

Efficiency of fixed assets use in the chosen company

Bachelor Thesis

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Brno 2016

Acknowledgement

I would like to thank to the supervisor of the thesis, doc. Ing. Patrik Svoboda, Ph.D. for his support, patience, willingness to help and time which he dedicated to me while working on the bachelor thesis.

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Abstract

Jízdný T. Efficiency of fixed assets use in the chosen company. Bachelor thesis. Brno: Mendel University in Brno, 2016.

The bachelor thesis is focused on increasing efficiency of the fixed assets of the examined company. Fixed assets are significant part of every company as without them companies would not be able to carry out their activities and perform their duties fully and in the best way possible. Therefore, efficient use of fixed assets is crucial for the company. Accounting Law must be also taken into consideration and is analyzed in the thesis, as it is binding on companies, since they are obliged to keep their accounting books according to the law. The thesis suggests specific recommendations that would lead to certain changes, which could be carried out in order to manage the fixed assets of the company and which could improve its efficiency.

Keywords

Amortization, Building, Depreciation, Fixed Assets, Leasing, Technical Appreciation

Abstrakt

Jízdný T. Efektivita využití hmotného majetku ve vybrané účetní jednotce. Bakalářská práce. Brno: Mendelova univerzita v Brně, 2016.

Bakalářská práce je zaměřena na zvýšení efektivity využití hmotného majetku ve vybrané společnosti. Dlouhodobý majetek je důležitá součást každé společnosti, bez které by společnost nemohla vykonávat svoje aktivity a povinnosti nejlepším možným způsobem. Proto efektivní využití dlouhodobého majetku je pro firmu klíčové. Zákon o účetnictví musí být brán do úvahy a proto je v práci analyzovaný, protože je pro firmy závazný a společnosti musí vést účetnictví podle tohoto zákona. Práce navrhuje specifické doporučení, které vedou ke změnám. Tyto změny jsou vykonávané za účelem řízení dlouhodobého majetku společnosti a taky vedou ke zlepšení jejich efektivity.

Klíčová slova

Budova, Dlouhodobý majetek, Leasing, Odpisy, Opotřebení, Technické zhodnocení

Table of Contents

1	Introduction	13
2	Objectives and Methodology.....	15
2.1	Objectives	15
2.2	Methodology	15
3	Fixed Assets of the Company	17
3.1	Accounting and measurement of fixed assets.....	20
3.2	Liquidation value	22
4	The Concept of Depreciation and Amortization of Fixed Assets	24
4.1	Accounting Depreciation.....	26
4.1.1	Methods of accounting depreciation	27
4.2	Tax Depreciation.....	28
4.2.1	Methods of Tax Depreciation	28
4.3	Removing Fixed Assets from Accounting Evidence.....	29
5	Technical Appreciation	31
5.1	Technical Appreciation of Tangible Fixed Assets	31
5.2	Technical Appreciation of Intangible Fixed Assets	31
6	Indicators of Effective Use of Fixed Assets	32
7	Practical Part	35
7.1	Characteristics of the company.....	35
7.2	Depreciation of Fixed Assets and Their Value	35
7.3	Structure of Fixed Assets.....	36
7.4	Analysis of the Effectiveness of Fixed Assets.....	38
7.5	Analysis of revenue from rent.....	39
7.5.1	The Annual Comparison of Sales Revenue.....	40
7.5.2	Revenue Development Forecast.....	41
7.5.3	Analysis of Activity Indicators (Effectiveness).....	42
7.6	Analysis of the Technical Evaluation of the Property.....	43

7.6.1	The value of technical appreciation	44
7.6.2	Financing Options for Technical Appreciation	45
7.6.3	Analysis of the Ways of Financing Technical Appreciation of the Building	46
7.6.3.1	Analysis of financing technical appreciation by a bank credit.....	46
7.6.3.2	Specification of demand for a bank credit.....	46
7.6.3.3	Analysis of Financing Technical Appreciation with Financial Leasing.....	48
7.6.4	Evaluation of financing methods of technical appreciation of the building.....	49
7.6.5	Analysis of Depreciation of the Building	49
7.6.5.1	The Choice of Depreciation Method.....	50
7.6.5.2	Depreciation Analysis of Technical Appreciation of the Building	50
7.7	Influence of Taxation and Inflation	51
7.7.1	Inflation and its impact on company decisions on investments	51
7.7.2	The Risk	52
8	Discussion and Recommendation.....	55
9	Conclusion.....	57
10	References.....	58

List of Tables

Tab. 1	Classification of fixed assets of the composition and designated purpose and function preformed	20
Tab. 2	Structure of fixed assets according to depreciation groups	37
Tab. 3	Revenue from rent in years 2010 – 2014 (in CZK), plan and reality	39
Tab. 4	Year – over – year sales revenue comparison (reality)	40
Tab. 5	Revenue development forecast from rent	41
Tab. 6	Revenue Activity Indicator	42
Tab. 7	Comparison of offered credits – 1 500 000 CZK	47
Tab. 8	Comparison of offered credit – 5 000 000 CZK	48
Tab. 9	Technical appreciation of the building with 100% efficiency	48
Tab. 10	Development of corporate income tax in the Czech Republic	52
Tab. 11	Development of Inflation in the Czech Republic	52

List of Figures

Figure 1.	Types of depreciation and its methods	25
Figure 2.	Structure of fixed assets in acquisition costs	32
Figure 3.	Structure of fixed assets in residual value	33
Figure 4.	Revenue from rent in year 2010 – 2014, plan vs. reality	34
Figure 5.	Graphical illustration of year – over – year sales revenue comparison (reality)	35
Figure 6.	Revenue development forecast from rent	36
Figure 7.	Effectiveness of asset turnover in years 2010 – 2014	37
Figure 8.	Development of inflation in the Czech Republic	47

1 Introduction

Every existing company needs for its normal functioning some kinds of means and sources. A big part of this means and sources is represented by basic assets consisting of buildings, structures, machineries, vehicles, plants, lands, equipment and other means of labor, which participate in the production processed and which are the most important foundation of activities of every company. Their presence plays a significant role in every company and without them it would be unlikely that something would be created. Without fixed assets company would not be able to carry out its activities and perform all its duties in the best way possible. Because of this great importance of theirs, the company started to realize the significance of the assets and started to study and examine them in order to use them and utilize them as much as possible.

Fixed assets are purchased by the company for its production or because of other kind of business purpose and, because of their character and value, companies benefit from them for many years after their purchase. They play an important role in the asset structure of the company and because of this reason they must be treated carefully and in the most efficient way.

Efficient and economic use of fixed assets is marked as a priority task for many companies. It is crucial to have a clear idea about all fixed assets that are in the ownership of the company, about each item of fixed assets in the manufacturing process, and about their physical depreciation the factors, which influence their usage. It is possible to name and identify the methods, which help companies increase efficient use of the fixed assets, which help increase production capacity, which also reduce production costs and, of course, which influence growth of labor productivity. Fixed assets of the company are one of the most important factors of any kind of production within any industry because of their condition and effective use has a direct impact on the final results of operations and on company's profit.

Above mentioned facts indicate that companies should analyze their fixed assets in detail and that each company should use the most suitable methods and ways of usage of fixed assets. Each country has a specific Accounting Law, according to which the companies are obliged to act and carry out specific accounting transactions, and so it is important for the companies to know the legislation and execute their processes in compliance with it. Besides the Czech Accounting Law there exist also International Accounting Standards, IFRS, US GAAP, whose main effort is focus on harmonization, which reduces differences among the accounting principles used around the world.

More complete and efficient use of fixed assets and production capacity promotes improvement of all of its technical and economic indicators: growth of labor productivity, increase of capital productivity, increase of production output, reduction of costs, economies of capital investments.

Because of the significant importance, which fixed assets play in every company, the bachelor thesis explains the issue of fixed assets and focuses on their effi-

cient use in the company A and at the same time, it put the emphasis on the law related to accounting of fixed assets.

2 Objectives and Methodology

2.1 Objectives

The main objective of the bachelor thesis is the analysis of the fixed assets in the specific departments of the company A. The company is divided into three main departments and based on the analysis the thesis proposes the steps that could be carried out in order to increase the efficient usage of fixed assets in analyzed company. The issues of amortization, technical appreciation and depreciation, all in compliance with the Czech accounting law, are discussed in the work. The thesis also solves the concrete accounting problems in the company, which are related to the issue of fixed assets.

2.2 Methodology

The bachelor thesis is divided into two main parts. The first part is theoretical part and the second is practical part.

The theoretical part is based on the study of literature of national and also international level. This part consists of acquired theoretical knowledge, which is necessary for the purpose and fulfillment of the objective of the thesis. When finding the needed information there was primarily chosen the literature focusing on fixed assets. The thesis depicts the most important findings from literature and it organizes it systematically. The authors from different countries were studied, which provides the reader with nice variety and diversity of opinions and views on the topic. Literature was in form of books, professional journals, articles and online sources related to fixed assets, accounting, depreciation, amortization, technical appreciation. Different types of accounting approaches and methods are discussed on the theoretical level but later on this theoretical knowledge is connected to practical usage. Important part of the theoretical part is examination of Accounting law of the Czech Republic, which provided the background to the topic and is obligatory for every company in the country. Theoretical knowledge was then implemented in the practical part of the thesis.

Practical part of the thesis is specific by own contribution of the author. Since the thesis focuses on the efficient usage of fixed assets in the specific company named A, it was necessary to acquire needed information and data for further analysis. This was done through personal meetings and discussions with an accountant of the company A. While analyzing efficiency of fixed assets, certain analyses were performed through studying both historical data, but also future predictions of the company based on business plan, future cash flow, and other predictions provided by the company. In the thesis there are often used comparisons that indicate which option is the most suitable and most efficient one. Comparisons also enable evaluate different potential scenarios and set their order.

Subsequently, these information and data were examined and the theoretical knowledge was put into practice. Based on this specific calculations and suggestions were made. The thesis takes into account also external factors, such as inflation, which may influence the performance of the company. The aim of the thesis is to increase efficiency of real existing company and therefore, it takes into consideration real conditions on the market and performs the calculations with concrete numbers. For better understanding and better visualization of the problem the graphs and tables were prepared.

3 Fixed Assets of the Company

Generally speaking assets of the company can be anything that would possibly bring future profit to the company (Peterson, 1994). Very similar definition is provided by Berry (1999), who states that assets present the rights of some kind of company's access to future benefits and they are controlled by an entity based on their past actions. Fixed assets can be defined as part of the property used as means of labor in the production of goods, performance of works or rendering of services or for management of the organization for a period of time, which is longer than 12 months.

Accounting Law No. 563/1991 is in accordance with the law of European Union and is not that often amended like the Taxation Law. The Czech version of definition of fixed assets can be found in Decree on double-entry – accounting for entrepreneurs of Ministry of finance no. 500/2002.

