

Constructed water well as part of the land asset..?

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Introduction

The nature of the business that is considered for this case study is importing and locally purchasing the electrical items and after assembling they are sold those products to customer. Their production can be categorized as solar panels & LED bulbs. Their main office is located near Colombo. It could be found that there are two water wells in their store premises and they have been capitalized them as a part of land so the issue has aligned with capitalization of land additions.

Discussion of the Issue

In that audit it has been identified that there is a classification error in Non-current assets in statement of financial position. Under their Non-current assets it has been stated increasing in land value, in this year state land value as Rs: 900,000.00 compare to previous year land value of Rs: 800,000.00. According to client's explanation, they have built up two wells on this land in the current reporting period and it has been considered as value additions to the land. Costs of those two wells were identified as Rs: 100,000.00 but in the other hand these wells are not using to business purposes in their business. Nature of this wells were dig deep into land and it covered with circular cement wall.

It should be calculated appropriately cost of those wells and it should be correctly stated in Non-current assets on statement of financial position according to point of view of us. As well as if it can be calculated the cost of circular cement wall in appropriate method, it can be stated as Building on statement of

financial position and it can be depreciated with buildings in to same depreciate rate. But it can't be capitalized the cost of digging wells under land and it should be stated under land improvement belongs to land on statement of financial position. This land improvement can't be depreciated because of it can't be identified the useful lifetime of this improvement due to uncertainty of water springs, quality of stagnate water and amount that can be extracted etc. Following accounting standards are used for this case.

- According to SLFRS for SMEs, Section 17

Section 17.8: Land and building are separable assets, and an entity shall account for them separately, even when they are acquired together.

Section 17.21: When determining the useful life of assets an entity shall consider the expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.

Implication of the issue: Those wells were capitalized to land and due to this reason cost of those wells didn't depreciate. As a result of that their profit in this reporting period was overstated based on fully cost value of wells. And also their land value increase, some person can understand this increase as an acquisition of land. It can mislead decisions of stakeholders.

Conclusions and Recommendations

This land addition was incorrect and the cost of two wells should be capitalized following way.

- ✓ The cost of digging floor in deeply should state under land improvement in property, plant & equipment. It is not allow for depreciation.

- ✓ The cost of circle cement wall should be capitalized under buildings.