



• **ATRILL'S** •

# ACCOUNTING

**FOR BUSINESS  
STUDENTS**

**ATRILL • McLANEY • HARVEY**

# BRIEF CONTENTS

About the Australian author	xii
Preface	xiii
About the contributor	xvii
Acknowledgements	xviii
For students: How do I use this book?	xx
Resources for students and educators	xxii
<b>1</b> Introduction to accounting	1
<b>2</b> Measuring and reporting financial position	46
<b>3</b> Measuring and reporting financial performance	92
<b>4</b> Recording transactions—the journal and ledger accounts	162
<b>5</b> Accounting systems and internal control	227
<b>6</b> Introduction to limited companies	280
<b>7</b> Regulatory framework for companies	326
<b>8</b> Measuring and reporting cash flows	376
<b>9</b> Corporate social responsibility and sustainability accounting	430
<b>10</b> Analysis and interpretation of financial statements	472
<b>11</b> Cost-volume-profit analysis and relevant costing	534
<b>12</b> Full costing	582
<b>13</b> Planning and budgeting	634
<b>14</b> Capital investment decisions	705
Glossary	759
Index	767

# CONTENTS

About the Australian author	xii
Preface	xiii
About the contributor	xvii
Acknowledgements	xviii
For students: How do I use this book?	xx
Resources for students and educators	xxii

## CHAPTER 1

<b>Introduction to accounting</b>	<b>1</b>
<b>Nature and role of accounting</b>	<b>3</b>
Accounting as a service function	4
Costs and benefits of accounting information	5
Accounting as an information system	6
<b>Users of accounting information</b>	<b>8</b>
<b>Financial and management accounting</b>	<b>9</b>
<b>What is the financial objective of a business?</b>	<b>11</b>
Stakeholder theory	13
Balancing risk and return	14
<b>The main financial reports—an overview</b>	<b>15</b>
Financial accounting	15
Management accounting	18
<b>Business and accounting</b>	<b>20</b>
What kinds of business ownership exist?	20
How are businesses managed?	25
Not-for-profit organisations	26
<b>The changing face of business and accounting</b>	<b>28</b>
Ethics and ethical behaviour in business	30
<b>How useful is accounting information?</b>	<b>33</b>
Why do I need to know anything about accounting and finance?	34
<b>The ALTC's Academic Standards for Accounting</b>	<b>35</b>
Characteristics of successful business people	37
<b>Summary</b>	<b>38</b>
<b>Reference</b>	<b>39</b>
<b>Discussion questions</b>	<b>39</b>
<b>Case study</b>	<b>41</b>
<b>Solutions to activities</b>	<b>42</b>

## CHAPTER 2

<b>Measuring and reporting financial position</b>	<b>46</b>
<b>Nature and purpose of the statement of financial position</b>	<b>47</b>
Assets	47
Claims against the assets	48
<b>The accounting equation</b>	<b>50</b>
The effect of trading operations on the statement of financial position	52
<b>The classification of assets and claims</b>	<b>55</b>
The classification of assets	55
The classification of liabilities	56
The classification of owners' equity	57
<b>Formats for statements of financial position</b>	<b>58</b>
Financial position at a point in time	61
<b>Factors influencing the form and content of the financial reports</b>	<b>62</b>
Conventional accounting practice	63
Valuing assets	67
<b>Usefulness of the statement of financial position</b>	<b>72</b>
<b>Statement of financial position deficiencies</b>	<b>74</b>
<b>Summary</b>	<b>77</b>
<b>Discussion questions</b>	<b>78</b>
<b>Application exercises</b>	<b>79</b>
<b>Case study</b>	<b>87</b>
<b>Solutions to activities</b>	<b>88</b>

## CHAPTER 3

<b>Measuring and reporting financial performance</b>	<b>92</b>
<b>The statement of financial performance—its nature and purpose, and its relationship with the statement of financial position</b>	<b>93</b>
The stock approach to calculating profit	95
<b>The format of the income statement</b>	<b>97</b>
Key terms	97
Classifying expenses	99
The reporting period	101



