Verification of Assets & Liabilities

Auditing- Unit IV

III BBA

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VALUATION OF ASSETS

- Determination or ascertainment of the money values at which the assets are shown in the balance sheet.
- In Auditing, ‘Valuation’ implies critical examination and testing of the determined values of the assets on the basis of generally accepted accounting principles.

Valuation of Assets involves the following:

- Obtainment of all the information available in respect of valuation of assets.
- Critical examination and analysis of all the values of the assets.
- Checking of the values of the various assets which have already been determined by the owners or the management of the business.
- Verifying whether the value of the assets as shown in the balance sheet have been determined properly on the basis of normally accepted accounting principles.
- Verifying whether the basis of valuation has been consistent from year to year.
- Seeking assistance from technical personnel, where necessary, for determining whether the values of the assets, as shown in the balance sheet, have been properly arrived at.

Objectives of Valuation of Assets:

- To verify whether the assets, as shown in the balance sheet has been properly valued.
- To indicate that the balance sheet represents a true and fair view of the state of affairs of the business.
- To indicate that there is no manipulation of accounts to inflate or to reduce the profits.

Classification of Assets for the purpose of valuation

The basis or mode of valuation of assets differs, depending upon the types of assets. They are classified as follows:

1. Fixed assets
2. Current/ Floating/Circulating assets
3. Wasting assets
4. Intangible assets
5. Fictitious assets
6. Contingent assets

1. Fixed assets

- Fixed assets are those assets which are acquired for the purpose of use in the business with the object of earning revenue, and are not intended for resale at a profit and conversion into cash in the ordinary course of business.
    - Not for resale
    - For permanent use in business
    - Utility of these assets last long
- Fixed assets can be classified into two:
    - Fixed assets not subject to Depreciation – eg. Land
    - Fixed assets subject to Depreciation – eg. Building, Plant, Machinery, Furniture

2. Current/ Floating/Circulating assets

- Current assets are those assets which are acquired for resale or for use in the process of manufacture or trade, and are expected to be converted into cash within a period of one year. They change continually and are in process of being converted into cash.
- It includes:
  - ➢ assets which are in liquid form like cash and bank balances.
  - ➢ Assets which are expected to be converted into cash like B/Rs, Debtors.
  - ➢ Assets meant for use in manufacture or trade like stores, supplies, raw materials.
  - ➢ Assets which are meant for sale and conversion into cash like stock of finished goods.

3. Wasting assets

- Wasting assets are fixed assets which are gradually depleted or exhausted in the process of earning income. These are assets whose value diminishes gradually on account of exploitation, extraction or depletion.
- Wasting assets differ from fixed assets in one respect i.e., FA lose their value due to wear & tear, resulting from use, obsolescence etc but WA lose their value gradually due to extraction, exhaustion or depletion.
- Example- mines, quarries, oil-wells, timber- tracts.

4. Intangible assets

- Intangible assets are assets which have no physical or concrete form, and so, are not visible, but are serviceable and have income producing ability for the business like any other asset.
- Examples- Goodwill, Patent Rights, Trade Marks, Copy Rights, Licences etc.

5. Fictitious assets

- Fictitious assets are assets which are neither physically visible nor realisable into cash. These are items of expenditure which have no exchange value. They are revenue expenditures that have been temporarily capitalised with the object of spreading the amount of expenditure over a period of years the benefit of which accrues.
- Examples- Preliminary expenses, Development expenses, expenses of issue of shares, discount on issue of debentures, underwriting commission, advertising costs, heavy repair charges etc.

6. Contingent assets

- The assets whose existence, value and ownership depend upon the occurrence or non-occurrence of a specified event, or upon the performance or non- performance of a specified event in the future.
- Example- uncalled share capital of a company, claim for refund of income- tax or sales tax, pending legal action for compensation, claim by the business for damages for breach of contract etc.

Classification / Types of Liabilities

- Fixed / Long-Term Liabilities
- Current/ Short-Term Liabilities
- Contingent Liabilities

1. Fixed / Long-Term Liabilities

Long term liabilities refer to liabilities which are not expected to be discharged within a year. They are liabilities which are to be paid after one or more years.

They are usually based on written agreements, specifying the borrower’s obligations, such as the due dates for interest and principal payments, types of security provided etc.

Example- debentures issued, long term loans borrowed, long term deposits accepted

2. Current/ Short-Term Liabilities

- They are liabilities of business which are required to be settled within a period of one year either by the use of current assets or by the creation of other current liabilities.
- Examples- Trade Creditors, Bills Payable, Short term loans accepted, outstanding and accrued expenses.

3. Contingent Liabilities

- A contingent liability is one which is not an actual liability, but which may become an actual liability on the happening or non-happening of a certain event in the future.
- Examples- bills discounted and not matured, calls on partly- paid shares held as investments, guarantees given, claims of employees pending settlement

Mode of Valuation of various types of Assets:

1. **Fixed Assets**: valued at the **Going Concern Value**.
   - These assets are acquired for the purpose of running the business.
   - The assets are not meant for resale in the market hence their market value is not considered.
   - Fluctuations in the market price are not taken into account.
   - Land is an exception as it is valued at Cost price.
   - Other assets are valued at cost price less depreciation.

2. Current assets: valued at **Cost price or Market price w.e.l at the date of the Balance Sheet.**

- Bank and Cash balances are not valued.
- Bills Receivables are valued at their Book Values
- Debtors are valued at their book values and provision is made for Bad Debts
- Stocks of Raw materials and semi- finished goods are normally valued at cost price.
- Stock of Finished goods are valued at Cost price or Market price w.e.l.

3. Wasting Assets: valued at Original cost. A provision is made for depletion/ depreciation during the year and shown separately. The value of the wasting assets should be reduced every year to the extent of the estimated amount by which such assets have diminished in value because of exhaustion.

4. Intangible Assets: treated just like fixed assets. They are **valued at cost less depreciation.** These assets are least liquid as they are attached to the business and so, are generally unsaleable, hence market value is not taken into account for valuation.

5. Fictitious Assets: shown in the Balance sheet at the amount of actual expenditure less any amount amortised or written off.