VALUE RELEVANCE OF PROPERTY PLANT AND EQUIPMENT, AND ASSET REVALUATION RESERVE: UPHOLDING FINANCIAL REPORT RELIABILITY AND EVADING MISJUDGEMENT

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ABSTRACT

In order to upsurge financial report's reliability and curb the misinterpretation which could severely lead to misjudgements among financial reporting users, this current study aims to investigate the value relevance of property, plant and equipment and asset revaluation reserves using a sample of top 100 listed companies from a neighbourhood between Malaysia and Indonesia for the period of 2018-2019. This study provides evidence that property, plant and equipment and asset revaluation reserves of Malaysian and Indonesian companies are value relevant. The result implicates that the adoption of Malaysian Financial Reporting Standard 116 (MFRS116-Property, plant and equipment in Malaysia and Financial Accounting Standard 16 (PSAK 16) in Indonesia are value relevant. Hence, any financial misjudgements among users could be evaded.

Keywords: Property, Plant and Equipment, Asset Revaluation Reserve, Value Relevance, Financial Misjudgements

INTRODUCTION

Notorious firms' dishonours around the world in the developed countries were always associated with bad financial reporting exercises (Seaman, 2013). Malaysia and Indonesia are also the part of the South East Asian's region and had a long history of financial reporting frauds. A recent survey in 2016 had highlighted that 17% of economic crimes are associated with financial reporting in Malaysia (PwC, 2016). Moreover, renowned frauds in Malaysia e.g. Transmile Group Berhad, Megan Media Holdings Berhad, Southern Bank Berhad and 1Malaysia Development Berhad (1MDB) (2013) are also associated with manipulation of the financial reporting. These firms cheated their investors by providing misleading financial reports Zunaira (2016) that resulted in huge loss to investors due to inappropriate investment decision making based on the misleading information. These financial reporting frauds not only battered the assurance of the investors in financial reporting but also elevated the concern alarming the low-quality financial reporting Mirza, Malek & Abdul Hamid (2019). The reliability of financial reports was globally interrogated. While users supposed to rely on high quality of these financial reports, their judgement was also queried by their interpretation.

On the other hand, Property, Plant and Equipment (PPE) are the backbone of a company as PPE is used to generate revenue for the company. According to Malaysian Financial Reporting standard no 116 (MFRS 116), Property, Plant and Equipment are tangible assets that are held for use in the production or supply of goods or services, for rental to others, for administrative purposes and are expected to be used during more than one period. In fact, the majority of non-current assets of a company comprise PPE. The financial reporting standards (MFRS116 & PSAK16) allow a company in their jurisdiction to value their PPE using either the cost model or the revaluation model.

Cost model is a valuation model whereby PPE is measured based on historical cost less accumulated depreciation and accumulated impairment. Revaluation model on the other hand measures PPE based on market value of the PPE less subsequent accumulated depreciation and subsequent accumulated impairment. The difference (when the PPE's carrying amount is increased as a result of revaluation) between the value prior to revaluation and the value after revaluation is known as Asset Revaluation Reserve (ARR). ARR form part of total equity in Statement of Financial Position and the change in ARR form part of other comprehensive income in Statement of Comprehensive Income.

In Malaysia MFRS 116 became enforceable starting from the period beginning on 1 January 2012 or after whereas the implementation of Financial Accounting Standard Statement 16 (PSAK 16) in Indonesia beginning on 1 January 2008 or after. Those standards (MFRS 116 and PSAK 16) are based on International Financial Reporting Standards 16 (IFRS 16) produced by International Accounting Standards Board (IASB). The rationale for adoption of IFRSs all over the world is, they bring transparency, strengthen accountability and contribute to economic efficiency to those countries ifrs.org, (2020).

