



# **BUSINESS FACULTY**

## **DEPARTMENT OF ACCOUNTING**

**An Assessment of Internal Control MechanismsoverFixed  
Asset: The Case of Artistic Printing Enterprise.**

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**JULY 2014**

**ADDIS ABABA**

**AN ASSESSMENT OF INTERNAL CONTROLLING MECHANISM  
OVER FIXED ASSET IN ARTISTIC PRINTING ENTERPRISE**

**A SENIOR ESSAY SUBMITTED  
TO THE DEPARTMENT OF ACCOUNTING  
BUSSINESS FACULTY  
ST. MARY'S UNIVERSITY**

**IN PARTIAL FULFILLMENT OF THE REQUIREMENTS  
FOR THE DEGREE OF BACHELOR OF ARTS  
IN ACCOUNTING**

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**JULY 2014**

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# ACKNOWLEDGEMENT

We wish to express our sincere application to ATO ABDU YMER for his assistance in preparing this manuscript. Special thanks are due to W/T HANNA for her help in locating data source documents. Finally, we would like to thank our families and friends for their moral and financial support.

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# **CHAPTER ONE**

## **1. INTRODUCTION**

### **1.1 Background of the study**

Assessment of Fixed asset is the main topic in this research paper specifically dealing with the internal control aspect. By definition, fixed assets (also called plant assets) are those assets that are long lived, tangible resources acquired for use in operation.

The objectives of internal control over fixed asset are to ensure that fixed assets

- are only acquired with proper authority
  - are properly maintained and used only in the business
  - are properly accounted for and recorded
  - are properly authorized and that proceeds of disposals are accounted for and recorded
- (Millichap, 2001)

Expenditures for acquiring plant assets or for additions to plant assets and expenditures that add to the utility of plant assets for more than one accounting period are called capital expenditures. Capital expenditure should be subject to authorization procedures which in all cases should be evidenced, in appropriate cases. (Eg. New products or production methods), capital investment appraisal techniques should be applied to acquisitions. It may be desirable in such cases for proposed expenditure to be reviewed by a special committee and for board authority to be required. Other capital expenditures, (eg. Replacement of equipment), may be subject to requests on specified forms with a board approval. In yet other cases, (eg. Motor Vehicles), the Board may lay down over all policy and detailed approval may be given by a designated senior official (eg. Transport Manager) subject to review by or reports to the Board, in other cases (eg routine replacement or update of equipment) the expenditure may be subject to budget limits with actual expenditure approved by a senior official after reviewing that the proposed expenditure is within the budget (Millichap: 2001).

All capital expenditures should be monitored by a senior official (eg chief accountant) with approvals; and any excess expenditure investigates and approval sought. Allocation of expenditure

between capital and revenue should be approved. Adequate recording of fixed assets should be made with detailed breakdowns as necessary (Mosich, 1982)

Where registers are maintained, frequent and regular review of the record with actual assets should be made by senior independent officials. Disposals whether by scrapping, sale, or trade in should be subject to authorization procedures. Receipt or /and assessment of reasonableness of proceeds should be monitored by a senior official (eg. Chief accountant)

Arrangement is done to see that fixed assets are properly maintained by regular inspection and reporting of location, operation and condition. This can be combined with the physical verification of the asset registers. Depreciation policy should also be laid down by the Board.

Therefore, any business organization should deal with how to acquire fixed assets, use them in the normal operation of the business and dispose them when the need arises. A strong internal control system over fixed assets should, therefore, be in place to ensure the safeguarding of the overall assets of the organization. Taking this as a background, we have conducted a case study at artistic printing enterprise on the internal control system over fixed assets.

## **1.2 Brief history of the organization**

Artistic printing Enterprise was first established in 1931 by two brothers who were Armenian by birth and Ethiopian by citizenship for the purpose of providing printing services. The enterprise was owned and run by these brothers until it was nationalized by the previous regime (Dergue) in 1975. At that time, enterprise was operating with a capital of birr 1,200,000 and a workforce of 284 employees.

Upon nationalization, the enterprise was put under the administration of the former Ethiopian printing corporation under the ministry of industry.

In 1993, the enterprise was re-established as a public enterprise by the EPDRF led transitional government through the council of ministers regulation No.23/1992 and made to be governed by the public enterprise proclamation No.42/1992.the authorized capita at the time of reestablishment was 2,703,000 which has been fully paid.

The business purposes (objectives) of the enterprise, as stated in the council of ministers regulation No.24/1993, are:

1. To carry on the business of printing, engraving, publishing and printing reproducing, and to engage in any activities related with the business of printing, publishing and reproducing literary works in general including:

- a. Books, booklets, newspapers, periodicals, reviews and magazines of and nature,
- b. Advertising materials such as pamphlets, posters and handbills and
- c. Personal and business stationary such as letterhead paper, bills, note-papers, calling cards, invitation and similar forms catalogues, account, inventory and stock forms, calendars, agenda, blotters, envelopes and similar and related items;

2. To do binding work;

3. To carry on scientific, industrial and technical research and survey to enhance its purposes; and

4. To generally engaged in any other business conducive to the attainment of its purposes.

#### Location, Land and Ownership

The head office and the main printing press is located in Addis Ababa in the former wereda 3, Kebele 53 on 8,459 sqm premises. The enterprise also has property in the former Webele 38 on 1,074 sqm premises which is used as a store. As of January 7, 2007, the enterprise has further acquired from the development bank of Ethiopia a small printing press located on 308sqm plot of land at a prime place in Hawassa town.

#### **Vision**

To become a leading printing and training enterprise in East Africa by 2017,

#### **Mission**

To provide customer based reliable quality printing service and training for East African region customers and contribute our share to the development of the country.

## **Values**

We do for customer satisfaction: - as the organizations existence is based on our customers, we do our best for their satisfaction.

We will go on change track: - inconsistency of customers need and the fast growing and transformation of technology engaged our effort with change.

We give priority for quality:-in every service and production, customers' main focus is quality. So we give priority for quality.

We believe in team work effectiveness: - organizational result comes from team work.by building team spirit we can achieve best result.

We give trustful and confidential service: - the sector we engaged in is printings, which disseminate knowledge and information. By securing our confidentiality we can assure to our customers our trustfulness intellectual property that devoted much knowledge of data.

We give practice oriented training: - we will give 80% practice based training.

We pursue human first principle:-the organization efficiency and improvement results from its employees and management strength and effectiveness. So, our first concern is fulfilling the employees and management team desire.

### **1.3 Statement of the problem**

Upon recording the acquisition cost of fixed assets, there are situations where some cost items like transportation, insurance installation cost, etc, are overlooked or directly charged to an expense account. In such a situation, the balance sheet will show a wrong amount due to the understatement of the fixed asset account. The total expense will also be exaggerated and do no match with the revenue of the accounting period.

In the normal operation of the business, consistency of using the proper depreciation method has a vital importance. It has a direct implication on the profit and loss statement. Failure in applying the right method of depreciation, in a consistent manner, usually results in reporting unrealistic profit or loss amount.

As for disposal of fixed assets is concerned, there should be a company policy that clearly shows the why and how of any disposal of fixed asset. In the absence of his policy, or in any failure of complying with it, if any, there will be a difficulty to safeguard the company's asset.

Therefore, this study assessed the internal control over fixed assets in case of Artistic Printing Enterprise.

#### **1.4 Basic Research Questions**

- Is there a proper segregation of duties that best facilitate the internal control system over fixed assets?
- What does the process of authorization of acquisition transfer, and disposal of fixed asset like? Does it help in ensuring a proper internal control?
- Is there a proper maintenance of record and document with regard to fixed assets?
- How are fixed asset safeguarded? Is there clear accountability for fixed asset?

#### **1.5 Objectives**

##### 1.5.1 General objectives

The general objective of this research is to evaluate the strength and weakness of the internal control system over fixed asset of the enterprise and forward recommendation for better strength of the system.

##### 1.5.2 Specific objective

From the answers we got from the questioners and from the data collected, our objective is to:

- ✓ Evaluation of the acquisition, depreciation, and control of fixed asset, and how they are safeguarded.
- ✓ Examining the proper maintenance of records, book of accounts and fixed asset register book to assure that all acquisition and disposal are fully recorded and accounted for in a proper manner.

- ✓ Ascertaining that the balance sheet reflects the accurate amount of fixed asset and these amounts are in harmony with corresponding fixed asset registers.
- ✓ Evaluation of adherence to the generally accepted accounting principles (GAAP) and company rules and procedures that facilitates the internal control system over fixed assets.

### **1.6 Significance of the study**

Using this study,

- ✓ Policy implementation issues with regard to internal control over fixed assets are properly addressed; amendment to policies and procedures will also be proposed.
- ✓ The case company, Artistic Printing Enterprise, is provided with valuable recommendations on the internal control system over fixed asset.
- ✓ The weakness and strength of the existing internal control system are clearly stated so as to help in taking corrective measures.
- ✓ The Enterprise can use the research report as a tool to achieve its goals and objectives.
- ✓ The research paper can also be used as reference for those who are interested in doing further study on the internal control over fixed asset.

