
Financial Accounting
CRAIG DEEGAN

ABOUT THE AUTHOR

CRAIG DEEGAN

CRAIG DEEGAN, BCom (University of NSW), MCom (Hons) (University of NSW), PhD (University of Queensland), FCA, is Professor of Accounting in the School of Accounting at RMIT University in Melbourne. Craig has taught at both undergraduate and postgraduate level for about three decades. Prior to working in the university sector Craig worked as a chartered accountant. His research has tended to focus on various social and environmental accountability and financial accounting issues and has been published in a number of leading international accounting journals, including: *Accounting, Organizations and Society; Accounting and Business Research; Accounting, Accountability and Auditing Journal; Accounting and Finance; British Accounting Review; Critical Perspectives on Accounting; Journal of Business Ethics; Australian Accounting Review; and The International Journal of Accounting.* **According to Google Scholar, Craig's work has attracted approximately 12,000 citations making him one of the most highly cited researchers internationally within the accounting and/or finance literature.**

Craig has regularly provided consulting services to corporations, government, and industry bodies on issues pertaining to financial accounting and corporate social and environmental accountability, he was former Chairperson of the Triple Bottom Line Issues Group of the Institute of Chartered Accountants in Australia, for a number of years was involved in developing the CPA Program of CPA Australia, and for many years was a judge on the *Australian Sustainability Reporting Awards.* **He is on the editorial board of a number of academic accounting journals and he has been the recipient of various teaching and research awards, including teaching prizes sponsored by KPMG, and the Institute of Chartered Accountants in Australia. He was the inaugural recipient of the Peter Brownell Manuscript Award, an annual research award presented by the Accounting and Finance Association of Australia and New Zealand. He was also awarded the University of Southern Queensland Individual Award for Research Excellence.**

Craig is also the author of the leading financial accounting theory textbook, *Financial Accounting Theory***, now in its fourth edition.** *Financial Accounting Theory* **is widely used throughout Australia as well as in many other countries.**

CONTENTS IN BRIEF

PREFACE

This is the eighth edition of a book that was originally published in 1995. Since the first edition of this book was published we have seen extensive changes in relation to the practice and regulation of general purpose financial reporting. These changes continue to occur and this book has always attempted to carefully explain the nature of the changes as well as the potential economic and social consequences which might result from such changes.

In the period of time between when the seventh edition of this book was published, and the writing of this eighth edition was completed (writing was completed in March 2016) there have been some rather significant changes in regulation and guidance pertaining to external reporting. These changes have been incorporated within this eighth edition and some of the major changes we cover relate to such areas as financial statement presentation, The Conceptual Framework for Financial Reporting, accounting for leases, revenue recognition, financial instruments, and corporate social-responsibility reporting. Because many of these changes are significant we will provide critical comparisons of the ‵old′ and ‵new′ requirements.

Each chapter of this eighth edition contains learning objectives, chapter summaries and a comprehensive end-of-chapter exercise. A glossary of key terms is provided towards the back of the book. The book provides material that will enable the reader to gain a thorough grasp of the contents and of the practical application of the majority of financial accounting requirements currently in place in Australia. In the discussion of these requirements, numerous worked examples, with detailed solutions, are provided throughout the text.

As well as addressing how to apply the various accounting requirements, this text also encourages readers to critically evaluate the various rules and guidelines. The aim is to develop accountants who are not only able to apply particular accounting requirements, but who will also be able to contribute to the ongoing improvement of accounting requirements. The view taken is that it is not only important for students to understand the rules of financial accounting, but also to understand the limitations inherent in many of the existing accounting requirements. For this reason, reference is made to various research studies that consider the merit, implications, and costs and benefits of the various accounting requirements. Also, various newspaper articles discussing different aspects of the accounting requirements are reproduced for consideration and discussion. The permission of copyright holders to reproduce this material is gratefully acknowledged.

Social-responsibility reporting continues to be an important area of accounting, and one that is rapidly developing. Its importance is further highlighted by the growing evidence of climate change, species extinction, and large scale poverty, hunger and social inequities in many countries. While this book predominantly considers financial accounting and reporting, Chapter 30 focuses on social-responsibility reporting and provides the most up-to-date and comprehensive material available on this important topic with additional material being added on the important topic of Climate Changeboth from an accounting and scientific perspectiveas well as the inclusion of commentaries on various alternative reporting frameworks.