Theoretically and proven scientifically, assets, liabilities and equity values stated in financial statements are relevant towards market value of companies' equity. Studies by Landsman (1986); Ohlson (1995); Kadri, et al., (2009, 2010 & 2020) and many other researchers have proven this. The focus of current study is on the relevance of property, plant and equipment, and asset revaluation reserve (ARR) towards market value of equity. Literature search found some studies done all over the world related to value relevance of PPE and ARR. Most of the studies were done outside Malaysia and Indonesia. Herrmann, Saudagaran & Thomas (2006) argue that fair value measures for property, plant, and equipment are superior to historical cost based on the characteristics of predictive value, feedback value, timeliness, neutrality, representational faithfulness, comparability, and consistency. Cotter & Richardson (2002) suggest there are differences in reliability of assets revaluations made by board of directors versus independent (external) appraisers. They found that revaluations for plant and equipment that are made by independent appraisers are more reliable than revaluations made by directors. However, for revaluations for other classes of non-current assets, the researchers were unable to find any difference.

In reality some of the researchers found asset revaluation reserves are relevant in explaining market value and some other researchers found asset revaluation are not value relevant. Aboody & Barth (1998); Cahan, Courtenay, Gronewoller & Upton (2000); Wan Ismail, Kamarudin & Mohamed (2009); Piosik, Kumor & Sulik-Górecka (2013); Khan, Bradbury & Courtenay (2014); Aladwan & Saaydah (2015); Evinita (2017); Yousefinejad, Ahmad & Embong (2017) found that asset revaluation reserve are value relevant. On the other hand (Brimble & Hodgson, 2001; Teixeira, Lopes & Da Costa, 2002; Duˇsan, 2017) found that asset revaluation reserves are not value relevant.

Current study intends to look at the relevance of PPE and ARR towards market value of the companies' equity in Malaysia and Indonesia. In particular, current study aims at addressing the following objectives:

1. To investigate the relationship between book value of equity and market value of equity of Malaysian and Indonesian companies.
2. To investigate the relationship between property, plant and equipment and companies' market value in Malaysia and Indonesia.
3. To investigate the relationship between asset revaluation reserve and companies' market value in Malaysia and Indonesia.
4. To investigate the relationship between depreciation charge and companies market value in Malaysia and Indonesia.

LITERATURE REVIEW

Assets, liabilities and equities are value relevant. These have been proven by many studies since 1968 by Ball and Brown. Later in 1986 Landsman had proven that book values of

net asset (also equal to equity) were proven relevant in explaining the variation in companies' market value of shares. (Landsman, 1986) also proved that pension fund asset and liabilities (the components of net asset) were also value relevant.

In 1995, Ohlson had developed an equity valuation model that argued market value of equity should be represented by book value of equity (that equals to net asset) and current year net income. He had proven his argument that book value of equity and current year net income could significantly explain the variation in market value of equity. Until today many studies have been done to prove the correctness of (Ohlson, 1995) equity valuation model.

It is important to note that asset revaluation reserve is one of the items that contributed to total equity other than ordinary share capital, retained earnings, general reserves and other reserves. Therefore, an effort should be taken to extract asset revaluation reserve from the total equity, to know whether it is also relevant individually. It is also important to note that asset revaluation reserve exist due to the change in market value of property, plant and equipment. It is presumed that a change in market value of property, plant and equipment could explain the change in market value of equity.

There are a few studies that investigated the value relevance of asset revaluation reserve. Some of the researchers found asset revaluation reserve are relevant in explaining market value and some other researchers found asset revaluation are not value relevant.

Aboody & Barth (1998) studied 738 firms from the UK stock market for the period from 1983 to 1995. They found revaluation reserve balances stated in financial statements were value relevant on top of book value of equity and net income of those firms. Cahan, Courtenay, Gronewoller & Upton, (2000) explored 63 New Zealand firms and found that changes in asset revaluation reserve were value relevant. Wan Ismail, Kamarudin & Mohamed (2009) studied Malaysian firms for the period of 1998 to 2001. They also found that asset revaluation reserves were value relevant.

