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2ND EDITION

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ACCOUNTING

INFORMATION FOR BUSINESS DECISIONS



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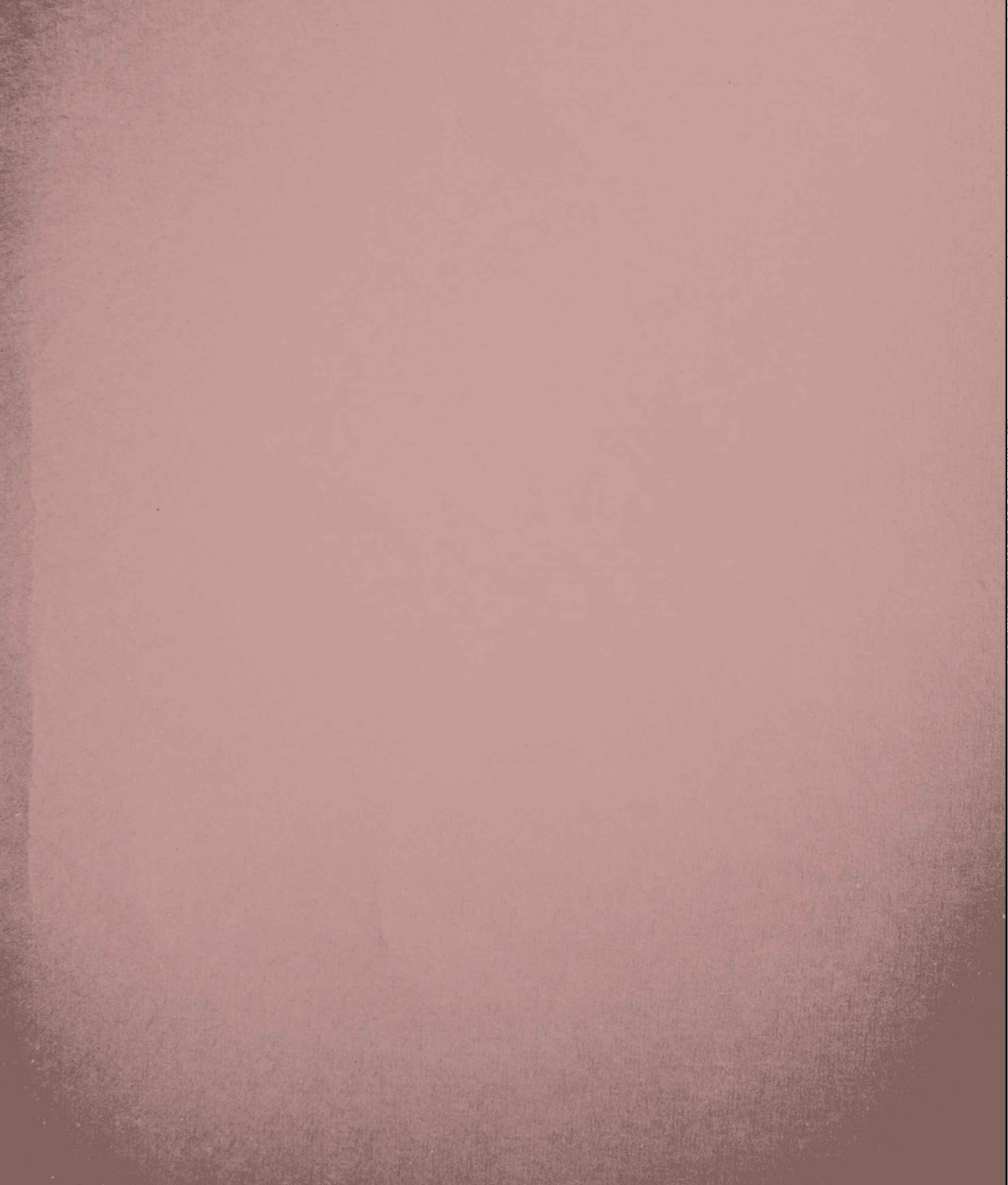
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2ND EDITION

ACCOUNTING

INFORMATION FOR BUSINESS DECISIONS



B.M.CUNNINGHAM, L.A.NIKOLAI, J.D.BAZLEY
M.KAVANAGH, G.SLAUGHTER & S.SIMMONS



Australia • Brazil • Japan • Korea • Mexico • Singapore • Spain • United Kingdom • United States

Accounting information for business decisions

2nd Edition

B. M. Cunningham**L. A. Nikolai****J. D. Bazley****M Kavanagh****G. Slaughter****S. Simmons**

Publishing manager: Dorothy Chiu

Publishing editor: Geoff Howard

Developmental editor: Duncan Campbell-Avenell

Senior project editor: Tanya Simmons

Art direction: Danielle Maccarone

Editor: Angela Tannous

Proofreader: Pete Cruttenden

Indexer: Russell Brooks

Permissions/Photo researcher: Q2A Bill Smith

Text designer: Pier Vido/Danielle Maccarone

Cover designer: Emily Pfitzner

Cover: Emilie Pfitzner (Everyday Ambitions)

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National Library of Australia Cataloguing-in-Publication Data

Cunningham, Billie M, author.

Accounting: information for business decisions/Billie M. Cunningham, Loren A. Nikolai, John D. Bazley, Marie Kavanagh, Geoff Slaughter and Sharelle Simmons.

2nd edition.

9780170253703 (paperback)

Accounting--Textbooks. Business planning. Business--Decision making. Other Authors/Contributors: Nikkolai, Loren A., author. Bazley, John D., author. Kavanagh, Marie, author. Slaughter, Geoff, author. Simmons, Sharelle, author.
657.071**Cengage Learning Australia**

Level 7, 80 Dorcas Street

South Melbourne, Victoria Australia 3205

Cengage Learning New Zealand

Unit 4B Rosedale Office Park

331 Rosedale Road, Albany, North Shore 0632, NZ

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Printed in China by China Translation & Printing Services.

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BRIEF CONTENTS

1	INTRODUCTION TO BUSINESS ACCOUNTING AND THE ROLE OF PROFESSIONAL SKILLS	1
2	DEVELOPING A BUSINESS PLAN: COST-VOLUME-PROFIT ANALYSIS	50
3	DEVELOPING A BUSINESS PLAN: BUDGETING	91
4	THE ACCOUNTING SYSTEM: CONCEPTS AND APPLICATIONS	129
5	RECORDING, STORING AND REPORTING ACCOUNTING INFORMATION	181
6	MANAGING AND REPORTING WORKING CAPITAL	234
7	THE INCOME STATEMENT: CONTENT AND USE	274
	APPENDIX: CALCULATING THE COST AND THE AMOUNT OF INVENTORY	301
8	THE BALANCE SHEET: CONTENT, USE AND ANALYSIS	324
9	THE CASH FLOW STATEMENT: CONTENT AND USE	372
	APPENDIX: INDIRECT METHOD FOR REPORTING CASH FLOWS FROM OPERATING ACTIVITIES	398
10	SUSTAINABLE BUSINESS	422
11	SHORT-TERM PLANNING DECISIONS	457
12	CAPITAL EXPENDITURE DECISIONS	490



