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VERIFICATION AND VALUATION OF DIFFERENT ASSETS

Introduction:

After the study of the general principles of verification and valuation of assets and liabilities, let us now take up the discussion of the verification and valuation of different assets.

Verification and Valuation of Freehold Property:

Freehold property refers to land and buildings which are absolutely the property of the business.

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

1. He should examine the title deeds relating to the freehold lands and buildings to ensure that they are in the name of the client.

He should ensure that the title deeds cover all the freehold lands and buildings shown in the balance sheet.

2. If there is any doubt regarding the title of the freehold property, he should consult the solicitors of the client.

3. If the freehold lands and buildings have been purchased, he should examine the correspondence, conveyance deed and broker's or auctioneer's account.

If the freehold property consists of buildings constructed by the client, the auditor should ask for and examine the architect's and builder's certificates.

4. He should see that if legal expenses, brokerage and any other expenses are incurred on the acquisition of freehold property, they are also capitalised (i.e., treated as part of the cost of acquisition of the freehold property).

5. If the freehold property, (i.e., freehold lands and buildings are mortgaged, the auditor should get a certificate from the mortgagee stating that the title deeds are in his possession.

6. He should also make proper enquiry to ensure that there is no second mortgage on the freehold property.

7. If the title deeds of the freehold property are with a bank or a solicitor for safe custody, the auditor should get a certificate from the bank or the solicitor, stating that they are held by him for safe custody, and not as a security for any loan.

8. He should check the additions to freehold property, if any, made during the year with the help of relevant vouchers. The costs of additions must be capitalised.

9. If any freehold lands and buildings are sold during the year, the auditor should check such sales, and see that the profit or loss thereon is correctly dealt with in the accounts.

10. He should see that repairs and renewals to freehold property are charged to revenue, and not to freehold property account.

11. He should examine the adequacy of the provision for depreciation on the freehold buildings. (It may be noted that no provision is made for depreciation on freehold lands, as lands are likely to appreciate, and not to depreciate in value.)

12. He should see that any appreciation in the value of the freehold property is not brought into account.

13. He should see that the freehold lands and freehold buildings are shown separately in the balance sheet.

He should also see that the freehold lands are shown in the balance sheet at cost, and freehold buildings are shown at cost less depreciation.

In case the freehold lands or freehold buildings are shown in the balance sheet at market value, the auditor must see that they are clearly mentioned in the balance sheet.

Verification and Valuation of Leasehold Property:

Leasehold property refers to land and buildings acquired by a business for a fixed period on lease.

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

1. He should examine the lease deed to ascertain the cost of the leasehold property, the duration of the lease and the terms and conditions of the lease.

2. If the lease is for more than one year, the auditor should see that the lease deed is registered.

3. He should ensure that the amount paid for the leasehold property (i.e., the lease money) is capitalised.

He should see that any legal expenses incurred in acquiring the leasehold property are also capitalised. He should see that the lease rent paid every year is charged to revenue, and not to capital (i.e., leasehold property account).

5. He should see that all the terms and conditions of the lease are complied with by the client.

6. He should see that the lease rent is paid regularly, and the lease is existing. For this purpose, he should examine the last receipt for the payment of lease rent.

7. Leasehold property cannot be mortgaged to others. But it can be sublet to others. In case it is sublet to anybody, the auditor should examine the agreement with the sub-tenant.

8. Additions to leasehold property must be verified with the relevant vouchers. The costs of additions must be capitalised.

9. He should see that repairs and renewals to leasehold property are charged to revenue account, and not to leasehold property account.

10. He should see that the leasehold property is adequately depreciated. He should see that the provision for depreciation is made according to the life of the lease.

11. He should see that the leasehold property is not combined with the freehold property in the balance sheet. It is shown separately.

12. He should see that the leasehold property is shown in the balance at cost less depreciation written off to date.

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Verification and Valuation of Plant and Machinery:

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Plant and machinery is a fixed asset meant for the use of the concern.

A small concern considers all the pieces of machinery as one item. So, it may not maintain a separate plant register, showing separately the details of various pieces of machinery. But, a big concern, usually, maintains a separate register called plant register. The plant register contains separate account for each piece of machinery. The plant

While undertaking the verification and valuation of livestock, an auditor should pay attention to the following:

1. He should obtain a schedule or list of livestock duly certified by a responsible official and verify it with the register of livestock maintained by the firm. He should see that any addition by way of purchase or births are included, and any animals which have been sold or have died are deleted from the schedule.