Writing a text like this is an extremely time-consuming exercise and it has been very gratifying that the effort involved has been rewarded by so many institutions across Australia (and also some outside Australia) electing to prescribe previous editions of this book as part of their accounting programs. Given the success of all previous editions, every effort has been made to ensure that this eighth edition is equally valuable to students and teachers, and that it has been substantially and thoroughly revised.

ACKNOWLEDGMENTS

There are many people who must be thanked for their contribution to the eighth edition of this book. First, our thanks to the following reviewers of the current edition:

Bobae Choi, *University of Newcastle;* **Sally Chaplin,** *Queensland University of Technology;* **Victoria Clout,** *University of New South Wales;* **Sajan Cyril,** *Australian Catholic University;* **Colin Dolley,** *Edith Cowan University;* **Peter Dryden,** *Federation University;* **Hermann Frick,** *University of Queensland;* **Syed Haider,** *Victoria University;* **Andrew Jackson,** *University of New South Wales;* **Arifur Khan,** *Deakin University;* **Eric Lee,** *Monash University;* **Janet Lee,** *Australian National University;* **Jinghui Liu,** *Southern Cross University;* **Tracey McDowall,** *Deakin University;* **Balachandran Muniandy,** *La Trobe University;* **Puspalila Muniandy,** *Deakin University;* **Gregory Phillip,** *University of Newcastle* **; Pranil Prasad,** *University of the South Pacific;* **Maria Prokofieva,** *Victoria University;* **Glenn Rechtschaffen,** *University of Auckland;* **Natasja Steenkamp,** *Central Queensland University;* **Grantley Taylor,** *Curtin University;* **Suzanne Mary Taylor,** *QUT Business School;* **Maria Tyler,** *CQUniversity Mackay campus;* **Effiezal Aswadi Abdul Wahab,** *Curtin University.*

This book has also been improved during the course of the first seven editions by the feedback received from many people and I would like to acknowledge the contribution that they have previously made. These people include:

Maria Balatbat, *University of New South Wales;* **Peter Baxter,** *University of the Sunshine Coast;* **Poonam Bir,** *Monash University;* **Phil Cobbin,** *University of Melbourne;* **Lome Cummings,** *Macquarie University;* **Matt Dyki,** *Charles Sturt University, Wagga Wagga campus;* **Natalie Gallery,** *Queensland University of Technology;* **John Goodwin,** *RMIT University;* **Deborah Janke,** *University of Southern Queensland;* **Maurice Jenner,** *University of Southern Queensland;* **Graham Jones,** *Flinders University;* **Peter Keet,** *RMIT University;* **Janet Lee,** *Australian National*

University; **Steven Lesser,** *Charles Sturt University, Wagga Wagga campus;* **Stephen Lim,** *University of Technology Sydney;* **Janice Loftus,** *University of Sydney;* **Wei Lu,** *Monash University;* **Diane Mayorga,** *University of New South Wales;* **Kellie McCombie,** *University of Wollongong;* **Malcolm Miller,** *University of New South Wales;* **Lee Moermon,** *University of Wollongong;* **Gary Monroe,** *Australian National University;* **Richard Morris,** *University of New South Wales;* **Anja Morton,** *Southern Cross University, Lismore campus;* **Karen Ness,** *James Cook University;* **Cameron Nichol,** *RMIT University;* **Gary Plugarth,** *University of New South Wales;* **Lisa Powell,** *University of South Australia;* **Jim Psaros,** *University of Newcastle;* **Michaela Rankin,** *Monash University;* **Andrew Read,** *University of Canberra;* **Kathy Rudkin,** *University of Wollongong;* **Dan Scheiwe,** *Queensland University of Technology;* **Mark Silvester,** *University of Southern Queensland;* **Stella Sofocleous,** *Victoria University of Technology;* **Jenny Stewart,** *Griffith University;* **Seng The,** *Australian National University;* **Len Therry,** *Edith Cowan University;* **Matthew Tilling,** *University of Western Australia;* **Irene Tutticci,** *University of Queensland;* **Mark Vallely,** *University of Southern Queensland;* **Trevor Wilmshurst,** *University of Tasmania;* **Victoria Wise,** *University of Tasmania;* **Ann-Marie Wyatt,** *University of Technology Sydney.*

Thanks also go to many of my colleagues at RMIT University for their friendship and encouragement. The team at McGraw-Hill Education (Australia) also deserve a great deal of thanks for helping in the preparation of this book.

