## TOPIC 6.1: ACCOUNTING FOR THE REVALUATION RESERVE

This section of the manual sets out the FSOP's that need to be executed by the municipality regarding the Revaluation Reserve. The FSOP's are drafted in the following categories:

**6.1.1 Overview of the accounting for the Revaluation Reserve (RR)**
**6.1.2 Introduction**
**6.1.3 Creating and utilising the Revaluation Reserve (RR)**
**6.1.4 Annual Financial Statement disclosure requirements.**

### 6.1.1 OVERVIEW OF THE ACCOUNTING FOR THE REVALUATION RESERVE

When accounting for the Revaluation Reserve the municipality must ensure that the necessary finance standard operating procedures are executed to address the following issues, which are summarised here, but for which the detailed FSOP's are set out in the rest of this section.

| Category | Section FSOP |
|---|---|
| **Introduction.** A revaluation reserve is established upon revaluation of a class of PPE. | **Section 6.1.2** |
| **Creating and utilising the Revaluation Reserve (RR).** GAMAP 17 does not require entities to revalue items of property, plant and equipment. It does, however, permit entities to revalue assets if they wish to do so. In other words, voluntary revaluation of land and buildings, and other assets for which there is an active market, is permitted. When land and buildings are revalued, a Non-Distributable Reserve (Revaluation NDR) is created. A transfer must be made from the NDR to the accumulated surplus account via the Statement of Changes in Net Assets to offset the additional depreciation charged as a result of the revaluation. | **Section 6.1.3** |
| The municipality must ensure that all transfers to the Revaluation NDR and transfers between the Revaluation NDR and accumulated surplus are correctly disclosed in the Statement of Changes in Net Assets. | **Section 6.1.4** |

### 6.1.2 INTRODUCTION / BACKGROUND

Property, plant and equipment may, after initial recognition as an asset, be carried at a revalued amount, as an allowed alternative accounting measurement.

The allowed alternative is to carry an asset at 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 reporting date.

If an asset's carrying amount is increased as a result of a revaluation, the increase shall be credited directly to a **revaluation surplus (reserve)**. However, the increase shall be recognised in surplus or deficit to the extent that it reverses a revaluation decrease of the same asset previously recognised in surplus or deficit.

### 6.1.3 CREATING AND UTILISING THE REVALUATION RESERVE

| # | FMBPR | FSOP | FSOP Type | Responsible Official | Date of Execution of FSOP |
|---|---|---|---|---|---|
| **1.** | Should an entity want to revalue assets, the following conditions apply: -<br>• All assets of a specific class must be revalued. It is not permissible to be selective on which items of a class (such as buildings) to revalue. If the accounting policy is to revalue buildings (as a class of PPE) then all buildings belonging to the class PPE: Buildings must be revalued.<br>• Depreciation must be calculated on the revalued amount if the asset is a depreciable asset, such as buildings.<br>• Revaluations must be done on a regular basis. The frequency of revaluations depends upon the movements in the fair values of land and buildings being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some land and buildings may experience significant and volatile movements in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for land and buildings with only insignificant movements in fair value. | A decision needs to be taken in terms of the accounting policy, whether or not the municipality wishes to revalue items of PPE. | **AP** | **CFO** | Date of implementation of GRAP |

| # | FMBPR | FSOP | FSOP Type | Responsible Official | Date of Execution of FSOP |
|---|---|---|---|---|---|
| | Instead, revaluation every three or five years may be sufficient. To summarise if there are significant changes in fair value on an annual basis the revaluation should be done annually. | | | | |
| **2.** | **GRAP 17.40** (previously **GAMAP 17.42**) stipulates that an appraisal of the value of an asset is normally undertaken by a member of the valuation profession who holds a recognised and relevant professional qualification. | If the municipality chooses to revalue items of land and buildings a valuation of fair value will most likely have to be performed at each financial year-end. The CFO will have to organise to have this valuation done at each financial year end by a specialist accredited valuator. | **AP** | **CFO** | 30 June |
| **3.** | **Dealing with accumulated depreciation and the Revaluation Reserve on the revaluation of depreciable assets.**<br><br>When land and buildings are revalued one alternative in terms of **GRAP 17.45(a)** (previously **GAMAP 17.44(a)**) is that the cost account relating to the land and buildings is increased to the new revalued amount. The corresponding entry, being the difference between the revalued amount and the balance on the cost account prior to the revaluation is credited to a Non-Distributable Reserve (Revaluation NDR). A backlog depreciation charge is then calculated being the difference between what the accumulated depreciation | For all items of PPE revalued during the year, ensure that the accumulated depreciation is restated and that the NDR is created in accordance with one of the two options in **the Annexure -** Example 1 or 2 below.<br><br>If, in the current year assets are in existence, that have been previously revalued, ensure that their depreciation charge is included in the depreciation charge that is reflected in the Statement of Financial performance for the year. | **AP** | **Manager Fixed Assets** | 30 June |

