CHAPTER 7: MANAGE BUSINESS ASSETS & LIABILITIES /MANAGING BUSINESS ASSETS & LIABILITIES.

7.1. Introduction of the Unit of Learning / Unit of Competency

This is a core unit that will enable the trainee manage business assets and liabilities. This unit involves preparing business assets and liabilities plan, evaluating business capital investment, establishing internal control system over assets and liabilities, maintenance and disposal of assets, documenting and computerizing business assets and liabilities. Assets are the items your company owns that can provide future economic benefit whereas liabilities are what you owe other parties. The critical aspects of competency/knowledge to be covered in this unit are; prepared business assets and liabilities plan, evaluate various investment projects, documenting and computerizing organizational assets and liabilities etc.
This unit is designed to equip a trainee to acquire competencies to prepare business assets and liabilities plan, evaluate investment, proposal, establish efficient internal control system over assets and liabilities. The trainee should also be able to maintain and manage disposal of assets as well as document and computerize business assets and liabilities.
The trainee should be able to develop an internal control system over assets and liabilities, undertake asset acquisition, physical controls and financial controls.
The trainee should also be able to update inventory transactions, carry out debtors, cash and liabilities management.

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7.2. Performance Standard

The trainee should be able to manage business assets and liabilities through development of a plan, evaluation of business capital investment plan, establishment of internal control system, and documentation of assets according to the Enterprise Risk Management Policy (ERM).

7.3. Learning Outcomes

7.3.1. List of Learning Outcomes

a) Prepare business assets and liabilities plan
b) Evaluate business capital investment
c) Establish internal control system over assets and liabilities
d) Maintenance and disposal assets
e) Document and computerize business assets and liabilities

7.3.2. Learning Outcome No. 1. Prepare Business Assets and Liabilities Plan

7.3.2.1 Learning Activities

Learning Outcome #No. 1. Prepare Business Assets and Liabilities Plan	
Learning Activities	Special Instructions
Trainers to analyze and document their institution asset and liabilities Identify and list internal control system for assets and liabilities in their institution	Provide Sample Plan & Budget

7.3.2.2 Information Sheet No 7/LO 1

Introduction

At the end of this learning outcome, the trainee should be able to assess asset requirement, analyze records of existing assets and liabilities, establish asset usage and acquisition, prepare business asset and liabilities plan and budget based on budget estimates. Accounting standards define an asset as something your company owns that can provide future economic benefits. Cash, inventory, accounts receivable, land, buildings, equipment – these are all assets. Liabilities are your company's obligations – either money that must be paid or services that must be performed. A successful company has more assets than liabilities, meaning it has the resources to fulfill its obligations. On the other hand, a company whose liabilities exceed its assets is probably in trouble.

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Definition of key terms

- **Budget**- This is a tool that aids in financial planning
- **Asset usage**- This is the extent to which a given asset has been used by an enterprise
- **Budget estimates**- This refers to those financial estimates of cost that are used in the preparation of budgets
- **Assets acquisition**- This is the act of obtaining an asset for use within an enterprise e.g. through buying or leasing

What are Assets?

Assets are something that keeps paying you for years. For example, let’s say that you have purchased an asset for your business. It has a lifetime value of 5 years. That means purchasing the asset allowed you to get paid for next 5 years from now.

Some assets offer you direct cash inflow and some provide you in kind. In the earlier example, it provides you 5 years of convenience so that you can keep and store important documents.

Now let's talk about investments. Organizations often invest a lot of money into meaningful equities, bonds, and other investment instruments. And as a result, they get an interest on their money every year. Investments are assets to the organizations since these investments are able to create direct cash flows.

Types of assets

Assets are classified based on their convertibility to cash , physical existence and usage. There are two main types of assets in business in the category of convertibility to cash. These are;

a) Current assets
b) Fixed assets

Another classification of assets based on physical existence are;

a) Tangible
b) Non tangible

Tangible assets are those assets that one can touch feel or see. All fixed assets are tangible and other current assets like inventory and cash. Intangible assets are those that one cannot tough or feel. They include good will, copyrights and agreements.

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Finally assets are classed as per their usability. These are

a) Operational
b) Non-operational assets

Operational assets are those items of business that are used on a day to day basis. This can include bank balance, cash, equipments inventory etc. Non-operational assets on the other hand are those that are not used on a daily basis but are useful in future operation of the business. Such include excess cash in the business real estate or undeveloped land.

Current assets

These are assets which can be easily converted into cash/ liquidity within a year. In the balance sheet, current assets are placed at first.

Examples of current assets include:

- Cash & Cash Equivalents
- Short-term investments
- Inventories

- Trade & Other Receivables
- Prepayments & Accrued Income
- Derivative Assets
- Current Income Tax Assets
- Assets Held for Sale
- Foreign Currency
- Prepaid Expenses

Fixed/ Non-current assets

These assets are also called "fixed assets". These assets can't be converted into cash immediately, but they provide benefits to the owner for a long period of time. Examples of fixed assets in business are land, buildings, equipments and furniture.

