Financial Accounting

TENTH EDITION

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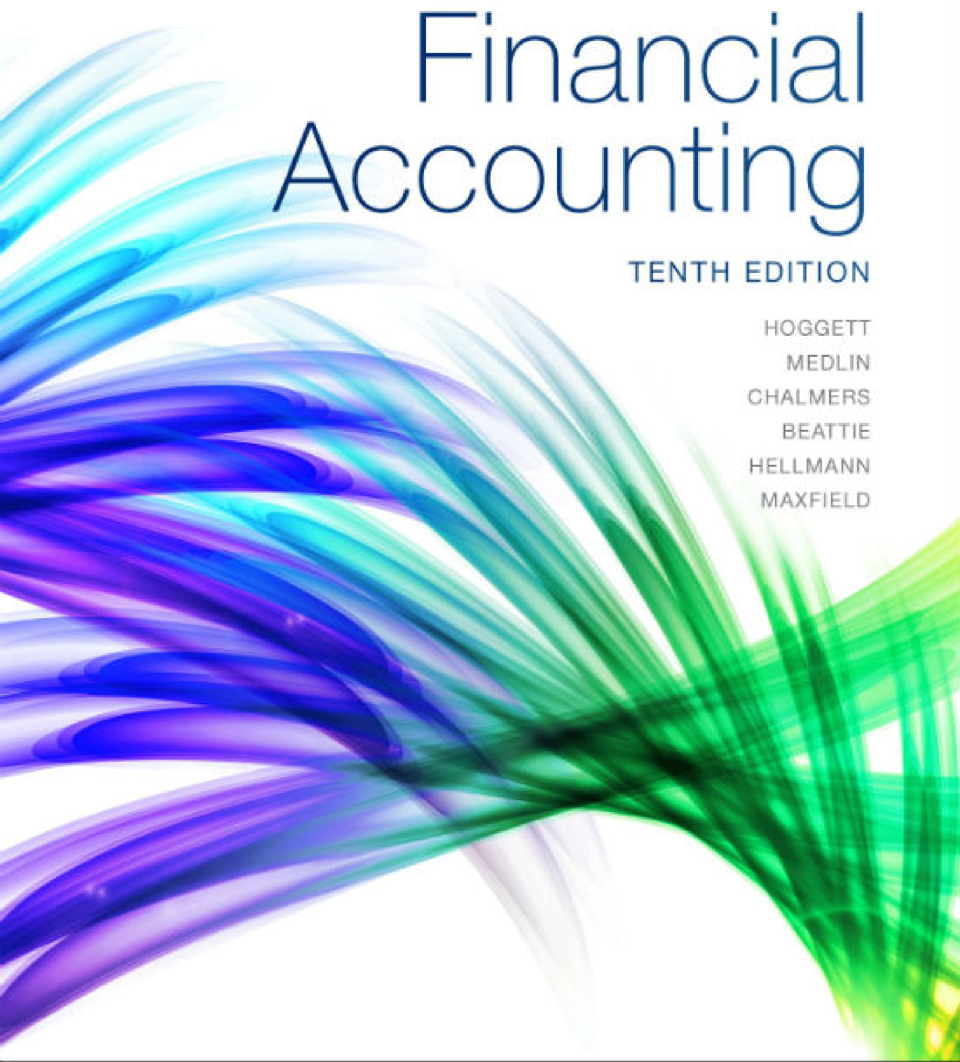

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CHAPTER 1

Decision making and the role of accounting

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1.1 outline the dynamic environment in which accountants work
1.2 discuss the nature of decisions and the decision-making process
1.3 outline the range of economic decisions made in the marketplace
1.4 explain the nature of accounting and its main functions
1.5 identify the potential users of accounting information
1.6 apply information to make basic economic decisions
1.7 describe the role of accounting information in the decision-making process
1.8 compare accounting information for management and external users
1.9 summarise how the accounting profession is organised in Australia
1.10 identify the different areas of the economy in which accountants work
1.11 identify the importance of ethics in business and accounting and how to recognise and handle ethical dilemmas as part of the decision-making process.

SCENE SETTER

Getting started with accountancy

A uniquely caring, fair and inclusive view of society is most often the product of a recipe that includes powerful life lessons, positive cultural understanding and thoughtful reflection.

These influences have turned Corinne Proske CPA into the person she is today. What is perhaps most surprising is that she fell so comfortably into accounting.

Proske grew up in Melbourne, but spent time in the US, France and Germany when she was young. Her parents' respect for nature was passed on to Proske who, as a teenager, once considered chaining herself to a tree during an anti-logging protest. Instead, a philosophical discussion with her father led her in an unexpected direction.

'We had a talk about whether it is more effective to strap yourself to the tree and wait for the bulldozer or to drive the bulldozer yourself,' she says.

'I began to realise the power of blending two worlds together.'

Proske originally dreamed of becoming a park ranger but instead studied commerce, specialising in environmental economics and later completing her accounting professional qualification.

'There is a role for people to be outraged but, using the skills of accounting and economics, I have been able to make the most impactful influences and decisions.'

Proske worked with NAB as head of community finance and development and led NAB's impact investment business, an emerging field of investment activities that aims to generate a measurable and beneficial social or environmental impact along with a financial return. The Australian market for impact investment is estimated to reach A$32 billion by 2022, so it makes economic sense for the bank to be involved.

From 'behind the wheel of the bulldozer', she developed, managed and launched NAB's microfinance program, offering assistance to individuals and businesses that have difficulty accessing mainstream finance.

'There are two key commercial drivers,' says Proske. 'One is that, economically, it makes sense to include everybody; it is good for GDP. Second, we will be regulated if we don't get this right. It is also simply about doing the right thing.'

Research from the Centre for Social Impact, conducted on behalf of NAB, shows that three million adult Australians are fully or severely financially excluded.

Corinne is now General Manager, Online and Retail at Good Shepherd Microfinance.

'I would never have got here without my accounting knowledge and experience,' says Proske. 'It has allowed me some real clarity.

'The tools that accounting offered me have been absolutely essential.'

One piece of advice

'Doing the right thing and achieving commercial outcomes need to, and can, align. Business is only successful when society succeeds. Accountants need to look beyond the numbers.'

Source: Excerpts from Sheedy, C 2016, 'A natural progression', *InTheBlack*, June 2016, p. 70, http://intheblack.com/articles/2016/06/01/could-394000-microfinance-projects-change-australian-market.

Chapter preview

Welcome to your journey into the field of accounting. If your initial reaction to accounting is 'boring!', then think again. Accounting, at times, can be full of politics and intrigue, and the financial figures it produces are useful for informing many business decisions. The figures also may be the result of unethical behaviour whereby people have 'cooked the books'. So let's begin.

Whether you are studying this subject with a view to following a career in community finance (as has Corinne Proske in our scene setter), sports management, financial planning, or simply to gain a basic understanding of the field as it relates to other areas of business, we hope that you find your study of the subject enjoyable, challenging and useful. Inevitably, a study of accounting requires a basic understanding of record keeping, but accounting is far more than that. Accounting plays a vital role in the decision-making processes of every organisation, whether it is a for-profit organisation (e.g. Commonwealth Bank), not-for-profit organisation (e.g. a charity such as Oxfam) or a government organisation (e.g. a local council).

1.1 The dynamic environment of accounting

LEARNING OBJECTIVE 1.1 Outline the dynamic environment in which accountants work.

Accountants traditionally have been viewed as the 'bean counters' or 'number-crunchers' of an organisation, but this is no longer their major task. Computerised accounting systems can now do much of the work. Even small businesses have access to computerised accounting systems such as Mind Your Own Business (MYOB) or Xero, so the role of accountants has changed radically. Accountants working in organisations have become important members of the management team, as organisations have to contend with social changes caused by several factors such as:

- the dramatic development of information and communications technology including electronic banking, the Internet and e-commerce
- the increasing demand by society for information of a non-financial nature. This may include information about an entity's attention to such issues as occupational health and safety, social and equity diversity (e.g. employment of people with disabilities and indigenous people), and environmental considerations (e.g. water usage, the organisation's carbon footprint and other sustainability practices).
- the globalisation of business. Instead of merely being involved in a particular local community, many organisations are seeing the world as their marketplace and as their source of labour and knowledge. This has placed increasing demands on organisations to be accountable for their corporate behaviour in foreign countries, including abiding by their rules and regulations, and their impact on the society and environment of those countries. Questions being asked include: How well does an organisation treat and pay its employees in developing countries? Is business conducted by way of political payments (bribes) to influential officials in those countries? What corporate governance practices apply in those countries?
- the globalisation of regulations affecting business organisations, such as the development and adoption of international financial reporting standards
- digital disruption and unlocking the power of big data.

One thing is certain: change will continue. In order to cope, accountants of the future need to have not only record-keeping knowledge but also analytical and communication skills, and business strategy and planning know-how. They need the ability to think clearly and critically in order to solve problems, a familiarity with information systems and technology, strong interpersonal communication skills with clients and business associates, and sound ethical behaviour in different cultural environments.

This text is designed for all students studying accounting for the first time at university level, both those majoring in accounting and those seeking a basic understanding of accounting but studying in other fields, such as marketing, management, economics, information technology, law, engineering, the arts and sciences. Accounting is usually a core unit in business degrees as it is the 'language of business'.

Many students in non-accounting majors can benefit greatly from reading this text. Engineers are often involved in designing products to reduce costs and meet target prices, so much of their work is driven by accounting measures. Marketers often strive to maximise sales, so a knowledge of costs, pricing and accounting methods is helpful for success. Human resources managers are responsible for one of the major costs in an organisation, so they need to choose a mix of staff to provide a quality service while keeping control of salary and wages costs. Indeed, many professional groups outside of accounting find that having a good grasp of accounting concepts is an advantage and enhances the opportunities for success in their chosen careers.

We begin the text by considering decision making in everyday life, and the role of accounting in providing information for the decision-making process. Also in this chapter, we acquaint you with the types of activities that are carried out by a professional accountant working in business.

LEARNING CHECK

- ☐ Accountants are not purely record keepers but are part of the management team in an organisation.
- ☐ Accountants need to have not only record-keeping knowledge but also analytical skills, and business strategy and planning know-how.
- ☐ Accountants need the ability to think clearly and critically in order to solve problems, a familiarity with information systems and technology, strong interpersonal communication skills with clients and business associates, and sound ethical behaviour in different cultural environments.

1.2 Decisions in everyday life

LEARNING OBJECTIVE 1.2 Discuss the nature of decisions and the decision-making process.

We make many decisions every day. For example, we decide when to get out of bed each morning (sometimes prompted by our parents!); we decide the appropriate clothes to wear for the coming day's activities (influenced by our peers); we decide what to eat for breakfast, unless we are in too much of a hurry, in which case we make another decision to go without breakfast.

Decisions involve choices because it is not possible to do everything we might like to do, as time and resources are always limited. Some decisions can be made in no time at all with little thought, such as putting on a coat if the weather is cold, but others may require much thinking, planning and information gathering, such as choosing a career, buying a house or a car, moving from one city to another, going on an overseas trip, choosing which subjects to study at university, and deciding when to retire from active employment.

Sometimes, decisions made in haste can affect us adversely for the rest of our lives. Each decision we make has outcomes which then affect decisions to be made at a later time. Ultimately, the decisions we make, or the decisions made by others which affect us, determine our destiny in life. Decisions affect our appearance, our economic wellbeing, even our emotional and spiritual wellbeing, so it is important that we make decisions after careful consideration of all information available at the time.

