

FINANCIAL ACCOUNTING

REPORTING, ANALYSIS AND DECISION MAKING
5TH EDITION

CARLON | MLADENOVIC | PALM | MITRIONE | KIRK | WONG

WILEY

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Shirley CARLON

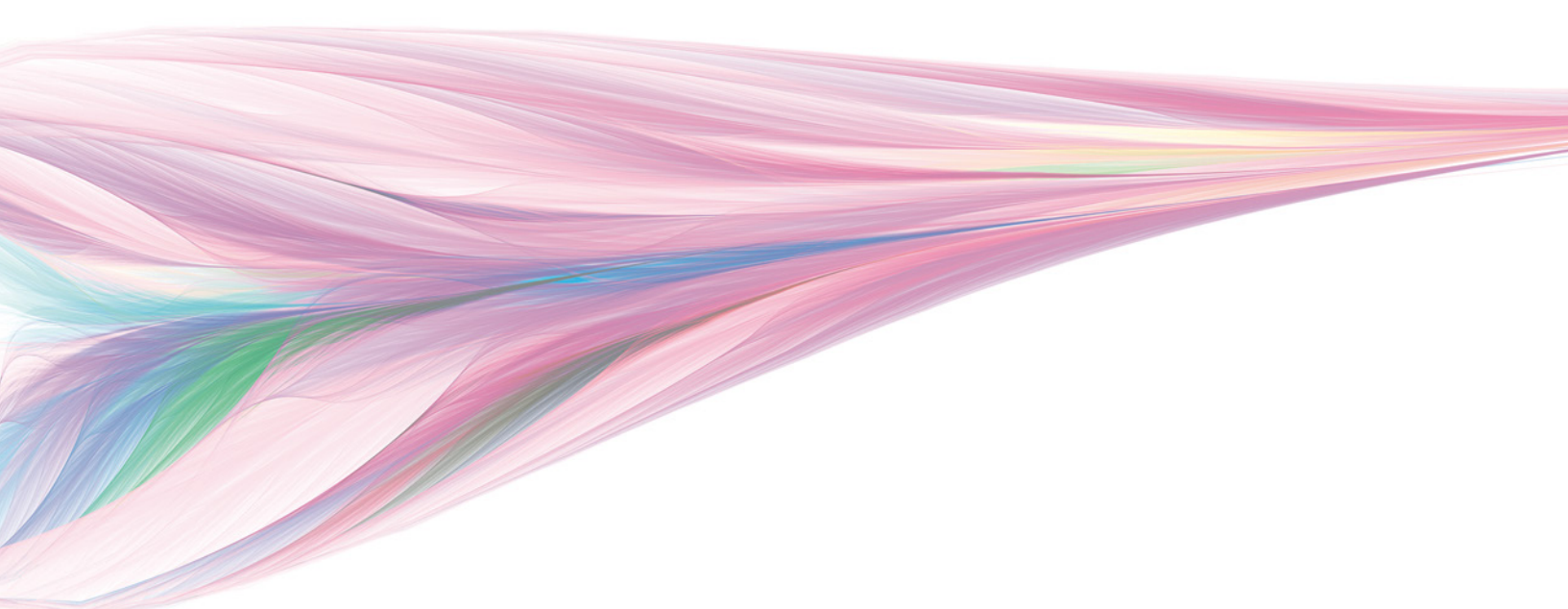
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preface

In recent years accounting education has seen numerous changes to the way financial accounting is taught. These changes reflect the demands of an ever-changing business world, opportunities created by new technology and instructional technologies, and an increased understanding of how students learn. The foundation of this textbook is based on a number of unique principles and innovations in accounting education.

‘Less is more.’

The objective of this textbook is to provide students with an understanding of those concepts that are fundamental to the preparation and use of accounting information. Most students will forget procedural details within a short period of time. On the other hand, concepts, if well taught, should be remembered for a lifetime. Concepts are especially important in a world where the details are constantly changing.

‘Don’t just sit there — do something.’

Students learn best when they are actively engaged. The overriding pedagogical objective of this book is to provide students with continual opportunities for active learning. One of the best tools for active learning is strategically placed questions. Our discussions are framed by questions, often beginning with rhetorical questions and ending with review questions, and our analytical devices, called decision-making toolkits, use key questions to demonstrate the purpose of each.

‘I’ll believe it when I see it.’

Students will be more willing to commit time and energy to a topic when they believe that it is relevant to their future career. There is no better way to demonstrate relevance than to ground discussion in the real world. Consistent with this, we adopted a macro-approach — starting in chapter 1, students are shown how to use financial statements of real companies. By using high-profile companies such as Domino’s Pizza Enterprises, Coca-Cola Amatil, Qantas and Vodafone to frame our discussion of accounting issues, we demonstrate the relevance of accounting while teaching students about companies with which they are familiar and may have daily contact. As they become acquainted with the financial successes and fluctuations of these companies, many students will begin to follow business news more closely, making their learning a dynamic, ongoing process. We also discuss small to medium-sized companies to highlight the challenges they face as they try to grow.