Establishing asset usage

- Determinate the need of the asset
- Determine the rate of depreciation being provided on existing assets to assess the book value of the assets

Analysis of existing assets and liabilities

This is an exercise that requires one to:

- Determine the enterprises' assets and liabilities
- Carry out a physical check to verify existence of the assets recorded in the books of account
- Verify the existing liabilities of the enterprise as recorded the books of account
- Preparation of an assets and liabilities budget;
- List out all the assets of the enterprise to determine;
    - ✓ Assets to be bought(additions)
    - ✓ Assets to be disposed
- Allocate time estimates i.e. when to acquire, when to dispose so as to allocate funds for asset acquisition in the budget.
- Prepare an asset movement schedule (budget) in advance that entails all expected acquisitions and disposals
- List all expected liabilities based on the existing liabilities and the financial requirements of a firm. Liabilities should be based on the enterprise management policy to ensure liquidity and avoid a poor coverage status.

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Liabilities

Generally liabilities are considered to be obligations that a business has to somebody. These can include legal financial debts or obligations. Good services and money are used to settle business liabilities over time. Examples of liability include accounts payables, mortgages, differed revenues , accrued expenses and loans. Liabilities are usually recorded on the right side of the balance sheet.

Differences between assets and liabilities in Business

The main difference between a**ssets** and liabilities is that assets provide a future economic benefit, while liabilities present future obligations. An indicator of a successful business is one that has a high proportion of assets to liabilities, since this indicates a higher degree of liquidity.

There are several other issues relating to the difference between assets and liabilities, which are:

2. One must also examine the ability of a business to convert an asset into cash within a short period of time. Even if there are far more assets than liabilities, a business cannot pay its liabilities in a timely manner if the assets cannot be converted into cash.
3. The aggregate difference between assets and liabilities is equity, which is the net residual ownership of owners in a business. For an individual, the primary asset may be his or her house. Offsetting this is a mortgage, which is a liability. The difference between the house asset and the mortgage is the equity of the owner in the house.

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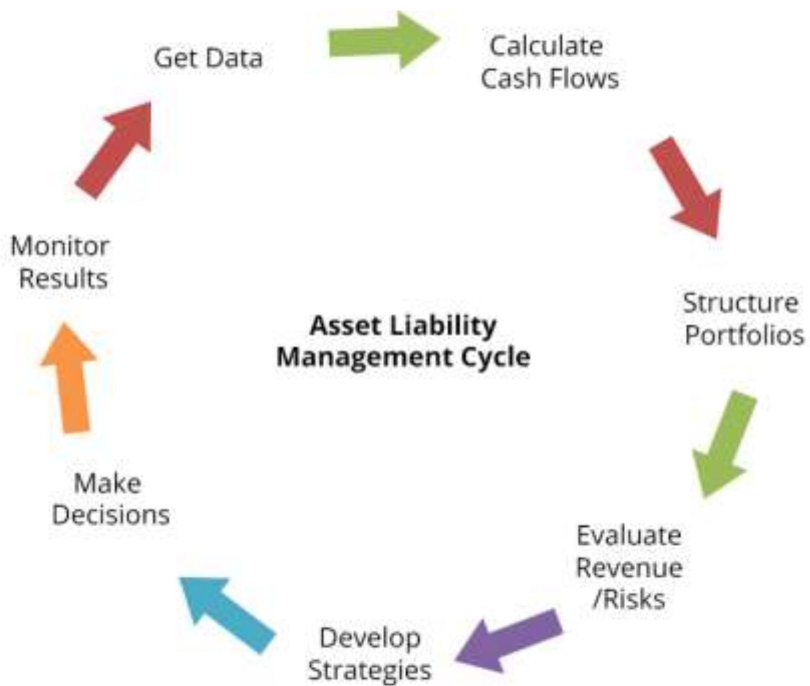
Asset and Liabilities Management (ALM)

In practice, assets and liabilities of a bank are continuously changing which affect interest cost and interest income. Since Micro level management of assets and liabilities is not possible, through ALM, the bank groups the assets and liabilities according to the maturity, rate, risk, and size so as to control mismatches.

While elimination of gaps arising due to mismatches is not possible, the ALM aims at minimizing the gaps as they are risk-prone and directly affect the NIM. Thus ALM will enable the bank to protect and if possible improve the Net Interest Margin through conscious strategies and decisions.

A sound ALM system for a company should include:

a) Interest rate movement and outlook
b) Pricing of assets and liabilities
c) Review of investment portfolio and credit risk management
d) Review of investment of foreign exchange operations
e) Management of liquidity Risk



ALM Cycle for management of assets and liabilities (Investopedia)

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Conclusion

The trainee should be able to establish asset usage, assess assets requirements, analyzing records of existing assets and liabilities, establishing asset usage, establishing asset acquisition and settlement of liabilities, receiving budget estimates and preparing business asset and liabilities plan and budget.

