Instituto Universitário de Lisboa
Lisbon University Institute

Financial Accounting I

2014/2015

GAi

Chapter 4

Solutions

Solutions (*)

Case 4.01 Porcel

Case 4.02 Saccor Brothers

Case 4.03 Jerómimo Martins

(*)These cases were prepared based on the consultation of the sources mentioned in each. They were built exclusively for educational and academic perspective. Some of qualitative and quantitative information and questions presented are purely hypothetical. The names, trademarks and logos are property of each organization to which we appreciate the understanding, cooperation and courtesy.

CASE 4.01 Porcel[1] [2]

Solution

Design, innovation and modernity…

Questions:

1. **Accruals and deferals**

   a. Suppose that you were appointed to record the adjustments that must be done in the closing process of year 2011 of Porcel. Start by doing a revision of the concepts that you must apply. Identify in which of the following situations you need to record a deferred revenue (or deferred expense) and an accrued revenue (or accrued expense)

   Revenue in N and receipt in N+1 → accrued revenue
   Receipt in N and revenue in N+1 → deferred revenue
   Expense in N and payment in N+1 → accrued expense
   Payment in N and expense in N+1 → deferred expense

   b. Identify in which of the following cases must be recognized, in year N, a deferred revenue (or deferred expense) and an accrued revenue (or accrued expense)

   In December N was paid the rent relative to January N+1, for the use of the factory: deferred expense, because the company pays in N but will recognize the expense in N+1

   The expenses with the consumption of electricity in december will be paid in January N+1: accrued expense, because the company recognize the expense in N but will pay in N+1

   The annual interest from a bank deposit will be received in march N+1: accrued revenue, because the company recognizes the revenue in N but will receive in N+1

   In December N was advance received the rent of January N+1 due to a store leased to a customer: deferred revenue, because the company receives in N but will recognize the revenue in N+1

   c. Adjustments at the end of the period

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[2] Case prepared by Isabel Lourenço and Ana Maria Simões Adaptation to GAi: Ana Isabel Lopes

a. **Comment the following statement: "The closing adjustments are intended principally to correct errors or omissions committed by the accounting officer of the company."**

The statement is incorrect. The year's closing adjustments are intended to ensure that revenue and expenses are recognized in the financial statements for the period to which such revenue and expenses relate. That is, the adjustments ensure that revenue and expenses are included in the respective period, regardless of receipts and payments associated with them (accrual basis).

b. **Record, in journal entry, the effect of each one of the following events in 2011:**

Nº	Description	Debit	Credit	Amount
1	Payment of ensure	Deferals	Cash deposits	1.500
2	Payment of rents	External supll. and serv		1.000
		Deferals		2.000
			Cash deposits	3.000
3	Consuption of electricity	FSE	Other acc. payables	4.000
4	Interests on bank loans	Interest expenses	Other acc. payables	2.917
5	Receipt of a rent	Cash deposits	Deferals	1.000
6	Interests on bank deposits	Other acc. receivables	Interests revenues	150
7	Depreciation of machine	Depreciation expenses	Fixed Tangible assets	18.000

3. Depreciations

a. Comment on the following statement: "the depreciation of tangible fixed assets has impact only in the balance sheet, more specifically, in total assets."

The statement is incorrect. Depreciation of tangible fixed assets has implications for the value of the asset (balance sheet) because they reduce the value of tangible fixed assets but also imply increased expenses (income statement) and therefore the decrease in the profit of period (which in turn is reflected in the decrease of equity).

In short, the depreciation of tangible fixed assets has an impact on the income statement (increased expenses) and balance (decrease in assets and a decrease of the shareholders' equity).

b. Comment on the following statement: "the expenses with depreciations affect the income statement and the statement of cash flows".

The statement is incorrect. Depreciation expenditures affect the income statement, increasing the costs of the period and therefore reduce net income for the period. Also affect the balance sheet, reducing the asset value and the shareholders' equity value (through profit or loss). However, depreciation charges do not affect the statement of cash flows, because they represent no payments or receipts.

c. Suppose that, after consulting information about fixed tangible assets of Porcel in 2011, you have identified the following information about a "furnace":

Nº	Description	Debit	Credit	Amount
1	Depreciation	Depreciation expense	FTA	100.000

Depreciation for 2011 = (1.200.000 – 200.000) / 10 years = 100.000

The assets must be presented in assets, on the balance sheet at the end of the year for 800.000 (= 1.200.000 – 4 x 100.000)

d. Assume that Porcel also has a warehouse recognized in assets for 2.000.000 euros. Which of the following statements related to the depreciation of this warehouse are false:

When depreciation is recognized, the asset value decreases.

