

Auditing PPE (IAS 16)

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Audit Staff Training Workshop
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Characteristics of PPE

- PPE are held for use in the production or supply of goods & services and for administrative purposes.
- PPE have a slow turnover and are carried over year to year
- Average unit of PPE are usually high in cost (materiality)
- Because of their high value, their acquisition (& disposal) are closely controlled. (Control)
- An error in accounting may affect financial statements for a long time
- In an inflationary environment, where cost model was adopted, the book values of PPE are considerably lower than replacement values



Holy grail of auditing PPE

- Existence / occurrence
- Valuation
- Completeness
- Accuracy
- Cut off
- Presentation & disclosure
- Rights & obligations



Procedures to cover Inherent Risks Associated with PPE

- Existence, auditor should check the asset and the related ownership documents.
- Completeness, check that expenses that should have been recognized as PPE, including capitalizing finance costs
- Cut off, correct period
- Client must have rights to the PPE
- Establish proper valuation or allocation of PPE & accuracy of transactions.
- Determine correctness and appropriateness of classification of PPE

Procedures to cover inherent risks associated with PPE

- Depreciation value: watch out for
 - Mechanical errors
 - Incorrect application of accounting policy
 - Inappropriate assessment of remaining useful life
 - Incorrect classification of the asset
- Carrying costs: watch out for
 - Failure to update valuations for current circumstances
 - Failure to brief valuers correctly
 - Valuation not performed by competent personnel



Procedures to cover Inherent Risks Associated with PPE

- Existence / valuation
 - Tangible assets acquired in a business combination may not have been initially recognized at their fair value at that date
- Value of impairment
 - Failure to recognise impairment or reversal of impairment
- Presentation & disclosure

Fraud risks and errors

- i. Purchase of an asset at inflated values especially from related parties
- ii. Wrong write off of the asset as scrap, obsolescence or missing, donated or destroyed
- iii. Expenditures for repairs & maintenance recorded as PPE or vice versa
- iv. Capitalization of expenses not normally attributable to cost of PPE
- v. Recording an asset purchased which hasn't been received by the entity
- vi. Removal of an asset paid for by the entity or use of an asset of the entity for the benefit of someone other than the entity



Some causes of fraud risk errors

- Inadequate involvement of management in overseeing employees with access to cash or key assets susceptible to misappropriation.
- PPE which are small in size, marketable, or lacking observable identification ownership
- Lack of complete & timely verification and reconciliation of assets
- Inadequate physical safeguards over PPE
- Misuse of company assets by employees
- Using entity assets for personal use e.g as collateral for a personal loan
- The asset is intentionally sold below fair market value



Internal control areas an auditor should check

- Control over expenditure incurred on PPE.
 - Usually can be informed by a capex budget.
- Accountability & utilization of controls.
 - Use of proper records of usage & custody
- Information controls, appropriate info on the PPE are immediately available e.g depr, insurance costs, repairs & maintenance
- Safeguarding of assets, these controls ensure the assets are well safeguarded and insured



Substantive procedures

- Verification of PPE
 - Auditor should verify records & documentary evidence of PPE
 - Auditor should also evaluate internal controls
 - Physical verification of PPE is primarily the responsibility of management
- Auditor must consider the appropriateness of the accounting policies, including policies to determine which costs are capitalized, use of cost or valuation model, depreciation and assessment of residual values.
- Ensure auditor has capitalized assets as per component e.g a significant component of an item which has a different useful life to the item should be capitalized separately.

Auditing PPE

- Opening balances
 - Examine accounting records & other information underlying the opening balances
 - Obtain summary of changes to PPE & reconcile the same to ledgers
- Capital Work in progress
 - Verify & ensure that assets under construction or pending installation are classified as WIP
 - Verify capital wip reference to underlying contractor bills, work orders, work certificates. Compare these with budgets, capital assets management policy and plans
 - Ensure system in place confirms completeness, reconcile movement of capital wip from start to finish.