## CHAPTER 6

### Introduction to limited companies 280

<b>The main features of companies</b>	<b>281</b>
Legal nature	281
Unlimited (perpetual) life	281
Limited liability	282
Legal safeguards	282
Public and proprietary (private) companies	283
Transferring share ownership—the role of the stock exchange	284
Separation of ownership and management	284
Extensive regulation	285
Advantages and disadvantages of the company entity structure	288
<b>Equity and borrowings in a company context</b>	<b>289</b>
Equity/capital (owners' claim) of limited companies	289
Reserves	292
Bonus shares	293
Raising share capital	294
Borrowings	298
<b>Restrictions on the rights of shareholders to make drawings or reductions of capital</b>	<b>299</b>
<b>The main financial statements</b>	<b>303</b>
The income statement	304
The statement of financial position	305
Dividends	305
<b>Accounting for groups of companies</b>	<b>307</b>
<i>Summary</i>	312
<i>Discussion questions</i>	312
<i>Application exercises</i>	313
<i>Case study</i>	321
<i>Solutions to activities</i>	323

## CHAPTER 7

### Regulatory framework for companies 326

<b>The directors' duty to account—the role of company law (Corporations Act)</b>	<b>327</b>
Auditors	328

<b>The need for accounting rules</b>	<b>331</b>
The role of accounting standards in company accounting	331
International accounting standards	332
The conceptual framework	334
<b>The role of the Australian Securities Exchange (ASX) in company accounting</b>	<b>337</b>
Corporate governance	338
<b>Presentation of published financial statements</b>	<b>344</b>
Statement of financial position	344
Statement of comprehensive income	345
Statement of changes in equity	350
Statement of cash flows	352
Notes	352
General points	352
<b>Segmental financial reports</b>	<b>353</b>
Segmental reporting rules	354
Segmental disclosure	354
Segmental reporting problems	356
<b>Creative accounting</b>	<b>358</b>
Creative accounting methods	358
Checking for creative accounting	361
Creative accounting and economic growth	361
<i>Summary</i>	363
<i>Discussion questions</i>	363
<i>Application exercises</i>	365
<i>Case study</i>	370
<i>Solutions to activities</i>	372

## CHAPTER 8

### Measuring and reporting cash flows 376

<b>The importance of cash and cash flow</b>	<b>378</b>
Differences between the four external financial reports	381
<b>The statement of cash flows</b>	<b>382</b>
<b>Preparation of the statement of cash flows—a simple example</b>	<b>386</b>
Deducing cash flows from operating activities	388
Deducing cash flows from investing activities	390
Deducing cash flows from financing activities	391

Reconciling profit for the year with cash from operating activities	396
Some complexities in statement preparation	400
The investing section	401
The financing section	402
What does the statement of cash flows tell us?	404
<i>Summary</i>	<b>408</b>
<i>Discussion questions</i>	<b>408</b>
<i>Application exercises</i>	<b>409</b>
<i>Case study</i>	<b>424</b>
<i>Solutions to activities</i>	<b>425</b>

## CHAPTER 9

<b>Corporate social responsibility and sustainability accounting</b>	<b>430</b>
Social issues in accounting	431
General background	431
Stakeholder concept	431
What is social responsibility?	433
Corporate social responsibility (CSR)— what does it mean?	436
Accounting for corporate social responsibilities	440
Triple bottom line reporting	442
The Global Reporting Initiative (GRI)	444
General background	444
Background and development of the GRI Guidelines	444
Current position—the GRI Standards	446
Integrated reporting	455
The balanced scorecard approach	457
The financial perspective	457
The business process perspective	458
The customer perspective	458
The learning and growth perspective	458
Overall conclusion	461
<i>Summary</i>	<b>462</b>
<i>References</i>	<b>462</b>
<i>Discussion questions</i>	<b>463</b>
<i>Application exercises</i>	<b>464</b>
<i>Case study</i>	<b>467</b>
<i>Solutions to activities</i>	<b>470</b>

