



**CRAIG
DEEGAN**

**AN INTRODUCTION TO
ACCOUNTING**

ACCOUNTABILITY IN ORGANISATIONS AND SOCIETY

BRIEF CONTENTS

MODULE ① ORGANISATIONS, RESPONSIBILITIES, ACCOUNTABILITY AND ACCOUNTING 1

- CHAPTER 1** What is accounting? 2
- CHAPTER 2** Organisations and their reporting boundaries 42

MODULE ② ACCOUNTING AND ITS ROLE IN MANAGERIAL DECISION MAKING 87

- CHAPTER 3** An introduction to management accounting 88
- CHAPTER 4** Budgeting as a means of organisational planning and control 146
- CHAPTER 5** Performance measurement and evaluation – further considerations 193

MODULE ③ ACCOUNTABILITY FOR SOCIAL AND ENVIRONMENTAL PERFORMANCE 249

- CHAPTER 6** The external reporting of social and environmental information 250

MODULE ④ ACCOUNTABILITY FOR FINANCIAL PERFORMANCE 315

- CHAPTER 7** An introduction to financial accounting 316
- CHAPTER 8** Recording transactions in journals and ledgers – more detail on the financial accounting process 381
- CHAPTER 9** The balance sheet 449
- CHAPTER 10** The income statement and the statement of changes in equity 520
- CHAPTER 11** The statement of cash flows, and cash controls 588

MODULE ⑤ TOOLS FOR REVIEWING AN ORGANISATION'S PUBLICLY AVAILABLE REPORTS 633

- CHAPTER 12** The analysis of organisations' external reports 634

CONTENTS

Guide to the text	xvi
Guide to the online resources	xviii
Preface	xx
About the author	xxiii
Acknowledgements	xxiv

MODULE 1 ORGANISATIONS, RESPONSIBILITIES, ACCOUNTABILITY AND ACCOUNTING 1

CHAPTER 1	What is accounting?	2
	Introduction	3
	What does 'accounting' mean?	3
	<i>Informed decisions</i>	4
	<i>Performance</i>	4
	<i>Stakeholders</i>	6
	<i>The role of accounting</i>	7
	The relationship between accounting and accountability	8
	<i>What do we mean by accountability?</i>	9
	Internal and external accounts	12
	Who produces these accounts?	14
	<i>The accounting function</i>	14
	Qualitative characteristics of accounting information	16
	<i>Relevance</i>	16
	<i>Reliability</i>	17
	<i>Comparability</i>	18
	<i>Verifiability</i>	18
	<i>Understandability</i>	18
	<i>Timeliness</i>	18
	An accountability model	19
	<i>Why is an organisation collecting and disclosing particular information?</i>	20
	<i>To whom is the account information being directed?</i>	23
	<i>What information needs to be reported?</i>	25
	<i>How should the information be disclosed?</i>	27
	<i>Real-world examples of our accountability model</i>	28
	<i>The influence of organisational objectives on accounting</i>	32
	The changing role of accountants	33
	<i>The drivers of change in accounting</i>	33
	Accounting as both a technical and social practice	34
	Study tools	37

CHAPTER 2	Organisations and their reporting boundaries	42
	Introduction	43
	What is the reporting boundary?	43
	<i>The reporting boundary in the context of financial reporting</i>	44
	<i>The reporting boundary beyond an organisation</i>	45
	<i>Sustainability reporting</i>	46
	The resources of an organisation	49
	<i>Accounting for non-financial resources</i>	50
	What constitutes a cost?	52
	<i>Which costs could be recognised?</i>	52
	The inputs and outputs of an organisation	55
	<i>Deciding what to measure</i>	56
	The influence of accounting frameworks on reporting	59
	Supply chain considerations	59
	<i>Life cycle considerations</i>	61
	Accounting: not a one-size-fits-all practice	62
	A brief introduction to management accounting	63
	<i>Information used by management can also form the basis of public reports</i>	64
	Some frameworks used to produce accounts for external stakeholders	65
	<i>External reporting – financial</i>	65
	<i>External reporting – social</i>	66
	<i>External reporting – environmental</i>	66
	For-profit and not-for-profit organisations	67
	Some general forms of organisations	69
	<i>Sole traders</i>	69
	<i>Partnerships</i>	72
	<i>Companies</i>	75
	Study tools	81

