

## GN(A) 9 (Issued 1994)

# Guidance Note on Availability of Revaluation Reserve for Issue of Bonus Shares<sup>1</sup>

1. In the recent past, a few private companies and closely held public companies have resorted to the practice of utilising the reserve created on revaluation of fixed assets for issue of bonus shares. This Guidance Note discusses the nature of revaluation reserve and in this context examines the question whether such reserves can be utilised for issue of bonus shares. It supplements the Guidance Note on Treatment of Reserve Created on Revaluation of Fixed Assets issued in 1982.

2. Revaluation of fixed assets is one of the issues dealt with in Accounting Standard (AS) 10 on 'Accounting for Fixed Assets', issued by the Institute of Chartered Accountants of India, which states, inter alia, as follows:

“13.1 Sometimes financial statements that are otherwise prepared on a historical cost basis include part or all of fixed assets at a valuation in substitution for historical costs....

13.2 A commonly accepted and preferred method of restating fixed assets is by appraisal, normally undertaken by competent valuers. Other methods sometimes used are indexation and reference to current prices which when applied are cross checked periodically by appraisal method.”

3. AS 10 lays down as below:

***“29. When a fixed asset is revalued upwards, any accumulated depreciation existing at the date of the revaluation should not be credited to the profit and loss statement.***

***30. An increase in net book value arising on revaluation of fixed assets should be credited directly to owners' interests under the head of revaluation reserve, except that, to the extent that such***

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<sup>1</sup> Published in the November 1994, issue of *The Chartered Accountant*.

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***increase is related to and not greater than a decrease arising on revaluation previously recorded as a charge to the profit and loss statement, it may be credited to the profit and loss statement. A decrease in net book value arising on revaluation of fixed asset should be charged directly to the profit and loss statement except that to the extent that such a decrease is related to an increase which was previously recorded as, credit to revaluation reserve and which has not been subsequently reversed or utilised, it may be charged directly to that account.”***

4. It may be noted that the excess of the revalued amount over the net book value of fixed assets, which is credited to revaluation reserve, is created as a result of a book adjustment only. The revaluation reserve does not result from an arm's length transaction; it represents an expert's perception of value. The revaluation reserve thus does not represent a realised gain.

5. Share capital represents the amount of money or money's worth received from the owners and the capitalisation of earned profits or other gains arising out of an arm's length transaction. It has, therefore, been a cardinal principle that only such profits as are earned or the relevant capital receipts (e.g. share premium), as are realised, can be capitalised.

6. In view of the above, in the opinion of the Institute of Chartered Accountants of India, bonus shares cannot be issued by capitalisation of revaluation reserve. If any company (including a private or a closely held public company) utilises revaluation reserve for issue of bonus shares, the statutory auditor of the company should qualify his audit report. An illustrative manner of the qualification is given below:

“The company has issued bonus shares for Rs. \_\_\_\_\_  
(\_\_\_\_\_ equity shares of Rs. \_\_\_\_\_ each) by capitalising its revaluation reserve. Accordingly, the Paid-up Equity Share Capital of the company stands increased by Rs. \_\_\_\_\_ and the revaluation reserve stands reduced by that amount. The issue of bonus shares as aforesaid is contrary to the recommendations of the Institute of Chartered Accountants of India.

Subject to the above \_\_\_\_\_”.

7. The above would also apply to situations where the revaluation reserve is utilised to increase the amount paid-up on equity shares of a company.

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8. In this context, it may also be noted that the Securities and Exchange Board of India (SEBI) has prohibited listed companies from issuing bonus shares out of revaluation reserves<sup>2</sup>.

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<sup>2</sup> Section M of Guidelines for Disclosure and Investor Protection [as amended by RMB (DIP Series) Circular No. (94-95), Dated April 15, 1994]