ACCOUNTING FOR AND AUDIT OF PROPERTY, PLANT AND EQUIPMENT

PRESENTED BY

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IN HOUSE SEMINAR SERIES NO 2

PEAK PROFESSIONAL SERVICES
(CHARTERED ACCOUNTANTS)
NIGERIA

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CHAPTER 1

Introduction

Property, Plant and Equipment (generally called fixed assets) are those tangible resources of a business that have the following characteristics:

1. Are not bought primarily to be resold
2. Are to be used in the business and
3. Are expected to be used for a long time. (More than one year)

Examples are Land and Buildings, Plant and Machinery, Equipment and Furniture.

Property, Plant and Equipment usually constitute a significant proportion of most company’s balance sheet though the actual proportion varies from company to company depending on their nature of business.

This paper presents the procedure for Accounting for items of Property, Plant and Equipment (Fixed Assets) and the procedures to be followed when carrying out an audit exercise on the items.

This paper is important for a number of reasons:

- Fixed Assets constitute large proportion of the balance sheet of most of our clients
- Fixed Assets require special accounting treatment because they are bought at a particular time and their use is spread over a number of years
- If appropriate audit procedures are not used, we may arrive at a wrong conclusion with the result that our audit opinion may also be wrong.

It is hoped that members of staff would be able to understand and apply the accounting and audit procedures required for fixed assets at the end of this paper.

The topics covered in this paper are as follows:

- Relevant Accounting standards for fixed asset accounting
- Accounting for Fixed Asset Acquisition
- Accounting for Fixed Asset Depreciation
- Accounting For Fixed Asset Disposal
- Accounting for Fixed Assets Revaluation
- Sundry Accounting issues
- Audit of Fixed Assets- General Procedures
- Understanding the Company’s fixed asset system
- Audit of Additions
- Audit of Disposal
- Audit of Depreciation
- Disclosure requirements
- Conclusion

ACCOUNTING STANDARDS

In Nigeria, Fixed Assets are accounted for using the Statement of Accounting Standard (SAS) 3 (Accounting for Property, Plant and Equipment). As we know SASs are issued by the Financial Reporting Council of Nigeria formerly known as the Nigerian Accounting Standards Board).
This position is expected to change from this year (2013) when companies with significant public interest are expected to convert from using the SAS to the International Financial Reporting Standards (IFRS). Most of our big clients (with Turnover of over ₦500 Million) are in this category.

We shall therefore also be looking at the Accounting treatment of Fixed Assets from the perspective of the International Financial Reporting Standards (IFRS). The relevant IFRS in accounting for Fixed Assets are:

IAS 16 Property, Plant and Equipment,
IAS 20 Government grants,
IAS 40 Investment Property,
IAS 36 Impairment of assets,
IAS 23, Borrowing Costs.

We shall however restrict ourselves to IAS 16 in this paper. Others will be treated in due course.

**Accounting for Fixed Assets Acquisition**

Please note that under IFRS, the name for Fixed Assets is Non Current Asset. So if accounts are prepared under the IFRS, we use the term Non Current Asset, while under the Nigerian SAS we use the term Fixed Asset.

An item of PPE can be acquired by two means:

1) Purchase or
2) By self construction.

Such acquired asset is initially recorded in the books of accounts at its **Historical cost**.

**Components of cost**

The components of cost of an item of PPE include:

- Purchase price less trade discount or rebate
- Import duties and non-refundable purchase taxes
- Directly attributable costs of bringing the asset to working condition for its intended use, e.g.:
  - The cost of site preparation
  - Initial delivery and handling costs
  - Installation costs
  - Testing
  - Professional fees (architects, engineers, etc.)
- Initial estimate of the unavoidable cost of dismantling and removing the asset and restoring the site on which it is located.

In the case of self-constructed assets, the same principles are applied as for acquired assets; the cost of the asset will be the cost of its production. Abnormal costs (wasted material, labour or other resources) are excluded from the cost of the asset. An example of a self-constructed asset is when a building company builds its own head office.

**Example 1:**

Wakabout Ltd, with 31st December year end, bought a motor van costing ₦1,000,000 on 1st July, 2011 for its marketing team and paid ₦200,000 as import duty, while the company was given a trade discount of 10%. Show the accounting entries.
Accounting entries:

Both the Nigerian GAAP and the International GAAP will treat this situation in the same way, the difference basically will be in names of statements and terms as follows:

Under the Nigerian GAAP and IFRS

On 1st July, 2011

<table>
<thead>
<tr>
<th>Debit</th>
<th>Motor Van</th>
<th>₦900,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td>Motor Van</td>
<td>₦200,000</td>
</tr>
<tr>
<td>Credit</td>
<td>Bank</td>
<td>₦1,100,000</td>
</tr>
</tbody>
</table>

Let's us now assume that Wakabout Ltd is a company that can make the VAN on its own. The Accounting entries will be different because it is the cost component that will now be accumulated to arrive at the cost of motor VAN.