### **1.7 scope & limitation of the study**

The study is conducted, specifically based on the internal control over fixed asset of Artistic Printing Enterprise. The existing practice of the enterprise with regards to accumulation of fixed assets is assessed. The accounting practice with regards to allocation of depreciation expense to proper revenue of the accounting period are reviewed. The research has also dealt with evaluation of the repair and maintenance of fixed assets. The research is based on the financial reports of the five consecutive years (2003/04-2007/08) of the enterprise, and feedback collected from questionnaires distributed.

Due to time and budget constraints, the study looked at the printing enterprise located in Addis Abeba. This limited the depth of the result and had a significant bias on the conclusion that is reached.

## 1.8 Research Design and Methodology

### 1.8.1 Data types and methods of collection

Both relevant primary and secondary data are gathered from the enterprise. For collection of data through interview and questionnaire, sources are identified in a judgmental method.

#### Primary Sources:

- Conducting interview with responsible officials of the enterprise and selected other employees.
- Distributing questionnaires with regards to the existing internal control over fixed asset of the enterprise and analyzing the feed back
- Physical observation of the handling of fixed assets;

#### Secondary Sources:

- Reference books, magazines, research papers, etc, are used to know about what the recent development is all about internal control over fixed assets;
- Reviewing Enterprise policies and procedures for acquisition, making use of, and disposal of fixed assets;
- Reviewing the records being maintained for fixed assets;
- Audit reports are also reviewed.

### 1.8.2 Sampling and its technique

#### Sample size

Even though there are 407 permanent employees, the population's size for this particular research is limited to 118 employees belonging to four relevant departments. They are 31 in the commercial department, 62 in administration department, and 24 in finance and 1 in audit. We believe that a sample size of 12 employees drawn from the aforementioned departments can sufficiently represent the enterprise in responding to the developed internal control questionnaire. They are:

- 5 employees from the finance department, whose function includes disbursement for procurement of fixed assets and accounting for fixed assets,

- 2 employees from the commercial department , whose function includes procurement fixed assets ,
- 4 employees from the Administration department, whose function includes ensuring proper handling of fixed assets and facilitating with the necessary repair and maintenance,
- 1 employee from the one-man department of internal audit , who is responsible for assessment of the overall internal control,

The questions are classified in to four categories so as to distribute them to the right (appropriate) departments. We believe that relevance is important to respond to questions in order to arrive at the right conclusion about the matter under study.

Both male and female respondents, with educational qualification ranging from diploma to 1<sup>st</sup> degree, have participated in responding to the questionnaire. According to us, the participation of the selected four department heads has a significant role in finding the required information about the subject under research.

#### Sampling technique

We used a judgmental method of data collection. In addition, we tried to use both random sampling and non-random sampling technique to decide on to whom to distribute the questionnaires.

#### 1.8.3 Data Analysis

Descriptive and Exploratory analysis methods, on the basis of the financial reports, feedback collected from questionnaires are applied in analyzing the data collected.

### **1.9 organization of the paper**

The paper consists of our chapters. Chapter one presents the introduction, which consists of background of the organization, statement of the problem, objective of the study, methodology, scope and significant of the study. Chapter two presents literature review. Chapter three is for presentation and interpretation of the primary and secondary data and its analysis. Chapter four consists summary, concluding remarks and recommendation.



## **CHAPTER TWO**

### **2. LITERATURE REVIEW**

#### **2.1 Concept of internal control**

As the size of the operations of an entity increases and nature of activities become complex, it becomes difficult for the manager of the entity to control the proration of the entity by his direct and close supervision. Control under his nose is impossible for every activity and even if possible it would be very costly in terms of time and efficiency. The management in such a circumstance is interested to devise a system which in its deficient operation provides desired control-effects. An efficient system of control is established by the management as a matter of convenience and effectiveness. (Kumar & Sharma, 2001)

##### 2.1.1 Objectives of internal control

Internal control comprises all the methods followed by an organization and there by

1. Ensures efficient conduct of the business and prevents wastage.
2. Minimizes occurrence of fraud and error or irregularity, if not completely eliminated.
3. Protects its assets against improper disbursement.
4. Assures the high degree of accuracy and dependability of all the financial and operating information.
5. Judges operating efficiency and highlights weakness.
6. Above all, measures the adherence to established policies of the company.

##### 2.1.2 Internal control

- a) A recent definition which is given by an organization of top federal government auditors from over 100 nations, describes internal control as a management tool used to provide reasonable assurance that management's objectives are being met. (Sawyer & Dittenhofer, 1996)

- b) Internal control system is one where in the accounting work of the employee is complemented and verified by the work of another employee but both employees are working independently and without duplication of each other's work. (Johnson,1944)
- c) According to the American institute of CPAS91948), "Internal control comprises the plan of organization and all of the coordinated methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies". ( Batra &Bagardia, 1992)

### 2.1.3 Types of internal control

An internal control system has a wide coverage that extends beyond those matters which related directly to the function of the accounting system. From this angle, internal control can be classified in to two broad categories: accounting controls and administrative controls.

1. Accounting controls: are controls related to the accounting system.
2. Administrative controls: are controls related to the rules and regulations followed by firms.

## 2.2 Fixed assets

Fixed assets are tangible assets that are used in the operation of a company and have a useful life of more than one year accounting period (Warren, 1990).

Examples are:

- Land used in operations (underlying the plant).
- Buildings, fixtures, furniture, machinery, and equipment used in operations. These are properties having a limited economic life and are subject to depreciation.

### 2.3 Characteristics of fixed assets

- The asset must be *tangible* in nature.
- The asset must be *held for use* and not resale.

- The asset must have an expected life of *more than one year*.

**Note that:**

- *Land held for speculation and undeveloped land* (land not yet put in to service) are long-term investments.
- *Standby equipment's* held for use in case of a breakdown or during peak periods of production is a plant asset because the equipment is used in operation and is not bough for resale. However, when equipment is removed from service and held for sale, it is no longer considered a plant asset. (Philip,1984)

## **2.4 Internal control over fixed assets**

Internal control over fixed assets helps to carry on the business in an orderly and efficient manner, to ensure adherence to management policy and to safeguard its asset and secure the accuracy and reliability of the records. In addition, it helps to ensure that;

- ❖ fixed assets are only acquired with proper authority
- ❖ fixed asset are properly maintained and used only in the business
- ❖ fixed assets are properly accounted for and recorded
- ❖ Disposals are properly authorized and that proceeds of disposals are accounted for and recorded. (Philip, 1984)

## **2.5 Depreciation**

Depreciation is a gradual, permanent and continuing fall in the value of fixed assets due to actual physical exhaustion, consumption or passage of time and obsolescence of an asset in the process of production. In spore of the most careful attention to the maintenance and repair of a fixed asset, a time will come when it will be more profitable to replace it than to incur additional expenditure on its maintenance and repair .A true economic profit can only be calculated after making a provision not only for maintenance of the equipment but also to act as a charge representing a measure of the expired capital outlay. The objective of this charge is to spread the initial cost of the equipment is rendered unprofitable; its cost can be eliminated from the books of accounts. (Kumar & Sharma, 2001)

## Methods of depreciation

A number of different methods have been developed for measuring depreciation, each of which will give a different annual charge to the income statement. There is no one method of depreciation that is superior or to all others in all circumstances. The most appropriate method will depend on the type of asset and the extent to which it is used in each period.

Whichever method is used to calculate depreciation, at least three pieces of data relating to the asset in question are needed:

- 1 the historical cost;
- 2 the length of the asset's expected useful economic life to the business;
- 3 the estimated residual value of the asset at the end of its useful economic life.

The useful life of an asset refers to the period that the business regards as being the most economical length of time to keep the particular asset. This will depend on a number of factors, such as the pattern of repair costs. The useful life of an asset may well be considerably shorter than its total life.

Residual value refers to the estimated proceeds of sale at the end of the asset's useful life to the business. This is usually considered ably more than its scrap value. It should be noted that both the useful life and the residual value have to be estimated when the asset is purchased.