Lastly, but certainly not leastly, thanks again go to my 16-year-old daughter Cassandra for all the love and support she gives me in whatever I seem to be doing and for continually helping me to put everything into perspective. As I have said before, she is indeed my finest work (and my most valuable 'asset') and represents that aspect of my life of which I am most proud.

Craig Deegan

The publisher would also like to thank the following digital contributors: Victoria Clout, Parmod Chand, Maria Prokofieva, Jackie Liu, Maria Balatbat, Eric Lee and Matt Dyki.

AACSB STATEMENT

McGraw-Hill Education is a proud corporate member of AACSB[1] **International. Understanding the importance and value of AACSB accreditation,** *Financial Accounting* **has sought to recognise the curricula guidelines detailed in the AACSB standards for business accreditation by connecting content and exercises to the general knowledge and skill guidelines found in the AACSB standards.**

The statements contained in *Financial Accounting* **and in its digital resources are provided only as a guide for the users of this text. The AACSB leaves content coverage and assessment within the purview of individual institutions, the mission of the institutions, and the faculty. While** *Financial Accounting* **and the teaching package make no claim of any specific AACSB qualification or evaluation, we have, within** *Financial Accounting* **identified chapters as containing content and labelled activities according to the general knowledge and skills areas.**[2]

HOW TO USE THIS BOOK

Learning objectives

Each chapter starts with a list of the chapter′s learning objectives. These flag what you should know when you have worked through the chapter. Make these the foundation for your exam revision by using them to test yourself. The end-of-chapter assignments also link back to these learning objectives.

LEARNING OBJECTIVES (LO)

- 6.1 Be able to measure the cost of property, plant and equipment.
- 6.2 Understand the meaning of 'fair value'.
- 6.3 Understand how and when to revalue an item of property, plant and equipment in accordance with AASB 116 *Property, Plant and Equipment.*
- 6.4 Understand how and when to revalue an intangible asset in accordance with AASB 138 *Intangible Assets.*
- 6.5 Understand the meaning of 'recoverable amount' and be able to calculate it.
- 6.6 Understand the difference in accounting treatments for upward revaluations to 'fair value', as opposed to write-downs to 'recoverable amount'.
- 6.7 Understand what an 'impairment loss' is and know when and how to account for one in accordance with AASB 136 *Impairment of Assets*.
- 6.8 Understand how to account for revaluations that reverse previous revaluation increments or decrements.
- 6.9 Understand how to account for accumulated depreciation when a non-current depreciable asset is revalued, and understand that, subsequent to revaluation, new depreciation charges will be based on the revalued amount of the non-current asset.

Chapter introduction

Each chapter begins with an excellent overview of the material to be covered, and places it in the broader context of how topics in various chapters interrelate.

Worked examples

A wide range of detailed scenarios and solutions, some fairly straightforward and some more complex, are provided throughout the text and are a great learning aid, helping to reinforce how the theory is applied in practice and their relevance to actual situations.

WORKED EXAMPLE 6.1: Revaluation of a depreciable asset using the net-amount method

Assume that, as at 1 July 2018, Farrelly Ltd has an item of machinery that originally cost $40 000 and has accumulated depreciation of $15 000. Its remaining life is assessed to be five years, after which time it will have no residual value. While completing a regular revaluation of all machinery, Farrelly decided on 1 July 2018 that the item should be revalued to its current fair value, which was assessed as $45 000.

REQUIRED

Provide the appropriate journal entries to account for the revaluation using the net-amount method.

