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HOW TO ACCOUNT FOR CHANGE IN RESIDUAL VALUE OF FIXED ASSET AND INCREASE IN THE USEFUL LIFE OF A FIXED ASSET?

The feature of the operation of the basic means is that they transfer their value to the manufactured products gradually, over several production cycles. Therefore, the accounting of fixed assets is reflected so that it was possible to know their initial physical shape and money loss.

Besides, the initial cost in operating a property does not change, except in cases of completion, reconstruction or partial liquidation. The replacement cost corresponds to the cost of acquisition or the creation of similar fixed assets in the market conditions. To determine the replacement cost of the swiipe revaluation of fixed assets adjusted for inflation or market prices. Residual value is the initial (replacement) value less depreciation.

International Accounting Standard (IAS) 16 recognizes that residual value of asset may increase or decrease as a result of revaluations or future assessments of non-current asset. IAS 16 recognizes such change as a change in accounting estimate i.e. adjustment will be prospective in nature. There is no need to adjust for previously recorded depreciation charge in the financial statements.

Residual value helps in determining the depreciable amount of asset and the same is spread over the useful life of the asset. In straight line method a fixed portion of depreciable amount is transferred to income statement as expense from the cost of fixed asset recognized in the financial statements.

Residual value can increase or decrease as a result of assessment. Treatment is the same in both the cases. However, if residual value equals the current carrying value of fixed asset or exceeds it then depreciation for such asset will be halted until the time residual value reduces below the carrying amount of asset.

Any asset that has a lifespan of more than a year is called a fixed asset. All businesses use equipment, furnishings, and vehicles that last more than a year. Although they may last longer than other assets, even fixed assets eventually get old and need replacing.

Recovery periods are the anticipated useful lifespan of a fixed asset. For example, cars have a five year recovery period. While the car will probably run longer than that, you're not likely to continue using that car for business purposes after the first five years. You're more likely to trade it in and get a new car.

- Cost of the fixed asset: What you paid for the equipment, furniture, structure, vehicle, or other asset.
- Sales tax: What you were charged in sales tax to buy the fixed asset.
- Shipping and delivery: Any shipping or delivery charges you paid to get the fixed asset.
- Installation charges: Any charges you paid in order to have the equipment, furniture, or other fixed asset installed on your business's premises.

- Other costs: Any other charges you need to pay to make the fixed asset usable for your business. For example, if you buy a new computer and need to set up certain hardware in order to use that computer for your business, those setup costs can be added as part of the cost basis of the fixed asset (the computer).

During the life of an asset, the management might need to revise its accounting estimates of the useful life or salvage value of fixed assets.

Factors that may increase or decrease the useful life of fixed assets are presented in the table below:

1. Increase Useful Life:

- Extensive capital investments in fixed assets;
- Upgrading and regularly maintaining fixed assets;
- Improved maintenance procedures;
- Technological advances;
- Typical industry practices;
- Engineering department estimates;
- Revision of operating procedures.

2. Decrease Useful Life:

- Unexpected physical deterioration;
- Unforeseen physical obsolescence;
- Technical obsolescence.

Typical ranges of useful life estimates are as follows: automotive equipment (3-6 years), furniture and fixtures (5-12 years), machinery and equipment (3-20 years), buildings and improvements (10-50 years).

Finally, management might be less optimistic in estimating the useful life when fixed assets are purchased. This would allow the management to increase the useful life of fixed assets later on. The increase in the useful life would result in the decrease in the depreciation expense, and as the result, in the increase in net income.

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