

Task IM-7.48: Exercise on Revaluations

(Impairment Loss and Disposal)

ROTTUM (Pty) Ltd. is a tool rental shop (Werkzeugvermieter). On 3.04.20X2, ROTTUM (Pty) Ltd. revalues a mini digger (Minibagger) at 42,000.00 EUR. ROTTUM (Pty) Ltd. recorded a revaluation reserve of 3,780.00 EUR (after deducting the deferred liabilities) and a deferred tax liability to the extent of 1,620.00 EUR.

The digger has a useful life of 5 years and no salvage value. The digger got a remaining useful life after revaluation of 3.5 years (= 42 months).

The digger is sold on 9.06.20X3 at 31,000.00 EUR net selling price.

Required: Calculate the profit/loss on disposal and show the Retained Earnings account as at 31.12.20X3. Assume the opening value of the Retained Earnings account on 1.01.20X2 is 0.00 EUR and besides the revaluation, deferred tax income and profit/loss on disposal entries, ROTTUM (Pty) Ltd. earns a pretax profit of 100,000.00 EUR in 20X2 and 90,000.00 EUR in 20X3.

Solution:

(OV) Recording the mini digging machine

(1a) Depreciation in 20X2 when the digger is deployed for 9 month. Depreciation equals to $9 \times 42,000 / 42 = 9,000.00$ EUR. Depreciation along the tax law is lower. It equals to: $9 \times (42,000 - (3,780 + 1,620)) / 42 = 7,842.86$ EUR. This results in a deferred tax income of: $30\% \times (9,000 - 7,842.86) = 347.14$ EUR.

DR Depreciation	9,000.00 EUR
CR Acc Depr	9,000.00 EUR

(1b, 1c) The portion of depreciation is a percentage of $9,000/42,000 = 21.43\%$. ROTTUM (Pty) Ltd. dissolves 21.43 % of the deferred tax liabilities and the revaluation reserves which gives a reduction of $21.43\% \times 1,620 = 347.17$ EUR on deferred tax liabilities and $21.43\% \times 5,400 = 1,157.22$ EUR on revaluation reserves (the amount is based on the revaluation reserves before deferred taxes are deducted):

DR Deferred Tax Liabilities	347.17 EUR
CR Revaluation Reserves	347.17 EUR

DR Revaluation Reserves	1,157.22 EUR
CR Retained Earnings	1,157.22 EUR

(2a) Depreciation in the next year equals to $5 \times 42,000 / 42 = 5,000.00$ EUR. Depreciation along the tax law is lower. It equals to: $5 \times (42,000 - (3,780 + 1,620)) / 42 = 4,357.14$ EUR. The profit on disposal along the tax law is: $31,000 - (42,000 - 5,400 - 7,842.86 - 4,357.14) = 6,600.00$ EUR. The profit on disposal along IFRS equals to $31,000 - 42,000 - 14,000 = 3,000.00$ EUR. This results in a deferred tax expense of: $30\% \times ((5,000 - 4,357.14) - (6,600 - 3,000)) = 887.14$ EUR.

DR Depreciation	5,000.00 EUR
CR Acc Depr	5,000.00 EUR

(2a) In the next year, the revaluation reserves and the deferred tax liabilities will be dissolved completely.

DR Deferred Tax Liabilities	1,272.83 EUR
CR Revaluation Reserves	1,272.83 EUR

DR Revaluation Reserves	4,242.78 EUR
CR Retained Earnings	4,242.78 EUR

Observe the accounts for the calculation:

D	P, P, E@valuation	C
OV	43,890.00	Real 43,890.00

D	Revaluation reserves	C
(1c)	1,157.22	OV 3,780.00
c/d	2,969.95	(1b) 347.17
	<u>4,127.17</u>	<u>4,127.17</u>
(2c)	4,242.78	b/d 2,969.95
	<u>4,242.78</u>	(2b) <u>1,272.83</u>
		<u>4,242.78</u>

D	Deferred tax liabilities	C
(1b)	347.17	OV 1,620.00
c/d	1,272.83	
	<u>1,620.00</u>	<u>1,620.00</u>
(2b)	1,272.83	b/d 1,272.83

D	Retained earnings	C
DTI _{x2}	347.14	(1c) 1,157.22
c/d	70,810.08	P&L2 70,000.00
	<u>71,157.22</u>	<u>71,157.22</u>
		b/d 70,810.08
		P&L3 60,840.00
		(2c) 4,242.78
c/d	136,780.00	DTI _{x3} 887.14
	<u>136,780.00</u>	<u>136,780.00</u>
		b/d 136,780.00

Earnings account along IFRS: $136,780 - 70,810.08 = \mathbf{65,969.92 \text{ EUR}}$. There is a rounding difference of 0.08 EUR.