Chapter 10

Accounting for Fixed Assets

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Introduction
Financial statements disclose certain information relating to fixed assets. In many enterprises, these assets are grouped into various categories, such as land, buildings, plant and machinery, vehicles, furniture and fittings, goodwill, patents, trademarks, and designs. Fixed Assets are those assets of a business that are of material value, like other assets with relatively permanent life acquired by the enterprise for use in the production or supply of goods or instructed to be used continuously or for administrative purposes and may include items held for the resale or conversion into cash in the ordinary source of business. A fixed asset, also known as long-lived assets or property, plant and equipment, is a term used in accounting for assets and property that may not easily be converted into cash. Fixed assets are different from current assets, such as cash or bank accounts, because the latter are liquid assets. However, there are other long-lived assets that we cannot see such as those are classified as tangible assets. They are Goodwill, trademark. Be it tangible or intangible all fixed assets represent a bundle of future services which are paid for in advance and used subsequently in the process of generating revenue.

Definition of Terms
Assets: These may be defined as anything owned by a business or by an individual that has a commercial or exchange value. They are classified according to their nature and are of various kinds.
Fixed Assets or Non-Current Assets: William Pickles refers to fixed assets as those assets of a business that are permanent and are held to earn revenue and not with a view to resale e.g. plant and machinery, buildings, furniture, and fittings, etc. It could still be sub-divided into tangible and intangible
Current Assets: Pickles also refers to this as "Those assets which are made or acquired and merely held for a short period of item to sell at a profit in the ordinary course of business" That is to say, they are easily converted into cash.
Cash: According to international accounting standard No. 16, the cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to working condition for its intended use.
Depreciation: Expiration in the service life of fixed assets. Other than wasting assets, attributable to wear and tear through use and lapse of time, obsolescence, inadequacy, or other physical or functional cause, the proportion of the cost of fixed assets other than a wasting asset charged as an expense during a particular period.
Goodwill: This represents the original cost of the assets.
Historical Cost: This is the usual basis for valuing assets it is measured by the cash or cash equivalent place of containing the asset and bring to the location and condition necessary for it.

New Value or Netbook Value: This is the gross value of the asset less the accumulated depreciation to date. It is the written down value.
Obsolescence: The process of becoming obsolete or out of date and use.
Residual Valve: Residual value is the realizable value of the asset at the end of its economic life.

How Do You Calculate Fixed Assets?
Determining the actual value of fixed assets can be achieved by calculating the net fixed assets. This is a metric that takes the purchase price of the fixed assets (as well as any improvements) and deducts the accumulated depreciation to obtain the true value. Below is a formula for determining net fixed assets:
Formula A: *Gross fixed assets — accumulated depreciation = net fixed assets*
To determine how much of the net assets the client owns, consider an alternative formula that eliminates the fixed asset liabilities (debts and financial obligations the company owes on those assets).
Formula B: *(Total fixed asset purchase price + improvements to the assets) — (accumulated depreciation + fixed asset liabilities) = net fixed assets.*

Advantages:
Generates Revenue: Fixed assets such as factory buildings, equipment, and vehicles can be used to generate income. Businesses use these assets to produce goods or render services that can be sold to generate revenue.
Collateral for loans: Fixed assets can be used as security for loans to help secure funds for expansion or fulfillment of other business needs.
Ease of Decision Making: These assets provide a clear picture of the business's long-term investments and ability to generate income from them, making it easier for future decisions.
Company insights: By analyzing a company's fixed assets, investors and stakeholders can gain insights into the company's financial health and prospects.
Disadvantages:
Value depreciation: Fixed assets depreciate over time owing to their age, usage, obsoleteness, etc. These assets also require repairs and replacements to keep up the production of goods or render services. So, the business needs to maintain updates on them for their disposal, reselling, or purchase.
Large investments: Fixed assets such as property, plant, machinery, or equipment are not cheap. They require large capital investments for businesses to generate profits. The key is ensuring that the long-term return on investment outweighs the initial cost.

What Is The Lifecycle Of Fixed Assets?
The fixed asset lifecycle is a series of stages that starts with the client acquiring an asset and ends when they dispose of that asset. The lifecycle includes four key stages:
Acquisition: This is the first stage of the lifecycle. Purchasing a fixed asset, like new machinery, is a common way to obtain a fixed asset. However, some clients may use internal workers to build their assets. In this case, take into consideration how much of the workers' salary to include in the cost of the asset.
Depreciation: During the second stage, the value of fixed assets, like machinery and office equipment, declines as they are used and age (except for land). This means fixed assets can be depreciated. An asset's useful life, the salvage value, and depreciation method (i.e.,

straight-line, declining balance, units of production, or sum-of-the-years' digits) are factors to consider when calculating depreciation.

Maintenance and repairs: After some time of use, most fixed assets will need repairs and maintenance. Consider whether to capitalize or expense the work, especially if it is extensive and boosts the asset's value.
Disposal: This is the final stage. In this stage, fixed assets are often converted into cash. There are, however, several ways a client can dispose of a fixed asset. They could sell, donate, or, perhaps, replace it with a similar, newer asset.

How do you determine the turnover ratio?
The formula for determining the fixed assets turnover ratio is as follows:
Net annual sales ÷ (Gross fixed assets - Accumulated depreciation) = Fixed asset turnover ratio
What is a good turnover ratio?
On average, most businesses have a turnover rate between 5 and 10. A higher turnover rate means greater success in its ability to manage fixed-asset investments. There is no specific ratio or range that defines a "good" turnover ratio. Instead, companies' turnover ratios are very industry-specific and other factors must be considered.

Depreciation of Fixed Assets
The depreciation process reflects this decrease in value on the financial statements. The method of depreciation chosen depends on the accounting standard being followed, i.e. GAAP or IFRS. Depreciation methods include:

Straight-Line Depreciation: This method evenly distributes the asset's cost over its useful life. It's straightforward and widely used.

Declining Balance Depreciation: In this method, depreciation is higher in the asset's earlier years and decreases over time.

Units of Production Depreciation: Used for assets whose usage varies, this method calculates depreciation based on the asset's actual usage.

Key Characteristics of a Fixed Asset:
Long-term: Fixed assets are intended to be used for more than one year.
Tangible: Fixed assets are physical assets that can be seen and touched.
Income-generating: Fixed assets generate income for a company through operations such as production or rental.
Depreciable: The cost of fixed assets is allocated over their useful life through the depreciation process.

Conclusion
Companies must carefully select the valuation methods and depreciation policies that best align with their business objectives and industry standards. By effectively managing fixed assets, organizations can optimize their financial performance, comply with accounting standards, and ensure tax efficiency. Fixed asset accounting enables businesses to effectively manage tangible assets, maintain financial transparency, and make well-

informed decisions. By following best practices, embracing technology, and addressing challenges proactively, organizations can streamline their fixed asset accounting processes, unravel complexity, and enrich their financial narrative with bursts of diverse insights.

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