Depreciate the warehouse means reducing the amount owed to the entity that sold the warehouse to the company. → False. The amount owed to the entity will reduce just when the company pays and not when recognize a depreciation.

The warehouse depreciation of the value depends only on its estimated useful life. → False. The depreciation depends on its estimated useful life but also depends on the residual value

Recognition of depreciation implies a decrease in equity.

CASE 4.02 Saccor Brothers[3]

Solution

Saccor Brothers

1. **Adjustments to be done at the end of the year**

a. Comment on the following statement: "an enterprise should recognize an accrued expense to defer or delay the recognition of an expense for the following year."

The statement is incorrect. Increases of expense aims accrue an expense in the current period. When you want to delay, or defer, an expense for the following period, a deferral of expense should be recognized.

b. Assume that, when preparing the process of closing the accounting period in 2011, it was identified the need for a set of adjustments for which it is requested journaling:

N.	Description	Debit	Credit	Amount
1	Depreciations of fixed tangible assets	Depreciation expense	Fixed tangible assets	900*
2	Expenses with comunications	External suppl. And services	Other accounts payables	10
3	Payment of insurance	Deferals	Cash deposits	3
4	Interests on bank loans	Interests expenses	Other accounts payables	3
5	Estimate for income taxes	Income tax expense	State	400

* Depreciation = (Carrying amount in the balance sheet – residual life) / nuber of year until the end of useful life = (11.000 – 2.000) : 10 years = 900 u.m.

[3] Case prepared by Isabel Lourenço and Ana Maria Simões. Adaptation to GAi: Ana Isabel Lopes

2. Trial Balance

a. What is the adjusted trial balance?

The adjusted trial balance is a document that includes, in addition to the balances of the accounts resulting from registration of transactions recorded during the accounting period, the adjustments made in the accounting closing process by:

- Accruals and deferrals
- Depreciation/amortization
- Income tax

b. Prepare the trial balance adjusted at the end of 2011.

Account	Balances (unadjusted)		Adjustments		Adjusted balances	
	Debit balance	Credit balance	Debit	Credit	Debit balance	Credit balance
Cash	20				20	
Cash deposits	2.592			3	2.589	
Clients	50				50	
Other accounts receivable	10				10	
Deferals			3		3	
Merchandises	2.017				2.017	
Fixed tangible assets	11.000			900	10.100	
Intangible assets	8.000				8.000	
Suppliers		300				300
State		10		400		410
Bank Loans		200				200
Other accounts payables		20		13		33
Capital		20.000				20.000
Reserves		15				15
Retained earnings		80				80
Sales		15.000				15.000
Other revenues		30				30
Interest revenues and equivalents		40				40
Cost of goods sold and consumed materials (CGSCM)	6.000				6.000	
External Supplies and services	1.500		10		1.510	
Employee expenses	4.500				4.500	
Depreciation expenses			900		900	
Interest expenses and equivalents	6		3		9	
Income tax expense			400		400	
Total	**35.695**	**35.695**	**1.316**	**1.316**	**36.108**	**36.108**

3. Preparation of financial statements

a. Comment on the following information: "the journal entry, the general ledger and the balance sheet are financial statements of secondary importance."

The statement is incorrect. The journal entry and the general ledger are not financial statements, but important tools to the accounting process. And the balance sheet is a financial statement but not of secondary importance.

b. Present the income statement for the year 2011.

	Income statment at 31 dec. 2011
Sales and rendered services	15.000
Cost of goods sold and consumed materials	(6.000)
External suppliers and services	(1.510)
Staff expenses	(4.500)
Other revenues and gains	30
Earnings before interests, taxes, depreciations and amortizations	**3.020**
Depreciation and amortization expenses/reversals	(900)
Operating result (earnings before interests and taxes)	**2.120**
Interests revenues and equivalents	40
Interests expenses and equivalents	(9)
Earnings before taxes	**2.151**
Income tax expense	(400)
Net income for the period	**1.751**

c. Present the balance sheet at the end of 2011.

	Balance sheet at 31 dec. 2011
ASSETS	
Non current assets	
Fixed tangible assets	10.100
Intangible assets	8.000
	18.100
Current assets	
Inventories	2.017
Clients	50
Cash and cash deposits	2.609
Other current assets (deferals and OCRec.)	13
	4.689
Total assets	***22.789***
SHAREHOLDERS EQUITY AND LIABILITIES	
Shareholders Equity	
Capital (contributed)	20.000
Reetained earnings and reserves	95
Net income	1.751
Total shareholders equity	***21.846***
Liabilities	
Non-current liabilities	
Bank Loans	100
	100
Current liabilities	
Bank loans	100
Suppliers	300
State	410
Other current liabilities/Other accounts payable	33
Total liabilities	***943***
Total shareholders equity and liabilities	***22.789***

CASE 4.03 Jerónimo Martins[4]

Solution:

1. Adjustments at the year end

a. Record, in journal entries, all the adjustments that were not yet recorded at the end of 2013.