Auditing PPE

- Additions to PPE
 - Should be verified with reference to support documents e.g., delivery reports, title deeds, customs and excise documents etc.
 - Check for possible comparative prices in market, justification & approval of purchase
 - Verify self constructed PPE with support documents e.g work certificates & independent confirmation & valuation of work done
 - Check to ensure that leases contracts and hire purchase agreements are correctly accounted for.
 - Auditor should review expense account e.g repairs & maintenance to ensure no new capital assets are included there.
- Ownership of PPE
 - Examine title deeds for land and buildings & get 3rd party confirmations where necessary e.g from the bank.
 - Obtain corroborating evidence that the client possesses the rights and obligations of the asset in question, e.g ensure the economic benefits actually accrue to it

Auditing PPE

- Impairment of PPE
 - Check whether there are circumstances that give rise to impairment of PPE and how the circumstances have been handled.
- Deletions from PPE
 - This can be from sale, scrapping, impairment, theft
 - Check whether assets were entered into PPE register before deletion or being fully written off. Especially for assets fully written off in year of acquisition.
 - Check whether the retirement of PPE have been properly approved and authorized
 - Whether asset and depreciation accounts have been properly adjusted
 - Whether sale proceeds have been fully accounted for.
 - Whether the resulting gains and losses have been properly accounted for especially if material.
 - Ensure that there are no omissions, i.e assets destroyed, sold or scrapped during the year are not recorded as deleted

Auditing PPE

- Physical verification
 - Physical verification is the duty of management but the auditor should satisfy themselves that such verification was done by observing the verification process & looking at instructions & competence of the staff doing it.
 - Examine whether the method of verification was reasonable relating to each asset.
 - Auditor should apply appropriate emphasis on the verification of assets by the management of the assets which are outside the premises of the company with 3rd parties.
 - Auditor should examine whether the frequency of verification was adequate under the circumstances
 - Auditor should test check the records of PPE with physical verification reports . The discrepancies noticed must be properly dealt with.

Auditing PPE

- Recognition
 - Ensure the cost of PPE is recognized as an asset only after they have been measured & future economic benefits accrue to the organization.
 - The recognition should be in line with IAS 16.
 - Ensure capital WIP is recognized as such until they are ready for use.
 - Ensure the component approach is taken into account.
- Valuation
 - Should be valued according to IAS 16
 - After initial recognition, the auditor should ensure subsequent measurement is accurate
 - Auditor should ensure the method by which the fair value has been determined is reasonable for the asset under consideration
 - Auditor should ensure that the value was determined with the help of a person competent to value the assets under consideration

Auditing PPE

- Valuation
 - Auditor should review whether the entity has reviewed the carrying value of its assets & how it determines the recoverable amount of the asset.
 - If several assets were purchased for a consolidated price, the auditor should examine the method by which consideration has been apportioned to the various assets. If done by expert valuation, examine whether the same appears reasonable.
 - where an entity owns assets jointly with others, the auditor should examine relevant ownership documents in order to ascertain the extent of the entity's share of the assets.



Auditing PPE

- PPE acquired on/as government grants
 - When PPE is acquired as government grant, at concessional rates it has to account for them at acquisition cost or at nominal cost
 - The grant can be shown as a deduction from the gross value of the asset
- Depreciation
 - Test check the calculations of calculation
 - Check the anticipated useful lives of the assets
 - Check whether the depreciation charge relatively represents the usage.
 - Ensure assets under construction or installation are not depreciated until such a time they are ready for use. But they should be tested for impairment.

Auditing PPE

- Useful life of PPE
 - Auditor should ensure the management has reviewed the useful life & residual value of the asset at least annually.
- Impairment of PPE
 - An asset is impaired when the carrying amount of the asset exceeds its recoverable amount. If the recoverable amount is less than the carrying amount, the carrying amount should be reduced to the recoverable amount.
 - Auditor should enquire if any compensation is receivable from third parties for items of PPE that are impaired or lost and credit the amount to the p&L when the amount becomes receivable
 - An impairment loss recognized for an asset in prior accounting periods should be reversed if there has been a change in the assets recoverable amount since the last impairment loss was recognized. The carrying amount will be reversed to its carrying amount.
 - The increased carrying amount of an asset due to a reversal of an impairment should not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior periods

Auditing PPE



- Revaluation of PPE
 - This is done where the fair value of the asset can be reliably measured
 - If valuation is done internally auditor should consider the basis on which it was done, the adequacy of the evidence obtained to support the valuation and overall reasonableness
 - The frequency of the valuation should also be adequate so that the fair value of the asset does not differ materially from the carrying value of the asset.
 - The auditor should verify the basis of derecognition and the accounting treatment of asset on disposal or when no future economic benefits are expected from its use.