MODULE 2 ACCOUNTING AND ITS ROLE IN MANAGERIAL DECISION MAKING

87

CHAPTER 3	An introduction to management accounting	88
	Introduction	89
	The role of management accounting	91
	<i>Why produce management accounts?</i>	91
	<i>To whom are management accounts directed?</i>	92
	<i>What information is generated?</i>	92
	<i>How is management accounting information disclosed?</i>	95
	What does management do?	96
	<i>Planning</i>	96
	<i>Implementing action</i>	103

<i>Monitoring and evaluating</i>	103
<i>Learning, revising and adjusting</i>	105
Short-term and long-term planning: a balanced approach	106
<i>Balancing planned long-term outcomes with short-term performance</i>	106
Planning for sustainable development	108
<i>The need for sustainability</i>	108
Planning to create value	110
<i>Porter's five primary activities of organisations</i>	110
<i>Porter's four supporting activities for organisations</i>	111
<i>Value chain analysis</i>	112
<i>Make or buy?</i>	117
The behaviour of costs	118
<i>Relevant costs</i>	119
<i>Variable costs</i>	119
<i>Fixed costs</i>	123
<i>Mixed costs</i>	125
The contribution margin	128
<i>Using the contribution margin to determine the break-even point</i>	129
<i>The margin of safety</i>	132
<i>Operating gearing</i>	132
<i>Generating a target financial profit</i>	133
Consideration of non-financial variable and fixed costs	134
Maximising the return on a constraining or scarce factor	136
Consideration of special orders	137
Adding value through critical thinking and application of professional skills	138
<i>Skills that accountants require</i>	138
Study tools	141
CHAPTER 4 Budgeting as a means of organisational planning and control	146
Introduction	147
An overview of budgeting	147
<i>What are budgets?</i>	147
<i>Why are budgets prepared?</i>	148
<i>Who are budgets for?</i>	149
<i>How are budgets prepared?</i>	149
Who needs to do budgeting?	150
The benefits of budgeting	152
<i>Using budgets sensibly</i>	153
The master budget	154
<i>The sales budget</i>	156
<i>The production budget</i>	158
<i>The direct materials budget</i>	159
<i>The direct labour budget</i>	160

<i>The manufacturing overhead expenses budget</i>	161
<i>The selling and administrative overhead expenses budget</i>	163
<i>The cash budget</i>	164
<i>The budgeted income statement</i>	169
<i>The budgeted balance sheet</i>	172
Budget variances	172
<i>Identifying and investigating budget variances</i>	172
Static and flexible budgets	174
<i>Static budgets</i>	174
<i>Flexible budgets</i>	175
Budgeting for non-financial aspects of performance	179
Behavioural implications of budgeting	182
<i>The potential for negative outcomes</i>	185
Study tools	187
CHAPTER 5	
Performance measurement and evaluation – further considerations	193
Introduction	194
Life cycle analysis	196
<i>Understanding the impacts of products and services</i>	196
<i>Assessing and reporting product and service impacts</i>	197
<i>Informing stakeholder decisions</i>	198
<i>Examples of life cycle analysis</i>	201
Life cycle costing	207
<i>A real-world example of life cycle costing</i>	207
Material flow cost accounting	209
<i>The MFCA process</i>	210
<i>The benefits of MFCA</i>	212
<i>Real-world examples of MFCA</i>	213
A focus on waste	217
The Balanced Scorecard	221
<i>The financial perspective</i>	221
<i>The customer perspective</i>	222
<i>The internal business perspective</i>	222
<i>The learning and growth perspective</i>	222
<i>Summarising the BSC framework</i>	223
<i>The BSC and management remuneration</i>	228
Capital investment decisions	230
<i>Payback period</i>	232
<i>Accounting rate of return</i>	234
<i>Net present value</i>	236
<i>Internal rate of return</i>	238
Study tools	243

