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# STUDY CONCERNING EVALUATION AND AUDIT OF TANGIBLE ASSETS

Case  
Study

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*Tangible assets,  
Evaluation,  
Revaluation,  
Audit*

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## JEL Classification

M40, M41, M42

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## Abstract

*Accounting, in order to be able to deal with the requirements and changes in the economical-social environment, with the meaning of providing useful and actual information to the different kinds of users, has developed different techniques and methods. Among these, evaluation is to be taken into account, which has the purpose of giving the real value of tangible assets, but also audit, having the purpose of certifying the provided information through financial reports. Within the entities, tangible assets have a significant value, and an inadequate evaluation of these assets has a powerful impact upon the provided information, inferentially upon the decisions of different users. Therefore, through the identification and evaluation of objectives and relevant risks, in the process of tangible assets' audit, emphasizing the inputs and outputs of the assets, more value is given to the entity, the efficiency of the management, control and presentation processes is improved, respectively decisions will be made based on a solidly grounded base.*

## INTRODUCTION

The economic and social reality of nowadays point out the necessity of real, pertinent and certified information, no matter the domain we refer to. In the economic environment, real information is obtained through an appropriate evaluation, respectively revaluation. Therefore the evaluation is defined as being a form of quantification through which the method of accounting determines the increasing of the wealth items in a natural expression and expresses this increase through the monetary standard. In this way through evaluation all asset items, all debt, and equity are homogenized, are expressed through the same standard and may be centralized. (Todea, 2009). Based on the information resulted from the evaluation process, financial reports are made.

The certification of the provided economical-financial information is made through audit, which has appeared as a result of a need at the level of society, for offering insurance upon the fact that the information provided by financial reports reflects the reality, respectively that they are made according to the financial reporting framework specific to the audited entity.

Also, generally, the audit is a systematic process of obtaining an objective evaluation of the information or financial reporting, for evaluating the degree of conformity to predetermined criteria and communicating the results to the interested users. An audit consists in verifying and certifying the financial reports by an independent expert, for providing an opinion concerning the facts and accuracy of the data that these financial reports contain. The role of audit is the one of giving the users information concerning the accounting principle and practices, accounting and presenting the trustworthy, clear and complete image of the financial position, of financial reports and the entity's performances. (Petraşcu, 2010).

Within any entity, no matter the activity object, the processes of evaluation and audit have an indisputable importance in providing economical-financial information about the different patrimonial items. Nevertheless, among these elements, tangible assets have an important place, because, without them, the entity couldn't carry out its work. Tangible assets are tangible elements owned for manufacturing goods, or for services provided, for being leased to a third party or for being administratively used and which are expected to be used for long periods. (IAS 16, 2015)

Conceived and structured on a complex matter, this paper is considering the presentation of the evaluation's and audit's importance, of tangible assets emphasizing the objectives and the risks associated to these elements, and which are being eyed by the evaluator, respectively by the auditor, as well as a study case which practically reflects

the implications of an evaluation and of an adequate audit on the information given in financial reports.

## METHODOLOGY

The purpose of this scientific research is the one of both theoretically and practically presenting aspects concerning the implications of tangible assets' evaluation and audit on the information reflected by financial reports. The methodology used to accomplish this scientific research is based on theoretical research concerning the concepts of tangible assets, evaluation, and audit, accompanied by an empirical research through which particular aspects concerning the approached concepts are emphasized. We have appealed to researching the papers in financial accounting domain, to studying the Accounting, Evaluation and Audit Standards, respectively the regulations in the domain, thus being an exploratory, qualitative research, but also to practical aspects specific to evaluation and auditing, thus being a descriptive quantitative research.

## ASPECTS CONCERNING EVALUATION RESPECTIVELY REVALUATION OF TANGIBLE ASSETS

Tangible assets, due to their usage for long periods of time, but also due to the inflationary environment in which the entity carries out its activity, bear both physical and moral changes, changes which are reflected in their value. As a result of this thing, the entities in order to be able to establish the real value of these elements, appeal to valuation, respectively revaluation.