‘You’ll need to make a decision.’

In a business environment there are many and varied decisions to be made. Illustrative examples of the types of decisions internal management and external financial statement users make are discussed throughout the text. Decision making involves identifying and sourcing the relevant information, analysing data and critically evaluating alternatives, and this takes practice. To assist you in locating the many insights contained within the text in relation to the role of accounting in decision making, we have placed decision-making icons in the minor column adjacent to this content.

‘It’s a small world.’

In addition, to develop your analysis and decision-making skills, we have integrated important analytical tools throughout the book. After each new decision-making tool is presented, we summarise the key features of that tool in a decision-making toolkit. At the end of each chapter we provide a comprehensive demonstration of an analysis of a real or hypothetical company using the decision tools presented in the chapter. The presentation of these tools throughout the book is logically sequenced to take full advantage of the tools presented in earlier chapters.

‘Apply what you learn.’

Business operates in a global environment. Rapid and ever-changing improvements in information technology, logistics and transport continue to strive towards a single global economy. The internet has made it possible for even small businesses to sell their products virtually anywhere in the world. Few business decisions can be made without consideration of international factors. To heighten student awareness of the issues that concern business most we have included a range of case studies that explore international, environmental, financial analysis and ethical issues in the Building Business Skills section.

In developing this text we have been mindful of the Accounting Threshold Learning Outcomes and accordingly for the first time we have integrated a case book. The case book features a series of capstone cases aligned to the first 12 chapters of the text, and has been designed to challenge students to apply their analytical skills, exercise judgement and communicate a financial decision. The text is also accompanied by a WileyPLUS course featuring algorithmic versions of most of the end-of-chapter questions, interactive revision modules and online versions of the case studies.

KEY FEATURES AT A GLANCE

This textbook is designed for students studying accounting for the first time. Real and hypothetical company financial information to support student understanding of accounting as an information system is presented in a clear, easy-to-follow way.

- The focus company is Domino's Pizza Enterprises Ltd. This company was selected because it has high brand name recognition with students, operates mainly in the retail sector and has clear, easy-to-read financial statements.
- Financial data from various real companies are used to highlight comparative financial results and measure financial performance. Nick Scali Furniture, Fantastic Furniture Holdings, Qantas and Fonterra Co-operative Group Ltd are a sample of the companies profiled.
- There is a clear, well-developed balance between the perspectives of the users and the preparers of financial statements.
- In several chapters, 'Review it' questions concerning Domino's Pizza Enterprises Ltd relate chapter topics to real-world scenarios.
- In the 'Building Business Skills' section at the end of each chapter, financial reporting problems use Domino's Pizza Enterprises Ltd's financial statements to align the chapter material to the real world.
- Analysis and decision making incorporated throughout the chapters reinforce applications to decision making and use of accounting information by management.

PEDAGOGICAL FRAMEWORK

We have used many constructive pedagogical tools to help students learn accounting concepts and apply them to decision making in the business world. Chapter 1 contains notes (printed in red) that explain each pedagogical element the first time it appears.





Understanding the context

- **Learning objectives**, listed at the beginning of each chapter, form a framework throughout the text, with each objective repeated in the margin at the appropriate place in the main body of the chapter and again in the **summary of learning objectives**. Also, end-of-chapter assignment materials are linked to the learning objectives.
- A **chapter-opening story** presents a scenario that relates an actual business situation to the topic of the chapter. The story also serves as a recurrent example throughout the chapter. All of the stories include the web site of the entity cited in the story to encourage students to go online to get more information about the entity.
- A chapter **preview** links the chapter-opening story to the major topics of the chapter. First, an introductory paragraph explains how the story relates to the topics to be discussed, and then a graphic outline of the chapter provides a 'road map', useful for seeing the big picture as well as the connections between subtopics.

