

Theoretical Classes nº 3 and 4

Chapter 2

Investing and Financing Decisions and the Balance Sheet

In the end of this chapter you should...

- ✓ Understand the relation between the Balance Sheet and the business (page 79 - 80);
- ✓ Define the objective of financial statements and characterize the elements that belong to Balance Sheet (page 81 - 85);
- ✓ Identify what is a business transaction and recognize the main parts of the Balance Sheet (page 86 - 87);

In the end of this chapter you should...

- ✓ Apply the transactions analysis process to a set of transactions through the basic equation of accounting (page 88 - 92);
- ✓ Identify the effect of transactions in two fundamental analytical tools: the journal entry and the T-account (page 93 - 101).

Introdução

4

To understand the information presented on
Balance Sheet it is necessary to know:

Which are the business activities cause changes to Balance Sheet

How each activity affects components of the Balance Sheet

How does firms record those effects on the Balance Sheet



Introdução

5

Effects of activities in the Balance Sheet

Financing activities

Investing activities

Operational activities

Chapter 2



Chapter 3



Introduction

6

Effects of activities in the Balance Sheet

Entity: Jerónimo Martins	2006	2010	Var.
Balance sheet			
ASSETS			
Fixed Tangible Assets	1.317.146	2.191.824	66%
Intangible Assets	446.385	863.368	93%
Proprietary Investments	34.876	52.047	49%
Financial Investments	37.903	8.274	-78%
Inventories	255.941	368.711	44%
Costumers	181.848	150.360	-17%
Cash and Bank deposits	175.764	303.927	72%
Other assets	154.959	220.511	42%
Total assets	2.604.721	4.159.022	60%
SHAREHOLDERS EQUITY AND LIABILITIES			
Shareholders Equity			
Contributed capital	651.745	651.745	0%
Retained earnings and other reserves	(35.372)	180.295	
Net income	150.908	299.772	99%
Total SE	767.281	1.131.812	48%
Liabilities			
Finance/Loans from Banks and others	653.306	853.399	31%
Suppliers	1.041.840	1.895.411	82%
Other liabilities	142.294	278.400	96%
Total liabilities	1.837.440	3.027.210	65%
Total SE and Liabilities	2.604.721	4.159.022	60%



Framework for Financial Statements

Objective

Qualitative Characteristics

Elements

Theory



Objective of Financial Statements



Provide information about:

i) the **financial position**

Balance sheet

ii) the **performance**

Income Statement and Statement of changes SE

iii) The **changes in financial position**

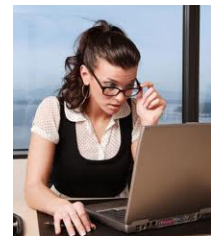
Statement of cash flows

of an entity that is **useful** to a wide range of users in **making economic decisions.**

Qualitative characteristics of Financial Statements

Comparability: Users must be able to compare the financial statements of an entity through time in order to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different entities.

Understandability: users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.



Qualitative characteristics of Financial Statements

Relevance: Information has the quality of relevance when it influences the economic decisions of users.

Reliability: information is it is free from material errors

1 + 1 = 2 ??



Framework

11

Elements of financial statements

Assets

Liabilities

Shareholders equity

Revenues

Expenses

Balance
Sheet

SCSE

IS

SCF

Notes




Balance Sheet

12

Elements of Balance Sheet

Concept



Asset: is a **resource controlled** by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

Liability: is a **present obligation** of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.


Shareholders' Equity: is the **residual interest** in the assets of the entity after deducting all its liabilities. (financing provided by investors/owners and by the business)

Balance Sheet

13

Elements of Balance Sheet

**Recognition
criterion**



Recognition of elements in the Balance Sheet: is the process of incorporating in the balance sheet an item that meets the definition of an element and satisfies the criteria for recognition process.

Recognition process:

- ✓ it is probable that **any future economic benefit** associated with the item will flow to or from the entity; and
- ✓ the item has **a cost or value that can be measured** with reliability.

