Volume 22, Special Issue

Print ISSN: 1099-9264
Online ISSN: 1939-4675

MANAGEMENT MOTIVES BEHIND THE REVALUATION OF FIXED ASSETS FOR SUSTAINABILITY OF ENTREPRENEURIAL COMPANIES

Rashid Khalil, University Utara Malaysia
Dr. Muzaffar Asad, Capital University of Science and Technology
Sajjad Nawaz Khan, University Utara Malaysia

ABSTRACT

In the last decade several companies have revalue their assets. The companies revalue their assets by showing that they want to present a true and fair value of their assets as identified by the international reporting standards. As prescribed in the standards, the purpose of any accounting policy is to give true and fair value of the company to make it more sustainable. Because depiction of true and fair view of the company enhances confidence of the investors, which ultimately keep the company sustainable especially in the case of entrepreneurial ventures. In order to meet the objective of identification of management motives behind the revaluation of assets, primarily literature was reviewed which highlighted certain factors. In order to explore other hidden motives, exploratory study was conducted. The purpose of conducting qualitative research was to identify any other factor which has not yet been covered. For the said purpose data was collected from seven professions; including academicians, entrepreneurs, chartered accountants, and finance heads. The findings revealed that revaluation is done primarily for the improvement of financial position to satisfy the investors so that more funds may be generated. The study suggested a quantitative study on the identified constructs and also suggested the entrepreneurs, policy makers, and governments to revalue the assets appropriately to get maximum benefits of revaluation for the sustainability of the companies.

Keywords: Revaluation of Assets, Sustainability, Entrepreneurial Firms**,** Management Motives**.**

INTRODUCTION

The purpose of the financial statements is to provide credible information to be used by the stakeholders especially the fun providers to take appropriate decisions (Asad & Farooq, 2009). Among other things many times the investors have to decide to buy, hold or sell equity or debt instruments and these statements become the base for these important decisions (Cartwright & Cooper, 2014). Credibility is the main issue as in the past, many financial scandals as if Enron and World com occurred which have shaken the confidence of investors and the reason behind this among other things is the bogus and fraudulent financial reporting (Wali, 2015). To make the information credible and to improve their quality IASB's framework has described some fundamental as well as enhancing qualities which the financial statements must have, otherwise, the investor and other stakeholders cannot take accurate decisions. To make the information reliable it must be neutral, complete, based on substance, prudently presented, free from errors, and verifiable from the original source (Tabari & Adi, 2014). Improving reliability at the cost of relevancy is not suitable, likewise, increasing relevancy at cost of reliability is also not appropriate. As both the qualities are inevitable and equally important for the financial statements (Gupta & Gupta, 2015).

The industrialization pace in Pakistan has witnessed few rapid growth phases especially in the joint stock companies but their way of working is entrepreneurial (Colombo et al., 2016). The companies listed in stock market therefore, reflect remarkable difference in book value to market value (Goh et al., 2015). This differential also revealed the aspect of revalued value of assets of companies normally land, buildings, and machinery. Despite the factual reflection, companies remain to take advantage of revaluation surplus to be duly recognized in books to improve upon enhanced equity base, achieving required debt equity ratio, building additional liquidity through borrowing and revealing the real rate of return on assets (Almansour et al., 2016).

The absence of revaluation also puts the company to disadvantages in terms of strategic decision making especially in terms of pricing policies under emerging competitive environment. Continuing with the historical value demotivate the general public shareholders forcing them to sell their investments which are in fact bought back by controlling owners concentrating the ownership and defying the basic spirit of a public limited company (Almansour et al., 2016). The foregoing aspects raised question about true and fair view of financial statements as presented by management to the shareholders through the audited financial statements (Barlev et al., 2007).

