Chapter: Four

VERIFICATION AND VALUATION OF ASSETS AND LIABILITIES

Meaning Of Verification:

It implies an inquiry into the value, ownership and title, existence and possession and the presence of any charge on the assets".

Verification is a process by which an auditor satisfies himself about the accuracy of the assets and liabilities appearing in the Balance Sheet by inspection of the documentary evidence available.

Verification means proving the truth, or confirmation of the assets and liabilities appearing in the Balance Sheet.

OBJECTS OF VERIFICATION

To show correct valuation of assets and liabilities.

1. To know whether the balance sheet exhibits a true and fair view of the state of affairs of the business
2. To find out the ownership and title of the assets
3. To find out whether assets were in existence
4. To detect frauds and errors, if any
5. To find out whether there is an adequate internal control regarding acquisition, utilisation and disposal of assets.
6. To verify the arithmetic accuracy of the accounts
7. To ensure that the assets have been recorded properly.

TECHNIQUES OF VERIFICATION

1. Inspection: It means physical inspection of the assets i.e. company cash in the cash box, physical inventory, inspection of shares certificates, documents etc.
2. Observation: The auditor may observe or witness the inspection of assets done by others.
3. Confirmation : It means obtaining written evidence from outside parties regarding existence of assets.

VERIFICATION OF ASSETS – ILLUSTRATION :

(i) Cash in hand and at bank :
Cash in hand includes all the following :

(a) Cash in hand :
1. Special care is necessary with regard to verification of cash balances. There can be no certainty that the cash produced for inspection was in fact held by the custodian.

2. For this reason, the cash should be checked not only on the last day of the year, but also checked again sometime after the close of the year without giving notice of the auditor's visit either to the client or to his staff.

3. If there is more than one figure for cash balance e.g. when there is a cashier, a petty cashier, a branch cashier and in addition, there are imprest balance with employees, all of them should be checked simultaneously, as far as practicable, so that the shortage in one balance is not made good by transfer of amount from the other.

4. It is desirable for the cashier to be present while cash is being counted and he should be made to sign the statement prepared, containing details and the cash balance counted. If he is absent at the time the cash is being verified, he may subsequently refute the amount of actual cash on hand which may put the auditor in an embarrassing position.

5. If the auditor is unable to check balance on the date of the Balance Sheet, he should arrange with his client for all the balance to be banked and where this cannot conveniently be done on the eve of the close of the financial year, it should be deposited the following morning. The practice should also be adopted in the case of balance at the factory, depot or branch where cash cannot be checked at close of the year.

6. Should this not be possible, the auditor should verify the receipts and payments of cash upto the date he counts the cash. This should be done soon after the cash balances have been counted. The cash book of the day on which the balance is verified should be signed by the auditor to indicate the stage at which the cash balance was checked.

7. If any cheques, or drafts are included in cash balance the total there of should be disclosed.
8. If there is any rough Cash Book or detail of daily balance are separately kept, the auditor should test entries from the rough Cash Book with those in the Cash Book, to prove that, entries in the Cash
Book are correct.

9. If the auditor finds any slip, chit or I.O.U's in respect of temporary advances paid to the employees, included as part of the cash balance, he should have them initialed by a responsible official and debited to appropriate accounts.

Furniture and Fixtures:
1. The auditor has to see that a proper record showing quantitative details of furniture and fixtures owned by the client is maintained.
2. The auditor has to see that all expenses incidental to the purchase of furniture and fixtures is capitalized along with the purchase price paid for it.
3. The auditor has to enquire whether the furniture and fixtures have been properly insured or not.
4. The auditor has to see that adequate provision for depreciation on furniture and fixtures is made.
5. The auditor if possible can go for physical verification of furniture on test check basis or he can rely on the management certificate to that effect.
6. He has to further see that any damaged or unusable furniture, if existing, is fully written off in the books.