The Debit Side will include

Cost of Steel and Iron Rods  
Cost of Wages of Direct Labour for Production  
Cost of Directly attributable overhead

While we credit our supplier and/ or Bank

ACCOUNTING FOR DEPRECIATION

Depreciation is that part of the original cost of a non current asset (fixed assets under NGAAP) that is consumed during its period of use in the business.

In this paper we are concerned with the Accounting treatment as all members of staff are expected to have known how it is calculated.

When depreciation is calculated the accounting entries are:

Debit Depreciation Account and  
Credit Accumulated Depreciation Account.

Example: 2

Wakabout Ltd, with 31st December year end, bought a motor van costing ₦1,000,000 on 1st July, 2011 for its marketing team. Estimated useful life of the Van is 5 years with residual value of ₦200,000. The company policy is to depreciate its depreciable assets on straight line basis.

Both the Nigerian GAAP and the International GAAP will treat this situation in the same way, the difference basically will be in names of statements and terms as follows:

Under the Nigerian GAAP

On 1st July, 2011

<table>
<thead>
<tr>
<th>Debit</th>
<th>Motor Van</th>
<th>₦1,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit</td>
<td>Bank</td>
<td>₦1,000,000</td>
</tr>
</tbody>
</table>

On 31st December, 2011
Debit       Depreciation Expense       ₦80,000
Credit      Accumulated Depreciation  ₦80,000

Debit       P & L Account       ₦80,000
Credit      Depreciation Expense       ₦80,000

Balance sheet as at 31st December, 2011

Fixed Assets Schedule

Motor Van       ₦1,000,000
Less Accumulated Depreciation  ₦80,000
Net Book Value ₦920,000

Under the International GAAP

On 1st July, 2011

Debit       Motor Van       ₦1,000,000
Credit      Bank      ₦1,000,000

On 31st December, 2011

Debit       Depreciation Expense       ₦80,000
Credit      Accumulated Depreciation  ₦80,000

Debit       Profit or Loss (Statement of Profit or Loss and other Comprehensive Income)  ₦80,000
Credit      Depreciation Expense       ₦80,000

Statement of Financial Position as at 31st December, 2011

Property, Plant and Equipment Schedule

Motor Van       ₦1,000,000
Less Accumulated Depreciation  ₦80,000
Less Impairment Loss  0
Carrying value ₦920,000

If in our Example 1, recoverable amount is known and different from the asset’s carrying value, then impairment loss will be recognised.

Example 3:

As in Example 2:
Wakabout Ltd, with 31st December year end, bought a motor van costing ₦1,000,000 on 1st July, 2011 for its marketing team. Estimated useful life of the van is 5 years with ₦200,000 residual value. The company policy is to depreciate its depreciable assets on straight line basis.

But at 31st December, 2011, the recoverable amount of the asset is found to be ₦900,000

Accounting entries:
Under the Nigerian GAAP

On 1st July, 2011

Debit     Motor Van  ₦1,000,000
Credit   Bank       ₦1,000,000

On 31st December, 2011

Debit     Depreciation Expense  ₦80,000
Credit   Accumulated Depreciation  ₦80,000
Debit     P & L Account  ₦80,000
Credit   Depreciation Expense  ₦80,000
Debit     P & L Account  ₦20,000
Credit   Impairment Loss  ₦20,000

Balance sheet as at 31st December, 2011

Fixed Assets Schedule

Motor Van  ₦1,000,000
Less Accumulated Depreciation  ₦80,000
Net Book Value  ₦920,000
Less Impairment Loss  ₦20,000
Carrying value  ₦900,000

Under the International GAAP

On 1st July, 2011

Debit     Motor Van  ₦1,000,000
Credit   Bank       ₦1,000,000

On 31st December, 2011

Debit     Depreciation Expense  ₦80,000
Credit   Accumulated Depreciation  ₦80,000
Debit     Profit or Loss (Statement of Profit or Loss and other Comprehensive Income)  ₦80,000
Credit   Depreciation Expense  ₦80,000
Debit     Profit or Loss (Statement of Profit or Loss and other Comprehensive Income)  ₦20,000
Credit   Impairment Loss  ₦20,000

Statement of Financial Position as at 31st December, 2011

Property, Plant and Equipment Schedule

Motor Van  ₦1,000,000
Less Accumulated Depreciation  ₦80,000
Methods of measuring Fixed Assets

There are two possible treatments here, essentially a choice between keeping an asset recorded at cost or revaluing it to fair value.

