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Financial Accounting I

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GAi

Chapter 3

Solutions

Solutions (*)

Case 3.01 Corticeira Amorim

Case 3.02 Média Capital

Case 3.03 Delta Cafés

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CASE 3.01 Corticeira Amorim[1]

AMORIM

Solution

Corticeira Amorim: Leading in the cork industry

1 Elements of the income statement

a. Identify and define the two main elements of the income statement of the Corticeira Amorim.

The two main elements of the income statement of the Corticeira Amorim are the revenues and expenses of this entity.

Revenues are increases in economic benefits during the accounting period in order to obtain assets, or enhancements of assets, or decreases of liabilities, that result in increases in equity, other than those relating to contributions of the shareholders of the entity.

Expenses are decreases in economic benefits during the accounting period in the form of use or reduction of assets or increase of liabilities that result in decreases in equity, but they are not related to the distributions to shareholders of the entity.

Revenues and expenses are usually associated with the ordinary activities of the entity (eg. Sales, service, personnel expenses, raw material consumption). However, there may be revenues and expenses that do not arise from the ordinary activities of the entity, usually known as gains and losses (eg. Gains from sale of tangible fixed assets and losses resulting from a fire).

b. Discuss any examples of income and expenses that must be highly importance to Corticeira Amorim.

The most significant income of Corticeira Amorim are sales. This income is also referred to as revenue from sales during the normal course of ordinary activities of the entity. Corticeira Amorim sells stoppers, liners, insulation among others.

The most significant expense of Corticeira Amorim is the cost of goods sold and aterials consumed. This item incorporates:

- ✓ The cost of goods sold, in companies with a commercial activity;

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- ✓ The cost of materials consumed, in companies with a industriail activity.

In the case of Corticeira Amorim, this item includes the cost of materials consumed, highlighting the cork acquired the farmers.

c. What is the weight of the cost of goods sold and materials consumed, supplies and services and personnel expenses in total operating expenses of Corticeira Amorim in the year 2011?

The cost of goods sold and materials consumed by Corticeira Amorim in 2011 is 56% of operating expenses this entity. This situation is common in companies that develop a business of an industrial nature.

Supplies and services of Corticeira Amorim in 2011 have a weight of 20% in total operating expenses of this entity. Personnel expenses on the Corticeira Amorim staff in 2011 have a weight of 22% in total operating expenses.

d. Assume, hypothetically, that the operating expenses of Corticeira Amorim include, among others, the following elements. Identify which are included in cost of goods sold and materials consumed, (third part) supply and services and (staff) personnel expenses.

Operating Expenses	Classificação
Render of a warehouse of finished products used by the entity	supply and services
Consumption of various fuels and fuel oil	supply and services
Salaries of employees	personnel expenses
Social security contributions paid by the entity	personnel expenses
Consulting services acquired	supply and services
Electricity consumption in the factory and administrative facilities	supply and services
Consumption of cork (for production of stoppers)	cost of goods sold and materials consumed
Wood consumption for manufacture of parquet	cost of goods sold and materials consumed
Law services	supply and services
Glue consumption (in the case of agglomeration)	cost of goods sold and materials consumed
Performance bonuses to employees processed	personnel expenses
Telecommunications	supply and services

e. What is the value and the meaning of the Corticeira Amorim depreciation for the year 2011?

Depreciation of Corticeira Amorim in 2011 totaled 21.060 thousand euros. These depreciations represent the cost associated with the use of tangible fixed assets Corticeira Amorim during the year 2011. Its value represents just 5% of operating expenses, which indicates that the manufacturing process of Corticeira Amorim is still based on the use of labor.

f. If Corticeira Amorim is only financed by its shareholders, which is net income before taxes that would appear in the year 2011?

If Corticeira Amorim was financed just by shareholders, the net income before taxes would be higher because no financial costs would exist. Thus, instead of 40.162, it would be 45.677, because the 5.515 (financial costs) would not appear.

g. Was the Statement of Results of Corticeira Amorim prepared in accordance with the cash basis or according to the accrual basis? Why?

National and international accounting standards provide that the revenues and expenses are recognized in the income statement when they occur, regardless of when occurs the respective receipt or payment. This procedure is called the accrual basis.

