

# BRIEF CONTENTS

*Preface* xi

*About the authors* xiii

*Key features* xv

Chapter 1: An introduction to accounting	1
Chapter 2: The recording process	77
Chapter 3: Accrual accounting concepts	133
Chapter 4: Inventories	190
Chapter 5: Reporting and analysing inventory	234
Chapter 6: Accounting information systems	283
Chapter 7: Reporting and analysing cash and receivables	352
Chapter 8: Reporting and analysing non-current assets	413
Chapter 9: Reporting and analysing liabilities	465
Chapter 10: Reporting and analysing equity	512
Chapter 11: Statement of cash flows	559
Chapter 12: Financial statement analysis and decision making	626
Chapter 13: Analysing and integrating GAAP	684

*Appendix: Time value of money* 736

*Index* 751

COPYRIGHTED MATERIAL

# CONTENTS

Preface xi  
About the authors xiii  
Key features xv

## CHAPTER 1

### An introduction to accounting 1

Chapter preview 2

- 1.1 Introduction to accounting 2
  - The business world 2
- 1.2 Accounting: the language of business 4
  - The accounting process 5
  - The diverse roles of accountants 5
- 1.3 Forms of business organisation 7
  - Sole proprietorship 7
  - Partnership 8
  - Company 8
  - Other forms of business organisation 9
  - Not-for-profit organisations 9
- 1.4 Introduction to the *Conceptual Framework* 10
  - The objective of general purpose financial reporting 11
  - The reporting entity 11
- 1.5 Users and uses of financial information 12
  - Internal users 13
  - External users 14
  - Financing activities 14
  - Investing activities 14
  - Operating activities 14
  - Sustainability reporting 15
- 1.6 Financial statements 16
  - Statement of profit or loss 18
  - Statement of changes in equity 19
  - Statement of financial position 19
  - Statement of cash flows 20
  - Interrelationships between the statements 21
- 1.7 The financial reporting environment 31
  - Australian Securities and Investments Commission 32
  - Financial Reporting Council 33
  - Australian Accounting Standards Board 33
  - Australian Securities Exchange 33
  - Regulation in New Zealand 34
  - Professional accounting bodies 34
- 1.8 Assumptions, concepts, principles and qualitative characteristics 35
  - Assumptions, concepts and principles 35
  - Qualitative characteristics 37
- 1.9 Analysing financial statements 39
  - Analysis and decision making 40

- Profitability 41
- Liquidity 44
- Solvency 48
- Summary 55
- Key terms 56
- Demonstration problem 58
- Self-study questions 59
- Questions 61
- Brief exercises 61
- Exercises 62
- Problem set A 65
- Problem set B 69
- Building business skills 73
- Reference 76
- Acknowledgements 76

## CHAPTER 2

### The recording process 77

Chapter preview 78

- 2.1 Accounting transactions and events 78
  - Analysing transactions 79
  - Summary of accounting transactions 83
- 2.2 The account 84
- 2.3 Debits and credits 85
  - Debit and credit procedures 86
  - Equity relationships 88
  - Expansion of the basic accounting equation 89
- 2.4 Steps in the recording process 90
- 2.5 The journal 92
  - Chart of accounts 93
- 2.6 The general ledger 94
- 2.7 Posting 95
  - The recording process illustrated 96
  - Summary illustration of journalising and posting 106
- 2.8 The trial balance 109
  - Limitations of a trial balance 110
  - Summary 113
  - Key terms 113
  - Demonstration problem 113
  - Self-study questions 116
  - Questions 116
  - Brief exercises 117
  - Exercises 118
  - Problem set A 121
  - Problem set B 125
  - Building business skills 130
  - References 132
  - Acknowledgements 132