Learning the material

- This book emphasises the accounting experiences of real entities throughout, from chapter-opening story to the chapter's last item of homework material. Details on these many features follow. In addition, every financial accounting chapter uses **financial statements** from real companies.
- Continuing the real-world flavour of the book, **application in business** boxes in each chapter give students glimpses into how real companies and users of financial statements make decisions using accounting information. The boxes focus on various accounting perspectives — those of investors, managers, e-business, ethical and governance, and international business.
- Colour **illustrations** support and reinforce the concepts of the text. Infographics help students visualise and apply accounting concepts to the real world. The infographics often portray important concepts in entertaining and memorable ways.
- **Learning reflection and consolidation** sections occur at the end of each key topic and consist of two parts. **Review it** serves as a learning check within the chapter by asking students to stop and answer knowledge and comprehension questions about the material just covered. Questions marked with the Domino's Pizza Enterprises logo send students to find information in that company's 2013 financial statements, which are printed in Appendix A at the back of the book. These exercises help cement students' understanding of how topics covered in the chapter are reported in real-world financial statements. Answers to questions using Domino's financial statements appear at the end of the chapter. **Do it** is a brief demonstration problem that gives immediate practice using the material just covered. Solutions are provided in the text to help students understand the reasoning involved in reaching an answer.
- **Accounting equation analyses** have been inserted in the margin next to key journal entries. This feature reinforces students' understanding of the impact of an accounting transaction on the financial statements.
- **Helpful hints** in the margins expand on or help clarify concepts under discussion in the nearby text. This feature actually makes the book an annotated student edition.
- **Alternative terminology** notes in the margins present synonymous terms that students may come across in subsequent accounting courses and in business.
- Marginal **international notes** provide a helpful and convenient way for instructors to expose students to international issues in accounting, reporting and decision making.
- Each chapter presents **decision tools** that are useful for analysing the financial statement components discussed in that chapter. At the end of the text discussion relating to the decision tool, a **decision-making toolkit** summarises the key features of that decision tool and reinforces its purpose. For example, chapter 7 presents the receivables turnover and average collection period as tools for use in analysing receivables. At the end of that discussion the toolkit shown opposite appears.

DECISION-MAKING TOOLKIT


Decision/Issue 	Info needed for analysis 	Tool or technique to use for decision 	How to evaluate results to make decision 
Are collections being made in a timely fashion?	Net credit sales and average receivables balance	$\text{Receivables turnover} = \frac{\text{Net credit sales}}{\text{Average net receivables}}$ $\text{Average collection period} = \frac{365 \text{ days}}{\text{Receivable turnover}}$	Receivables turnover and average collection period should be consistent with the entity's credit policy. Any significant deviation which results in a slower receivables turnover or a longer collection period may suggest a decline in the financial integrity of credit customers.

- A **using the decision-making toolkit** exercise, which follows the final **learning reflection and consolidation** section in the chapter, asks students to use the decision tools presented in that chapter. Students evaluate the financial situation of a company, often using ratio analysis to do so. In most cases, data of a real company are used in this analysis.

Putting it together


- At the end of each chapter, between the body of the text and the homework materials, are several useful features for review and reference: a **summary of learning objectives** lists the main points of the chapter; the **decision-making toolkit — a summary** presents in one place the decision tools used throughout the chapter; and a **glossary** of important terms gives definitions with page references to the text.
- Next, a **demonstration problem** gives students another opportunity to refer to a detailed solution to a representative problem before they do homework assignments. **Problem-solving strategies** help establish logic for approaching similar problems and assist students in understanding the solution.

Developing skills through practice

Throughout the homework material, certain questions, exercises and problems make use of the decision tools presented in the chapter. These are marked with the icon .

- **Self-study questions** comprise a practice test to enable students to check their understanding of important concepts. These questions are keyed to the learning objectives, so students can go back and review sections of the chapter in which they find they need further work.
- **Questions** provide a full review of chapter content and help students prepare for class discussions and testing situations.
- **Brief exercises** build students' confidence and test their basic skills. Each brief exercise focuses on one of the learning objectives.
- Each of the **exercises** focuses on one or more of the learning objectives. These tend to take a little longer to complete, and they present more of a challenge to

students than the brief exercises. The exercises help instructors and students make a manageable transition to more challenging problems.

- **Problems** stress the applications of the concepts presented in the chapter. Problems are keyed to the learning objectives. Certain problems, marked with the icon , help build business writing skills.
- Each brief exercise, exercise and problem has a **description of the concept** covered and is keyed to the learning objectives.

Building business skills

This is a unique section at the end of each chapter that offers a wealth of resources to help instructors and students pull together the learning for the chapter. This section offers problems and projects for those instructors who want to broaden the learning experience by bringing in more real-world decision making and critical thinking activities.

- **Financial reporting and analysis** problems use financial statements of real-world companies or other sources such as journals for further practice in understanding and interpreting financial reporting. A selection of some of the following types of problems is used in each chapter. A **financial reporting problem** directs students to study various aspects of the financial statements of Domino's, which are printed in chapter 1 (in simplified form) and in appendix A (in full), or of another company. A **comparative analysis problem** offers the opportunity to compare and contrast the financial reporting of Domino's Pizza Enterprises Ltd with a competitor. Since the ability to read and understand business publications is an asset in one's career, **research cases** direct students to articles published in popular business periodicals for further study and analysis of key topics. The **interpreting financial statements** problems ask students to read parts of financial statements of actual companies and use the decision tools presented in the chapter to interpret this information. A **global focus** or **real-world** problem asks students to apply concepts presented in the chapter to specific situations faced by actual international companies. **Financial analysis on the web**

exercises guide students to web sites from which they can obtain and analyse financial information related to the chapter topic.

