ACCOUNTING AND FINANCE AN INTRODUCTION

TENTH EDITION

Eddie McLaney Peter Atrill



ACCOUNTING AND FINANCE AN INTRODUCTION

Accounting and Finance: An Introduction

Table of Contents

Front Cover

Half Title Page

Title Page

Copyright Page

Brief contents

Contents

Preface

How to use this book

Publisher's acknowledgements

1 Introduction to accounting and finance

Introduction

Learning outcomes

What are accounting and finance?

Who are the users of accounting information?

The conflicting interests of users

How useful is accounting information?

Evidence on the usefulness of accounting

Providing a service

Further qualities

Weighing up the costs and benefits

Accounting as an information system

Management accounting and financial accounting

Scope of this book

The changing face of accounting

Why do I need to know anything about accounting and finance?

Accounting for business

What is the purpose of a business?



What kinds of business ownership exist?

Sole proprietorship

Partnership

Limited company

How are businesses organised?

How are businesses managed?

The quest for wealth creation

Meeting the needs of other stakeholders

Balancing risk and return

Reasons to be ethical

Not-for-profit organisations

Summary

Key terms

References

Further reading

Critical review questions

Part 1 Financial accounting

2 Measuring and reporting financial position

Introduction

Learning outcomes

The major financial statements an overview

The statement of financial position

Assets

Claims

The effect of trading transactions

Classifying assets

Current assets

Non-current assets

Classifying claims

Current liabilities

Non-current liabilities

Statement layouts

Capturing a moment in time

The role of accounting conventions



Business entity convention

Historic cost convention

Prudence convention

Going concern convention

Dual aspect convention

Money measurement

Goodwill and brands

Human resources

Monetary stability

Valuing assets

Non-current assets

Non-current assets with finite lives

Non-current assets with indefinite useful lives

Fair values

The impairment of non-current assets

Inventories

Meeting user needs

Self-assessment question 2.1

Summary

Key terms

Reference

Further reading

Critical review questions

Exercises

3 Measuring and reporting financial performance

Introduction

Learning outcomes

The income statement

Different roles

Income statement layout

Gross profit

Operating profit

Profit for the period

Further issues

Cost of sales

Classifying expenses

Recognising revenue



Revenue recognition and cash receipts

Recognising revenue over time

Recognising expenses

When the expense for the period is more than the cash paid during the period

When the amount paid during the period is more than the full expense for the period

Profit, cash and accruals accounting

Depreciation

Calculating the depreciation expense

Depreciation method

Impairment and depreciation

Depreciation and asset replacement

Depreciation and judgement

Costing inventories

Inventories some further issues

Trade receivables problems

Doubtful debts

Uses and usefulness of the income statement

Self-assessment question 3.1

Summary

Key terms

Further reading

Critical review questions

Exercises

4 Accounting for limited companies (1)

Introduction

Learning outcomes

The main features of limited companies

Legal nature

Perpetual life

Limited liability

Legal safeguards

Public and private companies

Taxation

The role of the Stock Exchange

Managing a company

Financing limited companies

Equity (the owners claim)

The basic division



Share capital

Reserves

Bonus shares

Share capital jargon

Borrowings

Raising share capital

Withdrawing equity

The main financial statements

The income statement

The statement of financial position

Dividends

Accounting for groups of companies

Self-assessment question 4.1

Summary

Key terms

Further reading

Critical review questions

Exercises

5 Accounting for limited companies (2)

Introduction

Learning outcomes

The directors duty to account

The need for accounting rules

Sources of accounting rules

The growing authority of the IASB

Adopting IFRSs

The need for a conceptual framework

The IASB framework

Criticisms of the framework

The auditors role

The framework of annual financial reports

Presenting the financial statements

Fair representation

Statement of financial position

Statement of comprehensive income

Statement of changes in equity

Statement of cash flows



Notes

General points

Segmental financial reports

Segmental reporting rules

Segmental disclosure

Segmental reporting problems

Management commentary

Directors report

Criticisms of the directorsa report

Strategic report

Corporate governance

Strengthening the framework of rules

Creative accounting

Creative accounting methods

Checking for creative accounting

Creative accounting and economic growth

Self-assessment question 5.1

Summary

Key terms

References

Further reading

Critical review questions

Exercises

6 Measuring and reporting cash flows

Introduction

Learning outcomes

Why is cash so important?

The statement of cash flows and its relation to the other major financial statements

The main features of the statement of cash flows

A definition of cash and cash equivalents

The layout of the statement of cash flows

Cash flows from operating activities

Cash flows from investing activities

Cash flows from financing activities

Net increase or decrease in cash and cash equivalents

The normal direction of cash flows

Preparing the statement of cash flows



Deducing net cash flows from operating activities

Assessing performance using cash flows from operating activities

Deducing the other areas of the statement of cash flows

Reconciliation of liabilities from financing activities

What does the statement of cash flows tell us?