Steps in decision making

In *simple* terms, a **decision** is the making of a choice between two or more alternatives. Every time a problem arises and we need to make a decision, we consciously or unconsciously follow four main steps, which can be framed as questions.

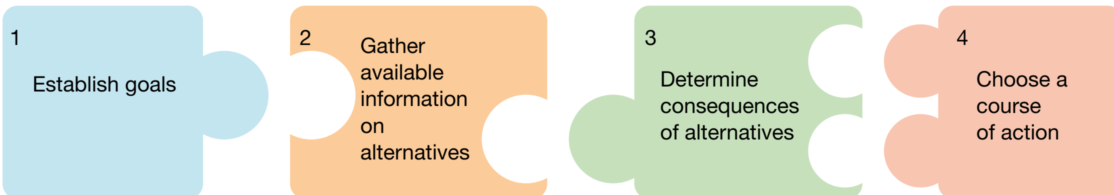
1. *What are we trying to achieve?* We must identify each situation in which a decision is needed and determine the goals we wish to achieve. The decision we make will be influenced by our values, motives and desires.
2. *What information do we need?* Information can help change our attitudes, beliefs or expectations. Information relevant to each decision helps us determine the alternatives available from which to choose given the time, resources and degree of effort that we are prepared to commit to making a choice.
3. *What are the consequences of different alternatives?* Having obtained information to help us determine the alternatives available, we then need to assess the consequences or outcomes of these alternatives. Since the outcomes of each alternative lie in the future, every decision we make involves a degree of

uncertainty, which means that there is an element of risk in achieving a desired outcome. For example, even a decision to take out car insurance involves a degree of risk as we balance the likelihood of causing a car accident with the cost of the insurance premium.

4. *Which course of action will we choose?* Finally, after consideration of the alternatives available and the consequences of those alternatives, we must choose a course of action which we hope will achieve the goals that we established in the first place.

The steps in the decision-making process are illustrated in figure 1.1.

FIGURE 1.1 Steps in the decision-making process



Once we have made a choice, we eventually find a set of actual outcomes or consequences. We may be satisfied or dissatisfied with these outcomes. If we are dissatisfied, we may need to make further decisions to achieve our ultimate goals. Hence, the outcomes or consequences of decisions commonly lead to further decisions, which in turn have further outcomes, and so on.

LEARNING CHECK

☐ The decision-making process involves four main steps: (1) establishing goals, (2) gathering information on alternatives, (3) determining the consequences of alternatives, and (4) choosing a course of action.

1.3 Economic decisions

LEARNING OBJECTIVE 1.3 Outline the range of economic decisions made in the marketplace.

Many (if not most) of the decisions that we make involve the use of **economic resources**. These are resources that are traded in the marketplace at a price because they are in limited or scarce supply. Some decisions are made for *consumption* purposes, such as what to eat for lunch and which brand of petrol to buy for the car. Other decisions are made for *investment* purposes. These decisions usually require major uses of resources, such as the decision to buy a car or a house. In business, some decisions require the investment or commitment of many millions of dollars for the purchase of large items of machinery. Still other decisions are of a *financial* nature, for example if a business wants to make an investment decision to purchase new machinery, a decision must be made to find a source of finance.

However, even though the economic aspects of decisions are very important, other factors must also be considered, and may be more important than economic factors in a particular circumstances:

- *personal taste* — our decision to buy a certain brand of clothing may be determined on the basis of preferred appearance or fabrics rather than price
- *social factors* — such as the impact on unemployment in the local community if a business decides to withdraw from that community
- *environmental factors* — such as the potential for carbon emissions or water pollution
- *religious and/or moral factors* — our decision not to purchase particular types of meat may depend on religious beliefs
- *government policy* — such as the prohibition of trade in certain types of drugs.

Economic decisions usually involve a flow of money. We may purchase goods for immediate cash payment, on EFTPOS, payWave or on credit, in which case the flow of money occurs at a later date than the flow of goods. The use of credit card facilities allows businesses to sell merchandise or provide services to us and to collect money from our bank, which then charges the cost to our account. Purchase of goods and services through the use of EFTPOS or payWave facilities, or through the Internet also allows a business to charge the cost to our bank account, which means that the flow of money may occur at a different time from the flow of goods and services.

Individuals and business entities make economic decisions in many different marketplaces. The marketplace with which we are all familiar is the retail market, where we make decisions as we buy groceries, mobile devices, cars, home furnishings and electrical goods. Then there is the wholesale market, where retailers decide to buy their supplies of goods in large quantities from various manufacturers for sale in their different retail outlets. Another popular market is the stock market, where individuals and business entities buy and sell shares, debentures and options. Even the flea market is a place where people make decisions to buy and sell merchandise, some of which they have handcrafted, others of which are second-hand. Services are also traded in a marketplace.

BUSINESS INSIGHT

Professional accountants needed in South-East Asia

With the year coming to a close, many countries in the South-East Asian region are busy preparing for the formal establishment of the ASEAN Economic Community (AEC).

From where I stand, the AEC offers opportunities, not just challenges, for Indonesian businesses, especially professional accountants, who will join a bigger market not limited by borders. The businesses that will reap the benefits are those that meet competition head on, by lifting their skills and knowledge.

For accountants, seeking professional certification would not only support them to do their job well but, more importantly, give them credibility and a competitive edge in AEC markets.

The government of Indonesia is on the right track in addressing the low number of professional accountants. In 2014, the government initiated a strategy to create an additional 100,000 professional accountants over the next few years.

In addition to increasing the number of accountants, the Government blueprint also aims to strengthen accounting regulation, improve the quality of accountants through certification and increase cooperation between the professional accounting association, the regulator and professional accountants.

Throughout history, accounting has always been at the core of every successful business, which makes accounting one of the oldest professions in the world.

In 1954, the Accountant Law (UU Akuntan) was ratified in Indonesia, following the country's independence to secure the national treasury. To satisfy government demand for accountants, the country established the National College of Accounting (STAN) in 1964. Demand for professional accountants then increased in the private sector as Indonesia's economic focus moved to crude oil. However, even with the increase, the number of professional accountants is still low.

Data from the Finance Ministry's Accountants and Appraisers Supervisory Center (PPAJP) in 2014 reveals that Indonesia is still in need of more professional accountants.

In 2014, the Ministry had recorded less than 16,000 professional accountants. Meanwhile, there are more than 226,000 companies in Indonesia that require accounting services. From this, one can see that many opportunities still exist for Indonesian accountants domestically let alone regionally.

To tap into the opportunities provided by the AEC, let alone the untapped domestic demand, quality education is a key factor in determining whether an accountant is able to compete with their ASEAN counterparts.

With the framework already well positioned by Indonesia's Finance Ministry, professional Indonesian accountants have a bright future with a large pool of untapped domestic market potential, and with even bigger regional opportunities ahead.

Source: Excerpts from Bond, D 2015, 'Professional accountants needed in Southeast Asia', *The Jakarta Post*, December.

Economic decisions may be made not only in the local marketplace but also in markets in different cities, states or countries. Many organisations have been prepared to establish places of business not only in their home country but also in overseas countries.

Hence, whenever an economic decision is to be made, there are many aspects and alternatives to consider, and this makes the decision-making process a fascinating study in itself. How do people in business organisations make decisions? What role does accounting play in the decision-making process? If decision makers are able to gain a certain level of accounting knowledge and understand the concepts and standards on which accounting information and reports are based, this will help them make more informed economic decisions, regardless of whether they are engineers, marketers, human resource managers, or any other business decision makers. In the scene setter at the start of the chapter, Corinne Proske, as an accountant, has been confronted with making many decisions about investing for measurable and beneficial social or environmental impact as well as financial return.

LEARNING CHECK

- ☐ Economic decisions are made for consumption purposes, investment purposes and/or financial purposes.
- ☐ Various factors must be considered when making economic decisions such as: financial aspects, personal taste, social factors, environmental factors, religious and/or moral factors, and government policy.
- ☐ Individuals and business entities make economic decisions in many different marketplaces, including the retail market, the wholesale market and the stock market, locally, nationally and overseas.

1.4 The nature of accounting

LEARNING OBJECTIVE 1.4 Explain the nature of accounting and its main functions.

Accounting is a service activity. Its function is to provide and interpret financial information that is intended to be useful in making economic decisions. Business entities, government departments, charitable organisations and not-for-profit organisations, family units and individuals all engage in economic activity which involves making decisions about allocating available resources effectively. People need relevant information to be able to make sound economic decisions.

In a complex society, decision makers have to rely on data supplied by specialists in various fields. For example, lawyers provide information about the ramifications of existing and changing legislation, and medical practitioners offer advice about the possible effects of different healthcare decisions. Accounting as a profession has evolved in response to society's need for economic information to help people make economic decisions. The accountant's main role is to be involved in steps 2 and 3 of the decision-making process illustrated in figure 1.1, to offer advice regarding step 4, and to measure the outcomes or consequences of the decision-making process. However, as you will see once you have studied accounting more closely, much of the information needed to make an economic decision never makes its way into the accounting records, but exists outside of those records.

Accounting is often called the 'language of business'. A language is a means of social communication and involves a flow of information from one person to one or more other people. Everyone involved in business, from the beginning employee to the top manager, eventually uses accounting information in the decision-making process. To be effective, the receiver of the information must understand the message that the sender intends to convey. Accounting uses its own special words and symbols to communicate financial information that is intended to be useful for economic decision making by managers, shareholders, creditors and many others. As you study accounting, you must learn the meanings of these words and symbols if you are to understand the messages contained in financial statements. The end-of-chapter key terms build up this language progressively as you proceed through the text.

The importance of understanding accounting information is not restricted to those engaged directly in business. Many people with little knowledge of accounting must interpret accounting data. For example, lawyers must often understand the meaning of accounting information if they are to represent their clients effectively, marketing consultants must be aware of the costs of developing advertising campaigns, and engineers and architects must consider cost data when designing new equipment and buildings. Thus, accounting plays a significant role in society and, in a broad sense, everyone is affected by accounting information.

Although accounting techniques are used in all types of economic units, in this text we concentrate mainly on accounting for business entities. Business owners and managers need information provided by the accounting system to plan, control and make decisions about their business activities. In addition, shareholders, creditors, government departments and not-for-profit organisations (such as clubs and societies) need financial information to help make investing, lending, regulatory and tax-related decisions.

Accounting defined

Accounting has been defined as the process of identifying, measuring, recording and communicating economic information to permit informed judgements and economic decisions by users of the information.

Identification involves observing economic events and determining which of those events represent economic activities relevant to a particular business. Selling goods to a customer, paying wages to employees and providing services to a client are examples of economic activities. Economic events of an entity are referred to by accountants as **transactions**, and are of two types, external and internal. Accountants use the single term *transaction* to refer to both internal and external transactions. Transactions constitute the inputs of the accounting information system.

External transactions (often called *exchange transactions*) are those that involve economic events between one entity and another entity. When an entity purchases goods from a supplier, borrows money from a bank, or sells goods and services to customers, it participates in external or exchange transactions. *Internal transactions* are those economic events that take place entirely within one entity. For example, when a car component is transferred from the stores department to the assembly line in a car manufacturing business, the transfer must be accounted for, even if it is by simply transferring the cost of the component from the records of one department to those of the other. Similarly, the depreciation of machinery used in the production of goods must be accounted for, and since it does not concern an outside party, it is an internal transaction. Internal transactions may even involve such things as the growth of grapevines held by the entity or the market value of trading securities, because, under certain accounting standards, the increased value of these items must be recognised in the accounts of the organisation.

