

Jacqueline Birt
Keryn Chalmers
Diana Beal
Albie Brooks
Suzanne Byrne
Judy Oliver

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*Business Reporting for
Decision Making*



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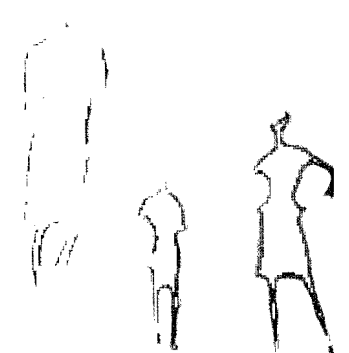
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About the authors

Jacqueline Birt is a lecturer in accounting at the Australian National University. She has degrees from the University of Melbourne and RMIT, and is currently a PhD candidate at the Australian National University. She has had vast experience in teaching accounting to students at both Higher School Certificate level and tertiary level over the past 16 years. In 2003 she was a recipient of the Pearson Education Accounting/Finance Lecturer of the Year Award and she also received a teaching excellence award from the Faculty of Economics and Commerce at the Australian National University. Jacqueline's research interests lie in financial accounting (accounting standards) and accounting education.

Keryn Chalmers, BCom, GradDipl, PhD, joined Monash University in 2003 as an associate professor in the Department of Accounting and Finance. For 15 years prior to this she was with the School of Accounting and Finance at Victoria University. Her teaching responsibilities at the undergraduate and postgraduate levels have primarily been in financial accounting and financial analysis. Keryn is an active researcher in the financial accounting and financial reporting area, specifically in relation to accounting policy and disclosure choices of management.

Diana Beal retired as an associate professor in finance at the University of Southern Queensland. Diana's initial training was as an economist and she worked for the government, both federal and state, for eight years. She also has a commerce degree, and can therefore read between the lines of a balance sheet. She has always had an interest in both business and personal finance. With an interest in most financial markets, Diana has traded property, shares, collectibles, forex and options. In addition, she ran her own business for 15 years before joining USQ. While at USQ, Diana taught courses in business finance, personal finance, applied microeconomics, macroeconomics, financial markets and financial institutions management.

Albie Brooks, BCom, DipEd, PhD, FCPA, is a senior lecturer in accounting at Victoria University where he has taught for 15 years. His teaching is predominantly in the areas of management accounting and business research methods. His research interests include management accounting innovation issues, corporate governance issues and accounting education. With Judy Oliver he was recipient of the 2003 Vice-Chancellor's Award for Teaching Excellence in the Faculty of Business and Law.

Suzanne Byrne, BBus, MPhil, FCPA, worked in the accounting and finance field (both in practice and academia) for the past 15 years. Her current position is as a senior lecturer at the University of Southern Queensland. She works closely with professionals in practice and in 2002 was the Queensland state president of CPA Australia. Suzanne is the recipient of a number of awards including the Institute of Chartered Accountants Teaching Award and the CPA Australia Young CPA of the Year Award.

Judy Oliver, BBus, MBus, CA, is a senior lecturer in accounting at the University of Tasmania. She teaches management accounting at both the undergraduate and postgraduate levels. With Albie Brooks she was the recipient of the 2003 Vice-Chancellor's Award for Teaching Excellence in the Faculty of Business and Law.

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Preface

The growth of the diversified and multinational business entity, the harmonisation and convergence of accounting standards worldwide, and the large-scale corporate collapses of the last two decades have had a profound impact on the role of the accountant. Today's accountants are employed in such roles as investigating insolvencies, detecting e-commerce fraud, assisting entities to comply with international accounting standards and providing advice on the disclosure of social and environmental issues.

While this new edition of *Accounting: Business Reporting for Decision Making* covers business reporting issues related to both preparers and users, it predominantly explores and reinforces the principles of financial and management accounting from a user perspective. We view accounting as a decision-making tool rather than a record-keeping function. Accounting information is being used more extensively throughout our daily lives by stakeholders such as investors, lobby groups, environmental consultants and government bodies. As the title indicates, the emphasis of this text is on *business reporting for decision making*, and a systematic, integrated and cohesive approach to business reporting is adopted.