7.3.2.3 Self-Assessment

1. The following are current assets which one is not
   a) Foreign currency
   b) Furniture
   c) Inventory
   d) Receivables
2. Intangible assets are the same as non-operational assets
   True [ ] False [ ]
3. Which of the following statements is true
   a) Fixed assets are used in daily operation of the business
   b) Good will is a current assets in most businesses
   c) Non-operational assets are included in the balance sheet
   d) Businesses operate well with more liabilities than assets

4. Explain the meaning of the following terms
a) Current assets
b) Liabilities
c) Fixed assets
5. Using examples discuss the various categories of assets used in businesses
6. Outline the various differences between assets and liabilities in a business
7. Using your institution as an example prepare a list of assets showing their various categories
8. Prepare an assets and liabilities plan and budget for the institution where you undertake your training.
9. Analyze existing assets and liabilities of an enterprise situated nearby your institution

7.3.2.4 Tools, Equipment, Supplies and Materials

- Computer
- Internet connectivity
- Stationery
- Format templates balance sheets
- Case studies

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7.3.2.5 References

1. **Meigs W.B** and **Meigs R.B(1989)**; intermediate accounting(6th edition) McGraw Hill, New York
2. **Mosich A.N** (1988); INTERMEDIATE ACCOUNTING (6th edition), McGraw Hill-New York
3. **Jennings A.R** (1994); financial accounting (2nd edition) Dp publications limited, London.

7.3.3. Learning Outcome No. 2. Evaluate Business Capital Investment

7.3.3.1. Learning Activities

Learning Outcome #N0. 2. Evaluate Business Capital Investment	
Learning Activities	Special Instructions
• Identify two companies in near your institution, obtain their strategic plan and evaluate the alternative business investment method using appropriate business investment criteria. • Select strategic plan from two county governments and prepare a business investment report and hence propose appropriate capital investment.	Apply various methods of investment evaluation i.e. Accounting Rate of Return (ARR) and payback period method and modern methods such as Profitability Index (PI), Net Present Value(NPV), Internal Rate of Return (IRR) and discounted payback period method in suggested investments in both companies.

7.3.3.2. Information Sheet No. 7/LO2

Introduction

Any investment project with a positive net present value is profitable for the firm and should be undertaken. For example, you're evaluating a capital investment project that generates cash flows for the next four years. The most commonly employed technique for evaluating investment alternatives is the net present value technique.

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Definition of key terms

- **Business investment**: Refer to those funds that have been put in productive business in order to generate returns.
- **Cash flows:** in business investment, cash outflows and cash inflows. **Cash flows** is the difference in amount of cash available at the beginning of a period[opening balance] and the amount at the end of that period[closing balance] and are generated from operating activities, financing activities and investment activities(IFRS NO.7).
- **Investment evaluation**: The process of selecting the best investment alternative among the available alternatives.

Modern and Traditional methods for investment evaluation

Traditional methods of investment evaluation; includes the

a) **Accounting rate of return**
b) **Payback period method**

Modern methods of investment evaluation include the net present value (NPV) method, internal Rate of Return method, discounted payback period (DPBP) method, and Profitability Index (PI) method.

Investment Evaluation Methods

a) **Accounting Rate of Return (ARR):** A method of investment evaluation based on past historical accounting profits averages. Disadvantage of this method is that it uses accounting profits which are historical in nature.

b) **Payback period method:** A method of investment evaluation that accepts those projects that have a shorter payback period of the invested amount. It has several advantages and disadvantages.

c) **Net Present Value (NPV)** method: A method of investment evaluation that involves use of discounted cash flows to determine whether to accept or reject an investment option. The discount rate used should be the cost of capital (shareholder's required rate of return). Accept those projects that have positive NPV and reject those with a negative NPV.

d) **Internal Rate of Return Method (IRR)**: Refers to that discount rate that will give an NPV of zero. Accept projects that IRR is greater than the cost of capital.

e) **Discounted Payback Period Method (DPBM):**A method similar to the payback period but involves the use of discounted cash flows(DCF's)

f) **Profitability index (PI):** A method that compares the total; discounted cash flows of an investments to the investment initial outflow.

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Summary of decisions using the modern methods of appraising investment projects

i) NPV-accept when positive-reject when negative
ii) IRR-accept when IRR<cost of capital-reject when IRR>cost of capital
iii) PI-accept when PI>1-reject when PI<1

Note: For mutually exclusive projects, that are acceptable, then choose the investment alternative that promises a greater return in the future.

Components of investment evaluation report

The following components are included in a investment evaluation report

Cover page

- Business name
- Location
- Year
- Writers Name

Main body

- Executive summary
- Problem/Opportunity
- Background of the business

- Business scope
- Strategic impact
- Recommendation
- Approval and authority
- Implementation Plan
- Business team, approval and signature
- Appendices

Conclusion

The trainee should be able to use both the traditional and modern methods of investment evaluation by obtaining alternative business investment, evaluating business investment, prepare investment evaluation report and selecting capital investments.