Measurement must take place before the effects of transactions can be recorded. If accounting information is to be useful, it must be expressed in terms of a common denominator so that the effects of transactions can be combined. We cannot add apples to oranges unless we express them in terms of a common measuring unit. In our economy, business activity is measured by prices expressed in terms of money. *Money* serves as both a medium of exchange and as a measure of value, allowing us to compare the value or worth of diverse objects and to add and subtract the economic effects of various transactions. Accounting transactions are therefore measured and recorded in terms of some monetary unit, such as the dollar.

Recording provides a history of the economic activities of a particular entity. Recording is the process of systematically maintaining a file of all transactions which have affected the business entity after they have been identified and measured. Simply measuring and recording transactions, however, would provide information of limited use. The recorded data must be classified and summarised to be useful in making decisions.

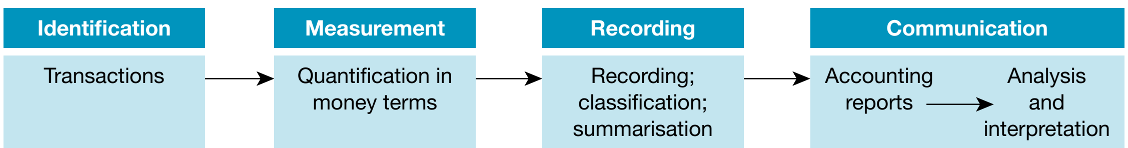
- Classification allows thousands of transactions to be placed into more meaningful groups or categories. All transactions involving the sale of goods, for example, can be grouped into one total sales figure and all transactions involving cash received can be grouped to report a single cash receipt figure.

- Summarisation of financial data is presented in reports and financial statements, which are provided for use by both management and external users of accounting information. These reports usually summarise the effects of all transactions occurring during some time period such as a month, a quarter or a year.

Communication is the final part of the accounting process. Identifying, measuring and recording economic activities are pointless unless the information contained in accounting records can be communicated in some meaningful form to the potential users of the information. Communication can be described as the process of preparing and distributing accounting reports to potential users of accounting information. Once the users of accounting reports have access to appropriate reports, they are able, after analysing and interpreting the reports, often with the assistance of professional advice, to make informed economic decisions. The most common forms of accounting reports are the financial statements, which are introduced in the chapter that looks at financial statements for decision making.

The accounting process briefly overviewed above can be summarised diagrammatically as shown in figure 1.2.

FIGURE 1.2 The accounting process



Many people with little knowledge of accounting tend to view it as being limited to the recording process and do not distinguish clearly between the recording and communicating of accounting data. The *recording* or *record-keeping process* involves measuring and recording business transactions and may take place in one of several forms: handwritten records, mechanical or electronic devices, or simply magnetic tapes or disks in a computerised system.

The *communication process* is a much broader function of accounting. It consists of placing accounting data that have been classified and summarised into financial statements, as well as preparing interpretive disclosures necessary to make the data understandable. The process requires extensive training, business experience and professional judgement.

Computers have had a significant impact on the recording phase of the accounting process. The processes of recording, classification and summarisation can be done electronically, and hence the recording process is much more automated. However, the output from a computerised system is only as good as the data input. Full coverage of the manual system is given in this text to help students understand the processes performed by computerised accounting systems.

The communication process involves many potential users, and accountants who prepare reports must have a full appreciation of who the users of the reports are and their needs for accounting information in order to help them make economic decisions effectively. In this way, the accountant adds significant value to the running of the organisation.

LEARNING CHECK

- ☐ Accounting is defined as the process of identifying, measuring, recording and communicating economic information so that people can make informed judgements and decisions about scarce resources.
- ☐ Accounting deals with 'transactions', which can be 'external' or 'internal'. External transactions are those that involve economic events between one entity and another entity. Internal transactions are those economic events that take place within one entity.

1.5 Users of accounting information

LEARNING OBJECTIVE 1.5 Identify the potential users of accounting information.

Although accountants are involved mainly in the analysis and interpretation of financial data when they serve as advisers to users of accounting information, the first objective of accounting is to provide information in reports which can be used by *internal* and *external* decision makers.

Managers (internal decision makers) must have financial data for planning and controlling the operations of the business entity and hence need answers to such questions as follows.

- How much profit is being earned?
- What products should be produced?
- What resources are available?
- What is the most efficient production process?
- How much does it cost to reduce carbon emissions from the production process?
- What will be the effect of increasing or decreasing selling prices?
- How much is owing to outsiders?
- Will cash be available to pay debts as they fall due?
- What are the benefits of purchasing an asset as opposed to leasing it?

Providing data to help answer these and many other questions generally called *management accounting*. The data are presented to management in the form of **special purpose financial statements**. These are prepared for users who have specialised needs and who possess the authority to obtain information to meet those needs. Apart from internal management (which includes marketing, production, finance, human resources, research and development, information systems and general managers), some external users such as banks and government agencies (e.g. Australian Taxation Office) also have the authority to command the type and nature of the information they require and may demand special purpose reports.

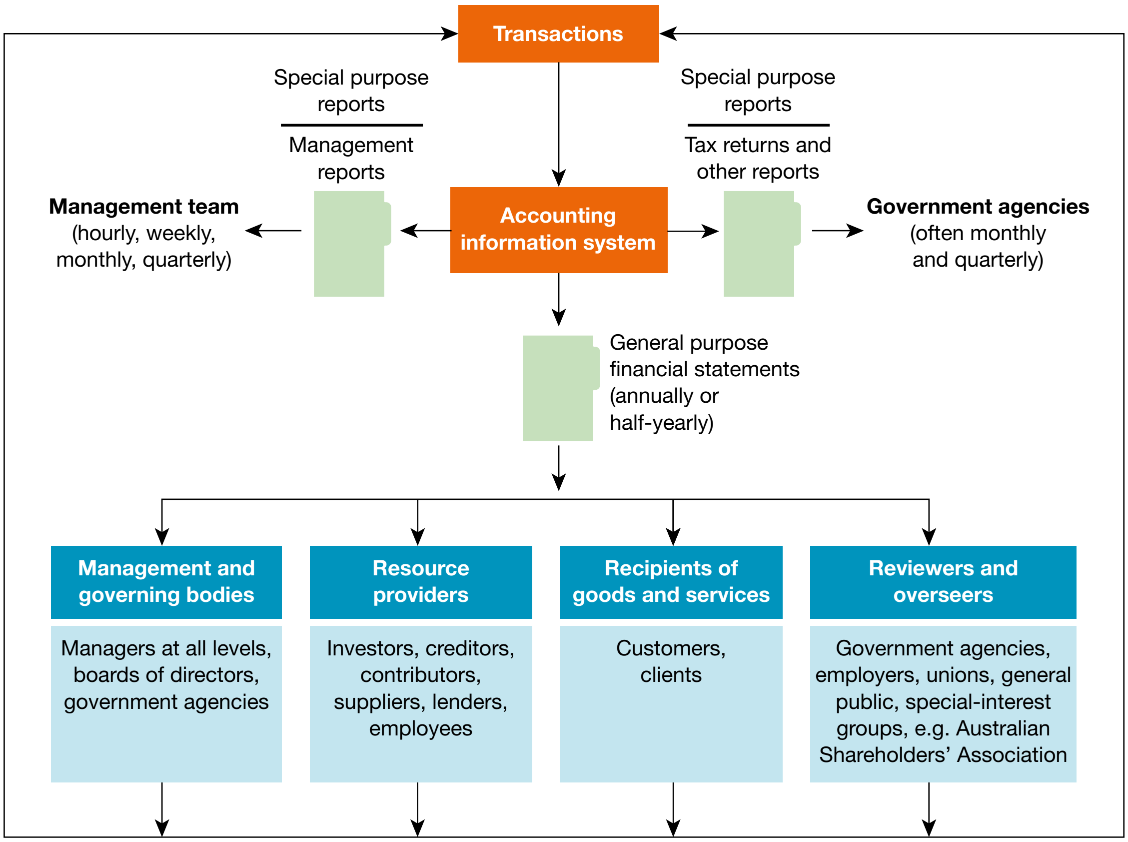
External decision makers such as resource providers (creditors and investors), recipients of goods and services (customers) and reviewers and overseers of business entities (employers, unions, government agencies) need accounting information for making decisions concerning granting credit, investing, purchasing goods and services, and complying with tax laws and other regulatory requirements. Questions raised by external users include the following.

- Should I invest money in this business?
- Am I likely to be paid my wages?
- Will the business be able to repay money lent to it?
- What are the company's earnings prospects?
- Is the business financially sound?
- Is the business providing products that are socially and environmentally friendly?

Reports prepared for external users include *financial statements* which generally consist of an income statement (also called a statement of comprehensive income), a balance sheet (also called a statement of financial position), a statement of changes in equity and a statement of cash flows. These are often called **general purpose financial statements** because they provide general information for use by all external users.

General purpose financial statements are designed to meet the information needs of a wide range of users who are unable to command the preparation of reports tailored to satisfy their individual specific needs for information. Figure 1.3 illustrates the relationship between financial statements/reports and users of accounting information.

FIGURE 1.3 Financial statements and users



LEARNING CHECK

- ☐ Internal decision makers — managers — require special purpose financial statements to help in planning and controlling the operations of an entity.
- ☐ External decision makers — creditors, investors, customers, employees, unions, government agencies — receive general purpose financial statements to obtain information about an entity. These are designed to meet the information needs of a wide range of users who are unable to command the preparation of statements tailored specifically for their needs.

1.6 Using information in economic decisions

LEARNING OBJECTIVE 1.6 Apply information to make basic economic decisions.

Economic decisions are made in business every day. To illustrate, consider the following business scenario.

Cynthia loves beauty therapy. After several years in retail as a sales assistant, she decides to accept a redundancy package from her employer and take on a new career. She now has the opportunity to work in her own beauty business. On investigation, she finds there is an opportunity to set up such a business to service a number of local suburbs in her area.

First she will need to invest in some equipment. The required items are listed below with their estimated costs.

Second-hand van	$32 000
Massage tables	2 500
Manicure tables and chairs	1 950
Booking information system	2 600
Facial skin machine	2 150
Manicure and pedicure machines	1 600
Waxing pots	1 700
Uniforms	2 000
Towels	2 400
Robes	1 800
Cash register	1 850
	52 550

Therefore, Cynthia needs approximately $53000 in cash to establish the business.

She is unsure about the running costs of the business, but expects the cost of power, beauty products and laundry to be about $320 per week. She is hoping to be able to provide services to about ten clients per day, and to work for 6 days each week. She wants to work only 48 weeks of the year and have 4 weeks holiday. Furthermore, she intends to pay $150 per week to her boyfriend, Fred, for keeping the records, doing the banking, and helping with some of the maintenance duties. (For the time being, we are ignoring employer superannuation payments, workers compensation and insurances, but in reality these would need to be taken into account.) Thus, running costs per week are estimated to be as follows.

Power, beauty products and repairs and maintenance	$320
Part-time employee (Fred)	150
	470

Initially, Cynthia expects to have the following numbers of clients for the various services she intends to provide the following.

Waxing (under a regular program)	42
Facials, manicures and pedicures (under a regular program)	12
Spray tans (as requested)	24

Based on this client list, each day she plans to perform waxing services on seven clients, and facials, manicures and pedicures on two clients. She expects that the waxing will take, on average, 30 minutes per client; facials, manicures and pedicures will take 1 hour per client; and spray tans will take about 15 minutes per client. The cost of each of the services is as shown.