Paik (2009) investigated the effect of adopting the IFRS standard for fixed asset revaluation by examining the relationship between changes in revaluation reserves and stock prices. The sample for this study includes 15 countries, each with at least 30 companies that have valid revaluation reserves data for the year 2005. Out of the 15 countries used for the analyses, five countries (Great Britain, Bermuda, Australia, Hong Kong, and the Philippines) have revaluation reserves that are statistically significant in explaining the market value of equity, suggesting that revaluation reserves are value relevant for those countries. For each of the five countries with value-relevant revaluation reserves, their reported net income numbers are also value relevant (the net income for these five countries are statistically significant at least at the 5 percent level). However, the book-value of equity is not always value relevant; the book value of equity for Hong Kong and Australia is not value relevant.

Piosik, Kumor & Sulik-Górecka (2013) investigated companies listed on the Warsaw Stock Exchange (WSE) in Poland during the period 2000–2010 and found that asset revaluation reserves were associated with companies' total asset and earnings. Khan, Bradbury & Courtenay, (2014) discovered that revaluation reserve and change in revaluation reserves of 92 New Zealand Firms over the period of 2003 to 2010 are value relevant. Aladwan & Saaydah (2015) conducted a research on the association between revaluation reserves and changes in operating profit. The result proved that revaluation reserves were associated with change in operating income. Evinita (2017) examined 386 companies in Indonesia Stock Exchange and found asset revaluation reserves were value relevant. Last but not least, Yousefinejad, Ahmad & Embong (2017) found that changes in asset revaluation reserve were value relevant.

Contrary to the above, Brimble & Hodgson (2001) explored a sample of 92 Australian industrial firms listed on the Australian Stock Exchange (ASX) over the full data period from 1988 to 1997. They discovered changes in asset revaluation reserves were not value relevant. Similar to the above, (Teixeira, Lopes & Da Costa, 2002) investigated 98 companies in Sao Paulo Stock Exchange from 2000 to 2001 and found that revaluation reserves were not value relevant. (Dušan, 2017) found that the change in asset revaluation reserves of Slovak Republic companies is not value relevant. In addition, (Ahmed, Goodwin & Sawyer, 2005) investigated the value relevance of recognized and disclosed revaluations of land and buildings in Australian

firms. They found weak evidence that revaluations of recognized and disclosed land and buildings are value relevant. Sharma, Kumar & Singh (2012) studied financial reports of 71 non-financial firms from CNX 100 firms listed on NSE from 2000 to 2008. They found that value relevance of financial statements especially cash flow reporting have negligible effect on the stock returns in Indian market.

Due to the inconsistent results above, the current study intends to fill the gap by studying a more recent situation in Malaysia and Indonesia (2018-2019) by investigating the relevance of both PPE and ARR of property, plant and equipment.

HYPOTHESES

Based on the above previous studies the following null and alternative hypotheses are developed:

H01: There is no significant relationship between property, plant and equipment and market value of equity of Malaysian and Indonesian companies.

HA1: There is a significant relationship between property, plant and equipment and market value of equity of Malaysian and Indonesian companies.

H02: There is no significant relationship between asset revaluation reserve and market value of equity of Malaysian and Indonesian companies.

HA2: There is a significant relationship between asset revaluation reserve and market value of equity of Malaysian and Indonesian companies.

H03: There is no significant relationship between depreciation charge and market value of equity of Malaysian and Indonesian companies.

HA3: There is a significant relationship between depreciation charge and market value of equity of Malaysian and Indonesian companies.

RESEARCH METHODOLOGY

The study employs the value relevance model found by Landsman (1968); Ohlson (1995) to test the value relevance of asset revaluation reserve and property, plant and equipment of Malaysian and Indonesian listed companies. The sample is selected from top 100 Malaysian companies listed on Bursa Malaysia and top 100 Indonesian companies listed on Indonesian Stock Exchange.

The data are processed using the Microfit 5.5 developed by Pesaran & Pesaran (2017). The software is equipped with sophisticated statistical tools suitable for secondary data research. Statistical models to test the relevance of property, plant and equipment and asset revaluation reserve. The study is related to equity valuation – that is the relationship between market value of equity and book value of equity. So the study selected the (Landsman, 1986) model to be used throughout the study. The basic model is well known as The Balance Sheet Identity model as first mentioned by (Landsman, 1986)

Basic (Landsman, 1986) model:

$MV_{jt}=\alpha+\beta_1 BV_{jt}$ --- (1)

The model is modified to facilitate the inclusion of asset revaluation reserve and property, plant and equipment.