### I. Straight-Line Method

- Equal amount of the depreciation cost is allocated to each period of use.

$$\text{Annual depreciation} = \frac{\text{Depreciable base}}{\text{Estimated useful life in years}}$$

- Another way to describe this calculation is to say that the asset's depreciable cost is multiplied by the *straight-line rate*, which equals one divided by the number of years in the asset's useful life.

$$\text{SL Rate} = \frac{1}{\text{Estimated useful life in years}}$$

$$\text{Annual depreciation} = \text{SL Rate} \times \text{Depreciable cost}$$

- It is appropriate when:

- The asset provides an even amount of service throughout its useful life.
- Time (rather than obsolescence) is the most important factor causing depreciation. This method relates depreciation directly to the passage of time rather than to the asset's use. ( Warren, 1990)

## II. *Units-of-Production (Output) Method*

- This technique involves calculations that are quite similar to the straight-line method, but it allocates the depreciable cost of an asset based on its usage rather than years of use.

$$\frac{\text{Depreciable Cost}}{\text{Units in Useful Life}} = \text{Per-Unit Depreciation}$$

$$\text{Per-Unit Depreciation} \times \text{Units During Year} = \text{Annual Depreciation Expense}$$

- The useful life of some assets, particularly vehicles and equipment, is frequently determined by usage (not with passage of time). So length of life of the asset is expressed in terms of productive capacity such as machine hours, miles driven, or number of units produced.

- This method is appropriate when:

- Usage of a plant asset changes from year to year. The higher the usage of the asset in a period the higher the deterioration (i.e, depreciation expense).
- Total number of units of output (usage) can be reasonably estimated. ( Warren, 1990)

## III. Accelerated Depreciation Methods

- These methods are designed to recognize greater amount of depreciation early in the useful life of plant assets and lesser amounts later. Thus they accelerate the recognition of depreciation.

- The justifications for an accelerated method of depreciation include:

- The expected service for the asset declines with age.
- The asset is high technology asset subject to rapid obsolescence (e.g computers).

- Services are constant (i.e., revenues is constant) but repairs and maintenance costs increase with age of the asset. The related amount of depreciation in later years is therefore offset to some extent by increased maintenance expense. ( Warren, 1990)

Two most widely used accelerated methods are discussed below.

### Declining-Balance Depreciation

- Declining-balance depreciation is found by applying constant depreciation rate to the declining book value of the asset as a result periodic depreciation declines with age. The depreciation rate is some multiple of the straight-line rate for the asset. Companies typically use twice (200%) the straight-line rate, which is called the *double-declining-balance* rate, but rates of 125%, 150%, or 175% of the straight-line rate are also used.
- Note that declining balance ignores residual value in its computation. Declining-balance depreciation is calculated as follows:

$$\frac{1}{\text{Useful Life in Years}} \times \begin{matrix} \text{Multiple} \\ (200\%, 175\%, 150\%, \text{ or } 125\%) \end{matrix} = \begin{matrix} \text{Declining-Balance} \\ \text{Depreciation Rate} \\ \text{(DBD Rate)} \end{matrix}$$

$$\begin{matrix} \text{Declining-Balance} \\ \text{Depreciation Rate} \\ \text{(DBD Rate)} \end{matrix} \times \begin{matrix} \text{Beginning-of-Year} \\ \text{Net Book Value} \end{matrix} = \begin{matrix} \text{Annual Depreciation} \\ \text{Expense} \end{matrix}$$

### Sum-of-the-Years'-Digits Depreciation.

- It is so called because the consecutive digits for each year of an asset's estimated life are added together and used as a denominator of a fraction.
- Under this method, depreciation expense is calculated using the following equation.

$$\frac{\begin{matrix} \text{Years Remaining In the} \\ \text{Asset's Useful Life at the} \\ \text{Beginning of the Year} \end{matrix}}{\text{Sum of the Years' Digits}} \times \text{Depreciable Cost} = \begin{matrix} \text{Annual Depreciation} \\ \text{Expense} \end{matrix}$$

- The equation's denominator (the sum of the years' digits) can be found by adding each integer from one through the number of years in the asset's useful life (1 + 2 + 3...) or by substituting the number of years in the asset's useful life for  $x$  in the following equation.

$$\frac{x(x + 1)}{2} = \text{Sum of the Years' Digits}$$

- In the later life of the asset, no depreciation may be reported if the asset has been reduced already to residual value even though the asset is still producing benefits.

### Factors in the Estimation of Periodic Depreciation

- a) **Cost of the Asset**– Acquisition cost discussed above
- b) **Estimated Residual Value** (salvage value or scrap value)– equals the value, if any that a company expects to receive by selling or exchanging an asset at the end of its useful life. Estimated salvage value should be adjusted for dismantling, and restoring and disposal costs. The residual value is not matched against revenue through depreciation.
- c) **Depreciable Base (Cost)**– it is the amount subject to depreciation.  
*Depreciable cost = Original cost of the asset – Estimated net residual value*
- d) **Useful life–Useful life**– the useful life(service life) of a plant asset refers to the length of time it will be used in the operations of the business. ( Mosich & Larsen,1982 )

### Comparison of Depreciation Methods

The straight line method provides for uniform periodic changes to depreciation expense over the life of the asset. The units-of-production method provides for periodic charges to depreciation expense that may vary considerably, depending up on the amount of usage of the asset. (PHILIP & WARREN, 1984).

Bothe the declining-balance and the sum-of-the-years- digits methods provide for a higher depreciation charge in the first year of use the asset and a gradually declining periodic charge thereafter. For this reason, they are frequently referred to as accelerated depreciation methods. These methods are more appropriate for situation in which the decline in productivity or earning power of the asset is proportionally greater in the early years of its use than in the later years.

### Composite rate Depreciation Method

Another called the composite-rate depreciation method is to determine depreciation for entire groups of assets by use of single rates. The basis for grouping may be similar in life estimates or other

common traits, or it may be broadened to include all assets within a functional class, such as office equipment or factory equipment (Philip & WARREN, 1984).

When depreciation is computed on the basis of composite group of assets of differing life spans, a rate based on averages must be developed. This may be done by; 1) computing the annual depreciation for each asset, 2) determined by the total annual depreciation, and 3) dividing the sum thus determined by the total cost of the asset. (Philip & WARREN, 1984)

## 2.6 Acquisition of fixed Assets

- Operational assets can be acquired through purchase, exchange, etc. The major accounting problem is determining the cost of the asset.
- General approach: Costs of plant assets include all necessary costs incurred to bring it to the condition and location necessary for its intended use.
- Note that unnecessary costs such as; expenditures resulting from carelessness, accidents, errors in installing the asset, vandalism, theft ,etc do not increase the usefulness of the asset and should be expensed. . ( Mosich & Larsen,1982 )

### Application

#### Land:

- If a land is acquired as building site, the entire cost of bringing the land into suitable conditions as a building site are associated to land.
- These include: Purchase price(invoice price), legal costs (title transfer costs), general land preparation costs (eg grading, filling, draining, surveying, clearing) to make the land suitable for the desired use, delinquent (past due) taxes assumed, brokers' commissions, escrow fees, and additional improvements with an *indefinite* life, cost of removing old houses (if land is acquired for redevelopment or use as a building site) or existing structures less any salvage recovered (proceeds from salvaged materials)

#### Buildings:

- All expenditures related **directly** to acquisition or construction is capitalized. This includes attorneys' and architects' fees, building permits, and all costs incurred beginning with excavation and ending with completion of the building.



## Equipment

- All expenditures incurred in acquiring the equipment and preparing it for use are included. This includes freight charges, insurance while in transit, assembly costs, and the cost of conducting trial runs.

## Lump-sum (Group) Acquisition - Special Method of Acquisition

- When a company purchases a group of plant assets at a single *lump sum price*, an allocation of costs must be made to each individual asset.
- The best way to allocate the purchase price of the assets to the individual items is the relative fair market values of the assets acquired. To determine fair market value, an appraisal for insurance purposes, the assessed valuation for property taxes, or simply an independent appraisal by a qualified appraiser might be used.

## **2.7 Disposal of fixed Assets**

- Depreciable assets are disposed of by *retiring, selling, or exchanging* them.
- When a depreciable asset is disposed of, there are three procedures to be performed
  - i) Update accumulated depreciation account – record depreciation up to the date of disposal. Under the matching rule, the accounting period should receive the proper allocation of depreciation expense
  - ii) Remove the PA and its corresponding accumulated depreciation account from the book
  - iii) Record other events if any e.g. cash paid or received, new PA, gains or losses. Any recognized losses or gains associated with the disposition appear in the portion of the income statement named *other income/expense*). (MOICH & LARSEN, 1982)

## Disposal Methods:

### A) Plant Asset disposal through discarding(Retirement):

- This involves abandoning the asset(taken out of service) without receiving anything in return
- A gain never occurs when an asset is retired. If the entire cost of an asset has been depreciated before it is retired, however, there is no loss. But if the asset is not fully depreciated, loss results to the extent of the assets book value.

## B) Plant asset disposal for selling

- The asset is given out and cash is received.
- There are three possibilities: gain /loss/neither of the two: if cash proceed is greater than book value, there is gain; if cash proceed is less than book value, there is loss; if cash proceed is equal to book value, there is neither gain nor loss.