SOLUTION

The total revaluation increment will represent the difference between the carrying amount and the fair value of the asset at the date of the revaluation. In this case it would be:

$45 000 − ($40 000 − $15 000) = $20 000

The appropriate journal entries on 1 July 2018 would be:

Dr	Accumulated depreciation—machinery	15 000	
Cr	Machinery		15 000
Dr	Machinery	20 000	

Financial accounting in the real world

Accounting is often a major and controversial part of news items that hit the headlines. Excerpts from the media put various aspects of accounting under the spotlight, emphasising how integral it is to business life. They also help students gain a wider grasp of accounting by presenting opposing viewpoints in relation to hot topics. Some show accounting in a historical context; others relate to contemporary issues.

11.1 FINANCIAL ACCOUNTING IN THE REAL WORLD

Effect on retailers from proposed new rules around lease accounting

In 2008, following spectacular corporate collapses like that of Enron, the International Accounting Standards Board (IASB) outlined a proposal that operating leases should be included on a company's balance sheets in the interest of transparency for creditors and investors around corporate debt. The IASB was forced into a rethink after a backlash from major retailers including Woolworths and Wesfarmers, denouncing the original proposals as complex and costly.

Under the latest changes to lease accounting rules put forward by the IASB, retailers such as Woolworths, Wesfarmers, Myer, David Jones, JB Hi-Fi, Harvey Norman, Specialty Fashion and Premier Investments will have to calculate the net present value of future lease commitments and recognise them as debt on their balance sheets. Instead of recognising rent payments as costs incurred, retailers will have to expense theoretical amortisation and financing costs. This will boost earnings before interest, tax, depreciation and amortisation but will reduce pre-tax and net profits, as the amortisation and financing costs will exceed rental payments, especially for faster growing retailers with relatively new leases. According to a report by Morgan Stanley, the impact on retailers will be 'considerable', blowing out gearing levels and reducing return on capital employed, but will vary from retailer to retailer.

Reactions to the proposed rules include a report by Morgan Stanley predicting a considerable but varied impact on retailers including reduced capital return and a blow out of gearing levels. The report says Myer, Specialty Fashion and The Reject Shop will be more affected than Kathmandu and Fantastic Furniture as the former have significant and long-term lease liabilities. Also new retailers like Lovisa, who are early into lease terms will probably be impacted more than established leaseholder retailers.

Morgan Stanley analyst Tom Kierath says investors aren't as aware of the change to lease accounting rules as

Figures

Figures provide a graphical representation of how events and actions link.

Tables

Tables provide useful checklists.

Exhibits

These features contain extracts from actual company reports or documents, or provide a commonly used format for accounting. They highlight the relevance of the chapter content to the practice of accounting, provide another element to the topics covered and help to reinforce learning.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Inventories

Recognition and measurement
Inventories are valued at the lower of cost and net realisable value. The net realisable value of inventories is the estimated selling price in the ordinary course of business less estimated costs to sell.

Key estimate: net realisable value
The key assumptions, which require the use of management judgement, are the variables affecting costs recognised in bringing the inventory to location and condition for sale, estimated costs to sell and the expected selling price. These key assumptions are reviewed at least annually. The total expense relating to inventory write-downs during the year was $46 million (2014: $19 million). Any reasonable possible change in the estimate is unlikely to have a material impact.

Costs incurred in bringing each product to its present location and condition are accounted for as follows:

- *Raw materials:* purchase cost on a weighted average basis.
- *Manufactured finished goods and work in progress:* cost of direct materials and labour and a proportion of manufacturing overheads based on normal operating capacity, but excluding borrowing costs. Work in progress also includes run-of-mine coal stocks for resources, consisting of production costs of drilling, blasting and overburden removal.
- *Retail and wholesale merchandise finished goods:* purchase cost on a weighted average basis, after deducting any settlement discount and including logistics expenses incurred in bringing the

Exhibit 7.1 Accounting policy note from the 2015 Annual Report of Wesfarmers Ltd

Chapter summary

Key points of the chapter are summarised in this section. Check through it carefully to make sure you have understood topics covered before moving on.

Key terms

Key terms are bolded in the text the first time they are used, defined in the margin at that point, and listed at the end of each chapter. They also appear in the glossary at the end of the book.

End-of-chapter exercise

A comprehensive exercise and worked solution is provided at the end of each chapter. These are a great revision aid; work through them before tackling the more challenging questions to ensure you are on the right track.