VALUATION OF ASSETS

Valuation of assets means determining the fair value of the assets shown in the Balance Sheet on the basis of generally accepted accounting principles. The valuation of assets is very important because over-statement or under-statement of the value of assets in the Balance sheet not only distorts the true and fair view of the financial position but also gives wrong position of profitability.

The valuation of the assets is the primary duty of the officials of the company. The auditor is required to verify whether the value ascertained is fair one or not. For this, he may rely on the technical certificate issued by the experts in the field.

Valuation of assets means not only checking value of the assets owned by an organization as on Balance Sheet date, but also critical examination of the value of these assets

The auditor has also to see that the principle of valuation of assets is consistently adopted and is based on established principles of accountancy. For the purpose of convenience, those assets are classified as under to determine their value.
1. Fixed Assets
2. Current Assets or Floating Assets
3. Wasting Assets
4. Intangible Assets
5. Fictitious Assets.

Fixed Assets :
Fixed Assets are usually valued at `going concern value' which means cost less depreciation. Cost here means purchase price of the assets plus all incidental manufacturing, buying and installation expenses incurred to bring the assets in use. Depreciation is the provision made for the reduction in the value of the assets on account of their usage, natural wear and tear and obsolescence etc. The depreciation provided should be fair, otherwise the value of fixed assets may not be fair. What is a fixed asset depends on the nature of the business organization.

Current Assets or Floating Assets:
These are usually converted into cash at the earliest opportunity in the process of business activity, e.g. stocks, bills receivables, sundry debtors, etc. Based on conservatism principle, usually current asset are valued at original value (cost price) or market value (realizable value) whichever is lower. Because they are intended to be converted into cash at the earliest possible time, hence what value we may realize is important. This method is adopted to strengthen the financial position of a concern by indirectly providing for expected loss by way of fall in the market value of the assets. This principle is held by the conservatism convention of accounting, i.e. do not expect profits but provide for anticipated losses.

Wasting Assets:
Wasting Assets means those which lose their value gradually upon their use, e.g. a mine, a quarry etc. To value these assets firstly we should determine the usefulness of the assets in terms of units of production etc. and as per their actual use the value is to be reduced on proportionate basis. If in a particular period this type of asset is not used then the value may not diminish also. Thus, these assets are to be reduced on the basis of consumption. But sometimes it may be difficult to adopt this method, then the `cost less depreciation' principle may have to be applied.

4. Intangible Assets:
Usually intangible assets like goodwill, patent rights, know how, etc. are valued on cost basis. But if the same are acquired by a non-cash transaction, then the fair market value is to be taken as the value of intangible assets. Auditor should also see the period of time and till it is fully written off, they are shown as assets because they do not have any realizable value. They are to be valued at actual cost less amount written off as depreciation upto Balance Sheet date.

Methods of Valuation
The following are the various principles of valuation of assets

(1) **Cost Price (Going Concern Value) :** Under this method actual cost of assets are reduced by the depreciation provided. Usually this method is applied to value fixed assets.

(2) **Market Value :** This refers to the market value of the asset i.e. the price at which the asset is being transacted in the market. This is applied to value the current assets only when this is lower than cost of the asset. Usually market value is adopted to value items having perishable nature.

(3) **Scrap Value :** Assets which are useless for the enterprise may be sold as scrap in the market. The value for which such assets can be disposed of as scrap, is called as scrap value of assets.

(4) **Replacement Value :** This represents the value at which the existing assets can be replaced. That means the price to be paid to acquire such type of assets in the market on the date of the balance Sheet.

(5) **Realisable Value :** The value that can be obtained if the asset is sold in the market i.e. anticipated selling price. Usually, expenses such as commission, brokerage etc. are deducted from it.

AN AUDITOR IS NOT A VALUER

Valuation of assets means determining the fair value of the assets as on the date of the balance Sheet. Verifying such value of assets is an important part of the auditor's duties. As the assets are belonging to the proprietors, it is their basic duty to see that the value of assets is properly determined on the basis of generally accepted accounting principles.