Cost Model

* Carry the asset at its cost less any accumulated depreciation and any accumulated impairment loss.

Revaluation Model

- Carry the asset at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment loss.
- Revaluations shall be made regularly enough so that the carrying amount approximates to fair value at the reporting date.

Example 3:

An asset acquired, by an entity with 31st December year end, on 1st January, 2010 at a cost of ₦300,000 with a useful life of 4 years was revalued to ₦200,000 on 31st December, 2011 and to ₦40,000 on 31st December, 2012.

Accounting entries on 31st December, 2011:
Debit | Asset value | ₦50,000
Credit | Revaluation surplus | ₦50,000

**Accounting entries on 31st December, 2012:**
Under Nigerian GAAP

Debit | Revaluation surplus | ₦50,000
Debit | Profit and Loss | ₦10,000
Credit | Asset Value | ₦60,000

**Downward Revaluation**

If the initial revalued amount of an asset is less than its carrying amount (under International GAAP) or net book value (under Nigerian GAAP), the revaluation decrease is treated in the same way as impairment loss i.e. the decrease should be recognised as an expense. Debit Profit and Loss (SASs) or Profit or Loss (IFRSs) and credit the asset account with the amount of decrease. However, a revaluation decrease (or impairment loss) should be charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation surplus in respect of the same asset.

A reversal of an impairment loss should be treated in the same way as a revaluation increase i.e. a revaluation increase should be recognised as income to the extent that it reverses a revaluation decrease or an impairment loss of the same asset previously recognised as an expense.

An asset cannot be revalued to a carrying amount that is higher than its value would have been if the asset had not been impaired originally i.e. its depreciated carrying value had the impairment not taken place. An exception to this rule is goodwill. Reversal of impairment loss is not allowed for goodwill.

Revaluation model can only be used if the fair value of the asset can be determined reliably.

**Example 4:**

An asset acquired, by an entity with 31st December year end, on 1st January, 2010 at a cost of ₦300,000 with a useful life of 4 years was revalued to ₦100,000 on 31st December, 2011.

**Accounting entries on 31st December, 2011:**

Debit | Profit and Loss | ₦50,000
Credit | Asset value | ₦50,000

**Revaluation and depreciation**

When an asset is revalued upwards, the depreciation charge will increase. Normally, a revaluation surplus is only realised as the asset is sold, but when it is being depreciated, part of that surplus is being realised as the asset is used. The amount of the surplus realised is the difference between depreciation charged on the revalued amount and the (lower) depreciation which would have been charged on the asset’s original cost. **The entity can then choose to transfer this amount to retained (i.e. realised) earnings but not through the statement of profit or loss.**

**Example 5:**

Asset cost in year 1 = ₦10,000. Useful life = 5 years. Revaluation in year 3 = ₦12,000. No change in useful life after revaluation.
Accounting entries:

Debit | Asset value | ₦6,000  
Credit | Revaluation surplus | ₦6,000  

Debit | Revaluation surplus | ₦2,000  
Credit | Retained earnings | ₦2,000  

Disclosure

An accounting policy note should disclose the valuation bases used for determining the amounts at which depreciable assets are stated along with the other accounting policies. IAS 16 requires the following to be disclosed for each major class of depreciable assets:

- Depreciation methods used
- Useful lives or the depreciation rates used
- Total depreciation allocated for the period
- Gross amount of depreciable assets and the related accumulated depreciation

Retirement and disposals

When an item of PPE is permanently withdrawn from use or sold or scrapped and no future economic benefits are expected from its disposal, it should be withdrawn from the statement of financial position. Any revaluation surplus in respect of a fixed asset disposed may be taken from the revaluation surplus account to retained earnings.