Problems with IAS 7

Self-assessment question 6.1

Summary

Key terms

Reference

Further reading

Critical review questions

Exercises

7 Analysing and interpreting financial statements

Introduction

Learning outcomes

Financial ratios

Financial ratio classifications

The need for comparison

Past periods

Similar businesses

Planned performance

Calculating the ratios

A brief overview

Profitability

Return on ordinary shareholders funds

Return on capital employed

Operating profit margin

Gross profit margin

Efficiency

Average inventories turnover period

Average settlement period for trade receivables

Average settlement period for trade payables

Sales revenue to capital employed

Sales revenue per employee

Relationship between profitability and efficiency

Liquidity



Current ratio

Acid test ratio

Cash generated from operations to maturing obligations ratio

Financial gearing

Gearing ratio

Interest cover ratio

Investment ratios

Dividend payout ratio

Dividend yield ratio

Earnings per share

Cash generated from operations per share

Price/earnings ratio

Financial ratios and the problem of overtrading

Trend analysis

Using ratios to predict financial failure

Using single ratios

Using combinations of ratios

Z-score models

Limitations of ratio analysis

Quality of financial statements

Inflation

The restricted view given by ratios

The basis for comparison

Statement of financial position ratios

Self-assessment question 7.1

Summary

Key terms

References

Further reading

Critical review questions

Exercises

Part 2 Management accounting

8 Making management decisions

Introduction

Learning outcomes

Costbenefit analysis

What is meant by cost?



Relevant costs: opportunity and outlay costs

Irrelevant costs: sunk costs and committed costs

Sunk cost fallacy

Determining the relevant cost of labour and materials

Labour

Materials

Non-measurable costs and benefits

Risk

Sensitivity analysis

Self-assessment question 8.1

Summary

Key terms

Further reading

Critical review questions

Exercises

9 Costvolumeprofit analysis

Introduction

Learning outcomes

Cost behaviour

Fixed cost

Variable cost

Semi-fixed (semi-variable) cost

Analysing semi-fixed (semi-variable) costs

Finding the break-even point

Contribution

Contribution margin ratio

Margin of safety

Achieving a target profit

Operating gearing and its effect on profit

Profitvolume charts

The economists view of the break-even chart

The problem of breaking even

Weaknesses of break-even analysis

Using contribution to make decisions: marginal analysis

Pricing/assessing opportunities to enter contracts

The most efficient use of scarce resources



Make-or-buy decisions

Closing or continuation decisions

Self-assessment question 9.1

Summary

Key terms

Further reading

Critical review questions

Exercises

10 Full costing

Introduction

Learning outcomes

What is full costing?

Why do managers want to know the full cost?

Single-product businesses

Process-costing problems

Multi-product businesses

Direct and indirect cost

Job costing

Full costing and cost behaviour

The problem of indirect cost

Overheads as service renderers

Job costing: a worked example

Selecting a basis for charging overheads

Segmenting the overheads

Dealing with overheads on a cost centre basis

Batch costing

Non-manufacturing overheads

Full (absorption) costing and estimation errors

Full cost (cost-plus) pricing

Price makers and price takers

Use of cost-plus information by price takers

Full (absorption) costing and relevant costs

Full (absorption) costing versus variable costing

Which method is better?

Self-assessment question 10.1

Summary

Key terms



Reference

Further reading

Critical review questions

Exercises

11 Costing and performance evaluation in a competitive environment

Introduction

Learning outcomes

Cost determination in the changed business environment

Costing and pricing: the traditional way
Costing and pricing: the new environment

Cost management systems

The problem of overheads

Taking a closer look

Activity-based costing

Assigning overheads

Benefits of ABC

ABC and the traditional approach compared

ABC and service industries

Benefits and costs of ABC

ABC in practice

Managing costs over the product life cycle

Total life-cycle costing

Target costing

Kaizen costing

Other approaches to managing costs in a modern environment

Value chain analysis

Benchmarking

Total quality management

Managing quality costs

An alternative view

Non-financial measures of performance

The balanced scorecard

Scorecard problems

Measuring shareholder value

The quest for shareholder value

How can shareholder value be created?

The need for new measures

Economic value added (EVA®)



Self-assessment question 11.1

Summary

Key terms

References

Further reading

Critical review questions

Exercises

12 Budgeting

Introduction

Learning outcomes

How budgets link with strategic plans and objectives

Exercising control

Time horizon of plans and budgets

Budgets and forecasts

Periodic and continual budgets

Limiting factors

How budgets link to one another

How budgets help managers

The budget-setting process

Using budgets in practice

Incremental and zero-base budgeting

Preparing budgets

The cash budget

Preparing other budgets

Activity-based budgeting

Non-financial measures in budgeting

Budgets and management behaviour

Who needs budgets?

