

Class: B.Com (Hons) Semester III

Subject : BCH 3.1 AUDITING AND CORPORATE GOVERNANCE

6.Topic: Valuation of Assets and Liabilities, Components of Valuation, Basis of Valuation, Verification and Valuation of Fixed Assets (PART A)

6.1: Valuation of Assets and Liabilities

Valuation means estimation of various assets and liabilities. It is the duty of Auditor to confirm that assets and liabilities are appearing in the balance sheet exhibiting their proper and correct value. In the absence of proper valuation of assets and liabilities, they will exhibit either overvalued or under-valued.

It is therefore required for an Auditor to exercise reasonable care and skill to analyze the basis of valuation from technical experts and satisfy himself that assets shown in Balance-sheet are properly valued accordance with the generally accepted conventions and accounting principles.

6.2: Components of Valuation

Methods of valuation of assets are as hereunder –

- **Cost Price** – This is the cost price paid at the time of acquisition of assets plus the freight charges, octroi charges, and commissioning and installation charges, etc. to bring that asset in usable condition.
- **Book Value** – This is the value as appearing in the books of accounts; the cost price less depreciation.
- **Realizable Value** – A Value which can be realized from the sale of assets.
- **Market Value** – A value which the asset can fetch at the time of sale.
- **Replacement Value** – A value on which an asset can be replaced.
- **Conventional Value** – It means the cost price less depreciation written off ignoring any kind of fluctuation in the price.

- **Scrap Value** – If the asset is not in working condition and sold as scrap, then the sale value of asset is scrap value.

6.3: Basis of Valuation

Auditor should ensure that the basis of valuation is correct and reliable. He should keep in mind the process of valuation which is as follows –

- Original cost
- Expected working hours of the assets
- Wear and tear expenses
- Scrap value
- Chances of asset become obsolete

Fixed asset is valued at cost price less depreciation and current assets should be valued at cost or market price whichever is less.

6.4: Vouching, Verification and Valuation

In vouching, accounting entries are checked with the bona-fide vouchers.

- Vouching is done after **original entry** in the books of accounts.
- Vouching is done by **Senior Auditor** and **Audit Clerk**.
- Bonafide vouchers are sufficient **evidence** for vouching
- Verification proves the **existence, ownership** and **title** of assets.
- Verification is done by physical verification, title deeds and receipt of payment, etc.
- Verification and valuation are done at the **end of the financial year**.
- Verification and valuation are done by the **Auditor** himself.
- Valuation certifies the **correct value of asset**.
- For Valuation Auditor has to depend upon **certification** from owner/partner/director.

6.5: Verification and valuation of various assets and liabilities:

6.5 A: Verification and Valuation of Copyright

Copyright

Copyright provides legal protection and legal rights to an author by which the publication of his work by another is prohibited. Copyright remains with the author for lifetime and even 50 years after his death.

Verification of Copyright

- The Auditor should examine the agreement between the author and the publisher.
- If there are numbers of copyright with the same publisher. Auditor should ask for the schedule of copyrights.

Valuation of Copyright

Copyrights lose their value over a passage of time; hence the value of copyright is not stable. In case where the sale of publication is very low or nil, value of copyright should be written off.

Value of copyright in the Balance-sheet will be shown as *cost less* the value written off.

6.5 B: Verification and Valuation of Fixed Assets

We will discuss the verification and the valuation of different fixed assets –

i) Verification of Freehold Land and Building

- Auditor should examine the title deed of the land and building.
- Land and building shown in the books should be according to the title deed.
- Profit or loss on sale of it should be duly adjusted in the account.
- Any addition to it should be carefully examined by the Auditor.

ii) Verification of Mortgage Property

- The Auditor should confirm that there should be no second or third mortgage on it.
- The Auditor should obtain certificate from mortgagee that title deed is in his possession.
- The Auditor cannot be held responsible if there is any defect of title. The Auditor can only verify that title deed apparently in order and in the name of client.
- If Auditor feels necessary he can obtain certificate from legal advisor about the validity of title deed of the client.

iii) Valuation of Building

- Building should always be valued at *cost less* depreciation.
- Although the market value of building may be much higher than the cost, still depreciation on building should be provided.
- Depreciation will be provided even if building is not in use.
- Market or releasable value should not be taken into account because both are fluctuating.

iv) Verification of Freehold Land

- Freehold land is a non-depreciable asset, hence it will be shown at cost.
- Cost includes legal charges, registration fees, purchase price and broker commission, etc.
- Payment made to improvement trust or Municipal Corporation for water, sewerage, road, development charges, etc. it will also be included in the cost of the freehold land.
- If the basis of valuation of it is market value or realizable value, it should be clearly mentioned in the balance sheet.

v) Verification of Building under Construction

- Auditor should verify the architect certificate and contractor receipt for the amount paid.

- Auditor should obtain a certificate from a responsible officer to that effect, if the staff of client is also engaged in its construction.

vi) Verification of Leasehold Property

There should be separate accounting for freehold and leasehold property. Leasehold property is acquired for fix duration on lease. The Auditor should consider the following –

- Inspection of lease agreement for value and duration.
- Lease agreement should be registered with the registrar.
- Terms and condition of the lease should be properly complied for.
- The Auditor should examine the last receipt of rent to ensure the lease agreement is in continuation without any break due to nonpayment of rent.