7.3.3.3. Self-Assessment

1. Which of the following id not a traditional; method of investment evaluation
   D) Accounting rates
   E) Payback period
   F) Profitability index method
2. Define the following terms
   a) Business Investment
   b) Capital Investment
   c) Business investment evaluation
3. Discuss the various methods used in evaluating investment. Highlight advantages and disadvantage of each method.
4. Why is it important to prepare an investment evaluation report
5. What factors should one consider when selecting capital investments for a business
6. Brainstorm on a business idea and prepare a business investment report after evaluating the available option for investments.
7. Prepare business assets and liabilities plan
8. ABC Company intends to invest in one of the two mutually exclusively projects, X and Y. the investment initial outlay is Ksh.1, 500,000.00 .The following are the expected cash flows:

Year expected cash flows	**Project X**	**project Z**
1	500000	400000
2	800000	1000000
3	1000000	500000
4	800000	700000

The cost of capital is 14%

Advice the management of ABC limited on the project to invest in based on each of the following investment appraisal methods:

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a) Payback period method
b) Net present value method
c) Internal rate of return
d) Profitability index
e) Discounted payback period method

7.3.3.4. Tools, Equipment, Supplies and Materials

- Computer
- Internet connectivity
- Stationery
- Format templates
- Case studies
- Sample business plan

7.3.3.5. References

1. Meigs W.B and Meigs R.B (1989); intermediate accounting (6th edition) McGraw Hill, New York
2. Mosich A.N (1988); INTERMEDIATE ACCOUNTING (6th edition), McGraw Hill-New York
3. Jennings A.R (1994); financial accounting (2nd edition) Dp publications limited, London.

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7.3.4. Learning Outcome No. 3. Establish Internal Control System over Assets and Liabilities

7.3.4.1. Learning Activities

Learning Outcome #No. 3. Establish internal control system over assets and liability	
Learning Activities	Special Instructions
• Visiting a nearby institution of your choice, and develop a report on; • The various controls for assets and liabilities • Suggest ways of managing debtors, cash and liabilities in a business organization with the finance department of your institution	• Trainee to be guided in identify an institutions and Identify Controls in the identified institution- physical, non-physical and financial controls

7.3.4.2. Information Sheet No. 7/LO3.

Introduction

Internal control as defined by accounting, is a process for assuring of an organizations objectives in operational effectiveness and efficiency, reliable financial reporting and compliance with laws, regulations and policies.

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Definition of key terms

- **Physical controls**-all controls that relate to the physical security of the assets e.g use of lockable doors and cabinets, employing a security guard etc.
- **Financial controls**–all controls put in place to guard against financial impropriety and also minimize accounting errors usually done through internal check and internal audit.
- **Debtor's management**–managing debtors in such a way that the business deals with credit-worthy customers and also ensure timely payment from the debtors.
- **Cash management** –the management of cash such that excess cash is invested and ensure there is sufficient cash to handle business operations. This ensures an optional level of cash available.
- **Liabilities management** –this involves avoidance of excess liabilities for a firm e.g., creditors should be managed well to ensure continued supply and good relations with suppliers. Excess liabilities should be avoided as this may result to firm's illiquidity and solvency.

Development Internal control system (ICS) for Assets and Liabilities

A good internal control system helps in efficient management of assets and liabilities .The following features of a good internal control system must be incorporated;

- Organization plan
- Recording of assets and liabilities
- Division of work
- Authorization and approvals

- Segregation of duties
- Accountability and transparency

Note: Discuss the benefits of each of the features of an internal control system (ICS)

Objectives of Internal Control System

- To ensure that the **business transactions take place as per the general and specific authorization** of the management.
- To make sure that there is a **sequential and systematic recording** of every transaction, with the accurate amount in their respective account and in the accounting period in which they take place. It confirms that the financial statement fulfils the relevant statutory requirements.
- To provide **security to the company's assets from unauthorized use**. For this purpose, physical security systems are used to provide protection such as security guards, anti-theft devices, surveillance cameras, etc.
- To **compare the assets in the record with that of the existing ones** at regular intervals and report to the charged with governance (TCWG), in case any difference is found.
- To evaluate the **system of accounting for complete authorization** of the transactions.
- To review the **working of the organization and the loopholes in the operations** and take necessary steps for its correction.
- To ensure there is the **optimum utilization of the firm's resources**, i.e. men, material, machine and money.
- To find out **whether the financial statements are in alignment with the accounting concepts and principles**.

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An ideal internal control system of an organization is one that ensures best possible utilization of the resources, and that too for the intended use and helps to mitigate the risk involved in it concerning the wastage of organization's funds and other resources.

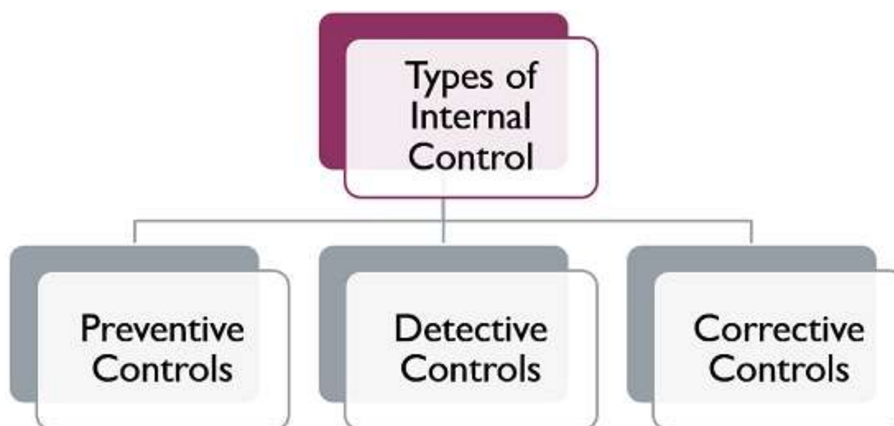

Figure 25: Types of Internal Control System

1. **Preventive Controls**: These controls are introduced in the firm to stop errors and irregularities from taking place.
2. **Detective Controls**: These controls are implemented to reveal errors and irregularities, once they take place.