What the auditor is required to do is satisfy himself that all the assets are shown at their "full and fair value". Auditor need not himself value the assets. But he has just to see whether the value that have been placed are true, correct and fair. As such he has to apply his skill, intelligence and tactfulness to confirm the values of the assets as indicated. Usually assets are valued by specially qualified persons like valuers and surveyors. Hence he can rely on the certificate issued by those professionals, but must disclose the fact of this in his report. An auditor is not supposed to have special technical knowledge in respect of valuation of assets. But he should always try to examine the value of assets himself with the help of supporting evidence available with the company. He has also to depend many a times upon the valuation made by the directors, partners and proprietors of the organization.

Audit Report

The **auditor's report** is a disclaimer thereof, issued by either an internal auditor or an independent external auditor as a result of an internal or external audit or public]], among others) as an assurance service in order for the user to make decisions based on the results of the audit.

There are four common types of auditor's reports, each one presenting a different situation encountered during the auditor's work. The four reports are as follows:

Unqualified Opinion

An opinion is said to be unqualified when the Auditor concludes that the Financial Statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the Financial Statements. An Auditor gives a Clean opinion or Unqualified Opinion when he or she does not have any significant reservation in respect of matters contained in the Financial Statements.

An Unqualified Opinion indicates the following –

(1) The Financial Statements have been prepared using the Generally Accepted Accounting Principles which have been consistently applied;

(2) The Financial Statements comply with relevant statutory requirements and regulations;

(3) There is adequate disclosure of all material matters relevant to the proper presentation of the financial information subject to statutory requirements, where applicable;

(4) Any changes in the accounting principles or in the method of their application and the effects thereof have been properly determined and disclosed in the Financial Statements.

Qualified Opinion report

Qualified report is given by the auditor in either of these two cases:

1. When the financial statements are materially misstated due to misstatement in one particular account balance, class of transaction or disclosure that does not have pervasive effect on the financial statements.
2. When the auditor is unable to obtain audit evidence regarding particular account balance, class of transaction or disclosure that does not have pervasive effect on the financial statements.

Adverse Opinion report

An **Adverse Opinion Report** is issued on the financial statements of a company when the financial statements are materially misstated and such misstatements have pervasive effect on the financial statements.

An **Adverse Opinion** is issued when the auditor determines that the financial statements of an auditee are materially misstated and, when considered as a whole, do not conform with GAAP. It is considered the opposite of an unqualified or clean opinion, essentially stating that the information contained is materially incorrect, unreliable, and inaccurate in order to assess the auditee's financial position and results of operations. Investors, lending institutions, and governments very rarely accept an auditee's financial statements if the auditor issued an adverse opinion, and usually request the auditee to correct the financial statements and obtain another audit report.

Disclaimer of Opinion report

A **Disclaimer of Opinion** is issued in either of the following cases:

- When the auditor is not independent or when there is conflict of interest.
- When the limitation on scope is imposed by client, as a result the auditor is unable to obtain sufficient appropriate audit evidence.
- When the circumstances indicate substantial problem of going concern in client.
- When there are significant uncertainties in the business of client.

A **Disclaimer of Opinion**, commonly referred to simply as a **Disclaimer**, is issued when the auditor could not form and consequently refuses to present an opinion on the financial statements. This type of report is issued when the auditor tried to audit an entity but could not complete the work due to various reasons and does not issue an opinion.

Statements on Auditing Standards (SAS) provide certain situations where a disclaimer of opinion may be appropriate:

- A lack of independence, or material conflict(s) of interest, exist between the auditor and the auditee (SAS No. 26)
- There are significant scope limitations, whether intentional or not, which hinder the auditor's work in obtaining evidence and performing procedures (SAS No. 58);
- There is a substantial doubt about the auditee's ability to continue as a going concern or, in other words, continue operating (SAS No. 59)