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The Impact of Assets Revaluation on Banking Capital Adequacy Ratio

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Abstract

The financial industry, especially the banking industry, requires the bank to maintain its capital structure well. Bank can change the accounting policy of fixed assets into revaluation method. This study would like to see the impact of assets revaluation and its effect on the capital structure. There are two elements of capital structure that can affect the CAR ratio, that is, core capital and complementary capital. In the supplementary capital, there is an asset revaluation reserve This study looks at a bank that revalued its fixed assets since 2014. Based on the results of the study, it was concluded that the revaluation of assets could improve the capital structure of these banks, especially it increases the capital adequacy ratio.

Keywords: assets revaluation, capital adequacy ratio, risk weighted assets

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1. Introduction

Currently, many financial institutions grow and develop in the Indonesian economy, one of which is banking. Banks are financial institutions that collect funds from the public in the form of savings and then channeled back to the community in the form of credit and/or other forms in order to improve the standard of living and broaden the national economic growth.

Among many financial institutions, the Bank has a very important role for the Indonesian economy. A good bank is a bank that greatly maintains the trust of its customers. The trust factor of customers is the most important element in running the banking business in Indonesia.

Because of the banking existence is very necessary, it needs supervision for the banking's business. The purpose of bank guidance and supervision pursuant to Article 29 paragraph 2 of the Law of the Republic of Indonesia Number 10 of 1998, Banks shall maintain the provisions of capital adequacy, asset quality, quality of management,

liquidity, rentability, solvency, and other related aspects which is related to the Bank, and shall conduct business activities in accordance with the principles of prudence.

In performing its function, the Bank shall maintain its Capital Adequacy Ratio (Article 29 paragraph 2 of the Law of the Republic of Indonesia No. 10 of 1998). Capital is also a very important aspect to assess the health of the Bank as it relates to the solvency of the Bank. The capital adequacy ratio to be achieved by commercial banks is set at about 8%, but may change at any time by the government in accordance with the level of need deemed most appropriate. It is intended to improve the discipline and professionalism for each Bank to manage all its assets to gain profit for the bank.

There are two elements that can affect the CAR ratio of core capital and complementary capital. In the supplementary capital, there is a fixed asset revaluation reserve. One of which is the reserves that are formed from the difference in the re-acquisition of fixed assets that have been approved by the Directorate General of Taxation (DGT).

This study raises one element of the supplementary capital, namely the revaluation of fixed assets that can affect the capital structure that occurs in the Bank as measured using the Capital Adequacy Ratio.

2. Literature Review

2.1. Theoretical framework

Asset revaluation can affect the banking capital structure by analyzing its capital adequacy ratio. This can be illustrated in Figure 1:
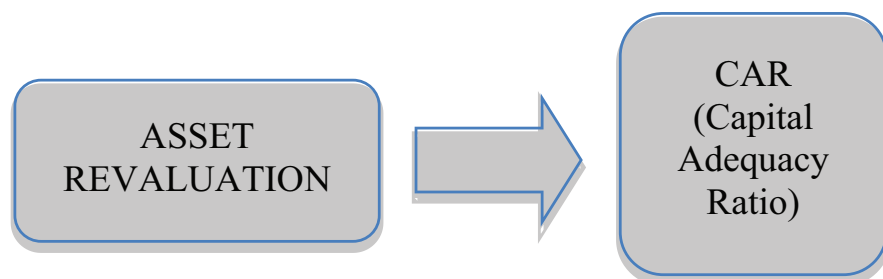

Figure 1: The effect of asset revaluation.

2.2. Other literature

2.2.1. Asset revaluation

The revaluation of property, plant and equipment for accounting purposes follows the SAK 16 concerning Fixed Assets. The SAK 16 states that revaluation of fixed assets is done with regularity to ensure that the carrying amount does not differ materially to the amount determined at fair value at the end of the reporting period; and if an asset is still revalued, fixed assets in the same class are revalued (IAI, 2014).

While revaluation of fixed assets for tax purposes refers to the Regulation of the Minister of Finance no. 191/PMK.010/2015 and supplemented with PMK 233/2015, among which provides that revaluation of fixed assets cannot be revalued again before the expiry of five years, may be exercised in part or in whole of property, the useful life of the assets after revaluation is adjusted to full benefits for the group of those assets, and the basis for depreciation of property, plant and equipment is the value at the time of fixed asset revaluation.

