Accounting I

10TH CLASS
INVESTMENT ACTIVITIES
DEPRECIATIONS AND AMORTIZATIONS
FINANCIAL INVESTMENTS
FINANCIAL INSTRUMENTS

DEPRECIATIONS AND AMORTIZATIONS

Depreciation/Amortization of an asset – tangible or intangible – is the recognition of its depreciation due to the use of the asset

DEPRECIATIONS AND AMORTIZATIONS

The depreciation value can be calculated as a function of:

- The estimated time of it useful life; or
- The activity/usage planned for the asset (measured in total units that it is planned that the asset produces during all of its useful life – kms, hours of usage or other any variable).

DEPRECIATIONS AND AMORTIZATIONS

Useful Life

- **of an asset is the shorter of the physical life of the asset (before it wears out) or the economic life of the asset (before it becomes obsolete).**

DEPRECIATIONS AND AMORTIZATIONS

Useful Life
- Finite → To be depreciated/ amortized
- Undefined → Not to be depreciated/ amortized

DEPRECIATIONS AND AMORTIZATIONS

Depreciable value

- It is the amount of the acquisition cost to be depreciated or allocated over the total useful life of the asset

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Residual value

- is the amount a company expects to receive from sale or disposal of a long-lived asset at the end of its useful life.

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Book value

- Value that appears in the balance sheet

Acquistion cost – accumulated depreciation/amortization – accumulated impairments

DEPRECIATIONS AND AMORTIZATIONS

- **Straight-line depreciation**
  - Spreads the depreciable value evenly over the useful life of an asset
  - Is by far the most popular method for financial reporting purposes
- **Depreciation Based on Units**
  - When physical wear and tear determines the useful life of the asset, depreciation may be based on units of service or units of production instead of units of time (years)

DEPRECIATIONS AND AMORTIZATIONS

Straight Line Method

- The A depreciation/amortization is calculated as follows:

$$Q_t = \frac{V_o - R}{n} = \frac{A}{n}$$

V_o – Acquistion value
R – Residual value
A – Value to depreciate/amortize: $A = V_o$-R
Q_t – Depreciation/Amortization at period t
n – Number of years of useful life

Depreciation and Cash Flow

- Depreciation
  - Does not generate cash
  - Allocates the original cost of an asset to the periods of use
  - Is a deductible noncash expense for income tax purposes
- Higher tax depreciation results in lower taxable income and lower taxes, keeping more cash in the business

Expenditures After Acquisition

- Repairs and maintenance are treated as expenses of the current period
  - **Repairs** include the costs of breakdowns, accidents, or damage
  - **Maintenance** includes the routine costs of oiling, polishing, painting, and adjusting
- Improvements are capitalized as assets
  - **Improvements** are expenditures that increase the future benefits provided by a fixed asset

Gains and Losses on Sales of Tangible Assets

- When a tangible asset is sold, a gain or loss occurs when there is a difference between the cash received and the net book value of the asset
  - Cash received > book value = gain
  - Cash received < book value = loss
- The disposal requires the removal of the asset's book value, which appears to two accounts:
  - Equipment
  - Accumulated Depreciation

Impairment of Tangible Assets

- An asset is considered to be **impaired** when it ceases to have economic value as large as the book value
- Impairment of assets held for use:
  - Step 1: Recoverability test—if undiscounted expected cash flow < book value, impairment exists
  - Step 2: Impairment loss = book value – fair value
- The entry to record the impairment loss is:

Loss on impairment	xxx	
Accumulated impairments		xxx

Financial Investments

Includes all financial assets that are not measured at the fair value and are not part of Class 1.

- Measurement criteria: cost or amortized cost method;
- Parts in other companies should be measured by the equity method (patrimonial equivalence method) if participation is equal or above 20%
- Joint venture can be measured by the equity method or proportional consolidation

Financial Investments

It is divided into:

- *Investments in branches*
- *investments in associates*
- *investments in joint ventures*
- *investments in other firms*
- *other financial investments*
- *accumulated impairments*

Financial Investments

Rules – Equity Method

– Acquisition cost	DEBIT(+)
– % of Calculated Net Income	DEBIT(+)
– % of Other variations in OE	DEBIT(+)
– % of losses coverage	DEBIT(+)
– % of calculated loss	CREDIT (-)
– % of negative variations in OE	CREDIT (-)
– % of distributed profits	CREDIT (-)