3. **Corrective Controls**: These controls are designed to take corrective action for removing errors and irregularities after they are detected.

Limitations: It's important to keep in mind that internal controls, while effective, are not a guarantee that a company's objectives will be met. Human errors and computer errors are not accounted for by internal controls. In addition, internal controls assume employees are honest and that will not alter data to benefit themselves.
The type of internal control system implemented in the organization will be based on the company's nature and requirements.
Internal Control System is important for every organization, for efficient management as well as it also assist in the company's audit. It includes all the processes and methods to help the company in reaching its ultimate objective.

- Physical controls
    - Lockable doors
    - Use of passwords-to gain entry to some information on computers
    - Biometric doors
    - Use of CCTV cameras
    - Use of a reliable security firm etc.
- Financial controls

Financial controls include all those controls that are aimed to ensure there is accountability and transparency.
Financial controls include the following;

- Internal audit department
- Internal check for all transactions
- Procurement controls to avoid collusion between the employers and suppliers
- Proper authorization and approvals when acquiring or disposing assets

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- Debtors management
    - ➢ Involves management of debtors .Assess the credit –worthiness of debtors using the following "C"s
        i) Capital
        ii) Character
        iii) Collateral
    - ➢ Debtor's management policy should be put in place e.g duration of debt, any discounts to be offered to encourage earlier payment (cash discount), quantity discounts to be offered etc.
- Cash management
    - ✓ Involves having an optimal cash balance within the enterprise.
    - ✓ Reasons for holding cash:
        i) **Speculative motive**- firms hold cash to avail the benefit of bargain purchases that may arise in future .i.e. if the firm feels the prices of raw materials are going to rise in the near future, it will hold cash and wait till the prices actually falls.
        ii) **Transaction motive**- cash required by a firm to meet the day to day needs of its business operations.

iii) **Precautionary motive**- this refers to the tendency of a firm to hold cash, to meet the contingencies such as increase in the price of raw materials, labor strike, change in the demand or unforeseen circumstances arising in the course of business.
iv) To take care of emergencies as they arise

- Apply the **miller-Orr** model and **Baumol's** model of cash management. **Baumols model** is based on the basic assumptions that the size and timing of cash flows are known with certainty while **miller-Orr model [**a model of the demand for money] expanded on the Baumol model and developed stochastic model for firms with uncertain cash inflows and cash outflows.

Liabilities management

- Creditors should be well managed to ensure timely payment of creditors
- Long-term liabilities should also be well managed to ensure there is proper operating and financial leverage for an enterprise
- Total liabilities should be less than the total assets to ensure shareholders' control is not diluted
- Internal control of liabilities ensures accountability and transparency

Conclusion

The trainee should be able to develop an internal control system over assets and liabilities as well as undertake physical and financial controls over assets. The trainee should also be able to carry out debtor, cash and liabilities management.

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7.3.4.3. Self-Assessment

7. Which of the following is not used in assessing debtors worthiness
    1. Capital
    2. Collateral
    3. Investment
    4. Capital
8. Which of the following internal control system is shows errors and irregularities
    - Preventive control
    - Financial control
    - Corrective control
    - Detective control
9. Explain the following terminologies as used in business ;
    5. Internal control system
    6. Capital expenditure
    7. Debtors management
2. Define and give examples of the following terms
    1. Physical control
    2. Financial Control
3. What factors /procedure to be considered while updating inventory transactions
4. Discuss the importance of carrying out cash transaction for a business

5. What procedures are used in liability management for a business
6. Design and recommend an efficient internal control system for management of your institution assets and liabilities

7.3.4.4. Tools, Equipment, Supplies and Materials

- Computer
- Internet connectivity
- Stationery
- Format templates of business internal control system
- Case studies

7.3.4.5. References

1. Meigs W.B and Meigs R.B(1989); intermediate accounting(6th edition) McGraw Hill, New York
2. Mosich A.N (1988); INTERMEDIATE ACCOUNTING (6th edition), McGraw Hill-New York
3. Jennings A.R (1994); financial accounting (2nd edition) Dp publications limited, London.

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7.3.5. Learning Outcome No.4. Maintenance and Disposal of Assets

7.3.5.1. Learning Activities

Learning Outcome #No. 4. Maintenance and Disposal of Assets	
Learning Activities	Special Instructions
• Visit a nearby company and find out the procedures they use in preparing an asset maintenance schedule. • Discuss factors considered when preparing an asset maintenance budget with the management of your institution. • Using the selected company management, Discuss factors considered when carrying out disposal of assets.	• Field visits

7.3.5.2. Information Sheet No. 7/LO4.

Introduction

The trainee should be able to prepare assets maintenance schedule, assets maintenance budget and carry out maintenance and disposal of assets.