According to the list of accounts defined by Decree on accounting no. 500/2002, an accounting class 0 is primarily used when charging fixed assets. Sedláček (2003) describes fixed assets as assets, which are characterized by their property of long – term lifetime. Resulting from what Sedláček (2003) said, it is clear that its consumption is also long – term oriented. There exist many divisions of fixed assets. However, the most basic one which is also known the best is the division of fixed assets into three basic groups.

1. Tangible fixed assets: assets that are characterized by its tangible nature and the period of usage which is longer than 1 year (in many cases even much longer, e.g. buildings). The value of fixed assets should exceed a limit chosen by the company according to so called “common traditions”. The exceptions are buildings and parcels (structures) which are regardless to their value. By “common traditions” we understand the amount of 40 000 CZK which is normally respected. From the accounting point of view the sum of 40 000 CZK is not obligatory, however, it is necessary to have in mind that it is obligatory from the viewpoint of taxation as this sum is determined by the Income taxes act No. 586/1992. Therefore, because of practical reason the sum of 40 000 CZK is also respected in accounting since it simplifies the accounting process. Examples of tangible assets are buildings (structures), parcels (lands), apartments, cars, cultural heritage, machinery, hardware, equipment and other separable movable items and sets of movable items, orchards and vineyards, adult animals and their groups, etc. The tangible assets can be then divided into two parts:
 - a. Tangible assets depreciated
 - b. Tangible assets non-depreciated (especially lands, separated artistic works and collections.)
2. Intangible fixed assets: assets which are characterized by their intangible nature. Their period for usage is similarly to tangible assets stated for longer than 1 year with the value exceeding the „common traditions“ of amount of 60 000 CZK. The examples of intangible assets are valuable rights, soft-

wares, goodwill, intangible results of research and development etc. Intangible assets are amortized.

3. Financial fixed assets: assets which are characterized by their financial nature and their term of payment which is longer than 1 year regardless to their value. Accounting group 06 – Long – term financial assets is primarily used for this kind of assets. The examples of financial fixed assets are long – term investments, capital shares, equity participation and other credit obligations held for more than 1 year, long – term bills of exchange, etc. Important fact about the financial fixed assets compared to tangible or intangible assets is that they must never be depreciated.

Fixed assets of industrial enterprises represent a set of material values created by social labor, long involved in the production process in the same kind and transferring its value to the products on manufactured products by parts in process of deterioration. Besides the basic division of fixed assets, there are many authors who use more detailed and comprehensive division. For example, Cantor (2002) says that fixed assets have the following characteristics:

- They exist physically and, thus, are tangible assets.
- They are owned and used by the company in its normal operations.
- They are not offered for sale as part of normal operations.
- Object can bring economic benefits (income) in the future.

There are several classifications of fixed assets. Division based on the purpose and the scope of application of fixed assets is made as well:

- Fixed production assets are present in primary activities, which function in the production process, they are constantly involved in transferring their value into the finished product. Another specification is that they are replenished at the expense of capital investments;
- Non-productive fixed assets, which are intended to service the manufacturing process, and therefore they are not directly involved, and did not carry its value to the product, because it is not made. They are not replenished at the expense of capital investments but they are reproduced at the expense of the national income.

Despite the fact that non-productive fixed assets do not have a direct impact on the volume of production and labor productivity growth, but there can be noticed the constant increase of these funds associated with improved well-being of employees, increase of materials and also increase of cultural standards of life that ultimately affects the result of the company activities (Cantor 2002). The author also says that among the main non-productive assets are objects of the company, which include non-production objects, for example, houses, kindergartens and nurseries, schools, hospitals and other health care facilities and social amenities, which are owned by industrial enterprises (they indirectly affect production process). Fixed assets related to production process are collection of means of labor functioning in sphere of material production, which keep the same natural form for a long time and they carrying their value to the newly created product in parts, as wear and tear for a number of circuits.

According to the existing classification of fixed capital industry based on their composition depending on designated purpose and functions, they can be divided into the following types, which are shown in the table:

Name of the group	Composition of group	Brief characteristics
The Buildings	Industrial buildings, offices, laboratories, warehouses, shops	Create favorable conditions for the normal course of the manufacturing process, protect machinery and equipment from the external atmospheric environment
Structures	Mines, oil and gas wells, culverts, bridges, tunnels hydraulic structures, water and sewer facilities, overpasses	Perform the functions of maintenance of production, is not related to changes of the object of labor
Transfer devices	Electricity transmission and communication devices: mains and Heating Network, pipelines, cable lines, air lines of communication, sewage networks, water pipes	Transmit electrical, thermal and mechanical energy to a working machine.
Machinery and equipment	Metal cutting and woodworking machines, presses, heat treatment furnaces, electrical equipment, electrical equipment, energy, working and information machinery and equipment	Directly involved in the manufacturing process during which when exposed on the subject of labor a finished product is formed
Means of transport	Railway rolling stock, water transport, cars, air transport, subway trains, trams.	Designed for production, domestic and sanitary functions, transportation of goods and people, as intraproductive intrashop transport.
An Instrument	All kinds of tools for metal, wood: mechanical, pneumatic and electric tools	Involved in the production process and service on its maintenance
Measuring and regulating instruments and devices, laboratory equipment	Control and the check, measuring and test equipment, control panels, alarm and locking	Intended to automate the management production, testing and laboratory testing of finished products, semi-finished products, raw materials and components

Inventory production and household	Manufacturing equipment - items for industrial purposes: liquid storage tanks, containers, and furniture. Household equipment.	Involved in the production process (with the exception of household equipment)
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Tab. 1 Classification of fixed assets of the composition and designated purpose and function preformed

Source: own elaboration based on Gorfinkel & Kupryakov (1996)

Share (percentage) of the different groups of fixed assets in the total value in the company present the structure of fixed assets. Cantor (2002) provides an example of mechanical engineering enterprises where in the structure of fixed assets the highest share is occupied by machinery and equipment - an average of about 50% and about 37% of the building.

When taking into consideration the degree of participation in the production process, basic production assets are divided into active assets and passive assets. Active assets have a direct impact on the change in the shape and properties of the items of work and they include machinery, equipment, vehicles, equipment, inventory and others.

Passive assets are buildings and inventory, whose purpose is to ensure the normal functioning of the active elements of fixed assets.

Fixed assets are also characterized by a specific gravity value of fixed assets (equipment) of different age groups in the total value of funds. The basic division based on the age structure of the grouping equipment is that the age groups are divided into up to 5 years, from 5 to 10 years, from 10 to 15 years, from 15 to 20 years and above 20 years.

According to the degree use of fixed assets are divided into:

- fixed assets that are in operation;
- fixed assets that are in stock (reserve);
- fixed assets, which are in the process of completion, additional equipment, reconstruction and partial liquidation;
- fixed assets that are on conservation.

3.1 Accounting and measurement of fixed assets

Accounting and measurement of fixed assets is carried out in-kind and cash. Natural form of accounting of fixed assets is needed when determining their technical condition, capacity of the enterprise, degree of use of equipment and other purposes. Fixed assets of enterprises, which are accounted in monetary terms, represent the most significant means. When talking about measurement of fixed assets, Sedláček (2003) states that tangible, intangible and financial fixed assets may be valued by its:

- acquisition cost (mainly the assets acquired in terms of purchase),
- replacement acquisition costs (these costs are used for assets acquired for free)
- own costs, also called production costs (used for the assets, which are made by own activity of the company.)
- face value, also called nominal value (used mainly for measurement of cash, checks etc.)

Acquisition price represents the value for which the asset was purchased but also including the costs connected with the purchase (for example, transportation costs, brokerage, duty, installations etc.) Replacement acquisition costs (sometimes referred to only as replacement costs) are used when the assets were acquired for free. In such case, the current fair market price for making purchase of another, similar asset that provides the same future benefit or service potential, is used. The third method of measurement, the own cost approach, is used when valuating the assets, which were produced by own activities of the company. When calculating own costs, there are included direct costs spent on the creation of the asset, then part of indirect costs spent on the creation of the asset (for example, administrative overheads).

According to Waren (1999), the monetary measurement of fixed assets is carried out in a following manner:

1. In daily practice, the fixed assets are taken into account and planned for at cost. It represents the cost of purchase or construction of fixed assets. Machinery and equipment are accepted on balance of the enterprise at their purchase price, including the wholesale price of given kind of labor, freight and other purchase costs, installation costs and installation. The initial cost of buildings and transfer devices is the estimated cost of their creation, including the cost of construction and installation work and all other costs associated with the work on the introduction of this facility into action. All costs associated with the creation of fixed assets are carried in current prices (Thomas, 2014). Over time, the fixed assets on the balance sheet are accounted by the mixed assessment, i.e. at current prices and tariffs, their creation or acquisition of fixed assets. Measurement of fixed assets at historical cost needed to determine the amount of fixed assets, which are reserved for the certain company. Depreciation and indicators of use of funds are calculated on the basis of historical cost. Replacement cost expresses the cost of reproduction of fixed assets at the time of the revaluation, that is, it reflects the cost of acquisition and the creation of the means of labor in prices, rates, operating in their reproduction period, taking into account revaluation. To determine the replacement cost of regularly held revaluation of fixed assets by means of two basic methods:
 - a. through indexation their carrying amounts;
 - b. through direct calculation the carrying amount of in relation to the prices formed on January 1 of the next year.

2. With their help it is possible to achieve similar measurement of fixed assets of industry in accordance with the present value of their recovery, which will set the wholesale prices of means of production, and lending of capital investments.
3. The full value of fixed assets (book value) is calculated without regard to the value, which is transferred by parts on the finished products.
4. Residual value is the difference between the original cost and depreciated (fixed assets not transferred to the finished product). It allows you to judge the degree of depreciation the means of labor, plan update and repair of fixed assets.
 - it is determined at historical cost, determined by the extent of depreciation;
 - at replacement value which determined expert way in the process of re-valuation means of labor.

3.2 Liquidation value

Liquidation value may be defined as the amount of money that could be possibly received through the sale of an asset. It is also used when estimating the worth of the physical assets when the company goes out of business or as if it was. Fishman (2013) explains liquidation value as “the value of a business or of an asset when it is sold in liquidation, as opposed to being sold in the ordinary course of business”. Revaluation of fixed assets, as Thomas (2014) states, is the real value of the fixed assets of organizations at the present stage formation of market economy and the creation of preconditions for the normalization of investment processes in the country. Liquidation value is the likely price of an asset when it is allowed insufficient time to sell on the open market, thereby reducing its exposure to potential buyers. Liquidation value is typically lower than fair market value. Unlike cash or securities, certain illiquid assets, like real estate, often require a period of several months in order to obtain their fair market value in a sale, and will generally sell for a significantly lower price if a sale is forced to occur in a shorter time period. Liquidation value may be either the result of a forced liquidation or an orderly liquidation. Either value assumes that the sale is consummated by a seller who is compelled to sell and assumes an exposure period, which is less than market normal. Get a copy of the latest annual report. This report can be requested by contacting the Investor Relations department of the company. Besides, it can also be downloaded directly from the website of the company.