2. He should see that the livestock are annually revalued, and any loss on account of death or sale is written off.

3. He should see that the values of livestock are shown in the balance sheet separately.

Verification and Valuation of Goodwill: Imp

Goodwill is the value of the reputation of a business, which enables the business to earn more than the normal rate of profit. In short, it is the reputation of a business valued in terms of money.

The value of goodwill depends upon the earning capacity of the business. It (i.e., the value of goodwill) increases with rise in profit and decreases with fall in profit. That means, goodwill cannot have a permanent value.

Goodwill is an intangible asset. That is, it has no physical existence or form.

Goodwill is, generally, brought into books of account in the following circumstances:

(a) When goodwill has been purchased along with a running business from some vendors, goodwill is brought into books of account.

(b) When a company has written up the values of its assets on the revaluation of the whole of its assets, goodwill account may be raised in the books of the company.

(c) In the case of a partnership firm, when a new partner is admitted or an existing partner retires or dies, goodwill account may be raised in the books of the partnership firm.

As goodwill is an intangible asset, it will be a wise financial policy to write off the goodwill over some years, though, legally, it is not necessary to do so.

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

1. When goodwill has been purchased along with a running business from some vendors, the amount of goodwill should be verified by the auditor from the purchase agreement with the vendors, showing the price paid for the goodwill. Where the price to be paid for goodwill is not specifically fixed, the auditor should ensure that the amount of goodwill taken into account is the amount of purchase consideration (i.e., the amount paid for the purchase of the business) over the net assets taken over.

2. When goodwill account has been raised by a company by writing up the value of its assets on the revaluation of the whole of its assets, the auditor should examine the basis on which the assets have been revalued, and satisfy himself that the amount of goodwill brought into account in the books of the company is proper.

3. The amount of goodwill created in the books of a partnership firm, on the admission of a new partner or on the retirement or death of an existing partner, should be verified by the auditor with the help of the partnership deed. The auditor can also verify the changes made in the goodwill account from time to time on the basis of the provisions in the partnership deed.

4. The valuation of goodwill is a matter of financial policy, to be decided by the management of the business. The auditor cannot interfere in the valuation of goodwill, though he may give his advice on the valuation of goodwill, if his advice is sought. So, as regards the valuation of goodwill, the duty of the auditor is just to see that the goodwill is shown in the balance sheet at its proper value.

5. It is a sound financial policy to write off the goodwill in course of time. But there is no law compelling a concern to write off the goodwill. So, the auditor cannot insist upon the writing off of the goodwill. However, he should satisfy himself that the future benefits associated with goodwill exist to justify the continuation of the goodwill. If it appears to him that the future benefits associated with goodwill do not exist, he should insist on the writing off of the goodwill. If the management does not accept his suggestion regarding the writing off of goodwill, he should qualify his report and state the facts in this regard in his report.

6. Goodwill should be valued at cost less amount (of goodwill)

written off. So, the auditor should see that goodwill is valued and shown in the balance sheet at cost less amount written off.

Verification and Valuation of Patent Rights or Patents: Imp

Patent refers to the sole right vested with a party over a design or production formula. Patent can also be defined as an official document granted by the Government, giving an inventor an exclusive right to make, use or sell his invention for a term of years. A patent right has 16 years of life unless the term is extended.

Patent rights can be acquired in two ways, viz., (i) by research and development and (ii) by purchase from somebody else.

When a concern holds a large number of patent rights, it maintains a schedule or list of patent rights. The schedule of patent rights gives the details of the patent rights, such as the registration number, date of acquisition, description and the unexpired period of the patents.

While conducting the verification and valuation of patent rights, an auditor should observe the following points :

1. He should ask for and examine the schedule or list of patent rights, if his client holds a number of patent rights and maintains a schedule of patent rights.

2. He should examine and verify the patent rights with the help of the certificate of patents, which has granted the patent rights. Where the patent rights are purchased from another person, the auditor should verify the assignment deed and also the registration of the assignment.

3. He should ensure that the patents are registered in the name of the client. Where patents have been obtained in the name of an employee of the firm, the auditor must see that it is properly assigned in favour of the firm.

4. If the patent rights are developed by the concern by doing some reseach work, the cost of research and development should be capitalised. Similarly, if the patent rights have been purchased, the cost of purchase of patents should be capitalised.