Balance Sheet

14

Basic/fundamental equation of accounting

Assets

=

Liabilities

+

**Shareholders
equity**

Economic
resources

Funding sources of economic
resources

Balance Sheet

15

Elements of Balance Sheet

Formats for presentation

•Assets

Current

Non-current

•Liabilities

Current

Non-current



Seems like a nice and naughty list

Balance Sheet

16

Elements of Balance Sheet

Formats for presentation

Current Assets:

- ✓ Expected to be performed, or intended to be sold or consumed during the normal operating cycle of the entity;
- ✓ Is held primarily for the purpose of being traded;
- ✓ It is expected to be realized within twelve months after the balance sheet date, or
- ✓ It's cash or cash equivalent.



Non-current assets: those assets that can not be classified as current.



Balance Sheet

17

Elements of Balance Sheet

Formats for presentation

Current liabilities:

- ✓ Expected to be settled during the normal operating cycle of the entity;
- ✓ Is held primarily for the purpose of being traded;
- ✓ Must be settled within twelve months after the balance sheet date, or
- ✓ The entity has an unconditional right to defer settlement of the liability for at least twelve months after the balance sheet date.



Non-current liabilities: those liabilities that can not be classified as current



Balance Sheet

18

Current and Non-current assets



Entity: Jerónimo Martins		2010
Balance Sheet		
ASSETS		
Non-current assets		
Fixed tangible assets		2.191.824
Investment properties		52.047
Intangible assets		863.368
Financial investments		8.274
ther non-current assets		139.076
		<u>3.254.589</u>
Current assets		
Inventories		368.711
Costumers		150.360
Cash and bank deposits		303.927
Other assets		220.511
		<u>903.433</u>
		<u> </u>
Total assets		<u>4.159.022</u>

Balance Sheet

Current and Non-current liabilities



Entity: Jerónimo Martins		2010
Balance Sheet		
SHAREHOLDERS EQUITY AND LIABILITIES		
Shareholders Equity		
Contributed capital		651.745
Retained earnings and other reserves		180.295
Net income		299.772
	Total SE	1.131.812
Liabilities		
Non-current Liabilities		
Finance/Loans from Banks and others		634.182
Other non-current liabilities		168.258
		802.440
Current Liabilities		
Finance/Loans from Banks and others		219.217
Suppliers		1.895.411
Other current liabilities		110.142
		2.224.770
	Total liabilities	3.027.210
	Total SE and liabilities	4.159.022

Balance Sheet

20

Fixed Tangible Assets



Tangible items held for:

- ✓ Use in the **production or supply of goods or services**, for **rental to third parties** (other properties) or for **administrative purposes**, and
- ✓ Expected to be used during more than one accounting period.



Balanço

21

Properties investment

Land and / or buildings held for:

- ✓ Earn rentals and / or
- ✓ Capital appreciation.



Balanço

22

Intangible assets

PATENTES



Assets:

- ✓ Non-monetary, and
- ✓ **Without physical substance** (immaterial).



Balance Sheet

23

Inventories



Assets that are:

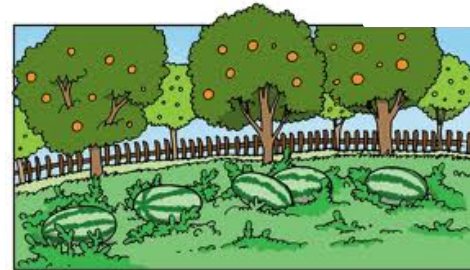
- ✓ Held for sale in the ordinary course of business (eg, **goods and finished goods**);
- ✓ In the process of production for sale (eg **ongoing product/under construction**), or
- ✓ Materials to be used in the production process or the provision of services (eg **raw materials**)



Balance Sheet

24

Biological assets



They are animals and / or plants alive:

- ✓ Related to **agricultural activity**.
- ✓ Agricultural activity is the management of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.



Balance Sheet

25

Elements of Balance Sheet



Model include in *Portaria 986/2009*,
published in *Diário da República* a
7/Setembro/2009



There is no pre-defined model
(Minimum Content - IAS 1).