The steps in order to calculate the liquidation value are:

1. Find the line item assets and liabilities where assets refer to the complete range of assets owned by a company and liabilities represent the debt taken on by the company to purchase these assets.
2. Determine the expected liquidation value. This is done by subtracting the company's liabilities from its assets.

3. To conclude with, the liquidation value presumes that the sale is carried out by a seller who is compelled to sell and presumes an exposure period which is lesser than the market norms.

4 The Concept of Depreciation and Amortization of Fixed Assets

In the Czech Republic, there exist two types of depreciation. The first one is accounting depreciation and the second one is tax depreciation. Method of depreciation of assets as well as its course is governed by the Law on Accounting and the Law on Income Tax. Depreciable amount of an asset is the value which is systematically allocated over the serving period of this asset. The term “amortization” is usually used in the case of intangible assets instead of “depreciation”. Landa (2006) writes that fundamental characteristics of fixed assets is its long – term usage and its continuous depreciation. There are two main reasons because of which the depreciation of fixed assets is used:

1. both tangible and intangible assets are being worn out over the time and this fact must be expressed from both economic and accounting point of view, and thus, are in some manner included in the expenses of the company,
2. the second reason comes from the fact that the price of fixed assets cannot be included in the company’s expenses. Regarding this, there must exist accounting tool in order to somehow include acquisition price into company’s expenses.

The tool for realization of both mentioned factors is depreciation. As already mentioned in previous chapter, there are some assets that cannot be depreciated. Landa (2006) stated these:

- financial assets,
- lands (parcels),
- work of arts , which are not part of building, movable cultural heritage, and similar movable things determined by special law,
- unfinished tangible and intangible assets, technical appreciation unless it is in the state suitable for usage,
- financial property,
- rented or similarly used fixed tangible and intangible assets, if not stated by law differently,
- receivables.

Useful life of an asset is the period over which an asset is expected to be utilized or the number of production units expected to be obtained from the use of the asset. Expected useful life is the period “used” not the assets economic life, which can be significantly longer. The useful life is determined on the basis of use, expected capacity, expected output, legal limits, maintenance program, expected wear and tear, and technical or commercial innovations. Then it depends on the term the physical durability of fixed assets, of moral depreciation of existing fixed assets, of the availability of the national economy ability to provide replacement of obsolete

equipment (Warren, 2012). The value of depreciation is determined on the basis of depreciation rates. Depreciation rate - is established amount of depreciation charges on the full restoration for the certain period of time on a particular type of fixed assets, expressed as a percentage of their book value. Depreciation rate is differentiated over separate species and groups of fixed assets.

Depreciation starts being charged when an asset is in the location and condition that allows it to be used in the intended manner. The depreciation should be charged even if the asset is temporarily idle because future economic benefits are consumed not only through usage but also through wear and tear and obsolescence. Depreciation ceases at the earlier of its derecognition (i.e. disposal or scrapping) or its reclassification as "held for sale" (Frank J. Fabozzi 2007).

Each part of an item of property plant and equipment with a significant cost shall be depreciated separately. The depreciation should be charged to the profit and loss statement of comprehensive income unless it is included in the cost of producing another asset.

Depreciation of fixed assets is determined for a full calendar year (no matter what month of the reporting year they are acquired or constructed) in accordance with established standards. Depreciation cannot represent more than 100% of the cost of fixed assets (Kocmanová, 2006). Depreciation in the amount of 100% of the objects (subjects) that are suitable for further use, cannot serve as the basis for the write-off because of their complete deterioration. With regard to existing fixed assets, their physical depreciation depends on several factors:

- quality of fixed assets (materials from which they are made, the technical design excellence, the quality of construction and installation);
- the degree of load (number of shifts and hours of work per day, duration of work the year, the intensity of the use in each unit of time);
- features of technological process and the degree of protection of fixed assets;
- the influence of external conditions, including corrosive environments (temperature, humidity, etc.);
- quality of care (timeliness cleaning, lubrication and painting, regularity and quality of repair);
- Qualification of workers and their relation to fixed assets.

Physical deterioration may be partially compensated at the expense the repair, reconstruction and modernization. Physical depreciation by working life may be applied to all types of fixed assets. Fixed assets that are found on the enterprise exposed not only physically, but also obsolescence. However, capital assets are also subject to moral depreciation, which is after serving for some period of time, they may become obsolete before they are physically worn out and have to be replaced by more up-to-date means of production. Such obsolescence of the assets is caused by technological changes and by the introduction of new and better machinery and methods of production. Obsolescence can also be caused by the commodity produced by the asset, for example, if it goes out of fashion. In the latter case, the de-

degree of obsolescence will depend on the specific nature of the asset. Sometimes assets can be easily adapted to alternative uses while others may have only one application. Obsolescence is characterized by decrease in the cost of capital assets under the influence of scientific and technological progress. Obsolescence has two forms. The essence of the first form is reduced to a gradual decrease in the value of fixed assets in the current environment, while maintaining the same value in them. Early replacement of fixed assets is not required, as the technical characteristics of these resources while satisfying the requirements of the market. This form is included in the reassessment of the replacement cost.

The second form of obsolescence is to reduce the use-value of fixed assets due to the appearance on the market of more sophisticated and effective. Thus, with the advent of digital stations lose their significance coordinate. Fiber optic cables are replacing traditional cables, computer equipment replaced the telegraph devices, and mobile radio communication becomes more and more popular and gradually rises in line with a wired telephone. The introductions of new technology obsolete funds are eliminated before their service life, despite physical fitness for use. They are simply unnecessary.

4.1 Accounting Depreciation

Accounting depreciation determines fair depreciation according to real usage in the conditions of the concrete company, which means that it depicts real asset depreciation. Companies themselves determine monthly amount of depreciation based on depreciation schedules (used internally). The accounting depreciation is regulated by Accounting Act no. 563/1991, by Decree on accounting of Ministry of finance no 500/2002 and by the Czech accounting standards n. 013. Accounting depreciation plays an important role in the company as it affects the value of the depreciation fund, the degree of concentration of resources in different periods of operation of fixed assets at the amount of deductions, which will be included in the cost of production.

Companies can calculate the depreciation of assets with many in accounting depreciation the company sets its own methods and approaches of write - offs. The company is obliged to create a depreciation plan for all depreciable fixed assets. The basis for depreciation is the value of fixed asset which is found in the accounting group 01 or 02, in the moment of usage of the asset, alternatively increased by technical appreciation which is realized during the usage of tangible fixed asset (Šebestíková, 2013). The expenses can be burdened by write - offs on monthly, quarterly or yearly bases.

It is a right of the accounting unit to choose a method of depreciation and a period of a life cycle of the fixed asset according to its real usage. The calculated depreciation must be charged on accounts 07 - Cumulated depreciation to intangible assets and 08 - Cumulated depreciation to tangible assets. It can be said that accounting depreciation represents an operating expense of the company.

4.1.1 Methods of accounting depreciation

An accounting unit has a right to choose a method of depreciation. The role of accounting depreciation is to determine asset's fair amortization. In general, it can be stated that there are methods of accounting depreciation based on time and output. However, in general, there are three most common depreciation methods used, which are also named by Marininč (2013) in his book and those are:

- Linear (proportional) method: when using this method the same amount is amortized in each year of usage. Thomas (2014) explains that depreciation expense is recognized evenly over the estimated useful life of asset under linear method of depreciation. This method is the easiest for administration, however, it does not always express the real amortization of the asset and in some cases it may cause obsolescence of technology.
- Accelerated (digressive) method: when using this method the size of write-offs is getting smaller. Amortized value each following year of usage is smaller than in the previous year. For the company this means faster accumulation of internal financial resources that better functioning of the assets at the beginning, which causes faster renewal of technology. This method continues to decrease the value of the asset over its useful life until at the end of assets' life, all there is left is a residual value. This residual value is the scrap value at which assets can be sold in the market after its useful life is finished.
- The double – declining balance method, so called DDB, is the method of depreciation, which is the most aggressive one when recognizing the expenses toward the beginning of the useful life of assets. The first step when calculating using this method it is necessary to determine the straight - line depreciation for the first year. The next step is to double the amount and then to subtract the depreciation of the first year from the asset cost. This calculation is repeated again in the next year. The method is used during the useful life of the asset (Bragg, 2008).
- The SYD (Sum of the years' digits) is another method in which its yearly depreciation declines firmly over the useful life of depreciated asset. This method is less extreme than the double – declining balance method. When calculating using this method we need a fraction which is found by summing up the years' digits. For example, the useful life is 5 years it is necessary to sum up the years' digits: $5+4+3+2+1=15$. The first year's fraction is then $5/15$, the second year's fraction $4/15$, the third year's is $3/15$ etc. (Eisen, 2007).
- Progressive method: when using this method the size of write-offs is growing. Amortized value each following year of usage is greater than in the previous year. Even in case that we write – off the asset only once a year it is needed to divide it by the number of months in which the asset is in use. This method is used pretty rarely in the practice.
- Component depreciation is the method in which there are set the components of the asset. These components are different parts of the asset that

should be depreciated with different treatment. At the end of the useful life of a component and at the time of its replacement this component reduces the measurement of fixed asset and on the other hand, the new component increases the measurement of fixed asset. In case of IFRS it is mandatory for the companies to use component depreciation when the parts of the asset are of different patterns of benefit. US GAAP also permits this method, however, it is not commonly used in practice.

4.2 Tax Depreciation

Tax depreciation determines the part of depreciable value, which is accepted as a tax cost regardless real depreciation of fixed assets. The amount and form is determined by the law on income tax. These write-offs are applied directly to the accounting costs of the company, but are taken into account in determining the income tax (are deductible). The tax depreciation is regulated by law no. 586/1992 of income taxes, especially in paragraphs 26 – 33. The law provides the depreciation groups with their length of depreciation period. The tax depreciation is divided on tax depreciation of tangible assets and tax depreciation of intangible assets. Only tax depreciation is declared as tax expense, not the accounting one. However, tax depreciation does not have any affect on the accounting economic result of the company and it is declared only in tax declaration. As Weil, Schipper and Frncis (2013) state, if the choice of depreciation method in case of tax depreciation is permitted then the aim of the company should be the maximization of the present value of the reductions in tax payments. If there are fulfilled the two conditions of not changing tax rates over time and the company being sufficiently profitable to benefit from the mentioned tax deductions, the company should follow the rule that deductions processed earlier are of greater value than the later ones. The company should conduct in a way that it pays the least amount of tax as late as possible, but of course, within the national law.

4.2.1 Methods of Tax Depreciation

Regarding the methods of tax depreciation related to fixed assets, Dvořáková (2016) writes about two of them.