Definitions of key terms

- **Asset maintenance schedule:** A schedule that lists out the plan for assets maintenance. It must include date of previous and next maintenance, company engaged in maintenance of assets, any major repairs to be done etc.
- **Asset maintenance budget:** A budget that contains the costs that are to be incurred for proper maintenance of assets e.g. payment to service providers, cost of buying spares and any replacement items
- **Disposal of asset**: it is the act of selling off the assets

Asset maintenance schedule

A schedule should be prepared to include all assets of an organization. The following format may be used;

Asset classification	Date of Acquisition	Date of previous Maintenance	Cost of Maintenance	Date of next Maintenance
A. Land and buildings	xx	xx	xx	xx
B. Motor Vehicles KBL, KAX	xx	xx	xx	xx
C. Computer and Accessories	xx	xx	xx	xx

Assets maintenance budget

A budget for all assets must be maintained .An asset maintenance budget may be in various forms. The following is a simple budget.

Asset	Date of acquisition	Expected Monthly cost of maintenance Ksh '000'
A	XX	XX
B	XX	XX

Monitoring maintenance of assets

Assets should be monitored well to ensure that the value is maintained.

Institute a repair and maintenance team within the enterprise to manage assets maintenance

Disposal of Assets

Disposal should be done upon management approval and following laid down policies on assets management.

Record all disposals in the assets movement schedule.

All disposal should be properly accounted for to determine either the loss or gain on disposal of an asset. The trainee should be able to also prepare:

i. Assets account
ii. Asset Provision for depreciation account
iii. Assets disposal account

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Accounting Entries for Depreciation of Fixed Assets

In a business with financial year ended 31st December, a machine was bought for $2,000 on 1st January 2005. It has been depreciated at a rate of 20% using the reducing balance method. The records for the first three years are now shown below:

Machinery

2005	Bank	$	2005	Balance c/f	$
1 Jan		2,000	31 Dec		2,000
		2,000			2,000
2006	Balance b/f	2,000	2006	Balance c/f	2,000
1 Jan			31 Dec		
		2,000			2,000
2007	Balance b/f	2,000	2007	Balance c/f	2,000
1 Jan			31 Dec		
		2,000			2,000
2008	Balance b/f	2,000			
1 Jan					

Provision for depreciation

2005		$	2005		$
31 Dec	Balance c/f	400	31 Dec	Profit & Loss account	400
		400			400
2006			2006		
31 Dec	Balance c/f	720	1 Jan	Balance b/f	400
			31 Dec	Profit and Loss account	320
		720			720
2007			2007		
31 Dec	Balance c/f	976	1 Jan	Balance b/f	720
			31 Dec	Profit and Loss account	256
		976			976

Balance Sheet (extract)

As at 31 Dec. 2005	$	$
Fixed Assets		
Machinery (at cost)	2,000	
Less: Provision for Depreciation	400	1,600
As at 31 Dec 2006	$	$
Fixed Assets		
Machinery (at cost)	2,000	
Less: Provision for depreciation	720	1,280
As at 31 Dec 2007	$	$
Fixed Assets		
Machinery (at cost)	2,000	
Less: Provision for depreciation	976	1,024

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The terms 'aggregate depreciation' and 'net book value (NBV)' are often used. What they mean in the above example is shown below:

	31 Dec. 2005	31 Dec. 2006	31 Dec. 2007
	$	$	$
Machinery at cost	2,000	2,000	2,000
Less: Aggregate depreciation	400	720	976
Net book value	1,600	1,280	1,024

New Terms:

Aggregate depreciation / Accumulated depreciation

The total amount of depreciation written off a fixed asset up to a specific time.

Net book value (NBV)

The cost or valuation of a fixed asset less accumulated depreciation.

Example 3

In a business with financial year ended 30th June. A motor lorry was bought on 1st July 2001 for $8,000. Another motor lorry was bought on 1st July 2002 for $11,000. Each lorry is expected to be in use for 5 years, and the disposal value of the first lorry is expected to be $500 and the second lorry is expected to fetch $1,000 disposal value. The method of depreciation to be used is the straight-line method. The first two years' accounts are shown.

Motor Lorries

		$			$
2001			2002		
1 Jul	Bank	8,000	30 Jun	Balance c/f	8,000
		8,000			8,000
2002			2003		
1 Jul	Balance b/f	8,000	30 Jun	Balance c/f	19,000
1 Jul	Bank	11,000			
		19,000			19,000
2003					
1 Jul	Balance b/f	19,000			

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Provision for Depreciation – Motor Lorries

		$			$
2002			2002	Profit & Loss account	
30 Jun	Balance c/f	1,500	30 Jun	($8,000 - $500) / 5	1,500
		1,500			1,500
2003			2002		
30 Jun	Balance c/f	5,000	1 Jul	Balance b/f	1,500
				Profit and Loss account	
			2003	$1,500 + ($11,000 - $1,000)	
			30 Jun	/ 5	3,500
		5,000			5,000
			2003		
			1 Jul	Balance b/f	5,000

Profit and Loss Account for the year ended 30 June (extracts)

	$	
2002		
Provision for depreciation	1,500	

2003		
Provision for depreciation	3,500	

Balance Sheet as at 30 June (extracts)

As at 30 Jun. 2002	$	$	
Fixed Assets			
Motor lorries (at cost)		8,000	
Less: Accumulated depreciation		1,500	
Net book value		6,500	
As at 30 Jun. 2003		$	
Fixed Assets			
Motor lorries (at cost)		19,000	
Less: Accumulated depreciation		5,000	
Net book value		14,000	

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Disposal of an asset / sale of an asset

Upon the sale of an asset, we will want to delete it from our accounts. This means that the cost of that asset needs to be taken out of the asset account. In addition, the depreciation of the sold asset will have to be taken out of the depreciation provision. When we dispose of an asset, the cash received for it is usually different from our original guess. Therefore, the profit or loss on sale, if any, will have to be calculated. For instance, let us assume the sale of machinery.