In developing this new edition of the text, we have carefully considered the positioning of the chapters and the flow of the learning objectives. We believe that the order of the chapters suits the sequence of topics covered in most accounting courses. Throughout the text, key terms are consistently defined and applied. We have frequently used the international company Nokia Corporation, as well as the home-grown Foster's Group Ltd, in illustrative cases or as a basis for the exercises and problems. Changes in standard setting resulting from the Australian adoption of International Financial Reporting Standards (IFRSs) are discussed, and an overview of the new *Framework* is provided. We have extended our chapter on the important subject of ethics and corporate governance to include additional case studies and descriptions of the issues for the accounting profession. This new edition also includes three new management accounting chapters: chapter 10 (budgeting), chapter 11 (focusing solely on cost-volume-profit analysis) and chapter 15 (performance management).

Key features

This text is most suitable for introductory accounting units that focus on the different users of business reports rather than on the preparers of such reports. It is particularly suitable for first units in accounting for business degrees, MBA introductory accounting units and accounting service units.

The text has several unique features:

- Reference to Nokia Corporation and other real-life companies such as Foster's Group Ltd enhances the understanding of the concepts covered in the chapters. Each of the chapters on financial reporting provides a step-by-step illustration of the components, preparation and use of financial reports. Nokia Corporation and Foster's Group Ltd reports are provided for guidance.



1

Introduction to accounting



Learning objectives

After studying this chapter, you should be able to:

1. Explain the process of accounting.
2. Explain the differences between accounting and bookkeeping.
3. Outline the role of accounting in decision making by various users.
4. Explain the differences between management accounting and financial accounting.
5. Give examples of the limitations of accounting information.
6. Outline how corporate collapses and the growth of the multinational entity have changed the role of accountancy.
7. Describe traditional and new career opportunities for accountants.
8. List the professional associations for accountants in Australia and New Zealand.

Chapter 1 preview

Introductory chapters to first-year accounting textbooks typically explain the difference between accounting and bookkeeping, highlight the traditional role of accounting, and describe the main users of accounting information. Collapses of such companies as Enron, One.Tel and HIH have raised questions about the role and integrity of the accountant. Changes in the structure of business entities, including the growth of the multinational and diversified entity, have had consequences for the accounting profession. The past decade has also seen enormous changes in information technology, resulting in improved accounting systems of recording and reporting information for various users.

Accounting today is much more than just bookkeeping, the rudimentary preparation of financial reports, and the traditional work areas of management and financial accounting. Accountants can work in exciting new growth areas such as forensic accounting, environmental accounting and e-commerce. Company collapses such as that of Enron and advances in information technology have resulted in a new breed of accountant, who must possess the skills and knowledge to complete the varied range of tasks that the profession now performs.

It is important to appreciate that people in all walks of life rely on accounting information to make daily decisions. For example, a retired schoolteacher may rely on accounting information to help guide investment decision making on the allocation of his or her superannuation funds; and a student might use budgeting tools to help organise his or her finances for the university year. Or, financial information could help a builder form an opinion about the growth prospects of a construction company. In addition to explaining the importance of accounting in terms of decision making by its main users, this chapter outlines the limitations of accounting information, new careers in accounting and the role of professional accounting associations in Australia and New Zealand.

INTRODUCTION

Many students who are about to embark on a first course in accounting anticipate that the course is going to be about recording transactions, balancing debits and credits, creating financial reports and not much else. There is, however, a lot more to accounting! An understanding of accounting and its various roles in decision making will equip you with some important tools and techniques for understanding a broad range of accounting and business issues. By reading this text and gaining an understanding of the topics, you should be able to answer all of the following questions:

- Why do we associate accounting with *debits* and *credits*?
- What does it mean to be *ethical* in business?
- Why do some entities appear quite *profitable* in the financial reports, yet ultimately go *bankrupt*?
- What does *auditor independence* mean?
- Why do accountants prefer *financial reports* to balance?
- What do the letters 'CA', 'CPA' and 'PNA' after a person's name mean?
- How are *management* and *financial accounting* different from one another?
- What skills and attributes should a member of the accounting profession possess?
- What is *earnings per share (EPS)* and why is it important in analysing share investments?
- What is the difference between an *income statement*, a *balance sheet* and a *cash flow statement*?
- What is a *double-entry system*?

The accounting process

The word *account* derives from the Latin words 'ad' and 'computend', which mean 'to reckon together' or 'to count up or calculate'. **Accounting** can be defined as the process of identifying, measuring and communicating economic information about an entity to a variety of users for decision-making purposes. The first component of this definition is the process of identifying **business transactions**. A business transaction is an event which affects the financial position of an entity and can be reliably measured and recorded.

