

# ASSETS

## Property, Plant and Equipment (PPE)

A resource:

- controlled by the company
- as a result of past events
- future economic benefits (cash) probable / potential to produce future economic benefits
- can be measured reliably:
  - Cost
  - Fair Value (FV) - price asset could be sold for
  - Present Value (PV) of future cash flows

### IAS 16 Initial Recognition

- Capitalise as part of PPE asset:
  - Cost of asset and subsequent replacement parts
  - Costs directly attributable to bringing asset into working use (costs to obtain and make it work)
  - Costs to dismantle asset and restore land (provisions)
- Expense to P&L:
  - Costs not meeting the asset definition
    - Repairs will not produce additional future economic benefits
    - Planned future expenditure is not a result of past events
  - Costs not directly attributable to bringing asset into working use

### IAS 16 Subsequent Measurement

- Two models: assets of same class (buildings/machinery) must follow same model

#### 1. Cost Model

- Asset depreciated over Useful Economic Life (UEL) when it is ready for use
  - Each separate component depreciated over its UEL
    - Dr P&L, Cr PPE
  - Land is not depreciated as has infinite UEL
  - UEL, residual values and depr method reviewed annually
- PPE Carrying Amount (CA) on SFP = Cost – Accumulated Depr

#### 2. Revaluation Model

- Asset depreciated over UEL when it is ready for use as per cost model
- Asset revalued to FV
  - $FV > CA$ : Dr PPE CA, Cr OCI
- Depr in later years will be higher as PPE now has higher CA
  - This additional depr will cause profits to be lower
  - Profits are transferred to Retained Earnings (RE) so RE will be lower due to revaluation
  - OCI gains are transferred to Revaluation Surplus (RS) so RS will be higher due to revaluation
  - Can transfer the amount of additional depr from RS to RE
    - Dr RS, Cr RE
- Assets must be revalued frequently enough so that FV and CA do not materially differ
- PPE Carrying Amount (CA) on SFP = FV – Accumulated Depr

<b>Intangible Assets</b> (note in financial statements)		
<b>COST</b>		
<b>b/f</b>	<b>X</b>	
Additions	X	Cost of asset purchased + directly attributable costs Development costs (not internally developed goodwill/brands/customer lists)
Disposals	(X)	Asset derecognised as no longer controlled
Revaluation	X	Rare as needs to be active market for asset
AHfS	(X)	Asset reclassified to AHfS so removed
<b>c/f</b>	<b>X</b>	
<b>AMORTISATION</b>		
<b>b/f</b>	<b>(X)</b>	
CY Amortisation	(X)	CY amortisation charge on asset (UEL: expected sales period/legal rights)
CY Impairment	(X)	CY impairment charge
Disposals	X	Removes accumulated amortisation on asset derecognised
Revaluation	X	Rare as needs to be active market for asset
AHfS	X	Removes accumulated amortisation on asset which is now reclassified to AHfS
<b>c/f</b>	<b>(X)</b>	
<b>CA</b>		Cost – Amortisation = CA
<b>b/f</b>	X	PY SFP
<b>c/f</b>	X	CY SFP

## EXAM TECHNIQUE GUIDANCE

Explain Financial Reporting Treatment Questions

- Brief abstract
  - relevant parts of relevant standards
- Application
  - apply standard to specific scenario
  - explain why current treatment is incorrect
- Financial Statement (FS) numbers
  - P&L/OCI/SFP impact
  - journal entry if requested in requirement
- Correct draft FS figures if required for next part of question

The 'explain the financial reporting treatment' questions have more available marks than maximum marks. This makes it realistic to target full marks on those questions because you do not need get everything correct to score full marks. However, you must ensure that you get enough points down to score the marks.

