Disposal of Capital/Fixed Assets

by Sophia

WHAT'S COVERED

This tutorial will discuss the disposal of capital and fixed assets, specifically focusing on:

1. Asset Disposal

Asset disposal is selling, donating, or removing an asset from the business, so the business no longer owns or uses the asset.

An asset would be disposed of if the asset may have reached the end of its useful life and a company may need to upgrade the asset. Instead, the company may need an asset that has increased utility, quality, efficiency, or a different style, perhaps because there are new manufacturing techniques or equipment, or assets that have a different functionality.

You can dispose of an asset by:

- Throwing it away
- Donating it
- Selling it

When an asset is sold, it can be sold for a gain, loss, or for book value, which is no gain or loss.

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2. Recording the Disposal

Prior to recording, the depreciation expense needs to be recorded through the date of disposal, regardless of the disposal method. So, whether you donate it, sell it, or scrap it, you need to perform this step.

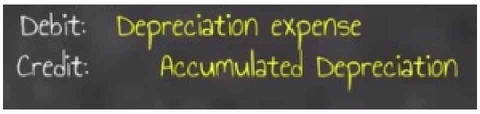
You need to do this to have an accurate book value, or carrying value, prior to recording the disposal. Remember, **book value** is the cost of a depreciable asset, less its accumulated depreciation, and**carrying value** is the book value of an asset cost, less accumulated depreciation. You need to have an accurate value in order to properly record the disposal.

> ↱ EXAMPLE Suppose ABC Company disposes of equipment on June 30, 2013. The equipment costs $50,000 and was purchased January 1, 2010, and has a useful life of five years.
>
> This company uses straight line depreciation, which means, factoring in the cost and useful life,

depreciation is $50,000 divided by 5 years, or $10,000 per year.

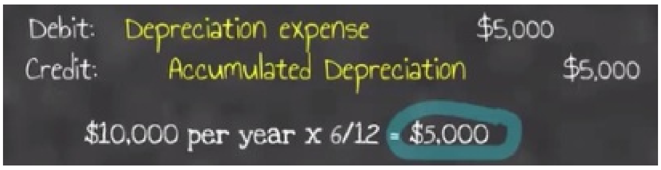
Depreciation has been recorded through 12/31/12--through the end of the last year--so accumulated depreciation is $10,000 times 3 years, or $30,000.

The depreciation expense journal entry that you need to record is a debit to depreciation expense and a credit to accumulated depreciation.



If your straight line depreciation is $10,000 per year, and this is being disposed of after six months of the year, you would take that straight line depreciation and multiply it by the fraction of the year for which you need to record it, or $10,000 per year x 6/12 <nowikit>=</nowiki></nowikit> $5,000.

This equals $5,000, so you would record an entry to depreciation expense and accumulated depreciation of $5,000--which is how you record depreciation prior to disposal.



TERMS TO KNOW

Book Value
The cost of a depreciable asset less its accumulated depreciation.

Carrying Value
The book value of an asset, cost less accumulated depreciation.

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3. Calculating Gains and Losses

Next, let's shift our focus to how to record asset disposal. The asset, and all of its related accounts, must be removed from the books; you are essentially taking everything related to this asset off the books.

In order to do this, you make an entry to the opposite side of the natural balance. Remember, an asset is removed with a credit, and accumulated depreciation is removed with a debit.

When you sell an asset, an asset will be sold at**market value**, which is the price at which an asset could be bought or sold. Market value is what someone is willing to pay you for that asset.

Remember, there are three outcomes:

- Sell it for a gain: The asset is sold for more than carrying value
- Sell it at a loss: The asset is sold for less than the carrying value

- Sell it for no gain or loss: The asset is sold for the carrying value.

> EXAMPLE Let's look at each of these scenarios, using the same example as above with ABC Company. Again, ABC Company has disposed of $50,000 of equipment on June 30, 2013.
>
> Depreciation has also been recorded through June 30, 2013, the date of disposal.
>
> Accumulated depreciation is $35,000, which, given the cost of the equipment and the accumulated depreciation, provides a carrying value of $15,000.