Different accounting options are available in different accounting standards to deal with different issues. It is the case with IAS 16 that deals with property, plant, and equipment. As for as initial measurement is concerned all the tangible non-current assets should be calculated at cost. This cost price includes purchase price along with the cost required to bring the asset in working condition like freight, insurance, carriage inward, taxes, installation charges and preproduction testing charges etc. Regarding subsequent measurement, IAS 16 gives choice i.e., either to measure the assets on historical cost basis or revalue it (Bednarek & Moszoro, 2014). According to the cost model the value of asset should be calculated after deducting accumulated depreciation, accumulated impairment losses. On the other hand, the value of asset under revaluation model is measured after deducting subsequent accumulated depreciation and accumulative impairment loss from fair value (Rahman, 2017).

Previously IAS 16, allowed only cost model to a company. Cost model-based measurement and valuation of fixed assets can easily be verified with original documents and hence more reliable. However, these figures did not reflect or show the current market value of the assets. Consequently, companies' total assets reported in the balance sheet were typically lower than the market value and could potentially misled investors, for instance in their decision-making presses (Andison & Nasser, 2017). Hence there is a strong criticism that cost based value is not relevant to users of financial statements reason being the market value may significantly differ from the value written in the book on the basis of cost model. In this context, fair value of the assets is mainly determined as market value of the assets (Belkaoui, 2004). Hence according to this approach this value is more relevant. However, financial managers' opportunistic behaviour may, therefore, occur in pursuing predetermined targets at the expense of other parties' best interests (Tabari & Adi, 2014). Moreover, the reliability of the value may be questioned especially when assets' market value is inactive, volatile or dose not exists. In the absence of active market of non-financial items, when fair value determination depends more or less on manager assessments, enable them to creative accounting practices (Baek & Lee, 2016). Therefore, it would be right to say that valuation of asset is a serious matter and is necessary to conduct research on the motives behind revaluation of assets because from the above discussion there are different reasons behind revaluation, and consequences of revaluation might also be quite different, hence, it is important to understand the management perspective behind revaluation of assets as several Pakistani companies have gone through revaluation recently.

LITERATURE REVIEW

The studies of accounting standards revealed that accounting standards provide significant freedom to the companies in choosing the method for the valuation of assets. This discretion is given in the standards in the valuation of non-current assets. One very relevant way and close to the market value of revaluation of assets. Revaluation can be done on incremental or detrimental basis. The method of preparing financial reports on the conventional method is criticized because it lacks relevance. Revaluation methods change the value of asset in the books of accounts from historical value to market value, therefore, providing more relevant current and true value of assets (Henderson & Goodwin, 1992). Upon the increase in the value of assets upon revaluation the debt cost is reduced. Fixed asset revaluation may also affect a firm's power in negotiating debt contracts with debt holders (Asad & Qadeer, 2014). Two main contracting factors that were examined in previous studies are leverage level and declining cash flows from operations (Bashir & Asad, 2018). The concept of default on covenant in debt agreement is well established that it is expensive and consequently reduces the wealth of shareholders (Almansour et al., 2016). The technical violation of accounting-based debt agreements, or a high level of leverage on balance sheet may result in expensive repayment of debt or an increased renegotiation costs to the company (Asad et al., 2011; Asad & Qadeer, 2014; Bashir & Asad, 2018). Therefore, management of the company may choose an accounting method which would be helpful for the reduction of contracting costs linked with the gearing and debt contracting.

In the same domain, another aspect behind revaluation of assets is declining cash flows from operations. A firm's borrowing capacity depends not only on existing leverage but also on the firm's ability to repay debt (Bashir & Asad, 2018). Declining cash flows from operations may cause debt holders to be concerned with the firm's liquidity (Asad & Farooq, 2009). It is also believed that size of the company is also very relevant factor behind revaluation decision. At the same time when the value of assets in increased then the return on assets is also declined. Therefore, lessened political attention of the labor unions if they plan to strike for call for bonus. In order to reduce adverse political influence, firms tend to avoid reporting excessively high returns on assets. An upward asset revaluation can be an effective way to reduce reported profit through increased depreciation charges on the asset revaluation increments, and it is, therefore, expected to mitigate the political pressures faced by larger firms from unions (Haider et al., 2016:2017).