Accounting entries needed:

(A) Transfer the cost price of the asset sold to an assets disposal account (e.g. Machinery Disposals account)	Debit: Machinery Disposals account Credit: Machinery account
(B) Transfer the depreciation already charged to the assets disposals account	Debit: Provision for Depreciation – Machinery account Credit: Machinery Disposals account
(C) For remittance received on disposal	Debit: Cash / Bank account Credit: Machinery Disposals account
(D) Transfer the difference (amount needed to balance the account) (i) If the Machinery Disposals account shows a CREDIT balance, it is a profit on sale, or (ii) If the Machinery Disposals account shows a DEBIT balance, it is a loss on sale.	 Debit: Machinery Disposals account Credit: Profit and Loss account Debit: Profit and Loss account Credit: Machinery Disposals account

Conclusion

The trainee should be able to prepare an assets maintenance schedule, preparing assets maintenance budget, carrying out and monitoring maintenance of assets and carrying out disposal of assets. The trainee should be able to prepare the ***assets account***, ***provision for depreciation*** account and assets ***disposal account*** for a period of time.

7.3.5.3. Self-Assessment

1. Suppose a machinery disposal account shows credit balance. The company is said to have made
    1. Profit
    2. Loss
    3. Depreciation
2. Which of the following is not included in assets maintenance
    - Dates of maintenance
    - Cost of disposal
    - Date of acquisition
    - Cost of maintenance
3. Define the following terms as used in business
    - Fixed assets
    - Assets maintenance schedule
    - Assets Disposal
4. Describe the key elements that is comprised is assets maintenance budget
5. Explain the importance of assets maintenance and monitoring
6. Outline procedures required for of assets disposal in a business
7. Prepare a sample of assets maintenance schedules for an organization of choice
8. Prepare a sample of assets maintenance budget
9. Prepare an asset maintenance budget of a nearby business enterprise

Given the following items

a) Cost of assets
b) Rate illustrations
c) Date of acquisition
d) Price paid for upon disposal of assets

7.3.5.4. Tools, Equipment, Supplies and Materials

- Computer
- Internet connectivity
- Stationery
- Format templates
- Case studies

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7.3.5.5. References

1. Meigs W.B and Meigs R.B(1989); intermediate accounting(6th edition) McGraw Hill, New York
2. Mosich A.N (1988); INTERMEDIATE ACCOUNTING (6th edition), McGraw Hill-New York
3. Jennings A.R (1994); financial accounting (2nd edition) Dp publications limited, London.
4. Strathmore study pack. Accounting for assets and liabilities, Strathmore, Nairobi

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7.3.6. Learning Outcome No. 5. Document and computerize business assets

7.3.6.1. Learning Activities

Learning Outcome #No. 5. Document and computerize business assets	
Learning Activities	Special Instructions
• Visit a nearby reputable business and discuss benefits of computerizing business assets and liabilities • Using your institution management, document and updating assets and liabilities • Prepare an assets and liabilities report of your institution. (use the financial records of your institution)	• Sample report on assets and liabilities

7.3.6.2. Information Sheet No. 7/LO5

Introduction

A successful company should have assets that override the sum of liabilities. Organization assets and liabilities are identified by calculating assets, money, investments and products that can be converted into cash.

Definitions of key terms

- **Assets-**Assets are items that are owned by the enterprise. They can be current assets or noncurrent assets
- **Liabilities-**This are those items that belong to outsiders .i.e. Current liabilities e.g. accounts payables and bank overdraft and the noncurrent liabilities e.g. long term bank loans
- **Assets and liabilities report-**A report that contains assets acquisitions assets maintenance and disposal affecting the liabilities owed by the business as at a given date.

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Documentation of organization assets and liabilities

There are 3 key documents in any asset management program;

a) Asset Management Policy
b) Strategic Asset Management Plan
c) Asset Management Plan

While the length, size, and level of detail will vary between organizations, the core of the documents will be the same. The purpose of these documents is to align the organization to common goals, and a common approach to asset management. Now, on to the documents
Asset Management Policy
The asset management policy is a short document, typically not extending more than a single page. The asset management policy highlights key principles and requirements that the organization must follow for implementing and sustaining and asset management strategy and defining the asset management objectives.
These principles and requirements are derived from the organization's strategic plan and should directly support the organization's key objectives.

These principles and requirements could be;

- All decisions relating to asset management shall be formally assessed against risk and economic outcomes.
- Maintain assets in a manner that ensures they meet the life cycle requirements.
- Ensure adequate resources are provided to achieve the asset management objectives.