- **Critical thinking** problems offer additional opportunities and activities. A selection of the following types of problems is used in each chapter. The **group decision cases** help promote group collaboration and build decision-making skills by analysing accounting information in a less structured situation. These cases

require teams of students to analyse a manager's decision or to make a decision from among alternative courses of action. They also give practice in building business communication skills. **Communication activities** provide practice in written communication — a skill much in demand among employers. **Ethics cases** describe typical ethical dilemmas and ask students to analyse the situation, identify the ethical issues involved, and decide on an appropriate course of action.

acknowledgements

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Special thanks to Wendy Pabst for developing the end-of-book cases which provide students with the opportunity to apply their analytical and decision-making skills to a fictional business scenario.

Images

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CHAPTER 1

AN INTRODUCTION TO ACCOUNTING

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- 1 Explain the business context and the need for decision making.
- 2 Define accounting, describe the accounting process and define the diverse roles of accountants.
- 3 Explain the characteristics of the main forms of business organisation.
- 4 Understand the *Conceptual Framework* and the purpose of financial reporting.
- 5 Identify the users of financial reports and describe users' information needs.
- 6 Identify the elements of each of the four main financial statements.
- 7 Describe the financial reporting environment.
- 8 Explain the accounting concepts, principles, qualitative characteristics and constraints underlying financial statements.
- 9 Calculate and interpret ratios for analysing an entity's profitability, liquidity and solvency.

'IT'S ALL GOOD'

Here are some slogans for fast food outlets. Can you pick Domino's? 'Eat fresh.' 'I'm lovin' it.' 'Today tastes so good.' 'Just gotta go' 'It's all good!' If you haven't guessed by now the title should give it away — 'It's all good!' When you think of Domino's pizza what comes to mind? For me, it's spicy pepperoni, stretchy cheese, tangy tomato sauce, crispy crusts and a cardboard box with dots . . . all of which make for a delicious pizza. It also conjures up images of sharing a meal with family and friends.

Do you know anything about the history of pizza? Most people think it originated in Italy, but it can be traced back to ancient Middle Eastern cultures. The earliest forms of pizza evolved from flat, unleavened bread cooked in mud ovens and topped with olive oil and native spices. Today's pizzas don't resemble these humble beginnings, as Domino's is continually reinventing its pizzas and launching new ranges of non-pizza products. Did you know that Domino's even changed their 50-year-old pizza sauce recipe in 2010? Did you taste the difference? I can't say that I noticed!

If you've been a fan of Domino's for a while, you'd know that there is a lot more than just pizza on the menu. Over the years Domino's has added a whole range of items such as chicken, chips and even a very large dessert range, including Belgian chocolate lava cake and mini Dutch pancakes. YUM!

Domino's Pizza Enterprises Limited's 2013 annual report states: 'This year marks 30 years since the first store opened in Australia . . . The company has evolved and matured considerably . . . over the years, but one thing that has remained the same is our passion and drive to own the "social eating occasion". Our product brings people together, and it's evident by the growth the business has seen over the past 35 years that we have a recipe that works'. Whether you believe Domino's pizzas bring people together, one thing you can't argue about is that Domino's has achieved great success.

Domino's Pizza Enterprises Limited (Domino's) is the largest pizza chain in Australia both in terms of sales and store numbers. Since the first Silvio's store (Domino's original name) opened 35 years ago, Domino's has expanded throughout Australia and New Zealand and internationally. In fact, the chain also operates in Europe with stores in Belgium, France and the Netherlands. In 2013, Domino's store count was 970 with the majority, over 520, in Australia and New Zealand! And guess what? Domino's opened 40 new organic stores in Europe.

Domino's holds the exclusive master franchise rights for the Domino's brand in Australia, New Zealand, Belgium, France and the Netherlands. Franchising is a way of doing business where the franchisor allows



On the World Wide Web
Domino's Pizza Enterprises Ltd:
www.dominos.com.au

Note: Every chapter-opening vignette ends with the internet addresses of the companies cited in the story to help you connect with these real businesses and explore them further.

a franchisee to use the business name and business operations for a regular remuneration. To find out more on franchising see www.franchise.org.au. The Domino's franchise has brought the company huge success. In 2013, the company reported an after-tax profit of \$28.7 million, which is an increase of 6.4% on the previous period. Domino's are looking forward to even greater profits with its latest acquisition of a 75% interest in Domino's Pizza Japan — the company's biggest acquisition to date.

Domino's hasn't only introduced new products, but also new technology. Its smartphone App was designed and built in Australia and allows you to customise your pizza with 1.8 billion pizza combinations in your pocket.

For the latest news on the company you can visit its web site. First select corporate and look at the news section.

Source: Based on information from the Domino's Pizza Enterprises Limited annual report 2013, www.referenceforbusiness.com and www.franchise.org.au.