CONTENTS

	Preface	xii
	Resources guide	xvii
	About the authors	xix
	Acknowledgements	xx
CHAPTER 1	INTRODUCTION TO BUSINESS ACCOUNTING AND THE ROLE OF PROFESSIONAL SKILLS	1
	The changing business environment	3
	The successful businessperson	6
	Private enterprise	7
	The forms that businesses take	10
	The regulatory environment of business	14
	The accounting system	16
	Management activities	17
	Accounting support for management activities	19
	Accounting support for external decision making	21
	Ethics in business and accounting	26
	The accountant of the 21st century	29
	Critical thinking	32
	Applying critical thinking to business decisions	33
	Orientation of the book	40
	Framework of the book	40
	<i>Summary</i>	41
	<i>Key terms</i>	43
	<i>Weblinks</i>	44
	<i>Integrated business and accounting situations</i>	44
	<i>Dr Decisive</i>	48
	<i>Endnotes</i>	49
	<i>List of company URLs</i>	49
CHAPTER 2	DEVELOPING A BUSINESS PLAN: COST-VOLUME-PROFIT ANALYSIS	50
	Planning in a new business	51
	Cost-volume-profit (C-V-P) planning	61
	Using C-V-P analysis	72
	Other planning issues	75

	What can happen if a business doesn't have a business plan	76
	Business issues and values: waste not, want not	77
	<i>Summary</i>	78
	<i>Key terms</i>	79
	<i>Weblinks</i>	79
	<i>Integrated business and accounting situations</i>	80
	<i>Dr Decisive</i>	90
	<i>Endnotes</i>	90
	<i>List of company URLs</i>	90
CHAPTER 3	DEVELOPING A BUSINESS PLAN: BUDGETING	91
	Why budget?	92
	Operating cycles	94
	The budget as a framework for planning	96
	Using the master budget in evaluating the business' performance	114
	Budgets: business issues and ideas	117
	<i>Summary</i>	118
	<i>Key terms</i>	119
	<i>Weblinks</i>	119
	<i>Integrated business and accounting situations</i>	120
	<i>Dr Decisive</i>	128
	<i>Endnotes</i>	128
	<i>List of company URLs</i>	128
CHAPTER 4	THE ACCOUNTING SYSTEM: CONCEPTS AND APPLICATIONS	129
	Financial accounting information and decision making	130
	Basic concepts and terms used in accounting	133
	Components of the accounting equation	137
	Accounting for transactions to start a business	140
	Expanding the accounting equation	147
	Accounting principles and concepts related to net income	148
	Recording daily operations	150
	End-of-period adjustments	158
	Net income and its effect on the balance sheet	163
	Business issues and values: A billion here, a billion there	165
	<i>Summary</i>	166
	<i>Key terms</i>	167

	<i>Weblinks</i>	167
	<i>Integrated business and accounting situations</i>	168
	<i>Dr Decisive</i>	180
	<i>List of company URLs</i>	180
CHAPTER 5	RECORDING, STORING AND REPORTING ACCOUNTING INFORMATION	181
	Accounts	182
	Accounting cycle	185
	Recording (journalising) transactions	185
	Posting from journals to the accounts	193
	Trial balance	200
	Preparing adjusting entries	200
	Adjusted trial balance	206
	Preparing the financial statements	208
	Preparation of closing entries	210
	Modifications for companies	214
	Other journal entries	217
	Accounting information: business issues and values	217
	<i>Summary</i>	219
	<i>Key terms</i>	220
	<i>Weblinks</i>	220
	<i>Integrated business and accounting situations</i>	221
	<i>Dr Decisive</i>	233
	<i>List of company URLs</i>	233
CHAPTER 6	MANAGING AND REPORTING WORKING CAPITAL	234
	Working capital	235
	Cash	239
	Accounts receivable	250
	Inventory	253
	Accounts payable	259
	Working capital: business issues and values	260
	<i>Summary</i>	261
	<i>Key terms</i>	262
	<i>Weblinks</i>	262
	<i>Integrated business and accounting situations</i>	262
	<i>Dr Decisive</i>	273

	<i>Endnotes</i>	273
	<i>List of company URLs</i>	273
CHAPTER 7	THE INCOME STATEMENT: CONTENT AND USE	274
	Why the income statement is important	275
	Expanded accounting system	278
	The retail business' income statement	278
	Revenues	279
	Expenses	285
	Operating income, other items and net income	291
	Uses of the income statement for evaluation	291
	Statement of comprehensive income	295
	Statement of changes in owner's equity	296
	Closing the temporary accounts	299
	<i>Summary</i>	300
	<i>Key terms</i>	301
	<i>Appendix: Calculating the cost and the amount of inventory</i>	301
	<i>Weblinks</i>	308
	<i>Integrated business and accounting situations</i>	308
	<i>Dr Decisive</i>	319
	<i>Additional questions</i>	319
	<i>Dr Decisive</i>	323
	<i>List of company URLs</i>	323
CHAPTER 8	THE BALANCE SHEET: CONTENT, USE AND ANALYSIS	324
	Why the balance sheet is important	325
	The accounting equation and the balance sheet	328
	Using the balance sheet for evaluation	336
	Relationship between the income statement and the balance sheet	340
	Evaluations using the balance sheet and the income statement	342
	Limitations of the income statement and the balance sheet	348
	Business Activity Statements (BAS)	349
	<i>Summary</i>	355
	<i>Key terms</i>	356
	<i>Weblinks</i>	356
	<i>Integrated business and accounting situations</i>	357
	<i>Dr Decisive</i>	370
	<i>Endnotes</i>	371
	<i>List of company URLs</i>	371

CHAPTER 9	THE CASH FLOW STATEMENT: CONTENT AND USE	372
	Why the cash flow statement is important	373
	Understanding cash flow transactions	374
	The organisation of the cash flow statement	378
	Net cash flows from operating activities	379
	Preparing the cash flow statement	381
	Expanded discussion of calculations for the direct method	385
	Analysis of the cash flow statement	389
	Cash flows: business issues and values	396
	<i>Summary</i>	397
	<i>Key terms</i>	398
	<i>Appendix: Indirect method for reporting cash flows from operating activities</i>	398
	<i>Weblinks</i>	405
	<i>Integrated business and accounting situations</i>	406
	<i>Dr Decisive</i>	421
	<i>Endnotes</i>	421
	<i>List of company URLs</i>	421
CHAPTER 10	SUSTAINABLE BUSINESS	422
	Corporate social responsibility	423
	The triple bottom line	424
	Sustainability reporting	426
	Triple bottom line accounting: practical measures	431
	Material flow cost accounting	432
	Eco-efficiency	435
	Share percentage	437
	Environmental project appraisal	437
	Social accounting	440
	Qualitative social cost benefit analysis	442
	Intergenerational equity	442
	Characteristics of sustainable business	444
	Sustainability: business issues and values	445
	<i>Summary</i>	446
	<i>Key terms</i>	448
	<i>Weblinks</i>	449
	<i>Integrated business and accounting situations</i>	449
	<i>Dr Decisive</i>	454

	<i>Endnotes</i>	454
	<i>List of company URLs</i>	455
CHAPTER 11	SHORT-TERM PLANNING DECISIONS	457
	Decision making	458
	Relevant costs and revenues	459
	Deciding whether to drop a product	467
	Deciding whether to make or buy a part	472
	Deciding whether to sell a product or process it further	476
	Decision making: business issues and values	478
	<i>Summary</i>	479
	<i>Key terms</i>	480
	<i>Weblinks</i>	480
	<i>Integrated business and accounting situations</i>	480
	<i>Dr Decisive</i>	488
	<i>Endnotes</i>	489
	<i>List of company URLs</i>	489
CHAPTER 12	CAPITAL EXPENDITURE DECISIONS	490
	Capital expenditure decisions	491
	Making a capital expenditure decision	492
	The time value of money and present value	497
	Net present value method	505
	Alternative methods for evaluating capital expenditure proposals	513
	Selecting alternative proposals for investment	515
	Capital expenditure: business issues and values	517
	<i>Summary</i>	519
	<i>Key terms</i>	521
	<i>Weblinks</i>	521
	<i>Integrated business and accounting situations</i>	521
	<i>Dr Decisive</i>	530
	<i>Endnotes</i>	531
	<i>List of company URLs</i>	531
	Glossary	532
	Index	541

PREFACE

FOR STUDENTS

There is a saying that 'knowledge is power'. But for that to be true, knowledge must be based on an objective, independent thought process that tests new information against evidence, assumptions, bias and other points of view. In other words, in order for you to gain new 'knowledge', you must 'think through' the related issues and ideas, understand them, satisfy yourself that they are reasonable, and make them a part of your personal knowledge base. Furthermore, you must be willing to re-evaluate that knowledge, and perhaps change it, as new issues and ideas arise.