### MASTER PLAN

TOPIC	VIDEO CLASS	QUESTIONS	ICAEW Workbook
PPE	Assets	Q47 Longhorn – Issue 2 Q50 Otillab – Issue 2 Q52 Murgese – Issue 2 Q53 Pleione – Issue 2 Q54 Mukota – Issue 3 Q55 Nickleby – Issue 2 Q58 Tarascon – Issue 1 Q59 Chayofa – Issues 1 and 3 Q61 Altura – Issue 1 Q64 Ambridge – Issue 1	Ch.11
IA	Assets	Q49 Ballito – Issue 1 Q53 Pleione – Issue 3 Q60 Naples – Issue 2 Q63 Helstar – Issue 1	Ch.12
Inventory	Assets: additional questions	Q48 Frangula – Issue 2 Q52 Murgese – Issue 1 Q60 Naples – Issue 1	Ch.13.3

**Key**

Small topic

Medium topic

Large topic

Questions are in the ICAEW Question Bank

## Model Answers

### Intangibles

Under IAS38, internally developed brands cannot be recognised because they cannot be measured reliably.

Brands acquired externally can be recognised because they can be measured reliably (cost paid) and they meet the definition of an asset as they are controlled, as a result of past events, will result in future economic benefits and are identifiable (separable from business and legal rights over asset).

IA amortised over UEL.

IA can only be revalued if an active market for the asset so cannot apply to brands as they are unique.

Therefore, internally generated H5 brand cannot be recognised.

It was incorrect to revalue brand and this needs to be reversed by reducing asset and profit (Cr Asset, Dr PL).

Acquired HT brand can be recognised at cost of £150k and amortised over 5-year UEL.

Also incorrect to revalue HT brand and this needs to be reversed by reducing asset and profit (Cr Asset, Dr PL).

		HT	H5
	Cost	£150,000	£0
5yr/9m	Amort	(£22,500)	
	CA	£127,500	£0

RISK	PROCEDURES/EVIDENCE
<p><b>REVENUE</b> (presumed fraud risk)</p> <p><b>Numbers (AP)</b></p> <p>Overstatement:            Increase in revenue &gt; increase in COS            GPM increase            Increase in price per unit/volume            Increase in revenue per employee</p> <p><b>Scenario</b></p> <p>Cash received before/after goods/services provided: risk of incorrect revenue recognition</p> <p>Goods/services provided over time: risk of incorrect revenue recognition</p>	<p>Enquire with management to establish commercial reasons why</p> <p>Review budgets/forecasts for the year to ascertain if revenue higher than expected</p> <p>Obtain breakdown by region/product/service to identify anomalies</p> <p>General procedures for sales system (bottom of page):</p> <ul style="list-style-type: none"> <li>▪ Inspect delivery note to see if delivery to customer was in current period</li> <li>▪ Trace revenue transactions back to invoice/despatch note/sales order</li> <li>▪ Vouch revenue transactions to bank statements</li> <li>▪ Data analytics for three-way match between invoice/despatch note/sales order</li> <li>▪ Inspect goods returns/customer correspondence and trace credit note to debit record in revenue</li> <li>▪ Inspect post year end cash payments to customers for refunds and compare to returns provision at year end</li> <li>▪ Reconcile returned goods to inventory records</li> <li>▪ Use software to identify notable or unusual transactions</li> </ul> <p>Inspect contract with customer to establish performance obligations</p> <p>Inspect correspondence with customer to establish goods/services provided</p> <p>Recalculate revenue to be recognised/contract liability (asset)</p> <p>Inspect contract/correspondence with customer to establish work performed</p> <p>Recalculate revenue to be recognised/contract liability (asset)</p>
<p><b>RECEIVABLES</b></p> <p>Overstatement:</p> <p><b>Numbers (AP)</b></p> <p>High compared to increase in revenue            Receivables days increase            Receivables days &gt; credit terms</p> <p><b>Scenario</b></p> <p>Customer dispute / distress</p>	<p>Enquire with management to establish commercial reasons why</p> <p>Data analytics to identify all aged amounts</p> <p>Analyse management bad debt allowance calculation and reperform</p> <p>Reconcile receivables with customer confirmations of balances</p> <p>Inspect correspondence to assess if overdue balances will be paid</p> <p>Inspect credit policy/sales contracts to see if shorter than receivables days</p> <p>Inspect post year end transactions to see if payment made</p> <p>Inspect credit notes raised post year end</p> <p>Data analytics for three-way match between invoice/despatch note/sales order</p> <p>Use software to identify notable or unusual transactions</p> <p>Inspect correspondence to assess if balance will be paid</p> <p>Inspect FS of customer/recent press reports to see if customer a going concern</p> <p>Obtain customer confirmation of balance</p> <p>Inspect credit policy/sales contracts to assess legal position</p> <p>Trace balance back to invoice/despatch note/sales order</p> <p>Inspect post year end transactions to see if payment made</p>