| # | FMBPR | FSOP | FSOP Type | Responsible Official | Date of Execution of FSOP |
|---|---|---|---|---|---|
| | was and what it would have been had the revalued amount been in existence from the date on which the asset was brought into use. This amount is credited to the accumulated depreciation account. This backlog depreciation is then recovered from the Revaluation NDR account. These complex accounting entries are illustrated in **the Annexure -** Example 1 below.<br><br>The other alternative is that according to **GRAP 17.45(b)** (previously **GAMAP 17.44(b)**) the accumulated depreciation at date of revaluation is eliminated against the gross carrying amount (cost) of the asset and the net amount is restated to the revalued amount of the asset. . For example, this method is often used for buildings which are revalued to their market value. This alternative is illustrated in **the Annexure -** Example 2 below.<br><br>A transfer from the Revaluation NDR, equal to the additional depreciation arising from the revaluation is made annually to the accumulated surplus account. This enables the NDR to be realised over the remaining useful life of the asset. This principle is also illustrated in **Example 1 and Example 2** below. | Ensure that a transfer is made from the NDR to the accumulated surplus on the Statement of Changes in Net Assets in respect of additional depreciation brought about as a result of the revaluation of assets, as per **Example 1 and 2** in the Annexure below. (R 400 entry made in last journal entry in Example 1 and 2)<br><br>Ensure that for all items of revalued PPE that are disposed of during the financial year, the balance on the NDR in respect of these assets is transferred to the accumulated surplus account, also on the Statement of changes in Net Assets. | | | |

| # | FMBPR | FSOP | FSOP Type | Responsible Official | Date of Execution of FSOP |
|---|---|---|---|---|---|
| | When a revalued asset is disposed of or written-off, the balance on the Revaluation NDR must be transferred to the accumulated surplus account. In other words, the Revaluation NDR is realised by such an event. | | | | |

### 6.1.4 AFS DISCLOSURE REQUIREMENTS

| # | FMBPR | FSOP | FSOP Type | Responsible Official | Date of Execution of FSOP |
|---|---|---|---|---|---|
| **1.** | The annual transfer from the NDR to offset additional depreciation as result of the revaluation must be reflected on the Statement of Changes in Net Assets.<br><br>When a revalued item of property, plant and equipment is disposed of, the balance in the NDR relating to such item is transferred to the accumulated surplus/ (deficit), also on the Statement of Changes in Net Assets. | Ensure that all the transfers to the Revaluation NDR and transfers between the Revaluation NDR and accumulated surplus are correctly disclosed in the Statement of Changes in Net Assets. | **AP** | **CFO** | 30 June |

## ANNEXURE 1 – ILLUSTRATIVE EXAMPLES

### Example 1: Accumulated depreciation is restated proportionately

The accounting treatment of a building that is revalued by a municipality is illustrated by the following example. Assume that a building is purchased for R10 000 on 1 July and depreciated at a rate of 20% (R2 000) p.a. At the beginning of Year 3 the municipal valuation roll values the building at a gross replacement cost of R12 000. The carrying value at the beginning of Year 3 will be R6 000 (R10 000 – 2 years depreciation).

| Description of calculation | Debit R | Credit R |
|---|---|---|
| **Calculation One:** | | |
| Debit Fixed Asset | 2,000 | |
| Credit Non-Distributable Reserves | | 2,000 |
| Restatement of cost to gross municipal valuation (R12 000-R10 000) | | |
| **Calculation Two:** | | |
| Debit Non-Distributable Reserves | 800 | |
| Credit Accumulated depreciation | | 800 |
| Being restatement of accumulated depreciation (20% x 2 years {R12, 000-R10, 000}) | | |

The carrying value of the building after the revaluation will be as follows: -

| | R |
|---|---|
| Revalued cost amount | 12 000 |
| **Less**: Adjusted accumulated depreciation | 4 800 |
| **Equals**: Carrying value | 7 200 |

An alternative calculation which will substantiate the above journal entries is that a comparison of the carrying amount pre and post revaluation is as follows:

| | **Building pre revaluation** | **Building post revaluation** | **Explanation of difference** |
|---|---|---|---|
| **Cost Price / revaluation** | 10 000 | 12000 | R 2000 is additional entry to reflect increase in gross replacement cost. |
| **Accumulated depreciation** | 4000 | 4800 | |
| **Carrying amount** | 6000 | 7200 | Gross replacement cost is R 12 000, but Net replacement cost (as building is already two years old) is 60 % (6000/10000) of R 12 000 = R 7200. |

The effect of these transactions is that the asset is stated at its net replacement cost of R 7 200 at the start of year 3. At the end of Year 3, the amount depreciated should be (R12 000 * 20%) = R2 400 and the journal entry will be as follows:

| **Description** | **Debit** | **Credit** |
|---|---|---|
| Debit Depreciation | 2 400 | |
| Credit Accumulated Depreciation | | 2 400 |
| Being the depreciation charge for the year based on the revalued building. (R 7200 / 3 yrs remaining useful life) | | |

The balance on the accumulated depreciation account will be R7 200 and the carrying amount of the asset will be R 4800 representing 2 years depreciation of R 2 400 per year.