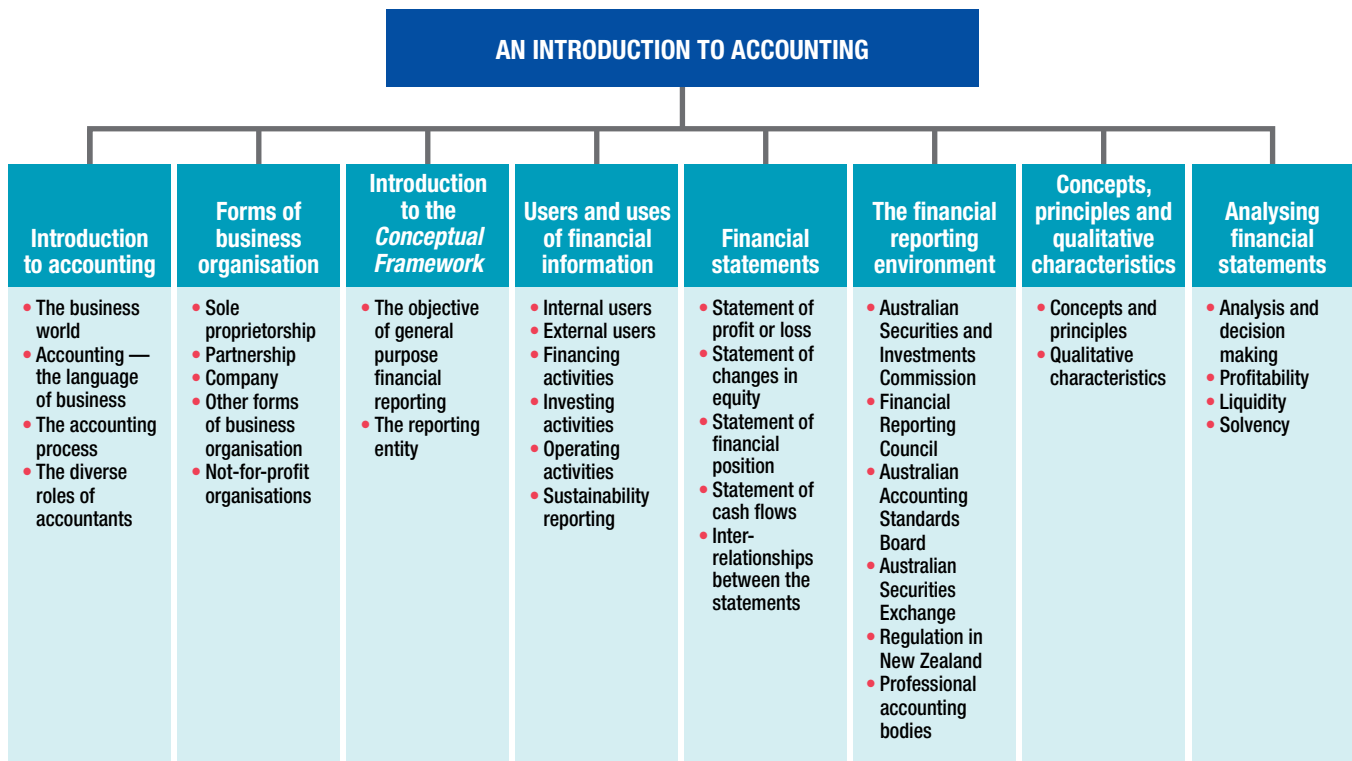
PREVIEW OF CHAPTER 1

The **preview** describes the purpose of the chapter and outlines the major topics and subtopics you will find in it.

Welcome to the accounting journey, it is not just about recording numbers. Throughout this book you will explore the concepts and regulations that underlie the preparation of the accounting reports and the various decisions that need to be made in preparing the financial information and reports. As well, we will examine the decisions made using the accounting information as inputs into the decision-making process both inside and outside the business organisation. Accounting information can help you understand a business entity's past performance and its current financial position and provide some insight into its future prospects.

It is an exciting ever-changing business environment which keeps pace with the changes in technology and knowledge management. Domino's commenced as a single franchise in Australia and now is the largest franchisee of the US's largest pizza chain, with operations in Europe, Japan, Australia and New Zealand. How did this occur? Why have they embraced technologies such as online ordering, including a mobile phone app and Facebook? Domino's effectively obtains information from customers using this technology, which feeds into the sale growth predictions and the strategic future directions of the business.

In this chapter we introduce the business environment, including the role of accounting, the forms of business organisation, the regulatory environment, the financial statements, and some tools that can help you analyse financial statements for decision making. The content and organisation of this chapter are as follows.



LEARNING OBJECTIVE

1 Explain the business context and the need for decision making.

INTRODUCTION TO ACCOUNTING

THE BUSINESS WORLD

What's your favourite business? Apple, Google, Nike? Would you like to start your own business? How do you start a business? How do you make it grow and become widely recognised like Domino's? How do you determine whether your business is making or

losing money? How do you manage your resources? When you need to expand your operations, where do you get money to finance the expansion — should you borrow, should you issue shares, should you use your own funds? How do you convince lenders to lend you money or investors to buy your shares? Success in business requires countless decisions, and decisions require financial and other information. A **decision** is a choice among alternative courses of action.