2 Effect of transactions on the elements of the income statement

a. Assume, hypothetically, that in the year 2012 the following events with an economic impact on the Corticeira Amorim (amounts in Euros' 000) occurred. Identify the effect of each of these events in the income statement and / or balance sheet of Corticeira Amorim.

Oper	BALANCE SHEET						INCOME STATEMENT				
	Assets		Shareholders Equity		Liabilities		Revenues		Expenses		Net income
1	Cash deposits Clients	+140.000 +60.000	+200.000				Sales	+200.000			+200.000

Assets	=	Shareholders Equity	+	Liabilities
+200.000	=	*+200.000*	+	*0*

Oper	BALANCE SHEET						INCOME STATEMENT				
	Assets		Shareholders Equity		Liabilities		Revenues		Expenses		Net income
2	Inventories (raw materials) Cash deposits	+120.000 -100.000			Supliers	+20.000					

Assets	=	Shareholders Equity	+	Liabilities
+20.000	=	*0*	+	*+20.000*

Oper	BALANCE SHEET						INCOME STATEMENT				
	Assets		Shareholders Equity		Liabilities		Revenues		Expenses		Net income
3	Inventories (raw materials)	-80.000	-80.000						Cost Good Sold and Consumed materials	+80.000	-80.000

Assets	=	Shareholders Equity	+	Liabilities
-80.000	=	*-80.000*	+	*0*

Oper	BALANCE SHEET						INCOME STATEMENT				
	Assets		Shareholders Equity		Liabilities		Revenues		Expenses		Net income
4	Cash deposits	-40.000	-80.000						Employee expenses	+40.000	-40.000

Assets	=	Shareholders Equity	+	Liabilities
-40.000	=	*-40.000*	+	*0*

Oper	BALANCE SHEET						INCOME STATEMENT				
	Assets		Shareholders Equity		Liabilities		Revenues		Expenses		Net income
5	Cash deposits	-45.000	-50.000		Suppliers	+5.000			External supllies and services	+50.000	-50.000

Assets	=	Shareholders Equity	+	Liabilities
-45.000	=	*-50.000*	+	*+5.000*

Oper	BALANCE SHEET						INCOME STATEMENT				
	Assets		Shareholders Equity		Liabilities		Revenues		Expenses		Net income
6	Fixed tangible assets	-10.000	-80.000						Depreciation expense	+10.000	-10.000

Assets	=	Shareholders Equity	+	Liabilities
-10.000	=	*-10.000*	+	*0*

b. Explain how and to what value this income and these expenses affected the equity of Corticeira Amorim.

Income (revenues) and expenses affect net income, which is an integral part of equity. Therefore, any changes in revenues and expenditures imply changing the value of equity.
Revenues are positive components of net income and, therefore, influence the equity positively. Expenses are negative components of net income and as such influence the equity negatively.
Revenues and expenses totals presented, respectively, 200.000 thousand euros and 180.000 thousand euros. Its effect on equity is 20.000 thousand euros.

Solution

Media Capital: Media Capital: global entertaining

1. Revenues, expenses and operating results

a. **Identify the major operating revenues of Media Capital and discuss any examples of these elements.**

The principal operating revenues of Media Capital are services which include, for example, television advertising, radio advertising and audiovisual production.

b. **Identify the major operating expenses of Media Capital. What is the weight of each in total operating expenses in 2010? Comment.**

The principal operating expenses of Media Capital are:

- Subcontracts and third party supplies (External supplies and services): 106.848 thousand euros (48%)
- Payroll expenses (employee expenses, staff expenses): 67.190 thousand euros (30%)
- Cost of broadcasts and cost of goods sold: 25.334 euros thousand euros (11%)
- Depreciation and amortization: 12.174 thousand euros (5%)

Supplies and services and personnel expenses account for about 80% of the operating expenses of Media Capital. Depreciation has a negligible share in total operating expenses. This situation is characteristic of an entity providing services.

c. **What amount was EBIT (Earnings Before Taxes and interets) of Media Capital, in the year 2010? What does this indicator mean?**

The EBIT of Media Capital in the year 201 is 27.306 thousand euros. EBIT is a term much used in Anglo-Saxon literature and corresponds to the results of an entity before financials and income taxes. EBIT also can be designated as operating net income, or operating results.

