

Short Introduction to Accounting

An introduction to the fundamentals of accounting and how it is used that will help students apply accounting as a usable, everyday business tool. It adopts an intuitive, informal approach to describe basic principles – what they are, why they exist and how they are used – to help students see the connections between different parts of accounting and the rest of the business world. Written by an award-winning teacher, it encourages students to engage with the material by using questions and worked examples to test knowledge and understanding as they read. It includes a glossary of financial terms that is a useful guide to the language of business.

RICHARD BARKER is Senior Lecturer in Accounting at the Judge Business School, University of Cambridge, and Visiting Professor in Accounting at the Saïd Business School, University of Oxford.

Cambridge Short Introductions to Management

Series editors: Cary L. Cooper CBE, Lancaster University
Thomas G. Cummings, University of Southern California

The purpose of this innovative series is to provide short, authoritative, reasonably priced books for students taking a first course in Management, particularly at MBA and Master's level. The books include concise coverage of the key concepts taught in the core subjects, as well as suggestions for further study. Written by a team of experts from the world's leading business schools, these books are highly recommended for anyone preparing to study for an advanced management qualification.

For supplementary materials, visit the series website: www.cambridge.org/csi

About the series editors:

Cary L. Cooper is Distinguished Professor of Organizational Psychology and Health, and Pro Vice-Chancellor at Lancaster University. He is the author/editor of over 120 books and is a frequent contributor to national newspapers, TV and radio. Professor Cooper is a past president of the British Academy of Management, a companion of the Chartered Management Institute and one of the first UK-based fellows of the (American) Academy of Management. In 2001, Professor Cooper was awarded a CBE in the Queen's Birthday Honours List for his contribution to occupational safety and health.

Thomas G. Cummings is a leading international scholar and consultant on strategic change and designing high-performance organisations. He is Professor and Chair of the Department of Management and Organization at the Marshall School of Business, University of Southern California. He has authored over 70 articles and 22 books. Professor Cummings was the 61st President of the Academy of Management, the largest professional association of management scholars in the world with a total membership of over 19,000.

Short Introduction to Accounting

Richard Barker



CAMBRIDGE
UNIVERSITY PRESS

Cambridge University Press & Assessment
978-1-107-00440-5 — Short Introduction to Accounting Euro Edition
Richard Barker
Frontmatter
[More Information](#)



CAMBRIDGE
UNIVERSITY PRESS

Shaftesbury Road, Cambridge CB2 8EA, United Kingdom
One Liberty Plaza, 20th Floor, New York, NY 10006, USA
477 Williamstown Road, Port Melbourne, VIC 3207, Australia
314–321, 3rd Floor, Plot 3, Splendor Forum, Jasola District Centre, New Delhi – 110025, India
103 Penang Road, #05–06/07, Visioncrest Commercial, Singapore 238467

Cambridge University Press is part of Cambridge University Press & Assessment,
a department of the University of Cambridge.

We share the University's mission to contribute to society through the pursuit of
education, learning and research at the highest international levels of excellence.

www.cambridge.org

Information on this title: www.cambridge.org/9781107004405

© Richard Barker 2011

This publication is in copyright. Subject to statutory exception and to the provisions
of relevant collective licensing agreements, no reproduction of any part may take
place without the written permission of Cambridge University Press & Assessment.

First published 2011

7th printing 2014

A catalogue record for this publication is available from the British Library

Library of Congress Cataloging-in-Publication data

Barker, Richard.

Short introduction to accounting / Richard Barker.

ISBN 978-0-521-17947-8 Paperback

1. Accounting I. Title

HF5636.B37 2011

357–dc22 2011002699

ISBN 978-1-107-00440-5 Hardback

ISBN 978-0-521-17947-8 Paperback

Additional resources for this publication at www.cambridge.org/delange

Cambridge University Press & Assessment has no responsibility for the persistence
or accuracy of URLs for external or third-party internet websites referred to in this
publication and does not guarantee that any content on such websites is, or will
remain, accurate or appropriate.

Contents

List of figures vi

List of tables vii

Introduction 1

Part I

Introduction to Part I

- 1** A guided tour of the financial statements 13
- 2** The need for financial information 27
- 3** Keeping track of economic activity 47
- 4** Summary of the foundations of accounting 65

Part II

Introduction to Part II

- 5** The accounts as a lens on growth 87
- 6** Measuring value creation 99
- 7** Understanding risk 111
- 8** Building a corporate valuation model 128

Appendix 1 Glossary of accounting terms 142

Appendix 2 Further reading 153

Index 155

Figures

- 7.1 Breakeven analysis 115
- 7.2 Cost categories 118

Tables

- 1.1 Albert's cash flow statement for the past financial year 14
- 1.2 Albert's income statement for the past financial year 17
- 1.3 Albert's balance sheet on his first day of business 21
- 1.4 Albert's balance sheet at the end of the financial year 21
- 1.5 Retail company 24
- 2.1 Sarah's bank statement 30
- 2.2 Sarah's cash flow statement 32
- 2.3 Operating cash flow plus accruals equals profit 37
- 2.4 Opening balance sheet 40
- 2.5 Piecing together all of Sarah's financial activities 42
- 2.6 Sarah's summary financial statements 44
- 3.1 Impact of Sarah's transactions and events on the balance sheet 49
- 3.2 Summary of changes to Sarah's balance sheet 51
- 3.3 Changes to the balance sheet 52
- 3.4 Different types of change to the balance sheet 55
- 3.5 'T' accounts 59
- 3.6 Sarah's general ledger 60
- 3.7 Consulting firm's general ledger 63
- 3.8 Consulting firm's financial statements 63
- 4.1 Journal entries for the first year 74
- 4.2 Financial statements for the first year 76
- 4.3 Journal entries for the second year 81
- 4.4 Financial statements for the second year 82
- 5.1 Nine different routes to zero net cash flow 89
- 5.2 A summary of the nine different routes to zero net cash flow 91
- 5.3 Balance sheets for the nine companies 92
- 5.4 Balance sheets with depreciation and increase in accounts receivable 95
- 5.5 Income statements 96
- 6.1 Profitability and growth 102

6.2	Economic profit	108
6.3	Variation in economic profit	108
7.1	Operating leverage	112
7.2	Effects of operating leverage	114
7.3	Financial leverage	120
7.4	Effects of financial leverage	125
7.5	Financial leverage when buying a house	126
8.1	Income statement	131
8.2	Balance sheet	132
8.3	Cash flow statement	134
8.4	Determining free cash flow	135
8.5	Valuation of cash flows	136
8.6	Corporate valuation	140