CHAPTER 4

VERIFICATION AND VALUATION OF ASSETS AND LIABILITIES

Meaning of verification: Verification means 'Proving the truth' or 'Confirmation'. Verification is an auditing process in which auditor satisfy himself with the actual existence of assets and liabilities appearing in the financial statements.

Verification of assets includes the following

- The existence of assets
- Legal ownership and possession of the assets
- Ascertaining that the asset is free from any charge
- Correct valuation.

Objectives of verification and valuation of assets and liabilities:

1. To verify whether the values of assets shown in the balance sheet are valued as per GAAP
2. To verify the evidence of proper accounting of the assets
3. To verify whether his client is the owner of the assets shown in the balance sheet through legal and official documents examination.
4. To verify the existence of assets shown in the balance sheet are under the possession of his client.
5. To verify whether the assets shown in the balance sheet are free from any charge or lien.
6. **(Liabilities**) to see that all liabilities of the clients business are disclosed in the financial statements.
7. To see that all liabilities of the clients biz are properly valued as per GAAP.
8. To see that all the liabilities of the clients business are properly classified and disclosed.
9. The auditor will be liable for the non-disclosure of certain liabilities in the B/S.
10. To see that all fictitious liabilities are not disclosed in the financial statements.

Advantages of verification

- It avoids manipulation of accounts
- It protects improper use of assets
- It ensures proper recording and valuation of assets
- It exhibits true and fair view of the state of affairs of the company.

Techniques of verification

- **Inspection**
- **Observation**
- **confirmation**

VALUATION OF ASSETS AND LIABILITIES

Meaning of valuation: Valuation is an act of determining the value of assets and liabilities and critically examination of these values on the basis of normally accepted accounting standard.

Valuation process

- Obtaining all the necessary info regarding valuation
- Analysing all figures available
- Confirming the fact is being determined on the basis of generally accepted conventions and accounting principles.
- Ensuring consistency of the methods followed for the valuation from year to year
- Obtaining an opinion regarding the accuracy of valuation.

Objectives of valuation

1. To show the actual financial position
2. To know the real position of profit and loss.
3. To increase goodwill
4. To assure shareholders
5. To ensure easy for sale
6. Easy to get loan
7. Easy to get compensation.

Valuation of assets

- Cost price
- Market price
- Replacement price
- Book value
- Going concern value /conventional value

Modes of valuation of different types of asset

1. Fixed assets
2. Current asset or floating asset
3. Wasting asset
4. Intangible asset
5. Fictitious asset

Fixed asset: Permanent use and not for resale

- Acquired for the purpose of earning revenue
- Not intended for resale
- These assets are valued at cost less depreciation, not at market value.

Current assets or floating assets:

- Can't be touched, seen or felt but fetches value.
- They have the ability to generate revenue
- These assets can't be sold separately, but can be sold along with the business.
- Hence it is charged at cost price or fair market price method.

Wasting assets

- These assets gradually exhaust as they are put into use
- Includes mines, quarries, and oil wells.
- They are subject to depletion only when put into use.
- Auditor has to check out ownership/original cost of acquisition, provision for depletion.

Fictitious assets:

- Nominal in nature
- Huge expenditure like preliminary expenses, cost and discount on issue of shares and debentures
- Fictitious assets are usually written off.

VERIFICATION AND VALUATION OF ASSETS

- Verification of free hold land and building
- Verification of leasehold land and building

Meaning of free hold land and building: the owner enjoys complete ownership and can use the land for any purpose (sell, renovate or transfer), keeping the local regulations in mind.

Meaning of leasehold land and building: here the ownership of the land on which the property is built is leased for a certain amount of time to the developer. Generally, the lease period varies from 30 to 99 years.

Verification of land and building. (Procedure for verifying l&b)

1. The auditor should examine the title deeds in order to ensure that they are in the name of the client.
2. In case the property is mortgaged, he should obtain a certificate from the mortgagee or his solicitor (lawyer) He should also enquire whether there is any second or subsequent mortgage or not.

3. If the client has constructed the building, the auditor should examine the certificates received from the builder, contractor, architect and other necessary papers and documents.
4. If the building is a newly purchased one, the value of building can be ascertained by vouching the amount paid to the contractor. If it is partly constructed, by obtaining architect's certificate, its value can be determined.
5. If the client's own staff members are also engaged in its construction, the auditor should see that a reasonable basis of allocation of wages, supervisor charges, etc. has been adopted.