Finally, a transfer must be made from the NDR to the accumulated surplus account via the Statement of Changes in Net Assets to offset the additional depreciation charged as a result of the revaluation. The consumers cannot be expected to pay for the increase in the value of the asset that has been revalued. This amount will be as follows: -

| **Description** | **Debit** | **Credit** |
|---|---|---|
| Debit NDR | 400 | |
| Credit Accumulated Surplus | | 400 |
| Being the depreciation charge for the year based on the revaluation reserve created of R2000: Depreciation charge is R2 000x20%.Alterntively it can be seen as the balance on the NDR after the revaluation and accumulated depreciation adjustment entries have been made, which needs to be spread over the three remaining years of useful life of the asset. (R 2000 – R800)/3 | | |

**Example 2: Accumulated depreciation is eliminated against the gross carrying amount of the asset**

The accounting treatment of a building that is revalued by a municipality is illustrated by the following example. Assume that a building is purchased for R10 000 on 1 July and depreciated at a rate of 20% (R2 000) p.a. At the beginning of Year 3 the municipal valuation roll values the building at a gross replacement cost of R12 000. The carrying value at the beginning of Year 3 will be R6 000 (R10 000 – 2 years depreciation).

| Description of calculation | Debit R | Credit R |
|---|---|---|
| **Calculation One:** | | |
| Debit Accumulated Depreciation | 4,000 | |
| Credit PPE: Buildings at Cost Price | | 4,000 |
| Elimination of accumulated depreciation against cost price of building. Building cost is now reflected at R 6000. | | |
| **Calculation Two:** | | |
| Debit PPE: Buildings | 1,200 | |
| Credit NDR: Revaluation of PPE | | 1,200 |
| Revaluation of building to its Net replacement cost. (( R 12000 * 60% *) less R 6000) | | |

The carrying value of the building after the revaluation will be as follows: -

| | R |
|---|---|
| Revalued cost amount | 7 200 |
| **Less**: Adjusted accumulated depreciation | 0 |
| **Equals**: Carrying value | 7 200 |

It is important to compare the balances on the accounts after the revaluation entries have taken place for the method followed under Example 1 and the method followed under Example 2. Both methods provide the same balance on the carrying amount of the asset and also on the NDR account.

| | **EXAMPLE 1** | **EXAMPLE 2** |
|---|---|---|
| **Cost price of building** | 12000 | 7200 |
| **Less Accumulated depreciation** | (4800) | 0 |
| **Equals Revalued carrying amount** | **7200** | **7200** |
| | | |
| **Balance on the NDR** | 1200 | R 1200 |
| | (R 2000 less R 800) | (( R 12000 * 60% *) less R6000) |
| | | |

An alternative calculation which will substantiate the above journal entries is that a comparison of the carrying amount pre and post revaluation is as follows:

| | **Building pre revaluation** | **Building post revaluation** | **Explanation of difference** |
|---|---|---|---|
| **Cost Price / revaluation** | 10 000 | 7200<br>(Difference between pre and post revaluation is<br>R 10 000 less R 7200 = R 2800) | R 2800 difference is as a result of R 4000 depreciation less R 1200 revaluation. R 4000 difference is the 2 years depreciation eliminated against the gross carrying amount of the asset on date of revaluation. |
| **Accumulated depreciation** | 4000 | 0 | |
| **Carrying amount** | 6000 | 7200 | Gross replacement cost is R 12 000, but Net replacement cost (as building is already two years old) is 60 % (6000/10000) of R 12 000 = R 7200. |

The effect of these transactions is that the asset is stated at its net replacement cost of R 7 200 at the start of year 3. At the end of Year 3, the amount depreciated should be (R12 000 * 20%) = R2 400 and the journal entry will be as follows:

| Description | Debit | Credit |
|---|---|---|
| Debit Depreciation | 2 400 | |
| Credit Accumulated Depreciation | | 2 400 |
| Being the depreciation charge for the year based on the revalued building. (R 7200 / 3 yrs remaining useful life) | | |

The balance on the accumulated depreciation account will be R7 200 and the carrying amount of the asset will be R 4800 representing 2 years depreciation of R 2 400 per year.

Finally, a transfer must be made from the NDR to the accumulated surplus account via the Statement of Changes in Net Assets to offset the additional depreciation charged as a result of the revaluation. The consumers cannot be expected to pay for the increase in the value of the asset that has been revalued. This amount will be as follows: -

| Description | Debit | Credit |
|---|---|---|
| Debit NDR | 400 | |
| Credit Accumulated Surplus | | 400 |
| Being the depreciation charge for the year based on the revaluation reserve created of R2000: Depreciation charge is R2 000x20%.Alterntively it can be seen as the balance on the NDR after the revaluation and accumulated depreciation adjustment entries have been made, which needs to be spread over the three remaining years of useful life of the asset. (R 2000 – R800)/3 | | |