1. Straight line method: the period of time is determined by one of the six accounting groups in which the given asset was classified. Yearly depreciations are the same each year when using this method, only with exception of the first one. The tax payer may, however, use lower yearly depreciation rates as only the maximal depreciation rates are given by the law.
2. Accelerated method: the period of time is again determined by one of the accounting groups in which the given asset was classified. However, yearly write – offs are getting lower compared to the previous year, starting in the second year of depreciation. In the first year of depreciation, the write – offs are lower than in the second one. In this method, of course, the tax payer

cannot use the lower depreciation rate, the depreciation rates are strictly given by the coefficients provided by the law.

Both straight-line method and accelerated method can be interrupted. Regarding straight-line method it is possible to use lower write-off than originally calculated one and the rest will be applied at the end of the useful life. In case of accelerated there is the option of not applying the write-off or interruption, which results in prolongation of tax depreciation.

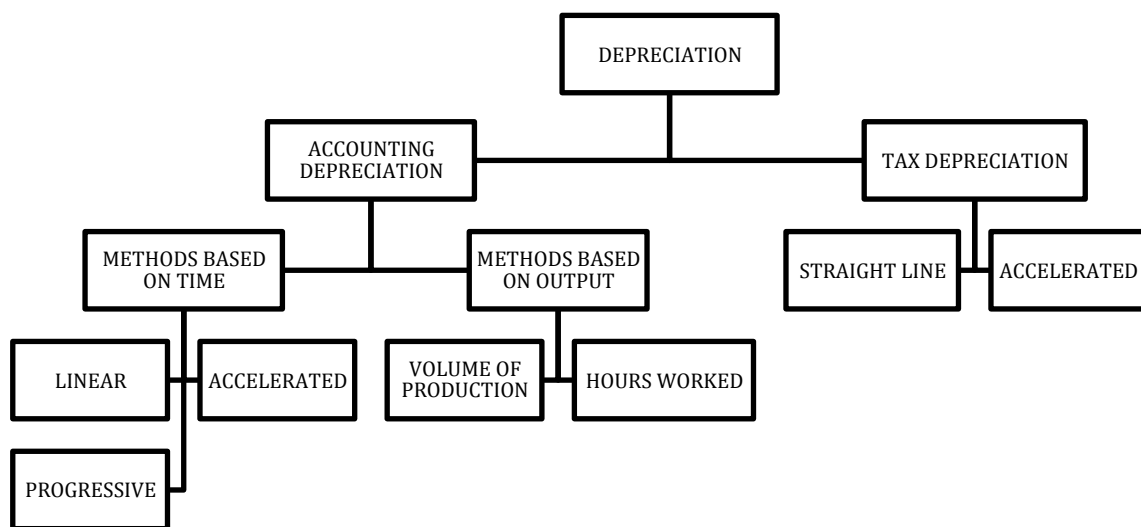


Figure 1. Types of depreciation and its methods
Source: own elaboration based on Landa (2006)

4.3 Removing Fixed Assets from Accounting Evidence

In order to remove fixed tangible and intangible assets and technical appreciation lead accounting unit to the most common unfunctionality of the assets due to wear, total destruction of the asset or its replacement by different asset (Šebestíková, 2013). Because of these factors it is possible to remove the fixed assets from accounting evidence. Warren (2008) defines it in the following reasons for removal:

- liquidation as a result of physical wear,
- liquidation as a result of damage,
- sale,
- donation,
- transfer into different business unit.

There are two possible scenarios related to fixed assets removal (Landa, 2006):

1. The situation when the asset is fully depreciated, which means that its net book value in the moment of its disposal is zero.
2. The situation when the asset is not fully depreciated, which means that its net book value in the moment of its disposal is not zero.

In the first situation, the asset may be simply removed from accounting evidence as it was fully depreciated. Its disposal is charged in its historical cost. In the second situation, the asset must be firstly charged on so called „one – off depreciation of the amortized value“, whose aim it to fully depreciate the fixed asset. Then it is necessary to consider the reason why the asset is being removed from the evidence. The reasons can be sale and donating assets, liquidation and damage. Just after this it is possible to remove the asset from the accounting evidence.

5 Technical Appreciation

Technical appreciation increases the value of fixed assets. By technical appreciation we understand the interventions of the asset, which has been already used, and these interventions result in a change of its purpose or technical parameters, or improvement of its facility, equipment or usability of the asset. This includes superstructures, outbuildings and construction works. Expenses spent on interventions related to fixed assets are considered to be technical appreciation of fixed assets (Bulla, 2015).

5.1 Technical Appreciation of Tangible Fixed Assets

Income Tax Law §33 describes technical appreciation as expenses spent on completion of superstructures, outbuildings, construction work, reconstructions and modernization of asset, which resulted in increase of the value of the asset by more than 40 000 CZK. However, change of tires on vehicles is not considered as technical appreciation. Extension of equipment or usage of asset is considered as modernization. If technical appreciation is not written – off individually, it increases the entry price and residual value of given asset. Technical appreciation is newly defined also in regulation for entrepreneur §47. Its definition is very similar to the one coming from income tax law, the difference is in the limitation for determination of technical appreciation. This limit in accounting must be identical to limit for categorizing of individual things into long – term depreciated assets. Regarding the buildings and constructions the expenses must reach significant values in relation to acquisition price of building or construction (Skálová, 2016).

Defining the technical appreciation in the regulation led to cancellation of interconnection between the accounting and income tax law.

5.2 Technical Appreciation of Intangible Fixed Assets

Skálová (2016) also says that according to the income tax law §33 the technical appreciation is considered as expenses spent on completion of extension of equipment or usage of intangible fixed assets or interventions which result in change of purpose of intangible fixed asset, if after the completion of individual intangible asset it exceeded the amount of 40 000 CZK.

6 Indicators of Effective Use of Fixed Assets

Resulting from the main purpose of fixed assets it is derived that fixed assets are employed in the business mainly for the purpose of generating sales, then profits. Every business should analyze, report and keep record of what is the success with which fixed assets participate in producing turnover (Gowthorpe, 2005). When Albrecht, Strice and Swain (2007) discuss the issue of fixed assets turnover ratio, they describe it as ratio which uses data from financial statements in order to give a rough indicator of how efficient a company's performance is utilizing its property, plant and other equipment when fulfilling its aim which is to generate sales. The authors warn the readers about being careful when interpreting the fixed asset turnover ratio because the values which are acceptable for this ratio are significantly different from one industry to the next one. Therefore, it would not be objective and meaningful to compare two ratios representing two different industries. It is also possible to use fixed asset turnover when evaluating the appropriateness of company's level of property, plant and equipment. This efficiency ratio is also used in order to assess the amount of extent to which asset are well managed and utilized. Their profiles determine the characteristics of the benefits they provide during their service life. Once their characteristics and profile was determined, it is possible to compute periodical consumption of fixed assets. The number is calculated as sales divided by average fixed assets. Albrecht, Strice and Swain (2007) provide following formula:

$$\frac{\text{Turnover (Sales)}}{\text{Fixed Assets}}$$

The analysts using fixed asset turnover must be aware that the calculations use the historical costs of fixed assets (Megginson, Smart, 2008). However, there are companies which have assets of different ages and so comparing their fixed asset turnover can also lead to a misleading as companies owning newer assets usually have lower turnover ratio that the ones with older assets and so lower book value. The reason of this is also that when computing the formula the fixed assets are considered net of depreciation. Therefore, Banerjee (2009) suggests calculating the ratio on the basis of gross block of fixed assets rather than on the net basis. However, the author also emphasize the fact that when comparing a time series of mentioned ratio related to an individual company, net block should be considered, unless the depreciation policy is changes.

Accounting and measurement of fixed assets are helping judge the quantitative share of fixed assets in the overall composition of the elements which are present in the enterprise economy. In order to consider how such funds (qualitative aspect) could be managed and what does affect the change of its economy and its structure, all this information can be obtained only from the analysis of groups of indicators. All indices of fixed assets can be grouped into three groups.

- Indicators of extensive use of fixed assets, reflecting the level of use of their time;
- Indicators of intensive use of capital assets, reflecting the level of use for power (performance);
- Indicators integrated use of fixed assets, taking into account the cumulative effect of all factors – both extensive and intensive.

The first (extensive) group of indicators include (Thomas, 2014):

- 1) the extensive use of equipment;
- 2) coefficient of variability of the equipment;
- 3) load factor of equipment;
- 4) variable rate mode time of the equipment.

1. Coefficient extensive use of equipment (K_{ext}) is determined by the ratio of actual numbers of hours the equipment to the number of hours of operation under the plan

$$K_{ext} = t_{act}/t_{pl}$$

2. Enterprises should strive to increase the coefficient of variability of the equipment, leading to an increase in output at the same cash funds.

Main directions of increasing variability of the equipment:

- Increasing specialization of jobs, providing growth batch production and loading facilities;
- Increase the rhythm of work;
- Reduction of downtime associated with deficiencies of maintenance jobs of machinists slabs, tool;
- Better organization of repair case, the application of advanced methods of repair;
- Mechanization and automation of basic work, and especially support workers. This will free up labor and put it on heavy support work on the main work in the second and third shift.

3. Coefficient loading equipment also describes the use of equipment over time. Set it for the whole fleet, which are mainly manufacturing. Calculated as the ratio of labor producing all products of this type of equipment to the fund since its work. Thus, the load factor of equipment as opposed to the factor takes into account the variability of data on labor-intensive products. In practice, the load factor is usually taken as equal to the size of the coefficient of variability, reduced twice (in two-shift mode) or three times (in three-shift operation).
4. Based on the rate variability of the equipment is calculated and the factor variable treatment time of the equipment. It is determined by dividing

made in this period, the coefficient of variability of the equipment installed in the enterprise (in the shop) the duration of the change.

However, the process of equipment and has the other side. Equipment can be downloaded fully, to work at idle and at that time did not produce products or working, producing low quality products. In all cases, the counting rate of extensive use of equipment, normally we get good results. However, they are not allowed to conclude that the efficient use of capital assets. The results should be supplemented by calculations of the second group of indicators – intensive use of capital assets, reflecting the level of their use of power (performance). The most important of these is factor intensive use of equipment.

Factor intensive use of equipment is determined by the ratio of the actual performance of the main process equipment to its regulatory performance that is progressive technically sound performance. To calculate this indicator using the formula:

The third group of indicators of capital assets is integral coefficient of equipment, utilization of production capacity, rates on capital and capital intensity products.

Integral ratio of equipment is determined as the product of the coefficient of intensive and extensive use of equipment and comprehensively describes the operation of his time and productivity.

7 Practical Part

7.1 Characteristics of the company

The bachelor thesis examines the company A that was founded in 1997 and it is located in Brno, Czech Republic. The company A employs around 20 employees including regular workers, sellers, security, servicemen and managers. The company focuses on different types of activities, which can be divided into three main parts. According to these parts, the company A is divided into three main centers as the activities of all of them differ significantly.