Architects use technical and structural knowledge of the building codes together with their creative ability to design a model or plan of a building. Just like architects, in order to start and run a business you need not only your creative ideas and marketing plan, but you need information on the business environment in order to understand the context of your business. Accounting provides an economic model of the business world. It plays a key role in the provision of financial information for decisions made by people inside and outside a business. The continued growth of Domino's in both the European and the Australian and New Zealand markets required a variety of information including the past and current performance of the Domino's operations. Projections on future store sales growth and potential market share growth from opening new stores was also required in order to plan ahead and to help towards the achievement of targets. The provision of accounting information within the business entity is referred to as **management accounting**. **Financial accounting** is the term used to describe the preparation and presentation of financial reports for external users. However, both financial accounting and management accounting draw on the same information system used to record and summarise the financial implications of transactions and events. Businesses also need to provide information on the environment and the community within which the business operates. The concept of sustainability is explained later in this chapter.

The business environment is ever changing. Driven by technology, life cycles of businesses are shortening. New technologies, new processes, new products, faster information flows are driving changes. How often do you update your mobile phone? Everyone in society is affected by technology change. Computers provide the technology to process the information so more time is devoted to the analysis of the information to make the best-informed decision. Accountants work in businesses as part of management teams who analyse the information gathered to make decisions. So how do we go about the decision making?

The first step in the process of decision making is to identify the issue or the decision to be made. The next step is to gather the relevant information required for the analysis. Once gathered, you then identify the tool or technique that can provide the analysis of the issue so a decision may be made. The final step is to evaluate the results of the analysis and make the decision. Figure 1.1 summarises this process.

Essential terms and concepts presented in the chapter are printed in **blue** where they are first explained. They are then listed and defined again in the **glossary** at the end of the chapter.



DECISION MAKING

Throughout each chapter, **decision-making icons** identify content explaining how accounting information can inform management decisions.

Each chapter presents useful information about how decision makers use financial statements. **Decision-making toolkits** summarise discussions of key decision-making contexts and techniques.





DECISION-MAKING TOOLKIT			
Decision/Issue 	Info needed for analysis 	Tool or technique to use for decision 	How to evaluate results to make decision 
Which film your friends wish to see	Cinema times and films showing Who are the lead actors Personal preferences	Eliminate unsuitable times and films Discuss which preferences are left and rank in popularity	Film most wish to see is the one chosen If none suitable re-evaluate or select another social activity and start the decision process again.

Figure 1.1 The decision-making toolkit

For example, if you were wanting to choose which film a group of friends wish to watch, you would need information concerning each of your preferences for the genre and how flexible you are in your preferences, maybe who is in the leading roles and the times the movie is being shown. The tool would be to rank the films in order of preference starting with what is showing at the times your group is available, then reducing the

alternatives to which films are showing, and then eliminating any alternative which one of your group didn't want to see. You may end up with no suitable film or you may go back and change the parameters, which may include looking for another social activity. Even with this analysis your group may not enjoy the film as it was a dud, but that is the risk you take. Decisions are future oriented and you need to make informed judgements.

Similar to the social activity decision, in the business world with all the information available the final outcome of the decision may not be what was expected. Next we are going to consider what accounting is and how it is used in the decision-making process in the business environment.

LEARNING OBJECTIVE

Define accounting, describe the accounting process and define the diverse roles of accountants.

2

ACCOUNTING: THE LANGUAGE OF BUSINESS

The primary function of accounting is to provide reliable and relevant financial information for decision making. Accounting has been around for centuries and has developed significantly since its humble beginnings in ancient times when scribes recorded simple agreements between parties, and other information, on clay tablets. Today, almost every person engages in business transactions in relation to the financial aspects of life such as purchasing products and paying bills. This means that accounting plays a significant role in society.

Accounting can be referred to as the 'language of business' as it is a means of common communication where information flows from one party to others. In order for information to be effective it must be understood. Accounting, like many other professions, has its own terminology or jargon which is unique to the profession and can have alternative meanings in different contexts. Accounting terms, concepts and symbols are used to provide financial information to a variety of users including managers, shareholders and employees. You will need to learn these specialised terms and symbols in order to be able to prepare and use accounting information effectively. The glossary at the end of each chapter provides definitions of key terms and this will support your learning. Providing reliable and relevant accounting information is a complex process.

THE ACCOUNTING PROCESS

Accounting is the process of identifying, measuring, recording and communicating the economic transactions and events of a business operation. Figure 1.2 summarises these main steps.