5. He should examine the last renewal fee payment certificate and see that the renewal fee is paid in time and the patent is renewed in time to ensure that the patent has not lapsed. He should also see that the renewal fee is charged to revenue.

6. He should see that the cost of patents is written off (i.e., the

patent is depreciated within its life time of 16 years unless the term has been extended. (In this context, it may be noted that there are three causes of depreciation, viz., (i) lapse of time, (iii) obsolescence and (ii) the patented article going out of fashion.)

7. As regards the valuation of patents, he should see that each patent is reduced to its unexpired value at the end of every year. He should see that the patents are valued at cost less depreciation.

8. If a patent becomes obsolete, its entire book value should be written off to profit and loss account even before the expirty of its life.

9. If patents are revalued at the end of every year, and if there is any fall in the value of patents, no doubt, the depreciation is debited to the profit and loss account. On the other hand, if there is any appreciation in the value of patents, the appreciation should not be taken into account.

10. The auditor should see that patents are clearly stated in the balance sheet separately. He should see that the patents are disclosed in the balance sheet at original cost less depreciation to date.

11. The auditor need not bother about any charge or mortgage on patents, as the question of any charge or mortgage on patents does not arise. The question of any charge or mortgage on patents does not arise, because the patents are maintained and used as rights by the business which develops or acquires them.

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Verification and Valuation of Trade Marks:

A trade mark is a distinctive mark attached to the goods offered for sale in the market so as to distinguish the same from similar goods, and to identify the goods with a particular trader.

Like patent rights, trade marks also are registered in the name of the owner. The life of a trade mark is, generally, 7 years, and its life can be extended from time to time. Trade marks can be acquired through registration or purchase.

While undertaking the verification and valuation of trade marks, the auditor should proceed on the following lines:

1. He should see that the trade marks are registered in the name of the client, and they are the property of the client.

2. Trade marks acquired through designing can be verified by examining the certificate of registration granted by the office of the registrar of trade marks, and trade marks acquired through purchase

can be verified by examining the assignment deed executed by the seller of the trade mark.

3. The auditor should vouch (i.e., check) the expenditure incurred in connection with the designing of trade marks, e.g., the payment made to the designers, registgration fees, etc. Similarly, he should vouch the expenditure incurred in connection with the purchase of trade marks, e.g., the payment made to the seller, registration charges, etc.

4. If the business holds a number of trade marks, the auditor should call for a schedule of trade marks duly signed by a responsible official of the business.

5. He should see that the expenditure incurred in connection with the acquisition of trade marks, whether designed or purchased, is capitalised.

6. He should verify the payment of renewal fee. He should see that the renewal fee is paid in time, and the trade mark has not lapsed. He should also see that the renewal fee is charged to revenue.

7. He should see that the trade marks are written off over their life time. As the revaluation method of depreciation is the most suitable method of providing depreciation on trade marks, the auditor should see that trade marks are written off or depreciated according to the revaluation method.

8. He should see that the trade marks are shown separately in the balance sheet at their proper values, i.e., at cost less depreciation written off to date.

Verification and Valuation of Copy Rights: Imp

A copy right is the exclusive legal right to produce or reproduce some literary work, say, a book, an article, lecture, musical composition, etc. It is the legal protection provided to an author by which the production or reproduction of his literary work by others is prohibited. The effect of a copy right is that the author gets an exclusive right to publish or reproduce the work for a certain number of years. The author of the copy right is the first owner of the copy right. The copy right lasts for the entire life of the author and 50 years after his death.

While conducting the verification and valuation of patent rights, an auditor should observe the following points:

1. He should examine the agreement between the author and the publisher (i.e., the client) to verify the copy rights.

2. If there are many copy rights with his client, the auditor should call for a schedule or list of his client's copy rights and verify them from the schedule.

3. Copy rights suffer depreciation from the efflux of time and lose their value with the passage of time. So, depreciation must be charged on copy rights. As the revaluation method of depreciation is considered to be most appropriate for charging depreciation on copy rights, the auditor should see that the copy rights are depreciated accordingly (i.e., according to the revaluation method).

4. An auditor is not competent to undertake the valuation of copy right. So, he may rely on the certificates of experts who are responsible for the revaluation of the copy rights as regards the value of a copyright.

5. If the sale of the publication is very low or nil, the auditor should see that the entire value of the copy right is written off.

6. The auditor should see that, in the balance sheet, the copy right is shown at cost less the amount of depreciation written off from time to time.

Verification and Valuation of Investments: Imp

Investments include Government securities, shares and debentures of joint stock companies, etc.