Waxing	$40
Facials, manicures and pedicures	80
Spray tans	10

In each week, the approximate amount of cash received, ignoring spray tan activities which are requested on an irregular basis, is expected to be as follows.

7 waxes for each of 6 days at $40 each	$1 680
2 facials, manicures and pedicures for each of 6 days at $80 each	960
	2 640

This means that her gross annual turnover for the year's work of 48 weeks is equal to $2640 × 48 = $126 720, plus spray tan revenue. Because her annual turnover is greater than $50 000, her accountant tells her that she will have to get an Australian business number (ABN) from the Australian Taxation Office (ATO) and that she will be required to collect goods and services tax (GST) from each of her clients and forward the GST to the ATO at regular intervals. Also, the cost she will pay to her accountant for preparing the annual tax return and GST documents is $1632. On a weekly basis over 48 weeks, this adds $34 per week ($1632 ÷ 48) for accounting services to the $470 per week calculated previously, a total of $504 per week. (Detailed consideration of the GST is covered in other chapters. It is assumed in this chapter that the figures quoted include the GST where applicable.)

Therefore, the expected weekly cash flow, excluding spray tanning revenue, is $2640 less the weekly costs of $504, equalling $2136. Since Cynthia is so enthusiastic about owning her own beauty salon, after consultation with Fred she decides to proceed with the business. Thus, a decision is made after considering how much money she will need to contribute to set up the business (financing activity), the equipment she will need to buy (investing activity), the running costs of the business and the weekly cash inflow (operating activity).

Note that the decision is based on the steps illustrated in figure 1.1 — establishing goals (earning a living while working as a beauty therapist), collecting information about the proposed business, and considering the future consequences of conducting such a business. Of course, many of the factors considered in making such a decision are estimates of future events and, hence, there is a need to proceed with caution. Cynthia would be very wise to keep a careful eye on how well these cash flow estimates approximate reality.

Particularly important are the financial results. Will the actual weekly performance of Cynthia's business live up to the estimated performance? How much impact does the spray tanning service have on the actual results? Is the waxing service more profitable than the facial, manicure and pedicure, or spray tan services? When does Cynthia plan to replace the assets she bought at the start? How will she account for the fact that these assets gradually wear out over time through use? And how much income tax and GST will she have to pay? Cynthia may not have considered many of these aspects in making her decision, and much of this information can be provided by an accountant.

In the next four chapters, we shall consider other examples of service businesses — Minh's TV Repairs and Intellect Management Services — and how accounting information can help in the businesses' operations and decision making. We shall also return to Cynthia's beauty business and ask further questions which accounting can help to answer.

LEARNING CHECK

- ☐ Many questions need to be asked when making economic decisions. A decision to set up a business can be made only after considering things such as how much money will be required to start (financing activity), what equipment will be needed (investing activity), the running costs of the business and the weekly net cash inflow (operating activity).
- ☐ Many of the factors considered in making an economic decision are estimates of future events, and financial results will need to be monitored to see whether the cash flow estimates approximate reality.

1.7 Accounting information and decisions

LEARNING OBJECTIVE 1.7 Describe the role of accounting information in the decision-making process.

From the example above, we can see that much financial information is needed before an economic decision is made. But how much of that information is accounting information? Since accounting is concerned mainly with identifying transactions and recording the financial history of the transactions of an entity, a major focus of accounting information is on actual financial events, not on future events. However, knowledge of information about actual events is useful in establishing relationships that are likely to hold in the future. In other words, for the purpose of decision making, past information is used often as a guide to future estimates of the consequences of different alternatives.

Accounting information is also very useful in providing decision makers with information about the outcomes or results of their decisions. Once these outcomes are known and investigated, decision makers are able to evaluate whether their decisions were correct or whether new decisions are required. The accountant can help significantly in investigating, interpreting and communicating these results for the guidance of decision makers. In this way, accountants can add value by pointing out to decision makers any areas needing attention, where new economic decisions may become necessary.

Nevertheless, the accountant in commerce is also heavily involved in the budgeting process for a business entity, and therefore in estimating the future plans for the entity. Thus, the work of the accountant in commerce is not restricted merely to recording a history of the entity's past. The accountant adds value by helping the owners and managers of a business in many ways. In some businesses, the accountant has the title 'information manager' or 'finance manager'.

The information needs of managers are quite different from those of parties external to the entity. By definition, a manager is anyone in an organisation responsible for the work of other people who report to the manager for direction and support. The managers in a given organisation are collectively called its management.

LEARNING CHECK

- ☐ A major focus of accounting information is on actual financial events, not on future events, and therefore accounting does not provide all information needed for making an economic decision.
- ☐ Accountants are often heavily involved in the budgeting process for a business entity, and in estimating the financial data for the future plans of the entity, so the accountant adds value by helping owners and managers in many ways.

1.8 Management and financial accounting

LEARNING OBJECTIVE 1.8 Compare accounting information for management and external users.

What is management accounting?

Management accounting (also referred to as managerial accounting) is that area of accounting concerned with providing financial and other information to all levels of management in an organisation to enable them to carry out their planning, controlling and decision-making responsibilities. The accountants responsible for providing this information are known as management accountants. Management accounting is used in all forms of organisations — for-profit and not-for-profit organisations; sole traders, partnerships and companies; retailing, manufacturing and service businesses; government; and charities.

Management accounting covers many activities, including cost behaviour and cost–volume–profit relationships, decision making through incremental analysis, capital budgeting, budgeting for financial planning and control, flexible budgeting for performance evaluation, the determination of manufacturing costs and costing systems, and accounting and reporting for business segment operations.

What is financial accounting?

Financial accounting is concerned with reporting information to users external to an entity in order to help them to make sound economic decisions about the entity's performance and financial position. The financial accountant is heavily involved in the determination of an entity's overall financial performance (profits or losses), its financial position, financing and investing activities (which include raising and investing money), and information as to whether the entity is complying with the requirements of the law. The financial accountant must be well trained in the regulatory arrangements affecting various entities; such regulations include accounting standards, auditing standards, the law relating to corporations and other types of organisations, and the law relating to taxation (including income tax, fringe benefits tax and GST). Through financial accounting, an entity discharges its financial reporting obligations and other corporate governance responsibilities to the community at large.

Management accounting versus financial accounting

Management accounting can be distinguished from financial accounting in a number of ways: by reference to (1) the main *users* of the reports, (2) the *types of reports* produced, (3) the *frequency of reports*, (4) the *content and format of reports*, and (5) *external verification*. Table 1.1 summarises the differences between management accounting and financial accounting.

TABLE 1.1 Differences between management accounting and financial accounting

	Management accounting	Financial accounting
Users of reports	*Users are inside the entity.* • Managers • Chief executive officers • General managers • Account managers • Sales managers	*Users are outside the entity.* • Shareholders • Lenders • Potential investors • Creditors • Customers • Government • Interest groups
Types of reports	*Special purpose financial statements for internal users.* • Financial budgets • Sales forecasts • Performance reports • Cost-of-production reports • Incremental analysis reports Do not have to comply with accounting standards	*General purpose financial statements for external users.* • Balance sheet • Income statement • Statement of changes in equity • Statement of cash flows Required by regulatory authorities; must comply with accounting standards
Frequency of reports	On-demand reports — daily, weekly, monthly — as requested by management to help with decision making.	Income tax legislation, the corporations law and securities exchange listing rules require reports at regular intervals.
Content and format of reports	• Management establishes own guidelines for structure, content and type of information (financial and non-financial); structure and classification of reports are tailored to specific needs of decisions to be made • Reports can relate to particular segments of an entity or to a particular decision	• Structure and content are largely standardised with certain disclosures dictated by accounting standards • Statements generally contain historical, verifiable data • Reflect the results of the entity as a whole, thus contain much aggregation, summarisation and restricted classification • Based on the formal double-entry system
External verification	Special purpose financial statements are not required to be audited, but management may want verification of the contents by internal auditors	General purpose financial statements must be audited by independent external auditors who verify that the statements are in compliance with accounting standards and provide a true and fair view of the performance and financial position of the entity

LEARNING CHECK

- ☐ A management accountant provides information to all levels of management in an organisation. Management accounting includes cost behaviour, capital budgeting, financial planning and control, determination of manufacturing costs and costing systems, and accounting and reporting for the activities of business segments.
- ☐ A financial accountant is concerned with reporting information to senior management and users external to an entity so they can make sound economic decisions about the entity. Financial accounting is concerned with the entity's overall financial performance, its financial position, its financing and investing activities, and whether the entity is complying with the law.

1.9 Accounting as a profession — Australian perspective

LEARNING OBJECTIVE 1.9 Summarise how the accounting profession is organised in Australia.

Accounting has developed as a profession over the past hundred years or so, attaining a status equivalent to that of law and medicine. The profession in Australia is self-regulating and there are three professional associations of accountants — CPA Australia, Chartered Accountants Australia and New Zealand (CAANZ) and the Institute of Public Accountants (IPA) — of which you can become a member. There are many other professional associations of accountants (e.g. Malaysian Institute of Accountants, Association of Chartered Certified Accountants (ACCA), Chinese Institute of Certified Public Accountants, Chartered Institute of Management Accountants (CIMA)). Consistent with the globalisation of business, many of these associations operate globally to service their members in various countries. For example, CPA Australia has offices throughout Australia, Asia and also in London. Even if you are a member of a professional accounting association, there are certain additional legislative requirements to provide particular services. For example, it is necessary to register as a company auditor in order to practise auditing for a company. People providing taxation services for a fee in Australia are required under taxation law to be registered as tax agents with the Tax Practitioners Board, an agency of the Australian Government.

Entry to the Australian professional accounting bodies varies. The traditional entry pathway is to hold a degree or postgraduate accounting qualification from a tertiary institution accredited for entry purposes by the particular professional body. Before full membership status is granted, additional accounting professional studies must be undertaken in addition to having practical experience and/or participation in a mentoring program. Upon completion, a member is then referred to as a **certified practising accountant (CPA)** in CPA Australia, or as a **chartered accountant (CA)** in the CAANZ, or a **member** or **MIPA** in the IPA. CAs and CPAs are required to undertake a certain level of continuing professional development activities each year to maintain their level of membership. For further information on the membership pathways and requirements, visit the website of CPA Australia (www.cpaaustralia.com.au), the CAANZ website (www.charteredaccountantsanz.com), and the IPA's website (www.publicaccountants.org.au).

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

LEARNING CHECK

- ☐ The accounting profession in Australia is self-regulating and is largely controlled by three major professional associations of accountants — the Chartered Accountants Australia and New Zealand (CAANZ), CPA Australia and the Institute of Public Accountants (IPA). Entry to these bodies requires the possession of an appropriate qualification, further study and practical experience.

1.10 Public accounting versus commercial accounting

LEARNING OBJECTIVE 1.10 Identify the different areas of the economy in which accountants work.

Public accounting

Public accountants run businesses which offer their professional services to the public for a fee. These vary from small businesses to very large international organisations with several thousand employees. Because of the complexity of today's business structure and increasing regulation by government, members of public accounting businesses tend to specialise in one of four general services: auditing and assurance, taxation, advisory, and insolvency and administration.