## C) Exchange of fixed assets

Exchange of plant assets for similar plant assets were recorded in a variety of ways for financial accounting purposes. Such transaction frequently were recorded following the income tax requirements; that is ,the asset acquired was recorded at the carrying amount of the asset given in exchange plus any cash paid or less any cash received, and no gain or loss was recognized.

Alternatively ,a gain in exchange was used to record the transaction ,and the asset acquired generally was recorded at the current fair value of the asset exchanged plus any cash paid or less any cash received.

## Fully depreciated assets

When a fully depreciated plant asset with no residual value is retired, and no proceeds are received, the retirement is recorded by a debit to accumulated depreciation and a credit to the plant asset. A fully depreciated plant asset with no residual value is retired without receipt of any proceeds: no gain or no loss is recognized on such retirement (Warren, 1990)

## Partially depreciated assets

- Partial-year depreciation expense calculations are necessary when depreciable assets are purchased, retired, or sold in the middle of an annual accounting period or when the company produces quarterly or monthly financial statements. The units-of-activity method is unaffected by partial-year depreciation calculations because the per-unit depreciation expense is simply multiplied by the number of units actually used during the period in question.
- For all other depreciation methods, however, annual depreciation expense is multiplied by a fraction that has the number of months the asset depreciates as its numerator and twelve as its denominator. Since depreciation expense calculations are estimates to begin with, rounding the time period to the nearest month is acceptable for financial reporting purposes.

When a partially depreciate plant asset is retired and no proceeds are received, a loss is recognized equal to the difference between cost and accumulation depreciation. when fully or partially desparation plant asset is retired or sold with some recovery of residual value, gain or loss is recognized equal to the different between the carrying amount of the asset and the proceed received (Warren, 1990)

#### Idle plant asset

Plant asset some times are retired from active services and neither sold nor abandoned but are kept on a stand by status for use in emergency or to make peak-load requirements. When this occurs, the assets should be discontinued while they remain idle .when the amount of stand by equipment is significant, it should be reported separately in the balance sheet .(MOSICH, 1982).

## CHAPTER THREE

### 3. Data analysis and presentation

Based on the fact the enterprise is engaged in printing business, the majority of the resources allocated for fixed assets refer to machinery.

Ser. No	Items of fixed assets	1996 E.C	1997 E.C	1998E. C	1999E.C	2000 E.C	Total	Proportion (%)
1	Building (including revaluation)	5,900 birr	27,390 birr	0	1,429,873 birr	0	1,463,167 birr	9%
2	Machinery (including revaluation)		4,781,356 birr	20,552 birr	5,747,903 birr	657,272 birr	11,207,083 birr	69%
3	Specialized equipment	8,965 birr	242,952 birr	14,800 birr	511,700 birr	46,536 birr	824,953 birr	5%
4	Furniture equipment and tools	17,110 birr	100,711 birr	71,517 birr	86,458 birr	144,830 birr	420,626 birr	3%
5	Motor vehicles		263365 birr	0	120,494 birr	58,620 birr	442,479 birr	3%
6	Computers and related assets	199,188 birr	388,869 birr	172,369 birr	324,657 birr	155,044 birr	1,240,057 birr	8%
7	Fixed asset in transit	4,313,431 birr	4,313,431 birr	87,273 birr	130,919 birr	228,434 birr	446,626 birr	3%
8	Construction in progress	237 birr	-237 birr	0	144,100 birr	0	144,100 birr	1%
Total		4,544,761 birr	1,490,979 birr	366,511 birr	8,496,104 birr	1,290,736 birr	16,189,091 birr	100%

Table 3.1 .Acquisition of fixed Assets of yearly basis (1996-2000 E.C)

As described above, during the five years under research, total of birr 16,189,091 has been reportedly disbursed for procurement of fixed assets. Of this total procurement, birr 10,695,383 was for machinery. It is 69% of the total. It is followed by building and computers and related, constituting 9% and 8% of the total procurement, respectively. The rest goes to other fixed assets.

Therefore, Machinery is a fixed asset category that is dominantly important in the enterprise. Under this major category we find printing machines, cutting machines, sorting machines, folding machines binding machines etc. all being used in the production department.

### **3.1. Segregation and Rotation of Duties**

Based on the questionnaire collected in this research, we can see the following.

#### **3.1.1 Are duties of various persons relating to fixed assets rotated periodically? Table 3.2**

Respondent: Administration and Audit department's staff				
Respondents			% share	
Yes	No	Total	Yes	NO
4 persons	1 person	5 people	80%	20%

According to 80% of the respondents from Administration and Audit departments, duties of various persons relating to fixed assets is periodically rotating (Ref. Table 3.2). Therefore, irregularities committed by one person can be detected by others when they are rotated periodically.

#### **3.1.2. Is there proper segregations of the following duties relating to fixed asset?**

**Table 3.3**

Respondent: Commercial and Audit department's staff						
1.1	Questions	Respondents			% share	
		yes	No	Total	Yes %	No %
	Authorization of acquisition	3 people	0	3 people	100%	0%
1.2	Execution of transactions relating to acquisitions	3 people	0	3 people	100%	0%
1.3	Recording of transactions upon acquisitions					

		3 people	0	3 people	100%	0%
1.4	Physical custody of items acquired.	3 people	0	3 people	100%	0%

Source:-computed from questionnaire responded

100% of the respondents from the commercial and Audit departments confirmed that there is a well laid down segregation of duties relating to fixed asset. Authorization of acquisitions, execution of transaction, recording of transaction and physical custody of items are properly segregated, so that one cannot get access for abuse of authority, manipulation of records, etc.

### 3.1.3. Is there a proper segregation of the following duties relating to fixed asset?

Table 3.4

Respondent: Commercial and Audit department's staff						
2.1	Questions	Respondents			% share	
		yes	No	Total	Yes %	No %
	Authorization of disposal	2 people	1 person	3	66.67%	33.33%
2.2	Execution of transactions relating to disposal	2 people	1 person	3	66.67%	33.33%
2.3	Recording of transactions upon disposal	2 people	1 person	3	66.67%	33.33%

Source:-computed from questionnaire responded

As to the majority of the respondents (66.67), authorization of disposal is properly segregated from both execution of transaction and recording of transaction (ref. table 3.4)

This means that there is no room to dispose fixed assets that should not be disposed, and transactions related to disposal are executed neither by the authorizing nor by the transaction recording personnel, Providing no loop hole for misappropriation.

**3.1.4 Is there a system of obtaining prior approval of a senior manager in case of transfer of fixed assets, e.g. from one department/unit to another department/unit?**

Table 3.5

Respondent: Administration and Audit staff				
Respondents			% share	
Yes	No	Total	Yes%	No%
3 people	0	3	100%	0%

Source: - computed form questionnaire responded

According to the response to the questionnaire (table 3.5), there is always a prior approval to transfer fixed assets from one department to the other. Therefore, we understood that location of each and every fixed asset is well controlled. If any fixed asset is lost for various reasons, the internal control system helps to identify the right person that should be responsible.

**3.1.5 with regards to adequate controls over disposal of fixed assets?**

Table 3.6

Respondent: Administration and Audit departments staff					
Questions	Respondents			% share	
	Yes	No	Total	yes	No
A Are fixed assets scrapped or re tired from use only on the basis of written authorization of a senior manager?	4 people	1 person	5	80%	20%
B Are limits prescribed on the authority of the specified managers to scrap or retire fixed assets?	4 people	1 person	5	80%	20%

C	Are there proper controls over disposal of fixed assets, particularly with regard to invitation of quotations, approval of prices, etc.?	5 people	0	5	100%	0%
d	Is there a proper documentation of the disposal of fixed assets?	5 people	0	5	100%	0%

According to the above data (table 3.6), fixed assets are scrapped or retired from use only upon approval of a senior manager. Different level managers are also authorized for their respective limits of authority to scrap or retire fixed assets.

However, we interviewed the finance manager and the audit manager on some details of the procedure and discovered that:

- There is a committee for disposal of fixed assets (usually metallic fixed assets), who approves the disposal.
- Upon approval of disposal, these metallic fixed assets are sold to Akaki metal factory. There is a fixed price set by the factory at which it is sold. It is neither negotiated nor sold to other potential buyers.

We have learnt from the above point that sale of these materials is not competitive. So, no one can be sure that there is other better offer in the market other than akaki metal factory, for the materials to be disposed.

