6.1 If an upward asset revaluation has been undertaken for a depreciable asset, then depreciation in subsequent periods will increase, as the depreciation will be based on the higher revalued amount. Profit on sale of the asset, before the completion of its useful life, will also be lower.

For example, to show how a revaluation can reduce any profit recorded on the ultimate sale of an asset, assume that a reporting entity has land recorded at a cost of $100 000 and then elects to revalue it to $300 000. The difference of $200 000 will be transferred to the revaluation surplus account, and is not treated as part of the period’s profits (although the increase will be included as part of ‘other comprehensive income’). If in a subsequent period the entity sells the asset at a price of $350 000, then it will record a profit on sale of $50 000 which will be included in profit or loss. Had it not revalued the land it would have recorded a profit on sale of $250 000. While the related revaluation surplus balance of $200 000 will need to be transferred to retained earnings when the revalued asset is ultimately sold, this transfer will be directly to retained earnings and will not go via profit or loss. Hence the transfer will not impact reported profits in the year of transfer.

In summing up, upward asset revaluations will have an effect of decreasing profits in subsequent periods, either through increased depreciation and/or through decreased gains on sale.

6.2 In relation to revaluation increments, paragraph 39 of AASB 116 states:

*If an asset’s carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of a revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a devaluation decrease of the same asset previously recognised in profit or loss.*

In relation to revaluation decrements, paragraph 40 of AASB 116 states:

*If an asset’s carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.*

As we know from the above, if an asset’s fair value goes up (and it does not represent a reversal of a decrement) then the increment does not go to profit or loss, rather, it goes directly to equity (to revaluation surplus) and is included as part of ‘other comprehensive income’. If it goes down, however, it is treated as an expense (to the extent it does not reverse a previous increment) and therefore does impact profit or loss. This seems to be a conservative approach and does seem somewhat conservatively biased. It certainly is not a symmetrical treatment and therefore does seem somewhat biased. Conceptually, financial statements should not be biased in one direction or another. Indeed, the IASB/AASB Conceptual Framework proposes that general purpose financial statements should be free from bias and represent faithfully the underlying transactions in a neutral and objective way. It is a little hard to believe that the treatment of revaluations as required by AASB 116 is totally neutral and unbiased. What do students think?
6.3 A revaluation increment will always go to the statement of comprehensive income, but it might be included either as part of profit or loss, or as part of ‘other comprehensive income’. A revaluation increment should be credited to the statement of comprehensive income as part of profit or loss when it reverses a previous devaluation to a particular class of assets. (The initial revaluation decrement would have been treated as an expense.), otherwise the increment goes to a revaluation surplus (and the increase in the revaluation surplus would be shown as part of ‘other comprehensive income’ in the statement of comprehensive income). As paragraph 39 of AASB 116 states in relation to property, plant and equipment:

If an asset’s carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

6.4 Pursuant to AASB 136 Impairment of Assets, AASB 116 Property, Plant and Equipment and AASB 138 Intangible Assets, intangible assets and property, plant and equipment shall not be disclosed in the financial statements at an amount in excess of their recoverable amount. Recoverable amount is defined in AASB 116 as the higher of an asset’s fair value less costs of disposal and its value in use. This is consistent with the definition provided in AASB 136.

6.5 A cash-generating unit is defined in AASB 136 as:

the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

In some cases it will not be appropriate to consider the expected net cash inflows applicable to individual assets where a group of assets working together supports the generation of net cash flows relevant to the determination of recoverable amount. In such cases, AASB 136 states that, in order to identify whether there has been a decline in the future economic benefits represented by particular assets, it might be necessary to estimate the net cash inflows for the relevant group of assets—with the group typically being referred to as a ‘cash-generating unit’—and compare that amount with the carrying amount of the combined group of assets.

6.8 Where a revaluation of a non-current asset is undertaken, that revaluation must be to fair value. As paragraph 31 of AASB 116 states:

After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

Fair value is defined in AASB 116 as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
6.9 A reporting entity must elect to measure a class of assets at either cost or fair value. An entity can switch from the cost basis to the fair value basis and from the fair value basis to cost. However, the switch from the fair value basis of measurement back to the cost basis is an option only as long as there are justifiable reasons and as long as adequate disclosures of the change in accounting policy are made.

6.13 The revaluation takes place 4 years after acquisition, therefore, assuming the straight-line method of depreciation is used, the accumulated depreciation at revaluation date would be equal to $120 000 x 10% x 4 = $48 000. The written-down book value would be $72 000.

1 July 2015

Dr Accumulated depreciation 48 000
Cr Machinery 48 000

Dr Machinery 38 000
Cr Revaluation surplus 38 000

6.19 In relation to the buildings, the revaluation entries would be:

Dr Accumulated depreciation 100 000
Cr Buildings 100 000

Dr Buildings 200 000
Cr Revaluation surplus 200 000

The residential land, which has not previously been revalued, has increased in value by $100 000. Hence the accounting entry pertaining to the residential land is:

Dr Residential land 100 000
Cr Revaluation surplus 100 000

AASB 116 requires that where a decrement in value reverses a previous increment credited to and still included in the balance of the revaluation surplus in respect of that same asset, the decrement may be debited directly to the revaluation surplus (rather than be treated as an expense of the period—nevertheless the reduction would be recorded within ‘other comprehensive income’). Hence, the $200 000 decrement in the value of the factory land can be debited against the existing balance of the revaluation surplus ($300 000) created in respect of that same asset, and the entry would be:

Dr Revaluation surplus 200 000
Cr Factory land 200 000
6.21 2013

<table>
<thead>
<tr>
<th></th>
<th>Cost</th>
<th>Valuation</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Block A</td>
<td>250 000</td>
<td>230 000</td>
<td>(20 000)</td>
</tr>
<tr>
<td>Block B</td>
<td>350 000</td>
<td>370 000</td>
<td>20 000</td>
</tr>
<tr>
<td>Net change</td>
<td></td>
<td></td>
<td>0</td>
</tr>
</tbody>
</table>

The above increments and decrements offset each other within a class of assets. Under our former accounting standard, as both assets would belong to the same class of assets, there would be no accounting entries as increases and decreases were allowed to be offset with a class of assets. However, pursuant to AASB 116 revaluations must be undertaken on an asset by asset basis and not offset within the class. Hence the accounting entries on 30 June 2013 would be:

Dr Loss on revaluation of land (included in profit or loss) 20 000
Cr Land—Block A 20 000

Dr Land—Block B 20 000
Cr Revaluation surplus (this increase in revaluation surplus—which is part of equity—will be shown as a gain in ‘other comprehensive income’) 20 000

2015

<table>
<thead>
<tr>
<th>Carrying value</th>
<th>Valuation</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Block A</td>
<td>230 000</td>
<td>60 000</td>
</tr>
<tr>
<td>Block B</td>
<td>370 000</td>
<td>(30 000)</td>
</tr>
<tr>
<td>Net change</td>
<td></td>
<td>30 000</td>
</tr>
</tbody>
</table>

The accounting entries in 2015 would be:

Dr Land—Block A 60 000
Cr Gain on revaluation of land (included in profit or loss) 20 000
Cr Revaluation surplus 40 000

Dr Loss on revaluation of land (included in profit or loss) 10 000
Dr Revaluation surplus (this reduction in the revaluation surplus would also be shown as a loss within ‘other comprehensive income’) 20 000
Cr Land—Block B 30 000