Auditing and assurance services

Auditing has traditionally been the main service offered by most public accounting businesses. An **audit** is an independent examination of a business entity's financial statements, supporting documents and records in order to form an opinion as to whether they comply with certain levels of quality, as specified in accounting standards, and present a true and fair view of the entity's performance and financial position. Banks and other lending institutions often require an audit by an independent accountant before making a loan to a business. Companies that offer their shares for sale normally prepare a set of audited financial statements, and annual audited statements must be presented thereafter if the shares are traded through a stock exchange. External users who rely on financial statements in decision making place considerable emphasis on the auditor's report. It is essential, therefore, that auditors are independent observers in carrying out their duties.

These traditional audit services are changing — the role of the auditor is becoming one of providing 'assurance services'. **Assurance services** are defined as 'independent professional services that improve the quality of information, or its context, for decision makers'.[1]

This change in role has been driven largely by the availability of online real-time information which results in less demand for historical information. More emphasis is being placed on the detection of fraud and commenting on whether the entity has sustainable practices and is appropriately placed to remain as a going concern. The auditor is required to report on the 'credibility' of information.

Examples of assurance services in which auditors are becoming involved include:

- *assessment of risk* — evaluates whether an entity has appropriate systems in place to effectively manage business risk
- *business performance measurement* — evaluates whether an entity's accounting system contains measures to assess the degree to which an entity is achieving its goals and objectives, and how the entity's performance compares with that of its competitors
- *information systems reliability* — assesses whether the entity's accounting system provides reliable information for making economic decisions
- *electronic commerce* — assesses whether electronic commerce systems provide appropriate data integrity, security, privacy and reliability
- *sustainability audits* — independent assessment of compliance with environmental requirements and the assessment of risks and preventative or corrective actions; for example, the assurance of carbon emissions and water reporting[2]
- *health care and care of the elderly* — provides assurance on the effectiveness of health care and elderly care facilities provided by hospitals, nursing homes, and other carers.

[1] This definition first appeared in the *Report of the Special Committee on Assurance Services (the Elliott Report)*, prepared by the American Institute of Certified Public Accountants. It has since been adopted by the CAANZ and CPA Australia. For further information, see Coram, P 1998, 'Towards assurance services — redefining the audit role', *Australian CPA*, November, pp. 55–7.

[2] See Simnett, R 2009, 'Getting the world on board', *InTheBlack*, October, pp. 46–9; and proposed new guidance for practitioners conducting assurance engagements on general purpose water accounting reports in the Auditing and Assurance Standards Board's (AUASB) ED 04/12 *Standard on assurance engagements* ASAE 3610/*Australian water accounting standard* AWAS 2 *Assurance engagements on general purpose water accounting reports*, Issued jointly by the Auditing and Assurance Standards Board and the Water Accounting Standards Board/the Bureau of Meteorology.

Taxation services

Few economic decisions are made without considering the tax consequences. Accountants provide advice concerning the tax consequences of business decisions. Individuals and business entities have to collect or pay various forms of taxes including income tax, capital gains tax, fringe benefits tax, goods and services tax, local government rates, and other taxes. Accountants are often engaged to help in tax planning to minimise the tax liability of the business, consistent with the rules and regulations established by taxing agencies. Accountants are often called on to prepare tax returns, including business activity statements (BASs), required by law. To offer such services, accountants must be thoroughly familiar with tax laws and regulations. They must also keep up to date with changes in tax law and court cases concerned with interpreting tax law, which occur frequently. As many businesses now operate globally, detailed knowledge of the tax laws of many overseas countries is also useful.

Advisory services

Although audit and tax services have traditionally been the main activities of public accountants, advisory services are very important today. Accountants provide advice on overcoming detected defects or problems in a client's accounting system. Public accountants offer a wide range of advisory services, including advice on such events as installation of computer systems, production systems and quality control; installation or modification of accounting systems; budgeting, forecasting and general financial planning; design or modification of superannuation plans; company mergers and takeovers; personal financial planning; and advice for clients in managing deceased estates.

As a result of several well-publicised corporate collapses between 2000 and 2002, it has been argued that auditors may not be independent from their client firms. Hence, the Australian Government has taken steps to address this lack of independence, in fact or appearance, by introducing rules related to providing non-audit services to a client firm and the rotation of auditors. Auditors are required by law to be independent of the client and must declare their independence annually. Audit firms must also disclose all of the non-audit services provided to their client firms. Furthermore, auditors of companies should be rotated every five years, and there should be a 2-year delay before a former auditor can become an officer of an audited client.[3]

In some countries (e.g. United States), an audit firm is prohibited from providing both audit services and non-audit services to client firms.

Insolvency and administration

Public accountants are also employed in helping businesses with trading difficulties. Some businesses have difficulty in paying their short-term debts as they fall due, which means that they are becoming illiquid. If an entity cannot pay its long-term debts, the entity is said to be **insolvent**. Public accountants are employed to help businesses administer their recovery from trading difficulties or insolvency. However, if recovery is not possible, accountants then assist in the winding-up of the business's affairs. In the case of the company form of business organisation, such a wind-up is referred to as **liquidation**.

Accountants in commerce and industry

Many accountants are employed in business entities, such as Corinne Proske in the chapter scene setter. The entity's chief financial officer (CFO) has overall responsibility for directing the activities of accounting personnel. In a large company, the CFO may have several assistants, each with assigned responsibility for various accounting functions, as discussed below. These accountants are commonly referred to as management accountants.

[3] See ss. 324DA–DD of the Corporations Act, available at www.austlii.edu.au.

General accounting

One function of the accountant in commerce and industry is to oversee the recording of transactions undertaken by the business entity and to prepare reports specially tailored for use by management in their planning, control and decision-making activities. The transaction data must be classified and summarised appropriately for the preparation of financial statements for external distribution. It is difficult to draw a clear line of distinction between general accounting and the other phases of commercial accounting because the accounting data recorded from transactions form the basic database from which other phases draw relevant information for planning, controlling, decision-making and reporting purposes.

Cost accounting

Cost accounting deals with the collection, allocation and control of the costs of producing specific products and services. Knowledge of the cost of each manufacturing process and each service activity is important in making sound business decisions. If management wants to know whether the production and sale of a product or service is profitable, it must know the cost of that product or service. Large manufacturing entities have employed several accountants in their cost accounting departments over time, but with the increased use of accounting packages in business, much of the routine work of capturing accounting information is now carried out by computerised information systems.

Accounting information systems

Commercial accountants may also be heavily involved in designing both manual and computerised accounting information systems. Once systems have been designed and installed, their operation is constantly monitored for improvements and system maintenance. Developments have occurred in the design of accounting systems for e-commerce with integrity of data and privacy issues of paramount importance.

Budgeting

Budgeting is the phase of accounting that deals with the preparation of a plan or forecast of future operations. Its main function is to provide management with a projection of the activities necessary to reach established goals. Budgets are generally prepared for the business entity as a whole as well as for subunits. They serve as control devices when used in conjunction with performance reports, which measure actual results for the period. Budgets are also used in assessing the efficiency of operations.

Taxation accounting

Businesses are assessed for a variety of taxes — including income tax, capital gains tax, GST and fringe benefits tax — all of which require the preparation of periodic reports for the various taxing agencies. Tax effects must be considered in every investment and financing decision made by management. Although many businesses rely on public accountants for some tax-planning advice and tax-return preparation, many large companies also maintain a tax accounting department to deal with day-to-day tax accounting issues and problems.

Internal auditing and audit committees

To supplement the annual audit by the external auditor, many organisations also maintain an **internal audit** department. Its main function is to conduct ongoing reviews to make certain that established procedures and policies are being followed. Thus, any deficiencies can be identified and corrected quickly. An efficient internal audit process can also reduce the time required by the external auditors in conducting their annual audit, often producing significant cost savings.

During the 1990s, many companies in Australia established an audit committee, often in response to growing public pressure for greater accountability by management brought on by several major corporate collapses. The existence of an audit committee was made mandatory in some overseas countries, e.g. the United States, Canada and Singapore, but not in Australia.[4]

[4] The Australian Securities Exchange requires an entity included in the S&P All Ordinaries Index to have an audit committee under ASX Listing Rule 12.70.

In Australia, the Australian Securities Exchange has insisted that companies disclose in their annual reports whether they have an audit committee, and if not, explain why.

An audit committee acts as a corporate governance device in order to:

- safeguard the independence of the internal audit process
- ensure continual improvement in management performance and accountability by seeking any necessary action as a result of adverse reports provided by internal and external auditors.

To be effective, audit committees are encouraged to have a long-term strategy as a means of ensuring that an entity's overall financial plans are put into action. In this way, members of the audit committee can have an important role to play as part of an organisation's management team.[5]

Public sector and not-for-profit accounting

Other areas of activity that employ accountants are public sector accounting and not-for-profit accounting. City councils, shire councils, state governments and the federal government, as well as charitable organisations, collect and spend large amounts of money annually. Elected and appointed officials have ultimate responsibility for the collection and efficient use of the resources under their control. Many of the problems and decisions faced by government officials and the management of not-for-profit entities are the same as those encountered in for-profit private industry, but accounting for not-for-profit entities may require a different approach in some respects because of the absence of a profit motive. Government accounting is concerned with the efficient use of its resources, consistent with the provisions of city, shire, state and federal laws. Not-for-profit organisations (churches, hospitals, charities, clubs, private educational institutions) also have specialised accounting needs.

So far, this chapter has presented a basic introduction to decision making and to the nature of accounting, its purpose and its fields of specialisation. Accounting is applicable to all types of economic entities, including not-for-profit entities, which engage in making economic decisions. The rest of this text, however, concentrates largely on accounting methods used for making economic decisions in business entities that have a profit motive. Nevertheless, throughout the text, selected exercises and problems applicable to not-for-profit entities are provided.

LEARNING CHECK

- [ ] Accountants generally practise in the following main areas:
  1. public accounting — offering services to the public, such as auditing and assurance, taxation, financial advice, and insolvency and administration
  2. commercial accounting — where accountants are employed by business entities, and are involved in general accounting, cost accounting, accounting information systems, budgeting, taxation, and internal auditing
  3. public sector and not-for-profit accounting — the absence of the profit motive often requires a different accounting approach; for example, government accounting is concerned with the efficient use of resources consistent with the provisions of laws.

1.11 Ethics and accounting

LEARNING OBJECTIVE 1.11 Identify the importance of ethics in business and accounting and how to recognise and handle ethical dilemmas as part of the decision-making process.

In the 1990s, ethics and moral behaviour in business received a great deal of attention from the media, professional associations and regulatory bodies, particularly those concerned with the operation of companies and the conduct of company directors. The early 2000s in Australia saw the collapse of a number

[5] See Couttas, G 2012, 'A new world for the audit committee', *Charter*, September, p. 38.

of large business and financial institutions, causing huge monetary losses and hardship to shareholders and policy holders. Incidences of such collapses continue today. This has increased the pressure from the community to improve the ethics of all people working in business. Most professional bodies have laid down some form of code of ethical and moral behaviour.

BUSINESS INSIGHT

Survey finds most SMEs shun professional advice, possibly at their peril

SME owners favour 'gut instinct' above all, rank accountants most trusted external adviser

Small business owners are prone to a 'lone wolf' approach in decision-making, with the vast majority much more likely to trust their own instincts over advice from family and friends, their business partner and even most professional advisers, according to new research.

The findings are based on a survey of more than 1000 Australian owners of small-to-medium enterprises (SMEs) commissioned by accounting software provider CCH, a unit of global information services group Wolters Kluwer.