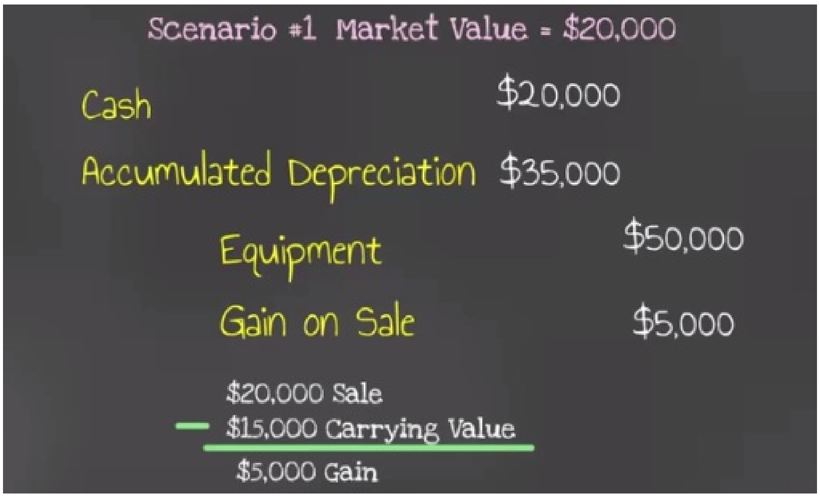
TERM TO KNOW

Market Value
The price at which an asset could be bought or sold.

3a. Gain

Suppose we have a market value of $20,000, this means we will get $20,000 in cash by selling the equipment. Now, we need to remove the accumulated depreciation, as well as remove the equipment cost, and then record a gain of $5,000.

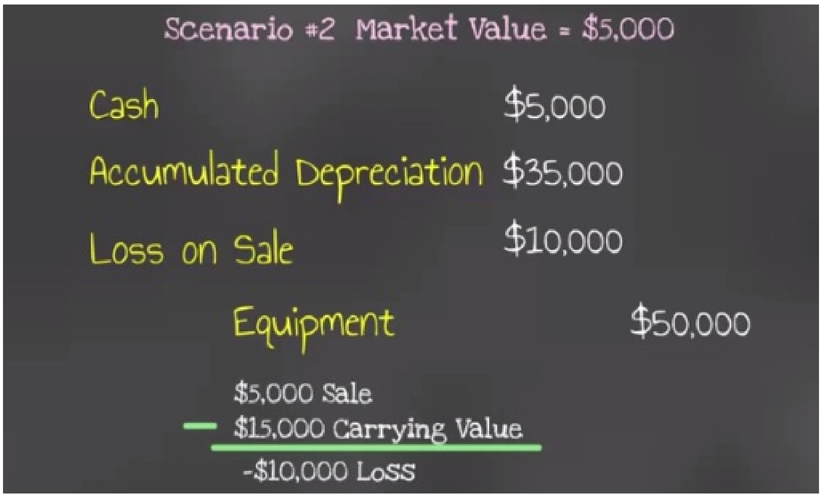
To compute this gain, it's the sale price minus the carrying value.



3b. Loss

Suppose we have a market value of $5,000. Because it's the market value, the cash that we will receive is $5,000. Again, we still need to remove our accumulated depreciation and our equipment. Then, we record a loss.

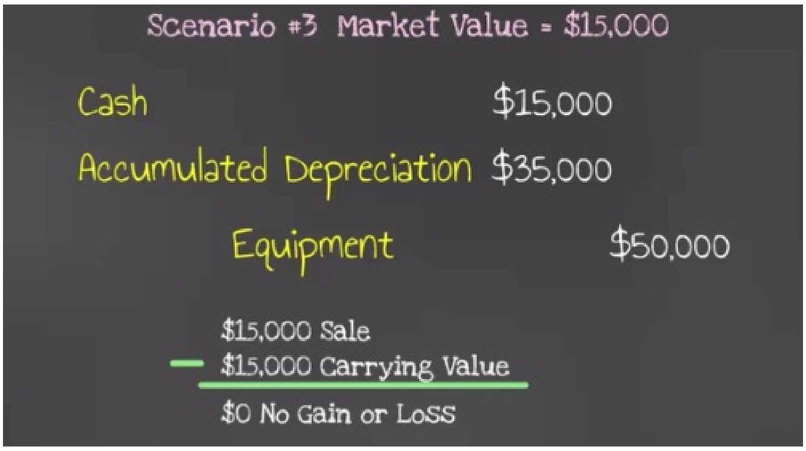
The loss is calculated as a $5,000 sale, minus a $15,000 carrying value, resulting in a $10,000 loss.



3c. No Gain or Loss

Suppose the market value is $15,000--the amount of cash we will receive. We remove our accumulated depreciation from the books, remove our equipment from the books, and that's it. We don't record a gain or a loss.

Because it was a $15,000 sale, and we have a $15,000 carrying value, so there is no gain or loss. We sold the asset for its carrying value, or book value.



SUMMARY

Today we learned about **asset disposal**, including why and how assets are disposed of. We learned how to **record the disposal**, keeping in mind that we must record the depreciation expense prior to recording the disposal. Lastly, we explored three scenarios of **calculating gains and losses** on the sale of an asset: selling for a gain, selling for a loss, and selling for no gain or loss.

Source: This work is adapted from Sophia author Evan McLaughlin.

TERMS TO KNOW

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Carrying Value

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Market Value

The price at which an asset could be bought or sold.