### **3.2 Authorizations of acquisition, Transfer and Disposal**

#### **3.2.1 Is there an effective system of capital budgeting with laid down procedures?**

Table 3.7

Respondents: Finance and Audit departments staff						
Ser. No	Questions	No .of respondents			% share	
		yes	No	Total	Yes %	No%



1.1	Proposal for capital expenditure are invited from departments well –in-time?	6 people	0	6	100%	0.00%
1.2	The proposals are received in a properly laid downs format which provides for compete details about the financial, commercial and technical aspects of proposal?	6 people	0	6	100%	0.00%
1.3	Are the proposals for capital expenditure scrutinized by committee consisting of senior managers and then a composite budget put up to the top management or government body for approval?	5 people	1 person	6	83.33 %	16.67 %
1.4	Is the approved budget communicated in writing to various departments and the accounts division?	6 people	0	6	100%	0.00%

Source: - computed from questionnaire responded

According to the above data (table 3.7), and the interview with the finance and audit departments managers, there is a practice of inviting departments for proposal of fixed assets purchase. Departments use a standardized format that provides for complete details about the financial, commercial and technical aspects of the items to be purchased. Based on the proposal of the departments, a committee of senior level managers discuss and develop a list of items that should be purchased on company level and submit to the board of directors for approval. Upon approval of the board of directors, the approved budget is communicated in writing to the various departments including the commercial and finance departments. The concerned departments, then, prepare and submit a formal request for purchase of fixed assets. We have learnt from the above point that the laid down procedures are effective for capital budgeting.

**3.2.2 Is prior written authorization of a manager of a manager at a sufficiently senior level required for incurring capital expenditure for items included in the budget?**

Table 3.8

Respondent: Finance and Audit departments staff				
Responses			% share	
Yes	No	Total	Yes%	No%
5 people	1 person	6	83.33%	16.67%

Source: - computed from questionnaire responded

As indicated in the above table (table 3.8) and from the physical observation we made, there is a prior written authorization of designated manager for incurring capital expenditure. This shows that any purchase of fixed asset is made with the knowledge of the responsible authorizing officials.

**3.2.3 Is there a well laid down procedure for acquisition of items of fixed assets?**

Table 3.9

Respondent: Commercial and Audit departments staff				
Respondents			% share	
Yes	No	Total	Yes%	No%
3 people	0	3	100%	0.00%

Source: - computed from questionnaire responded

As show above (table 3.9), there is a well laid down procedure for acquisition of items of fixed assets. This, in the student researcher’s opinion, helps to facilitate the internal control by clearly stating authorities and associated responsibilities attached to the acquisition process.

**3.2.4 If there is a well laid down procedure, then, does it provide for adequate controls, particularly with regard to invitation of quotations, selection of suppliers, approval of prices, and payment terms and others?**

According to our research’s physical observation to the procurement procedure manual of the enterprise, there is a well laid down procedure for acquisition of fixed assets. The manual shows the details of the

procurement process including invitation of bidders, selection of supplier's approval of prices, the required payment terms, purchase contracts and delivery schedules.

**3.2.5 Are there sufficient safeguards to ensure timely delivery of fixed assets, such as**

**Provisions for penalty in case of delayed deliver yet?**

*Table 3.10*

<u>Respondent: Commercial and audit departments</u>				
<u>Staff</u>				
Respondents			% share	
Yes	No	Total	Yes %	No %
3 people	0	3	100.00%	0.00%

It is confirmed by all the respondents, as shown on table 3.10 that there is a sufficient safeguard to ensure timely delivery of fixed assets purchased. In addition to the above data, the student researchers have further observed that contracts concluded with suppliers indicate that there is a provision of penalty for delays forms the date of delivery.

**3.2.6. When purchases of fixed assets are made on the basis of competitive bids, is there a requirement for documenting the reasons for making purchases otherwise than at the lowest price?**

*Table 3.11*

<u>Respondent: Commercial and audit departments</u>				
<u>Staff</u>				
Respondents			% share	
Yes	No	Total	Yes %	No %
3 people	0	3	100.00%	0.00%

*Source: Computed form questionnaire responded*

According to our observation, it is not always true that bidder with least price is awarded. Where purchases of fixed assets are made on competitive bids, there are items other than price such as delivery

time, degree of compliance to technical specification, etc., that determine the award. In such a situation, therefore, the bid document that is send to each bidder along with the invitation letter clearly states the weight assigned to each evaluating criteria. Finally, when the bid is evaluated, a bidder not only with a least price offer, but also with comprehensively least evaluation can be awarded. This shows that the enterprise pays necessary attention to ensure the right value for money.

### 3.2.7. Are controls over receipt of items of fixed assets effective?

**Table 3.12**

<u>Respondent: Commercial and audit departments</u>				
<u>Staff</u>				
Respondents			% share	
Yes	No	Total	Yes %	No %
3 people	0	3	100.00%	0.00%

*Source: - Computed from questionnaire responded*

100% of the respondents, according to table 3.12 confirmed that there is effective control over receipts of fixed asset. This shows that fixed assets purchased are received in accordance to the required technical specification, and by the agreed upon price.

<u>Respondent: Commercial and audit departments staff</u>						
Questions	Response			% share		
	Yes	No	Total	Yes %	No%	No response
Are the technical specifications of the items received verified with the purchase order?	3 people	0	3	100.00%	0.00%	0
In case any items are rejected, are debit memorandums raised promptly?	3 people	0	3	100.00%	0.00%	0

Source” - Computed form questionnaire responded

**Table 3.13**

According to the above data (table 3.13) technical specifications of items received are verified with each purchase order before accepting them. In doing so, there are situations where the items do not conform to the technical specification and hence rejected. According to the respondents of the questionnaire and the student researcher’s further observation, debit memorandums are sent to each suppliers as soon as the discrepancy is discovered. Therefore, it shows that there is an internal control system that enables the enterprise to follow-up and ensures delivery of required fixed assets.

**3.2.8. Is there a system of obtaining prior approval of a senior manager in case of transfer of fixed assets (e.g. from one department/unit to another department/unit)**

*Table 3.14*

<u>Respondent: Commercial and audit departments Staff</u>				
Respondents			% share	
Yes	No	Total	Yes %	No %
5 people	0	5	100.00%	0.00%

Source:- Computed from questionnaire responded

In the process of transferring fixed assets form one department/unit to other department/unit, the researchers, in addition to the above data (table 3.14) have confirmed through observation, that there is a system of prior approval of designated senior managers.

**3.2.9. With regards to adequate controls over disposal of fixed assets, does the system ensure that all such disposals are recorded in the books of account promptly?**

*Table 3.15*

<u>Respondent: Commercial and audit departments staff</u>				
Respondents			% share	
Yes	No	Total	Yes %	No %
6 people	0	6	100.00%	0.00%

According to the above date (3, 15), all disposals of fixed assets are recorded by general accounts. We have also observed that there is a system where disposal reports are submitted in writing to the finance department including such details as particular items disposed, their identification numbers and the amount at which they are sold (if disposed by selling).

### 3.3. Maintenance of records and documents

#### 3.3.1. Does the enterprise maintain proper records of all fixed assets?

*Table 3.16*

<u>Respondent: Commercial and audit departments</u> <u>Staff</u>				
Respondents			% share	
Yes	No	Total	Yes %	No %
5 people	0	5	100.00%	0.00%

*Source:- Computed from questionnaire responded*

The administration department as a responsible office to maintain general records related to fixed assets has confirmed that proper records are being maintained. In our observation we have also confirmed that each record which was manually maintained is currently in the process of being computerized.

#### 3.3.2 Do the records contain details of such fully depreciated assets also which are in use or are kept for disposal

*Table 3.17*

<u>Respondent: Commercial and audit departments</u> <u>Staff</u>				
Respondents			% share	
Yes	No	Total	Yes %	No %
5 people	0	5	100.00%	0.00%

*Source:- Computed from questionnaire responded*

As shown on the above table (table 3.17), records of fully depreciated assets which are in use or kept for disposal are maintained. We further interviewed the finance manager and it has been disclosed that there are several fixed assets whose expected useful life has lapsed and still in use .In our opinion, this practice of not deleting fully depreciated fixed assets from records until disposal is one of the strength of the internal control. Had the practice been otherwise, the where about of a number of fixed assets could have been unknown.

### 3.3.3 Are the records kept up-to date and reconciled periodically with financial accounts?

**Table 3.18**

<u>Respondent: Commercial and audit departments</u>				
<u>Staff</u>				
Respondents			% share	
Yes	No	Total	Yes %	No %
5 people	0	5	100.00%	0.00%

*Source:- Computed from questionnaire responded*

According to table 3.18, the records are kept up-to-date. They are also reconciled with each record with finance department periodically. The finance department, besides maintaining general ledger accounts for fixed assets, maintains records of individual items of fixed asset. We believe that this facilitates the reconciliation process. The records contain particulars such as date of purchase, supplier’s name, identification number; details of cost, location, estimated life estimated residual value, rate of depreciation and accumulated depreciation till date.