With ABS data showing that more than half of small businesses in Australia do not survive beyond their first four years, the CCH survey revealed a cavalier attitude among SME owners toward the value of professional business advice.

Only 26% of respondents considered the failure to seek professional advice to be a factor in business failure, while 70% trusted their 'gut instinct' over any professional advice.

When pressed on which external adviser they trusted most, SME operators nominated their accountant ahead of their financial planner, business partner or lawyer. They were least likely to turn to their family and friends for financial and business advice.

CEO of Wolters Kluwer Asia Pacific, Russell Evans, said the findings suggested SME operators guarded independence of decision-making closely, but could be too willing to back their own instincts ahead of sound professional advice.

'It's not surprising a small business owner will micromanage, especially in the early stages of their business life, but this should not be at the expense of being open to advice from trusted professionals,' he said.

In contrast to the response from SME owners, a separate CCH survey of more than 210 accountants servicing small businesses ranked bad business models as the main reason SMEs fail. This view is backed up by ASIC data on 5600 business failures in 2011–12, showing poor strategic management to be the most common cause of failure (19%), with another 15% of failures attributed to poor financial control. CCH's survey found SME owners typically open up to the advice of their accountant as their businesses grow. SME owners with a higher turnover ($1m+) were more likely to consider their accountant as their most trusted adviser, not only for transactional accounts but for advice on business growth, than owners of businesses with turnover under $1 million. Older SME owners were also more likely to rank their accountant as their most trusted adviser (47% of owners aged 50+ compared to 31% of owners aged 18 to 34).

Source: CCH 2013, 'Survey finds most SMEs shun professional advice, possibly at their peril', 11 April, www.cch.com.au.

Ethics in business

Most businesses today appreciate the importance of ethical behaviour in all their business dealings. In order for a business entity to function effectively, all people working in the entity have to be honest, abide by the rules and 'do the right thing'. If managers, owners, employees and customers regularly deceived one another, told lies, falsified records and did not conform to the rules, the entity would eventually collapse and cease to exist. A high standard of ethical behaviour is thus in the long-term interest of business entities.

It is sound economic policy to have a business highly regarded by the whole business community for its reputation for honest and straight dealings, quality products and service. Most of the highly successful businesses today are noted generally for their high ethical standards of business. Financial statements are one of the many control mechanisms designed to assess the accountability of management and protect the interests of parties who have an interest in the performance of a particular business entity. The reports enable an evaluation to be made of a company's management performance, and provide information on the establishment of contracts, business dealings and resource allocations. The audit and assurance services function of accounting also represents a controlling influence in maintaining ethical behaviour in business entities.

Ethics and professional accounting bodies

The standing of the profession and individuals within the profession depends on the highest level of ethical conduct by members. The professional accounting bodies in Australia have recognised this, and in 2006 both CPA Australia and Chartered Accountants Australia and New Zealand established an independent body called the Accounting Professional & Ethical Standards Board Limited (APESB) to set and maintain a code of ethics by which accountants who are members of these bodies must comply. More recently, the Institute of Public Accountants has also become a member of the APESB. According to the website of the APESB (www.apesb.org.au) the APESB's vision is to be recognised by their stakeholders for their leading contribution in achieving the highest level of professional and ethical behaviour in the accounting profession. To achieve this vision, the APESB will:

- issue professional and ethical standards that are integral to the Australian accounting profession
- be innovative in engaging key stakeholders, including professional accountants and the public
- influence the international standards agenda
- advocate for professionalism and ethical conduct to drive the behaviour of accountants.

The professional and ethical standards include but are not limited to:

- code of ethics for professional accountants
- miscellaneous professional statements and joint guidance notes
- such other ethical issues or similar matters of interest in respect of the accounting profession.

The code of ethics establishes the fundamental principles of professional ethics and provides a conceptual framework for applying those principles. Members of the professional accounting bodies are expected to adhere to various aspects of professional accounting activities, including competence; conformity with the law, accounting standards, and auditing and assurance standards; confidentiality of client information; and independence.

Ethics in practice

As a graduate, you will undoubtedly enter the business world as an accountant, an employee, a manager, a marketer, a consumer, or in some other capacity. As a future professional in the business world, it is important that you appreciate the importance of ethical behaviour, have an appreciation of ethical issues and dilemmas that may arise, are able to analyse the consequences of unethical behaviour, can identify the stakeholders (i.e. those who are affected by the unethical behaviour), and can identify the correct course of action to follow.

The ability to always choose the correct course of action and be seen to be 'doing the right thing', will not necessarily be easy. In the world of business, many personal and business pressures are experienced which make ethical behaviour a considerable challenge. There are no widely held, generally accepted codes of ethics or rules of ethical business behaviour. The resolution of ethical issues and dilemmas is greatly influenced by personal attitudes, personal and financial problems, pressure within the workplace (e.g. superior–subordinate relationships and peer pressure), and the pressure of meeting deadlines.

In order to provide practice in analysing, evaluating and resolving ethical issues that may arise in the workplace, an ethical case is included at the end of many chapters in this text. In analysing these cases, you will be required to identify the ethical issue(s) involved, resolve the issues by analysing the key elements, including who are the major stakeholders who stand to benefit or be disadvantaged by the situation, and then select the appropriate course of action. In some cases there will be one obvious correct resolution; in others there may be a number of ethical resolutions which may require further analysis to arrive at the most ethical outcome.

An examination of the significance of ethical issues that challenge professional accounting bodies by Jackling et al. (2007) assesses the perceptions via an online survey of 66 professional accounting bodies worldwide in respect of ethical issues, potential causes of ethical failure and the need for ethics education.[6]

Key ethical risks suggested are:

- self interest
- failure to maintain objectivity and independence
- improper leadership and poor organisational culture
- lack of ethical courage to do what is right
- lack of ethical sensitivity
- failure to exercise proper professional judgement.

The important challenges identified by respondents include conflicts of interest, earnings management and whistleblowing. The survey findings also suggest strong support for participation in prescribing the nature of ethics education by members of professional accounting bodies and the importance of teaching ethics, in addition to technical skills, in the accounting curriculum.

LEARNING CHECK

- ☐ A high standard of ethical behaviour is in the long-term interests of business entities. Financial reports are one of the many control mechanisms designed to assess the accountability of management.
- ☐ The professional accounting bodies in Australia have set down rules of professional conduct for members which prescribe high standards of practice in many areas including competency, compliance with the law and accounting standards and auditing and assurance standards, confidentiality and independence.

[6] Jackling, B, Cooper, B, Leung, P & Dellaportas, S 2007, 'Professional accounting bodies' perceptions of ethical issues, causes of ethical failure and ethics education', *Managerial Auditing Journal*, vol. 22, pp. 928–44.

KEY TERMS

accounting the process of identifying, measuring, recording and communicating economic information to permit informed judgements and economic decisions by users of the information

assurance services independent professional review services that improve the quality of information, or its context, for decision makers

audit an examination by an independent accountant of the financial statements and supporting documents of an entity

budgeting preparing a plan for the future operating activities of a business entity

certified practising accountant (CPA) an accountant who has met the qualifications and experience requirements for membership of CPA Australia

chartered accountant (CA) an accountant who has met the qualifications and experience requirements for membership of the Institute of Chartered Accountants in Australia

cost accounting the aspect of accounting that deals with the collection, allocation and control of the cost of producing a product or providing a service; a specialised form of accounting that enables an entity to measure, record and report product costs using a perpetual inventory system

decision the making of a choice between two or more alternatives

economic resources resources that are scarce and are traded in the marketplace at a price

financial accounting the area of accounting that provides information to external users to help them assess the entity's financial performance, financial position, financing and investing activities, and solvency

general purpose financial statements financial statements that are intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs

insolvent unable to pay debts as they fall due

internal audit the ongoing investigation of compliance with established procedures and policies of an entity by its internal audit staff

liquidation the process of winding up the affairs of a company so that it ceases to exist

management accounting the area of accounting that provides information to management for planning, controlling and decision making

member (MIPA) a member of the Institute of Public Accountants

special purpose financial statements reports prepared for users who have specialised needs and who possess the authority to obtain information to meet those needs

transactions the events that are identified as making up the economic activities of an entity

DISCUSSION QUESTIONS

1. You are considering buying an apartment. Outline the information you would like to assist you to make this decision. Identify how much of this information is accounting information.
2. Accounting is described as the language of business, and everyone is affected by the business world. Discuss whether or not everyone should be required to study accounting.
3. Describe the differences between accounting information and other information.
4. 'Accounting is irrelevant in decision making because the information it provides relates only to the past.' Evaluate this remark.
5. Describe how you would identify if a financial statement is a special purpose financial statement or a general purpose financial statement.
6. Users of accounting information can be identified as internal and external users. List examples of users in each category and the type of information they require.
7. Distinguish between the work performed by public accountants and the work performed by accountants in commerce and industry and in not-for-profit organisations.

8 List some of the fields (other than financial reporting) that have opened up to accountants in recent years.
9 Regulators are concerned with external auditors providing advisory services to a client at the same time as providing auditing services to that client. Explain why this is a concern.
10 Discuss the actions taken by regulators in Australia, the United States and China to address auditor independence concerns.
11 'When one examines the distinctive and different functions of financial and management accounting, it is obvious that to maximise the usefulness of the information derived, two systems of accounting are necessary. It does not matter how large or small the entity is, it is just common sense that one system cannot do the job.' (An assertion made by a recent management graduate.) Evaluate this assertion.
12 Describe what it means to behave ethically.
13 'Accounting is all about numbers.' Evaluate.

EXERCISES

1.1 Information for decisions **LO2**

Ian Boardman has been appointed as the loans officer for the local community bank. One day, a person walks into the bank looking for a loan to buy a new car. List six items about that individual that Ian should find out before deciding whether to approve the loan. Classify these items as 'economic' or other (specify). Which type of information is more important for the purposes of good decision making?

1.2 Information for decisions **LO6**

Tran Qu's family lives in Beijing, China. She has been accepted into a university course in Sydney, and has to find accommodation in the city within walking distance of the university, or at least be close to public transport. She searches the Internet to find suitable accommodation and comes across the following apartment:

CBD **$525 pw**
Great unfurnished one bedroom apartment in Maestri Towers. Send an enquiry via the 'email agent' button to access the booking page to schedule an inspection time. Bond is $2120.

Required

(a) Discuss how this information may help Tran make a decision.
(b) List additional information Tran would need before deciding whether to rent this apartment.

1.3 Information for decisions **LO6**

Renee Carter has decided to study medicine at a university in Melbourne. She has arranged to stay with a family on the north side of the city. In order to get to and from the university, she decides she will need to buy a car, costing a maximum of $10 000. She searches the internet and comes across the following at Car City:

MAZDA 323 Red, 4D Sedan; 5 SP Manual; 2.0 Ltr, 4 cyl; odometer 153 293.

Required

(a) Evaluate how useful this information is in arriving at a decision.
(b) List extra information that Renee should ascertain before deciding whether to buy this car.
(c) Assume that Renee does purchase the car, and subsequently finds that the car has mechanical problems which will require $2000 to fix. Discuss what she should do, given that she does not have enough money to pay for the repairs.
(d) Hypothesise as to how ethical the community regards used car salespeople.

1.4 Choosing a university major **LO6**

You have just enrolled in a course in business at the Western University. There are several specialty areas, one of which you must choose — accounting, business law, economics, finance, management, marketing or information systems. The choice you make is important as it will affect your future so you must give it careful consideration.