RUBRICAS	NOTAS	DATAS	
		31 DEZ N	31 DEZ N-1
ACTIVO			
Activo não corrente			
Activos fixos tangíveis			
Propriedades de investimento			
Trespasse (goodwill)			
Activos intangíveis			
Activos biológicos			
Participações financeiras - método da equivalência patrimonial			
Participações financeiras - outros métodos			
Acionistas, sócios			
Outros activos financeiros			
Activos por impostos diferidos			
Activos não correntes detidos para venda			
Activo corrente			
Inventários			
Activos biológicos			
Clientes			
Adiantamentos a fornecedores			
Estado e outros entes públicos			
Acionistas, sócios			
Outras contas a receber			
Diferimentos			
Activos financeiros detidos para negociação			
Outros activos financeiros			
Caixa e depósitos bancários			
Total do activo			
Capital próprio			
Capital realizado			
Ações (quotas) próprias			
Prestações suplementares e outros instrumentos de capital próprio			
Prémios de emissão			
Reservas legais			
Outras reservas			
Excedentes de revalorização			
Ajustamentos em activos financeiros			
Outras variações no capital próprio			
Resultados transitados			
Resultado líquido do período			
Interesses minoritários			
Total do capital próprio			
Passivo			
Passivo não corrente			
Provisões			
Financiamentos obtidos			
Responsabilidades por benefícios pós-emprego			
Passivos por impostos diferidos			
Outras contas a pagar			
Passivo corrente			
Fornecedores			
Adiantamentos de clientes			
Estado e outros entes públicos			
Acionistas, sócios			
Financiamentos obtidos			
Outras contas a pagar			
Passivos financeiros detidos para negociação			
Outros passivos financeiros			
Diferimentos			
Total do passivo			
Total do capital próprio e do passivo			

Formato do Balanço pelo SNC

Changes in FS

26

Events impacting the economic entity



TRANSACTIONS

External

Events that **involve exchanges** of assets or services by an entity in return for assets, services or promises of payment by another entity. Example: purchase of industrial equipment.



Internal

Events that do **not involve exchanges** between the organization and the outside but which nevertheless have a direct and measurable effect on the entity.



Changes in FS

27

Effect of transactions in the financial statements

Accounts

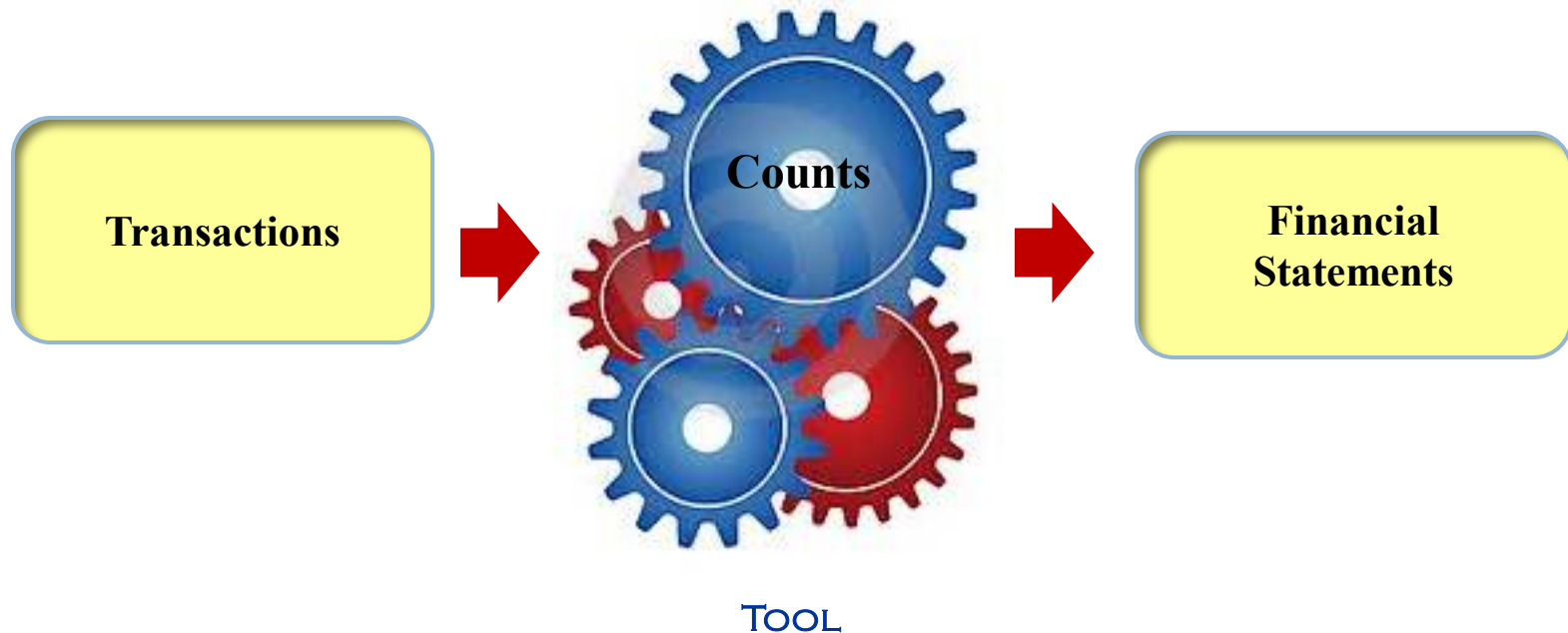
Organized way to accumulate the effect
monetary transaction in each of the
financial statement items