### 3.3.4 Do the records contain specific particulars?

<u>Respondent: Administration and audit Staff</u>							
Ser. No	Question	Respondents				% share	
		Yes	No	No response	Total	Yes%	No%
A	Date of purchase	5 people	0	0	5	100.00%	0.00%
B	Supplier’s name	5 people	0	0	5	100.00%	0.00%
C	Identification number	5 people	0	0	5	100.00%	0.00%
D	Details of cost	5 people	0	0	5	100.00%	0.00%
E	Location	5 people	0	0	5	100.00%	0.00%

F	Estimated life	4 people	1 person	0	5	80.00%	20.00%
G	Estimated residual value	4 people	1 person	0	5	80.00%	20.00%
H	Rate of depreciation and accumulated depreciation till date	5 people	0	0	5	100.00%	0.00%

**Table 3.19**

As shown on table 3.19, above, the majority of the respondents have confirmed that the fixed assets record maintained by the enterprise has contained details of the required information. Therefore, in our view, it helps

- A) To know particular supplier of the item and facilitate further inquiry about the asset
- B) To identify each asset so as to fix responsibility of the users
- C) To know the cost of the item of at which the fixed asset had to be recorded
- D) To know the exact location and control physical existence of the items
- E) To know the minimum value of the items upon retirement of the item

**3.3.5 Are there fixed assets owned by others and used by the enterprise on lease basis?**

**Table 3.20**

<u>Respondent: Commercial and audit departments</u>				
<u>Staff</u>				
Respondents			% share	
Yes	No	Total	Yes %	No %
1 person	4 people	5	20.00%	80.00%

*Source:- Computed from questionnaire responded*

As shown on table 3.20, 80% of the respondents confirming that there are no fixed assets used on lease basis by the enterprise, 20% of the respondents responded otherwise. We believe that there should be no different ideas among the respondents in this case. In further verification, therefore, we have discovered that there is no such expense accounted for as lease expense, in the audited income statement. Therefore, one can conclude that there are no fixed assets acquired on lease basis.



### 3.3.6 Are there fixed assets given by the enterprise to others on lease basis?

**Table 3.21**

Respondent: Commercial and audit departments Staff				
Respondents			% share	
Yes	No	Total	Yes %	No %
1 person	4 people	5	20.00%	80.00%

*Source:- Computed from questionnaire responded*

As shown table 3.21, 80% of the respondents confirmed that there are no fixed assets given by the enterprise to others on lease basis and 20% of the respondents responded otherwise. We believe that there should be no difference of ideas among the respondents in this particular case. It has been discovered that there is no such other income accounted from lease of fixed assets in the audited income statement. Therefore, one can concluded that there are no fixed assets given by the enterprise to others on lease basis. This means that there is a simplified physical control over the fixed assets.

### 3.3.7 Is a register containing particulars of title deeds of buildings maintained?

**Table 3.22**

Respondent: Administration and Audit departments staff						
Respondents				% Share		
Yes	no	No response	Total	Yes%	No %	No response
3 people	1 person	1 person	5	60.00%	20.00%	20.00%

*Source: Computed form questionnaire responded*

According to the above data (table 3.22), It has been confirmed that there is a register that contains particulars of title deeds.

### 3.3.8 Are the title deeds kept in safe custody and verified periodically?

*Table 3.23*

Respondent Administration and audit departments staff						
Response				% share		
Yes	No	No response	Total	Yes %	No %	No
4 people	0	1 person	5	80.00%	0.00%	20.00%

According to table 3.23, above, it has been confirmed that these deeds are kept in safe custody (under lock) by the administration department, and periodic verification is consistently carried out.

### 3.3.9 When deeds are lodged as security against loans, are certificates of lodgment obtained periodically from banks, financial institutions, or other parties with whom the title deeds have been lodged?

*Table 3.24*

Respondent Administration and audit departments staff						
Response				% share		
Yes	No	No response	Total	Yes %	No %	No
3 people	1 person	1 person	5	60.00%	20.00%	20.00%

*Source: Computed of questioner responded*

60% of the respondents (table 3.24) confirmed that the enterprise obtains certificate of lodgment. During interview with the Audit manager we also discovered that there are situation where title deeds are lodged as security for the overdraft facility granted by the commercial Bank of Ethiopia. In such a situation, the enterprise obtains letter from the bank certifying the lodgment.

This shows that there is a strong control over the title deeds implying the strength of internal control over related fixed assets.

### 3.3.10 Are registration books of vehicles maintained properly and verified periodically?

*Table 3.25*

Respondents: Administration and audit staff				
Respondents			% share	
Yes	No	Total	Yes %	No%
5 people	0	5	100.00%	0.00%

*Source: Computed from questionnaire responded*

As shown on table 3.25 and physically observed, this is a properly maintained registration book of vehicles. This registration book as per the interview conducted with each administrator, contains information such as type of vehicle plate number, fuel consumption per kilometer, engine number chassis number additional cost incurred due to repair and maintenance, etc.

### 3.3.11 is there a system whereby each item of fixed asset is given an identification number indicating its location, use etc.

*Table 3.26*

Respondents: Administration and audit staff				
Respondents			% share	
Yes	No	Total	Yes %	No%
5 people	0	5	100.00%	0.00%

*Source: Computed from questionnaire responded*

According to the above table (table 3.26) and we additional observation, it has been confirmed that all fixed assets are given identification number indicating its classification, location, use, etc. This shows that any fixed asset, by its identification number, can easily show its classification (type of fixed asset) its location (the department to which it belongs) etc.

Equally important in this regard is how the identification number is marked on the item.

**3.3.12 is it in such a manner that cannot be removed easily?**

*Table 3.27*

Respondents: Administration and audit staff				
Respondents			% share	
Yes	No	Total	Yes %	No%
5 people	0	5	100.00%	0.00%

*Source: Computed from questionnaire responded*

In addition to the response shown on the above table, we have observed that the identification number is marked on punched metallic material and a fixed on every fixed asset. Therefore, it cannot be easily removed and can last as long as the life of the fixed asset.

**3.3.13 Are there adequate safeguards to protect the items of fixed assets from theft, fire, etc. such as restricting access to items of fixed assets authorized personnel and use of device like locks, burglar alarms, etc.**

*Table 3.28*

Respondents: Administration and audit staff				
Respondents			% share	
Yes	No	Total	Yes %	No%
4 people	1 person	5	80.00%	20.00%

*Source: Computed from questionnaire responded*

For further understanding about the mechanism of safeguarding fixed assets, in addition to the response on the above table, we physically observed that access has been restricted on assigned workers only, to the machines in the production department. There are also fire extinguishers located at every room where the machines are located.

This shows that is a mechanism established by the enterprise on avoid or at least minimize the risk of theft or fire accident

### 3.3.14 Are the items of fixed asset properly insured?

*Table 3.29*

Respondent Administration and audit departments staff						
Response				% share		
Yes	No	No response	Total	Yes %	No %	No
3 people	1 person	1 person	5	60.00%	20.00%	20.00%

*Source: Computed from questionnaire responded*

According to the above table (table 3.29), the majority of the respondents (60%) have confirmed that items of fixed asset are properly insured. This also shows that the insurance policy is another means of minimizing risk

### 3.3.15 Are fixed assets verified periodically on the basis of a well laid down written procedure?

*Table 3.30*

Respondents: Administration and audit staff				
Respondents			% share	
Yes	No	Total	Yes %	No%
5 people	0	5	100.00%	0.00%

*Source: Computed from questionnaire responded*

According to the policy of the enterprise, physical existence of fixed assets is verified by annual inventory usually conducted following the close of fiscal year. We fortunately could observe how the inventory of fixed asset was attended by the inventory committee. During the inventory employees of the enterprise were showing the existence of the fixed assets undertaker custody. The administration head, told us that missing items will be identified and the necessary action will be taken by the senior level management

In our opinion therefore there is a periodic verification system that internal control over fixed assets.

### 3.3.16 Does the verification procedure extends to fixed assets with third parties?

**Table 3.31**

Respondent Administration and audit departments staff						
Response				% share		
Yes	No	No response	Total	Yes %	No %	No
3 people	1person	1person	5	60.00%	20.00%	20.00%

*Source: Computed from questionnaire responded*

As indicated on the above table, 60% of the respondents confirmed the extension of the verification procedure to fixed assets with third parties. However, this confirmation contradicts with our previous conclusion that there are no fixed assets given to others on lease basis. Therefore, we could not come across how the verification process takes place. Confirmation letters certifying the fixed assets of the enterprise, for specific reasons, are under the third party’s custody so it was not available to us as a source document for the verification. The only confirmation letter obtained by the enterprise, in this regard, is certificate of lodgment of title deeds issued by the commercial bank of Ethiopia, as security to the overdraft facility. Other confirmation letters could not be made available to us.