Required

(a) Identify two possible specialty areas in business that interest you.
(b) Set down your goals and personal preferences in selecting a business major. Identify the factors which will help you make this decision, and specify the factors which are most important to you.
(c) Establish a set of criteria which must be met before making a decision about your appropriate specialty area.
(d) Determine the sources of information you will need to make such a decision.

1.5 Making an economic decision **LO2**

You have decided that now is the time to buy a new laptop. List the factors that are important in choosing a new laptop and gather relevant information from various sources about different models on the market. Given that you have a maximum of $1600 to spend, identify which model you will buy and discuss the reasons for your choice. Present your answer so as to illustrate the steps required in the decision-making process as discussed in this chapter.

1.6 Factors in making a business decision **LO2, 3**

Consult the business section of a local newspaper, *The Australian Financial Review* or a business journal, and find an appropriate article detailing an important business decision that has been made in the last month. Based on the article, determine the factors that were taken into account in arriving at the decision. Discuss the effects such a decision will have on various interested parties or stakeholders.

1.7 Factors in making a government decision **LO2, 3**

Consult a local newspaper, *The Australian Financial Review* or a business journal, and find an appropriate article detailing an important federal government decision in the last month. Based on the article, determine the factors that were taken into account in arriving at the decision. Discuss the effects such a decision will have on various interested parties or stakeholders.

1.8 Economic decisions made by management **LO3**

Accounting provides much information to help managers make economic decisions in their various workplaces.

Required

(a) List examples of economic decisions that the following people would need to make with the use of accounting information:
  i. a marketing manager
  ii. a production manager
  iii. the chief executive officer of a national football league
  iv. the manager of a second-hand clothing charity.

1.9 Choosing an accounting career **LO10**

After reading the chapter, discuss the areas in which accountants work, and indicate which area(s) you find most interesting and/or familiar. If you intend to pursue a career in any one of these areas of accounting, discuss the types of decisions and advice that you believe you will be involved in making and giving.

1.10 Setting up a business **LO2, 6**

Luigi and Gina Cicello have decided to lease some newly built premises for the purpose of opening a seafood outlet. They intend to provide a wide range of different products, including a variety of seafood for sale and takeaway fish and chips.

Required

(a) Discuss the types of economic decisions they will need to make, and the information required to make those decisions. Distinguishing non-economic and economic information, identify non-economic decisions they may face. Discuss why Luigi and Gina may require the services of an accountant.

1.11 Becoming an accountant **LO9**

Read the article 'New pathways to business success' from *InTheBlack* and answer the following questions.

Required

(a) Compare the entry requirements to become a full member of CPA Australia, CAANZ, and IPA. Identify the commonalities and differences.
(b) Discuss why the professional accounting bodies would have different entry requirements.
(c) Identify what qualifications are required to:
   i. be a company auditor
   ii. be a public accountant
   iii. be a financial adviser
   iv. prepare tax returns.

New pathways to business success

As you may know, our 2009–2011 corporate plan established the importance of having a globally competitive CPA Program and broadened entry pathways. With this in mind, CPA Australia has for a long while now been working on making the CPA Program more focused and competitive and appropriately opening up entry routes to becoming a CPA Australia member. Last month CPA Australia celebrated the launch of the new entry pathways to the CPA designation along with the revised CPA Program. These changes will create more opportunities for potential members to attain the CPA Australia designation and become part of one of the world's largest accounting bodies.

The revised CPA Program syllabus addresses the needs of employers and will provide candidates with a highly valued and global designation. The program is a rigorous education and experience program. It consists of 14 subjects along with integrated workplace learning. CPA Australia has maintained the same high standards of competence that have always been required to achieve the CPA designation.

The new pathways to membership will welcome people who want a career built on professional accounting skills — in Australia and around the globe — and who have the desire, appropriate level of competence, and the professionalism and integrity to carry the CPA Australia designation. In addition to recognising the prior learning and experience that potential members bring, we are providing more options for graduates from other disciplines and for candidates with gaps in their core knowledge to work towards becoming a CPA. This means that more aspiring business leaders will now be able to become members of our professional body. It is important, however, to note that to attain CPA status candidates must complete the Professional Level within six years of starting the CPA program and hold an eligible degree or higher education award.

The changes will enable us to become more relevant globally while retaining the highest professional standards and the quality of the CPA designation. And, importantly, they take us a step forward in the aim of realising our organisational vision: for CPA Australia to be the global professional accountancy designation for strategic business leaders.

Against the backdrop of an increasingly competitive global marketplace we must work harder and smarter than ever to realise this vision. The new entry pathways are vital to ensuring that the CPA Australia designation continues to be recognised by key stakeholders as a valuable asset.

Source: Petty, R 2009, 'New pathways to business success', *InTheBlack*, August, p. 7.

1.12 Conduct in business **LO11**

Read the following prelude to NIKE's code of ethics by the President of NIKE, Inc. and discuss the points that follow.

> ### Inside the lines: The NIKE code of ethics
>
> At Nike, we are on the offense, always. We play hard, we play to win, and we play by the rules of the game.
>
> This Code of Ethics is vitally important. It contains the rules of the game for NIKE, the rules we live by and what we stand for. Please read it. And if you've read it before, read it again. Then take some time to think about what it says and make a commitment to play by it.
>
> Defining the NIKE playing field ensures no matter how dynamic and challenging NIKE may be, our actions and decisions fit with our shared values.
>
> Thanks for your commitment.
>
> ***Source:*** NIKE 2011, *Inside the lines: The NIKE code of ethics — Defining the NIKE, Inc. playing field and the rules of the game*, http://investors.nikeinc.com.

Required

(a) Check if there is a code of ethics to guide your behaviour as a student at your university.

(b) Identify if the university that you are attending has a course on ethics in accounting or in business. Also find out whether this ethics course (if it exists) is compulsory in your degree.

(c) If such a course exists, list the types of issues discussed in the course.

(d) Referring to 'Inside the lines', NIKE, Inc.'s code of ethics governing the conduct of all employees, identify the values employees should operate by as part of the NIKE team.

(e) Assume that you are employed by NIKE Inc. Referring to the company's code of ethics, discuss how the code would guide your behaviour in the following situations:

i. A retailer offers you an all-expenses paid holiday if he can have a special price on a runner soon to be released.

ii. You are aware that NIKE is shortly to announce a profit increase for the most recent reporting period and think that it would be a good time to sell some of your NIKE shares.

1.13 The power of intentional trust in professional services **LO10**

Read the following article from *Chartered Accountants* and answer the question that follows.

> ### International trust
>
> In the pragmatic world of professional services, quite often when the issue and potential for trust building is discussed, it can be too easy to put it in the 'soft skills' basket and disregard the real consequences and opportunities of ensuring your business has embedded an 'intentional trust' model that can be applied, reviewed, measured and therefore, managed.
>
> Beyond the 'feel good' notion of trust, what science tells us from a wide range of research about trust in organisations is that when trust is high, things get done better, quicker, and more profitably. When trust is high, people more openly share and exchange information that facilitates more productivity. When trust is high, people tend to be more engaged in their work, find meaning from that work, and are happier in the workplace.
>
> When trust is high, clients more readily seek advice, are more willing to pay for that advice because they trust in the value they're receiving, and are more likely to be comfortable and confident to refer more business.
>
> Further to the outcomes that are produced from embedding an intentional trust process into your everyday operations, what science also validates is that when trust is high, employee stress goes down, mistakes go down, rework is reduced, absenteeism is reduced and excuses and blame are reduced.

What is an intentional trust model?

When we speak of trust, we need to consider it not as a general concept, but more specifically as self-trust, trust in others, and others trusting in us. This sharpens what can be a general concept into more manageable and accountable units of measure. To what degree do you and the people within your business have self-trust? To what degree do you and the people within your business have trust in others they interact with on a daily basis (internally and externally)? And to what degree have you and the people within your business earned the trust of others they interact with on a daily basis, again, both internally and externally?

While it is relatively easy for any of us to 'self-report' that we have high levels of self-trust, trust in others and others trusting in us, it is also relatively easy and much more valuable to bring a more practical, rigorous and measurable process to ensure the 'self-reporting' is aligned with reality.

The wisdom and philosophy of Aristotle can provide some insight on where and how we can begin to understand the constructs of what's required to embed and implement an intentional trust model.

Aristotle wrote: 'Our actions and behaviours are our morals shown in conduct'. As you reflect on these words, it becomes very obvious that Aristotle was advising us that everything we say, and everything we do, sends loud and clear messages to the world about who we are and what we represent.

Another way of saying this is: 'People get your truth'. Over time, your intentions, promises, actions and results will either promote you (as someone people can trust) or expose you (as untrustworthy).

This is the genesis for the 'Intentionomics Trust Model'.

Intentionomics refers to the impact of your intentions (the real reasons why you do what you do) across every aspect of your personal and professional life, and . . . it is your intentions that form the platform of the Intentionomics Trust Model.

Here's a practical exercise for you to complete that will help you ensure that you can apply the model. Make a list of all your stakeholders. This will of course include clients (existing and potential), referral partners, management, employees, and any other internal or external people or groups you deal with on a daily basis as you go about delivering on your professional services. The more stakeholders you can list, the more robustly you will be able to apply the model.

Once you've got your list, next to each stakeholder group, complete this statement: 'My intention for my (name the stakeholder group) is . . . '

Instead of using the word intention, you can interchange it with your goal, your wish, or what you want for that stakeholder. What's most important in gaining the most value from this exercise is that you ensure that your statement does not reflect in any way what you want from this stakeholder, but what you want for them . . . what your intention is for them when you do what you do with and for them in your everyday interactions.

The power of this one relatively easy exercise is that it gives you clarity around your intention. This is not an academic exercise; it's a practical and important process in embedding more trust throughout every aspect of your business' operations. The more clarity you have on what your intentions are for each of your stakeholders, the more practically measurable you'll be able to work through the rest of the Intentionomics trust model.

There are three pillars of trust in the Intentionomics trust model. The first of these pillars of trust are your 'intentional promises'. If you're not clear on your intentions for your stakeholders, the danger is you may be unintentionally making promises that form unrealistic and unintentional expectations for and by those stakeholders.

One of a number of ways to apply this first pillar of trust is to define very clearly the promises you want to make, and the promises you don't want to make for each stakeholder group you've listed. This one exercise can highlight potential areas of communication, across all areas of your professional services firm, which may need refining to ensure you are communicating your intentional promises.

The second pillar of trust is your intentional actions. Aristotle again provides insight to the importance of intentional actions in the following quote: 'We are the sum of our actions, therefore, our habits make all the difference.' Our habits are the actions we repeat on a regular basis. Habits are the learned, automatic behaviours we repeat over and over again.

It's commonly accepted wisdom that people are creatures of habit, and that our ability to develop habits has evolved to enable us to not require continued and focused concentration on menial tasks.

However, the dark side of habits is that we can fall into the trap of acting unintentionally habitually at the wrong times and in the wrong situations.

For example, it is very easy to unintentionally be just habitually answering the work phone, sending emails, inactively listening to a colleague (or even worse, a client), or in the way you explain a certain strategy or provide a piece of advice that you've provided so many times, that you don't really need to think much about it, and you deliver that strategy or advice while 'in habit'.

