

Task IM-7.47: Exercise on Revaluations**(Impairment Loss and Disposal)**

CREMLINGEN (Pty) Ltd. is a lodge rental hotel. The lodges are separate buildings scattered over the area next to a natural reserve. CREMLINGEN (Pty) Ltd. owns 35 lodges on its premises. The land is worth 1,500,000.00 EUR.

The lodges were built in 20X6 and the buildings were ready to rent-out on 24.11.20X6. They are written-off along straight line method of depreciation over a useful life of 25 years. Every lodge building was built at cost of 60,000.00 EUR.

CREMLINGEN (Pty) Ltd. equipped every lodge with an interior that comprises a living room, a bed room with en-suite bathroom and a kitchen. For the interior, CREMLINGEN (Pty) Ltd. pays 15,000.00 EUR/lodge. The interior is written-off along straight line method over 10 years.

On 2.02.20Y3 (the lodges are at that time more than 6 years old), a fire destroys 3 lodges completely. The interior is totaled as well as the building. CREMLINGEN (Pty) Ltd. builds 3 new lodges at 69,000.00 EUR/lodge. The interior built in costs 18,000.00 EUR/lodge. The new lodges are ready for rent-out on 1.10.20Y3 which is the date for commencing depreciation on the building and the interiors. The useful life is as for the other lodges and interiors 25 and 10 years.

On 4.06.20Y3 guests have a fight in one of the lodges (not the new ones) and destroy the interior to an extent of 40%. Its repair costs 7,500.00 EUR (net amount).

In December, the owner of CREMLINGEN (Pty) Ltd. decides to give up the Lodge-business and to relocate to Australia in order to open a scuba diving school. The company is liquidated on 31.12.20Y3. The land is sold at 2,000,000.00 EUR and the old lodges at 50,000.00 EUR (building and interior together) for the old lodges and at 100,000.00 EUR for the 3 new ones.

Required: Prepare the accounts and determine the profit/loss on liquidation for CREMLINGEN (Pty) Ltd. Apply a Realisation account for each kind of lodge to be sold. Prepare also a register of non-current assets as at 30.12.20Y3 in order to show the buyer the value of the assets he intends to buy. Ignore VAT! The number of years goes as follows:20X8, 20X9, 20Y0, 20Y1, 20Y2 ...

Solution:

At the beginning of the Accounting period 20Y3, all lodges are 6 years and 1 month old. Accumulated depreciation equals to $(6 \times 12 + 1) \times 35 \times 60,000 / (12 \times 25) = \mathbf{511,000.00 \text{ EUR}}$.

At the beginning of the Accounting period 20Y3, the interior of the lodges are 6 years and 1 month old. Accumulated depreciation on the interior equals to $(6 \times 12 + 1) \times 35 \times 15,000 / (12 \times 10) = \mathbf{319,375.00 \text{ EUR}}$.

(1) Before the fire takes place, all lodge buildings are written-off for 1 month. Depreciation is $35 \times 200 = \mathbf{7,000.00 \text{ EUR}}$.

(2) Before the fire takes place, all interiors are written off for 1 month. Depreciation is: $35 \times 125 = \mathbf{4,375.00 \text{ EUR}}$.

(3) Depreciation on 32 lodge buildings for the rest of the year equals to $32 \times 11 \times 200 = \mathbf{70,400.00 \text{ EUR}}$.

(4) Depreciation on 31 interiors for the rest of the year equals to $31 \times 11 \times 125 = \mathbf{42,625.00 \text{ EUR}}$.

(5) The value of one lodge burned down (building) equals to: $60,000 - 74 \times 200 = 45,200.00 \text{ EUR}$. Hence, the impairment loss with regard to the building equals to: $3 \times 45,200 = 135,600.00 \text{ EUR}$. As the burned down lodges are of no value, the bookkeeping entry is as a disposal. This way, the lodges are deleted from the bookkeeping records. Acc depreciation equals to: $14,800 \times 3 = 44,400.00 \text{ EUR}$.

DR Acc Depreciation	44,400.00 EUR
DR Impairment loss	135,600.00 EUR
CR P, P, E	180,000.00 EUR

(6) The value per lodge burned down (interior) equals to: $15,000 - 74 \times 125 = 5,750.00 \text{ EUR}$. Hence, the impairment loss with regard to the interior equals to: $3 \times 5,750 = 17,250.00 \text{ EUR}$. As the burned down lodges' interior are of no value, the bookkeeping entry is as a disposal. This way, the interiors are deleted from the bookkeeping records. Acc depr equals to: $9,250 \times 3 = 27,750.00 \text{ EUR}$.

DR Acc Depreciation	27,750.00 EUR
DR Impairment loss	17,250.00 EUR
CR P, P, E	45,000.00 EUR

(7) The new lodges are acquired at 69,000.00 EUR each. $3 \times 69,000 = 207,000.00 \text{ EUR}$.

(8) The new interiors are acquired at 18,000.00 EUR each. $3 \times 18,000 = 54,000.00 \text{ EUR}$.

(9) Depreciation on the new lodges are $2 \times 3 \times 69,000 / (12 \times 25) = 1,380.00 \text{ EUR}$ (= 230 EUR/m)

(10) Depreciation on the new interiors is $2 \times 3 \times 18,000 / (12 \times 10) = 900.00 \text{ EUR}$ (= 150 EUR/m)

(11) Depreciation for Febr – May for the interior that is damaged equals to: $4 \times 125 = 500.00 \text{ EUR}$.

(12) The damage is 40 % of the carrying amount of the interior: $40\% \times (15,000 - 78 \times 125) = 2,100.00 \text{ EUR}$.

(13) The repair is 7,500.00 EUR but does not change the value of the interior.

(14) Depreciation on the repaired interior equals to $7 \times (15,000 - 9,750 - 2,100) / (120 - 78) = 525.00 \text{ EUR}$.

At this time the register of non-current asset looks as below:

Cremlingen Ltd.'s REGISTER of NON-CURRENT ASSETS as at 30.12.20Y3					
Asset	P, P, E @ cost / @ valuation	Acc. depr.	Acc. impairment loss	Carrying amount ×	Carrying amount
building	60,000.00	(17,000.00)		43,000.00 32	1,376,000.00
building new	69,000.00	(460.00)		68,540.00 3	205,620.00
interior	15,000.00	(10,625.00)		4,375.00 31	135,625.00
interior new	18,000.00	(300.00)		17,700.00 3	53,100.00
interior damaged	15,000.00	(10,275.00)	(2,100.00)	2,625.00 1	2,625.00
Asset 3				0.00	0.00
Total				115,915.00	1,717,245.00

Exhibit 1: Register of non-current assets before liquidation

When the company is sold, the amount paid equals to: $2,000,000 + 32 \times 50,000 + 3 \times 100,000 = \mathbf{3,900,000.00 \text{ EUR}}$. The P, P, E and Acc depr/IL accounts are closed-off to the Realisation account.

See the Accounts to read the profit on disposal (= liquidation revenue):

D		P, P, E - land		C		D		Cash/Bank		C		D		Repair		C	
OV	1,500,000.00	(R)	1,500,000.00	(R)	3,900,000.00	(7)	207,000.00	(13)	7,500.00	P&L	7,500.00	(8)	54,000.00	(13)	7,500.00		

Exhibit 2: Accounts

(Note, B/S provided by Excel file)