SOLUTIONS TO END OF CHAPTER QUESTIONS CHAPTER 2

RECALL AND REVIEW

Questions 2.1

Assets. An asset is 'a present economic resource controlled by the entity as a result of past events'. 'An economic resource is a right that has the potential to produce economic benefits'. The main points in this definition are as follows:

- Control: A resource is controlled by an entity when it can legally prevent others from benefiting from that resource.
- Past events: To gain control of a resource, it is likely that a contract has been signed transferring or granting the right to use that resource to the current owner.
- Economic benefits: The resource will be used within an entity to generate profit and cash.

Liabilities. A liability is 'a present obligation of the entity to transfer an economic resource as a result of past events'. The main points in this definition are as follows:

- Present obligation: The obligation must exist at the statement of financial position date.
- Past events: To give rise to an obligation, it is likely that a contract has been signed agreeing to pay for goods or services provided but not yet paid for or to take out a loan that will have to be repaid in the future.
- Economic resource: The obligation will result in the entity transferring cash to another party to settle the liability.

Equity. Equity is the 'residual interest in the assets of the entity after deducting all its liabilities'. The main point in this definition is that equity is the difference between the monetary value of the assets and the monetary value of the liabilities as stated in the accounting equation: assets – liabilities = equity.

Questions 2.2

£200,000 (cash introduced) + £100,000 (building introduced) – £5,000 (drawings) + £15,000 (profit to 30 April 2021) = £310,000 equity at 30 April 2021

DEVELOP YOUR UNDERSTANDING

Question 2.3

Resources that are assets

Apply the five criteria to show why the resources in the question are assets of entities and so are recognised on the statement of financial position.

(a) Motor vehicles purchased by an entity

- Is there a present economic resource? Yes, the motor vehicles are a present economic resource.
- Does the entity control the economic resource? Yes, by virtue of purchasing the motor vehicles and registering them in the company's name at the DVLA.
- Is there a past event giving rise to control of that economic resource by the entity? Yes, the purchase of the vehicles.
- Does the economic resource have the potential to produce economic benefits? Yes, the motor vehicles can be used to deliver goods to customers, be used by sales reps to visit customers to generate more sales or for any other business purpose that will result in increasing profits, cash and the production of economic benefits.
- Can the asset be measured and faithfully represented in monetary terms? Yes, the cost of the motor vehicles can be readily determined from the purchase documents and the cash paid from the bank.

(b) Inventory received from suppliers

- Is there a present economic resource? Yes, the inventory received from suppliers is a present economic resource.
- Does the entity control the economic resource? Yes, by virtue of the contract signed or verbal agreement with suppliers for the supply of goods to the entity.
- Is there a past event giving rise to control of that economic resource by the entity? Yes, the delivery of the inventory by suppliers and the receipt of that inventory by the entity (legally, title to the goods passes on receipt by the customer).
- Does the economic resource have the potential to produce economic benefits? Yes, the inventory can be used in production to produce more goods for sale or, in the case of retail businesses, the inventory can be sold at a higher price to customers and so produce economic benefits in the form of cash flow and profit.
- Can the asset be measured and faithfully represented in monetary terms? Yes, the cost of the inventory can be readily determined from the invoices from the suppliers and by the cash paid from the bank to suppliers for the goods delivered.

(c) Cash and cash equivalents

- Is there a present economic resource? Yes, cash is a present economic resource.

- Does the entity control the economic resource? Yes, the entity controls the cash through the presence of the cash on company premises or as a result of the cash being deposited into the entity's bank account.
- Is there a past event giving rise to control of that economic resource by the entity? Yes, the receipt of cash in exchange for goods or services sold and deposited in the bank.
- Does the economic resource have the potential to produce economic benefits? Yes, the cash can be used to purchase more goods for use in production or for resale or to repay liabilities upon which interest is being charged thereby saving interest and increasing cash resources in the future still further.
- Can the asset be measured and faithfully represented in monetary terms? Yes, cash can be measured in terms of the amount of physical cash on the business's premises or by reference to the bank statements if the cash has been paid into the bank.