Assets' evaluation is directly involved in providing information concerning the entity's financial position; therefore, assets' evaluation also influences the other critical components of financial reports. (Stan & Anghel, 2007). Referring to revaluation, this presumes to evaluate again the tangible assets, using the same methods and procedures as in evaluation, and having the purpose of establishing the fair value.

Both national norms and international accounting standards, respectively the valuation ones, include a series of rules that one have to be taken into account for making a pertinent evaluation. According to the national norms, approved by OMFP 1802/2014 revaluation of tangible assets at the date of the balance sheet, is made at fair value, avoiding the selective valuation and reporting certain amounts which are a combination of calculated values at different dates, made by qualified professionals in evaluation, members of a

professional body in the field, nationally and internationally acknowledged (OMPF 1802/2014).

The International Standards provide the fact that revaluations have to be made with sufficient regularity so that the accounting value does not significantly differ to the one which would be established using the fair value at the balance sheet date and their frequency depends on the fair value's evolution of the tangible assets in question. (IAS 16, 2015, paragraph 32)

Even if the proper evaluation is essential and it is based on a series of rules which are specifically stated through different normative acts and standards, there are still situations when it is not made, thus having major implications on financial reports.

### **GENERAL ASPECTS CONCERNING TANGIBLE ASSETS' AUDIT**

Depending on the activity of the audited entity, tangible assets own most of the time a considerable percentage of the total amount of patrimonial elements. Therefore, any operation connected to these which is wrongly interpreted and registered may lead to a significant distortion of financial reports, and if these errors are not identified and corrected in good time, they may generate the take of bad decisions by the final users, concerning the activity they carry out.

The general objectives which an auditor follows in auditing tangible assets refer to (Dreghiciu and Todea, 2015):

- Identifying and evaluating the inherent risks, including fraud risks, as well as appreciating the activity of the inner control department referring the owning and management of tangible assets;
- Determining the existence of tangible assets as well as certifying the existence of property rights on these elements
- Establishing if the tangible assets were correct or not totally registered, if their valuation is correct, as well as amortization and afferent depreciations;
- Obtaining a reasonable insurance concerning the existence and implementing of adequate procedures of acknowledgment on tangible assets within the financial reports;

An important step in this audit activity is the evaluation of significant distortion risk, respectively determining the inherent and control risks, identified at the level of the patrimonial elements.

Therefore, among the inherent identified risks connected to tangible assets, may be the following: technological changes from the activity branch which determines a moral erosion of tangible assets' value; closure of a certain segment of a business, which implies that, the tangible assets to

be evaluated at the net value of realization (supposing that this is inferior to cost), respectively difficulties in estimating the operating economic life for calculating the amortization, the value for the tangible assets being therefore under valued or over valued as a result of an oversized or undersized amortization. Concerning the inner control, an important segment which has to be verified is tangible assets' revaluation and identifying the ones which temporarily have become inactive. The existence of certain inner procedures for selecting the evaluator or using certain identification systems of inactive assets may be an adequate measurement of internal control. The auditor will identify if there are any clear internal procedures, a proper circuit of the documents, adequate hierarchical and managerial attributions and if the internal control verifies if all these are properly respected, and according to this information, will adjust the area of working procedures. The main evidence document of tangible assets is the Fixed Assets Register, in which all the goods of assets are presented along with each of its component elements and the afferent details. (Munteanu et al., 2012)

The level of inherent and control risk influences the determination of the significance threshold and establishing the statistic pattern from these total amount of elements which are to be audited. Therefore after verifying the established pattern, audit samples are collected, samples which the conclusions will be based on, and according to which the auditor will emit, within the audit report, his opinion concerning the conformity of financial reports with the general framework of financial reporting according to which these conclusions were made.