$MV_{jt}=\alpha+\beta_1 BVNOPPE_{jt}+\beta_2 PPE_{jt}$ ------------------ (2)

$MV_{jt}=\alpha+\beta_1 BVNOARR_{jt}+\beta_2 ARR_{jt}$ ------------------ (3)

Due to the fact that cost model and fair value model selected will also affect the profit after tax of the firms – depreciation for both cost model and revaluation model, (Ohlson, 1995) will also be employed. Below is the model developed by Ohlson (1995).

$MV_{jt}=\alpha+\beta_1 BV_{jt}+\beta_2 NP_{jt}$ -------------------------------- (4)

Since the purpose of utilizing this model is to compare the value relevance of depreciation charge based on cost model and revaluation model, Ohlson (1995) model is modified as follows:

$$MV_{jt} = \alpha + \beta_1 NP_{jt} + \beta_2 Dep_{jt} \text{ ------------------------------- (5)}$$

Where,

MV_{jt} is market value of equity of firm j at year t

BV_{jt} is book value of equity of firm j at year t

$BVNOARR_{jt}$ is book value of equity net off carrying amount of asset revaluation reserve of firm j at year t

$BVNOPPE_{jt}$ is book value of equity net off property, plant and equipment of firm j at year t

ARR_{jt} is asset revaluation reserve of firm j at year t

PPE_{jt} is property, plant and equipment of firm j at year t

NP_{jt} is net profit after tax of firm j at year t

And Dep_{jt} is depreciation charge of firm j at year t

RESULTS

Descriptive Results

To what extent is Malaysian and Indonesian Top 100 companies adopt revaluation model for their property, plant and equipment? According to the data gathered, 35 out of Top 100 Indonesian listed companies adopted revaluation model whereas only 13 out of Top 100 Malaysian companies adopted revaluation model. This finding shows that majority of Malaysian and Indonesian listed companies selected cost model rather than revaluation model. This could be due to cost benefit analyses that have been conducted by those companies. (Yossi, Sofyan & Ridwan, 2018) recently investigated firms listed on Indonesia Stock Exchange for the periods 2013-2016. They found that only around 30% of Indonesian companies apply revaluation model and 70% of Indonesia companies stay with a cost model. Zakaria (2011) also found only 30% of Indonesian companies are selecting revaluation model for their PPE.

Empirical Results

The empirical result starts with the test of the correctness of the theory that is the relationship between book value of net asset and market value (Landsman, 1986 model).

Table 1 RELATIONSHIP BETWEEN BV AND MV			
	Pooled sample	**Malaysia**	**Indonesia**
Variable	Coefficient (Sig.)	Coefficient (Sig.)	Coefficient (Sig.)
Constant	4815.6 (0.000)	4255.3 (0.000)	3994.6 (0.065)
Book Value of Equity	1.4208 (0.000)	1.0473 (0.000)	2.1508 (0.000)
N	398	198	200
F stat	312.2083 (0.000)	354.6442 (0.000)	186.4596 (0.000)
R^2	0.44084	0.64405	0.48499
Adj. R^2	0.43943	0.64224	0.48239
Note: Two-tailed regression models were utilized.			

The above table 1 explains the correctness of value relevance theory that book value of

equity has a significant relationship with market value of equity for pooled as well as separate samples of Malaysia and Indonesia. In other words, book values of equity of the companies are value relevant. According to (Landsman,1986) positive and significant coefficient for constant (intercept) of pooled and Malaysia sample means there are some other explanatory variables that need to be included to explain the variations in market value. Whereas insignificant constant of Indonesian sample indicates that market value is sufficiently explained by book value and no more variables are needed to explain further the variation in market value.

Next step is to investigate the relationship between property, plant and equipment and market value of pooled sample, Malaysian sample and Indonesian sample.