Resources that are NOT assets

Applying the five criteria to show why the resources in the question are NOT assets of an entity and why they are no longer/not recognised on the statement of financial position of entities.

(a) Redundant plant and machinery

- Is there a present economic resource? No. The plant and machinery is redundant, is no longer used in the business or the industry and has no resale or scrap value.
- Does the entity control the economic resource? Yes, by virtue of purchasing the plant and machinery in the past and using it in the business in prior financial periods to produce goods for sale.
- Is there a past event giving rise to control of that economic resource by the entity? Yes, the purchase of the plant and machinery in the past.
- Does the economic resource have the potential to produce economic benefits? No, the plant and machinery is now redundant and will not produce any more goods or result in a cash receipt when it is sold or scrapped, so there are no more potential economic benefits that can be produced by this piece of plant and machinery. If there are disposal costs for this plant and machinery, you might even be able to make out a case that a liability now exists in relation to this plant and machinery. There would then be a transfer of an economic resource in order to meet the obligation to pay these disposal costs which are unavoidable.
- Can the asset be measured and faithfully represented in monetary terms? Yes, the cost of the plant and machinery can be readily determined from the purchase documents and the cash paid from the bank.

Result: while the resource meets three of the five criteria, it fails on the first and fourth criteria (no present economic resource exists and there is no potential to produce economic benefits) and so the asset, which would have been previously recognised by the entity on its statement of financial position, is now derecognised and is removed from property, plant and equipment.

(b) Trade receivable that will not be recovered

- Is there a present economic resource? No. The trade receivable will not be recovered so no economic resource now exists.
- Does the entity control the economic resource? Yes, by virtue of delivering goods/providing services to the customer and the customer taking delivery of those goods/services and assuming the obligation to pay for them.
- Is there a past event giving rise to control of that economic resource by the entity? Yes, the delivery of the goods/services to the customer.
- Does the economic resource have the potential to produce economic benefits? No, the customer will not pay the invoice because of its bankruptcy, so there is no longer any potential for this trade receivable to produce economic benefits for the entity.
- Can the asset be measured and faithfully represented in monetary terms? Yes, the sales invoice from the entity to the customer can be used to measure the value of the trade receivable reliably.

Result: while the resource meets three of the five criteria, it fails on the first and fourth criteria (no economic resource and no potential to produce economic benefits) and so the asset, which would have been previously recognised by the entity on its statement of financial position, is now derecognised and is removed from trade receivables.

(c) A highly skilled workforce

- Is there a present economic resource? Yes, the highly skilled workforce is an economic resource that gives their employer a competitive advantage in its industrial sector.
- Does the entity control the economic resource? Yes, to the extent that the entity controls the workforce while they are working for the organisation, but the entity is powerless to stop individual workers leaving and joining another company, taking all their skills and knowledge with them.
- Is there a past event giving rise to control of that economic resource by the entity? Yes, each member of the workforce signed their contract.
- Does the economic resource have the potential to produce economic benefits? Yes, the highly skilled workforce will produce goods/services and hence sales, profits and cash for the company into the future.
- Can the asset be measured and faithfully represented in monetary terms? No: it is not possible to measure or faithfully represent the monetary value of employees to the business due to the subjective nature of such valuations and the wide range of possible outcomes of such a valuation process.

Result: while the resource meets three of the five criteria, it fails on the other two criteria (lack of control and no measurement that would faithfully represent the asset in monetary terms) and so the asset, which would never have been previously recognised by the entity on its statement of financial position, still cannot be recognised.