Auditing PPE

- Disclosure
 - The auditor should verify that the entity has made relevant disclosures for PPE or class of PPE.
 - Disclosures are on depreciation methods, measurement bases, details of additions and deletions, existence of rights and restrictions, the carrying amount during course construction contractual commitments, impairments of assets, revaluation of assets etc



Audit in an IT environment

- Benefits of an IT environment
 - Provides consistency in application of pre defined policies, e.g use of a depreciation rate based on asset classification or useful life.
 - Enhancing timelines & accuracy of information e.g monthly account closure procedures
 - Generating analytical information for example ratios, comparative information etc
 - Reducing risks that controls can be circumvented e.g purchase of authorisation of purchase of fixed assets



Audit in an IT environment

- Control threats in an IT environment
 - Reliance on systems which may inaccurately process data
 - Unauthorized access to data leading to data loss destruction. eg the fixed assets register maybe tampered with by an unauthorized user.
 - Inappropriate manual intervention
 - Inability to access data as required



Audit in an IT environment

- Auditor needs to check the following
 - That the changes to the programs are subject to controls
 - That the authorized version of the program is used
 - Other general controls
 - Inspection of the record of administration



The end

- Questions ???
- Comments



Key risks

THE MINDMAP

Imagine the entity has an extremely large PP&E balance and is located in a number of different locations.

What questions would you ask the client in relation to PP&E?

What other information would you need?

(Exercise in small groups; debrief in plenary)