The first center focuses on the purchase and subsequent treatment of cut flowers and potted flowers in the branch stores which are located in the city. The branch stores also offer different kinds of supplements for their customers such as pottery, ceramics, fertilizers, artificial flowers and others.

The main focus of the second center of the company is renting of commercial premises, offices, warehouses, garages, parking spots in the center of Brno.

The activity of the third center is offering the services related to tanning and so the company A owns two solariums also located in Brno.

From the description of all three centers it is clear that each center needs and owns different types of fixed assets and so they must be treated and used in a different way in order to be efficient.

7.2 Depreciation of Fixed Assets and Their Value

A characteristic feature of fixed assets (both tangible and intangible) is that they enable or enhance possibilities in existing business activities. This, of course, implies for company A, too. In business practice; therefore, the fixed assets are not generally intended to be resold, but to its long-term use in the company (the only exception is the sale of unnecessary assets or the need to obtain additional financing necessary for the security of the whole company). Unlike from international accounting standards it is not significant whether the company uses fixed tangible assets itself or is renting it for capital appreciation. All assets are recorded in the accounts of class 02 and cannot be considered as a financial investment, which is recorded in the class 06.

As the fixed assets are being used, gradually they wear down and their value decreases. Assets depreciate either physically (as a result of its use or by natural factors) or morally (as a result of its technical obsolescence). At the same time, with their use, the value of assets transfers to the value of the finished goods or services provided. Since the company A, owns different types of fixed assets, from which there are also buildings, garages and warehouses and other long – term assets, their depreciation plays an important role in accounting. Company A is the Czech company and therefore, it uses Czech accounting standards.

The rate of physical depreciation means the loss of value of tangible assets. The size and speed of material depreciation is influenced by various factors¹:

- Rate of the operational load (number and length of shifts, the intensity of use)
- Way of placement (protection against climatic influences and other)
- Quality of the particular asset (material, technical excellence of construction, etc.).
- Operating qualifications (both technical and cultural level)
- Quality of maintenance and repair
- Working items (type of material, e.g. ground- wood pulp)
- External operating conditions (e.g. the state of road networks, haul seats, layout of manipulation warehouse, etc.)

Life of fixed assets can be in some cases extended:

- By regular repairs and maintenance
- Technical appreciation, reconstruction or modernization (however, not every technical appreciation will extend the life of assets)

On the contrary, the firm does not acquire long- term financial assets in order to use it in the long term for its activities, but the goal of the company in the case of this type of asset is to achieve profitability in the form of certain financial income or capital appreciation.

7.3 Structure of Fixed Assets

Following part of the thesis deals with the question of the effectiveness of fixed assets, specifically a building that has long been used for rent and with a question of whether technical appreciation of assets can contribute to more efficient use and whether such an assessment will be profitable for the company.

But first, the thesis focuses on the structure of assets. Currently, the company owns assets with a total accounting cost of 12,605,556.93 CZK. Mentioned assets are assets whose purchase value was higher than 40,000 CZK and the period of use greater than one year ² (in terms of internal accounting regulations conducted by the synchronization of accounting and tax depreciation). They are the assets, which depreciate. It represents the depreciation allowance for deterioration or obsolescence. The current value of fixed assets of the company is 4,633,019.53 CZK.

The following table provides the illustration of the structure of fixed assets organized according to depreciation accounting groups, where the criterion is the

¹ *Hmotný a nehmotný investiční majetek, studijní materiál*; Available at: <http://ekonomie-otazky.studentske.cz/2008/05/opoteben-dlouhodobho-majetku.html>

² Within the framework of internal accounting rules the company carries out tax and accounting depreciation

number of years of depreciation of assets³. The company own assets that depreciate 5, 10, 30 and 50 years.

The structure of assets is also represented graphically, for visual comparison of the two versions. The first graph shows the percentage of fixed assets expressed in acquisition costs. The second chart reflects the percentage of fixed assets at residual value.

Structure of fixed assets according to depreciation groups

Depreciation accounting groups	DAG 2 (5 yrs)	DAG 3 (10 yrs)	DAG 5 (30 yrs)	DAG 6 (50 yrs)	Intangible Assets
FA in acquisition costs	3 703 892,53	901 973,00	6 947 005,50	985 135,90	67 550,00
Percentage proportion	29%	7%	55%	8%	1%
FA in residual value	1 250 847,13	515 198,00	2 142 656,50	724 317,90	0,00
Percentage proportion	27%	11%	46%	16%	0%

Tab. 2 Structure of fixed assets according to depreciation groups
Source: own elaboration based on the information provided by the company

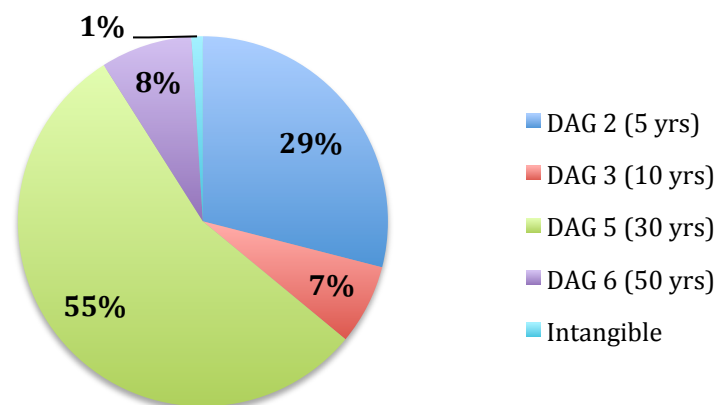


Figure 2. Structure of fixed assets in acquisition costs
Source: own elaboration based on the information provided by the company

³ Law No. 586/1992 on income tax; § 30; Available at: <http://www.zakonyprolidi.cz/cs/1992-586>

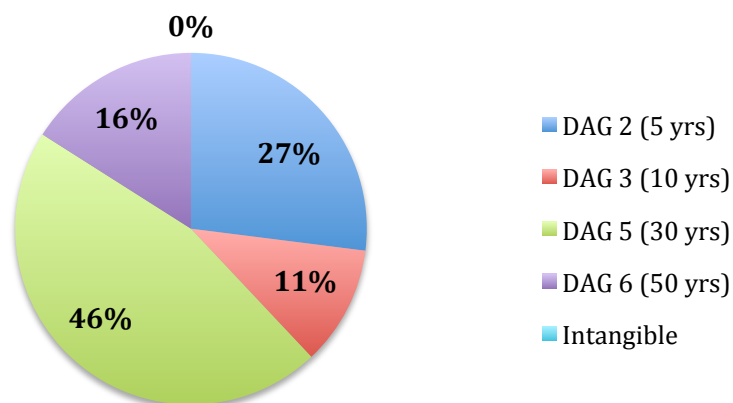


Figure 3. Structure of fixed assets in residual value

Source: own elaboration based on the information provided by the company

Based on the comparison, which is provided by the table above, it can be seen that the largest share in the structure of fixed assets represent two items in depreciation accounting group 5 (depreciation period of 30 years). This group consists of a building at the acquisition cost of 6, 634, 505.50 CZK and a parking lot at the acquisition cost of 312, 500 CZK. Both fixed assets, the building and the parking lot, are used for commercial purposes, specifically used to lease non-residential premises, which is one of the main business activities of the company. It is worth mentioning that basically the whole business activity is based on the ownership of the fixed asset by the company. The second largest group is represented by asset depreciation accounting group 2 with a depreciation period of 5 years. In particular, it is the asset, which is used in two other business activities of the company- for the department dealing with sales of cut and potted flowers and department providing services in the field of solarium.

7.4 Analysis of the Effectiveness of Fixed Assets

The term "effectiveness" is referred to the efficiency, effectiveness and productivity. Generally it indicates the effectiveness of invested resources and the benefits they earned. In other words, the ratio of inputs and outputs of an activity or a system. It is the use of such resources, which maximize the volume and quality of output. Within this analysis, the effectiveness of fixed assets is assessed - buildings in which non-residential premises are rented. The building is owned by the company since 1998 and it is the main product of their business activities.

The analysis is divided into two parts. The first part will deal with historical data and evaluate the effectiveness of the building in relation to revenues from rent. Forecasting cash flows will be also a part of this chapter. There will be analyzes economic indicators over the past five years. The next section addresses the

question of whether technical appreciation can bring positive economic results for the company.

7.5 Analysis of revenue from rent

Revenues represent a sum of money, which the company collects from the sale of their products or services. In our case, revenues from renting non-residential premises. The company in its business plan sets annually planned amount of sales. For that reason we will deal with the comparison of the business plan with actually realized revenues firstly.

Revenue from rent in years 2010-2014 (in CZK) plan and reality

REVENUE from rent (in CZK)	Year				
	2010	2011	2012	2013	2014
Plan	1, 197, 809	888, 529	1, 335, 848	1, 703, 353	1, 952, 302
Reality	1, 081, 771	885, 510	1, 299, 076	1, 654, 862	1, 761, 909
Difference	-116 038	-3 018	-36 772	-48 492	-190 393
In %	90,31%	99,66%	97,25%	97,15%	90,25%

Tab. 3 Revenue from rent in years 2010 – 2014 (in CZK), plan and reality
Source: own elaboration based on information provided by the company

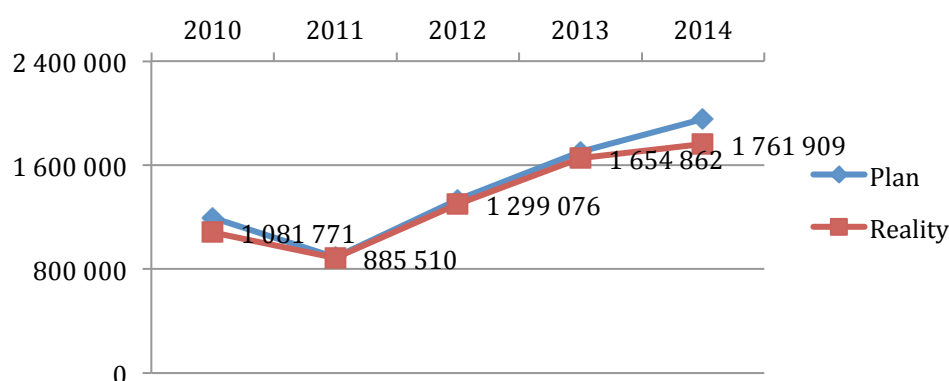


Figure 4. Revenue from rent in years 2010 – 2014, plan vs. reality
Source: own elaboration based on the information provided by the company

Although, from a comparison of planned and actual revenues it results that the actual revenues are growing, but they are growing slower than the company expected. This fact can be related to the breach of contract for rent and also by small repairs which are covered from the rent paid by a lessee. Since 2010, the company has not reached the expected (planned outcomes) in any of the cases. The closest to the sales plan were the actual sales in 2011 when the sales were achieved at 99.66 % and the difference in the absolute form was 3,018 CZK. Conversely, the biggest difference is recorded in 2014 when the difference between the plan and reality amounted to 190,393 CZK, which represents an achievement of 90.25 % in comparison of the actual to the projected state.