In business the saying is true – knowledge *is* power. Those who have it hold a competitive advantage over those who don't. Those who understand business information, and know how to interpret and use it, make the best business decisions.

A business's financial reports, generated by its accounting system, are a major source of business information. When reading these reports you must evaluate the information they contain by looking for supporting evidence, assumptions and bias, and by considering other points of view. Furthermore, you must know how to *interpret* the information contained in these reports. To do this, you must understand how a business' accounting system develops these reports, and what concepts, principles and assumptions underlie the accounting process used to produce the information in these reports. With this in mind, we designed this book to address these issues.

After you graduate, you may work in business and use accounting information to make decisions as an 'internal user'. Alternatively, you may consider investing in a business or have some other reason to use its accounting information to make decisions as an 'external user'. Your ability to use the material in this book to later help you make effective business decisions (regardless of your career choice) depends on you making it a part of your own knowledge base. This means that you should 'think through' the issues and ideas as you read about them, making sure that you understand them before you read further. This will require some effort on your part. As you read the book, read it critically. Test it in your mind. Does it make sense to you?

To help you learn this material and think about what you are learning, throughout the book we have placed questions labelled with a 'stop light' that we think are worth your time and effort to answer. Each time you encounter one of these questions, stop, reflect, think through the question, and answer it honestly. Base your answer on what you have learned in your life experiences, on your knowledge of accounting, business and the world – and on your own commonsense. By pausing in your reading and answering these questions, you will have time to process what you are reading and an opportunity to build new knowledge into your already-existing knowledge base. This edition also includes 'Discussion' questions that are aimed to spur critical thinking and judgement, and to test your development of these skills.

Besides answering these questions as you read the book, think about questions you have, or what else you would like to know about the subject at hand. Pursuing the answers to these questions in class or online will help you add to your knowledge base and the quality of your later decisions.

We hope you find this book interesting and fun to read, and that the examples based around chocolate sweeten your accounting experience! We also hope you find the book useful in increasing your personal capacity to manage financially, your appreciation of the power of using accounting information for making business decisions, and your ability to use accounting information for your own business decisions now and in the future.

CAUTION

This textbook has a number of themes that revolve around chocolate, and this preface is no exception. While this book has many of the great accounting ingredients you are used to (and all that you will need), it also 'breaks the mould' as it incorporates a number of phrases and terms well known to chocolate lovers (and we know that includes accountants!). Our intent is that you will get a number of cravings while reading this preface, not the least of which is the desire to consume and learn from the book and to share its great taste and contents with your colleagues and your students.

TWO GREAT COURSES THAT MAKE ONE GREAT TEXT . . .

In the real world, today's students will face an accounting environment where management accounting and financial accounting issues are integrated every day. The traditional – and artificial – separation of these topics in textbooks tends to lead students to a perception that the two areas are unrelated. We also believe that traditional and highly technical 'preparer-oriented' accounting textbooks (1) isolate accounting from general business decisions, (2) lose students' interest, and (3) reinforce a common misconception that accounting is best left solely to accountants. Such a separation misses the big picture that financial literacy knowledge and understanding is a 'life skill', and accounting systems provide economic information to all users. This textbook integrates management accounting and financial accounting topics in a way that is more reflective of the world the students in your first year accounting class will face outside of the classroom.

SOMETIMES YOU FEEL LIKE A DEBIT, SOMETIMES YOU DON'T . . .

A major focus of this textbook is on using management accounting and financial accounting information in various business settings. We wrote this book at a 'non-technical' level for all business and non-business students – not just those intending to be accounting majors. Because all of the authors are heavily involved in teaching second and third level accounting, we are aware of the needs of your accounting majors. So we discuss recording, storing and reporting accounting information. We begin with a non-procedural approach to explain transactions in terms of the accounting equation (with entries into account columns) to illustrate the effect of these transactions on the financial statements. In Chapter 5 we discuss the rules for double entry and cover the accounting cycle, from journal entries (using debits and credits) through the post-closing trial balance. We designed it so that you may use it anywhere you see fit in the process of teaching from this book. We assure you that our accounting majors who have used this elementary accounting text are well prepared to enter our second and third level accounting classes.

INGREDIENTS AND NUTRITIONAL INFORMATION (KEY FEATURES OF THIS TEXT)

An introduction to business approach

Chapter 1 takes an 'introduction to business' approach to orient students to the business environment – that is, the operations of a business, the different functions of business, managers' responsibilities, and the types of information, management reports, and financial statements the business' accounting system provides for use in internal and external decision making. This chapter provides students with a basic

understanding of business so they can more effectively envision the context in which accounting information is collected and used, and the types of decisions users make in this context. This approach allows students to see the 'big picture' more clearly.

Professional skills

Chapter 1 is unique for accounting textbooks, and we integrate that uniqueness into the rest of the book. It introduces students to professional skills, such as critical thinking, and demonstrates how they are used in decision making and problem solving. This book emphasises the type of analytical and critical thinking that successful accountants and other business people use in a world that is constantly changing and increasing in complexity. We believe that as you use analytical thinking in your decision process regarding this textbook, you will not only decide to adopt this book but will also be able to use it in a way that will foster your students' growth.

In keeping with Chapter 1, the remaining chapters introduce students to various aspects of accounting and are designed to help them develop their thinking skills. Stop questions throughout the textbook (identified by a traffic light) ask students to take a break from reading to think about an issue and/or consider the outcome of a situation. We also ask them why they think what they think. The end-of-chapter materials include both structured and unstructured questions and problems that emphasise the use of creative and critical thinking skills by the students. Therefore some of the questions and problems do not have a 'correct' answer; rather the focus is on the approach or process that students use to solve them. With the increasing complexity of business activities, we think our inclusion of critical thinking materials will better prepare students to understand the substantive issues involved in new or unusual business practices. An added feature of the book are the Sustainability icons, which draw attention to sections that discuss environmental and ethical issues and how they relate to students' understanding of triple bottom line accounting.

The simpler things

Earlier we mentioned a 'non-technical' approach. Although we explain identifying, measuring, recording and reporting of economic information, we discuss these activities at a basic level in Chapter 4 (increases and decreases in account balances) and do not include a discussion of debit and credit rules and journal entries in the main body of the text. We do emphasise the double-entry accounting system through the use of the accounting equation ($\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$) and its linkage to the income equation ($\text{Income} = \text{Revenues} - \text{Expenses}$). We use account columns to record transactions, but we explain the increases or decreases in relation to the accounting equation rather than as debits and credits. At the same time, we also emphasise the effects of the transactions on a business' financial statements and the impact they have on analysis of the business, for example its risk, liquidity, financial flexibility, and operating capability. We chose this approach to better help students gain an understanding of the logic of the accounting system and its interrelationships, the effects of transactions on a business' financial statements, and the use of accounting information in decision making without getting them 'bogged down' in the mechanics of the system. For those wanting to incorporate the mechanics of the system, as we mentioned earlier, we do provide a thorough coverage of the double entry system and the complete accounting cycle in Chapter 5.