Asset revaluation allows companies to value its assets in the fair value. A revaluation of a fixed asset of a company, which results from an increase in the value of fixed assets on the market or due to the low value of fixed assets in the company's financial statements caused by devaluations or other causes, so that the value of fixed assets in the financial statements no longer reflects a reasonable value.

The purpose of the revaluation of the company's fixed assets is intended to enable the company to make a more reasonable income and cost calculation to reflect the company's capabilities and values.

2.2.2. The capital adequacy ratio

The capital adequacy ratio (CAR) is a measure to calculate the capital of bank. This calculation is expressed a bank's risk weighted credit exposures which knows as capital-to risk weighted assets ratio. Minimum capital adequacy ratios are to make sure that banks have enough cushion to absorb a reasonable amount of losses before they become insolvent and consequently lose depositors' funds. Capital adequacy ratios ensure the efficiency and stability of a nation's financial system by lowering the risk of banks becoming insolvent. If a bank is declared insolvent, this shakes the confidence in the financial system and unsettles the entire financial market system.

In principle, this CAR level is adjusted to the internationally accepted CAR provisions that are in accordance with the standards issued by the Bank for International Settlements (BIS). This CAR increase aims to improve performance and to ensure the prudent banking principles are always assured.

Capital is an important factor for banks in the framework of business development and to accommodate losses. In order to be able to grow and compete in a healthy manner, the capital needs to be adjusted to an international standard known as the BIS (Bank for International Settlement) standard [8].

Capital consists of core capital and complementary capital. Core Capital (Tier 1) consists of paid up capital and reserves formed from profit net of tax. Complementary capital consists of reserves that are formed not from profits after taxes as well as loans of a nature can be equated with capital. Complementary capital reserve of revaluation of fixed assets, provision for income earning assets, quasi capital, that is, capital supported by instruments or scripts that have properties such as capital, and subordinated loans,

3. Methodology

3.1. Research questions

This study was made to investigate the following research questions:

RQ1. This study is analyze the effect of asset revaluation to the capital adequacy ratio (CAR).

RQ2. In order to analyze the capital adequacy ratio (CAR) in Bank

3.2. Research methodology

This study is based on primary data, which use financial statement of one bank in period 2014–2016 as a quantitative data. The qualitative data get from interview with the management.

4. Research Findings

4.1. Factor analysis

Capital Adequacy Ratio (Capital Adequacy Ratio) is one of the indicators used to measure the capability of existing capital to cover possible losses in credit activities. Table 1 shows the Capital Adequacy Ratio of Bank in the last 5 years.

TABLE 1: The CAR of bank in last 5 years.

	Year				
	2015	2014	2013	2012	2011
CAR	12.00%	12.30%	12.52%	12.75%	13.01%

The CAR ratio for the last 5 years has declined. Based on the question and answer with the management of bank, decreasing the quality of productive assets caused by default financing where if the financing failed to pay/default it will affect the company's revenue. A productive asset is an asset that generates revenue contribution for the bank. Therefore Bank decided to revise its fixed asset policy to increase its capital ratio.

Prior to the case study, the researcher conducted observations on 3 (three) Banks that revalued fixed assets to increase their CAR ratios, namely Bank A, Bank B and Bank C. All three banks have the same policy, which previously used the acquisition cost method and turned it into a revaluation method. Based on the observation of literature study on each audit report of three banks that do revaluation in 2016, can be seen through Table 2.

TABLE 2: The Analysis 3 of other banks.

	CAR		
	Before Revaluation	After Revaluation	Differences
Bank A	20.68%	25.22%	4.54%
Bank B	17.89%	24.53%	4.53%
Bank C	14.41%	20.42%	0.42%

From the analysis of the effect of revaluation of fixed assets to the capital structure of the three banks shown in Table 2, a significant increase from the revaluation due to the revaluation reserves of fixed assets become the complementary capital enhancement element of the CAR ratio calculation, so the CAR ratio of the three banks increases.