7.5.1 The Annual Comparison of Sales Revenue

Another indicator is the year - over - year comparison sales revenue. For the purpose of this analysis, there were used actual sales. It is the ratio comparison expressed in relative form. On year-over-year basis, the highest sales growth was achieved in 2010/2011, when sales revenue increased by almost 20%. The peak was reached in the years 2011/2012. In the following years there is the annual decrease. The average year-over-year increase in the observed period is 16 %.

Year-over-year sales revenue comparison (reality)

	2011/2010	2012/2011	2013/2012	2014/2013	Average
Year-over-year sales revenue comparison (reality)	0,82	1,47	1,27	1,06	1,16

Tab. 4 Year - over - year sales revenue comparison (reality)

Source: own elaboration based on information provided by the company

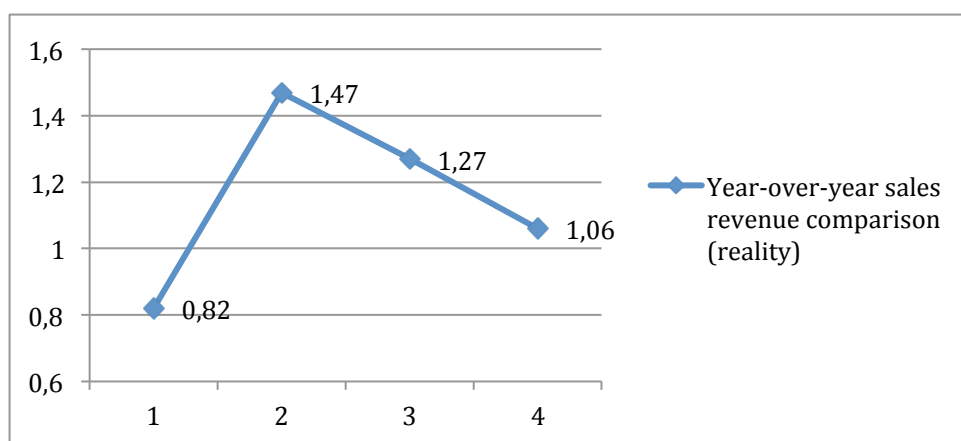


Figure 5. Graphical illustration of year - over - year sales revenue comparison (reality)

Source: own elaboration based on the information provided by the company

7.5.2 Revenue Development Forecast

When forecasting future developments in revenues the thesis proceeded from the present trend of proceeding years, when there is regular growth. It can therefore be expected, that this positive trend will also follow in future years.

The forecast is based on the fact that currently the building is utilized only from 70%, which was proven by the data and information provided by the company. This value should not decrease because there are long-term contract signed and from the historical point of view the utilization was not lower. In the forecast there are compared three default situations when the building will be utilized from 70, 90 and 100 %. Higher utilization could be achieved by technical appreciation, which is discussed further in the work. As the initial value for calculation the work taking the actual revenues from the year 2014. Furthermore, it is beginning with the assumption that the year-over-year average growth in revenues should be 15%. Other parameters remain unchanged.

Revenue development forecast from rent

Revenue from rent	Revenue development forecast from rent			
	2015	2016	2017	2018
70% utilization	1,761,909	2,026,195	2,330,125	2,679,643
90% utilization	2,114,291	2,431,434	2,796,150	3,215,572
100% utilization	2,290,482	2,634,054	3,029,162	3,483,536

Tab. 5 Revenue development forecast from rent

Source: own elaboration based on information provided by the company

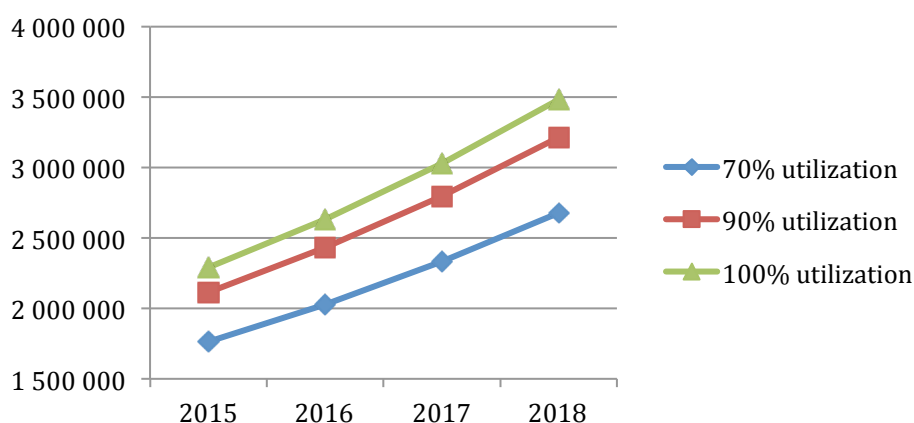


Figure 6. Revenue development forecast from rent

Source: own elaboration based on the information provided by the company

7.5.3 Analysis of Activity Indicators (Effectiveness)

Activity indicators provide us with information about how effectively the company is able to dispose of their assets, or even about the duration for how long the company has tied its assets in funds.

In the analysis of the effectiveness of sales (this indicator is sometimes called asset turnover) there are the actual revenues from the rent of the building and the residual value (buildings), from the year 2010 to 2014.

The table and the graph indicates that the value of this indicator is increasing, which can be evaluated as positive. However, ideally it should be near the coefficient of 1.0. A lower coefficient might mean that the company does not use its assets (buildings) effectively enough. The worst results were achieved in 2011, when revenues (compared to 2010) decreased by 196, 260.60 CZK, representing approximately 18 % decline. Since 2012, a gradual improvement is observed up until the indicator's value of 0.60 in 2014. This means that there is more efficient use of assets. More efficient use of assets also represents higher sales of its lease.

Calculation of revenue activity indicator (effectiveness)

Value	Calculation of activity indicator (effectiveness)				
	2010	2011	2012	2013	2014
Revenue	1 081 771,00	885 510,40	1 299 075,80	1 654 861,80	1 761 909,00
Residual value of the Building	3 861 271,50	3 635 597,50	3 410 123,50	3 184 549,50	2 958 975,50
Asset turnover	0,28	0,24	0,38	0,52	0,60

Tab. 6 Revenue Activity Indicator

Source: own elaboration based on information provided by the company

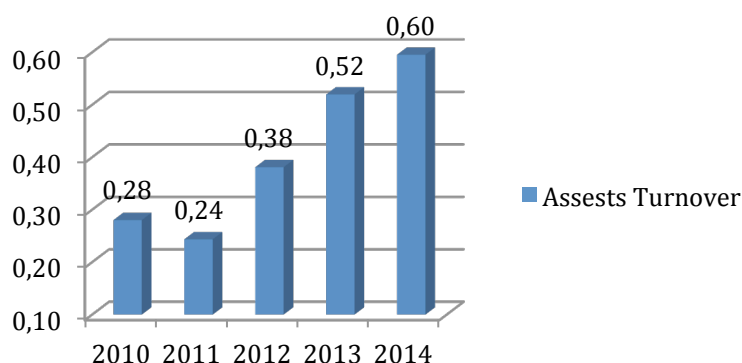


Figure 7. Effectiveness of Asset Turnover in years 2010 - 2014

Source: own elaboration based on the information provided by the company

Based on the analysis of economic results, it might be concluded that the effectiveness of fixed assets (buildings), which is part of the business activities and the source of income, is not optimal.

Company's revenues especially in the last three observed years are growing, but slower than the company expected. In the year-over-year comparison it leads to their decline. If the company will continuously pursue to increase sales by an average of 15 %, it will increase the profitability of invested fixed assets.

Practically possible (feasible) solutions how to achieve better results have these two options:

- By an increase in rent for existing clients, it can however represent fairly significant increase in clients' own costs and some might start considering termination of the existing lease. The intention of the continuous increase in sales could have reversed the effect and vice versa could lead to their decline.
- By attracting new clients thanks to which there would be growth in total revenues. This however is not possible with the current state of the building. The whole building would need to be modernized to extend the capacity of the rented premises.

The issue of technical appreciation in relation to its effectiveness and possible impacts on the functioning of the entire company will be discussed in the next section.

7.6 Analysis of the Technical Evaluation of the Property

Technical appreciation of tangible assets is an area in which both tax perspective on this issue as well as the accounting perspective intersect. The concept of appreciation is defined in § 33 of Act no. 586/1992 of the Legal Code on income taxes, as amended (the „ITA“). Since 1. 1. 2014 amendment to this law and decree no. 500/2002 came into force, which unifies the criteria for determining the value of fixed assets. The new legislation is related to setting boundaries of expenditures incurred on completed super-structures and extensions and construction works, reconstruction and modernization of the asset (Svoboda, 2007):

- for a **superstructure** is considered an increase of the construction in terms of additional built floors, etc. An **extension** means interference into the completed building, which will expand the building in ground- plan whereas the extension is connected to the original building. **Construction work** of the technical appreciation character represent changes, which maintain the ground- plan and height restriction of the building, e.g.: a substantial change in the appearance of buildings, changes in interior arrangements, completed remodeling and conversions.

- **reconstruction** means such interventions in the asset that change its purpose or technical parameters, **modernization** means the equipment expansion or usability of the asset. For example, as reconstruction can be considered replacing the original door for a gate door, thereby allowing the arrival of trucks to a company or windows replacement for shop window
- **modernization** can be for example retrofitting car of safety equipment, installation of air conditioning, sunroof, towing equipment, alarms, etc. For modernization is also considered the need for an additional movable to movables file depreciated as a whole.

For technical appreciation is not considered regular maintenance and repair of buildings. Repair concept unlike technical appreciation is not ITA defined, this term is defined both in § 47 para. 2 point. a) Decree no. 500/2002 Coll., as amended, and also in § 652 par. 2 Act no. 40/1964 Coll., the Civil Code, as amended as an activity which mainly removes defects, effects of damage or the effects of depreciation. For the repair can be considered a partial removal of physical depreciation or damage in order to restore the previous condition or working condition even by using other than original materials, parts, components or technology, provided that there will be no technical appreciation. Maintaining slows down physical depreciation, prevents its consequences and eliminates minor faults. Fixed assets can be repaired and maintained after they are put into use (Svoboda, 2007).

In the case of our technical appreciation, it is specifically the roof repair, air conditioning acquisition, replacement of windows, floor leveling, painting, acquisition of carpets, basic furniture (doors).

Part of the technical appreciation are construction works as well, which consist of:

- combination of smaller rooms into a large one (smaller rooms are not satisfactory for an office)
- provision of social facilities
- repair of existing rooms intended for rent (notably the entrance hall, stairs and other common areas), leading to an overall increase in rent
- repair of the electrical distribution (more offices consume more electricity) and telephone connections.

7.6.1 The value of technical appreciation

Technical appreciation of 1, 5 mil. Includes the repair of the roof, painting, and air condition, changing of the windows, floor and basic furniture, such as doors.

