

Understanding cost accounting and depreciation



**ASSIGN
BUSTER**

General:

Delta's cargo, the major transportation services in the Gulf Coast region. The Cargo manager Driscoll was making plan to buy a new crane from J. M. Crane Company. He was having issues about the depreciation for the crane and also for the forklifts that he had.

Case analysis:

The overall cost of the machine is \$ 2, 288, 000 on which includes (Shipping, assembly, Handling, Operator wages, Training cost, severance, consultant operator, support beams, special paint work, Stencil, etc). In that, \$2, 223, 000 become capitalized and \$45, 000 considered as on expense. Based on Driscoll's assumptions the crane cost will be depreciated by the 100, 000 salvage value after 10 years. Furthermore, he was disposing the forklifts for \$14, 000 after refurbishing. Results, the budgeted income for Delta's cargo on 2005, \$360, 203 in Straight line method and \$71, 488 in Double declining Method after the bonus pool calculations.

Conclusion:

Eventually, the investment plan for crane is being considered by two valuable methods. (SL and DDB). According to me, the straight line method can be taken into account for investment significantly for the crane purchase. While taking the double declining method could reduce the income for other managers. Furthermore the percentage of bonus pool value will be taken from them.

QUESTIONS:

What will be the impact on current and future profit of a number of costs, and in general what should guide the determination of whether an acquisition (buying) cost is capitalized or expensed?

In Driscoll's point of view to buy the crane, he was estimating all the costs into account. Research states that, when we capitalize the cost that we spent for acquisition, in normal the operating cash flow will be looking like a profitable in the company¹. Thus, it will be beneficial when they buy new assets. Nevertheless, if Driscoll makes some costs in expenses, also it can be easy to identify and manage in which is needed to allocate immediately and, which are not².

Complete Exhibit 1 of the case, assuming that Driscoll agrees to incur all \$2. 288 million in costs to acquire the crane; justify your classification of each cost.

First let's take the Crane cost (\$2, 100, 000), this is the original cost of the asset which is to be capitalize for further consideration.

Shipping, handling and assembling costs (50, 000), but in assembly cost could be reduced from the total, (i. e. 50, 000-20, 000= 30, 000). Because, Driscoll budgeted some of the assembly cost by his own dockworkers for 20, 000 dollars it.

The Operator's training, consultant operator, severance for forklift operators, all of these costs (15, 000+5, 000+25, 000) can be allocated as a future payable costs. So, it will be considered as Expense³.

Support beams for dock (should be capitalized because it will be necessary apparently.

Also special paint work and Stencil expenses need to capitalize subsequently. (30, 000+3, 000)

Complete Exhibit 2 of the case, using your total depreciable cost as determined above. What factors should guide Driscoll's final determination of depreciation expense?

According to Driscoll analysis about buying the new Crane, let's consider first the depreciation expense by using the salvage value,

$$= (2, 288, 000 - 100, 000) / 10$$

$$= 218, 800$$

Also let's figure out the accumulated depreciation, and also net book value by straight line Method (SL)⁴

And in Double - Declining Balance Method (DDB)⁵, the expected useful year for crane estimated by Driscoll is 10 years so, $(100\% / 10) = 10\%$

Then, multiply by 2 because this is double declining, $(10\% * 2) = 20\%$

Cost: \$2, 288, 000, Salvage: \$100, 000, Life: 10 years, First Year: 12 months

Using double declining balance the depreciation would be calculated as follows:

$$\text{Depreciation factor} = 2 * (100\% / 10) = 20 \%$$

Depreciation-Method Comparisons

Depreciable cost = 2, 188, 000

Driscoll is considering two options for disposing of the old forklifts; prepare the journal entries for each alternative and make a recommendation.

Delta cargo had \$60, 000/each worth of Forklifts that Delta's being used for 4 years. The net book value came now at the price of \$12, 000/each. Recent customers offered at a price of \$8000/each. So he was arranged for Refurbishing on each forklift at the price of \$6000. Later he sold for \$14, 000 on each of them.

Results of Journal Entry

Accounts Receivable balance increases \$14, 000. -> Increase in Assets

Sales Revenue account balance increases by \$2, 000. -> Increase in Revenue

Based on the calculations, delta cargo can get 2, 000 dollars extra on each forklift by selling them after repair. Also the refurbishing/repair occurred in the forklifts.

By seeing the overall totals, the acquisition of crane could be a very challengeable task for Driscoll. His strategy make the investment plan very effective, at what circumstances and when it can be buyable also in which method could be made for depreciation.

The overall gain from this case seems to get a new crane instead of forklift, and also Driscoll job will be easier than before.

Again it's creating for delta more profits, efficiency, speed, reducing human efforts, quick time loading and unloading. This will create in Driscoll potential bonus increases.

Eventually, while buying the new crane Driscoll could evaluate and accomplish all the needs for Delta cargo.