2. Financial Results

a. What is the value of the financial results of the Media Capital, in the year 2010?

The financial results of the Media Capital, in 2010, are (5.109) euros, meaning a loss. This amount includes financing costs (net) and results of associated companies.

b. Did the Media Capital generate enough results to meet its financial charges?

Yes. The Media Capital has positive operating results, which will be partly used to meet the financial chareges of this entity.

3 Effect of transactions on the elements of the income statement

Assume, hypothetically, that the Media Capital created in 2011, a new company for production and marketing of audiovisual content. During the first year of activity, the company generated the following revenues and incurred in the following expenses:

	2011
Sales and rendering services	800.000
External supllies and services	(400.000)
Employee expenses	(200.000)
Depreciations and amortizations	(90.000)
EBIT (earnings before interests and taxes =net operating result)	**110.000**
Interests revenues (financial revenues)	0
Interest expenses (financial expenses)	(30.000)
EBT (earnings before taxes)	**80.000**
Income tax expense	(20.000)
Net income	**40.000**

CASE 3.03 Delta Cafés

Delta Cafés: A company with Human Face

1. Record the effect of operating transactions in the accounts

a. Discuss the following statement: the Coffee & Tea Telda must move their accounts of revenues and expenses in the same way that moves their accounts of liabilities and assets, respectively.

The statement is true. When a revenue is recorded, and when a liability is recorded, if the amount is increasing the account is recorded in the credit side. If it is decreasing, should be in the debit side.

When an expense is recorded, as well as accounts from assets, when they are increasing a record must be done in the debit side, and when decreasing it should be in the credit side.

b. Discuss the following statement: whenever we charge an expense account, we have to credit an income account.

The statement is false. When a charge (increase) is done in an expense account, the expense account is credited. But the other account that should be debited usually is from balance sheet, namely, an asset or a liability. It can exist some situation for which we debit an account from expenses and at the same time an account for revenues, but it is not what usually happens, so, the statement is false.

c. Record the effect of each of the transactions Telda Coffee & Tea in the Journal entries.

Nº	Description	Debit	Cedit	Amount
1	Acquisition of coffee	Inventories(raw materials)	Suppliers	3.000
2	Borrow from banks	Cash deposits	Bank Loans	20.000
3	Consumption of coffee	Cost of goods sold and consumed materials	Inventories(raw materials)	3.500
4	Staff cost	Employee expenses		10.000
			Cash deposits	9.500
			State	500

Nº	Description	Debit	Cedit	Amount
5	Acquisiton of packings	Inventories(raw materials)	Cash deposits	500
6	Several expenses	External supplies and services		1.200
			Cash deposits	900
			Suppliers	300
7	Consumption of packings	Cost of goods sold and consumed materials	Matérias-primas	500
8	insurances and maintenance	External supplies and services	Cash deposits	250
9	Depreciations	Depreciation expenses	Fixed tangible assets	15.000
10	Sales of coffee	Cash deposits		27.000
		Clients		18.000
			Sales	45.000
11	Payment of interests on bank loans	Financing expenses	Cash deposits	4.500
12	Income taxes	Income tax	State	2.500

b. Record the effect of each of the transactions Telda Coffee & Tea in the general ledger (T-account), showing the balance of each account.

ACCOUNTS FROM THE BALANCE SHEET

Cash deposits

Si	70.000	4)	9.500
2)	20.000	5)	500
10)	27.000	6)	900
		8)	250
		11)	4.500
Total Db	*117.000*	*Total Cr*	*15.650*
Debit balance = 101.350			

Capital

		Si	350.000
Total Db	*0*	*Total Cr*	*350.000*
Credit balance = 350.000			

Fixed tangible assets

Si	270.000	9)	15.000
Total Db	*270.000*	*Total Cr*	*15.000*
Debit balance = 245.000			

Intangible assets

Si	150.000		
Total Db	*150.000*	*Total Cr*	*0*
Debit balance = 150.000			

Other accounts payables

		Si	120.000
Total Db	*0*	*Total Cr*	*120.000*
Credit balance = 120.000			

Banks loans

		Si	80.000
		2)	20.000
Total Db	*0*	*Total Cr*	*100.000*
Credit balance = 100.000			

Financial Investments

Si	70.000		
Total Db	*70.000*	*Total Cr*	
Debit balance = 70.000			

Suppliers

		1)	3.000
		6)	300
Total Db	*0*	*Total Cr*	*3.300*
Credit balance = 3.300			

Inventories (Raw materials)