In calculation to determine the CAR, there are two components used to determine the amount of capital owned by the bank, namely core capital and complementary capital. Components in the core capital are paid up capital, additional capital reserves, lack of non-productive assets and there is a substantial capital reducing factor such as Deferred Tax Assets and inclusion.

The researcher made 2 year comparison of calculation of minimum capital requirement ratio due to revaluation of assets conducted by bank. Table 3 shows the differences in 2015.

TABLE 3: Differences of asset revaluation in year 2015.

Accounts	2015		Differences
	Before Revaluation	After Revaluation	
A. Core Capital			
1. Paid-in Capital	1,103,435,151	1,103,435,151	–
2. Provision for additional capital	2,377,911,384	2,377,911,384	–
3. Non-earning under provision PPA asset	(204,581,908)	(204,581,908)	–
4. Offsetting Factor from Core Capital – Deferred Tax – Investment in shares	(118,536,214) (28,970,217)	(118,536,214) (28,970,217)	– –
Total Primary Capital (A)	3,129,258,196	3,129,258,196	–
B. Complementary Capital			
1. General reserve of allowance for impairment losses of eraning assets	363,607,461	363,607,461	–
2. Subordinated financing	1,500,000,000	1,500,000,000	–
3. Available for sale investment	388,527	388,527	–
4. Revaluation of premises and equipment differences	–	610,106,817	610,106,817
Total Complementary Capital (B)	1,863,995,988	2,474,102,805	610,106,817
Total (A) + (B)	4,993,254,184	5,603,361,001	610,106,817
Weighted risk assets (ATMR)	41,616,680,181	41,616,680,181	–
CAR available for financing and market risks	12.00%	13.64%	1.47%

Table 4 shows the differences in 2016.

The ratio of CAR seen in Tables 3 and 4 has significant differences. This is due to the addition of components to the supplementary capital that is the reserve of revaluation of fixed assets. This fixed assets revaluation reserve becomes one of the

TABLE 4: Differences of asset revaluation in Year 2016.

Accounts	2016		Differences
	Before revaluation	**After revaluation**	
A. Core Capital			
1. Paid-in Capital	1,103,435,151	1,103,435,151	–
2. Provision for additional capital	2,515,311,403	2,515,311,403	–
3. Non-earning under provision PPA asset	(146,468,753)	(146,468,753)	–
4. Offsetting Factor from Core Capital – Deferred Tax – Investment in shares	(114,884,885) (29,968,375)	(114,884,885) (29,968,375)	– –
Total Primary Capital (A)	3,327,424,541	3,327,424,541	–
B. Complementary Capital			
1. General reserve of allowance for impairment losses of eraning assets	392,706,357	392,706,357	–
2. Subordinated financing	1,500,000,000	1,500,000,000	–
3. Available for sale investment	94,758	94,758	–
4. Revaluation of premises and equipment differences	–	604,697,022	604,697,022
Total Complementary Capital (B)	1,892,801,115	2,497,498,137	604,697,022
Total Capital	5,220,225,656	5,824,922,678	604,697,022
Weighted risk assets (ATMR)	40,978,476,916	40,978,476,916	–
CAR available for financing and market risks	12.74%	14.21%	1.48%

components that can help increase the CAR ratio. In 2016, the CAR ratio without the use of fixed asset revaluation difference was 12.74%. While the CAR by using fixed asset revaluation increment increased to 14.21%. In 2015, the CAR ratio without the use of fixed asset revaluation difference was 12.00%. While the CAR by using fixed asset revaluation increment increased to 13.64%. The CAR has increased by 1.48% in 2016 and 1.47% in 2015. In general, the aforementioned CAR calculation results have been able to meet the minimum standards set by the existing rules, which amounted to 8% and entered into the ranks of Banks that perform well and healthy. This fixed assets revaluation policy can certainly be concluded to have a good impact on Bank capital. This policy may be applied to banks wishing to improve their capital structure, provided it complies with existing regulations.

5. Conclusions and Recommendations

The conclusion of this study is that the Bank revaluing its fixed assets can improve the Capital Adequacy Ratio (CAR). The revaluation made by the Bank is the Bank's effort to improve the capital structure of the company resulting in a fixed asset revaluation surplus. This fixed asset revaluation surplus is one of the components of the capital structure under which the CAR is calculated.

This study is only a preliminary study that needs to be studied more deeply.

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