Because you've kept us apart for too long. . .

We also mentioned earlier that this book integrates management accounting and financial accounting topics in a way that is more reflective of the world students will face outside of the classroom. In

blending our discussion of management accounting and financial accounting, we address several management accounting topics prior to discussing specific financial accounting topics. In this regard the chapters are designed to reflect actual practice in that a business must plan and understand its activities before it communicates its plans to external users, and it must operate and evaluate its operations (internal decision making) before it communicates the results of its operations to external users. Therefore, in keeping with the ‘introduction to business’ theme and the logical sequencing of business activities, we discuss accounting for planning first, and then operating and evaluating (controlling) – discussing management accounting and financial accounting where they logically fit into this framework.

For instance, Chapter 2 covers cost–profit–volume (C–V–P) analysis for planning purposes. After students have an understanding of cost and revenue relationships, we introduce them to budgeting in Chapter 3. The discussion of the master budget includes projected financial statements, which links the coverage back to the financial statements in Chapter 1. Chapter 4 then introduces accounting for the operations of a business. Chapters 7 to 9 describe a business’ major financial statements, and discuss how internal and external users would use these statements to analysis the business.

Besides integrating management accounting and financial accounting topics, this book also integrates business issues and values with international issues, where appropriate. Sustainability is also a key theme. This approach reinforces the idea that societal, environmental and global issues are not topics that can and should be dealt with separately from the other issues, but rather are an integral and significant part of business in today’s world.

Plain – and with fruit and nuts (a scaffolded approach)

This textbook also uses a building-block approach. It begins with starting and operating a small retail chocolate store – a sole proprietorship – and then progresses through the operations of a more complex business in the form of a chocolate manufacturer – a company. This allows students to learn basic concepts first, and then to broaden and reinforce those concepts later in a more complex setting. Several of the same topics re-emerge, but each time they are refined or enhanced by a different business structure or a different user perspective. For example, because of its location at the beginning of the semester, the Chapter 2 discussion of C–V–P analysis is simple. This topic would be covered again in greater depth in second and third year courses after students have a better understanding of costs in a manufacturing setting. Each time we revisit an issue, we discuss the uses of accounting information for both internal and external decision making, as appropriate.

Likewise, we use a scaffolded approach to arranging the end-of-chapter materials according to levels of learning. To indicate these levels, we have divided these materials into sections on *Testing your knowledge*, *Applying your knowledge*, and *Making evaluations*. These categories are arranged so that the answers to questions require students to use increasingly higher-order thinking skills as they move from one category of question to the next. The *Testing your knowledge* section includes questions that test students’ knowledge of specifics – terminology, specific facts, concepts and principles, classifications, and so forth. The *Applying your knowledge* section includes questions, problems, and situations that test students’ abilities to translate, interpret, extrapolate and apply their knowledge. The *Making evaluations* section includes questions, problems, and cases that not only test students’ abilities to apply their knowledge but also their abilities to analysis elements, relationships and principles, to synthesise a variety of information, and to make judgments based on evidence and accounting criteria.

NEW AND IMPROVED FLAVOUR

In this customised edition, and as a result of our own use of the book and feedback from other users, we have made the book even better. The new features of the textbook include:

- 1 Issues and real-life examples relating to ethical issues in triple bottom line accounting have been woven into this new edition. The sustainability theme that runs through the text is another key feature that differentiates it from other introductory accounting texts.
- 2 Chapter 10 has been specifically designed to give students a taste of the impact of environmental and energy issues on business, and how to record and manage them. It also broadens their perspectives by introducing them to the Global Reporting Initiative (GRI) to make them truly aware of the knowledge and skills they will need in the global business arena.
- 3 This edition of the text highlights the importance of developing a range of skills other than technical skills, such as judgement, critical thinking, ethical and sustainability skills, self management and teamwork using activities throughout each chapter and end of chapter materials and case studies.
- 4 We moved some topics to chapter appendices to keep them available to those who wish to teach them, including periodic and perpetual inventory.
- 5 We have revised many 'real' business examples in the text, and have also updated all of the 'real' business problems in the end of chapter materials.

We believe these features enhance the 'flavour' of the book and make its topics even more relevant and understandable to our students.

REAL-WORLD/WORLD-WIDE/TOTAL WORLD

Life is not a 'textbook case'. That's why we not only integrate management accounting and financial accounting topics, but also include information about real-world businesses as examples for many of these topics. We include analyses of the financial information of some of these businesses in the text and in the end of chapter materials. The Weblinks section of each chapter gives students the opportunity to connect to some of these businesses via the internet for further evaluation.

Because the website of each business may provide a unique path to its financial information, we provide navigating instructions in the following two sections. You may want to direct your students' attention to these sections.

SUGGESTIONS FOR NAVIGATING A BUSINESS WEBSITE

Use a search engine like Yahoo or Google to locate the home page of the business, then locate the financial statements, annual reports, and other financial information by finding a link on the home page to About Us, Business Information, Investors, Investor Relations, Investor Information, or some combination of these terms.

After clicking on this link, you will be sent to the financial information of the business. Sometimes the business will show a 'condensed' annual report containing only 'summary' financial statements. If you want complete financial information about the business for a specific year, you will need to find that year's annual report.

Generally you can access the home page of an organisation, such as the CPA, in a similar way. From the home page, you may find that you check several links before you find the proper section. Unfortunately, because organisations' websites tend to be less standardised than those of businesses, you may find yourself using the 'trial and error' method of finding information on those websites.

RESOURCES GUIDE

FOR THE STUDENT

As you read this text, you will find numerous features that will enhance your study and help you to understand accounting's applications.

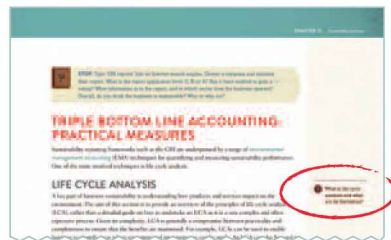


Key questions are listed at the start of each chapter. They give a clear outline of the accounting concepts each chapter covers and what you can expect to learn.

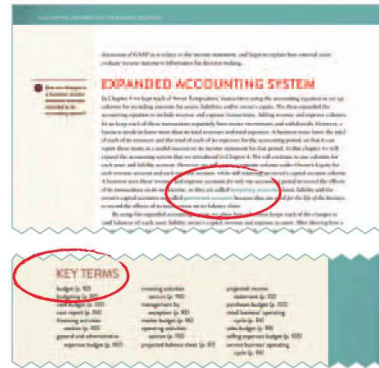
Ethics and sustainability icons highlight areas of the text that deal with ethical and environmental issues that relate to contemporary accounting.



Margin notes provide additional information and useful reminders.



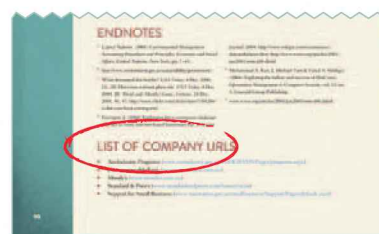
Key questions appear again in the margins, next to sections that cover the relevant topic.