This shows, therefore, that the response to the question does not represent the real situation

### 3.3.17 is there a system of identifying and reporting damaged, obsolete and idle fixed assets?

**Table 3.32**

Respondents: Administration and audit staff				
Respondents			% share	
Yes	No	Total	Yes %	No%
3 people	2 person	5	80.00%	20.00%

*Source: Computed from questionnaire responded*

80% of the respondents as per the above table confirmed that damaged, obsolete and idle fixed assets are reported to the administration manager who is responsible for property control and general service. This is an indication for a well-established follow-up and control over the fixed assets

### 3.3.18 is depreciation of fixed asset calculated and accounted for?

*Table 3.33*

Respondents: Administration and audit staff				
Respondents			% share	
Yes	No	Total	Yes %	No%
5 people	0	5	100.00%	0%

*Source: Computed from questionnaire responded*

According to table 3.33 above, depreciation of fixed assets is consistently accounted for by the finance department

### 3.3.19 is the method of depreciation chosen used in a consistent manner?

*Table 3.34*

Respondents: Administration and audit staff				
Respondents			% share	
Yes	No	Total	Yes %	No%
6 people	0	6	100.00%	0.00%

*Source: Computed from questionnaire responded*

Besides the 100% response confirming that depreciation method chosen is used in a consistent manner (table 3.34), the policy of the enterprise, with regard on depreciation indicates that depreciation of fixed assets has to be accounted for, and the rate of depreciation is based on the business income tax proclamation no 286/2002, article 23. According to this article,

- Buildings are depreciating individually on a straight line basis at 5%
- Computers, Information systems, software products and data storage equipment are depreciating according to a pooling system at 25%
- All other fixed assets are depreciating according to a pooling system at 20%

This means, the estimated useful life is 20 years for building, 4 years for computers and other equipment, and 5 years for other fixed assets. The enterprise has managed to record depreciation accordingly and consistently.

**3.3.20 is there a proper follow-up on discrepancies between the book records and the results of physical verification?**

*Table 3.35*

Respondents: Administration and audit staff				
Respondents			% share	
Yes	No	Total	Yes %	No%
6 people	0	6	100.00%	0.00%

*Source: Computed from questionnaire responded*

There is a proper follow-up on discrepancies between the book records and the results of physical verification (Table 3.35). In our opinion, this helps to properly account for items missed for various reasons

**3.3.21 Are these discrepancies investigated and responsibilities fixed?**

*Table 3.36*

Respondents: Administration and audit staff				
Respondents			% share	
Yes	No	Total	Yes %	No%
6 people	0	6	100.00%	0.00%

*Source: Computed from questionnaire responded*

As shown in the above table (table 3.36) and according to the interview with each finance manager, all such discrepancies are well investigated.

Therefore, this shows that the internal control system is so strong that every employee has developed a high level sense of responsibility in handling fixed asset under his/her custody.



**3.3.22 Are fixed asset records and financial accounts adjusted, with proper approval of a senior manager, to take recognize of the discrepancies noticed on physical verification?**

*Table 3.37*

Respondents: Administration and audit staff				
Respondents			% share	
Yes	No	Total	Yes %	No%
6 people	0	6	100.00%	0.00%

*Source: Computed from questionnaire responded*

According to the table 3.37 above, fixed asset records and finance accounts are adjusted periodically. In situations where there is a discrepancy, the finance manager told us that the discrepancy is investigated and the result will be reported to the senior level management. Based on the management’s decision, the necessary adjustment is made to the financial accounts.

## **CHAPTER FOUR**

### **4. SUMMARY, CONCLUSION AND RECOMMENDATION**

#### **4.1 Summary**

This research has been conducted with a particular focus on an assessment of internal controlling mechanism over fixed assets, the case of Artistic Printing Enterprise (APE).

As fixed assets in production industries like APE, are of vital importance, the internal control system has been assessed. Special attention has been paid to the processes of acquisition, use and disposal of fixed assets.

In these research, we have learnt that Artistic printing enterprise which was founded by two Armenian brothers by birth, but Ethiopian nationals, in 1931 is a printing enterprise that has been printing colorful materials using cliché-graphic method and installed modern color separation scanner machine before the introduction of modern printing and scanning machines in the country.

As far as the acquisition process of fixed assets is concerned, we have confirmed that there is a proper segregation of duty with regard to authorization of acquisition. There is also effective system of capital budgeting.

With regard to disposal of fixed assets, there is a committee, assigned by the management, for disposal of assets who proposes disposal. The disposal proposal however is limited to sale of metallic fixed assets to single buyer (Akaki Metal Factory).

During our observation, we have learnt that the general accounts division maintains general ledger accounts along with individual records for each fixed asset item containing details such as date of purchase, suppliers name, property identification number, details of cost location, estimated life, estimated residual value, rate of depreciation and accumulated depreciation to date.

We have also discovered that title deeds are properly registered and kept under lock by administration department. In situation where these deeds are lodged as security against overdraft facility being granted by the commercial bank of Ethiopia, the enterprise usually obtains certificate of lodgment.

As far as depreciation is concerned, the rate of depreciation is based on the business income tax proclamation no.286/2002, article 23. This article in effect limits the useful life for building equipment

and other fixed assets to 20, 4 and 5 years respectively. The recording is consistently based on straight line method.

With regard to accountability and safeguarding of fixed assets, there is a system whereby each item of fixed asset is given an identification number indicating its location and id number is marked on the item in a way that it cannot be removed easily. Therefore, physical control over the assets is well facilitated.

There is adequate safeguard to protect the items of fixed assets from theft, fire, etc., by restricting access to the items and use of fire extinguishers .besides, there is sufficient instance coverage.

Fixed assets are periodically verified on the base of well laid down written procedure of annual inventory .A system of identifying and reporting damage ,obsolete and idle fixed assets is well established .There is also adequate follow-up on such fixed assets.

## **4.2 Conclusion**

According to the assessment made under this research, the internal control system of Artistic printing Enterprise (APE) is a well-organized one. The enterprise, in the process of achieving ISO 9001-2000 quality management certificate, has made a remarkable effort in introducing integrated performance management system (IPMS), and this has brought transparency and accountability in the overall working process.

With regard to recording of acquisition, depreciation, and disposal of fixed assets, there is conformity to the generally accepted accounting principles (GAAP). The periodic review of the existence of fixed assets in their annual inventory is also checked against accounting records, aiming at detection of discrepancies between physical existence and book balance. Based on the discovered discrepancy and upon approval of the senior manager, proper adjustments are recorded by the accounts division.

### **4.3 Recommendation**

We recommend the enterprise to keep on maintaining the existing strong internal control system over fixed assets and further consider the following:

- With regard to disposal of metallic fixed assets, all potential buyers of disposed materials should be invited to offer quotation. The enterprise will be benefited by ensuring sufficient competition among prospective buyers.

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## DECLARATION

We, The Undersigned, Declare that this senior essay/project our original work, prepared under the guidance of Ato Abdu Ymer. All source of materials used for the manuscript have been dully acknowledged.

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PLACE OF SUBMISSION St. Mary's University

DATE OF SUBMISSION JULY, 2014

**Questionnaire Related To Internal Control System over Fixed Assets (To the Administration Department)**

Segregation and rotation of duties

1. Are duties of various persons relating to fixed assets rotated periodically?

Yes  No

Authorization of acquisition transfer and disposal

2. Is there a system of obtaining prior approval of a senior manager in case of transfer of fixed assets (e.g. from one department/unit to another department/unit)?

Yes  No

3. With regards to adequate controls over disposal of fixed assets,

- a. Are fixed assets scrapped or retired from use only on the basis of written authorization of a senior manager?

Yes  No

- b. Are limits prescribed on the authority of the specified managers to scrap or retire fixed assets?

Yes  No

- c. Are there proper control over disposal of fixed assets, particularly with regard to invitation of quotations, approval of prices, etc...?

Yes  No

- d. Is there a proper documentation of the disposal of fixed assets?

Yes  No

Maintenance of records and documents

4. Do the entries maintain proper records of all fixed assets?

Yes  No

5. Do the records contain details of such fully depreciated assets also which are in use or are kept for disposal?



Yes  No

6. Are the records kept up-to-date and reconciled periodically with financial accounts?

Yes  No

7. Do the records contain such particulars as:

Date of purchase Yes  No

Supplier's name Yes  No

Identification number Yes  No

Details of cost yes  No

Location Yes  No

Estimated life Yes  No

Estimated residual value Yes  No

Rate of depreciation and Yes  No

Accumulated depreciation till date? Yes  No

8. Are there fixed assets owned by others and used by the enterprise on lease basis?

Yes  No

9. If your answer for question no. 8 is yes is there a proper record maintained in respect of those leased items?

Yes  No

10. Are there fixed assets given by the enterprise to others on lease basis?

Yes  No

11. If your answer for question no.10 is yes is there a proper record maintained in respect;of those items?

Yes  No

12. Is a register containing particulars of title deeds of buildings maintained?

Yes  No

13. Are the title deeds kept in safe custody?

Yes  No

14. Are these deeds periodically verified?

Yes  No

15. Are registration books of vehicles maintained properly and verified periodically?

Yes  No

16. Is there a system where by each item of fixed asset is given an identification number indication its location, use, etc?