The procedure for this is as follows:

- When a fixed asset (non current asset) is sold you open an asset disposal account and transfer the cost price of the asset sold to the asset disposal account. This is done by Debit to the asset disposal account and Credit to the Asset Account
- Transfer the depreciation already charged on the asset to the asset disposal account. This is done by Debit to the Accumulated Depreciation Account and Credit to the Asset Disposal Account
- For the sales proceeds received we Debit our bank and Credit our asset disposal account
- Close the asset disposal account to the Profit and Loss Account. This is done as follows: If the asset disposal account shows a difference on the debit side, then there is a profit on the sale. Debit asset disposal account and Credit Profit and Loss Account
  
- If the asset disposal account shows a difference on the credit side, there is a loss on sale: Debit profit and loss account Credit asset disposal account

These entries can be illustrated by using the example below.
Example 6:

A fixed asset was purchased on 1st January, 2010 at a cost of₦300,000 with useful life of 5 years and nil residual value. On 31st December, 2012, the asset was sold for ₦100,000.

**Accounting entries on 31st December, 2012:**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets Disposal</td>
<td>Fixed Assets</td>
</tr>
<tr>
<td>₦300,000</td>
<td>₦300,000</td>
</tr>
<tr>
<td>Accumulated Depreciation</td>
<td>Assets Disposal</td>
</tr>
<tr>
<td>₦180,000</td>
<td>₦180,000</td>
</tr>
<tr>
<td>Bank</td>
<td>Assets Disposal</td>
</tr>
<tr>
<td>₦100,000</td>
<td>₦100,000</td>
</tr>
<tr>
<td>Profit &amp; Loss</td>
<td>Assets Disposal</td>
</tr>
<tr>
<td>₦20,000</td>
<td>₦20,000</td>
</tr>
</tbody>
</table>

Example 7:

A fixed asset was purchased on 1st January, 2010 at a cost of₦500,000 with useful life of 5 years and nil residual value. On 31st December, 2011 it was revalued to ₦450,000 and was sold on 31st December, 2012 for ₦350,000

**Accounting entries on 31st December, 2012:**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets Disposal</td>
<td>Fixed Assets</td>
</tr>
<tr>
<td>₦300,000</td>
<td>₦300,000</td>
</tr>
<tr>
<td>Bank</td>
<td>Assets Disposal</td>
</tr>
<tr>
<td>₦350,000</td>
<td>₦350,000</td>
</tr>
<tr>
<td>Assets Disposal</td>
<td>Profit &amp; Loss</td>
</tr>
<tr>
<td>₦50,000</td>
<td>₦50,000</td>
</tr>
<tr>
<td>Revaluation surplus</td>
<td>Retained earnings</td>
</tr>
<tr>
<td>₦150,000</td>
<td>₦150,000</td>
</tr>
</tbody>
</table>

**SUNDARY ISSUES ON FIXED ASSETS**

For further reading on the topic members of staff are strongly advised to be familiar with the following literatures:

- Business Accounting Book 1 by Frank Wood, Chapters 26 and 27
- SAS 3 Accounting for property, Plant and Equipment
- IAS 16 Property, Plant and Equipment,
- IAS 20 Government grants,
- IAS 40 Investment Property,
- IAS 36 Impairment of assets,
- IAS 23, Borrowing Costs.
AUDIT OF FIXED ASSETS (NON CURRENT ASSETS)

OBJECTIVES

The Audit of fixed assets is centred on the following objectives:

- To ensure that all fixed assets exist, are owned by the company and are in use
- To ensure that all fixed assets are recorded in the books, at the correct valuation, are adequately secured and properly maintained
- That acquisitions and disposals are properly authorized
- That assets are properly depreciated and the depreciation is properly accounted for

REQUIRED KNOWLEDGE

Before embarking on the audit of fixed assets you must note the following in your working papers.

- Fixed Asset Capitalization Policy
- Depreciation Policy and Rate of depreciation
- Acquisition Policy (Who authorizes the purchase of fixed asset)
- Disposal Policy (Who authorizes disposal)

This information can be gotten from company manual, interview with members of staff, previous year working papers and previous Audited Financial Statements

REQUIRED TESTS

1) Analytical procedures
2) Verify Opening Balances
3) Verify Current year acquisitions
4) Verify Current year disposals
5) Verify the ending balance in the asset account
6) Verify depreciation expense
7) Verify accumulated depreciation balance

REQUIRED PROCEDURES

Obtain a list of fixed assets at year end with comparative figures for previous year.