END-OF-CHAPTER EXERCISES

Anderson Pty Ltd is an Australian diversified industrial company with its major business activity being to manufacture flotation devices for babies and toddlers. Over the past decade, the business has been very profitable and the directors, Simon Anderson and Lisa Anderson, have kept payment of dividends to a minimum to allow the company to diversify into other activities. The following is a list of property, plant and equipment held by the company:

	Carrying amount ($)	*Current fair value ($)*
Property, plant and equipment		
Factory (NSW)		
Land	100 000	150 000
Buildings		
– Cost	70 000	80 000
– Accumulated depreciation	(20 000)	–
Factory (Qld)		
Land	150 000	120 000
Buildings		
– Cost	125 000	70 000

Review questions

These questions ask you to reflect on key topics within the chapter, and help cement your learning.

REVIEW QUESTIONS

1. What effect will an asset revaluation have on subsequent periods' profits? Explain your answer. **LO 6.10**
2. Explain the difference in the accounting treatment for revaluation increments and revaluation decrements. Do you consider that this difference is 'conceptually sound'? **LO 6.6**
3. When should a revaluation increment be included as part of profit or loss? **LO 6.6, 6.8**
4. For the purposes of AASB 116 or AASB 136, how is 'recoverable amount' determined? **LO 6.5**
5. When would you determine the recoverable amount for a cash-generating unit rather than for an individual item of property, plant and equipment? **LO 6.11**

Challenging questions

These questions require a detailed problem analysis and help to build problem-solving and critical thinking skills.

CHALLENGING QUESTIONS

20. What, if anything, is the difference between recoverable amount and fair value? Where revaluations are undertaken, can a reporting entity use 'value in use' as the basis for the revaluation? **LO 6.3, 6.5, 6.6**

21. Kanga Cairns Ltd owns two blocks of beachfront land, acquired in 2015 for the purposes of future residential development. Block A cost $250 000 and Block B cost $350 000.

    Valuations of the blocks are undertaken by an independent valuer on 30 June 2017 and 30 June 2019. The assessed values are:

	2017 valuation ($)	*2019 valuation ($)*
Block A	230 000	290 000
Block B	370 000	340 000

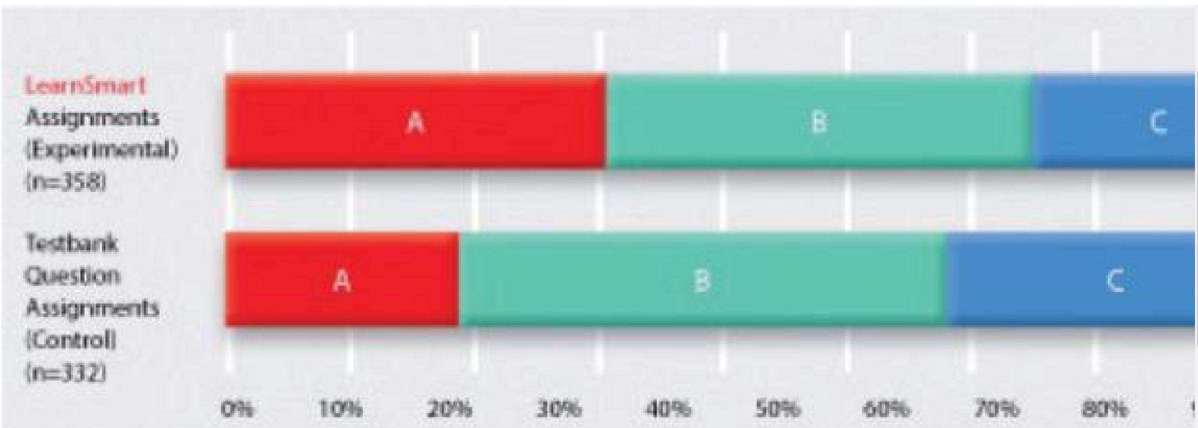
    REQUIRED

    Assuming asset revaluations were undertaken for the land in both 2017 and 2019, provide the journal entries for both years. **LO 6.3, 6.8**

LearnSmart Advantage is a series of adaptive learning products fuelled by LearnSmartthe most widely used and adaptive learning resource proven to strengthen memory recall, increase retention and boost grades.