» Question 2.4

Oxford Academicals Football Club Limited

This is a further application of the criteria to determine whether entities can recognise assets on their statement of financial position or not. Looking at the five criteria:

- The players are a present economic resource which enables the club to function.
- The football club controls the economic resources, the players, through the contracts that they signed.
- As the club holds the players' registrations and has contracts with the players that they will play exclusively for Oxford Academicals, other football clubs can legally be prevented from employing the club's players in their teams.
- There is a past event, the signing of the contracts by the players and, in the case of those players whose contracts were bought from other clubs, cash paid.
- All the players have the potential to produce economic benefits for the club as spectators will pay to watch the team play, there will be monetary rewards for end of season league position and trophies won and, when the players become surplus to requirements, lose form or fall out with the manager, their contracts can be sold to other clubs for a transfer fee or used in player for player swaps.
- In the case of the players whose contracts have been bought from other clubs, there is a monetary measurement of their cost which can be faithfully represented, the transfer fees of £25 million. In the case of players developed by the club, there is no monetary measure of their cost or value which can result in a faithful representation of this figure in the statement of financial position. This is due to the subjective nature of this assessment, the wide range of possible values and the very high level of measurement uncertainty connected with this valuation exercise.

Result: the contracts of the bought in players meet all the criteria for asset recognition, so they can be recognised on the statement of financial position at a cost of £25 million. The internally developed players cannot be recognised as assets on the statement of financial position as they only meet four out of the five criteria. This may seem unfair and even illogical, but this is how the accounting rules work.

The player registrations that can be recognised on the statement of financial position will be classed as intangible non-current assets. The players will normally be signed on contracts that exceed 12 months (once a player has one year or less to run on their contract, then these registrations should become intangible current assets as the assets will be used up within one year).

As accounting information is meant to be relevant in order to help make a difference in the decisions made by users, it is quite likely that there will be a note in the accounts explaining that not all player registrations are recognised on the statement of financial position but that the current value of the players not so recognised is estimated by the directors to be so many £million. In this way, an additional disclosure will help users understand all the player resources controlled by Oxford Academicals Football Club.

Question 2.5

Alma Limited: statement of financial position at 30 April 2021

ASSETS	£000	Note
Non-current assets		
Intangible assets	—	1
Property, plant and equipment	6,500	2
	6,500	
Current assets		
Inventories	1,000	
Trade receivables	1,750	
Cash and cash equivalents	10	
	2,760	
Total assets	9,260	3
LIABILITIES		
Current liabilities		
Short-term borrowings	1,000	4
Trade payables	1,450	
Taxation payable	540	
	2,990	
Non-current liabilities		
Long-term borrowings	1,000	5
Total liabilities	3,990	6
Net assets	5,270	7
EQUITY		
Called up share capital	1,000	
Share premium	1,500	
Retained earnings	2,770	
Total equity	5,270	8

Notes

1. There are no intangible assets in Alma so the total here is zero.
2. (Plant and machinery) £2,000 + (land and buildings) £4,500 = £6,500.
3. Total assets = non-current assets + current assets, so £6,500 + £2,760 = £9,260.
4. (Bank loan due within 12 months) £200 + (bank overdraft: overdrafts are repayable on demand, so due within the next 12 months) £800 = £1,000.
5. Long-term borrowings: the bank loan due seven years after the statement of financial position date on 30 April 2028.
6. Total liabilities = current liabilities + non-current liabilities, so £2,990 + £1,000 = £3,990.
7. Net assets: total assets – total liabilities = £9,260 – £3,990 = £5,270.
8. Total equity: share capital + share premium + retained earnings = £1,000 + £1,500 + £2,770 = £5,270.

Bella Limited: statement of financial position at 30 April 2021

ASSETS	£000	Note
Non-current assets		
Intangible assets	—	1
Property, plant and equipment	28,100	2
	28,100	
Current assets		
Inventories	700	
Trade receivables	3,000	
Cash and cash equivalents	825	3
	4,525	
Total assets	32,625	4
LIABILITIES		
Current liabilities		
Short-term borrowings	400	5
Trade payables	4,000	
Taxation payable	1,100	
	5,500	
Non-current liabilities		
Long-term borrowings	10,000	6
Total liabilities	15,500	7
Net assets	17,125	8
EQUITY		
Called up share capital	5,000	
Share premium	7,500	
Retained earnings	4,625	
Total equity	17,125	9