## CHAPTER 3

### Accrual accounting concepts 133

Chapter preview 134

- 3.1 Timing issues 134
  - Accrual versus cash basis of accounting 134
- 3.2 Revenue recognition criteria 136
  - Accounting standard for revenue recognition 137
  - Expense recognition criteria 138
- 3.3 The basics of adjusting entries 140
  - Types of adjusting entries 141
- 3.4 Adjusting entries for prepayments 141
  - Prepaid expenses 142
  - Revenues received in advance 145
  - Adjusting entries for accruals 147
  - Summary of basic relationships 152
- 3.5 The adjusted trial balance and financial statements 155
  - Preparing the adjusted trial balance 155
  - Preparing financial statements 156
- 3.6 Closing the books 157
  - Preparing closing entries 158
  - Preparing a post-closing trial balance 159
- 3.7 Summary of the accounting cycle 159
- 3.8 Adjusting entries — using a worksheet 161
  - Summary 165
  - Key terms 165
  - Demonstration problem 1 166
  - Demonstration problem 2 167
  - Self-study questions 168
  - Questions 169
  - Brief exercises 169
  - Exercises 170
  - Problem set A 174
  - Problem set B 181
  - Building business skills 187
  - Acknowledgements 189

## CHAPTER 4

### Inventories 190

- Chapter preview 191
- 4.1 Merchandising operations 191
  - Operating cycles 192
  - Inventory systems 192
- 4.2 Recording purchases of inventories 194
  - Purchase returns and allowances 196
  - Freight costs 196
  - Purchase discounts 197
- 4.3 Recording sales of inventories 199
  - Sales returns and allowances 201
  - Sales discounts 202
- 4.4 Statement of profit or loss presentation 203
  - Sales revenue 203
  - Gross profit 204
  - Other revenue 204
  - Operating expenses 205
- 4.5 Evaluating profitability 205
  - Gross profit ratio 205
  - Operating expenses to sales ratio 207

- 4.6 The goods and services tax 208
  - Overview of the GST process 208
- 4.7 Accounting for GST 210
  - Purchasing inventory 210
  - Purchases returns 210
  - Selling inventory 211
  - Sales returns and allowances 211
  - Settlement discount 212
  - Remitting GST to the taxation authority 213
  - Summary 216
  - Key terms 216
  - Demonstration problem 217
  - Self-study questions 218
  - Questions 219
  - Brief exercises 219
  - Exercises 220
  - Problem set A 222
  - Problem set B 226
  - Building business skills 230
  - References 232
  - Acknowledgements 233

## CHAPTER 5

### Reporting and analysing inventory 234

- Chapter preview 235
- 5.1 Classifying inventory 235
  - Periodic inventory system 236
  - Recording inventory transactions 236
  - Recording purchases of inventory 236
  - Recording sales of inventory 237
  - Comparison of entries — perpetual vs. periodic 238
- 5.2 Cost of sales 238
  - Determining cost of goods purchased 239
- 5.3 Determining inventory quantities 239
  - Counting the physical inventory 240
  - Determining ownership of goods 240
- 5.4 Statement of profit or loss presentation 241
- 5.5 Inventory cost flow methods — periodic system 243
  - Specific identification 243
  - Cost flow assumptions 244
- 5.6 Financial statement effects of cost flow methods 248
  - Statement of profit or loss effects 248
  - Statement of financial position effects 249
  - Taxation effects 249
  - Using inventory cost flow methods consistently 250
- 5.7 Valuing inventory at the lower of cost and net realisable value 250
- 5.8 Analysis of inventory 251
  - Inventory turnover 251

