

This paper is assuming that the business is selling, or junking, an old asset and is not exchanging an old asset as down payment for a new asset. See *Exchange of Non-monetary Assets* when there is a trade-in situation.

TERMS: A complete understanding of terminology is critical to your understanding!

Cost equals the fair market value of what was given up to acquire an asset; usually the cash paid.

Depreciation expense is the amount of the cost of the asset that would be recorded as expense for one time period (usually one year). A partial year's depreciation could also be recorded.

Accumulated depreciation is the total depreciation recorded since the asset was acquired. This is usually several time periods, and might be other than *full* time periods. For example, one could have an asset for 3 ½ years and, therefore, would record 3 ½ years of depreciation. Accumulated depreciation would be the total of the 3½ years depreciation.

Book value (basis) equals cost minus accumulated depreciation.

Gains would occur when the sales price is greater than the book value.

Losses would occur when the sales price is less than the book value.

Realized gain or loss is calculated by comparing the sales price to the book value.

Recognized gain or loss is the amount of the realized gain or loss that is actually recorded in the books. The recognized amount could be equal to the realized, be less than the realized amount, but not greater than the realized amount. This could occur when there is a trade-in of an old asset as a full or partial payment towards a new asset that is similar or dissimilar to the old asset. *See Exchange of Assets* paper when there is a trade-in situation.

Steps in calculating realized gain/loss:

1. Determine the original cost (amount capitalized) of the asset given up.
2. Determine the accumulated depreciation at date of disposal. I.e., previous years ending accumulated depreciation balance plus depreciation from first of year to the date of disposal.
3. Calculate the book value (basis) of the asset given up. (#1 above minus #2 above.)
4. Calculate gain or loss realized. I.e., compare amount received (if any) to basis (#3 above).
 - a. When amount received is larger than basis a gain is realized.
 - b. When amount received is smaller than basis a loss is realized.
 - c. When amount received is the same as basis there is no gain or loss.

Format approach for calculating realized gain/loss:

Example Number	<u>4a</u>	<u>4b</u>	<u>4c</u>
Sales price	820	500	650
Cost	900	900	900
Less accumulated depreciation	<u>250</u>	<u>250</u>	<u>250</u>
Book value (basis)	<u>650</u>	<u>650</u>	<u>650</u>
Gain or (loss)	170	(150)	0
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Journal entry approach for calculating realized gain/loss:

Put in debit or credit amounts in the order of accounts given below.

	<u>Debit</u>		<u>Credit</u>
1. Cash received, if any	xx		
2. Old Asset Cost			xx
3. Accumulated depreciation	xx		
4. Loss or Gain (realized and recognized)*	xx	or	xx

* When you enter the amounts for #1, #2 and #3 above you would then enter the amount needed to balance the entry for #4. When a debit is needed to balance, it would be a Loss; when a credit is needed, it would be a Gain.

Rules for recognizing gain or loss:

Record (**recognize**) the gain or loss calculated (**realized**) in all cases *except* when the asset given up (disposed of) is traded-in on a similar asset (earnings process not complete) AND a gain was realized. In this case recognize no gain, or if cash was also received on the exchange, recognize only a part of the gain. *See Exchange of Assets* paper when there is a trade-in situation.