Beyond conventional budgeting

Long live budgets!

Self-assessment question 12.1

Summary

Key terms

References

Further reading



Critical review questions

Exercises

13 Accounting for control

Introduction

Learning outcomes

Budgeting for control

Types of control

Variances from budget

Flexing the budget

Sales volume variance

Sales price variance

Materials variances

Labour variances

Fixed overhead variance

Reconciling the budgeted profit with the actual profit

Reasons for adverse variances

Variance analysis in service industries

Non-operating-profit variances

Investigating variances

Variance analysis in practice

Compensating variances

Standard quantities and costs

Setting standards

Who sets the standards?

How is information gathered?

What kind of standards should be used?

The learning-curve effect

Other uses for standard costing

Some problems

The new business environment

Making budgetary control effective

Behavioural issues

The impact of management style

Failing to meet the budget

Budgets and innovation

Self-assessment question 13.1

Summary



Key terms

Reference

Further reading

Critical review questions

Exercises

Part 3 Financial management

14 Making capital investment decisions

Introduction

Learning outcomes

The nature of investment decisions

Investment appraisal methods

Accounting rate of return (ARR)

ARR and ROCE

Problems with ARR

Payback period (PP)

Problems with PP

Net present value (NPV)

Why does time matter?

Interest lost

Risk

Inflation

What should managers do?

Dealing with the time value of money

Calculating the net present value

Using present value tables

The discount rate and the cost of capital

Why NPV is better

NPV and economic value

Internal rate of return (IRR)

Problems with IRR

Some practical points

Investment appraisal in practice

Survey evidence

Investment appraisal and strategic planning

Risk and investment

Managing investment projects

Stage 1: Determine investment funds available



Stage 2: Identify profitable project opportunities

Stage 3: Evaluate the proposed project

Stage 4: Approve the project

Stage 5: Monitor and control the project

Self-assessment question 14.1

Summary

Key terms

References

Further reading

Critical review questions

Exercises

15 Financing a business

Introduction

Learning outcomes

The main objective of financing policy

Sources of finance

Internal sources of finance

Internal sources of long-term finance

Retained earnings

Dividend policy

Internal sources of short-term finance

Tighter credit control

Reducing inventories levels

Delaying payment to trade payables

Some further points

External sources of finance

External sources of long-term finance

Ordinary shares

Preference shares

Borrowing

Forms of borrowing

Finance leases

Sale-and-leaseback arrangements

Hire purchase

Securitisation

External sources of short-term finance

Bank overdrafts



Debt factoring

Invoice discounting

Long-term versus short-term borrowing

Gearing and the financing decision

Financial gearing: the traditional approach

A challenge to the traditional approach

Raising long-term finance

Share issues

Rights issues

Offers for sale and public issues

Setting a share price

Private placings

Bonus issues

The role of the Stock Exchange

Advantages of a listing

Disadvantages of a listing

Going private

The Alternative Investment Market

Providing long-term finance for the small business

Is finance a particular problem for small businesses?

Equity finance

Venture capital

Business angels

Crowdfunding

Non-equity finance

Evidence on small business financing

Islamic finance

Self-assessment question 15.1

Summary

Key terms

References

Further reading

Critical review questions

Exercises

16 Managing working capital

Introduction

Learning outcomes



What is working capital?

Managing working capital

The scale of working capital

Managing inventories

Budgeting future demand

Financial ratios

Recording and reordering systems

Levels of control

Inventories management models

Managing trade receivables

Which customers should receive credit and how much should they be offered?

Length of credit period

Cash discounts

Debt factoring and invoice discounting

Credit insurance

Collection policies

Managing cash

Why hold cash?

How much cash should be held?

Controlling the cash balance

Cash budgets and managing cash

Operating cash cycle

Cash transmission

Bank overdrafts

Managing trade payables

Taking advantage of cash discounts

Controlling trade payables

Managing working capital

Self-assessment question 16.1

Summary

Key terms

Further reading

Critical review questions

Exercises

Part 4 Supplementary information

Appendix A Recording financial transactions

Introduction



Learning outcomes

The basics of double-entry bookkeeping

Recording trading transactions

Balancing accounts and the trial balance

Preparing the financial statements (final accounts)

The ledger and its division

Summary

Key terms

Further reading

Exercises

Appendix B Glossary of key terms

Appendix C Solutions to self-assessment questions

Appendix D Solutions to critical review questions

Appendix E Solutions to selected exercises

Appendix F Present value table

Index

Back Cover