Notes

1. There are no intangible assets in Bella Limited so the total here is zero.
2. (Plant and machinery) £9,500 + (land and buildings) £17,100 + (motor vehicles) £1,500 = £28,100.
3. (Cash at bank) £800 + (cash in hand) £25 = £825.
4. Total assets = non-current assets + current assets, so £28,100 + £4,525 = £32,625.
5. Bank loan due within 12 months of the statement of financial position date.
6. Long-term borrowings: the bank loan due seven years after the statement of financial position date on 30 April 2028.
7. Total liabilities = current liabilities + non-current liabilities, so £5,500 + £10,000 = £15,500.
8. Net assets: total assets – total liabilities = £32,625 – £15,500 = £17,125.
9. Total equity: share capital + share premium + retained earnings = £5,000 + £7,500 + £4,625 = £17,125.

Carla Limited: statement of financial position at 30 April 2021

ASSETS	£000	Note
Non-current assets		
Intangible assets	600	1
Property, plant and equipment	15,900	2
	16,500	
Current assets		
Inventories	800	
Trade receivables	2,750	
Cash and cash equivalents	15	
	3,565	
Total assets	20,065	3
LIABILITIES		
Current liabilities		
Short-term borrowings	1,550	4
Trade payables	1,750	
Taxation payable	800	
	4,100	
Non-current liabilities		
Long-term borrowings	1,500	5
Total liabilities	5,600	6
Net assets	14,465	7
EQUITY		
Called up share capital	2,500	
Share premium	4,500	
Retained earnings	7,465	
Total equity	14,465	8

Notes

1. (Goodwill) £400 + (trademarks) £200 = £600.
2. (Plant and machinery) £3,750 + (land and buildings) £10,200 + (motor vehicles) £1,950 = £15,900.
3. Total assets = non-current assets + current assets, so £16,500 + £3,565 = £20,065.
4. (Bank loan due within 12 months) £300 + (bank overdraft: overdrafts are repayable on demand, so due within the next twelve months) £1,250 = £1,550.
5. Long-term borrowings: the bank loan due seven years after the statement of financial position date on 30 April 2028.
6. Total liabilities = current liabilities + non-current liabilities, so £4,100 + £1,500 = £5,600.
7. Net assets: total assets – total liabilities = £20,065 – £5,600 = £14,465.
8. Total equity: share capital + share premium + retained earnings = £2,500 + £4,500 + £7,465 = £14,465.

Deborah Limited: statement of financial position at 30 April 2021

ASSETS	£000	Note
Non-current assets		
Intangible assets	350	1
Property, plant and equipment	14,250	2
	14,600	
Current assets		
Inventories	750	
Trade and other receivables	3,200	3
Cash and cash equivalents	558	4
	4,508	
Total assets	19,108	5
LIABILITIES		
Current liabilities		
Short-term borrowings	—	6
Trade payables	5,600	
Taxation payable	—	7
	5,600	
Non-current liabilities		
Long-term borrowings	—	6
Total liabilities	5,600	8
Net assets	13,508	9
EQUITY		
Called up share capital	3,000	
Share premium	5,000	
Retained earnings	5,508	
Total equity	13,508	10

Notes

1. (Goodwill) £250 + (trademarks) £100 = £350.
2. (Plant and machinery) £4,250 + (land and buildings) £8,750 + (motor vehicles) £1,250 = £14,250.
3. (Trade receivables) £2,950 + (tax repayable: cash will be coming into the business so this is a receivable, hence the title of this total is now trade *and other* receivables) £250 = £3,200.
4. (Cash at bank) £550 + (cash in hand) £8 = £558.
5. Total assets = non-current assets + current assets, so £14,600 + £4,508 = £19,108.
6. There are no short or long-term borrowings in Deborah, so a zero figure is recorded against these headings.
7. Taxation payable: this year there is a tax repayment due so this is recorded as a receivable rather than a payable, so there is zero taxation payable.
8. Total liabilities = current liabilities + non-current liabilities, so £5,600 + £nil = £5,600.
9. Net assets: total assets – total liabilities = £19,108 – £5,600 = £13,508.
10. Total equity: share capital + share premium + retained earnings = £3,000 + £5,000 + £5,508 = £13,508.