Key terms are highlighted where they first appear in the text, and are also listed at the end of each chapter.

STOP: What would the graph look like for Sweet Temptations' \$4235 total fixed costs? Why?

STOP questions encourage you to take a break from reading to think about an issue or consider the outcome of a situation.



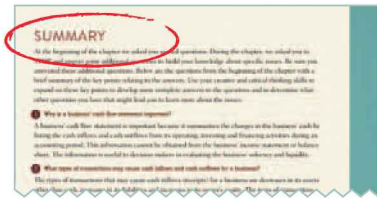
The names of real businesses are bolded and underlined in the text. These companies' websites, which you can search for further information, are listed at the end of each chapter.

In Chapter 7 Starbucks' profitability was higher than that of Walmart. Why do you think Starbucks' performance was higher than that of Walmart's?

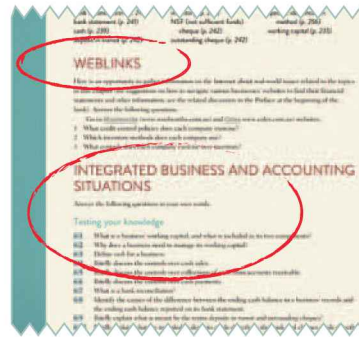
Discussion questions are designed to spur critical thinking, judgement and debate.

A complete glossary can be found at the back of the book.

At the end of each chapter, you will find several tools to help you review the chapter and its key questions, and extend your learning.



The end-of-chapter **Summary** highlights the important concepts covered in the chapter and links them back to the key questions.



Weblinks and accompanying activities encourage you to gather information on the Internet about real-world issues related to each chapter's topics.

Integrated business and accounting situations at the end of every chapter help you to revise and consolidate the concepts you have learned by testing your knowledge, applying your knowledge and making evaluations.



The **Dr Decisive** letter in each chapter asks you to apply your accounting knowledge and critical thinking skills to solving an everyday problem.

ONLINE RESOURCES

Visit <http://login.cengagebrain.com> and log in using the code card in the front of this book for access to the Accounting: Information for Business Decisions **CourseMate** website. You'll find interactive quizzes, real-life cases with questions, annotated weblinks, flashcards, crosswords, and more tools to help you excel in your studies.



FOR THE INSTRUCTOR

Cengage Learning is pleased to provide instructors with a selection of resources that will help in the preparation of lectures. These teaching tools are available on the instructor companion website, accessible via <http://login.cengage.com>.

Solutions manual

The solutions manual provides instructors with suggested solutions to all the end-of-chapter exercises in the text.

PowerPoint presentations

Chapter-by-chapter PowerPoint presentations cover the main concepts addressed within the book, and can be edited to suit individual requirements. Use these slides to enhance lecture presentations, to reinforce the key principles of your subject or in student handouts.

ExamView test bank

ExamView helps you to create, customise and deliver tests in minutes for both print and online applications. The quick test wizard and online test wizard guide you step by step through the test-creation process. With ExamView's complete word-processing abilities, you can add an unlimited number of new questions to the bank, edit existing questions and build tests of up to 250 questions using up to 12 question types. You can also export the files into Blackboard or WebCT. The test bank is also available in MS Word format for further customisation to meet students' learning requirements.

Artwork

These digital files of graphs and exhibits from the book can be used in a variety of media. Add them into a course management system, use them in student handouts or copy them into lecture presentations.



ABOUT THE AUTHORS

Professor Marie Kavanagh, University of Southern Queensland

Marie (DipTeach, BCom, AdvDipFinAcctg, MFinMgmt, PhD, ASA) works in accounting education at the University of Southern Queensland, and has taught accounting for many years across all levels of secondary and tertiary education. Marie's research interests are in the areas of accounting and business education, particularly online business education. She is well known for her involvement in several large ALTC/OLT grants, as both a leader and a team member, working in collaboration with other universities to further knowledge and improve practice in business and accounting education.

Marie is currently Australian Chair of the Accounting Education Special Interest Group for the Accounting and Finance Association of Australia and New Zealand (AFAANZ) and northern regional convenor for Enactus (Entrepreneurship and Action through Us) Australia. She was a winner of an individual Carrick Teaching award for Outstanding Contribution to Student Learning in 2006, and in 2007 was part of a team that won a national Carrick Program award for developing and delivering the program Peer Assisted Support Sessions at The University of Queensland. She was recently honoured when appointed as a Fellow of the Business Educators Association of Queensland and in 2013 was nominated for the Australian of the Year Award.

Associate Professor Geoff Slaughter, University of Southern Queensland

Geoff (ADipBus, BBus (Hons), PhD, MIPA, CMA) is an Associate Professor in Accounting and Associate Dean (Academic) for the Faculty of Business, Education, Law and Arts at the University of Southern Queensland. He has been involved in teaching accounting at tertiary level for over fifteen years with a focus on accounting curriculum development and sustainability accounting.

Geoff's research interests include the financial viability of environmentally sustainable management practices by business, and financial and environmental management issues relating to agribusiness and natural resource management. Geoff has had several major research grants from various funding bodies and government, and has co-authored numerous publications about the integration of financial and environmental sustainability in business.

Sharelle Simmons, Griffith University

Sharelle Simmons (BA, BEd, MCom, CPA) is a Lecturer in Accounting within the Accounting, Economic, and Finance Department of Griffith University. She has had extensive teaching experience, having held positions at Griffith University, University of Queensland, Newcastle University and Avondale College. Her primary areas of teaching are Financial Accounting, Management Accounting and Strategic Management Accounting.

Sharelle's research interests include the Adoption of Performance Measurement Systems, especially in the public sector, and the choice of and functioning of networks within the healthcare sector. Sharelle has been the recipient of an ARC Linkage Grant for research into networks in the healthcare sector. Her PhD research into the adoption of the Balanced Scorecard in the Australian healthcare sector has been presented at an EIASM conference.



ACKNOWLEDGEMENTS

Cengage Learning and the authors would like to thank the following reviewers for their incisive and helpful feedback:

- Tracy-Anne De Silva, Lincoln University
- Christina James-Overheu, University of Southern Queensland
- Raymond Leong, University of Southern Queensland
- Dr Afzalur Rashid, University of Southern Queensland
- Pat Thomson, University of Ballarat.

CHAPTER

1

INTRODUCTION TO BUSINESS ACCOUNTING AND THE ROLE OF PROFESSIONAL SKILLS

'Business is a game, the greatest game in the world if you know how to play it.'

Thomas J Watson Sr

KEY QUESTIONS

- 1 Why is it necessary to have an understanding of business before trying to learn about accounting?
- 2 What factors are causing the business environment to change?
- 3 How does someone become a successful businessperson in a complex business environment?
- 4 What is private enterprise, and what forms does it take?
- 5 What are the three most common forms of business organisations and their basic characteristics?
- 6 What types of regulations do businesses face?
- 7 What information does the accounting system provide to support management activities?
- 8 How does accounting provide support and information to people making decisions who are external to the business?
- 9 What roles do ethics and sustainability play in the business environment?
- 10 What skills do accountants of the 21st century require?
- 11 How can people learn to think critically?
- 12 How can critical thinking help people make better business decisions?
- 13 What are the logical stages in problem solving and decision making?