### **STUDY CASE CONCERNING THE IMPORTANCE OF TANGIBLE ASSETS' EVALUATION AND ITS INFLUENCE IN THE CASE OF AUDITING FINANCIAL REPORTS**

Entity SC AUDIT SRL, having the CAEN code no. 6920, *Activities of accounting and financial audit; tax consultancy*, carries out the audit mission on the SC DELTA SRL's Financial reports, having the CAEN code no. 1012 *Processing and conserving bird meat*. For SC AUDIT SRL the audit mission is a recurrent one, being in its third year of financial reports audit of SC DELTA SRL, respectively the afferent ones to the financial exercise ended at 31.12.2016.

SC AUDIT SRL, being at the third audit mission at SC DELTA SRL, knows the client, respectively the personnel within the financial – accounting department, but also the entity's management. Along the last audit missions, the collaboration

with these did not register any problem, SC AUDIT SRL, being satisfied with the perceptiveness and promptitude they proved each time it has been appealed to different explanations and documents which prove the way they carried out their activity along the financial exercise.

In the pre-planning step, the audit engagement officer observed the next situations, which may raise certain question marks along the audit mission:

- During the month of July 2016, within the financial – accounting department, its manager went on maternity leave, and another person from the department was transferred to the new entity's workstation.
- In their place, other people were hired to take over their attributions and responsibilities
- Financial – accounting department owns a procedure manual in which each operation within the department is provided, and the department's boss along with the inner audit department verify if each employee respects the code, but also verify and change the code's provisions each time when the legislation in effect modifies. In this way, they make sure that the activity they make lacks errors and also provides the real image of the entity's activity.
- One of the attributions of the person who was transferred in the entity's workstation is verifying the period in which the buildings and the entity's stores within the account 212 have to be reevaluated, and if this is the case, he/she must inform the department manager and initiate their revaluation process. Thus, these responsibilities go to the newly employed person during the month of August 2016.

The main indicators in the financial reports afferent to financial exercise 01.01.2016-31.12.2016 are presented in the Table no. 1 and Table no. 2.

Within the process of determination of audit risk level, **the general inherent risk** was established at being at high level, because in the financial – accounting department certain changes took place concerning the personnel in the second part of the year 2016, and this fact may generate certain risks in the way of carrying out the financial activity within the entity. The lack of experience in the way the department operates may lead to errors, therefore distorting the information presented at the level of financial reports.

In the case of **control risk**, this has been established as being at high risk. The main deficiencies were:

- It wasn't made certain that the new manager of accounting – financial department and the newly employed person in the department have understood and appropriated the way of developing their activity, according to the internal manual of procedures. This book ensured a good activity development of the department.

- The department's new employer hasn't verified if in the current year the buildings in the entity's patrimony need revaluation, this being one of his attributions according to the procedures book. The entity's buildings must be evaluated once at three years for being sure that the information from the entity's accounting department reflects the reality.
- Department manager, in the stage before making the financial reports, hasn't checked if all the accounting methods specific to this stage have been realized, especially revaluating certain patrimonial elements.

**For verification of tangible assets (buildings), the utilized fundamental procedures by the auditor were:**

- Verifying the fact that these patrimonial elements are faithfully presented in the accounting, in accordance with legislative regulations in effect.
- Verifying the accounts balances and if the initial balances coincides with the final ones of the previous financial exercise.
- Verifying
- Verifying the correct recording of input and output of these patrimonial elements in the current period.
- Checking the physical existence of these patrimonial elements.
- Verifying the justifying documents on which the patrimonial elements are based on, such as Property titles.
- The auditor has verified if all these patrimonial elements form the current exercise, needed to be evaluated and if as a result of this process, in the accounting the values have been modified according to the evaluation report.

#### **Establishing the Significance Threshold**

The auditor has established the inherent and control risk at a high level, thus the accepting detection risk is low, in this case, the audit risk is established at an acceptable low risk.