The amount of 5 mil. includes everything what was mentioned in the technical appreciation for 1, 5 mil. but there is additional construction work related to the enlargement of smaller space into bigger one as the small spaces are not convenient for office use. Next, it includes securing of sanitary facilities, repair of the actual offices for rent, which would be mainly related to the hall, stairs and shared space. This would lead to an increase of the value for renting.

7.6.2 Financing Options for Technical Appreciation

For financing technical appreciation, the company can use the following options:

- **internal funding sources**, which include :
 - depreciation- they are a crucial source of internal financing, if an asset is depreciated progressively, which may pose a higher savings on retained earnings. Depreciation is financial expression of the depreciation of fixed assets. It is a non-cash expense reducing total and retained earnings of the company and it does so by reducing the tax base.
 - retained earnings – is sometimes considered as the cheapest source of finance- that business "costs nothing"(it is not entirely correct, because each project financed from retained earnings must bring a higher return than what could be achieved with its alternative use). Cost of retained earnings is the cost of opportunities and must bring a comparable yield like in other capital gains.
 - reserve funds - represent another opportunity to finance investment projects. From the perspective of the enterprise it is a cost which reduces the profit of economic activities of the current period whereas expenses in connection with the fulfilment of the commitments follows in the future. Through the establishment of reserve funds company can "save" funds for future investments. Even in this case it is necessary to consider whether the use of its own resources is cheaper than the use of foreign ones. However, practice shows that businesses attribute less and less importance to them and many companies are dissolving them.
- **external funding sources**, which include :
 - long-term loan - the firm may earn a long-term loan in two forms, namely in the form of a *bank loan* (either as a term loan or a mortgage loan) or in the form of *supplier credit*. It is conditioned by contract of contractor, when the purchaser gradually repays the value of supply, assets are gradually becoming the property of purchaser but contractor's credit is provided against tangible or intangible forfeit.
 - leasing – financing of long-term assets can be in two forms, through *operating leases* (there is no transfer of ownership to the lessee, he has the property only in a temporary lease) or a *finance lease* (the ownership is transferred to the lessee of the assets after the full repayment).

7.6.3 Analysis of the Ways of Financing Technical Appreciation of the Building

In order to finance company's development projects at present, the company frequently uses a combination of internal and external financing. For internal sources, it is particularly the application of the depreciation of previously acquired fixed assets.

As already mentioned before, depreciation represents an expense item by which it is possible to reduce accounting profit by tax depreciation and tax base as well.

Out of the external sources of financing, the company A uses financial leasing. This financial leasing is primarily used by the company A in order to finance fixed assets purchased by two departments. The first department which does so is the department for dealing with sales of cut and potted flowers and the second one is the department providing services in the area of solariums.

Since the company is currently in a position when it does not possess enough available funds, it is necessary for the company A to find also other options. This fact puts the company into an unfavorable situation. Therefore, the management of the company A is considering the possibility to finance technical appreciation of the building through a bank loan or financial leasing. The bank loan and financial leasing are the only two possible options because of the fact that the company A has been in financial loss for a long time.

7.6.3.1 Analysis of financing technical appreciation by a bank credit

The reason why the company considers the option of financing technical appreciation of the building, which have been already discussed, is mainly because of the bank credit, which can be obtained relatively quickly, with relatively low initial cost. Another advantage for the company is that interests on the granted principal amount are tax deductible.

A disadvantage of this source of funding could be considered mainly that the drawdown of the granted credit and its payments are always time-limited. The company will have to use part of their future earnings (available financial resources) to repay the credit, and that may limit its further development. For the financial resources provided by the bank, the bank will request their detention.

7.6.3.2 Specification of demand for a bank credit

The Bank credit should be used for technical appreciation of the building, used for commercial purposes, it will be a long-term investment credit intended for business purposes. Desired inquiry will be prepared for two variants of the credit: 1,500,000 CZK and 5,000,000 CZK. Both variants should cover all financial de-

mands connected with the technical appreciation of the building. The credit will be repaid in monthly payments over 10 years.

The first table lists two offers for a bank credit of 1, 500, 000 CZK. The first offer was prepared by Komerční banka, a. s., and the second one by ČSOB, a. s. In the case of Komerční banka, a. s offer, the annual interest rate is 3.74 % p. a and ČSOB offers an interest rate of 10.21 % p.a.

If the company decides to use a bank credit, it should give priority to the Komerční banka, a. s. In comparison with ČSOB it would thus save 25 % per year, which amounts to 60 000 CZK.

Comparison of offered credit- 1, 500, 000 CZK

Bank	Annual payment	Monthly payment	Annual interest rate (p.a.)	Credit increase (in CZK)
KB, a. s.	180 000 CZK	15 000 CZK	3,74%	300 000
ČSOB, a. s.	240 000 CZK	20 000 CZK	10,21%	900 000

Tab. 7 Comparison of offered credits – 1 500 000 CZK

Source: own elaboration based on the information provided by the banks KB,a.s. and ČSOB, a.s.

The following table lists again the two offers and this time the amount of bank credit is 5, 000, 000 CZK. In this case, it is the offer of Komerční banka, a. s., and the second offer of ČSOB, a. s. In the case of an offer by Komerční banka, a. s., the annual interest rate is 3.74 % p. a again, and ČSOB, a.s. offers an interest rate of 7.75 % p.a. If the company decides to use a bank credit at this amount, it should give priority to the Komerční banka, a. s. In comparison with the competitor it would save 20 % per year, which amounts to 120 000 CZK.

Comparison of offered credit- 5, 000, 000 CZK

Bank	Annual payment	Monthly payment	Annual interest rate (p.a.)	Credit increase (in CZK)
KB, a. s.	600 000 CZK	50 000 CZK	3,74%	1 000 000
ČSOB, a. s.	720 000 CZK	60 000 CZK	7,75%	2 200 000

Tab. 8 Comparison of offered credit – 5 000 000 CZK

Source: own elaboration based on the information provided by the banks KB,a.s. and ČSOB, a.s.

When comparing the two offers, the thesis proceeds from the fact that the building is currently used by only 70%. Due to technical adjustment of current parameters, there would be an extension of the leased area, as follows:

Technical appreciation of the building - 100 % efficiency

Area type	Total for m2	Price for m2	Planned revenue at 100% occupancy	
Business area	309	3500,00	1 081 500,00	90 125,00
Office area	1564,54	2200,00	3 441 988,00	286 832,30
Warehouse area	760,36	800,00	608 288,00	50 690,70
Garages	174,88	600/month/1 spot	349 760,00	29 146,70
Shelter	10	400/month/1 spot	72 000,00	6 000,00
Free parking	46		220 800,00	18 400,00
Total			5 774 336,00	481 194,70

Tab. 9 Technical appreciation of the building with 100% efficiency
Source: own elaboration based on the information provided by the company

Based on a qualified estimate of the company's management, when there were measured individual variants of the offered credit and the potential use of the building after the technical appreciation, the first option (a credit of 1.5 mil. CZK) is considered more efficient because in the case of the second credit option in the amount of 5 CZK mil., there is a relatively long payback period. In further analyzes, therefore, the thesis will proceed only from the value of the technical appreciation 1.5 mil. CZK.

7.6.3.3 Analysis of Financing Technical Appreciation with Financial Leasing

Another option how to fund a technical appreciation of the building could be the use of a financial leasing in case of purchase of air conditioning, windows and office equipment, which would increase the value of the asset and also make it more attractive and modern, which is wanted. Financial leasing is a specific form of financing, especially of fixed tangible assets. Even in this case (as with a bank credit) the creditworthiness of the tenant is reviewed. Compared to a bank credit, leasing operation constitutes less demand for its security. Payments for leasing are spread over a certain period of time, representing certain amount.

The advantage is also that the rent (lease payments) are under the conditions set out in § 24 para. 2 point. h) and § 24 para. 4-6 ITA tax deductible (expenditure). Another advantage may be, for instance, that leasing (unlike a bank credit), does not represent an increase in indebtedness of the company, although from an economic point of view the company is in debt. The resulting obligation

under the lease agreement is not reflected in the balance sheet (liability section) as an item increasing foreign sources.

The disadvantage of financial leasing is that the lessee is not the owner of the subject lease, and it therefore does not appear in the balance sheet. The subject of the lease remains in the ownership of the lessor, namely the leasing company until its proper repayment.

7.6.4 Evaluation of financing methods of technical appreciation of the building

Based on used comparative method, two ways of financing technical appreciation of the building were analyzed. Since the company currently has a limited amount of available funds, this project will be financed using foreign sources. Particularly bank credit or financial leasing are in consideration.

In both variants there were considered both advantages and disadvantages of each of the available products. Based on this information, it is believed that a more appropriate means of financing the technical appreciation of the building will be a bank credit, especially with regard to lower input costs (no need to compose so called, down payment, known as the first irregular payment. Another reason why the company should give preference to a bank credit is that the asset is at all times the property of the company.

7.6.5 Analysis of Depreciation of the Building

The price that the company will pay for the acquisition of tangible and intangible fixed assets is tax deductible gradually, in the form of years of depreciation. It represents part of the depreciation entry price (usually is means the purchase price, which is at the VAT payers reduced by VAT, which a company can apply as a tax-deductible item in one year.

Acquired assets are classified according to Appendix 1 - Classification of tangible assets, the Law on Income Tax (586/1992 Coll.) In the corresponding depreciation groups 1-6, where the criterion for inclusion of the property is the number of years of depreciation.

Method of depreciation of assets as well as its course is governed by the Law on Accounting and the Law on Income Tax. Based on this methodology, companies can use two variants of depreciation:

- Accounting depreciation - depict real asset depreciation. Companies themselves determine monthly amount of depreciation based on depreciation schedules (used internally)⁴.
- Tax depreciation - the amount and form is determined by the law on income tax. These write-offs are applied directly to the accounting costs of the company, but are taken into account in determining the income tax (are deductible).

⁴ Law No. 563/1991 Sb. On Accounting. Available at: <http://www.zakonyprolidi.cz/cs/1991-563>

In practice, there are two methods of depreciation of fixed assets and each company can decide at the beginning (when acquired) which method they choose. The method chosen must be used throughout the depreciation of assets. Depreciation methods are:

- linear depreciation – the depreciation is in the same amount every year
- accelerated depreciation, the depreciation is higher in the first few years, and gradually declines.

In the case of analyzed building and its use, the accelerated depreciation option as a method of depreciation has been chosen. The building is well documented in the inventory card of fixed assets on November 11, 1998 when it was acquired. The entry price for assets amounted to 6,634, 505.50 CZK. Given that it is a building, it was enlisted according to Appendix 1 of the ITA in the fifth depreciation group with a length of depreciation of 30 years. The building is depreciated over 16 years and will be fully depreciated in the year 2029. Currently, the building is depreciated by 70.35 %, making it 4, 667, 541,00 CZK.

