

Boston Manufacturing

You are the audit assistant assigned to the audit of Boston Manufacturing. The audit senior has asked you to plan the audit of fixed assets. He has provisionally assessed materiality at £72,000.

Boston Manufacturing maintain a register of fixed assets. The management accountant reconciles a sample of entries to physical assets and vice versa on a three-monthly basis. Authorisation is required for all capital purchases. Items valued less than £10,000 can be authorised by the production manager, item costing more than £10,000 must be authorised by the Managing Director. The purchasing department will not place an order for capital goods unless it has been duly signed.

The company has invested in a large amount of new plant this year in connection with an 8 year project for a government department.

The management accountant has provided you with the following schedule of fixed assets:

	<i>Land and buildings</i> £	<i>Plant and equipment</i> £	<i>Computers</i> £	<i>Motor vehicles</i> £	<i>Total</i> £
<i>Cost</i>					
At 31 March 2003	500,000	75,034	30,207	54,723	659,964
<i>Additions</i>		250,729	1,154		251,883
At 31 March 2004	<u>500,000</u>	<u>325,763</u>	<u>31,361</u>	<u>54,723</u>	<u>911,847</u>
<i>Accumulated depreciation</i>					
At 31 March 2003	128,000	45,354	21,893	25,937	221,184
Charge for the year	<u>8,000</u>	<u>28,340</u>	<u>2,367</u>	<u>13,081</u>	<u>51,788</u>
At 31 March 2004	<u>136,000</u>	<u>73,694</u>	<u>24,260</u>	<u>39,018</u>	<u>272,972</u>
<i>Net realisable value</i>					
At 31 March 2004	<u>364,000</u>	<u>252,069</u>	<u>7,101</u>	<u>15,705</u>	<u>638,875</u>
At 31 March 2003	<u>372,000</u>	<u>29,680</u>	<u>8,314</u>	<u>28,786</u>	<u>438,780</u>

*Of which, £100,000 relates to land.

Required

- (a) Without undertaking any calculations, assess the risk of the tangible fixed assets audit, drawing reasoned conclusions. (6 marks)
- (b) Outline the audit procedures you would undertake on fixed assets in respect of the following assertions:
 - (i) Existence (3 marks)
 - (ii) Valuation (excluding depreciation) (4 marks)
 - (iii) Completeness (3 marks)
- (c) Describe how you would assess the appropriateness of the depreciation rates. (4 marks)

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(a) Risk in the tangible fixed asset audit

Control risk

The controls over fixed assets at Boston Manufacturing appear to be strong. The company maintains and reconciles a fixed asset register and there are authorisation procedures in operation. These controls should be tested, and if they prove effective, control risk could be assessed low.

Inherent risk

The tangible fixed assets are material on the basis of the proposed materiality level. There has been a substantial movement on the plant and equipment account this year, but this appears to be supported by the information given by the management accountant. There appear to be no disposals in the year, which may indicate that they have been omitted, or that obsolete items are included in the register. It is also unclear whether land is being depreciated. It would be inappropriate if it was being depreciated. Overall, the inherent risk seems to be medium.

Detection risk

Given that inherent risk has been assessed as moderate and control risk has been assessed as low, detection risk will be assessed as higher. However, there is usually good evidence in relation to existence and valuation of fixed assets and these are the key assertions which the auditors are interested in. There will also be scope to carry out good analytical procedures, such as proof in total of depreciation.

Conclusion

The audit of fixed assets appears to be medium to low risk.

(b) Audit procedures

(i) Existence

In many cases it is self-evident that land and buildings exist. However, it is important for the auditors to verify all components of land and buildings contained within the balance sheet, if they are on a site different to the one which the auditors are primarily attending, for example. Land and buildings should also be verified to **title deeds** to ensure that they **not only exist, but that they are owned** by the client.

The other classes of asset should be **inspected**. A sample of assets from the **register should be agreed to the physical asset**. There may be scope to rely on the work that the management accountant has undertaken here. The auditor should check a reconciliation which the accountant has undertaken. The auditors should make use of any identification marks on assets recorded in the register, for example, security tags or bar codes which are kept on assets to distinguish them. The auditor should inspect the **condition** of the assets and ensure that they are **in use**.

The motor vehicles should be **reconciled in terms of number of vehicles existing at the opening and closing positions**. Again, to ensure that they not only exist, but are owned by the company, the auditors should check the **registration documents** to ensure that the company is the registered owner.

For all the above assets, the external auditor should also review the insurance provision for the assets. This gives **third party evidence** of the existence of assets as the insurer would not insure a non-existing asset.

(ii) **Valuation (excluding depreciation)**

Land and buildings appear to be stated at historic **cost** as the schedule does not contain the words 'or valuation'. The auditors should **confirm** that this is the case with the management accountant. The cost can then be **agreed to brought forward figures** as there have been no additions in the year. These figures will have been audited in the previous year. If the assets are held at valuation, the auditors must ensure that the requirements of FRS 15 in relation to revaluations are being complied with.

Similarly, as there have been no movements in the year, **motor vehicles** can be agreed to the **opening position**.

To audit the valuation of **plant and computers**, the auditors should **agree the opening position**. They should then **obtain a schedule of additions** to fixed assets, which can be **agreed to purchase invoices** to verify valuation.

Lastly, the auditors should investigate whether the cost figures include any **fully-written down assets**. This is implied by the fact that the depreciation charge on plant excluding additions is low. If so, the auditor should find out whether these assets **are still in use**, and if not, consider whether they **should be excluded** from the cost and accumulated depreciation figures contained within the notes to the accounts. Excluding them would have a net effect on the reported figure of £0.

(iii) **Completeness**

The schedule of fixed assets prepared should be reconciled to:

- The **opening position** (that is, the previous balance sheet)
- The **closing position** (what is disclosed in the financial statements)
- The **underlying records** (the nominal ledger)

If the fixed asset register contains details of the cost and accumulated depreciation of each asset, the **register should also be reconciled to the schedule**. Explanations should be sought for any differences.

The additions of the schedule should also be checked to ensure that the opening and closing positions reconcile within the schedule.

The auditors should also carry out a test on some of the **individual additions**, tracing the transaction through the system, from purchase orders to delivery notes and invoices and through the ledgers to the financial statements to ensure that additions have been included completely.

(c) **Depreciation**

(i) **Appropriateness**

The appropriateness of the rates should be considered and discussed with management. **Relevant factors** to consider are matters such as;

- The **replacement policy** for the asset
- The pattern of **usage** in the business
- The **purpose of the asset** being owned

In this instance, the auditors should establish the rationale behind the depreciation rates applied, particularly in the case of plant. In the case of the plant purchased this year, the depreciation rate applied is 10%. However, the assets have been purchased in relation to an 8 year project, so 12.5% might be a more appropriate rate.

(ii) **Audit procedures**

Depreciation on **buildings** can be verified by agreeing the purchase date of the buildings to last year's file or historic invoices/purchase documents and the valuation applied to the building portion.

For the other classes of asset, depreciation should be agreed for individual assets, as it is not possible to agree them in total. The auditors should obtain a **breakdown of the charges** for the year. They should be able to **recalculate the depreciation** from details in the fixed asset register and compare the results.