1)	3.000	3)	3.000
5)	500	7)	500
Total Db	*3.500*	*Total Cr*	*3.500*
Null balance			

State

		4)	500
		12)	2.500
Total Db	*0*	*Total Cr*	*3.000*
Credit balance = 3.000			

Clients

10)	18.000		
Total Db	*18.000*	*Total Cr*	*0*
Debit balance = 18.000			

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Total Db		*Total Cr*	*0*
Debit balance =			

ACCOUNTS FROM INCOME STATEMENT

Cost of goods sold and consumed materials

3)	3.000		
7)	500		
Total Db	*3.500*	*Total Cr*	*0*
Debit balance = 3.500			

Employees costs

4)	10.000		
Total Db	*10.0000*	*Total Cr*	*0*
Debit balance = 10.000			

External supplies and services

6)	1.200		
8)	250		
Total Db	*1.450*	*Total Cr*	*0*
Debit balance = 1.450			

Depreciation expenses

9)	15.000		
Total Db	*15.000*	*Total Cr*	*0*
Debit balance = 15.000			

Sales

		10)	45.000
Total Db	*0*	*Total Cr*	*45.000*
Credit balance = 45.000			

Financing expenses

11)	4.500		
Total Db	*4.500*	*Total Cr*	*0*
Debit balance = 4.500			

Income tax expense

12)	2.500		
Total Db	*2.500*	*Total Cr*	*0*
Debit balance = 2.500			

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c. Prepare the income statement of Telda Coffee & Tea.

Entity Telda- Coffe & Tea, Sa	**Income Statement of 2011**
Sales and rendering services	45.000
Cost of goods sold and consumed materials	(3.500)
External supplies and services	(1.450)
Emplyees expenses	(10.000)
Others revenues and gains	0
Others expenses and losses	0
Earnings before interests, taxes, depreciations and amortizations (EBITDA)	**30.050**
Depreciation expenses	(15.000)
Earnings before interests and taxes (EBIT; operating results)	**15.050**
Interests revenues	0
Interests expenses	(4.500)
Earnings before taxes	**10.550**
Income tax expense	(2.500)
Net income	**8.050**

d. Draw up the balance of Telda Coffee & Tea.

Euros '000

Entity: Telda- Coffe & Tea, Sa Balance Sheet	Balance after investing and financing activ.
ASSETS	
Non-Current assets	
Fixed Tangible assets	245.000
Intangible assets	150.000
Financial Investments	70.000
Other non-current assets	0
	465.000
Current assets	
Inventories	0
Clients	18.000
Cash and cash deposits	101.350
	119.350
Total assets	***584.350***
SHAREHOLDERS EQUITY AND LIABILITIES	
Shareholders Equity	
Capital (contributed)	350.000
Retained earnings and other changes in SE	0
Net income	8.050
Total SE	***358.050***
Liabilities	
Non-current Liabilities	
Long term loans	80.000
Other accounts payables	120.000
	200.000
Current Liabilities	
Short-term loans	20.000
Suppliers	3.300
State	3.000
Other current liabilities/other accounts payables	0
	26.300
Total Liabilities	***226.300***
Total SE and Liabilities	***584.350***

2. Operating activities and income statement

a. Comment on the performance of Telda Coffee & Tea in 2011.

In 2011, the Telda Coffee & Tea showed a favorable performance, achieving a net profit of 8.050. Such was due to a favorable operating income amounting to 15.050 able to afford the costs of financing and even the income tax.

b. By analyzing the Income Statement which was prepared, one employee of Telda Coffee & Tea said: "The income tax should never have been considered in this income statement because in fact, this value is only paid in 2012." Comment on this statement critically, presenting the arguments for or against the opinion of this employee.

The employee is not correct. This company must apply the accrual basis, under which revenues and expenses are recorded and presented in the income statement in the period of their occurrence, regardless of the moment in which they are received or paid.

Thus, the income tax is applied to the period 2011, and must be recorded in 2011, but will be paid to the State just in 2012.