Information asymmetry also plays a significant role in the revaluation of assets. Because reduced information asymmetry regarding future prospects of the firm are considered as main objectives behind revaluation of assets of the company. Whenever, an upwards revaluation of assets is being conducted the book value of the company is increased which consequently improves the debt of equity and debt to assets ratio (Whittred, 1992). Information asymmetry exists when the external users of financial statements of the company are not provided with true information because of differences in the real position and the information reported in the financial statement (Wali, 2015). This information asymmetry influences the decision of management regarding revaluation of assets regarding time i.e. when to conduct revaluation of assets (Tabari & Adi, 2014). In the similar domain the information regarding takeover may also shatter the confidence of the investor that the performance is problematic. In order to improve the image, the firm may go for revaluation of assets (Cartwright & Cooper, 2014). Furthermore, to improve the bid price revaluation may also be conducted. Along with information of take over last revaluation is also important. As revaluation is costly, a firm may not choose to revalue its assets every year. Instead, the firm might delay exercising revaluation to a later time when the revaluation is perceived to be most beneficial (Andison & Nasser, 2017). As the disparity between book value and current value increases with the passage of time, the impact of this disparity on the financial statements may become greater (Belkaoui, 2004).

Hence, the decision as to whether to revalue in the current year may depend on the length of time since the firm's last revaluation. Since the revaluation process is costly, a large investment in assets enables the revaluation to be made with economies of scale and therefore to be more cost-effective (Baek & Lee, 2016). Undertaking revaluation would help firms to restore borrowing power, lower the cost of debts, and avoid potential underinvestment. The above reviewed literature shows that there are different motives behind revaluation of assets. In the presence of very diverse findings there is a need to identify if there is any other reason which has not yet been explored. Therefore, to explore the factors which may motivate the management to revalue the assets of the company have been explored through interviews.

METHODOLOGY

The main purpose of the study is to explore the concept of revaluation of assets. Prior literature helps to identify the need for a qualitative study in this regard. The approach that is being used in current study is grounded theory to develop the framework for identifying the motives of management behind the revaluation of assets. Data has been collection in a period of almost 2 months through interview technique. A very brief interview guide was developed to as the initial questions because subsequent questions were drawn from the responses of the respondents. The respondents were chosen on the basis of their experience. In order to collect the insight about the issue-chartered accountants, professors, and finance heads were chosen as respondents. The interviews were discontinued when the data saturation started (Creswell, 2012). The information about the respondents is mentioned below in Table 1.

Table 1
DEMOGRAPHIC INFORMATION RESPONDENTS

Name	Age	Designation	Experience	Industry/Sector
Imran Shahzad	52	Assistant Professor	12 years	University of Central Punjab
Hafiz Waqas Shahzad	40	Manager Finance	07 years	MGA Industries
Syed Muhammad Bilal	38	Internal Auditor	06 years	JGC Descon
Syed Saim Raza Zaidi	52	Audit Manager	19 years	Qavi & Co Chartered Accountant
Yousaf Jamshed Butt	48	Professor	17 years	Skans School of Accountancy
Abdul Azeem	42	Professor	12 years	Skans School of Accountancy

Muhammad Tahir	39	Finance Manager	10 years	Rupali Polyester Ltd

Interview technique from professional accounts is most suitable and appropriate to achieve the objectives of the study. Sampling technique used in the current study is purposive sampling and a total number of respondents in the current study were 7 professional accountants, as information dismissal was started after 5 respondents however 2 more respondents were interviewed to ensure the saturation point is achieved. Our sample in qualitative research is sufficient to ensure that all the possible perceptions or important dimensions (experiences, opinion and attributes etc.) are covered (Shane & Eckhardt, 2003).