What are you planning to do when you graduate from university? Maybe become an accountant or a veterinarian, work your way up to marketing manager for a multinational business, manage the local corner store, or open a sporting goods shop? Regardless of your career choice, you will be making business decisions, both in your personal life and at work. We have oriented this book to students like you who are interested in business and the role of accounting in business. You will see that accounting information, used properly, is a powerful tool for making good business decisions. People inside a business use accounting information to help determine and manage costs, set selling prices and control the operations of the business. People outside the business use accounting information to help them make investment and credit decisions about the business. Just what kinds of businesses use accounting? All of them! So let's take a little time to look at what business means.

Business affects almost every aspect of our lives. Think for a moment about your normal daily activities. How many businesses do you usually encounter? How many did you directly encounter today? Say you started the day with a quick trip to the local convenience store for milk and eggs. While you were out, you noticed that your car was low on petrol, so you stopped at the local petrol station. On the way to class, you dropped some clothes off at the drycleaners. After your first class, you skipped lunch so that you could go to the bookshop and buy the calculator you need; after buying a chocolate bar for sustenance, you headed to your next class. In just half a day, you have already interacted with four businesses – the convenience store, the petrol station, the drycleaners and the bookshop – and managed your own personal financial requirements; that is, having enough money to pay for these things.



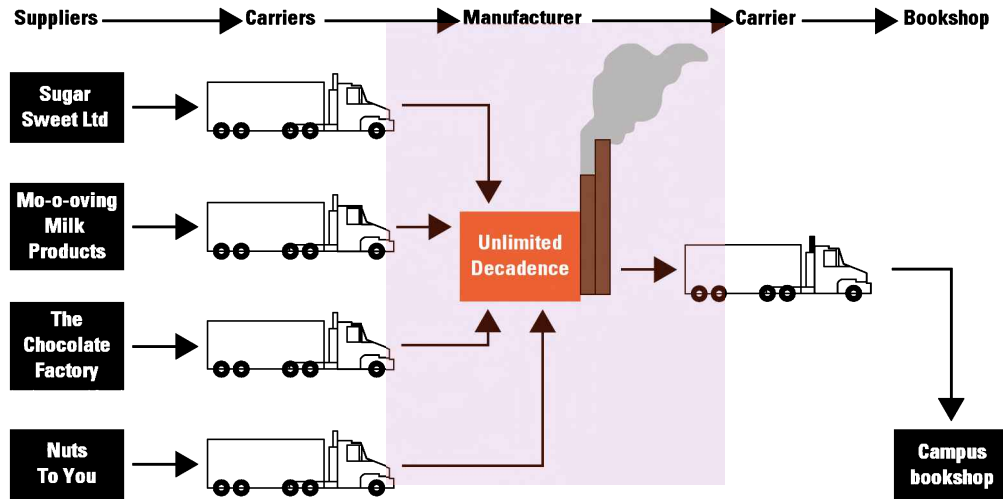
Actually, you encountered a fifth business, your university. Why would you describe your university as a business?

1 Why is it necessary to have an understanding of business before trying to learn about accounting?

Although you were directly involved with four businesses, you were probably affected by hundreds of them. For example, two different businesses manufactured the calculator and the chocolate bar you purchased at the bookshop. Suppose Unlimited Decadence Corporation manufactured the chocolate bar that you purchased. As we illustrate in Exhibit 1.1, Unlimited Decadence purchased the chocolate bar ingredients from many other businesses (suppliers). Each supplier provided Unlimited Decadence with particular ingredients. Shipping businesses (carriers) moved the ingredients from the suppliers' warehouses to Unlimited Decadence's factory. Then, after the chocolate bars were manufactured, a different carrier moved them from Unlimited Decadence to the bookshop.

Making and shipping the calculator would follow the same process. You can see that many businesses are involved with manufacturing, shipping and selling just two products. Now think about all the other products that you used during the morning and all the businesses that were involved with the manufacturing and delivery of each product. Before leaving your home this morning, you could easily have been affected by hundreds of businesses. All these businesses have a role to play in providing goods and services to final customers.

Products and services affect almost every minute of our lives, and businesses provide these products and services to us. As you will soon see, accounting plays a vital role for businesses by keeping track of a business' economic resources and activities, and, nowadays, measuring the environmental and social impacts of the business (these will be discussed throughout this textbook). The business' financial position and the results of its activities are then reported to people who are interested in how well it is doing. This is similar to the way statistics are gathered and reported for cricket players and other athletes.

EXHIBIT 1.1**Businesses involved with the manufacture and sale of chocolate bars**

In this chapter, we will introduce you to accounting by first looking at different forms of business enterprise and the environment in which they operate. Regulatory issues associated with forming, operating and reporting on the activities of a business, and the role of ethics and sustainability in the management of a business, are discussed. We will highlight knowledge and skills required to engage in business and the role that accounting information plays in problem solving, making judgements and decision making within a business.

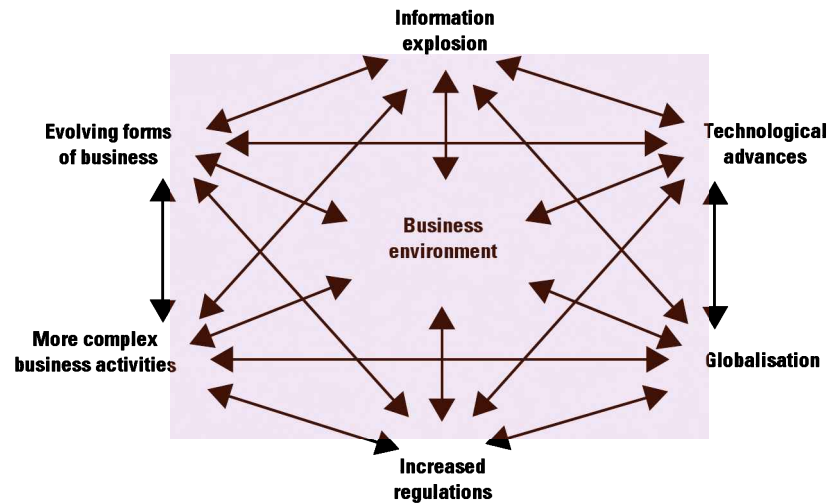
STOP: What do you think is the role of accounting and accountants in operating a business?

THE CHANGING BUSINESS ENVIRONMENT

Why is the business environment changing so rapidly? As Exhibit 1.2 illustrates, a combination of many interwoven factors in this environment contribute to its complexity and excitement.

One contributor to the rapidly evolving business environment is the information explosion. More information is being generated than ever before, and this information is available to more people than ever. On the information superhighway, networks such as the Internet make available an almost endless list of information that includes library listings, books, journal articles, financial reports, catalogues, and directories of businesses, organisations and people with similar interests. Because of the amount and accessibility of information, and because new information may replace existing information, business managers must be able to use their skills to evaluate and manage this information to their advantage. We will discuss this idea more thoroughly later in the chapter.

- 1 What factors are causing the business environment to change?

EXHIBIT 1.1**Factors affecting the complexity of the business environment**

Consider how *technological advances* have affected the transmission and sharing of information. Most business people have adapted their workday habits by using smartphones, text messaging, web conferences or online meetings, and Skype or WebEx to conduct business online. Email, fax, scanning machines and online data drop boxes to share documents facilitate information transmittal to and from multiple global sites. Huge databases, such as airline flight schedules and rate structures, are now stored in computer files and accessed by millions of users around the world every day. These developments have made the world more competitive. Businesses and individuals who in the past had difficulty travelling or communicating around the globe (perhaps because the infrastructures of their countries could not accommodate their needs) have enthusiastically 'thrown their hats in the ring'.