If the answer for the question no. 17 is yes

Is the identification number marked on the item in such a manner that it can not be removed easily?

Yes  No

17. Are there adequate safeguards to protect there items of fixed assets from theft, fire etc. such as restricting access to items of fixed assets authorized personnel and use of device like locks, burglar alarms, etc.?

Yes  No

18. Are the items of fixed assets properly insured?

Yes  No

**Questionnaire Related To Internal Control System over Fixed Assets (For**

**The Finance Department)**

Authorization of acquisition, transfer and disposal

1.1 Are proposal for capital expenditure invited form various departments of the enterprise well-in time?

Yes  No

1.2 Are the proposals received in a properly laid down format which provides for complete details about the financial, commercial and technical aspects of a proposal?

Yes  No

1.3 Are the proposals for capital expenditure scrutinized by a committee consisting of senior managers and then a composite budget put up to the top management or government body for approval?

Yes  No

1.4 Is the approved budget communicated in writing to various departments including the purchase department and the accounts division?

Yes  No

2. Is prior written authorization of a manager at a sufficiently senior level required for incurring capital expenditure for items included in the budget?

Accountability for and safeguarding of fixed assets

Yes  No

3. Is depreciation of fixed assets calculated and accounted for?

Yes  No

4. If your answer for question no. 3 is yes, do you use the method of depreciation chosen in a consistent manner?

Yes  No

5. Is there a proper follow-up on discrepancies between the book records and the results of physical verification?

Yes  No

6. Are these discrepancies investigated and responsibilities fixed?

Yes  No

7. Are fixed asset records and financial accounts adjusted, with proper approval of a senior manager, to take cognizance of the discrepancies noticed on physical verification?

Yes  No

**Questionnaire Related To Internal Control System over Fixed Assets (To the Commercial Department)**

Segregation and rotation of duties

1. Is there proper segregation of the following duties relation to fixed asset?

Authorization of acquisition

Yes  No

Execution of transactions relating to acquisitions

Yes  No

Physical custody of items acquired

Yes  No

2. Is there a proper segregation of the following deities relating to fixed asset?

Authorization of disposal

Yes  No

Execution of transactions relating to disposal

Yes  No

Recording of transactions upon disposal

Yes  No

3. Is there a well laid down procedure for acquisition of items of fixed assets?

Yes  No

If your answer for question 3 is yes, does the procedure provide for adequate continues particularly with regard to:

Invitation of quotations?

Yes  No

Selection of suppliers?

Yes  No

Approval of prices?

Yes  No

Payment terms and other terms of the purchase contract including technical specification and delivery schedule?

Yes  No

4. Is there a well laid down procedure for acquisition of items of fixed assets?

Yes  No

If your answer for question 3 is yes, does the procedure provide for adequate continues particularly with regard to:

Invitation of quotations?

Yes  No

Selection of suppliers?

Yes  No

Approval of prices?

Yes  No

Payment terms and other terms of the purchase contract including technical specification and delivery schedule?

Yes  No

5. Are there sufficient safeguards to ensure timely delivery of fixed assets, such as provisions for penalty in case of delayed delivery, etc?

Yes  No

6. Where purchases of fixed assets are made on the basis of competitive bids, is there a requirement for documenting the reasons for making purchases other wise than at the lowest price?

Yes  No

7. Are controls over receipt of items of fixed assets effective?

If your answer is yes for question no.6

Are the technical specifications of the items received verified with the purchase order before accepting them?

Yes  No

In case any items are rejected, are debit memorandums raised promptly?

Yes  No

8. With regards to adequate controls over disposal of fixed assets, does the system ensure that all such disposals are recorded in the books of account promptly?

Yes  No

**Questionnaire Related To Internal Control System over Fixed Assets Presented To Audit Department**

**A. Segregation and rotation of duties**

1. Is there a proper segregation of the following duties relating to fixed asset?

Authorization of acquisition

Yes  No

Execution of transactions relating to acquisitions

Yes  No

Recording of transactions upon acquisition

Yes  No

Physical custody of items acquired.

Yes  No

2. Is there a proper segregation of the following duties relating to fixed asset?

Authorization of disposal

Yes  No

Execution of transactions relating to disposal

Yes  No

Recording of transactions upon disposal

Yes  No

3. Are duties of various persons relating to fixed assets rotated periodically?

Yes  No

**B. Authorization of acquisition transfer and disposal**

1. With regards to the following is there an effective system of capital budgeting with well laid down procedures?

Yes  No

2. Is prior written authorization of a manger at a sufficiently senior lever required for incurring capital expenditure for items included in the budget?

Yes  No

3. Is there a well laid down procedure for acquisition of items of fixed assets?

Yes  No

4. If your answer for question no.3 is yes, does the procedure provide for adequate controls, particularly with regard to?

Invitation of questions?

Yes  No

Selection of suppliers?

Yes  No

Approval of prices?

Yes  No

5. Payment terms and other terms of the purchase contract including technical specification and delivery schedule?

Yes  No

6. Are there sufficient safeguards to ensure timely delivery of fixed assets, such as provisions for penalty in case of delayed delivery etc?

Yes  No

7. we purchases of fixed assets are made on the basis of competitive bids is there a requirement for documenting the reasons for making purchases other than at the lowest price?

Yes  No

8. Are controls over receipt of items of fixed assets effective?

Yes  No

If your answer is yes for question no. 6.

Are the technical specification of the items received verified with the purchase order before accepting them?

9. Is there a system of obtaining prior approval of a senior manger in case of transfer of fixed assets (e.g. from one department/unit to another department/unit)?

Yes  No

10. With regards to adequate controls over disposal of fixed assets

- Are fixed assets scrapped or retired from use only on the basis of written authorization of a senior manager?

Yes  No

- Are limits prescribed on the authority of the specified mangers to scrap or retire fixed assets?

Yes  No

- Are there proper controls over disposal of fixed assets, particularly with regard to invitation of quotations, approval of prices, etc...?

Yes  No

- Is there a proper documentation of the disposal of fixed assets?

Yes  No

- Does the system ensure that all such disposals are recorded in the books of account promptly?

Yes  No

### **C. Maintenance of records and documents**

2. Does the enterprise maintain proper records of all fixed assets?

Yes  No

3. Do the records contain details of such fully depreciated assets also which are in use or are kept for deposal?

Yes  No

4. Are the records kept up-to-date and reconciled periodically with financial accounts?

Yes  No



5. Do the records contain such particulars as:

- Date of purchase Yes  No
- Supplier's name Yes  No
- Identification number Yes  No
- Details of cost Yes  No
- Location Yes  No
- Estimated life Yes  No
- Estimated residual value Yes  No
- Rate of depreciation and Yes  No
- Accumulated depreciation till date? Yes  No

5. Are there fixed assets owned by others and used by the enterprise on lease basis?

Yes  No

6. If your answer for question no.5 is yes, is there a proper record maintained in respect of those leased items?

Yes  No

7. Are there fixed assets given by the enterprise to others on lease basis?

Yes  No

8. If your answer for question no. 7 is yes, is there a proper record maintained in respect of those items?

Yes  No

9. Is a register containing particulars of title deeds of building maintained?

Yes  No

10. Are the title deeds kept in safe custody?

Yes  No

11. Are these deeds periodically verified?

Yes  No

12. Where such deeds have been lodged as security against loans, are certificates of lodgment obtained periodically from banks, financial institutions, or other parties with whom the title deeds have been lodged?

Yes  No

13. Are registration books of vehicles maintained properly and verified periodically?

Yes  No

**D. Accountable for and safeguarding of fixed assets**

1. Is there a system where by each item of fixed asset is given an identification number indicating its location, use etc?

Yes  No

If the answer for the above is yes,

Is the identification number marked on the item in such a manner that it can not be removed easily?

Yes  No

2. Are there adequate safeguards to protect the items of fixed assets from theft, fire, etc...,

Yes  No

3. Are the items of fixed assets properly insured?

Yes  No

4. Are fixed assets verified periodically on the basis of a well laid down written procedure?

Yes  No

5. Does the verification procedure extend to fixed assets with third parties?

Yes  No

6. Is depreciation of fixed asset calculated and accounted for?

Yes  No

7. If your answer for question no. 6 is yes, do you use the method of depreciation chosen in a consistent manner?

Yes  No

8. Is there proper follow-up on discrepancies between the book records and the results of physical verification?

Yes  No

9. Are these discrepancies investigated and responsibilities fixed?

Yes  No

10. Are fixed asset records and financial accounts adjusted, with proper approval of a senior manger, to take cognizance of the discrepancies noticed on physical verification?

Yes  No

11. Is there a system of identifying and reporting damaged, obsolete and idle fixed assets?

Yes  No

12. Is there an adequate follow-up on such fixed asset?

Yes  No