The auditor should take the following steps to verify the leasehold property:

6. The auditor should inspect the lease agreement to find out value of the property and its duration. He should see that the lease agreement is registered with the Registrar and certificate testifying the validity of the same has been obtained from the client's legal advisor.
7. He should see that the terms and conditions of the lease are duly complied with.
8. If the asset is of building, the tax paid, and repair expenses made for it should be treated as operating expenditure. The auditor should see whether they are treated so.

Verification of plant and machinery

- Auditor should vouch the purchase of a plant with the receipts and invoices.
- It should also be checked that all the expenditure on this account is a capital charge.
- If the plant is erected by the client own men then auditor should check that allocation of plant has been made correctly.
- Auditor should check the schedule of the plant and machinery which should be certified by the engineer.
- Auditor should also do the physical checking of the machinery if possible.
- Auditor should also verify that sufficient amount of depreciation is provided.
- He should find out the ownership and title of plant and machinery through the examination of legal and official documents.

Valuation of Goodwill

While undertaking the verification and valuation of Goodwill, an auditor should observe the following points:

- If goodwill has been purchased along with a running business from the vendors, the auditor from the purchased agreement should verify the amount of goodwill.
- The auditor with the help of the partnership deed should verify the amount of goodwill created in the books of a partnership firm, admission or retirement or death of partner.

- The matter of goodwill is a matter of financial policy, to be decided by the management. Therefore, the duty of the auditor is just to see that the goodwill is shown in the BS at its proper value.
- When a company has raised goodwill account by writing up the value, he should examine the basis on which the assets.

Valuation and verification of stock

The following points should be kept in mind while verifying the stock

(1) The method of stock-taking should be examined so that possibilities of fraud and errors may be found out. It should also be seen whether proper control is exercised over the receipt and the issue of goods in stock.
(2) The auditor should obtain a list of instructions issued in connection with the stock-taking.
(3) A few items should be checked in the rough stock sheets.
(4) The totals and balances of Stock Sheets should be thoroughly checked.
(5) The value of different items of stock should be examined with the help of Valuation Sheets, Invoices, etc.
(6) The principles and bases followed in the valuation of stock should be examined to ensure that they are those followed in previous years. To verify the work-in-progress and the closing stock, the accounts relating to costs should be checked.

Valuation and verification of investment

If there are a large number of investments, as in the case of banks and insurance companies, the auditor should ask for a schedule of investments held by his client. The schedule should give full particulars of the investments, e.g., name of investment, the cost price, the market price, book value, date on which the investment was acquired, rate of interest payable and the dates of the payment on interest, tax deducted and so on and compare these with the records in the books of his client.

- He should ensure that the investments are registered in the name of the client
- In case of registered bonds, government securities the auditor has to verify seal, signature, documents, the market price, the date of purchase, rate of interest, tax deducted at source.
- Inscribed stocks: shares issued by the company with share certificate. Auditor has to examine date of purchase, rate of interest.
- Bearer stocks and share warrants: these are easily transferable securities auditor has to verify the seal of the company, signature, date of purchase, rate of interest etc.

VALUATION AND VERIFICATION OF LIABILITIES

Creditors: While undertaking the verification and valuation of Creditors, an auditor should verify the following points:

- He should get a list of creditors from the management, and verify whether the list contains all the details about sundry creditors.
- He may also obtain statement of accounts from the creditors to check the accuracy of the ledger balance
- He should check the good inward book to ensure that all goods purchased during the year have been actually received and are recorded in the purchases book
- He should examine the purchase invoice
- To ensure that all liabilities are properly valued, classified and disclosed
- He should check the schedule of creditors with the balances in the creditors ledger
- He should check the postings from the subsidiary books, such as purchase book, purchase return book etc.
- If there is any debit balance in the creditor's ledger, the auditor should see that they are shown on the asset side of the balance sheet.

Bills payable

- He should obtain a schedule of bills payable and verify whether the schedule contains all the details of the bills payable.
- He should check the total of the bills payable with the payable book, bills payable account and cash book.
- He should examine the returned bills payable, which can be taken as an evidence for the payment made for the matured bills.
- He should see that the bills payable, which can be taken as an evidence for the payment made for the matured bills
- He should check the bills payable paid are not shown as outstanding.
- He should check the bills payable paid after the balance sheet but before the date of audit with the entries made in the cash book.

Contingent liability

Meaning: A contingent liability is a potential liability that may or may not become an actual liability. Whether the contingent liability becomes an actual liability depends on a future event occurring or not occurring.

- He should obtain list of C/L duly certified from the management `to ensure that all C/L have been disclosed.
- He should see that C/L is properly disclosed in the Balance sheet.
- To verify the existence of C/L he should examine the accounts books, minutes, correspondence, share certificate
- If there is any provision for C/L, the auditor has to verify the minute's book or resolution.

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