FINDINGS, CONCLUSIONS, RECOMMENDATIONS AND LIMITATIONS

The research resign of the current study has facilitated and provided valuable insights and deep understanding of hidden constructs under discussion. The main agenda of the study was to identify the hidden motives of revaluation of assets by the companies operating in Pakistan. Therefore, to explore the issue qualitative study was conducted. For the analysis the data was collected through unstructured free flowing interviews. In qualitative research methodology, there is a continuous interplay between collection of data and analysis of data set (Shane & Eckhardt, 2003). The Same pattern has been adapted in the current study, by analysing data set, after successfully conducting the interviews from the selected respondents. In qualitative research data analysis is recognized as intellectual craftsmanship, so there is no single and authoritative method in qualitative research for data analysis, the core objective is making sense or identifying the underpinning themes from the responses given by the respondents.

The overall finding from all of the interviews has been summed as under: in the recent years several Pakistani companies have gone for revaluation of their fixed assets to improve the book value of their assets. The responses highlighted those entrepreneurial organizations that have high leverage uses revaluation of fixed assets in order to enhance the book value of their assets so that they may get loans at a cheaper rate. Thus, the first motive is to get the loans at a cheaper rate and at reduced debt contracting cost. Likewise, in order to show improved operating cash flows organizations go for revaluation of fixed assets, because it increases their overall profitability. Another finding was that companies that have high value of fixed assets usually revalue their assets to increase their market worth of company. The companies having high growth perspective also revalue their assets, because by revaluing their assets, these companies succeed in attracting more capital from the financers. Likewise, whenever the companies have any chance or threats of takeovers or buyouts, they revalue their assets in order to get high value. The motive behind revaluation at the time is to increase the bid price as well as to satisfy the existing financers of the company.

The findings of the study are significant for the academicians as these findings lead to further quantitative study on the same topic by empirically testing the identified constructs. These findings are also important for the practitioners as it provided conceptual and prediction models which can help companies to decide an appropriate measurement model for their fixed assets revaluation. Furthermore, investors can learn from the research results to predict investment decisions more accurately. The findings are also important for the banks and other lending institutions to understand the hidden motives of revaluation.

However, literature has documented limitations of qualitative research from small sample size to generalizability, we recognize the same limitations in current study and methodology employed. Current study considers small sample and the only number of professional accounts were interviewed, so there is a question mark on the generalizability of the current study.

REFERENECS

Almansour, A.Z., Asad, M., & Shahzad, I. (2016). Analysis of corporate governance compliance and its impact over return on assets of listed companies in Malaysia. *Science International*, *28*(3), 2935-2938.

Andison, A., & Nasser, E.M. (2017). Operating cash flow, earning response coefficient, and fixed asset revaluation: Study on manufacturing company. *Etikonomi*, *16*(1), 93-102.

Asad, M., & Farooq, A. (2009). Factors influencing KSE 100 index/share prices. *Pardigms: A Journal of Commerce, Economics, and Social Sciences*, *3*(1), 34-51.

Asad, M., Haider, S.H. & Javaid, M.U. (2011). Working capital management and corporate performance of textile sector in Pakistan. *Paradigms: A Research Journal of Commerce, Economics and Social Sciences*, *6*(1), 100-114.

Asad, M., & Qadeer, H. (2014). Components of working capital and profitability: A case of fuel and energy sector of Pakistan. *Pardigms: A Journal of Commerce, Economics, and Social Sciences*, *8*(1), 50-64.

Asad, M., Sharif, M.N., & Alekam, J.M. (2016). Moderating role of entrepreneurial networking on the relationship between access to finance and performance of micro and small enterprises. *Paradigms: A Research Journal of Commerce, Economics, and Social Sciences*, *10*(1), 1-13.

Asad, M., Sharif, M.N., & ALekam, J.M. (2016). Moderating role of entrepreneurial networking on the relationship between entrepreneurial orientation and performance of MSEs in Punjab Pakistan. *Science International*, *28*(2), 1551-1556.

Asad, M., Sharif, M.N., & Hafeez, M. (2016). Moderating effect of network ties on the relationship between entrepreneurial orientation, market orientation, and performance of SMEs. *Paradigms: A Research Journal of Commerce, Economics, and Social Sciences*, *10*(2), 69-76.

