

Revaluation of Assets

Revaluation of fixed assets is the process of increasing or decreasing their carrying value in case of major changes in fair market value of the fixed asset. A fixed asset is initially recorded at cost but subsequently its carrying amount is increased to account for any appreciation in value. Let's assume, a company revalued one of its fixed assets to \$190,000 on 31 Mar'14, while the book value of asset was \$170,000. So an upward adjustment of \$20,000 was required to fixed asset account. Upward revaluation is not considered a normal gain and is not recorded in income statement rather it is directly credited to an equity account called revaluation surplus. Revaluation surplus holds all the upward revaluations of a company's assets until those assets are disposed of.

If a revalued asset is subsequently valued down due to impairment, the loss is first written off against any balance available in the revaluation surplus and if the loss exceeds the revaluation surplus balance of the same asset the difference is charged to income statement as impairment loss. Suppose on 31 Mar'15 the company revalues the same fixed asset again to find out that the fair value should be \$160,000. Book value after depreciation as on 31 Mar'15 is \$167,648. The carrying amount exceeds the fair value by \$7,648 so the account balance should be reduced by that amount. We already have a balance of \$20,000 in the revaluation surplus account related to the same building, so *no impairment* loss shall go to income statement. Had the fair value been \$140,000 the excess of carrying amount over fair value would have been \$27,648. In that case \$7,648 (after adjusting \$20,000 with revaluation reserve) would have been recorded in income statement as impairment loss.

GAAP Insight	US GAAP does not allow revaluation of PPE.
--------------	--

Why Companies Revalue Assets?

- To reflect a better fair value of entity
- To increase collateral for loan
- To reduce leverage ratios
- Prior to announcing a sale and leaseback transaction
- To manage dividend policy (*increase in assets value will lead to increase in depreciation and hence reduce the profits*)

Impacts of Revaluation

- Increase in Depreciation
- Decline in EBIT
- No Change in EBITDA

--

Chapter 5, Para 5.3.1, *Investment Banking: The Dream Begins* (4th Edition)