Sales System at Client Business

Process	Internal Controls
Customer places sales order and goods despatched	Agree goods to be despatched to sales order Despatch notes numbered
Goods delivered	Goods signed for by customer; Delivery note issued to customer
Sales invoice sent	Agree to sales order/despatch note/delivery note/price lists Regular review of despatch notes not matched by invoice
Payment from customer	Match cash receipts to invoice; segregation of duties; follow up overdue amounts; authorisation for bad debt write off
Credit note issued to customer for goods returned	Check goods returned; authorisation of credit notes; provision for returns

## EXAM TECHNIQUE GUIDANCE

### Audit Risks

- Use scenario narrative **and** numbers (AP) to identify risks of overstatement / understatement
- Try to combine scenario narrative and numbers
  - There is a risk that revenue is overstated because revenue has increased significantly (x%), which is more than COS increase (x%) (a GPM increase), and because X Ltd receives payment from customers in advance of goods being provided which may have led to premature revenue recognition.
  - There is a risk that receivables are overstated because receivables days have increased significantly (x days to x days) which is more than stated credit terms of 30 days and bad debts may need to be written off.
- Use FR knowledge to identify potential misstatements (common accounting errors)
  - There is a risk that intangible assets are overstated because an internally generated brand has been recognised and this is not permitted under IAS 38.

### Audit Procedures

- When typing procedures, think: action; source; purpose
  - action (inspect, recalculate/reperform, confirm, enquire, observe; observation is weaker than inspection/recalculation);
  - source (independent better than client);
  - purpose (what does it help confirm: assertions below)
    - Inspect contract with customer to establish performance obligations
    - Recalculate revenue to be recognised and amount to be treated as contract liability
    - Inspect schedule of costs capitalised to ensure costs meet capitalisation criteria
    - Trace costs capitalised to purchase invoice/payroll to confirm amount of expenditure
- Consider the direction of testing (source document to financial statements or financial statements to source document) depending on whether it is a risk of overstatement or understatement and the assertion.

When thinking of audit risks, it is useful to think which financial statement assertions could give rise to a misstatement. When thinking of procedures, it is useful to think which assertion the procedure is testing. However, you do not need to always state which assertion you are testing with a particular procedure.

<b>Assertions</b>	
<b>P&amp;L</b>	
<b>Occurrence</b>	Transactions recorded in FS have occurred
<b>Completeness</b>	All transactions have been recorded and all related disclosures in FS
<b>Accuracy</b>	Amounts recorded correctly in FS
<b>Cut-off</b>	Transactions recorded in the correct period
<b>Classification</b>	Transactions classified correctly in FS
<b>Presentation</b>	Presented correctly on FS with disclosures
<b>SFP</b>	
<b>Existence</b>	Assets/liabilities/equity exist
<b>Rights and Obligations</b>	Right to control assets/obligation to pay cash
<b>Completeness</b>	All assets/liabilities/equity have been recorded and all related disclosures in FS
<b>Accuracy/Valuation</b>	Amounts recorded correctly in FS
<b>Classification</b>	Transactions classified correctly in FS
<b>Presentation</b>	Presented correctly on FS with disclosures

## Model Answers

### Risks

#### FS Level

B Ltd is a new client/first year audit so there is a risk of misstatement in opening balances.

