

43.2 An exercise on the accounting disclosure of future events and transactions

REQUIRED: describe at least two ways in which the following events or situations could or should be accounted for in Year 1 and Year 2, and state which way you would choose if you were responsible for preparing the firm's final accounts.

YEAR 1: a firm decides to upgrade its manufacturing capacity, and places an order for a new fixed asset costing £30 000.

YEAR 2: the fixed asset is delivered at a cost of £30 000 as expected, and paid for.

Are there any further facts, not stated above, that might be relevant to your decision?

Response

Option 1 would be ignore the events of Year 1 altogether in the accounts (easy to do because no payment has been made), and simply record the acquisition of the fixed asset in Year 2.

Option 2 would be to record the order in Year 1 as a promise to pay going out, with the right to receive a fixed asset coming in. In Year 2 the right to receive the fixed asset would be replaced in the accounts by the fixed asset itself.

The problem for accountants is that once an order has been placed, the firm will probably have a binding liability to pay for it, which the owners of the firm would wish to know about. On the other hand, until the fixed asset is received, its value (and the value of the firm's liability to pay for it) remains in some degree of doubt. Further information relevant to the decision might therefore include the exact terms of the order placed with the supplier.

A frequent compromise in such situations is to record nothing in the accounts in Year 1, but disclose information about the order in a note to the accounts.