The asset management policy sets the stage for the asset management program for the entire organization. As such, it should be reviewed and approved at the highest levels of the organization, and communicated and displayed with all other organizational policies, such as quality, safety, etc.

Strategic Asset Management Plan (SAMP)

SAMP is a key document which takes the asset management policy and specifies how the principles and requirements will be carried out to achieve the goals of the organization.

Depending on the size of the organization the asset management policy may be combined with the SAMP. This is typically found in smaller organizations or organizations without a complex asset portfolio.

The SAMP will describe;

- the asset management objectives and how they support the organizational objectives
- the role of the asset management program in achieving the organizational goals
- the approach for developing asset management plans

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The document summarizes a variety of additional information related to asset management at the strategic level. This includes, but is not limited to;

- The asset management framework
- What assets will be covered by the asset management program
- The organization context and the need for an asset management system
- The risks and opportunities associated with asset management
- The asset management planning process provides a summary of the approach to selecting the objectives
- A documented approach to achieving the asset management objectives. This may include decision-making criteria, the analysis techniques used or RACIs
- The specific asset management objectives
- Any specific asset management initiatives that could impact the asset management program
- Any measures that the asset management program will be reviewed against.

The overall goal of the SAMP is to provide clear direction, accountability, and responsibility for all those involved in the asset management program.

Asset Management Plan

The asset management plan (AMP) is where the rubber meets the road. It describes in detail the activities, resources, and timelines required for a specific asset, or class of assets, to achieve the asset management objectives.

In smaller organizations, or those with simple asset portfolios, a single AMP may be used, whereas large organizations with multiple business units and asset classes may have an AMP for each type of asset.

The **AMP** will typically include;

- Information on the asset or asset class such as a description of the asset(s), the roles of the asset(s), the criticality, quantity or assets, the geographical distribution, and the replacement value of the asset(s)
- Information on the stakeholders which will have an impact on the asset(s) and who is generally responsible for what
- The current performance and service levels of the asset(s) and any gaps to the desired level of performance
- Any life limiting factors of the asset(s) such as age, design, capacity, etc.
- Any specific environmental, health and safety or regulatory requirements of the asset(s)
- The lifecycle strategy for the asset(s) in all phases, such as acquisition, operation, maintenance, and disposal
- A summary of the budget requirements for the asset(s) to maintain, operate and any CAPEX requirements
- Any asset specific risks, and any measures to reduce the risk
- Any improvement initiatives across the asset(s)

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Upon the conclusion of reading the AMP, anyone should know how exactly the specific asset or asset class will be managed over its entire life cycle and the current state of the asset(s)

Identify the assets and liabilities of an organization through checking the organization financial statement records

Update assets and liabilities in the data base.

Update the assets and liabilities when there is new acquisition and when assets are disposed.

Preparing assets and liabilities reports, the report should contain the following items;

i. Date of assets acquisition
ii. depreciation provided for assets
iii. Book value of assets owned by enterprise
iv. Any disposal made during the year and whether there was a loss on disposal or a gain on disposal
v. All liabilities as at the financial year end
vi. Any proposals to acquire additional assets out of needs assessments

Benefits of Computerized Asset Register.

With a computerized system, management information reports can be generated to help management to:

- Better manage the Physical Assets in the Public Sector.
- Assess the budget incurred in the purchase, and repair and maintenance of Physical Assets by summary financial reports that will be generated in the system.
- Detect fraud or loss of assets by providing information on full history of movement, transfer or interventions on individual assets.
- Monitor the movement of assets from one ministry to another.
- Provide up- to- date statistical information on physical assets

Conclusion

The trainee should be able to identify organization assets and liabilities, update assets and liabilities in the database and prepare assets and liabilities report.

7.3.6.3. Self-Assessment

a) The following documents are key to organization assets and liabilities. Which one is not
    - Bank statement &strategic plan
    - Assets management policy
    - Assets management Plan
    - Strategic assets management Plan

b) Which document shows requirements to be followed by an organization to implement assets management
    - Assets management policy
    - Assets Management Plan
    - Business plan

c) Assets management plan is a document used to provide clear direction accountability and responsibility for all assets management program?
   True [ ]   False [ ]

d) Explain the meaning of the following terms
    - Assets and liability registers
    - Assets and liability data base

e) Describe the key elements of assets and liability report
f) Discuss the key components of an organization assets and liability register
g) Explain the importance of updating an assets and liability database
h) Prepare an asset and liabilities report of your institution (use financial records, of your institution)
i) Prepare an assets register for your institution assets and liabilities in an asset register

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7.3.6.4. Tools, Equipment, Supplies and Materials

- Computer
- Tablet
- Internet connectivity
- Stationery

- Format templates of assets and liability registers and reports
- Case studies

7.3.6.5. References

1. Meigs W.B and Meigs R.B(1989); intermediate accounting(6th edition) McGraw Hill, New York
2. Mosich A.N (1988); INTERMEDIATE ACCOUNTING (6th edition), McGraw Hill-New York
3. Jennings A.R (1994); financial accounting (2nd edition) Dp publications limited, London.

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