- 5.9 Inventory cost flow methods —
  - perpetual system 253
  - First-in, first-out (FIFO) 253
  - Last-in, first-out (LIFO) 254
  - Average cost 254
  - Demonstration problem for section 5.9 255
- 5.10 Inventory errors 256
  - Effects on profit 256
  - Effects on assets and equity 258
- 5.11 Closing entries for merchandising entities 258
  - Perpetual inventory method 258
  - Periodic inventory method 259
  - Worksheet 261
  - Summary 263
  - Key terms 263
  - Demonstration problem 264
  - Self-study questions 265
  - Questions 266
  - Brief exercises 266
  - Exercises 267
  - Problem set A 270
  - Problem set B 274
  - Building business skills 279
  - References 281
  - Acknowledgements 282
- 6.8 Internal control principles applied
  - to the sales and receivables cycle and purchases and payments cycle 299
  - Sales and receivables cycle 299
  - Purchases and payments cycle 299
- 6.9 Control accounts, subsidiary ledgers and special journals 300
  - Control accounts and subsidiary ledgers illustrated 301
  - Advantages of subsidiary ledgers 303
- 6.10 Special journals 304
  - Posting the special journals 305
  - Advantages of special journals 305
- 6.11 Computerised accounting information systems 306
  - Basic features of computerised systems 307
- 6.12 Advantages and disadvantages of computerised systems 308
  - Advantages 308
  - Disadvantages 308
- 6.13 Sales journal 309
  - Journalising credit sales 309
  - Posting the sales journal 310
  - Checking the ledgers 312
  - Advantages of the sales journal 312
- 6.14 Cash receipts journal 312
  - Journalising cash receipts transactions 314
  - Posting the cash receipts journal 315
  - Purchases journal 315
  - Cash payments journal 318
  - Effects of special journals on general journal 320
  - Summary 325
  - Key terms 326
  - Demonstration problem 326
  - Self-study questions 327
  - Questions 328
  - Brief exercises 329
  - Exercises 329
  - Problem set A 334
  - Problem set B 341
  - Comprehensive problem: chapters 3 to 6 348
  - Building business skills 349
  - References 351
  - Acknowledgements 351

## CHAPTER 6

# Accounting information systems 283

Chapter preview 284

- 6.1 Basic concepts of accounting information systems 284
  - Principles of accounting information systems 285
- 6.2 Developing an accounting system 285
- 6.3 Internal control systems 286
  - Internal control 286
- 6.4 Management's responsibility for internal control 287
- 6.5 Principles of internal control 288
  - Establishment of responsibility 288
  - Segregation of duties 289
  - Documentation procedures 290
  - Physical, mechanical and electronic controls 290
  - Independent internal verification 291
  - Limitations of internal control 292
  - Internal control and forensic accounting 293
- 6.6 Transformation of financial data 294
  - Accounting processes underlying the generation of financial statements 294
- 6.7 Sales and receivables, and purchases and payments cycles illustrated 295

## CHAPTER 7

# Reporting and analysing cash and receivables 352

Chapter preview 353

- 7.1 Cash and credit transactions 353
  - Business transactions and cash 353
- 7.2 Credit and electronic banking 355
- 7.3 Safeguarding and managing cash 355
  - Internal control over cash 355

7.4	Bank reconciliation	358
	Reconciling the bank account	360
7.5	Managing and monitoring cash	365
	Basic principles of cash management	365
	Cash budget	367
7.6	Assessing cash adequacy	370
	Ratio of cash to daily cash expenses	370
7.7	Recording and reporting receivables	372
	Accounting for receivables	372
7.8	Valuing accounts receivable	374
	Direct write-off method for uncollectable accounts	374
	Allowance method for uncollectable accounts	374
	Recording estimated uncollectables	376
	GST and bad debt write-off	379
	Notes receivable	381
7.9	Financial statement presentation of receivables	383
7.10	Analysing and managing receivables	384
	Extending credit	384
	Establishing a payment period	384
	Evaluating the receivables balance	386
	Accelerating cash receipts	387
7.11	Operation of the petty cash fund	389
	Establishing the fund	390
	Making payments from petty cash	390
	Replenishing the fund	391
	Summary	394
	Key terms	394
	Demonstration problem 1	395
	Demonstration problem 2	396
	Self-study questions	397
	Questions	398
	Brief exercises	399
	Exercises	399
	Problem set A	402
	Problem set B	406
	Building business skills	410
	References	412
	Acknowledgements	412

## CHAPTER 8

### Reporting and analysing non-current assets 413

Chapter preview	414	
8.1	Business context and decision making: overview	414
8.2	Property, plant and equipment	415
	Determining the cost of property, plant and equipment	416
8.3	Depreciation	420
	Factors in calculating depreciation	421
8.4	Depreciation methods	422
	Straight-line depreciation	422
	Diminishing-balance depreciation	423
	Units-of-production depreciation	425