Table 2 RELATIONSHIP BETWEEN PPE AND MV			
	Pooled sample	**Malaysia**	**Indonesia**
Variable	Coefficient (Sig.)	Coefficient (Sig.)	Coefficient (Sig.)
Constant	5025.3 (0.000)	4248.5 (0.000)	5760.5 (0.005)
BV Less PPE	1.5319 (0.000)	1.0387 (0.000)	2.4235 (0.000)
PPE	1.2481 (0.000)	1.0561 (0.000)	1.1130 (0.003)
N	398	198	200
F stat	160.2265	176.494	97.4363
R^2	0.44790	0.64415	0.49729
Adj. R^2	0.44511	0.64050	0.49218
Note: Two-tailed regression models were utilized.			

The above table shows the relationship between PPE and market value. PPE of pooled sample, Malaysian sample and Indonesian sample are significant and positively related to market value of the companies. This indicates that PPE of Malaysian companies and Indonesian companies are value relevant. PPEs are relevant in explaining the variation in market value of the companies when they are separated from the net asset of the company. It means it has its own value to the investors. It is important in setting the market value of the companies. Based on the above result, null hypothesis 1 can be rejected and alternative hypothesis 1 can be accepted.

The next table is about the relationship between asset revaluation reserve of the companies and market value of the companies. Since only 35% of Indonesian sample and 13% of Malaysian sample selected revaluation model, the number of observation (N) has also changed.

Table 3 RELATIONSHIP BETWEEN ARR AND MV (Malaysia Versus Indonesia)			
	Pooled Revaluation Model	**Malaysia**	**Indonesia**
Variable	Coefficient (Sig.)	Coefficient (Sig.)	Coefficient (Sig.)
Constant	-320.7024 (0.851)	836.4586 (0.274)	-2587.5 (0.352)
BV Less ARR	1.9885 (0.000)	1.2305 (0.000)	2.3915 (0.000)
ARR	1.8973 (0.009)	-23.7387 (0.033)	2.3831(0.000)

N	96	26	70
F stat	94.2592 (0.000)	583.2294 (0.000)	77.2764 (0.000)
R^2	0.66973	0.98066	0.69759
Adj. R^2	0.66263	0.97898	0.68856
Note: Two-tailed regression models were utilized.			

The above table shows the relationship between ARR and market value. ARR of pooled sample, Malaysian sample and Indonesian sample are significantly related to market value of the companies. This indicates that ARRs of Malaysian companies and Indonesian companies are value relevant. ARRs are relevant in explaining the variation in market value of the companies when they are separated from the equity of the company. It means it has its own value to the investors. It is important in setting the market value of the companies. The result was consistent with (Aboody & Barth, 1998; Cahan et al., 2000; Wan Ismail, Kamarudin & Mohamed, 2009; Piosik, Kumor & Sulik-Górecka, 2013; Khan, Bradbury & Courtenay, 2014; Aladwan & Saaydah, 2015; Evinita, 2017; Yousefinejad, Ahmad & Embong, 2017). From the result it can be concluded that null hypothesis 2 can be rejected and alternate hypothesis 2 can be accepted.

Table 4 RELATIONSHIP BETWEEN PPE AND MV (Cost Model Versus Fair Value Model)			
	Pooled sample	**Cost Model**	**Fair Value Model**
Variable	Coefficient (Sig.)	Coefficient (Sig.)	Coefficient (Sig.)
Constant	5025.3 (0.000)	8405.1 (0.000)	-320.7024 (0.851)
BV Less PPE	1.5319 (0.000)	0.82158 (0.000)	1.9885 (0.000)
PPE	1.2481 (0.000)	0.92415 (0.000)	1.8973 (0.009)
N	398	302	96
F stat	160.2265 (0.000)	44.8227 (0.000)	94.2592 (0.000)
R^2	0.44790	0.23066	0.66973
Adj. R^2	0.44511	0.22552	0.66263
Note: Two-tailed regression models were utilized.			