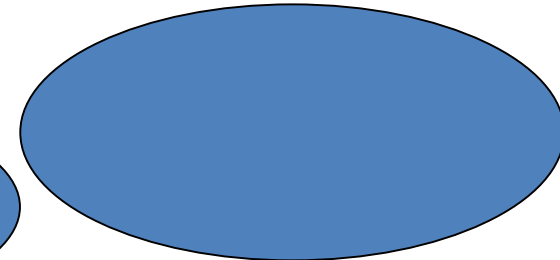
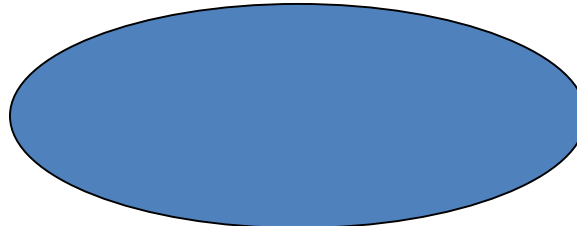
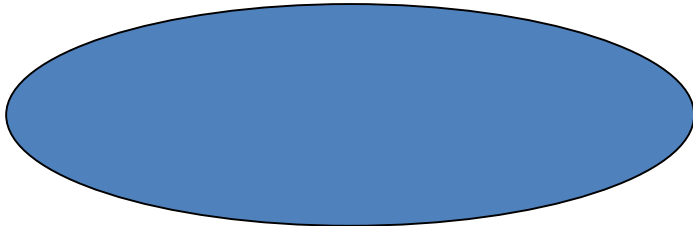
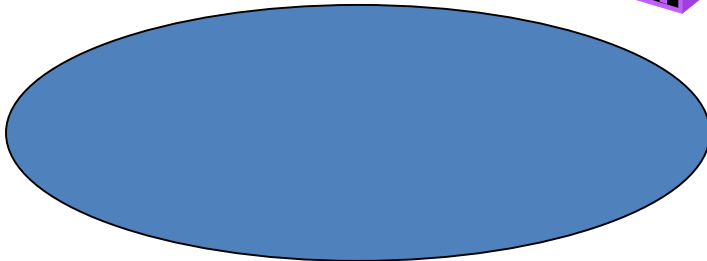
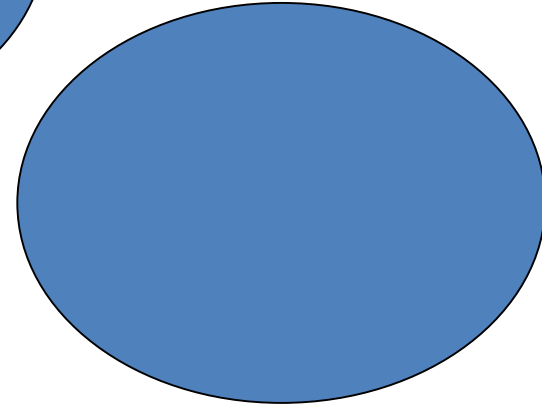
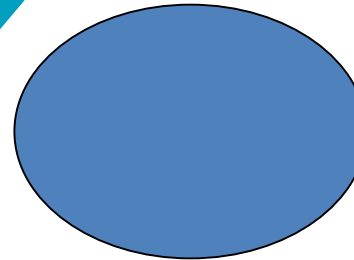
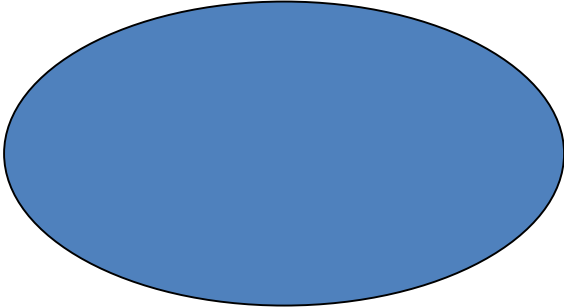
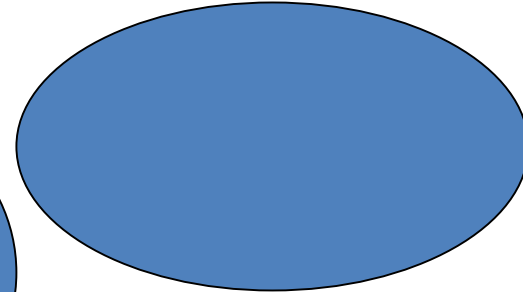
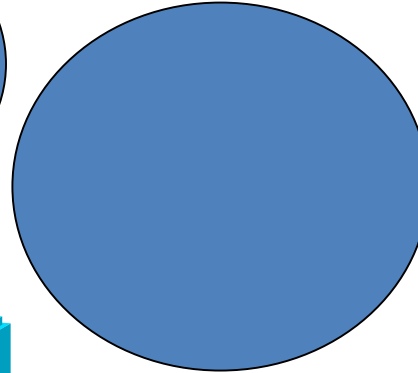
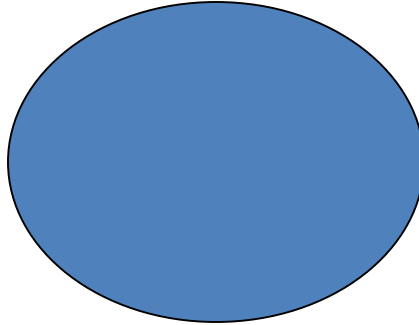
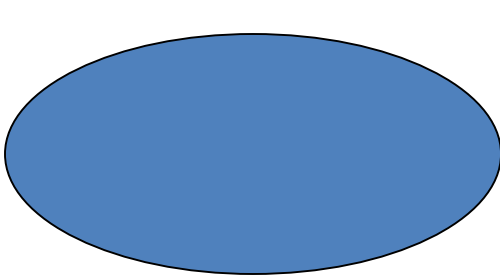
MIND MAP FOR PROPERTY & EQUIPMENT

Existence/Occurrence = E/O

Valuation = V

Completeness = C

Accuracy = A



Cut-off = CO

Presentation and Disclosure = PD

Rights and Obligations = RO

MIND MAP FOR PROPERTY & EQUIPMENT – Suggested questions

Existence/Occurrence = E/O

Valuation = V

Completeness = C

Accuracy = A

Has the purchase been authorised?(E/O)

Are capitalised and/or operating leases accurately recorded?
(C, A, PD, RO, V)

Have all P & E and P & E transactions been accounted for?(C)

Has depreciation been properly computed and recorded? (A, V, C)

Have P & E disposals been properly recorded with related gain/loss?
(C, A, E/O)



Does P & E still provide future benefit to the company? Is the accounting policy for P & E reasonable?
(V, R&O)

Has the asset / P & E transaction been recorded in the proper period at the proper amount? (A, CO)

Is the P & E listing accurate?
(C, E/O, V)

Does the P & E exist and does the entity own those assets?
(E/O, RO)

Are P & E that are pledged or leased to others properly disclosed? (PD)

Have fully depreciated assets been removed from the P & E listing? (PD)

Cut-off = CO

Presentation and Disclosure = PD

Rights and Obligations = RO