



QUESTION:

What is a revaluation reserve and are such reserves distributable?

ANSWER:

Revaluation reserves arise when the value of an asset is revisited and the revised value is computed at a higher level than its previous value on the Balance Sheet, thereby increasing shareholders funds. Of course, not every increase in value is added to the revaluation reserve and the precise treatment of each depends upon the history of the asset in question and, in particular, whether or not it had previously been impaired.

Fair value accounting stipulates that revaluations should be carried out whenever there is a material difference between the current market value of the asset and the current value at which it is carried on the Balance Sheet. This principle should be applied strictly to assets such as land and investments in which a market exists and for which a fair value can be arrived at. For practical reasons, and to keep the accrual principle effective, accounting regulations permit plant and equipment to be simply carried at its depreciated value.

The gain from a revaluation is termed a surplus and should be credited to equity under the heading of "Revaluation Surplus". It is not usually treated as a profit as it is not taken through the profit & loss account and thus recognised as a profit. This treatment is to preclude a company's profits being distorted by once-off gains, thereby obscuring trends in the business itself. A reduction in the value of an asset on revaluation is usually treated as a loss.

Of course, a surplus on a revaluation is not always added to the revaluation reserve. Where it reverses a previous impairment, that impairment is reversed. However, any surplus in excess of the amount of the impairment can be added to the revaluation reserve. Where an impairment is reversed, this is a profit, and it is necessary to reverse the loss from the impairment.

Similarly, a deficit on revaluation will be first used to reverse any previous surplus, thereby reducing the revaluation reserve, with any excess over that treated the same as any other impairment and taken through the Profit & Loss Account as a loss.

When a revalued asset is disposed of, any revaluation surplus may be transferred directly to retained earnings, or it may be left in equity.

Revaluation reserves are not distributable, but may be used for scrip or bonus issues.

Commentaries on provisions of legislation are not intended to be a legal or comprehensive interpretation. Professional advice should be sought in specific circumstances. For further information on statutory requirements, or any provision of the Companies Acts, 1963 to 2009, please contact our Company Secretarial Department on:

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