MODULE 3 ACCOUNTABILITY FOR SOCIAL AND ENVIRONMENTAL PERFORMANCE**249**

CHAPTER 6	The external reporting of social and environmental information	250
	Introduction	251
	Social and environmental accountability	252
	<i>Why report social and environmental information?</i>	252
	<i>To whom to report social and environmental information?</i>	258
	<i>What social and environmental information should be reported?</i>	260
	<i>How should social and environmental information be reported?</i>	262
	Corporate social responsibility reporting	264
	<i>Defining corporate social responsibility</i>	264
	<i>Social reporting</i>	265
	<i>Environmental reporting</i>	266
	<i>Sustainability reporting</i>	266
	The incidence of CSR reporting	268
	CSR and sustainability reporting frameworks	271
	<i>The Global Reporting Initiative</i>	271
	<i>The International Integrated Reporting Committee</i>	280
	<i>The Sustainability Accounting Standards Board</i>	287
	<i>The CEO Guide to Climate-related Financial Disclosures</i>	291
	<i>The Global Compact</i>	292
	<i>Other frameworks</i>	293
	CSR and sustainability-related measurement frameworks	294
	<i>The Greenhouse Gas Protocol</i>	294
	Corporate responsibilities: The cause of climate change	296
	<i>The Carbon Disclosure Project</i>	300
	Counter (shadow) accounts	301
	<i>Counter accounts incorporated within organisational reporting</i>	301
	<i>Separate counter accounts</i>	303
	Independent review of CSR reports	304
	Study tools	308

MODULE 4 ACCOUNTABILITY FOR FINANCIAL PERFORMANCE**315**

CHAPTER 7	An introduction to financial accounting	316
	Introduction	317
	Applying the accountability model to financial accounting	318
	<i>Why disclose financial accounting information?</i>	318
	<i>To whom are the financial disclosures directed?</i>	319
	<i>What types of disclosures are made?</i>	319
	<i>How are disclosures made?</i>	320
	The separation of ownership from management, and the resulting need for regulation	320

What is the objective of financial reporting?	324
<i>General purpose financial statements (GPFSS)</i>	325
<i>Special purpose financial statements (SPFSS)</i>	325
The historical nature of financial reports	326
Key financial accounting principles and terms	327
<i>Entity concept</i>	327
<i>Accounting period convention</i>	328
<i>Monetary unit convention</i>	329
<i>Going concern assumption</i>	329
<i>Accrual basis of accounting</i>	330
Sources of accounting standards	331
<i>IASB standards</i>	332
<i>FASB standards</i>	332
<i>The enforcement of accounting standards</i>	333
The role of the Conceptual Framework for Financial Reporting	334
Qualitative characteristics of financial accounting information	334
<i>Fundamental qualitative characteristics</i>	335
<i>Enhancing characteristics</i>	337
<i>Overview of the qualitative characteristics</i>	338
<i>Costs versus benefits</i>	339
The elements of financial accounting	339
<i>Assets</i>	340
<i>Liabilities</i>	346
<i>Owners' equity</i>	352
<i>Income</i>	355
<i>Expenses</i>	356
What is profit?	358
The accounting equation	362
<i>The double-entry effect of transactions</i>	365
<i>Expanding our accounting equation to incorporate specific changes in equity</i>	366
<i>The need for separate accounts</i>	368
Preparing simple financial statements	370
Study tools	375
CHAPTER 8	
Recording transactions in journals and ledgers – more detail on the financial accounting process	381
Introduction	382
The role of source documents	383
Recording transactions within the journal	385
<i>Use of debits and credits within the journal</i>	387
Posting entries from the journal to the ledger	397

Preparing a trial balance	404
Adjusting journal entries	407
<i>Income earned but not received</i>	408
<i>Expenses incurred but not yet paid</i>	409
<i>Income received in advance</i>	411
<i>Prepayments</i>	414
<i>Depreciation</i>	416
Closing entries	419
Real-world refinements to the accounting information system	427
<i>Multiple journals</i>	427
<i>Subsidiary ledgers</i>	427
A comprehensive example of recording transactions	429
<i>Solution</i>	430
Study tools	440
CHAPTER 9 The balance sheet	449
Introduction	450
Overview of the balance sheet	451
<i>Why prepare a balance sheet?</i>	453
<i>An overview of some of the steps necessary to generate a financial statement</i>	455
The definitions of assets, liabilities and equity	456
Recognising assets	457
<i>Relevance</i>	459
<i>Faithful representation</i>	460
Measuring assets	466
<i>Cash</i>	470
<i>Accounts receivable</i>	470
<i>Inventory</i>	474
<i>Prepayments</i>	477
<i>Property, plant and equipment</i>	478
<i>Marketable securities</i>	487
<i>Intangible assets</i>	487
<i>Leased assets</i>	491
<i>Summary of asset measurement rules</i>	493
The recoverable amount of an asset	494
Presenting assets in the balance sheet	497
Recognising liabilities	500
<i>Relevance</i>	501
<i>Faithful representation</i>	501
<i>Contingent liabilities</i>	502
Measuring liabilities	505