Generally, when the number of investments is large, a schedule of investments is maintained by the owner of investments. The schedule of investments gives all the details about investments, such as the names of the securities, dates of purchases, nominal values, cost prices, market prices at the date of balance sheet, rates of interest, dates of payment of interests, etc.

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

1. He should call for and examine the schedule of investments held by the client by reference to the relevant ledger accounts.

2. He should see that the investments have been shown in the balance sheet distinctly and properly.

3. If the investments are in the hands of the client, the auditor should verify the existence of the investments by personal inspection. He should examine all the investments at one sitting.

4. If the investments have been entrusted to a bank for safe

custody, he should get a certificate from the bank, giving the details of the securities in its hands and stating that they are free from any charge.

5. If the investments are held by a trustee on behalf of the company, the auditor should call for and examine the trust deed.

6. If the securities are held by the client's brokers, the auditor should call for the securities for personal inspection. He should not be satisfied with the certificates obtained from the brokers, because, ordinarily, the securities should not be left in the hands of brokers.

7. If the securities are deposited with a bank or any other creditor as securities towards loans borrowed, the auditor should get a certificate from the bank or the creditor to this effect.

8. If securities have been purchased during the year, he should verify the purchase by examining the certificate. If no certificate is available, he should examine the purchase with the help of the transfer deed and broker's bought note. He should examine the authority of purchase of investments (i.e., the management's approval for the purchase). He should also check the prices of investments by reference to allotment letters or stock broker's note. The stock exchange quotations also should be examined to verify the price paid.

9. He should see that transfer fees, stamp duty, etc. incurred on the purchase of investments are properly capitalised.

10. If the securities have been sold during the year, the auditor should verify the sale of investments with the help of broker's sold note. He should see that the sale of investments is approved by the board of directors.

11. He should see whether the profit or loss made on the sale of investments is properly adjusted in the accounts.

12. He should ensure that the investments are registered in the name of the client, and they are free from charges other than those disclosed.

13. After the verification of investments is over, the auditor should concern himself with the valuation of investments. He should see that the investments are properly valued.

In the context of valuation of investments, the following points may be borne in mind:

If the investments are held as fixed assets (i.e., if the object of custody, he should get a certificate from the bank, giving the details of the securities in its hands and stating that they are free from any charge.

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5. If the sale of the publication is very low or nil, the auditor should see that the entire value of the copy right is written off.

6. The auditor should see that, in the balance sheet, the copy right is shown at cost less the amount of depreciation written off from time to time.

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4. If the business holds a number of trade marks, the auditor should call for a schedule of trade marks duly signed by a responsible official of the business.

5. He should see that the expenditure incurred in connection with the acquisition of trade marks, whether designed or purchased, is capitalised.

6. He should verify the payment of renewal fee. He should see that the renewal fee is paid in time, and the trade mark has not lapsed. He should also see that the renewal fee is charged to revenue.

7. He should see that the trade marks are written off over their life time. As the revaluation method of depreciation is the most suitable method of providing depreciation on trade marks, the auditor should see that trade marks are written off or depreciated according to the revaluation method.

8. He should see that the trade marks are shown separately in the balance sheet at their proper values, i.e., at cost less depreciation written off to date.

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7. As regards the valuation of patents, he should see that each patent is reduced to its unexpired value at the end of every year. He should see that the patents are valued at cost less depreciation.

8. If a patent becomes obsolete, its entire book value should be written off to profit and loss account even before the expirty of its life.

9. If patents are revalued at the end of every year, and if there is any fall in the value of patents, no doubt, the depreciation is debited to the profit and loss account. On the other hand, if there is any appreciation in the value of patents, the appreciation should not be taken into account.

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4. If the patent rights are developed by the concern by doing some reseach work, the cost of research and development should be capitalised. Similarly, if the patent rights have been purchased, the cost of purchase of patents should be capitalised.

5. He should examine the last renewal fee payment certificate and see that the renewal fee is paid in time and the patent is renewed in time to ensure that the patent has not lapsed. He should also see that the renewal fee is charged to revenue.

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1. When goodwill has been purchased along with a running business from some vendors, the amount of goodwill should be verified by the auditor from the purchase agreement with the vendors, showing the price paid for the goodwill. Where the price to be paid for goodwill is not specifically fixed, the auditor should ensure that the amount of goodwill taken into account is the amount of purchase consideration (i.e., the amount paid for the purchase of the business) over the net assets taken over.