Eloise Limited: statement of financial position at 30 April 2021

ASSETS	**£000**	**Note**
Non-current assets		
Intangible assets	950	1
Property, plant and equipment	21,600	2
	22,550	
Current assets		
Inventories	900	
Trade and other receivables	3,900	3
Cash and cash equivalents	212	4
	5,012	
Total assets	27,562	5
LIABILITIES		
Current liabilities		
Short-term borrowings	—	6
Trade payables	5,800	
Taxation payable	—	7
	5,800	
Non-current liabilities		
Long-term borrowings	—	6
Total liabilities	5,800	8
Net assets	21,762	9
EQUITY		
Called up share capital	4,500	
Share premium	9,000	
Retained earnings	8,262	
Total equity	21,762	10

Notes

1. (Goodwill) £500 + (trademarks) £450 = £950.
2. (Plant and machinery) £5,000 + (land and buildings) £15,000 + (motor vehicles) £1,600 = £21,600.
3. (Trade receivables) £3,100 + (tax repayable: cash will be coming into the business so this is a receivable, hence the title of this total is now trade *and other* receivables) £800 = £3,900.
4. (Cash at bank) £200 + (cash in hand) £12 = £212.
5. Total assets = non-current assets + current assets, so £22,550 + £5,012 = £27,562.
6. There are no short or long-term borrowings in Eloise Limited, so a zero figure is recorded against these headings.
7. Taxation payable: this year there is a tax repayment due, so this is recorded as a receivable rather than a payable so there is zero taxation payable.
8. Total liabilities = current liabilities + non-current liabilities, so £5,800 + £nil = £5,800.
9. Net assets: total assets – total liabilities = £27,562 – £5,800 = £21,762.
10. Total equity: share capital + share premium + retained earnings = £4,500 + £9,000 + £8,262 = £21,762.

Question 2.6

Maria: statement of financial position at 31 October 2021 and 7 November 2021

	Statement of Financial Position at 31 October 2021 £	Increase £	Decrease £	Statement of Financial Position at 7 November 2021 £
Non-current assets				
Property, plant and equipment	15,000			15,000
Current assets				
Inventory	20,000	2,500[4]	1,200[3]	21,300
Other receivables	3,000			3,000
Cash and cash equivalents	500	2,000[3]	300[5]	2,200
	23,500			26,500
Total assets	38,500			41,500
Current liabilities				
Bank overdraft	7,000	3,500[1]	10,000[2]	500
Trade and other payables	8,000	2,500[4]	3,500[1]	7,000
Taxation	3,000			3,000
Total liabilities	18,000			10,500
Net assets	20,500			31,000
Capital account				
Balance at 31 October 2021 /7 November 2021	20,500	10,000[2]	300[5]	31,000
		800[3]		

Notes

1. Paying trade payables from the bank account will increase the overdraft by £3,500. Money has been paid out of the bank account thereby increasing the amount owed to the bank while reducing the amounts owed to trade payables by the same amount.
2. £10,000 paid into the bank account by Maria will increase the balance in her capital account by £10,000 (this is the owner's own money introduced into the business) and reduce the bank overdraft by £10,000. Less money is owed to the bank but more money is now owed to Maria.
3. Cash goes up by £2,000 as this is money flowing into the business. As inventory has been sold in the first week of November, the inventory will decrease by £1,200. This leaves a difference of £800 which is profit on the sales made (sales made – the cost of making those sales). Profit is added to the capital account. Any profit retained in the business during the year is added to the capital account as this profit belongs to and is owed to the business's owner.
4. New inventory purchased by the business means that the value of inventory will increase by £2,500. As the inventory was purchased on credit from suppliers (trade payables), trade payables will also increase by £2,500 as more money is now owed to them.
5. The £300 taken out of the business represents a repayment of money owed by the business to the owner. Therefore, the capital account is reduced by £300: the business owes Maria £300 less than it did before this transaction. The £300 was taken out in cash, so cash reduces by £300.

