A matter of record

Philip Dunn explains the principles behind the disposal of assets, a subject students must get to know well

Accounting for the disposal of assets is a competence that needs to be developed by both AAT and ICB students. The topic is included in AAT's Level 3 Diploma in Accounting, Accounts Preparation 1 and ICB's Certificate in Bookkeeping and Accounts (Manual) at Level 3. More complex tasks on this topic are likely to be included at Level 4.

When recording transactions in the general ledger for an asset disposal there are a number of factors to consider:

- The original cost of the asset disposed.
- The accumulated depreciation associated with the asset to-date.
- The proceeds from the sale of the asset (remember that this can be either funds received or a part exchange value).
- The profit or loss on disposal.

The case study that follows illustrates various aspects of accounting for fixed (non-current) assets, their accounting treatment over time and the procedure in handling a disposal of an asset.

Ernie Heyes is an agricultural contractor operating in North Yorkshire. He commenced in business on 1 January 2011, at which time he invested £120,000 in plant and equipment.

He has adopted a policy of depreciating his plant and equipment at a rate of 20% straight line and he depreciates his assets in the year of purchase but not in the year of sale.

At the 1 January 2014 his general ledger showed:

Plant and Equipment at Cost

1 Jan	Balance b/d	120,000			

Provision for Depreciation Plant and Equipment

			1 Jan	Balance b/d	72,000

namely: £120,000 x 20% for three years. = £72,000

On 1 December 2014 he disposes of an item of plant, purchased on 1 January 2011 that had cost £12,000 and receives a cheque for £6,000 on its disposal.

We now need to record this transaction and to determine whether there is a profit or loss on the disposal of the asset.

We need to open a disposal account and debit it with the original cost of the asset and show this asset being transferred from the Plant and Equipment Account at Cost.

Disposal Account

1 Dec	Plant & Equipment at cost	12,000			

Plant and Equipment

1 Jan	Balance b/d	120,000	1 Dec	Disposal a/c	12,000

Then we need to take account of the depreciation written off the asset to the point of disposal. This will be, considering his policy, three years at 20% per annum on £12,000 = £7,200; and therefore the net book value of the asset at the point of disposal is £4,800 (£12000-£7200).

We would then Debit the Provision for Depreciation Account on Plant and Equipment and Credit the Disposal Account with the cumulative depreciation to date.

Disposal Account

1 Dec	Plant & Equipment at cost	12,000	1 Dec	Depreciation Provision Plant & Equipment	7,200

Provision for Depreciation on Plant and Equipment

1 Dec	Disposal a/c	7,200	1 Jan	Balance b/d	72,000

Finally, the proceeds need to be recorded as: Debit the Bank and Credit the Disposal account. At that point we can then balance off the Disposal Account to determine the profit or loss on disposal of the asset.

Disposal Account

1 Dec	Plant & Equipment at cost	12,000	1 Dec	Depreciation Provision Plant & Equipment	7,200
31 Dec	*Profit & Loss account	1,200	1 Dec	Bank	6,000
		£13,200			£13,200

* This represents a profit on the disposal of the asset as:

Proceeds £6,000 less the Net Book Value of the asset £4,800 = £1,200. This would be transferred at the end of the accounting period to the profit and loss account/Income Statement.

The above example assumes that there were no other disposals in the year. Please also note that the Depreciation charge for the year would be based on (£120,000-£12,000)* 20% = £21,600 and would be dealt with in the year end procedures. PQ

- **Dr Philip Dunn is an education and training consultant**