In the case of the audit risk at an acceptable low level, the global significance threshold will be established the one having the greater value. Thus, in Table no. 3 the auditor has established the indicator with the greatest variation as being the one of 168.266, afferent to the indicator's *Profit Before Tax* 10% percentage. In this case, the global significance threshold was established worth 214.354 Ron.

In accordance to **ISA 580 "Written Declarations"**, the management of the audited entity has declared that it has made available all the needed information for the auditor, information on which the financial reports are based on, also it has offered the auditor necessary access to the entity's personnel, in this way, the auditor is being able to gather all the necessary evidence. Another important aspect mentioned by management was that due to personnel flux within the accounting

department and the relatively short period, in which the new employees have begun to carry out the activity, the buildings' evaluation was omitted. This error was produced due to omitting the verification of the period in which the buildings' evaluation needed to be done. In this regard, the management declared that they will proceed to evaluating the buildings and registering the modifications occurred as a result of these operations, in the entity's accounting system, respectively in the financial reports, therefore being prepared and finalized in good time so that the auditor to be able to finish the audit report, and therefore the financial reports to be transmitted till the date provided by law.

#### **Establishing the Audit Opinion Applying Professional Reasoning by the Auditor**

As a result of analysing the audited entity's tangible assets, the audit engagement officer observed the fact that the buildings' periodical evaluation was omitted, has brought this situation to the management's knowledge, and it had decided to evaluate the buildings in the shortest possible period of time in order to be able to make all the necessary modifications in the financial reports, offering the auditor enough time to finish the audit report, so that the financial reports' submission to be until the date provided by law.

Following the buildings' evaluation, the evaluation report has stated their value of 4.012.820 Ron, the initial value being 3.684.138, and the difference between these two values being of 328.682 Ron, thus surpassing the significance threshold of 214.354 Ron established by the auditor.

In this case, if the audited entity does not make the buildings' revaluation, the financial reports are significantly distorted. So, we present below the way in which the auditor's opinion is emitted, in the situation in which the entity's management has made the buildings' revaluation, but also the way in which the opinion is emitted if the management would have chosen not to make the building's revaluation.

#### **Case 1. The Management Revaluates the Building from the Patrimony**

In the situation when the management of the audited entity makes the buildings' from the patrimony revaluation, and the necessary modifications, based on the evaluation report, were made in accounting and in financial reports, then the auditor will emit an unqualified opinion.

The auditor will emit the opinion presented below, respecting the regulations of ISA 700 (Revised) "Forming an opinion and reporting on financial reports" (IAASB, IFAC, CAFR, 2016, p. 1041).

#### **Fragment from the Audit Report of the Entity S.C. DELTA S.R.L.**

##### *Opinion*

*I have audited the attached financial reports of the society DELTA S.R.L., which contain the balance sheet at the date of 31 of December 2016, loss and profit account, the situation of own capital modification and the treasury flux for the financial exercise finalised at this date and a summary of the significant accounting policies and other explanatory notes.*

*In our opinion, the attached financial reports offer a trusty image of the financial position of DELTA S.R.L at the 31<sup>st</sup> of December 2016 as well as the result of its operations and of treasury fluxes for the financial exercise finalized at this date, in accordance to the Order of the Minister of Public Finance no. 1802/2014 for approving the accounting regulations concerning the annual individual financial reports and the consolidated annual financial reports with the subsequent modifications ("OMPF no. 1802/2014").*

#### **Case 2. The Management Doesn't Evaluate the Buildings from the Patrimony**

Following the activity conducted, the auditor has identified that SC DELTA SRL did not reevaluate the buildings' value at 31.12.2016, being the financial exercise in which this operation had to be done. The responsible with the audit mission has brought this situation to the management's knowledge, but the management has decided not to make the operation due to lack of necessary time for being able to finish it and make the necessary modifications, for submitting them at the time provided by law. In this case, the auditor will emit an opinion with reservations.

