historical cost of the equipment sold in 20X2?

Answer 6.3: $139 - 45 = 94$

(historical cost of equipment sold = cost of equipment bought – Δ (historical cost of equipment))

Note: Δ (historical cost of equipment) is the increase in historical cost. If 300 of equipment is bought and the historical cost of equipment rises from 700 to 800, then 200 of equipment must have been sold.

Question 6.4: Accumulated depreciation

What is the change in the accumulated depreciation for equipment from 12/31/20X1 to 12/31/20X2?

Answer 6.4: $231 - 218 = 13$

Question 6.5: Accumulated depreciation for equipment sold

What was the accumulated depreciation for the equipment sold in 20X2?

Answer 6.5: $19 - 13 = 6$

(accumulated depreciation for the equipment sold = depreciation expense – Δ (accumulated depreciation))

- ! Accumulated depreciation increases by the depreciation expense in each year and decreases when the equipment is sold (or discarded).
- ! If no equipment is sold (or discarded), accumulated depreciation increases by the depreciation expense.

Question 6.6: Sales price

What was the sales price of the equipment sold in 20X2?

Answer 6.6: $94 - 6 - 19 = 69$

The book value (balance sheet value) of equipment is the historical cost minus the accumulated depreciation.

- The gain (loss) on sale is the sales price – the book value
- ⇒ The gain (loss) on sale = the sales price of equipment sold – (the historical cost of equipment sold minus the accumulated depreciation of equipment sold)
- ⇒ The sales price = historical cost of equipment sold – accumulated depreciation on equipment sold + gain (loss) on sale