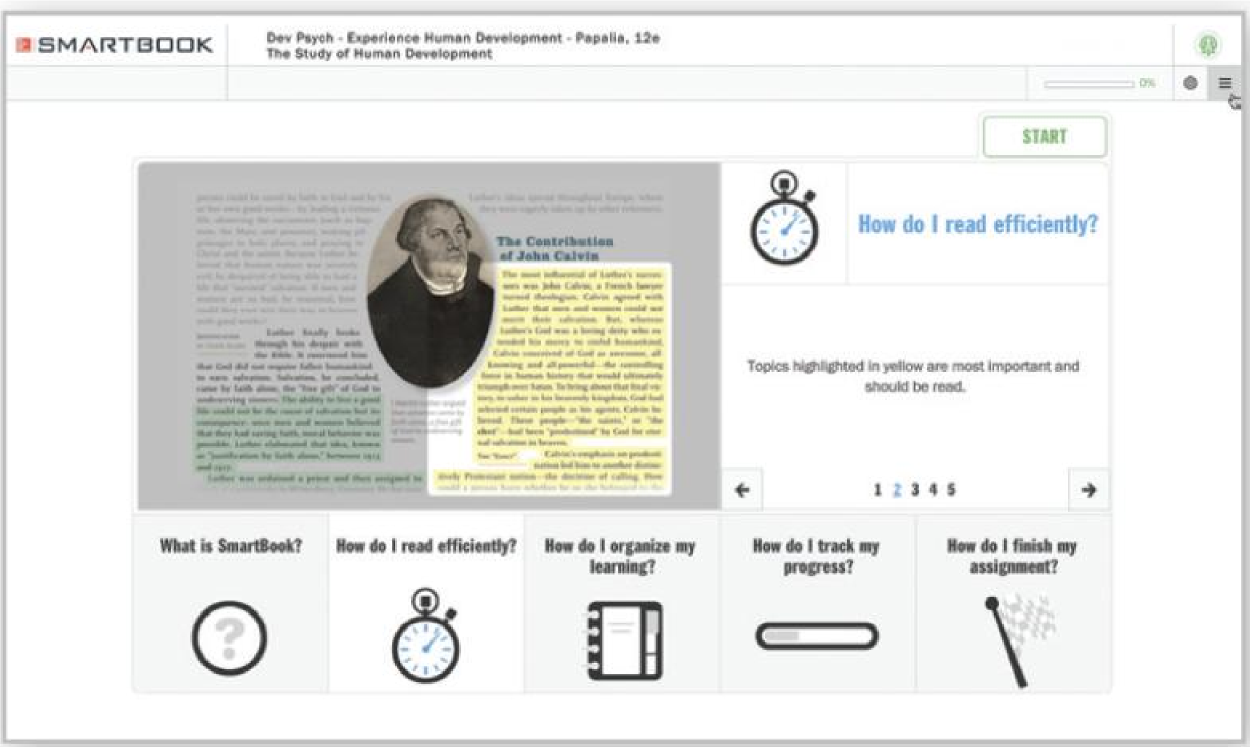
Adaptive learning

No two students are the same, so why should their learning experience be? Adaptive technology uses continual assessment and artificial intelligence to personalise the learning experience for each individual student. As the global leader in adaptive and personalised learning technologies, McGraw-Hill Education is pioneering ways to improve results and retention across all disciplines.



SmartBook

Fuelled by LearnSmart, SmartBook is the first and only adaptive reading experience available today. Starting with an initial preview of each chapter and key learning objectives, students read material and are guided to the topics they most need to practise at that time, based on their responses to a continuously adapting diagnostic. To ensure concept mastery and retention, reading and practice continue until SmartBook directs students to *recharge* **and review important material they are most likely to forget.**



LearnSmart

LearnSmart maximises learning productivity and efficiency by identifying the most important learning objectives for each student to master at a given point in time. It knows when students are likely to forget specific information and revisits that content to advance knowledge from their short-term to long-term memory. LearnSmart is proven to improve academic performance, ensuring higher retention rates and better grades.