Changes in FS

28

Effect of transactions in the financial statements



Changes in FS

29

List of Accounts



ASSETS
LIABILITIES
S.EQUITY
REVENUES
EXPENSES
INCOME

SNC



List included in *Portaria 1011/2009*, published in
Diário da República a 9/Setembro/2009

IASB

IAS - IFRS

List prepared by firms according to the nature of
their business

Important note:

Understand the nature of
each account

versus

memorize a list

Changes in FS

30

List of Accounts*

Assets	Liabilities	Shareholders equity	Revenues	Expenses
Cash Bank deposits Other deposits Other financial instruments Customers/Clients/Accounts receivables from... Other receivables Deferrals Goods Raw materials Finished products (or goods) Work in progress Financial investments Investment properties Tangible fixed assets intangible assets Investments in progress biological assets	Suppliers Employees State Borrowings Other payables Deferrals Provisions	Capital (contributed) Reserves Retained earnings Other changes in the SE	Sales Services rendered Production variation Works for the entity Operating subsidies Reversals Interest and similar Financial Income other revenues	Cost of Sales (cost of goods sold and consumed materials) External Supplies and services (third part supplies and services) Employees expenses Depreciation expense Impairment losses Provision losses Financing Expenses Other expenses
			Net income	

* Adapted from SNC

Analysis of transactions

31

Analysis of transactions:

analysis process to determine the effect of a transaction
in terms of the fundamental accounting equation.

Assets

=

Liabilities

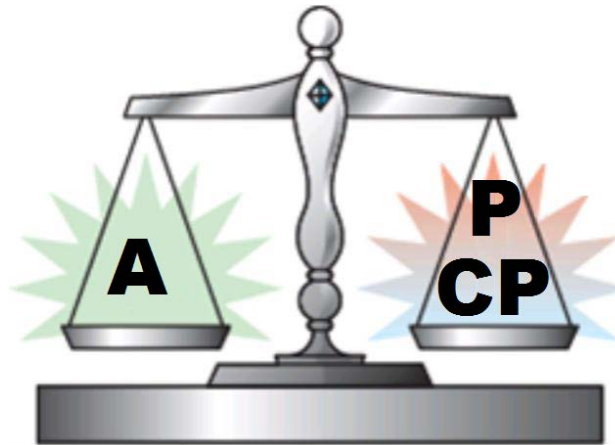
+

**Shareholders
equity**

Analysis of transactions

32

Principles of transaction analysis



Each **transaction** affects at least **two accounts**.

➔ **double entry
system**

The **fundamental equation of accounting** remain after registration of **every transaction**.

Analysis of transactions

33

Process analysis of transactions



Identify the accounts affected and ensure that at least two accounts will be changed.

Classify the accounts according to their nature (Asset, liability or equity).

Determining the **direction of the effect** (increase or decrease).

Confirm that the **fundamental equation of accounting** keeps unchanged.