The previous auditor resigned over disagreement with management which suggests potential contentious accounting treatment/misstatements.

CEO is majority shareholder so there is a risk of management override of controls/fraud risk.

CEO has a reputation for being aggressive and erratic which could intimidate auditors when challenging management, especially with junior staff on the audit.

There is a risk that there is insufficient time and inappropriate staff to obtain sufficient audit evidence because there is little margin for additional audit work, a tight reporting deadline and a new trainee has replaced a senior.

B Ltd is planning a stock market listing so there is pressure/incentive to report increasing revenue/profits.

#### Revenue

There is a risk of overstatement of revenue because:

- it has increased by 9.7%
- retail has increased by 16% despite difficult times/affordability issues
- Wholesale has only decreased by 2.2% despite underperforming
- management under pressure to report strong results for listing / VC investors
- presumed fraud risk which is increased with aggressive CEO and results pressure

#### Receivables

There is a risk of overstatement of receivables/understatement of expense because:

- TR days have increased to 44.2 from 26.2 and are greater than 42 per the revised terms despite increase only starting in Jan
- there is no credit control department

#### Assets – PPE

There is a risk of overstatement of PPE/understatement of expenses because:

- costs may have been incorrectly capitalised as they might not result in future economic benefits (e.g. repairs) or might not be directly attributable to bringing asset into use (e.g. general overheads)
- no depreciation has been charged for store furniture and assets should have been depr once ready for use
- UEL/residual value is judgement so potential for manipulation

#### 8.2 Procedures

Physically inspect assets to ensure they exist

Inspect legal documentation to confirm control/rights over asset

Trace costs capitalised to purchase invoice to confirm amounts

## Independent Auditor's Report to Shareholders of ABC Plc

### Opinion

In our opinion the FS of ABC Plc:

- Give a true and fair view
- Have been properly prepared in accordance with IFRS/Companies Act

Except for the **material misstatement/inability to obtain sufficient appropriate audit evidence** (qualified opinion),

in our opinion the FS of ABC Plc:

- Give a true and fair view
- Have been properly prepared in accordance with IFRS/Companies Act

Due to the **pervasive misstatement** described below,

in our opinion the FS of ABC Plc:

- **Do not** give a true and fair view (adverse opinion)
- Have **not** been properly prepared in accordance with IFRS/Companies Act

We do not express an opinion on the FS (disclaimer opinion)

### Basis for (Qualified/Adverse) Opinion / Basis for Disclaimer of Opinion

ISAs, auditor independence/ethical compliance

Reference to misstatement/inability to obtain sufficient appropriate audit evidence

Due to the **inability to obtain audit evidence** described above, we do not express an opinion on whether the FS of ABC Plc:

- Give a true and fair view
- Have been properly prepared in accordance with IFRS/Companies Act

### Responsibilities

Directors

- Prepare FS and assess going concern basis
- Prepare Director's/Strategic Report and other information
- Manage business:
  - Internal controls to safeguard assets and prevent fraud
  - Identify risks and develop mitigation strategies (including sustainability risks)
  - Comply with laws and regulations (including sustainability regulations)

Auditors

- Opinion on whether FS are free from material misstatement and give a true and fair view
- Opinion on whether Director's/Strategic Report are consistent with FS
- Reasonable level of assurance
- Link to FRC website on audit responsibilities

### Other Information (Director's/Strategic Report, Chairman's Statement, Sustainability Information)

Directors are responsible for preparing other information

Audit opinion is on FS and does not cover other information

Auditor reports if other information is materiality inconsistent with FS/information obtained during audit

The Director's/Strategic Report are materiality consistent with FS (Companies Act)

The Corporate Governance Statement is materiality consistent with FS (listed company)