<table>
<thead>
<tr>
<th>S/N</th>
<th>REQUIRED ACTION</th>
<th>OUR AUDIT TICK</th>
<th>IMPLICATIONS OF ACTION</th>
<th>FURTHER WORK</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Agree comparative figures with previous year working papers and financial statements</td>
<td>β</td>
<td>We have verified opening balances for each category of asset</td>
<td>If it is agreed no further work is required. If not let the client explain</td>
</tr>
<tr>
<td>2</td>
<td>Agree the list to the asset register, trial balance and draft accounts</td>
<td>Ł</td>
<td>We have verified closing balances of depreciation and asset accounts and confirmed that it agrees with clients books of accounts</td>
<td>If it is agreed no further work is required. If not let the client explain</td>
</tr>
<tr>
<td></td>
<td>Perform Analytical Procedures: This means that you should calculate the following ratios.</td>
<td>No tick. We prepare a table</td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td></td>
<td>a) Calculate depreciation expense as a percentage of carrying value of assets and compare with previous year</td>
<td>a) If you observe significant difference do a detailed test on depreciation</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>b) Calculated accumulated depreciation divided by gross asset value and compare with previous year</td>
<td>b) If you observe significant difference do a detailed test on depreciation</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>c) Compare maintenance expenses with previous year</td>
<td>c) If you observe significant difference with previous year you will have to prepare an analysis of maintenance expenses to determine whether fixed assets are not included</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td><strong>Verification of additions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1) Obtain a schedule of all additions suitably classified into asset categories. Agree the totals to the fixed asset schedule given to you earlier</td>
<td></td>
<td>You know that the schedule you are working on is the correct one</td>
</tr>
<tr>
<td></td>
<td>2) Select a sample of items that you wish to check the additions.</td>
<td>Ł</td>
<td></td>
</tr>
<tr>
<td></td>
<td>3) Inspect vendors invoices and supporting documents for the transaction</td>
<td>μ</td>
<td></td>
</tr>
<tr>
<td></td>
<td>4) Check the vouchers</td>
<td>Ą</td>
<td></td>
</tr>
</tbody>
</table>
for authorisation to acquire the assets

5) Confirm that the asset is properly classified
6) For land and Buildings inspect title documents, deeds and lease agreements

All these documents should be copied and kept in our file

7 Take a sample of material asset (both additions and balance brought forward) and physically inspect them

We would now use our standard file divider for the other procedures.

FIXED ASSETS AND ACCUMULATED DEPRECIATION AUDIT PROCEDURE

<table>
<thead>
<tr>
<th>Initial</th>
<th>W/P Ref.</th>
</tr>
</thead>
</table>

1. Obtain and check or prepare for each assets group schedule of cost and depreciation for years agreeing with Balance Sheet.

2. (a) Obtain and check or prepare additions schedules.
   (b) Obtain and check or prepare disposals schedules.
   (c) Check or prepare Profit and Loss on disposals schedules.

3. (a) Vouch significant additions and disposals and indicate on schedules how you have done so.
   (b) Reconcile Additional, Disposal and Proceeds of Sales with Capital Allowances Schedule.

4. Check against Fixed Assets Register.

5. Physically verify wherever possible and indicate on schedules and/or check physical inventories prepared by client.

6. (a) Examine and list title deeds or obtain confirmation from authorized holder.
7. Check and list insurance policies, ensure insurance cover is adequate.

8. Check that depreciation rates are adequate, not excessive and consistent with prior year. Consider note to Accounts if not.

9. Review appropriate expense accounts to ensure no capital items charged to revenue.

10. Ascertain amount of capital commitments outstanding at Balance Sheet date.

11. Get certificate signed.

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Client: [Name]

Address: [Address]

CERTIFICATE OF CAPITAL EXPENDITURE AND DISPOSALS OF FIXED ASSETS

YEAR ENDED:

<table>
<thead>
<tr>
<th></th>
<th>Additions</th>
<th>Disposals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Building</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Plant and Machinery</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Motor Vehicles</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixtures, Fitting and Equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office Furniture</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Fixed Assets</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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N N

I HEREBY CERTIFY that, to the best of my knowledge and belief:

(1) The capital expenditure during the year ended on the above date amounted to N as summarized above, and that such expenditure represented additions or improvements to the Company’s Fixed Assets during the period stated.
No fixed assets were sold, scrapped or otherwise disposed of during the year, except those having a book value (before deducting accumulated depreciation) of ₦ as shown above and which realized ₦.

Provision has been made at the above date for writing down to estimated realizable values all fixed assets considered to be obsolete and of no further use.

At the above date commitments for capital expenditure not included in the accounts to that date amounted to approximately ₦ and capital expenditure authorized by the directors but not contracted for amounted to approximately ₦.

Date……………………………………… (Signature)

………………………. (Office)

PEAK PROFESSIONAL SERVICES
CHARTERED ACCOUNTANTS
NIGERIA

CASE STUDY