Analysis of transactions

34

Exemples of transactions



1. Constitution of the company with a capital of 100,000 shares at 6 euros each

2. Obtaining a bank loan of 500,000 euros

3. Purchase of industrial equipment for cash for 750,000 euros

4. Purchase a patent for cash for 150,000 euros

Analysis of transactions

35

Exemples of transactions

Balance Sheet	(1)	(2)	(3)	(4)
ASSETS				
Fixed Tangible Assets			+ 750.000	
Intangible Assets				+ 150.000
Proprietary Investments				
Financial Investments				
Inventories				
Costumers				
Cash and Bank deposits	+ 600.000	+ 500.000	- 750.000	- 150.000
Other assets				
SHAREHOLDERS EQUITY AND LIABILITIES				
Shareholders Equity				
Contributed capital	+ 600.000			
Retained earnings and other reserves				
Net income				
Liabilities				
Finance/Loans from Banks and others		+ 500.000		
Suppliers				
Other liabilities				

Assets

=

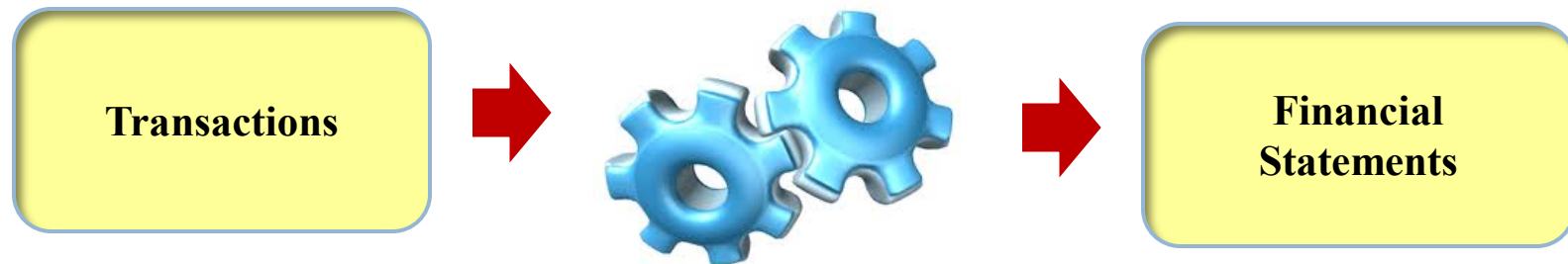
SE

+

Liabilities

Recording the effect of the transaction

36



RECORD THE EFFECT OF EACH
TRANSACTION IN THE
ACCOUNTS



Journal entry

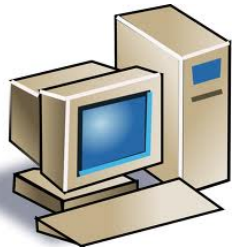
T-accounts

Recording the effect of the transaction

37

T-Accounts

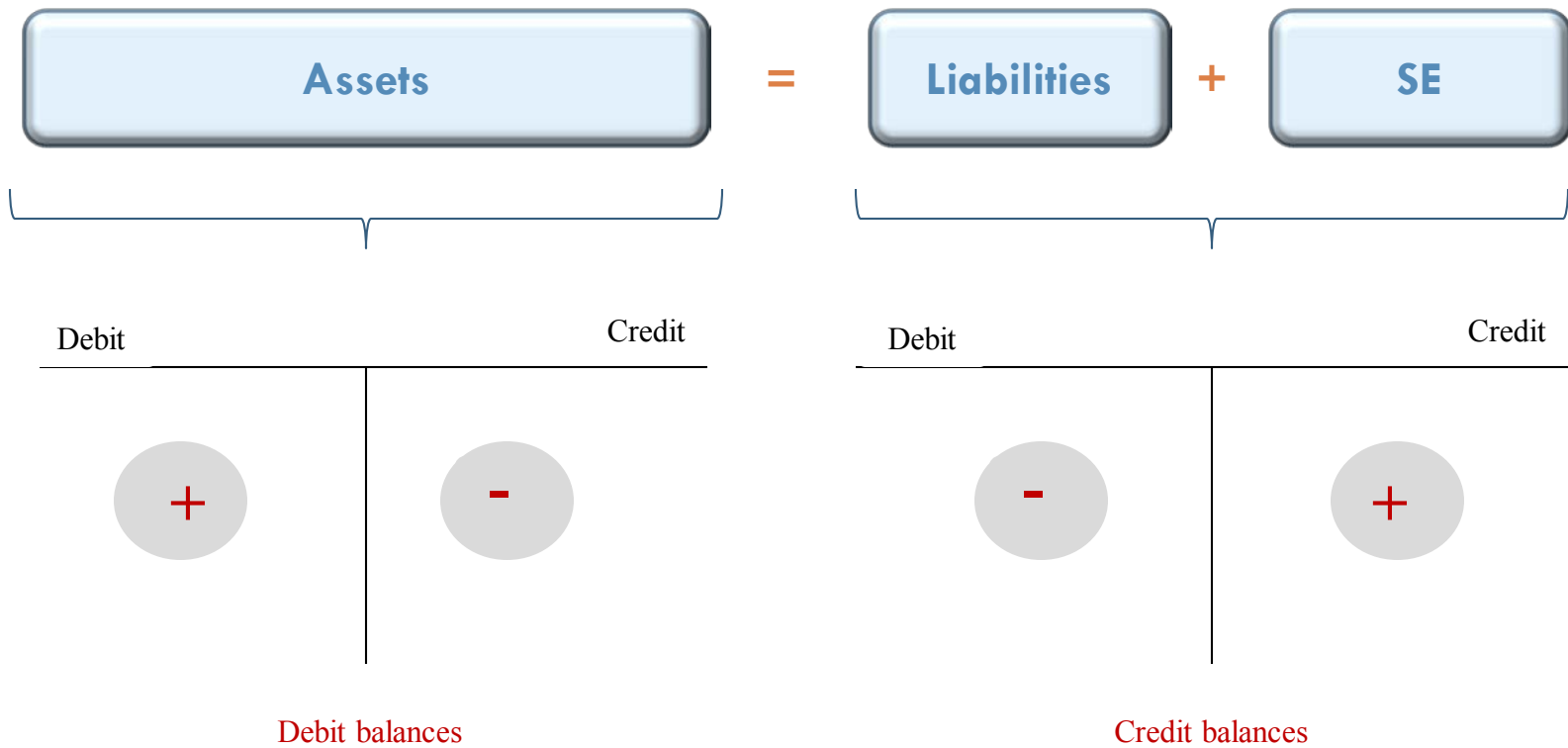
Book that includes all accounts, each represented by a T