<i>Bank overdrafts</i>	505
<i>Accounts payable</i>	506
<i>Provisions</i>	506
<i>Corporate bonds</i>	507
Presenting liabilities in the balance sheet	507
Recognising and measuring equity	508
Presenting equity in the balance sheet	508
<i>Share capital</i>	508
<i>Retained earnings</i>	509
<i>Reserves</i>	509
Further reflections on the balance sheet	511
Study tools	514
CHAPTER 10 The income statement and the statement of changes in equity	520
Introduction	521
Overview of the income statement	522
<i>Presentation of the income statement</i>	522
<i>The accountability model and the income statement</i>	523
<i>The income statement and the news media</i>	527
The use of accounting numbers in contractual arrangements negotiated by an organisation	528
Definitions of income and expenses	529
<i>Potential focus on short-term performance</i>	529
<i>Focus of not-for-profit organisations</i>	530
<i>The subdivision of income into revenues and gains</i>	532
Recognising income and expenses	532
<i>Income recognition and the requirement that control of the good or service has passed to the customer</i>	541
<i>Long-term construction contracts</i>	542
<i>Long-term service contracts</i>	544
<i>Revenue recognition policy notes</i>	544
<i>Summary of income and expense recognition</i>	545
Measuring income and expenses	548
<i>Measuring income when the receipt of cash has been deferred beyond 12 months</i>	549
<i>Measuring income when the asset being received is not cash</i>	551
<i>Measuring the cost of sales</i>	552
<i>Income tax expense</i>	560
Accounting rules change over time	561
Presenting income and expenses in the income statement	563
<i>Disclosing exceptional or unusual items</i>	566
<i>Profit or loss derived from discontinued operations</i>	567

	<i>Other comprehensive income</i>	568
	<i>Statement of comprehensive income</i>	569
	The statement of changes in equity	573
	Is profit a 'good' measure of an organisation's performance?	576
	<i>Study tools</i>	581
CHAPTER 11	The statement of cash flows, and cash controls	588
	Introduction	589
	Overview of the statement of cash flows	590
	<i>The relationship between cash flows and profits and losses</i>	591
	<i>The accountability model and the statement of cash flows</i>	592
	Understanding cash, and cash equivalents	594
	The difference between cash flows and accounting profits	597
	<i>Changes in accounts receivable</i>	597
	<i>Changes in accounts payable and inventory</i>	598
	<i>Changes in accrued expenses</i>	600
	<i>Changes in prepaid expenses (prepayments)</i>	600
	<i>Changes in revenue received in advance</i>	601
	<i>Changes in provisions</i>	602
	<i>Depreciation and impairment losses</i>	602
	The reduced risk of managerial manipulation	604
	Presenting the statement of cash flows	605
	<i>Operating activities</i>	605
	<i>Investing activities</i>	607
	<i>Financing activities</i>	607
	<i>Supporting information for the statement of cash flows</i>	610
	Preparing the statement of cash flows	611
	Cash controls	616
	<i>Cash receipts</i>	617
	<i>Cash payments</i>	618
	<i>Bank reconciliations</i>	618
	<i>Petty cash funds</i>	623
	<i>Study tools</i>	625

MODULE 5 TOOLS FOR REVIEWING AN ORGANISATION'S PUBLICLY AVAILABLE REPORTS 633

CHAPTER 12	The analysis of organisations' external reports	634
	Introduction	635
	The role of financial statement analysis	636
	<i>Who performs financial statement analysis?</i>	636
	<i>Why undertake financial statement analysis?</i>	637
	An overview of how financial statement analysis can be performed	638

<i>Horizontal and vertical analysis</i>	639
<i>Additional information</i>	639
Using accounting ratios	640
<i>Profitability ratios</i>	641
<i>Operating efficiency ratios</i>	648
<i>Financial gearing (or stability) ratios</i>	652
<i>Liquidity ratios</i>	654
<i>Investment-based ratios</i>	658
Important information also resides in the notes to the financial statements	662
<i>Accounting policies</i>	662
<i>Significant events occurring after the end of the accounting period</i>	664
<i>Contingent liabilities</i>	666
<i>Remuneration policies</i>	667
Information about accounting-based contractual agreements	668
Further reflections on assets	670
Analysing social and environmental (sustainability) reports	671
<i>Why has the CSR report been prepared?</i>	672
<i>The organisational context</i>	673
<i>A summary of some issues to consider when evaluating the 'quality' of a social and environmental report</i>	675
Independent auditing of information in reports	678
Concluding comments	679
Study tools	680
Glossary	688
Index	696