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6. Goodwill should be valued at cost less amount (of goodwill)

While undertaking the verification and valuation of livestock, an auditor should pay attention to the following:

1. He should obtain a schedule or list of livestock duly certified by a responsible official and verify it with the register of livestock maintained by the firm. He should see that any addition by way of purchase or births are included, and any animals which have been sold or have died are deleted from the schedule.

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2. If the lease is for more than one year, the auditor should see that the lease deed is registered.

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He should see that any legal expenses incurred in acquiring the leasehold property are also capitalised. He should see that the lease rent paid every year is charged to revenue, and not to capital (i.e., leasehold property account).

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6. He should see that the lease rent is paid regularly, and the lease is existing. For this purpose, he should examine the last receipt for the payment of lease rent.

7. Leasehold property cannot be mortgaged to others. But it can be sublet to others. In case it is sublet to anybody, the auditor should examine the agreement with the sub-tenant.

8. Additions to leasehold property must be verified with the relevant vouchers. The costs of additions must be capitalised.

9. He should see that repairs and renewals to leasehold property are charged to revenue account, and not to leasehold property account.

10. He should see that the leasehold property is adequately depreciated. He should see that the provision for depreciation is made according to the life of the lease.

11. He should see that the leasehold property is not combined with the freehold property in the balance sheet. It is shown separately.

12. He should see that the leasehold property is shown in the balance at cost less depreciation written off to date.

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Verification and Valuation of Plant and Machinery:

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Plant and machinery is a fixed asset meant for the use of the concern.

A small concern considers all the pieces of machinery as one item. So, it may not maintain a separate plant register, showing separately the details of various pieces of machinery. But, a big concern, usually, maintains a separate register called plant register. The plant register contains separate account for each piece of machinery. The plant

6. He should also make proper enquiry to ensure that there is no second mortgage on the freehold property.

7. If the title deeds of the freehold property are with a bank or a solicitor for safe custody, the auditor should get a certificate from the bank or the solicitor, stating that they are held by him for safe custody, and not as a security for any loan.

8. He should check the additions to freehold property, if any, made during the year with the help of relevant vouchers. The costs of additions must be capitalised.

9. If any freehold lands and buildings are sold during the year, the auditor should check such sales, and see that the profit or loss thereon is correctly dealt with in the accounts.

10. He should see that repairs and renewals to freehold property are charged to revenue, and not to freehold property account.

11. He should examine the adequacy of the provision for depreciation on the freehold buildings. (It may be noted that no provision is made for depreciation on freehold lands, as lands are likely to appreciate, and not to depreciate in value.)

12. He should see that any appreciation in the value of the freehold property is not brought into account.

13. He should see that the freehold lands and freehold buildings are shown separately in the balance sheet.

He should also see that the freehold lands are shown in the balance sheet at cost, and freehold buildings are shown at cost less depreciation.

In case the freehold lands or freehold buildings are shown in the balance sheet at market value, the auditor must see that they are clearly mentioned in the balance sheet.

Verification and Valuation of Leasehold Property:

Leasehold property refers to land and buildings acquired by a business for a fixed period on lease.

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

1. He should examine the lease deed to ascertain the cost of the leasehold property, the duration of the lease and the terms and conditions of the lease.

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VERIFICATION AND VALUATION OF DIFFERENT ASSETS

Introduction:

After the study of the general principles of verification and valuation of assets and liabilities, let us now take up the discussion of the verification and valuation of different assets.

Verification and Valuation of Freehold Property:

Freehold property refers to land and buildings which are absolutely the property of the business.

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

1. He should examine the title deeds relating to the freehold lands and buildings to ensure that they are in the name of the client.

He should ensure that the title deeds cover all the freehold lands and buildings shown in the balance sheet.

2. If there is any doubt regarding the title of the freehold property, he should consult the solicitors of the client.

3. If the freehold lands and buildings have been purchased, he should examine the correspondence, conveyance deed and broker's or auctioneer's account.

If the freehold property consists of buildings constructed by the client, the auditor should ask for and examine the architect's and builder's certificates.

4. He should see that if legal expenses, brokerage and any other expenses are incurred on the acquisition of freehold property, they are also capitalised (i.e., treated as part of the cost of acquisition of the freehold property).

5. If the freehold property, (i.e., freehold lands and buildings are mortgaged, the auditor should get a certificate from the mortgagee stating that the title deeds are in his possession.