The second component is the measuring of information, which refers to the analysis of business transactions and the recording and classifying of business transactions. This component identifies how transactions will affect the entity's position, and groups together similar items such as expenses and income. The final component is the communication of relevant information through accounting reports, such as the income statement and the balance sheet, for decision-making purposes for the various users. **Relevant information** is defined as information that makes a difference in decision making. The different users require accounting information for making decisions such as whether to invest in a business, whether the entity should continue to manufacture a product or outsource this process to another entity, and whether the entity has the resources to pay debts on time.

The practices of accounting and bookkeeping date back to the ancient civilisations of China, Egypt, Greece and Rome, where families had to keep personal records of their receipts and payments. The title, 'Father of accounting', belongs to the Italian mathematician Fra Luca Pacioli who, in 1494, produced *Summa de Arithmetica, Geometrica, Proportioni et Proportionalita*, which included chapters based entirely on how to record business transactions using a double-entry system.

Figure 1.1 summarises the role of accounting.

1.1

Figure 1.1
The process of accounting

Identifying	Measuring	Communicating	Decision making
Transactions that affect the entity's financial position are taken into consideration. They must be able to be reliably measured and recorded.	This stage includes the analysis, recording and classifying of business transactions.	Accounting information is communicated through various reports such as income statements, balance sheets and statements of cash flows.	Accounting information is used for investment decisions, make/buy decisions, decisions to supply an entity with goods etc.

So, how does accounting differ from bookkeeping, or is it the same thing? **Bookkeeping** is simply the recording and summarising of financial transactions and the preparation of basic financial reports. Therefore it may be useful to think of bookkeeping as being part of the accounting function.

Let us look at an example of a bookkeeper and an accountant to help further clarify the differences between these functions (see reality check 'The difference between an accountant and a bookkeeper').



Reality check

The difference between an accountant and a bookkeeper



Kieran O'Connor is a bookkeeper and Bev Bartov is an accountant. Both work for Outcome Recruitment Pty Ltd, an IT recruitment entity established in Canberra. The entity's head office is in Canberra and the entity has state offices in Adelaide, Brisbane, Melbourne, Sydney and Perth. Kieran works in the Melbourne office and Bev is the head accountant in the main office in Canberra. A summary of their respective weekly duties follows:

Kieran O'Connor (bookkeeper) — weekly duties

- Prepare and send invoices to debtors using Mind Your Own Business (MYOB) software.
- Print financial reports and debtors' listings from MYOB.
- Check customer credit ratings.
- Receive invoices from suppliers and enter into MYOB.
- Prepare a list of overdue accounts for Bev.
- Calculate and distribute wages and salaries.
- Verify recorded transactions and report inconsistencies to management.
- Prepare bank reconciliations.

Bev Bartov (accountant) — weekly duties

- Update and manage the MYOB system and other accounting systems in place at Outcome Recruitment.
- Supervise the activities of the bookkeeper.
- Assist in the preparation of the budget.
- Prepare financial statements for presentation to the CEO, and managers in Adelaide, Brisbane, Melbourne, Sydney and Perth.
- Compare the budget with the actual performance and produce a variance report.
- Provide assistance to management in setting prices.
- Prepare the business activity statement (BAS) for the company.
- Liaise with Challenge Bank (Outcome Recruitment's bank) to establish funds management arrangements.
- Assess cash flow and the financial risk of projects involving large sums of cash that Outcome Recruitment is considering pursuing.

As you can see, the range and type of tasks are quite different between Kieran's job and Bev's. However, depending on the size of the entity, sometimes a bookkeeper will perform some of the accounting duties and vice versa. We will extend our discussion on accounting-related roles later in this chapter when we look at positions in accounting.

You may have heard of the term **auditing** and wondered what an auditor does and how it fits in with accounting. **Auditing** can be defined as:

an independent, objective assurance and consulting activity designed to add value and improve an entity's operations. It helps an entity accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes (Institute of Internal Auditors United Kingdom and Ireland).

There are both internal and external auditors. Internal auditors assist management to improve the accounting systems and to generate accurate reports for various users. (An **accounting system** is a system of collecting and processing data, and communicating financial information to interested users.) An external auditor's task may be to check that the accounting information has been prepared by the entity in accordance with the Corporations

Act. The **Corporations Act** is the main body of legislation that companies must follow in Australia, and is administered by the Australian Securities and Investments Commission (ASIC). A more detailed explanation of the auditor's role is provided in chapter 3.