	Management's choice: comparison of methods	426
	Depreciation disclosure in the notes	426
	Revising periodic depreciation	427
8.5	Subsequent expenditure	428
8.6	Impairments	429
	Accounting for impairments	429
	Reversal of impairments	430
8.7	Revaluations	430
	Revaluation journal entries	431
	Reversals of increases and decreases	432
8.8	Disposals of PPE assets	432
	Sale of PPE assets	433
	Scrapping of PPE assets	434
8.9	Property, plant and equipment records	434
8.10	Intangible assets	435
	Accounting for intangible assets	435
8.11	Types of intangible assets	437
	Patents	437
	Research and development costs	437
	Copyright	438
	Trademarks and brand names	438
	Franchises and licences	439
	Goodwill	439
8.12	Other non-current assets	439
	Agricultural assets	439
8.13	Natural resources	441
	Amortisation (depletion)	442
8.14	Reporting and analysing issues	442
	Reporting non-current assets in the financial statements	442
	Analysis and decision making	443
	Summary	449
	Key terms	449
	Demonstration problem 1	450
	Demonstration problem 2	451
	Self-study questions	451
	Questions	452
	Brief exercises	453
	Exercises	453
	Problem set A	455
	Problem set B	458
	Building business skills	461
	References	464
	Acknowledgements	464

## CHAPTER 9

### Reporting and analysing liabilities 465

Chapter preview	466	
9.1	Current liabilities	466
9.2	Notes payable	467
	Payroll and payroll deductions payable	468
	Revenues received in advance	470
9.3	Non-current liabilities	472
	Why issue unsecured notes or debentures?	472

	Determining the market value of unsecured notes and debentures	473
	Accounting for issues of unsecured notes and debentures	474
	Redeeming unsecured notes and debentures at maturity	475
	Redeeming unsecured notes and debentures before maturity	475
9.4	Loans payable by instalment	476
	Accounting for loans payable by instalment	477
	Current and non-current components of long-term debt	480
9.5	Leasing	481
	What is a lease?	481
9.6	Accounting for leases	482
	Operating leases	482
	Finance leases	483
	Reporting leases	485
9.7	Provisions and contingent liabilities	485
9.8	Recording provisions for warranties	487
	Reporting provisions for warranties	489
9.9	Financial statement analysis	489
	Liquidity ratios	489
	Solvency ratios	492
	Summary	497
	Key terms	498
	Demonstration problem	498
	Self-study questions	500
	Questions	501
	Brief exercises	501
	Exercises	502
	Problem set A	504
	Problem set B	507
	Building business skills	510
	References	511
	Acknowledgements	511

## CHAPTER 10

### Reporting and analysing equity 512

	Chapter preview	513
10.1	Business context and decision making: overview	513
10.2	The corporate form of organisation	514
	Characteristics of a corporation	514
	Forming a company	517
	Shareholder rights	517
10.3	Share issues	518
	Issue of shares	518
	Accounting for the private issue of shares	519
	Accounting for the public issue of shares	520
10.4	Share splits	521

10.5	Dividends	522
	Cash dividends	522
	Share dividends	523
10.6	Earning power and irregular items	525
	Errors	526
	Changes in accounting estimates	528
	Changes in accounting policies	529
	Discontinuing operations	530
10.7	Reporting on equity	531
	Statement of profit or loss and other comprehensive income	531
	Statement of changes in equity	532
	Statement of financial position — equity section	534
10.8	Retained earnings	536
10.9	Financial statement analysis and decision making	537
	Dividend record	537
	Earnings performance	539
10.10	Debt versus equity financing decision making	539
	Summary	543
	Key terms	543
	Demonstration problem 1	544
	Demonstration problem 2	545
	Self-study questions	546
	Questions	547
	Brief exercises	547
	Exercises	548
	Problem set A	550
	Problem set B	553
	Building business skills	556
	References	558
	Acknowledgements	558

