

INTRODUCTION TO  
**Accounting**

3rd Edition

Pru Marriott, J.R. Edwards and H.J. Mellett



SAGE Publications  
London € Thousand Oaks New Delhi

## Contents

Series editor's preface	xi
Preface	xiii
1 THE FRAMEWORK OF ACCOUNTING	1
The accounting process	1
Suppliers of accounting information	2
Financial accounting and management accounting compared	5
External users of accounting information	6
Principal accounting statements	7
2 THE BALANCE SHEET	10
The entity concept	10
Classification of assets and sources of finance	12
The accounting equation	15
Raising further finance	16
The investment decision	17
Business development	19
The trading cycle	20
Reporting changes in owner's capital	22
The accounting equation: a further illustration	23
Valuation of assets	24
Questions	26
Solutions to activities	29
3 PROFIT CALCULATED AS THE INCREASE IN CAPITAL	31
Profitable activity	31
Profit and changes in gross assets	32
Balance sheet presentation: vertical format	33
Profits, losses and changes in net assets	34
Profit measured by capital changes	36
Capital injections and withdrawals	39
Questions	43
Solutions to activities	45
4 THE PREPARATION OF ACCOUNTS FROM CASH OR INCOMPLETE RECORDS	48
Accounting systems and information requirements	48
The matching concept	50
Gross profit and net profit	51
The problem of periodic profit calculation	52

---

The identification of revenue: the realization concept	53
Matching expenditure with revenue: the benefit principle	55
The preparation of accounts from cash records:	
a worked example	61
Clubs and societies	66
Questions	71
Solutions to activities	79
5 THE DOUBLE ENTRY SYSTEM I: THE INITIAL RECORDING OF TRANSACTIONS	82
Introduction	82
Cash flows	82
Flows of goods and services	96
Questions	98
Solutions to activities	103
6 THE DOUBLE ENTRY SYSTEM II: LEDGER ACCOUNTS AND THE TRIAL BALANCE	107
Introduction	107
The interlocking effect of transactions	107
Ledger accounts	110
Books of prime entry	115
Control accounts for debtors and creditors	123
The trial balance	132
Computerized accounting systems	134
Advantages of double entry	136
Questions	137
Solutions to activities	144
7 THE DOUBLE ENTRY SYSTEM III: PERIODIC ACCOUNTING REPORTS	153
Periodic accounts	153
Adjustments to the trial balance	155
Stock (inventories)	156
Depreciation	159
Disposal of fixed assets	162
Prepayments and accruals	165
Bad debts	168
The adjusted trial balance	171
Questions	178
Solutions to activities	182
8 ASSET VALUATION, PROFIT MEASUREMENT AND THE UNDERLYING ACCOUNTING CONCEPTS	191
Asset valuation and profit measurement	191
Tangible fixed assets	191
Intangible fixed assets	200

---

Stock valuation methods	206
Accounting concepts	217
Questions	223
Solutions to activities	230
<b>9 PARTNERSHIPS</b>	<b>239</b>
Introduction	239
The partnership agreement	240
The creation of a partnership	240
The division of profit	243
Capital and current accounts	246
Changes in membership	248
Change in profit-sharing ratio	256
Dissolution of partnerships	259
Questions	263
Solutions to activities	269
<b>10 COMPANY ACCOUNTS</b>	<b>276</b>
Formation of registered companies	276
The annual report	280
Other sources of information	288
Share capital	289
Share premium account	293
Share forfeiture	295
The rights issue	297
Loan capital and debentures	297
The appropriation account	298
Revaluation reserve	309
Redemption of debentures	311
Bonus (capitalization, scrip) issue of shares	313
Reporting financial performance (FRS 3)	315
Groups of companies	316
Goodwill and intangible fixed assets (FRS 10)	319
Research and development (SSAP 13)	319
Limitations of company accounts	320
Questions	321
Solutions to activities	329
<b>11 INTERPRETATION OF ACCOUNTS:</b>	
<b>THE CASH FLOW STATEMENT</b>	<b>338</b>
Introduction	338
Format	339
Statement construction	340
Some complexities of the cash flow statement	346
Interpretation using the cash flow statement	356
Questions	361
Solutions to activities	366

12	INTERPRETATION OF ACCOUNTS: RATIO ANALYSIS	369
	The need for profit and cash	369
	Principles of ratio analysis	370
	Classification of accounting ratios	371
	Return on capital employed	371
	Profit ratios	376
	Solvency ratios	383
	Asset turnover ratios	387
	Relationship between accounting ratios	395
	Gearing (or leverage)	397
	Cash flow statement ratios	399
	Limitations of accounting ratios	401
	Linking together cash flow analysis and ratio analysis	402
	Questions	404
	Solutions to activities	415
13	DECISION-MAKING	421
	Introduction	421
	Cost behaviour	422
	Total costing and overhead recovery rates	427
	Investment appraisal	441
	Forecast results	447
	Questions	452
14	STANDARD COSTING AND BUDGETARY CONTROL	458
	Introduction	458
	Budgetary control	459
	Preparation of budgets	460
	Standard costing	465
	Calculation of variances	467
	Questions	475
	Appendix: Solutions to questions	481
	Index	533