N.	Description	Debit	Credit	Amount
1.	Insurance premium	Ext. suppl. services		100
		Deferals		200
			Cash	300
2.	Interests on bank loan	Interest expenses	Other accounts payables	10
3.	Holiday subsidies	Staff Costs	Other accounts payables	2.000
4 a)	Acquisition of a trade mark	Intangible assets		3.000
			Cash	1.000
			Other accounts payables	2.000
4 b)	Amortization of the trade mark	Amortization expense	Intangible assets	225 (*)
5.	Rent to be paid	Ext. suppl. services	Deferals	200
6.	Payment of interests on bank loans	Interests expense		11
		Other accounts payables		1
			Cash	12
7 a)	Aquisition of new equipment	Fixed tangible assets	Cash	5.000
7 b)	Depreciation of the equipment	Depreciation expense	Fixed tangible assets	100 (**)
8.	Estimate for income tax expense	Income tax expense	State	153

(*) Amortization of intangible assets for 2013 : (3.000 u.m. /10 years) x (9/12) mounths = 225 u.m

(**) Depreciation fixed tangible assets for 2013: (5.000 u.m. – 1.000 u.m)/10 years x (3/12) mounths = 100 u.m.

[4] Case prepared by Francisco Cambim and Isabel Lourenço. Adaptation for GAi: Ana Isabel Lopes

b. Prepare the adjusted trial balance of the supermarket chain "Well and Good"

Account	Balances (unadjusted)		Adjustments		Adjusted balances	
	Debit balance	Credit balance	Debit	Debit balance	Credit balance	Debit
Cash	8.080			6.312	1.768	
Cash deposits	2.368				2.368	
Clients	200				200	
Deferals	200		200	200	200	
Other accounts receivable	40				40	
Merchandises	8.068				8.068	
Fixed tangible assets	45.000		5.000	100	49.900	
Intangible assets	32.000		3.000	225	34.775	
Suppliers		11.400				11.400
State		40		153		193
Bank Loans		800				800
Other accounts payables		80	1	4.010		4.089
Capital		80.000				80.000
Reserves		60				60
Retained earnings		320				320
Sales		50.000				50.000
Other revenues		120				120
Interest revenues and equivalents		160				160
Cost of goods sold and consumed materials (CGSCM)	21.000				21.000	
External Supplies and services	7.000		300		7.300	
Employee expenses	8.000		2.000		10.000	
Depreciation Expenses	8.000		100		8.100	
Amortization Expenses	3.000		225		3.225	
Interest expenses and equivalents	24		21		45	
Income tax expense	0		153		153	
Total	**142.980**	**142.980**	**11.000**	**11.000**	**147.142**	**147.142**

2. **Financial Statements**

   a. **Present the Income Statement for the year 2013 of the supermarket chain "Well and Good".**

u.m.

	Income statment at 31 dec. 2014
Sales and rendered services	50.000
Cost of goods sold and consumed materials	(21.000)
External suppliers and services	(7.300)
Staff expenses	(10.000)
Other revenues and gains	120
Earnings before interests, taxes, depreciations and amortizations	**11.820**
Depreciation and amortization expenses/reversals	(11.325)
Operating result (earnings before interests and taxes)	**495**
Interests revenues and equivalents	160
Interests expenses and equivalents	(45)
Earnings before taxes	**610**
Income tax expense	(153)
Net income for the period	**457**

b. **Present the Balance sheet of the supermarket chain "Well and Good" at the end of 2013**.

u.m.

	Balance sheet at 31 dec. 2014
ASSETS	
Non current assets	
Fixed tangible assets	49.900
Intangible assets	34.775
	84.675
Current assets	
Inventories	8.068
Clients	200
Other accounts receivables	40
Deferals	200
Cash and cash deposits	4.136
	12.644
Total assets	***97.319***
SHAREHOLDERS EQUITY AND LIABILITIES	
Shareholders Equity	
Capital (contributed)	80.000
Reserves	60
Retained earnings	320
Net income	457
Total shareholders equity	***80.837***
Liabilities	
Non-current liabilities	
Bank Loans	100
Other accounts payable	1.000
Current liabilities	
Bank loans	700
Suppliers	11.400
State	193
Other current liabilities/Other accounts payable	3.089
Total liabilities	***16.482***
Total shareholders' equity and liabilities	***97.319***