Asad, M., Shabbir, M.S., Salman, R., Haider, S.H., & Ahmad, I. (2018). Do entrepreneurial orientation and size of enterprise influence the performance of micro and small enterprises? A study on mediating role of innovation. *Management Science Letters*, *8*(10), 1015-1026.

Baek, H.Y., & Lee, D.Y. (2016). Motives for and effects of asset revaluation: An examination of South Korean data. *Emerging Markets Finance and Trade*, *52*(12), 2808-2817.

Barlev, B., Fried, D., Haddad, J.R., & Livnat, J. (2007). Revaluation of revaluations: A cross-country examination of the motives and effects on future performance. *Journal of Business Finance & Accounting*, 1025-1050.

Bashir, A., & Asad, M. (2018). Moderating effect of leverage on the relationship between board size, board meetings and performance: A study on textile sector of Pakistan. *American Scientific Research Journal for Engineering, Technology, and Sciences*, *39*(1), 19-29.

Bednarek, Z., & Moszoro, M. (2014). The arrow-lind theorem revisited: Ownership concentration and valuation. *Applied Financial Economics*, *24*(5), 357-375.

Belkaoui, R. (2004). *Accounting theory.* Cengage Learning EMEA.

Beneish, M.D. (1995). The resolution of technical default. *Accounting Review*, 337-353.

Cartwright, S., & Cooper, C.L. (2014). *Mergers and acquisitions: The human factor*. Butterworth-Heinemann.

Colombo, M.G., Cumming, D.J., & Vismara, S. (2016). Governmental venture capital for innovative young firms. *The Journal of Technology Transfer*, *41*(1), 10-24.

Creswell, J.W. (2012). *Qualitative inquiry and research design: Choosing among five approaches*. Washington: SAGE Publications.

Goh, B.W., Li, D., Ng, J., & Yong, K.O. (2015). Market pricing of banks' fair value assets reported under SFAS 157 since the 2008 financial crisis. *Journal of Accounting and Public Policy*, *34*(2), 129-145.

Gupta, P.K., & Gupta, S. (2015). Corporate frauds in India–perceptions and emerging issues. *Journal of Financial Crime*, *22*(1), 79-103.

Haider, S.H., Fatima, M., Asad, M., & Ahmad, A.Z. (2016). A study on the issues of employment contracts and practices of employment contracts in UAE. *Paradigms: A Journal of Commerce, Economics, and Social Sciences*, *10*(1), 58-64.

Haider, S.H., Asad, M., & Fatima, M. (2017). Entrepreneurial orientation and business performance of manufacturing sector small and medium scale enterprises of Punjab Pakistan. *European Business and Management*, *3*(2), 21-28.

Haider, S.H., Asad, M., & Fatima, M. (2017). Responsibility of global corporations towards human resource to attain competitive advantage: A review. *Journal of Research in Administrative Sciences*, *6*(2), 9-12.

Henderson, S., & Goodwin, J. (1992). The case against asset revaluations. *Abacus*, *1*(21), 75-87.

Lin, Y.C. (2000). Fixed asset revaluation and equity depletion in the UK. *Journal of Business Finance & Accounting*, *4*(27), 359-394.

Rahman, M.T. (2017). Revaluation of fixed assets before IPO: A study on textile industry in Bangladesh. *Journal of Finance and Accounting*, *5*(5), 200-205.

Shane, S., & Eckhardt, J. (2003). Research design: Qualitative, quantitative and mixed methods approaches. *Handbook of Entrepreneurship Research*, 161-191.

Tabari, N.Y., & Adi, M. (2014). Factors affecting the decision to revaluation of assets in listed companies of Tehran Stock Exchange (TSE). *International Journal of Scientific Management and Development*, *2*(8), 373-377.

Wali, S. (2015). Mechanisms of corporate governance and fixed asset revaluation. *International Journal of Accounting and Finance*, *5*(1), 82-97.

Whittred, G., & Chan, Y.K. (1992). Asset revaluations and the mitigation of underinvestment. *Abacus*, *1*(28), 58-74.