Value to business

- Accounting can be defined as the process of identifying, measuring and communicating economic information about an entity for decision making by a variety of users.
- Bookkeeping is the recording and summarising of financial transactions and preparation of basic financial reports. The bookkeeping process is part of the accounting process. In some entities, an accountant may perform both bookkeeping and accounting roles.
- An external auditor checks the financial reports prepared by the accountant to ensure that the data contained are accurate and have been prepared in compliance with policies, laws and regulations.
- An internal auditor will assist management in ensuring that the appropriate accounting system is in place in the entity.

ACCOUNTING INFORMATION AND ITS ROLE IN DECISION MAKING

Accounting information is an important part of our everyday decision-making process, as summarised by this excerpt from the Jenkins Report:

People in every walk of life are affected by business reporting, the cornerstone on which our process of capital allocation is built. An effective allocation process is critical to a healthy economy that promotes productivity, encourages innovation, and provides an efficient and liquid market for buying and selling securities and obtaining and granting credit (AICPA, ch. 1).

Prospective and current investors, employees, consumers, regulatory bodies, government authorities and financial institutions are just some of the many individuals and groups who are interested in accounting information and require accounting to help them make decisions.

Individuals and entities need accounting information to assist in making decisions about the risks and returns of investment opportunities. Accounting information is designed to meet the needs of both internal users and external users of accounting information. Accounting information is extremely valuable to an entity's management (that is, **internal users**). It is used to help managers achieve the following:

- Make decisions concerning the operations of the business entity. The information managers require is usually detailed enough to assist them in management planning processes such as determining the appropriate sales mix and price of goods, forecasting profits, and determining the capacity of assets such as plant.
- Evaluate the success of the business entity in achieving its objectives. This is done by comparing the performance of the business entity against budgets, and assessing how well employees have achieved their set targets.
- Weigh up various alternatives when investing the resources of the business entity.

External users (the **stakeholders**) include such parties as employees, investors, suppliers, banks, consumers, taxation authorities, regulatory bodies and lobby groups, all of whom

have their own information needs. They have a 'stake' or interest in the performance of the entity.

- *Current investors of the entity* will seek accounting information to help them evaluate whether the entity's managers have been appropriate stewards or custodians of the entity's assets. They will examine entity reports to glean how effectively management has invested the assets of the business entity, and whether it has made appropriate business decisions on behalf of the investors. This is known as the stewardship function of management.
- *Prospective investors* will seek information from entity reports to determine whether or not a particular entity is a sound investment. Information such as the current financial health of the entity and its future growth prospects can help such external users to determine whether capital growth is expected for the entity.
- *Suppliers and banks* are interested in gauging the entity's ability to repay debt, and the level of risk associated with lending funds to it. Reports such as the statement of cash flows and the balance sheet enable them to evaluate if the entity has sufficient funds to meet debt repayments.
- *Employees* are most concerned about the future prospects of the entity. Is there a likelihood that the entity will expand, consequently creating additional job opportunities? Is there a possibility of promotion? Or, if the entity is performing poorly, are jobs at risk?
- *Government authorities* such as the Australian Taxation Office will be interested in the reported profit for the year, and the associated goods and services tax (GST) paid, in order to calculate the amount of tax payable or to be refunded in a particular financial year. Regulatory bodies such as the Australian Securities and Investments Commission (ASIC) will seek to identify whether the business has complied with Corporations Act requirements.

Table 1.1 summarises the accounting information required by different stakeholders for their decision making.

Table 1.1 Stakeholders and the accounting information they need for their decision making

Stakeholder	Accounting information and decision making
Investor	Information to determine the future profitability of the entity, to assess the future cash flows for dividends and the possibility of capital growth of investment.
Banks	Information to determine if the entity has the ability to repay a loan.
Suppliers	Information to determine an entity's ability to repay debt associated with purchase.
Employees	Information concerning job security, the potential to pay awards and bonuses, and promotional opportunities down the track.
Consumers	Information regarding the continuity of the entity and the ability to provide the appropriate goods and services.
Government authorities	Information to determine the amount of tax that should be paid and any future taxation liabilities or taxation assets.
Regulatory bodies	Information to determine if the entity is abiding by regulations such as the Corporations Act and Australian taxation law.
Community	Information to determine whether the entity is contributing positively to the general welfare and economic growth of the local community.
Special interest groups	Information to determine whether the entity has considered environmental, social or industrial aspects during its operations.