## CHAPTER 11

### Statement of cash flows 559

	Chapter preview	560
11.1	The statement of cash flows: purpose	560
	Purpose of the statement of cash flows	560
11.2	Classification of cash flows	561
	Significant non-cash activities	562
	Format of the statement of cash flows	563
	Usefulness of the statement of cash flows	564
11.3	Preparing the statement of cash flows	566
	Determining the net increase (decrease) in cash (step 1)	568
	Determining net cash provided (used) by operating activities (step 2)	568
	Determining net cash provided (used) by investing activities (step 3)	576

	Determining net cash provided (used) by financing activities (step 4)	577
	Completing the statement of cash flows	577
	Indirect method for determining cash flows from operating activities	578
	Summary of indirect method for determining cash flows from operating activities	582
11.4	Using cash flows to evaluate an entity	585
	The entity life cycle	585
11.5	Free cash flow	586
	Capital expenditure ratio	588
	Assessing liquidity, solvency and profitability using cash flows	589
	Summary	596
	Key terms	596
	Demonstration problem 1	597
	Demonstration problem 2 — comprehensive	598
	Self-study questions	604
	Questions	605
	Brief exercises	606
	Exercises	607
	Problem set A	610
	Problem set B	617
	Building business skills	623
	Acknowledgements	625

## CHAPTER 12

### Financial statement analysis and decision making 626

	Chapter preview	627
12.1	Comparative analysis	627
12.2	Horizontal analysis	627
12.3	Vertical analysis	632
12.4	Ratio analysis	635
	Liquidity ratios	636
	Solvency ratios	639
	Profitability ratios	641
12.5	Limitations of financial statement analysis	647
	Estimates	648
	Cost	648
	Alternative accounting methods	648
	Atypical data	649
	Diversification	649
	Summary	653
	Key terms	653
	Demonstration problem	654
	Self-study questions	658
	Questions	659
	Brief exercises	659
	Exercises	660
	Problem set A	664
	Problem set B	671
	Building business skills	678
	Acknowledgements	683

## CHAPTER 13

### Analysing and integrating GAAP 684

	Chapter preview	685
13.1	Assumptions, concepts and principles underlying accounting	686
	Monetary principle	686
	Accounting entity concept	687
	Accounting period concept	687
	Going concern assumption	687
	Historical cost principle	688
	Full disclosure principle	688
13.2	Conceptual frameworks	690
	Overview of the <i>Conceptual Framework</i>	691
13.3	The objective of general purpose financial reporting	692
	Stewardship and accountability objectives	693
	Decision-usefulness objective	693
	The <i>Conceptual Framework</i>	693
13.4	Users and uses of financial reports	694
	The <i>Conceptual Framework</i> — primary users	694
	The <i>Conceptual Framework</i> — other users	695
13.5	The reporting entity	696
	The reporting entity — defined	696
	Differential financial reporting	697
13.6	Qualitative characteristics and constraint on financial reporting	698
	Fundamental qualitative characteristics	698
	Enhancing qualitative characteristics	700
	Constraint on financial reporting	703
13.7	Definition, recognition and measurement of elements in financial reports	704
	Assets — definition and recognition criteria	704
	Liabilities — definition and recognition criteria	706
	Equity — definition	707
	Income — definition and recognition criteria	708
	Standards for revenue recognition	709
	Expenses — definition and recognition criteria	710
	Measurement of the elements of financial reports	713
13.8	Integrating assumptions, principles, concepts, standards and the <i>Conceptual Framework</i>	714
	Summarising GAAP	714
	Integrating GAAP	715

**13.9 Development in financial reporting 715**

**Integrated reporting 715**

Summary 720

Key terms 721

Demonstration problem 721

Self-study questions 723

Questions 724

Brief exercises 725

Exercises 727

Problem set 730

Building business skills 733

References 735

Acknowledgements 735

*Appendix: Time value of money 736*

*Index 751*