Question 2.7

(a) Non-current: this asset has the potential to produce economic benefits in accounting periods exceeding one year.

(b) Current: this asset is held in inventory and should be converted into either a trade receivable or cash when it is sold within the next 12 months.

(c) Current: this asset (trade receivable) will be converted into cash in 90 days (and so within the next 12 months) when what is owed is paid by the customer.

(d) Non-current: this asset has the potential to produce economic benefits in accounting periods exceeding one year.

(e) Non-current: this asset has the potential to produce economic benefits in accounting periods exceeding one year.

(f) Current: this inventory of wood will be converted into finished goods inventory and then either into cash or trade receivables within the next 12 months.

TAKE IT FURTHER

Question 2.8

Andy Limited: statement of financial position at 30 June 2021 and 7 July 2021

ASSETS	Statement of financial position at 30 June 2021 £	Increase £	Decrease £	Statement of financial position at 7 July 2021 £
Non-current assets				
Property, plant and equipment	320,000	20,000[2]		340,000
Current assets				
			2,500[4]	
Inventories	50,000	15,000[5]	7,500[3]	55,000
Trade receivables	75,000	10,000[3]	3,000[1]	82,000
		3,000[1]	2,500[1]	
Cash and cash equivalents	20,000	3,250[4]	10,000[6]	13,750
	145,000			150,750
Total assets	465,000			490,750
LIABILITIES				
Current liabilities				
			7,000[6]	
Trade payables	80,000	15,000[5]	2,500[1]	85,500
Taxation	20,000		3,000[6]	17,000
	100,000			102,500

	Statement of financial position at 30 June 2021 £	Increase £	Decrease £	Statement of financial position at 7 July 2021 £
Non-current liabilities				
Bank loan (long-term borrowings)	250,000	20,000[2]		270,000
Total liabilities	350,000			372,500
Net assets	115,000			118,250
EQUITY				
Called up share capital	20,000			20,000
		2,500[3]		
Retained earnings	95,000	750[4]		98,250
Total equity	115,000			118,250

Notes

- 1 July 2021: the payment of the trade payable reduces both trade payables and cash and cash equivalents by £2,500.
- 1 July 2021: the receipt of a cheque from a trade receivable reduces trade receivables by £3,000, but increases the cash and cash equivalents balance by the same amount.
- 2 July 2021: both the bank loan and the property, plant and equipment will increase by £20,000. There are £20,000 more assets and £20,000 more liabilities.
- 4 July 2021: inventory of £7,500 has been sold, so inventory decreases by this amount. The buyer has agreed to buy the goods for £10,000 and pay in August, so trade receivables increase by £10,000. The profit on the transaction of £2,500 (£10,000 – £7,500) will increase retained earnings.
- 5 July 2021: similarly, inventory of £2,500 has been sold, so inventory decreases by this amount. The buyer paid cash of £3,250 for the goods and so cash increases by £3,250. The profit on the transaction of £750 (£3,250 – £2,500) increases retained earnings.
- 6 July 2021: both inventory and trade payables increase by £15,000 as there are more goods in stock and there is a bigger liability due to trade payables for goods supplied.
- 7 July 2021: taxation payable reduces by £3,000 and trade payables decreases by £7,000 as these two amounts have now been paid and are no longer obligations of Andy Limited. The total payment of £10,000 reduces the balance in the bank account by this amount.