## CHAPTER 10

<b>Analysis and interpretation of financial statements</b>	<b>472</b>
Financial ratios	473
Financial ratio classification	473
The need for comparison	474
The key steps in financial ratio analysis	475
The ratios calculated	475
A brief overview	478
Profitability ratios	479
Return on ordinary shareholders' funds (ROSF) (also known as return on equity (ROE))	479
Return on capital employed (ROCE)	480
Operating profit margin	481
Gross profit margin	481
Efficiency ratios	483
Average inventories turnover period	483
Average settlement period for accounts receivable (debtors)	484
Average settlement period for accounts payable (creditors)	485
Sales revenue to capital employed	486
Sales revenue per employee	486
Alternative formats	486
The relationship between profitability and efficiency	487
Liquidity	489
Current ratio	489
Acid test ratio	490
Cash flows from operations ratio	490
Financial gearing (leverage) ratios	491
Gearing ratio	494
Interest cover ratio (times interest earned)	494
An aside on personal debt	496
Investment ratios	497
Dividends per share ratio	497
Dividend payout ratio	498
Dividend yield ratio	498
Earnings per share ratio	499
Operating cash flow per share	500
Price/earnings ratio	500

Issues relating to financial analysis	502
Financial ratios and the problem of overtrading	502
Trend analysis	503
Index or percentage analysis	506
Ratios and prediction models	507
Limitations of ratio analysis	511
<b>Summary</b>	<b>516</b>
<b>References</b>	<b>517</b>
<b>Discussion questions</b>	<b>517</b>
<b>Application exercises</b>	<b>518</b>
<b>Case study</b>	<b>529</b>
<b>Solutions to activities</b>	<b>529</b>

## CHAPTER 11

<b>Cost–volume–profit analysis and relevant costing</b>	<b>534</b>
<b>The behaviour of costs</b>	<b>535</b>
Fixed costs	535
Variable costs	536
Semi-fixed (semi-variable) costs	537
<b>Break-even analysis</b>	<b>540</b>
<b>Contribution</b>	<b>543</b>
Profit–volume charts	545
Margin of safety and operating gearing	546
Weaknesses of break-even analysis	548
<b>Use of spreadsheets</b>	<b>551</b>
Expected costs rather than historic costs	554
More complex cost and revenue behaviour patterns	555
<b>Relevant cost, outlay cost and opportunity cost</b>	<b>556</b>
<b>Marginal analysis/relevant costing</b>	<b>559</b>
Accepting/rejecting special contracts	560
The most efficient use of scarce resources	560
Make or buy decisions	561
Closing or continuing a section or department	562
<b>Summary</b>	<b>567</b>
<b>Discussion questions</b>	<b>567</b>
<b>Application exercises</b>	<b>569</b>
<b>Case study</b>	<b>576</b>
<b>Solutions to activities</b>	<b>577</b>

## CHAPTER 12

<b>Full costing</b>	<b>582</b>
<b>The nature of full costing</b>	<b>583</b>
<b>Deriving full costs in a single or multi-product or service operation</b>	<b>584</b>
Single-product businesses	584
Multi-product operations	585
<b>Segmenting the overheads</b>	<b>594</b>
Dealing with overheads on a departmental (cost centre) basis	594
Batch costing	601
The forward-looking nature of full costing	602
<b>Activity-based costing (ABC)</b>	<b>603</b>
Costing and pricing: the traditional way	603
Costing and pricing: the new environment	603
An alternative approach to full costing	604
ABC contrasted with the traditional approach	605
Attributing overheads	606
Benefits of ABC	607
Criticisms of ABC	610
<b>Uses of full (absorption) cost information</b>	<b>611</b>
Full cost (cost-plus) pricing	612
Criticisms of full costing	613
<b>Summary</b>	<b>618</b>
<b>References</b>	<b>619</b>
<b>Discussion questions</b>	<b>619</b>
<b>Application exercises</b>	<b>620</b>
<b>Case study</b>	<b>628</b>
<b>Solutions to activities</b>	<b>629</b>

## CHAPTER 13

<b>Planning and budgeting</b>	<b>634</b>
<b>Planning and control</b>	<b>635</b>
Corporate objectives, long-term plans and budgets—their relationship	635
Exercising control	636
<b>The role of projected financial statements</b>	<b>637</b>
Likely information needed for forecast statements	638