The auditor will emit an opinion with reservations, this being presented below, respecting the regulations of ISA 705 (Revised) "Amendments to the opinion of the independent auditor's report" (IAASB, IFAC, CAFR, 2016, p.1090).

#### **Fragment from S.C. DELTA S.R.L. Entity's Audit Report**

##### *Opinion with reservations*

*I have audited the attached financial reports of the society DELTA S.R.L., which contain the balance sheet at the date of 31 of December 2016, loss and profit account, the situation of own capital modification and the treasury flux for the financial exercise finalised at this date and a summary of the significant accounting policies and other explanatory notes.*

*In our opinion, excepting the effects of the aspect described in section Base for opinion with reservations from our report, the attached financial reports offer a trusty image of financial position of DELTA S.R.L at the 31<sup>st</sup> of December 2016 as well as the result of its operations and of treasury fluxes for the financial exercise finalised at this date, in accordance to the Order of the Minister of Public Finance no. 1802/2014 for approving the accounting regulations concerning the annual*

*individual financial reports and the consolidated annual financial reports with the subsequent modifications ("OMFP no. 1802/2014").*

**The Base for Opinion with Reservations**

*Delta S.R.L didn't make the buildings' revaluation; therefore, their value from the financial reports is distorted, having a more powerful effect because they are a significant part of the tangible assets category, which represents the patrimonial element with the greatest share.*

## CONCLUSIONS

Free prices, the exchange ratio of the national currency, the inflationist environment, as well as internal management, has as result the modification of the patrimonial elements' value of the entity. In order for the financial reports to reflect the reality, it is appealed to evaluation, respectively revaluation. Due to the fact that the tangible assets within the entities have a significant percentage, and their presentation at a distorted value in the financial reports has a strong influence on the decisions made by the final users, they require special attention in establishing the real value.

A certification of the fact that the financial reports not only reflect the trusty image but also of the fact that they are made in accordance with legal norms, is brought by an audit. Thus, the insurance of the fact that the patrimonial elements, respectively the tangible assets, were subjected to a pertinent evaluation respectively revaluation process, is an important objective of the audit. As a result, the identification by the auditor of an inadequate valuation attracts the emitting of a modified opinion.

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ANNEXES

Table No.1  
*Extract from the balance sheet of SC DELTA SRL*

<b>Indicators</b>	<b>2016</b>	<b>2015</b>
<b>Fixed assets</b>	8.151.587	9.604.879
Buildings	3.684.138	3.684.138
<b>Current assets</b>	8.825.758	7.829.749
<b>Current debts</b>	7.427.534	7.375.112
<b>Long-term debts</b>	1.682.824	3.619.422
<b>Company Funds</b>	6.805.232	5.062.943

Source: personal creation

Table No.2  
*Extract from the profit and loss account of SC DELTA SRL*

<b>Indicators</b>	<b>2016</b>	<b>2015</b>
<b>Turn-over</b>	83.230.059	76.882.262
<b>Gross Profit</b>	2.143.536	511.277

Source: personal creation

Table No.3  
*Establishing the materiality threshold*

<b>Indicators</b>	<b>2016</b>	<b>2015</b>	<b>Trend</b>
<b>Total assets</b>	<b>16.977.345</b>	<b>17.434.628</b>	
1,00%	169.773	174.346	-4.573
2,00%	339.547	348.693	-9.146
<b>Turnover</b>	<b>83.230.059</b>	<b>76.882.262</b>	
1,00%	832.300	768.823	63.477
2,00%	1.664.601	1.537.645	126.956
<b>Profit before tax</b>	<b>2.143.536</b>	<b>511.277</b>	
5,00%	107.177	25564	81.613
10,00%	214.354	51.128	168.226
<b>Global materiality threshold</b>	<b>214.354</b>		

Source: personal creation