››› Question 2.9

(a) Frankie Limited: statement of financial position at 31 December 2021

ASSETS	£000	Note
Non-current assets		
Intangible assets	1,000	1
Property, plant and equipment	27,800	2
	28,800	
Current assets		
Inventories	2,500	
Trade receivables	4,910	
Cash and cash equivalents	605	3
	8,015	
Total assets	36,815	4

LIABILITIES	£000	Note
Current liabilities		
Short-term borrowings	850	5
Trade payables	6,720	
Taxation payable	1,380	6
	8,950	
Non-current liabilities		
Long-term borrowings	8,500	7
Total liabilities	17,450	8
Net assets	19,365	9
EQUITY		
Share capital	2,000	
Share premium	4,000	
Retained earnings	13,365	
Total equity	19,365	10

Notes

1. Goodwill is an intangible asset, so £1,000,000 is recorded as a non-current asset under this heading.
2. (Land and buildings) £15,500,000 + (fixtures and fittings) £1,670,000 + (plant and machinery) £10,630,000 = £27,800,000.
3. (Cash at bank) £600,000 + (cash in hand) £5,000 = £605,000.
4. Total assets = non-current assets + current assets, so £28,800,000 + £8,015,000 = £36,815,000.
5. Short-term, current borrowings are the borrowings due for repayment within one year of the statement of financial position date, i.e. due for repayment by 31 December 2022, so these borrowings are recorded as current liabilities.
6. Taxation payable is a short-term, current liability.
7. Long-term, non-current borrowings are those due for repayment after more than one year from the statement of financial position date. As 31 December 2030 is nine years after the current statement of financial position date, the £8,500,000 is classified as a non-current liability.
8. Total liabilities = current liabilities + non-current liabilities, so £8,950,000 + £8,500,000 = £17,450,000.
9. Net assets: total assets – total liabilities = £36,815,000 – £17,450,000 = £19,365,000.
10. Total equity: share capital + share premium + retained earnings = £2,000,000 + £4,000,000 + £13,365,000 = £19,365,000.

(b) Frankie Limited: statement of financial position at 31 December 2021 and 31 January 2022

ASSETS	Statement of Financial Position at 31 December 2021 £000	Increase £000	Decrease £000	Statement of Financial Position at 31 January 2022 £000
Non-current assets				
Intangible assets	1,000			1,000
Property, plant and equipment	27,800	2,500[3]	2,000[8]	28,300
	28,800			29,300
Current assets				
Inventory	2,500	12,200[1]	11,450[2]	3,250
Trade receivables	4,910	15,500[2]	6,450[6]	13,960
		1,500[4]	690[5]	
		6,450[6]	8,210[7]	
Cash and cash equivalents	605	2,500[8]	200[9]	1,955
	8,015			19,165
Total assets	36,815			48,465

LIABILITIES	Statement of Financial Position at 31 December 2021 £000	Increase £000	Decrease £000	Statement of Financial Position at 31 January 2022 £000
Current liabilities				
Short-term borrowings	850		200[9]	650
Trade payables	6,720	12,200[1]	8,210[7]	10,710
Taxation payable	1,380		690[5]	690
	8,950			12,050
Non-current liabilities				
Long-term borrowings	8,500	2,500[3]		11,000
Total liabilities	17,450			23,050
Net assets	19,365			25,415
EQUITY				
Share capital	2,000	500[4]		2,500
Share premium	4,000	1,000[4]		5,000
		4,050[2]		
Retained earnings	13,365	500[8]		17,915
Total equity	19,365			25,415