The problem with acting 'in habit' at inappropriate times like these, is they create 'dis-trust' — disengaged trust. Once again this is a practical way of understanding the platform principle — over time, your intentions, promises, actions and results will either promote you or expose you. When you're acting unintentionally 'in habit', your internal and external stakeholders pick up on your 'truth'. They quickly get a sense that you're not really tuned into them and not intentionally 'in the moment'. For this reason, we want to get away from an unintentional disengagement and create an intentional connection, by being more intentionally mindful in more moments, more often throughout the day – especially when we are communicating with our internal and external stakeholders.

One of a range of strategies to practically apply this second pillar of trust is to clearly define what are the intentional actions required to deliver on the intentional promises you've listed that will deliver on your intentions for each of your internal and external stakeholders.

The third pillar of trust is your 'intentional results'. Integrity is not just about acting in good character, acting ethically, morally and professionally. While all of these are of course fundamental to the professional services firm, part of acting with integrity is in delivering on your intentional results.

Here's where the Intentionomics model provides defined and measurable accountability and responsibility. If, in any area of your business' operation, you are not achieving the intentional results expected, then either you're implementing unintentional actions, or the intentional actions you're implementing are not delivering on the intentional promises you've made to your internal and external stakeholders.

Without clarity and communication of intentional results, measurable results that people clearly understand they are going to be held accountable and responsible for, trust is at risk . . . and when trust is at risk, everything is at risk. Where your intention for each stakeholder provides the why you do what you do, and forms the platform for trust throughout your professional service operations, the three pillars of intentional trust provide you with the what, when, where and how.

Trust and character matter

Resting on top of the three pillars of intentional promises, intentional actions and intentional results is trust. Again, this starts with self-trust on an individual level that is gained from clarity about why you do what you do, and practically applied through understanding the what, when, where and how to do what you do, and your confidence in your competence to deliver. When self-trust is high, based on intentional promises, actions and results, this directly impacts trust in others and in others trusting in you.

Conclusion and challenge

At the start of this article it was highlighted that it's relatively easy to put trust in the 'soft-skills' basket. Implementing the Intentionomics trust model takes courage and effort. While the basic constructs of the model are readily understandable and well validated through research on the impact of trust in our lives, the value to be gained on individual and collective levels through the intentional application of the model is significant.

Your intentions impact every area of your personal and professional life, and every area of your personal and professional life is impacted by trust. Clarity of intention builds trust. Without clarity of intention, trust is at risk . . . and when trust is at risk, everything is at risk.

Note: David Penglase is author of the Amazon bestseller *Intentionomics* and a professional speaker and corporate educator. He holds degrees in business and human resource development, an MBA, and Masters degree in Professional Ethics. davidpenglase.com. www.charteredaccountants.com.au/News-Media/Charter/Charter-articles/Business-management/2014-04-Intentionomics.aspx.

Source: Penglase, D 2014 'The power of intentional trust in professional services', *Institute of Chartered Accountants in Australia*, vol. 85(3), pp. 18–20.

Required

(a) Discuss the significance of intentional trust to the success of a professional services firm.

DECISION ANALYSIS

CHOOSING AN ACCOUNTANT FOR A SMALL BUSINESS

After reading the following extract from a company profile of Explore Engage, winner of the Best Services Start-up in the 2012 Best StartupSmart Awards for a service company, list the factors that would be important for someone like the owners of Explore Engage in making a decision about which accounting firm to employ. Also list the services that a business such as Explore Engage is likely to require of its accountant.

Explore, engage, win

Explore Engage specialises in augmented reality (AR) and interactive applications for mobile devices such as iPhones and tablets. It is also in the process of developing a pair of AR glasses. The company defines AR as real-time animation superimposed on each user's real-time view of the world, usually imposed through a camera device.

AR solves marketing and utility problems by contextualising data or images for an informative or entertaining simulation, feedback, brand recall, in situ placement and a mixed reality. In doing so, it can assist in decision-making or simply create a 'magical experience'.

Explore Engage is an international leader in AR, providing 3D experiences across advertising, marketing, gaming, retail and property. 'We saw an opportunity in the Australian market as there was no one specialising in AR. Also, with the emergence of the smartphone, we now have the capabilities to do AR,' Crane says. 'There was a need for advertisers, general consumers, B2B and B2C companies to use augmented reality.'

The three founders funded the business by 'chasing down clients' and completing projects. They also received investment once it was established. O'Brien says the founders 'invested heavily from our own funds, gained seed funds and won projects to drive significant growth over the last 12 months.'

While cashflow proved to be the most challenging part of starting the business, the best part of starting up is the 'ability to say you have started your own business and that it is going well'.

Explore Engage is now looking to take its technology to the international stage. 'We are developing a pair of AR glasses that will change the way people consume media globally and interact day to day,' Crane says. '[Our goal is to] become one of the top three AR companies in the world.'

Source: StartupSmart 2012, StartupSmart Awards 2012, www.startupsmart.com.au.

CRITICAL THINKING

BUSINESS INCREASE REVENUE WITH SOCIAL MEDIA

Read the article below and address the questions that follow.

Marketing into the future

The importance of social media in business marketing is becoming more apparent as those businesses who engage with customers via social media are seeing positive effects on their bottom line. Studies have shown that customers who are actively involved with a business's social media campaign generate more revenue than customers who aren't.

The return on investment in social media marketing was once difficult to measure and many businesses were sceptical about whether there were any true benefits or even if the social media 'fad' would stick around long enough to provide ROI. Over time we have come to learn that the benefits from an active and well managed social media platform are substantial with 92% of marketers indicating that their social media presence has generated more business exposure.

These days a customer's experience with a brand doesn't just end at the check-out. Social media enhances the customer's overall experience, by allowing them to be part of an online community where they can send and receive messages, contribute their thoughts to various social media platforms and be privy to new products and promotions.

Not only is social media an effective tool for communicating with customers, but it can also be used to keep an eye on the market and competitors. According to HubSpot, 71% of marketers use social media to gain intelligence on marketplace trends.

A successful social media campaign must involve effective management to ensure posts are regular, the sites are easy to use, and interactions with customers are personalised. Social media also allows for more targeted marketing, giving companies the ability to narrow down their audience to customers to that would respond best to their products and services. This means greater efficiency for less expenditure.

With the popularity of social media and the ease and speed with which information can be passed around the internet, incorporating social media into a business plan seems to be an effective and cost efficient way to increase performance.

Sources: Adapted from DeMers, J 2014, 'The top 10 benefits of social media marketing', *Forbes*; Kusinitz, S 2014, '16 Stats that prove social media isn't just a fad [new data]', *HubSpot*; Rishika, R, Kumar, A, Janakiraman, R & Bezawada, R 2013, 'The effect of customers' social media participation on customer visit frequency and profitability: an empirical investigation', *Information Systems Research*.

Required

Assume you are a newly graduated marketing student. You recall from your studies that accounting plays a vital role in the decision-making processes of every commercial organisation. Your employer, the Trendy Tie Company, is suffering from a downturn in economic conditions, and in preparing the budget for 2018 they have reduced the marketing budget by 10%. The marketing manager suggests that, if the budget cannot be increased to the previous year's level, then you will lose your job.

(a) Drawing on the study discussed in the article, prepare a draft report for the marketing manager to submit to the company's accountants explaining why they should not reduce the marketing budget but rather increase the investment in social media.

(b) In drafting your report, explain why marketing might be considered an investment rather than a cost, why it is important from an accounting point of view, and how the funds could be used more effectively. You should also consider why brands, customers and information about them are valuable assets of a company. Remember that your report is being written to the company's accountants and you must justify your position in terms of the best financial interests of the company as opposed to best marketing practice.

COMMUNICATION AND LEADERSHIP

ETHICAL DILEMMA

Within your tutorial group, organise yourselves into groups. Where possible, organise the groups according to the professional majors that students are studying, such as groups of accounting, marketing, human resource management, economics and management students. Read the following ethical dilemma and discuss how you would respond to the situation described. Present your group's response to the class.

Auditing hidden agendas

All members of the accounting profession, regardless of their role, are required to comply with the fundamental principles contained in APES 110 *Code of Ethics for Professional Accountants*. The first principle, integrity, requires members to be straightforward and honest in professional and business relationships. It is reasonable, and expected, that an audit committee will scrutinise key financial risks and the risk management processes, particularly in a dramatically changed business-lending environment. It is the responsibility of the audit committee, rather than the CEO, to determine the need to review future loan compliance reports before they are provided to lenders.

Dilemma: You are a member of an audit committee of a company that has experienced some volatility as a result of the recent financial crisis. You have just received the agenda for the first meeting in 2009 and, much to your surprise, there are no agenda items in relation to any impact the financial crisis may have had on your company. You are particularly concerned that the company may be at risk of default on some debt covenants. In addition, the scheduled quarterly compliance audit on the loan portfolio, which is required as part of the performance reporting to lenders, is not included.

You approach the chair of the audit committee and seek an explanation as to why these agenda items do not appear. The chair advises that he has raised the issue with the CEO and has had assurances that there are no matters that need to be discussed by the committee in relation to the current financial crisis. The CEO has also advised that the committee no longer needs to sign off on the loan compliance audits as these audits are at the request of the debt providers and not the committee.

You remain unconvinced by this assurance and are also concerned that the debt providers will assume the loan compliance audits are reviewed by the audit committee in accordance with past practice. You are also aware that the continuing support of the company's lenders is dependent on a favourable compliance audit.

Given your knowledge of the debt portfolio and the company's current performance, you are concerned that some figures may have been 'massaged'.

Source: Sexton, T 2009, 'Auditing hidden agendas', *InTheBlack*, March, p. 63.

ETHICS AND GOVERNANCE

ETHICAL PRACTICES AMONG FRIENDS

Two friends, Becks and Vicky, had just started university studies. Both intended to major in accounting. During the first week of lectures, Vicky, who had to go home for family reasons, asked Becks to buy a copy of the prescribed accounting text for her from the university bookshop. She left Becks $100 to cover the cost of the text currently selling in the bookshop for $80.

On the day Becks visited the bookshop to buy the text, he noted that there were a number of copies that had been returned to the shop by students who had managed to get second-hand copies. These returned copies had been marked down to $65 and looked new. Unable to resist a bargain, Becks bought a copy for $65.

Becks then realised that Vicky would not know that the text he had bought was a return and had been bought at a special price, and that he could give Vicky change of $20 and keep the savings on the text of $15 for himself. He simply had to tell Vicky that he had lost the receipt, and given the crowds in the bookshop on the day the text was bought, Vicky could not possibly learn that he had not bought a new copy of the text for her.

Required

(a) Identify who the stakeholders are in this situation.
(b) Outline the ethical issues involved.
(c) Discuss what you would do if you were Becks.

FINANCIAL ANALYSIS

Refer to the latest financial statements of Woolworths Group on its website, www.woolworthsgroup.com.au/page/investors/our-performance/reports/Reports. Browse through the chairman's and chief executive officer's reports and the notes to the financial statements and address the following.

(a) Describe the main activities and operations of the company.
(b) Identify the company's chief executive officer and chief financial officer.
(c) List any important investment or financing decisions made by the company during the year.
(d) Summarise what the directors are declaring in relation to the information in the financial statements.

(e) Assess whether Woolworths Group complies with the Australian Securities Exchange Corporate Governance Council (ASXCGC) Corporate Governance Principles and Recommendations.
(f) Examine the independent auditor's report on the company for the year and address the following:
  i. Identify the company's audit firm.
  ii. Specify what the auditors state in relation to the accounting information in the company's report.
  iii. Specify what the auditors state in relation to their independence.
(g) Ascertain if the auditors received any money from the company for doing any work apart from conducting the audit.

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