Technological advances affect not only the products we use and the way business is conducted, but also the way the products are manufactured. For example, advanced technologies have allowed the production process in many businesses to become fully automated. In many of our factories, computers are used to plan, operate and monitor manufacturing processes, and to make adjustments to these processes as needed. Robots are now common workers on many production lines; for example, car manufacturers such as **Toyota** (www.toyota.com.au).

The *globalisation* of business activities and economies is providing more opportunities for businesses and individuals to conduct business by creating a larger, more diverse marketplace. At the same time, it is providing new business challenges. For example, when businesses begin to sell their products in other countries, they must translate their product names and advertising slogans into different languages. This type of translation is not as straightforward as it might first appear. Consider the dilemma **KFC** (www.kfc.com.au) faced when it tried to translate its slogan 'finger-lickin' good' into Taiwanese. The literal translation was, 'Eat your fingers off'.

Businesspeople must also translate transactions involving foreign currencies (for example, Japanese yen to Australian dollars). Furthermore, they must learn to negotiate other cultures, economies, laws and ways of conducting business.



Monty Rakusen/Cultura/Getty Images

Another factor adding to the complexity of the business environment is the increase in regulations that companies must address. These are discussed later in the chapter.

More complex business activities also contribute to the changing business environment. For example, business owners and managers are finding more creative methods of financing their activities, new outlets for investing their excess cash, a larger variety of alternatives for compensating their employees, and more complicated tax laws with which they must comply. In addition, the way companies conduct business is evolving. Where businesses used to be 'bricks and mortar', they now exist on the Internet. It is now common and convenient for business to conduct business using **e-commerce**, where businesses and consumers buy and sell goods and services over the Internet. E-commerce takes three forms: business-to-business or B2B (**Cisco Systems, Inc** [www.cisco.com]), business-to-consumer or B2C (**Amazon** [www.amazon.com]) and consumer-to-consumer or C2C (**eBay** [www.ebay.com.au]).

Businesses also need to factor in the effect that climate change is having, and monitor the impact of business activities on greenhouse gas emissions. Businesses need to consider disclosure frameworks to keep their stakeholders informed about physical risks to the business associated with climate change, and details of any compliance obligations; for example, in Australia, those dictated by the *National Greenhouse Energy Reporting Act 2007* (NGER).

Finally, *evolving forms of business* are cropping up in the new business environment. For example, numerous variations of the simple business organisation (sole proprietorships, partnerships and companies) now exist. Each of these forms of organisation has legal advantages and disadvantages that the others don't have, and each addresses a particular aspect of the business environment. A business owner chooses the form of business that most closely meets the business' needs.

How has the use of email and the Internet affected the way in which we communicate and do business?

FACTORS AFFECTING THE COMPLEXITY OF THE BUSINESS ENVIRONMENT

The factors discussed above not only contribute to the complexity and excitement of the business environment, but also challenge the assumptions on which businesses and their employees operate. For example, the assumption that a university graduate will go out into the world, pursue a lifelong career and never return to university is no longer valid. Many people now change careers – careers, not just jobs! – several times before they retire. Often, in order to make a change, they return to study between careers to ‘retool’, or to expand their education to include new skills. Even people who stay in the same career expand their education (through continuing professional education, short courses, conferences and seminars) to improve their knowledge and abilities.

It is easy to see that a person entering or remaining in this dynamic environment must also be dynamic. In the following sections, we will discuss the characteristics, attitudes and skills that help people succeed in the business world. While reading these sections, keep in mind that these are attributes and abilities that people learn over a period of time and continue to develop for the rest of their lives (similar to the way athletes learn and improve their athletic skills).

1 How does someone become a successful businessperson in a complex business environment?

THE SUCCESSFUL BUSINESSPERSON

Imagine a successful businessperson. Perhaps the person, with sleeves rolled up and hands dirty, is working hard on some project. Or maybe he or she, in a business suit and with a briefcase in hand, is heading for a meeting. You may have a picture of what this businessperson looks like, but what really determines success is harder to see. It’s more a matter of approach than of image.

The successful businessperson thrives on change, seeing it as an opportunity rather than an obstacle. However, treating change as an opportunity is more than just a matter of attitude – not simply seeing the glass as ‘half full’. It also involves being *prepared* for the opportunity; the successful businessperson is both willing and *able* to change. Therefore, this person is devoted to lifelong learning, realising that continuous learning is the only way to keep up with and be prepared for the fast-paced change we described earlier. This means that the businessperson must be willing to read industry or professional journals, attend conferences and/or take courses to stay up-to-date.

To be able to adapt to change (or ‘go with the flow’), the successful businessperson develops certain other qualities as well. He or she welcomes others’ viewpoints, appreciates differences among people, takes educated and thoughtful risks, anticipates environmental trends and identifies the potential problems and opportunities associated with these trends, and willingly abandons old plans if new information or technology makes them less workable. This doesn’t mean that the successful businessperson is a chameleon, changing colours every time the business environment changes, but it does mean that he or she is flexible and adaptable.

STOP: What qualities can people develop to better prepare themselves for problem solving and decision making in the rapidly changing business environment?

PRIVATE ENTERPRISE

Business in Australia, New Zealand and most other countries operates in an economic system based on private enterprise. In this system, individuals – that is, people like us, rather than public institutions like the government – own businesses that produce and sell services and/or goods for a profit. These businesses generally fall into three categories: service businesses, merchandising businesses and manufacturing businesses.

1 What is private enterprise, and what forms does it take?

SERVICE BUSINESSES

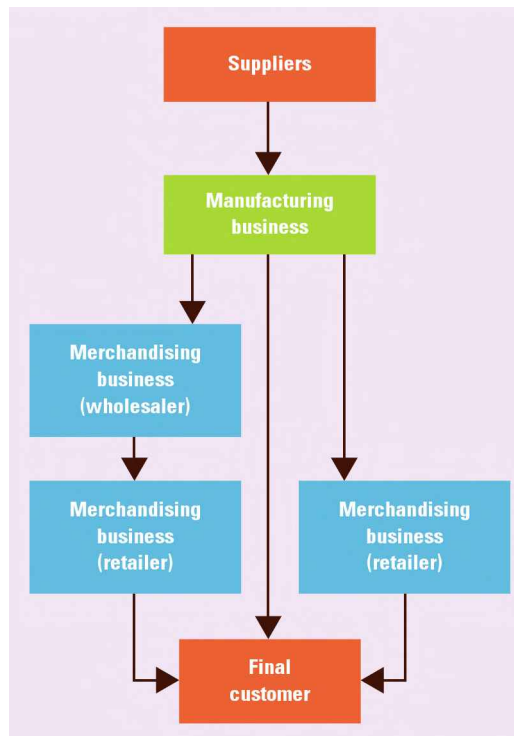
Service businesses perform services or activities that benefit individuals or business customers. The dry-cleaning establishment, where you dropped off your clothes this morning, provides the service of cleaning and pressing your clothes for you. Businesses like Stefan Hair Fashions (www.stefan.com.au), LJ Hooker (www.ljhooker.com.au), Qantas Airlines Limited (www.qantas.com.au), and professional practices such as accounting, law, architecture and medicine are all service businesses. Other businesses in the private enterprise system produce or provide goods or tangible/physical products. These businesses can be either *merchandising businesses* or *manufacturing businesses*.