Identifying	Measuring	Recording	Communicating
Taking into consideration all transactions which affect the business entity	Quantifying in monetary terms	Analysing, recording, classifying and summarising the transactions	Preparing the accounting reports; analysing and interpreting

Figure 1.2 The accounting process

Identifying involves determining which economic events represent transactions. **Transactions** are economic activities relevant to a particular business and include, for example, the sale of a good to a customer or the purchase of office stationery from a supplier. Transactions are the basic inputs into the accounting process. **Measurement** is the process of quantifying transactions in monetary terms and must be completed in order to record transactions. The recording process results in a systematic record of all of the transactions of an entity and provides a history of business activities. To enhance the usefulness of the recorded information, it must be classified and summarised.

Classification allows for the reduction of thousands of transactions into meaningful groups and categories. For example, all transactions involving the sales of goods can be grouped as one total sales figure and all cash transactions can be grouped to keep track of the amount of money remaining in the business's bank account. The process of summarisation allows the classified economic data to be presented in financial reports for decision making by a variety of users. These reports summarise business information for a

specific period of time such as a year, 6 months, one quarter or even a month. Domino's provides 6-monthly reports that are available to the general public via the securities exchange web site.

Communicating is the final stage in the accounting cycle. Communicating involves preparing accounting reports for potential users of the information. There are many reasons for maintaining accurate financial accounting records, including legal and other reporting requirements. The Australian Taxation Office (ATO) and the New Zealand Inland Revenue (NZIR) require businesses to provide a variety of financial information to comply with legal requirements. Users of financial information, both internal and external to the entity, will require financial information to make decisions in relation to the business. Once the users have acquired the information they can use a variety of techniques to analyse and interpret the data. In most of the chapters in this book, there are sections which demonstrate a variety of techniques that are useful for analysing and interpreting financial statements. These sections are intended to support the development of your skills in analysis and interpretation of financial information, and to enhance your understanding of accounting. Throughout the book you will be given the opportunity to apply your understanding by analysing and interpreting real company data from companies such as Domino's, Nick Scali, Michael Hill and Coca-Cola Amatil.

To recap this section, accounting provides an economic model of the business world and plays a key role in the provision of financial information for decision making. Accounting is the process of identifying, measuring, recording and communicating the economic transactions and events of a business operation to users of financial information. The first three activities of identifying, measuring and recording the business information are commonly referred to as **bookkeeping**. Bookkeeping forms the foundation of the activities underlying accounting and these processes are explained in detail in the early chapters of this book, using a manual accounting system. In the early part of the twentieth century, the role of the accountant did not extend much beyond this bookkeeping function. Today, however, the roles and responsibilities extend far beyond preparing accounting records.

THE DIVERSE ROLES OF ACCOUNTANTS

Accountants practise accounting in four main areas: commercial accounting, public accounting, government accounting and not-for-profit accounting.

Commercial accounting

Commercial accountants work in industry and commerce. Companies like Domino's and Qantas employ a number of accountants in different roles, such as management accounting and financial accounting. The accounting information system provides these accountants with the information they need for planning, decision making, and compiling reports for a range of users. The **chief financial officer (CFO)** is a senior manager in an organisation and directs the accounting operations. Financial accountants oversee the recording of all of the transactions and prepare reports for users external to the business entity, such as shareholders and creditors. Management accountants focus on providing information for internal decision making as they prepare specifically tailored reports for use by management. Commercial accountants are employed within organisations, and their work is directed by their employers. Public accountants, on the other hand, run their own businesses and are therefore more autonomous.

Public accounting

Public accountants, as the name suggests, provide their professional services to the public. They can practise in business organisations that range from small, single-person-run offices to very large organisations with branches all over the world and thousands of employees. Public accountants tend to specialise in one or more areas of accounting when providing services to the public. Auditing is one of the primary services provided by large public accounting firms such as Deloitte and KPMG. An **audit** is an independent examination of the accounting data presented by an entity in order to provide an opinion as to whether the financial statements fairly present the results of the operations and the entity's financial position. Public accounting firms also provide a wide range of taxation services including

advice for minimising an entity's tax liability, of course within the law, and preparation of tax returns, among other things. In more recent years, management advisory services have been a growing area for public accountants. Services include providing advice on improving their clients' business efficiency and effectiveness, the design and installation of accounting information systems, and assistance with strategic planning. Public accounting firms can also provide advisory services to government organisations or be employed by the government.

Government accounting

Government accountants, employed within government entities, engage in a variety of roles and activities, such as financial accounting and auditing. Local councils, state governments and federal government receive and pay out large amounts of funds each year and these activities need to be accounted for. Nowadays, many of the issues and decisions faced by government entities are the same as those in the commercial sector. As a result, these entities often follow accounting policies and practices similar to those in the private sector. Although most government entities are not-for-profit, some government departments, such as the Brisbane City Council, run profit-making businesses.

Not-for-profit accounting

Not-for-profit accountants, working in the not-for-profit sector, engage in many activities including planning, decision making, and preparing financial and management reports for both internal and external users. Management processes, accounting systems and operational methods are often similar between profit-making and not-for-profit entities. However, there is one major difference and that is the *profit motive*.

