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Fixed Assets Valuation

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1. Concept of Fixed Assets

Let us first clarify the concept of Fixed Assets

Valuation of fixed asset is discussed in Accounting Standard - 10. As per AS-10, fixed assets means any asset which has characteristics like:

1. Held with the intention of being used for the purpose of producing goods or providing services.
2. It is not held for sale in normal course of business.
3. Such asset is expected to be used for more than one accounting period.

Is called as 'Fixed Asset'

Examples of Fixed assets are Land, Building, Plant and Machinery, furniture, motorcar etc.

2. Valuation of fixed assets

Now let us see how fixed assets are valued and how they are shown in financial statements.

AS-10 states that fixed assets should be shown in the financial statements either at historical cost or at revalued price. A Fixed asset is acquired by purchasing from outside OR constructed or developed in house OR exchanged for other asset or shares.

If fixed asset is purchased from outside, Historical cost of any such acquired assets consists of its purchase price, any import duties or non-refundable taxes, any cost directly attributable to the asset for bringing it into working condition for the intended purpose in the business.

Such directly attributable cost may include, inward freight, installation cost, site preparation cost, expenses incurred on test runs to check functioning of machine less any income from sale of products produced during test runs, any overheads directly attributable to such construction or installation, loss or gain in payment of foreign currency liability in relation to this as per AS-II, changes in duties etc.

It should be noted that as per AS-12, accounting for government grants, any subsidy or grant received from government for fixed assets should be deducted from cost of fixed assets.

If a fixed asset is self-constructed or developed in house, its Historical cost includes:

All costs directly attributable to the construction activity should be allocated to specific assets.

In case, there is any internal profit included in the costs, it should be eliminated.

If a Fixed asset is acquired in exchange of existing assets or shares its historical shall depend upon situations like:

(i) If asset was exchanged for not a similar one :-

Asset shall be recorded either at Fair Market Value of asset given up or Fair Market Value of the asset acquired, whichever is clearly evident.

(ii) If asset was exchanged for a similar one :-

Asset acquired shall be recorded at either Fair Market Value of asset given up or Fair Market Value of asset acquired, whichever is clearly evident or Net Book Value of the asset so exchanged or given up.

(iii) If asset was acquired in exchange of shares or other securities as payment, the asset acquired should be recorded at Fair Market Value of asset purchased or Fair Market Value of securities whichever is more clearly available.

A question may arise in your mind that a fixed asset once recorded at its historical value and shown in the balance sheet, can it be revalued in future?

Yes it can be revalued.

Whenever fixed assets are revalued, these assets should be shown in financial statement at such revalued price.

It should be noted that when a fixed asset is revalued, an entire class of assets are revalued or the assets selected for revaluation should be made and disclosed on systematic basis.

The revalued assets can be represented by two methods in the financial statement. These methods are:-

(i) Representing asset at gross book value and the accumulated depreciation till date.

(ii) Representation of asset at net book value & thereby adding the net increase on account of revaluation.

The important provision relating to this is that Revalued price cannot exceed the net recoverable amount of fixed asset.

Now let us understand the Accounting treatment for Revaluation of assets, under different situations of upward and downward revaluation when revalued for the first time or subsequent:

Situation 1: First time revaluation

a. If net book value of the asset is increased it is called as Upward revaluation, and Increase in net book value is credited to "Revaluation Reserve" and the increase is added to net book value in the balance sheet in the year of revaluation

b. If net book value of the asset is decreased it is called as downward revaluation and decrease in the book value of asset shall be charged to profit and loss account and the balance sheet will show the decrease in the net book value in year of revaluation.

Now let us see how the accounting treatment is given in case of subsequent revaluation?

Situation 2: Subsequent revaluation

a. If the first revaluation was downward and subsequent revaluation is upward, the increase in the value of asset is charged to profit and loss account by the amount of first downward revaluation and further increase should be credited to revaluation reserve.

b. If the first revaluation was upward and subsequent revaluation is downward, any subsequent downward revaluation shall be charged to revaluation reserve up to the amount of balance in such reserve created at the time of upward revaluation and balance amount over and above the amount in revaluation reserve shall be debited to P & L Account.

3. Valuation of fixed assets under special cases

Now let us see Valuation of fixed Assets under special cases:

(i) Under hire purchase terms:

Asset acquired through hire purchase terms should be recorded as per Accounting Standard-19, which is accounting for lease.

(ii) Jointly held assets:

In case any asset is jointly held, the business organization should record the asset at its percentage of holding or proportionate ownership. May it be the original cost and accumulated depreciation or written down value. Such assets can also show with similar fully owned assets at a pro-rata or proportionate cost.

(iii) Assets acquired at consolidated price say at Rs.1 only.

The cost of such fixed asset should be determined on a fair basis as per valuation by competent valuer.

Accounting Standard -10 also discusses the treatment of cost of improvement and repair to an existing fixed asset, which arises the question of whether it should be considered as revenue expense or capital expense.

4. Accounting treatment on improvement and repairs of an asset

Hence two accounting treatments are possible for any kind of improvement and repair costs.

(i) If expected future benefits from fixed asset after repair or improvement remain the same, the cost or expenses for such repair should be considered as revenue expense and charged to Profit and Loss Account.

(ii) If expected future benefits from fixed asset after repairs or improvement increase as compared to earlier assessed benefits, the cost or expense of such repairs or improvement should be considered as capital expense and added to gross book value of fixed assets.

In case of Addition or extension of capital nature made to an existing asset and such addition becomes as an integral part of existing asset, cost of such addition is added to gross book value and if the addition or extension has a separate identity and can be used after disposal of existing asset it is accounted separately.

5. Accounting treatment on disposal of asset

Accounting standard-10 also takes care of accounting treatment when an asset is disposed off. Let us discuss the same.

I. Gain/loss arising on disposal of fixed asset is recognized in profit and loss a/c

II. When an asset is disposed of it will not be recorded in the balance sheet after its disposal.

III. At times it may so happen that fixed asset is withdrawn from the active use and may be held for disposal. In such a case, the fixed assets is to be stated at the lower of net book value and net realizable value in the books of accounts and shown separately under balance sheet. Any loss shall be immediately recognized.

IV. In case any revalued asset is disposed and there is profits, it should be credited to P & L Account and in case of losses it should be first adjusted against balance in revaluation reserve and any balancing loss should be debited to P & L Account. If the amount of loss is less than the balance in revaluation reserve, the additional loss shall be transferred to P & L Account.

6. Compulsory disclosure of fixed asset (As per AS-10)

Let us end the discussion with Compulsory disclosure of fixed asset:

I. In financial statement, disclosure of the gross and net book values of fixed asset at the beginning and end of accounting period showing additions, disposals, acquisition and other movements should be made.

II. Expenses incurred on Account of fixed assets in course of construction or acquisition should be disclosed.

III. In case of revaluation, revalued amount substituting the historical cost of fixed assets, the method adopted to revalue the asset, whether any external valuer has valued the fixed asset must be disclosed.

I conclude today's session with remark that valuation of fixed asset is made and required accounting effect is given as per AS-10 while acquiring it, at the time of subsequent revaluation and at the time of disposal of fixed assets.