7.6.5.1 The Choice of Depreciation Method

The company decided to choose an accelerated depreciation method especially because the depreciation is higher in early years, which will positively affect the tax base, as applied depreciation reduces the tax base.

Accelerated depreciation is in comparison to linear depreciation (if the depreciation was in the same amount) more profitable until 2016, when the company through steady depreciation will apply 229, 480, 00 CZK. In the case of linear depreciation it would amount to 225, 574,00 CZK in the same year. Although in the following years the accelerated depreciation will be declining, the building will have more than 75% depreciated, and that was convenient from the company's point of view. The detailed breakdown of depreciation is listed on the assets' inventory card. For visual comparison of the two versions, both accelerated and linear depreciation are included.

7.6.5.2 Depreciation Analysis of Technical Appreciation of the Building

Technical appreciation would also allow expansion of the offer of offered leased non- residential premises, while it would factually appreciate. The value of the building would increase to 8,134, 505.50 CZK.

Made technical appreciation would also alter the current parameters of accelerated depreciation. In 2015, increase in the acquisition cost of assets of 1.5 mil. CZK would occur, from which tax depreciation would be calculated. Due to technical appreciation the length of depreciation would extend. Without the technical appreciation, the building will be fully depreciated in 2029, as a result of technical appreciation it will be depreciated in 2043.

The difference is also evident in the depreciation rate. While the depreciation rate of accelerated tax depreciation of the building (without technical appreciation) is 3.71% in the 2015, for buildings with technical appreciation the rate in

the same year is 2.40%. The rate develops in following years similarly. This is because of technical appreciation, which prolongs the length of depreciation of assets, and thus influences the amount of depreciation rates - they are for buildings with technical appreciation lower (breakdown of depreciation for the technical appreciation variant is in appendix).

What then results from the depreciation analysis? Namely, due to a result of technical appreciation, a real decline in applicable tax deduction will occur when calculating the tax assessment of corporate income tax. This decline represents factual depreciation reduction of almost 14%. The tax base will increase and from higher tax base company will be paid higher income taxes. Conversely, due to the technical appreciation the life of assets will expand and that will be depreciated about 14 years longer.

7.7 Influence of Taxation and Inflation

The tax rate imposed on business income not only affects the value of the funds in time, but also the company's production and expected investments. Development and predicted rates and tax laws affect business decisions about future investments, because income tax expense represents actual cash. For investments with a long economic life, this factor may have a significant effect on the final outcome of the decision, so it is good to know (or at least predict), how could the rate of income tax develop in the future. From the perspective of companies, the trend in the tax area in the Czech Republic is developing positively and the tax rate on corporate income has been stable since 2010 at 19%, as shown in the following table. It can be expected that even in the near future there will be no sudden increase, even though everything is a matter of political pressures and negotiating skills of members of political parties. The table below illustrates the development of corporate income tax in the Czech Republic since 1999 till now.

Development of corporate income tax in the Czech Republic

Year	1999	2000-2003	2004	2005	2006-2007	2008	2009	2010-2016
Tax rate	35%	31%	28%	26%	24%	21%	20%	19%

Tab. 10 Development of corporate income tax in the Czech Republic

Source: own elaboration based on MF Czech Republic. Available at: <http://www.mfcr.cz>

7.7.1 Inflation and its impact on company decisions on investments

Another factor that can significantly influence company's decisions about future investments is inflation. In the case of fixed assets registered particularly in the fifth depreciation group, related to the assets with a long life and so even relatively

low inflation may significantly affect their value, or sales price. Inflation affects the discount rate itself (and through bank credit rate), while the influence inflation rises the discount rate, which affects the current interest rate of lend capital.

The current forecast, published on February 5th, 2015 by Czech National Bank expects inflation at a level of 0.10 %. According to estimates, inflation in 2016 should be in the range from 1.1 to 1.6 %. The intention of CNB in the following years is to maintain a stable inflation rate at 2.5%.

Development of inflation in the Czech Republic

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Inflation (%)	1,90	2,50	2,80	6,30	1,00	1,50	1,90	3,30	1,40	0,40

Tab. 11 Development of Inflation in the Czech Republic

Source: own elaboration based on CNB. Available at: <http://www.cnb.cz/cs/index.html>

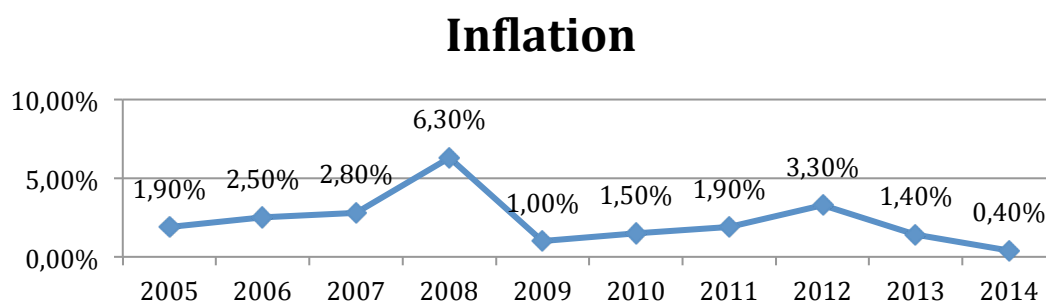


Figure 8. Development of inflation in the Czech Republic

Source: own elaboration based on the information provided by the company

7.7.2 The Risk

Implementation of a long-term investment plan in itself usually involves many partial risks that affect the overall result. Financing long-term projects (investments) can be described as relatively risky. Valach (2006) provides the basic division of these risks as follows:

1) According to dependence or independence on corporate activities

- Objective risk - is independent of the business venture, the will and ability of corporate management, owner or employee (for example, natural events, changes in macroeconomics, political influences)

- Subjective risk - it depends on the actions of corporate management, shareholders and employees (such as lack of technical and economic knowledge, negligence)
- Combined risk - the cause of deviation is both objective and subjective factor at the same time

2) According to the company's activities

- Operational risk - the risk of machinery accidents, accidents, risk of strikes etc.
- Market risk - the risk of sales, price evolution etc.
- The risk of innovation - the introduction of new products and technologies
- Investment risk - risk in the allocation of funds in the tangible , intangible assets and financial assets
- Financial risk - the risk arising from the use of different types of capital, liquidity risk, risk arising from changes in tax rates and interest
- Overall business risk - includes in itself all the previous risks and their interdependencies

3) According to the dependence on the overall economic development

- A systematic risk - arises due to changes in the economy, and affects all companies (cannot reduce diversification)
- Unsystematic risk - is specific to individual disciplines, companies, projects

4) According to possibilities of influence:

- Influential risks – business may affect them with its behavior and actions
- Uninfluential risks - they cannot be influenced, they include a significant portion of risks

The greatest risk associated with the technical appreciation of the building to consider is whether the average expectation of cash flows will be met. Thus, whether it will fill out all of the leased rooms. It depends on factors of both internal and external environments. In particular it includes:

Factors of external environment:

- legislative measures regulating the business environment in the Czech Republic (e.g. the laws governing business - Licensing Act , Civil Code, etc.).
- tax policy of the state
- Inflation development
- effects of competition

Factors of internal environment:

- the correct setting of the marketing mix, especially in the setting of reasonable prices for the rental of office space as well as in promotion of the leased property

8 Discussion and Recommendation

The main aim of the practical part of the thesis was to evaluate whether fixed assets (namely the building) are used in an effective way and whether its technical appreciation can contribute towards better its use, while increasing the efficiency of contributed assets. As studies literature states in the theoretical part, the thesis emphasized the fact of how important and significant the fixed assets are and that the company really should use them in the most effective way possible. It applied also for the examined company A, regarding its asset structure and way of managing its assets.

The first part of the practical part of the thesis was focused on exploring the history of the company, it introduced its main activities and it performed an economic analysis of revenues from the lease of the building and efficient utilization of existing assets. It was found out that the company A had not yet used its fixed assets in the most effective way possible.

The most probable reason why it is so is because the building is currently used by only 70%. This leads to the decision of the company A to consider also other possible options that will lead to a more efficient use, which would mean the realization of higher sales and better economic performance. The thesis recommends using one of possible options. Based on the real indicators from the current situation in the Czech market the thesis calculates possible scenarios and suggests using the most efficient one.

Another recommended solution in order to achieve better results could be a technical appreciation of the building. This would include partial modernization and reconstruction of existing utility areas. The company A should consider two alternative variants of the technical appreciation. The first option is worth a total of 1.5 mil. CZK, the second option is worth 5 mil. CZK.

Based on the performed analysis of financial resources, the best way of financing appears to be a bank credit. The thesis studies, discusses and reviews bank offers for both variants. In terms of funding it is considered and recommended to use \$ 1.5 mil. CZK bank as this credit appears to be more efficient option for the company A. Based on the results from the analysis the credit worth 5 mil. CZK is considered as ineffective with regard to the time of its return period.

In further analysis, the thesis dealt with the depreciation of fixed assets and technical appreciation consequences on economic results of the company. Technical appreciation will cause the building to depreciate longer by 14 years. At the same time, there is a change in depreciation rates. The result will be that the company will apply lower depreciation in the tax return, which means a higher tax liability. At the same time, however, the company will be able to claim additional expense - interest on the credit, which will have a positive effect on the tax base. This all was done within the framework of legal concept.

Given the current state of development of the Czech economy, we can expect a stable market environment in the upcoming years, which is very important indicator when making future predictions and plans. This concerns particularly the

question of taxes and inflation. It is a positive economic development, which should not impede further business. Therefore, it is believed that the technical appreciation of the building amounting to 1.5 mil. CZK can contribute to better economic results of analyzed company and so the thesis recommends this project.

9 Conclusion

Fixed assets represent a very significant part of asset structure of every company. This was also showed in the bachelor thesis, which main focus was to analyze and work with fixed assets of the company in the most convenient and the most efficient way possible.

The examined company A has a wide range of fixed assets as it carries out three totally different activities, for which, different types of fixed assets are needed.

Firstly, the study of the literature provided a theoretical background for the issue of fixed assets, its depreciation, and technical appreciation and explained the terms of efficiency. For the topic like this, accounting law is very important as it is binding and obligatory for all accounting units and therefore, it had to be considered throughout the whole thesis.

Information and data necessary for analyzing of the situation and making further suggestions were gathered directly through communication with the company. The information was analyzed, which provided a clear picture of the situation of the company from the historical point of view and based on the analyzed numbers it was able to predict the future development, which means that the thesis provides the real picture of the situation. The situation in the company A was not optimal and it was proven that there is space for improvements, for example, carrying out of specific repairs, replacements, reorganization, reconstruction, resizing of specific fixed assets and by improving their technical conditions in general. The recommendations, based on the calculations and forecasts, were made in order to improve the situation in the company A.

By the thesis it was proven that fixed assets really are important part of every company as their help the company fulfill its aim and purpose and by their efficient treatment the company can reach better financial results.

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