MERCHANDISING BUSINESSES

Merchandising businesses purchase goods (sometimes referred to as *merchandise* or *products*) for resale to their customers. Some merchandising businesses, such as plumbing supply shops, electrical suppliers or beverage distributors, are *wholesalers*. Wholesalers primarily sell their goods to retailers or other commercial users, like plumbers or electricians. Some merchandising businesses, such as the bookshop where you bought your calculator and chocolate bar or the convenience store where you bought your milk and eggs, are *retailers*. Retailers sell their goods directly to the final customer or consumer. Woolworths Supermarkets (www.woolworths.com.au), Toys“R”Us (www.toysrus.com.au) and Dick Smith Electronics Pty Limited (www.dicksmith.com.au) are retailers. Other examples of retailers include shoe shops, online bookshops and car dealerships.

MANUFACTURING BUSINESSES

Manufacturing businesses make their products and then sell these products to their customers. Therefore, a basic difference between merchandising businesses and manufacturing businesses involves the products that they sell. Merchandising businesses *buy* products that are physically ready for sale and then sell these products to their customers, whereas manufacturing businesses *make* their products first and then sell the products to their customers. For example, the bookshop is a merchandising business that sells the chocolate bars it purchased from Unlimited Decadence, a manufacturing business. Unlimited Decadence, though, purchases (from suppliers) the chocolate, sugar, dairy products and other ingredients to make the chocolate bars, which it then sells to the campus bookshop and other retail stores. Ford Australia (www.ford.com.au), Black & Decker (www.blackanddecker.com.au) and BlueScope Steel Ltd (www.bluescopesteel.com.au) are examples of manufacturing businesses. Exhibit 1.3 shows the relationship between manufacturing businesses and merchandising businesses and how they relate to their customers.

EXHIBIT 1.1**Relationship of manufacturing and merchandising businesses**

The line of distinction between service, merchandising and manufacturing businesses is sometimes blurry because a business can be undertaking activities in more than one area. For example, Dell Inc. (www.dell.com.au) manufactures personal computers, sells the computers it manufactures directly to business customers, government agencies, educational institutions and individuals, and services those computers through installation, technology transition and management.

STOP: Do you think a supplier to a manufacturing business is a merchandising business or a manufacturing business? Why?

Whether a business is a service, merchandising or manufacturing business (or all three), for it to succeed in a private enterprise system it must be able to obtain cash to begin to operate and then to grow. As we will discuss in the following sections, businesses have several sources of cash.

ENTREPRENEURSHIP AND SOURCES OF CAPITAL

Owning a business involves a level of risk, along with a continuing need for capital. Although **capital** has several meanings, we use the term here to mean the funds a business needs to operate or to expand operations. In the next two sections we will discuss the risk involved with owning a business and possible sources of capital.

Entrepreneurship

Businesses in a private enterprise system produce and sell services and goods for a profit. So profit is the primary objective of a business. Profit rewards the business' owner or owners for having a business idea and for following through with that idea by investing time, talent and money in the business. The business' owner hires employees, purchases land and a building (or signs a lease for space in a building), and purchases (or leases) any tools, equipment, machinery and furniture necessary to produce or sell services or goods, expecting, but not knowing for sure, that customers will buy what the business provides. An individual who is willing to risk this uncertainty in exchange for the reward of earning a profit (and the personal reward of seeing the business succeed) is called an **entrepreneur**.

Entrepreneurship, then, is a combination of three factors: the business owner's idea, the willingness of the business' owner to take a risk, and the abilities of the business' owner and employees to use capital to produce and sell goods or services. But where does the business get its capital?

Sources of capital

One source of capital for a business is the entrepreneur's (or business owner's) investment in the business. An entrepreneur invests money 'up front' so that the business can get started. The business uses the money to acquire the resources it needs to function. Then, as the business operates, the resources, or capital, of the business increase or decrease through the profits and losses of the business. It is important to the sustainability of the business that it generates sufficient funds to allow expansion as opportunities arise.

When an entrepreneur invests money in a business, he or she hopes to eventually get back the money he or she contributed to the business (a return of the contribution). Furthermore, the entrepreneur hopes to periodically receive additional money above the amount he or she originally contributed to the business (a return on the contribution). The entrepreneur would like the return on the contribution to be higher than the return that could have been earned with that same money on a different investment (such as an interest-bearing savings account).

Borrowing is another source of capital for a business. To acquire the resources necessary to grow or to expand the types of products or services it sells, a business may have to borrow money from institutions like banks (called *creditors*). This occurs when the cash from the business' profits, combined with the business owner's contributions to the business, is not large enough to finance its growth. But borrowing by a business can be risky for the owner or owners. In some cases, if the business is unable to pay back the debt, the owner must personally assume that responsibility.

Borrowing in general can also be risky for a business. If the business cannot repay its debts, it will be unable to borrow more money and will soon find itself unable to continue operating. In addition to earning a profit, then, another objective of a business is to remain solvent. Remaining **solvent** means that the business can pay off its debts.

STOP: Why are reliable sources of capital important to the sustainability of a business?

THE FORMS THAT BUSINESSES TAKE

Several types of organisations use accounting information in their decision-making functions but do not have profit making as a goal. These organisations are called *not-for-profit organisations*; they include many educational institutions, religious institutions, charitable organisations, councils, governments and some hospitals. Since making a profit is not a goal of these organisations, some aspects of accounting for these organisations' activities are unique and beyond the scope of this book.

STOP: Can you list two not-for-profit organisations?

In this book we emphasise *business* organisations. These business organisations, or *businesses*, are a significant aspect of the Australian, New Zealand and world economies. As Exhibit 1.4 on page 14 shows, a business may be organised as one of the following general types of business organisations: (1) sole proprietorship, (2) partnership or (3) company.

Choosing a business' legal form is an important decision for the business' owners to make. For example, as a business owner, this decision determines how laws and regulations affect your personal responsibility to pay the business' debts. When choosing among legal forms, you need to know the characteristics and advantages and disadvantages of each. Once you select a legal form and start operating your business, laws and regulations specific to your type of organisation will affect some of your business decisions. In this section we will discuss the three most common forms of business organisations: sole proprietorships, partnerships and companies/corporations.

SOLE PROPRIETORSHIP

A **sole proprietorship** or **sole trader** is a business owned by one person who is the sole investor of capital into the business. Sweet Temptations is a chocolate shop (that is, a retail business) run by Anna Cox, which sells chocolate manufactured by Unlimited Decadence. Because Anna Cox is the only investor in Sweet Temptations, this business is an example of a sole proprietorship. In general, sole proprietorships are small businesses that focus either on selling merchandise or on performing a service. Many of the small shops you see are sole proprietorships.

The owner of a sole proprietorship usually also manages the business. The owner makes the business' important decisions, such as when to purchase equipment, how much debt to incur and which customers are extended credit. In Australia and New Zealand, tax laws and regulations require each owner of a sole proprietorship to report and pay taxes on his/her business' taxable income. The business' taxable income is included in the owner's individual income tax return; there is no separate income tax return for a sole proprietor. So, the owner adds the income from the sole proprietorship to his or her other sources of income, such as wages earned from other jobs and interest received from bank deposits. In the case of Sweet Temptations, Anna Cox includes with her personal income tax return a schedule that reports Sweet Temptations' taxable income. She includes this amount in her total personal taxable income. Anna calculates her personal income tax liability based on all her sources of income.

Australian and New Zealand laws state that an owner of a sole proprietorship must assume personal responsibility for the debts incurred by the business. This requirement is referred to as **unlimited liability**.

1 What are the three most common forms of business organisations and their basic characteristics?