Notes

1. Inventory has been acquired, so the value of inventory increases by £12,200,000. As the inventory has not yet been paid for, trade payables (= suppliers) will also increase by £12,200,000 as they are now owed this additional amount for the inventory supplied on credit.
2. Sales have been made on credit to trade receivables (= customers), so trade receivables now owe a further £15,500,000 to Frankie Limited and so increase by this amount. The cost of the goods sold by the company was £11,450,000. As this inventory has now been sold, inventory decreases by £11,450,000 to derecognise the asset that is no longer represented on Frankie Limited's statement of financial position. The difference between the selling price of £15,500,000 and the cost of the inventory sold of £11,450,000 is £4,050,000, which represents the profit on the sales transactions. This profit is added to retained earnings.
3. New plant and machinery has been acquired, so property, plant and equipment increases by £2,500,000. The money used to acquire these new non-current assets has been borrowed, so borrowings must also rise by the same amount. The new borrowings are due for repayment in December 2026, which is more than one year after the end of January 2022, so these new borrowings are added to non-current liabilities.
4. Cash has been raised from the share issue, so cash increases by £1,500,000, the total proceeds of the share issue. As £500,000 of the cash raised relates to the share capital, this balance also increases by £500,000. The remaining £1,000,000 of the cash raised relates to share premium, so this balance increases by this amount.
5. Cash has been paid to the tax authorities, so cash must decrease by £690,000. Now that this liability has been discharged, taxation payable also falls by £690,000 as the obligation has been settled and economic benefits in the form of cash have flowed out of the company to settle the obligation.
6. Trade receivables have paid £6,450,000 of the amounts owed to Frankie, so trade receivables now decrease by this amount to reflect the realisation of this asset through the receipt of cash. Cash will also increase by the same amount as these amounts owed by the trade receivables have now turned into cash.
7. Frankie has discharged obligations owed to trade payables of £8,210,000, so trade payables fall by this amount as the liability has now been paid. As the amounts owed were paid in cash, cash also falls by the same amount to reflect the transfer of economic benefits to settle the obligations to trade payables.
8. The sale of the non-current asset results in the derecognition of the land as the resource is no longer owned or controlled by Frankie. As a result of the sale of the land, property, plant and equipment fall by the original historic cost of the land of £2,000,000. Cash has now been received of £2,500,000, so cash increases by this amount. The difference between the original cost of the land of £2,000,000 and the selling price of £2,500,000 represents a profit on the sale so this £500,000 profit on the transaction is reflected as an increase in retained earnings.
9. The transfer of cash to settle the obligation to short-term borrowings results in a decrease in short-term borrowings of £200,000 to reflect the settlement of the obligation. As the amounts owed were paid in cash, cash also falls by the same amount to reflect the transfer of economic benefits to settle the obligations to short-term borrowings.

Question 2.10

Martina: statement of financial position at 31 March 2021

	Increase	Decrease	Statement of financial position at 31 March 2021
	£	£	£
Non-current assets			
Shop fittings	1,000[3]		1,000
Current assets			
Inventory	4,300[2]	3,000[4]	300
		1,000[6]	
Trade receivables	4,500[4]	2,250[7]	2,250
Cash	10,000[1]	4,300[5]	8,450
	1,500[6]	1,000[8]	
	2,250[7]		
			11,000
Total assets			12,000
Current liabilities			
Trade payables	4,300[2]	4,300[5]	—
	1,000[3]	1,000[8]	
Total liabilities			—
Net assets (total assets – total liabilities)			12,000
Capital account			
Capital introduced	10,000[1]		10,000
Retained earnings		1,500[4]	2,000
		500[6]	
Total equity			12,000

Notes:

1. 1 March 2021: Cash paid into the business bank account by the owner increases the cash account by £10,000 and increases the capital account by the same amount.
2. 4 March 2021: Inventory purchased by the business will increase the value of inventory by £4,300. As the inventory was purchased on credit from Alex, trade and other payables will also increase by the same amount.
3. 5 March 2021: Shop fittings purchased by the business will increase the value of shop fittings, a non-current asset, by £1,000. As the asset was purchased on credit, trade and other payables will also increase by the same amount.
4. 10 March 2021: Inventory of £3,000 has been sold, so inventory decreases by this amount. The buyer will pay at a later date, so trade receivables increase by £4,500. The profit on the transaction of £1,500 (£4,500 selling price – £3,000 cost of inventory sold) will increase retained earnings.
5. 17 March 2021: The payment of the trade payable reduces both trade payables and cash by £4,300.
6. 21 March 2021: Inventory of £1,000 has been sold, so inventory decreases by this amount. The buyer has paid in cash, so cash increases by £1,500. The profit on the transaction of £500 (£1,500 selling price – £1,000 cost of inventory sold) will increase retained earnings.
7. 26 March 2021: The amount received from the customer reduces trade receivables by £2,250 (£4,500 ÷ 2) and increases cash by the same amount.
8. 30 March 2021: The payment of the trade payable reduces both trade payables and cash by £1,000.