A **not-for-profit entity** focuses on successfully fulfilling its mission and administrative goals, rather than focusing on making a profit. Not-for-profit entities include public hospitals, clubs, some schools and charities. For example, the World Vision charity works with poor, marginalised people and communities to improve their lives and take control of their futures. Not-for-profit entities are exempt from income taxes on activities related to their exempt purpose, have fiduciary responsibilities to members, contributors and other constituents, and their activities may require reporting to supervising government entities.

In summary, accountants have many diverse roles and can work in different forms of organisation from small, one-person businesses to large corporations with a world-wide presence. Once trained as an accountant you can also work in organisations in non-traditional accounting roles or be better equipped to run your own business.



APPLICATION IN BUSINESS

Career perspective

Who said accountants are boring? CPA Australia profiles several young CPAs' careers, which combine both their background in accounting and finance with their personal interests and social responsibility. Steve Hui, a CPA, had experience in a travel agency, but it was while working for Macquarie Bank and helping set up an outsourcing operation in New Delhi that his iFLYflat business idea was born. The work involved overseas business class travel, receiving frequent flyer points. Realising many people failed to maximise the benefits from their reward points, in 2012 he set up his business targeting people in the small-to-medium (SME) business sector. For an upfront monthly fee, iFLYflat provides strategies that maximise a client's frequent flyer and credit card reward points, then books the flights using those points to gain a discount fare. CPA Paul Luzak, whose first love is music and who played in bands, realised the need for musicians to have good financial advice, which led him to set up his own business, White Sky.

Rachael Chong wanted to volunteer, but couldn't find the right organisation. So to give back, she set up an unusual model for her organisation Catchafire, which matches professionals with non-profit organisations based on their skills, interests and time availability. Catchafire uses the professional networking site LinkedIn to advertise projects. Or you could simply work for a not-for-profit organisation like Chelsea Collins the finance manager for Oxfam GB (Great Britain).

Source: Based on information from CPA Australia 2014, 'Young business leaders 2014', *InTheBlack*, May, pp. 40–50.

Would you like to run your own business? How do you decide how to structure your business and what resources will be required? In the next section we explore the different forms of business organisation in more depth.

LEARNING REFLECTION AND CONSOLIDATION

>> REVIEW IT

1. What information would you require to set up and run your own business?
2. What is the primary objective of accounting?
3. Accountants practise accounting in four main areas. Describe these areas, with examples.

Review it questions at the end of major text sections prompt you to stop and review the key points you have just studied. Sometimes these questions stand alone; other times they are accompanied by practice exercises called *Do it*.

FORMS OF BUSINESS ORGANISATION

Business organisations can be classified into profit-oriented businesses such as sole proprietorship, partnership or a company, and not-for-profit entities such as charities and government departments. Throughout this textbook, we concentrate on preparing financial reports for the profit sector. However, many of the concepts and regulations apply equally to the not-for-profit sector.

Suppose you graduate with a marketing degree and open your own marketing agency. One of the first important business decisions you will need to make is the organisational structure under which the business will operate. You have three choices: sole proprietorship, partnership or company. Figure 1.3 (p. 11) outlines the three main forms of business organisation. In selecting a suitable business structure, some of the factors to consider are:

- establishment fees and maintenance costs
- asset protection (business and personal assets)
- the type of business and how it impacts on your record keeping
- legitimate tax minimisation.

SOLE PROPRIETORSHIP

A **sole proprietorship** is a business owned by one person. It is the simplest form of business structure, and has very few legal formalities. It is quick and inexpensive to establish, and inexpensive to wind down. Under this structure, the owner of the business has *no separate legal existence* from the business. You might choose the sole proprietorship form if you have a marketing agency. You would be referred to as a *sole trader*. As a sole trader, the business is fully owned by you and you have total autonomy over the business's strategic direction and all business decisions. The assets and profits completely belong to you. The business's income is treated as the business owner's individual income (hence, no separate legal existence). Sole traders pay the same tax as individual taxpayers, according to the marginal tax rates. Depending on the level of profits from the business, this could be a disadvantage. In the 2014 year, at an income level of around \$132 000, the effective average tax rate of an individual is equal to the 30% company tax rate, so for any profits above this level the sole trader is paying more income tax than if the business was organised as a company. Other disadvantages are that the business is limited by the owner's skills, the funds available to invest, and the time available for running the business, as well as bearing full personal liability for the business's debts. Small owner-operated businesses such as restaurants, dentists and panel beaters are often sole proprietorships, as are farms and small retail shops.

PARTNERSHIP

Another possibility for your new marketing agency is for you to join forces with other individuals to form a partnership, in which all partners share control. A **partnership**

LEARNING OBJECTIVE

Explain the characteristics of the main forms of business organisation.

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