The above table shows the relationship between PPE and market value of cost model and revaluation model. The result shows PPE of revaluation model is more significant as compared to PPE of cost model. According to Herrmann, Saudagaran & Thomas (2006), fair value measures for property, plant, and equipment are superior to historical cost based on the characteristics of predictive value, feedback value, timeliness, neutrality, representational faithfulness, comparability, and consistency. Even though they are producing different amount of explanation towards market value of equity, both cost model and revaluation model used proven MFRS 116 and PSAK 16 fulfill the objective of promoting relevant information about PPE to investors.

Table 5
RELATIONSHIP BETWEEN PPE AND MV (Cost Model: Malaysia Versus Indonesia)

	Cost Model	Malaysia	Indonesia
Variable	Coefficient (Sig.)	Coefficient (Sig.)	Coefficient (Sig.)
Constant	8405.1 (0.000)	5526.4 (0.000)	11491.5 (0.001)
BV Less PPE	0.82158 (0.000)	0.91315 (0.000)	0.60581 (0.219)
PPE	0.92415 (0.000)	0.99351 (0.000)	0.96625 (0.066)
N	302	172	130
F stat	44.8227 (0.000)	99.4009 (0.000)	1.2382 (0.291)
R^2	0.23066	0.54051	0.019126
Adj. R^2	0.22552	0.53508	0.003639
Note: Two-tailed regression models were utilized.			

Table above describes the relevance of PPE under cost model in Malaysia and Indonesia. The result of cost model shows that PPE of Malaysian companies are value relevant at 95% confidence level whereas PPE of Indonesian companies and value relevant at 90% confidence level.

Table 6
RELATIONSHIP BETWEEN DEP AND MV (Cost model Versus Revaluation model)

	Full sample	Cost model	Revaluation model
Variable	Coefficient (Sig.)	Coefficient (Sig.)	Coefficient (Sig.)
Constant	5041.5 (0.000)	7943.2 (0.000)	1007.3 (0.302)
Net Income	13.3772 (0.000)	10.4505 (0.000)	16.8408 (0.000)
Depreciation	0.21957 (0.065)	0.32154 (0.037)	-17.3921 (0.001)
N	398	302	96
F stat	310.5385 (0.000)	76.3169 (0.000)	240.3821 (0.000)
R^2	0.61125	0.33796	0.83791
Adj. R^2	0.60928	0.33353	0.83443
Note: Two-tailed regression models were utilized.			

Using the Ohlson (1995) net income model, the following table shows the value relevance of depreciation under the cost model and revaluation model. The result show depreciation charges are value relevant regardless whether they are calculated based on cost model or revaluation model. However, the result indicates that depreciation charged based on revaluation model is more relevant than depreciation charged based on cost model. This result support the argument by (Hermann et al., 2006) argument that fair value measurement provide predictive value, feedback value, timeliness, neutrality, representational faithfulness, comparability, and consistency. The result enables the researcher to conclude that null hypothesis 3 can be rejected and alternative hypothesis 3 can be accepted.

SUMMARY, CONCLUSION AND RECOMMENDATION

Current study investigates the reliability of financial reports *via* the examination of value relevance of property, plant and equipment and asset revaluation reserve of top 100 Malaysia and Indonesian companies. Descriptive statistics indicated that majority of Malaysian and Indonesian companies selected cost model rather than revaluation model. This is not surprising as other part of the world also show the same scenario. Book value of equity (net assets) of Malaysian and Indonesian companies are not contradicting the theory (Landsman, 1986; Ohlson, 1995) whereby they are value relevant.

Property, plant and equipment's are value relevant regardless of the valuation model selected or the country they are situated. However, property, plant and equipment's valued based on revaluation model are more relevant than property, plant and equipment valued based on cost model in explaining the market value.

Asset revaluation reserves are relevant in explaining market value of equity in Malaysia and Indonesia. Lastly, all depreciation charges are value relevant, but depreciation charge calculated based on revaluation model is more value relevant in explaining market value of equity. So, Malaysian and Indonesian companies need to reconsider their selection of property, plant and equipment valuation model as the results of current study provide evidence that investor put more attention (value) to asset revaluation reserve rather than property, plant and equipment per say.

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