To find out more about SmartBook visit
www.mheducation.com.au/student-smartbook

McGraw-Hill Connect is the only learning platform that continually adapts to you, delivering precisely what you need, when you need it.

Proven effective

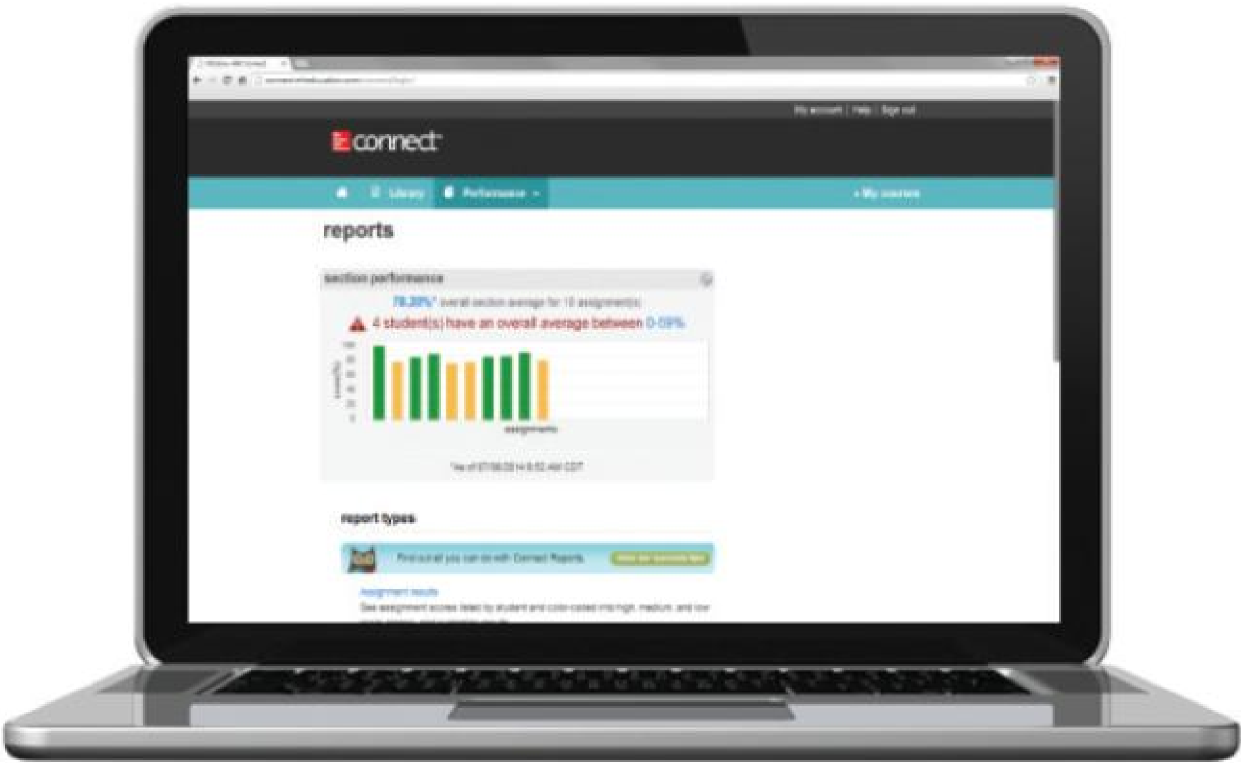
With Connect, you can complete your coursework anytime, anywhere. Millions of students have used Connect and the results are in: research shows that studying with McGraw-Hill Connect will increase the likelihood that you'll pass your course *and* get a better grade.

Connect support

Connect includes animated tutorials, videos and additional embedded hints within specific questions to help you succeed. The Connect Success Academy for Students is where you'll find tutorials on getting started, your study resources and completing assignments in Connect. Everything you need to know about Connect is here!

Visual progress

Connect provides you with reports to help you identify what you should study and when your next assignment is due, and tracks your performance. Connect's Overall Performance report allows you to see all of your assignment attempts, your score on each attempt, the date you started and submitted the assignment, and the date the assignment was scored.



To learn more about McGraw-Hill Connect, visit www.mheducation.com.au/student-connect

CREDITS

CONTENTS IN FULL

Page x