Débit	Account X	Credit

Recording the effect of the transaction

38





Recording the effect of the transaction

Assets	=	Liabilities	+	Shareholders Equity
Is debited by ↑		Is credited by ↑		Is credited by ↑
Is credited by ↓		Is debited by ↓		Is debited by ↓
The accounts have debit balance		The accounts have credit balance		The accounts have credit balance

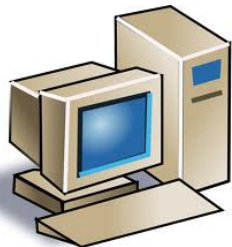


Recording the effect of the transaction

40

Journal entry

Book where it proceeds to the effect of chronological record every transaction in each of the accounts.



Date	Description	Debit	Credit	Amount

Recording the effect of the transaction

41

1. Constitution of the company with a capital of 100,000 shares at 6 euros each

Date	Description	Debit	Credit	Amount
	Initial capital	Cash	Capital	600.000

Debit	Cash	Credit	Debit	Capital	Credit
(1) 600.000				600.000 (1)	

Recording the effect of the transaction

42

2. Obtaining a bank loan of 500,000 euros

Date	Description	Debit	Credit	Amount
	Bank Loan	Cash	Loans	500.000

Debit	Cash	Credit
(1) 600.000		
(2) 500.000		

Debit	Loans	Credit
		500.000 (2)

Recording the effect of the transaction

43

3. Purchase of industrial equipment for cash for 750,000 euros

Date	Description	Debit	Credit	Amount
	Purchase of industrial equipment	Tangible F.Assets	Cash	750.000

Debit	Cash	Credit	Debit	TFA	Credit
(1) 600.000			(3) 750.000		
(2) 500.000					
	750.000 (3)				

Recording the effect of the transaction

44

4. Purchase a patent for cash for 150,000 euros

Date	Description	Debit	Credit	Amount
	Purchase of patent	Intangible assets	Cash	150.000

Debit	Caixa	Credit
(1) 600.000	750.000 (3)	
(2) 500.000	150.000 (4)	

Debit	IA	Credit
(4) 150.000		

Recording the effect of the transaction

45

Assets		=	Liabilities		+	SE	
TFA	750.000		Loans	500.000		Capital	600.000
IA	150.000						
Cash	200.000						
1.100.000			1.100.000				

End of Chapter 2