- Internal users are the management of the entity, who use the information to assist with various management functions.
- External users (also known as stakeholders) are groups outside the entity, who use the information to make decisions about the entity.

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Explain the differences between management accounting and financial accounting.

FINANCIAL ACCOUNTING AND MANAGEMENT ACCOUNTING

Financial accounting is the preparation and presentation of financial reports for all types of users to enable them to make economic decisions regarding the entity. **General purpose financial reports** (GPFR) are prepared to meet the information needs common to users who are unable to command reports to suit their own needs, while **special purpose financial reports** (SPFR) are prepared to suit a specific purpose and do not cater for the generalised needs common to most users. This information is governed by **generally accepted accounting principles** (GAAP), which provide accounting standards for preparing accounting and financial reports. Financial accounting is also guided by rules set out in the Corporations Act and the **Listing Rules** of the **Australian Securities Exchange** (ASX). Financial accounting is traditionally based on historical figures that stem from the original transaction; for example, the purchase of a motor vehicle for \$60 000 would be shown in the financial report (the balance sheet) as an asset for \$60 000. Even though the \$60 000 may not reflect the current market value of the vehicle, the vehicle is still shown at its **historical cost**, which is the original amount paid for an asset. (Note that depreciable assets are usually shown in the balance sheet at their carrying value, which is the historical cost less the accumulated depreciation.)

The **financial reports** consist of the entity's cash flow statement, balance sheet and income statement. The **cash flow statement** reports on an entity's cash inflows and cash outflows, which are classified into operating, investing and financing activities. The **income statement** (also called the **statement of financial performance**) reflects the profit for the entity for a specified time period. (**Profit** is the excess of income over expenses for a period.) An entity's assets, and its claims against those assets at a point in time, are reported in the **balance sheet** (also called the **statement of financial position**).

Financial reports will suit a variety of different users, such as the management of the entity, investors, suppliers, consumers, banks, employees, government bodies and regulatory authorities.

Management accounting is a field of accounting that provides economic information for internal users. The core activities of management accounting include formulating plans and budgets and providing information to be used in the monitoring and control of different parts of the entity. Management accounting reports are bound by few rules and are therefore less formal. Because management accounting reports are prepared for and tailored to suit the needs of management, they can provide any level of detail. For example, if the human resources manager requires information on the number of employees who have opted for additional superannuation contributions, then a report can be produced. Management accounting reports must be up to date, and can be prepared at any time for

any period. For example, a sales manager in the entity may demand information on current day's sales by the end of the day.

Ultimately, there will be an interaction between financial accounting and management accounting, because management accounting will provide economic information for internal users that is then reflected in the financial accounting reports for external users. One such example of the interaction between financial and management accounting is illustrated in the area of segment reporting by reporting entities. **Reporting entities** are those entities that have users who depend on general purpose financial reports for decision-making purposes. Such entities must disclose segment information as part of their accompanying notes to the financial reports. The segments are reported according to the entity's internal reporting system. Table 1.2 summarises the main differences between management and financial accounting.

This text will look at different topics involving accounting information use in decision making. Some of these topics are orientated more towards financial accounting and others are orientated towards management accounting. The financial accounting topics include: chapter 5, *Business transactions*; chapter 6, *Balance sheet*; chapter 7, *Income statement and statement of changes in equity*; chapter 8, *Cash flow statements*; and chapter 9, *Analysis and interpretation of financial reports*. The use of accounting for management purposes will be covered in chapter 10, *Budgeting*; chapter 11, *Cost-volume-profit analysis*; chapter 12, *Costing in an entity*; chapter 13, *Capital investment decisions*; chapter 14, *Financing the business*; and chapter 15, *Performance measurement*.

Table 1.2 Differences between financial accounting and management accounting

	Financial accounting	Management accounting
1. Regulations	Bound by GAAP. GAAP are represented by accounting standards, the Corporations Act, and relevant rules of the accounting association and other organisations such as the ASX.	Much less formal and without any prescribed rules. The reports are constructed to be of use to the managers.
2. Timeliness	Information is often outdated by the time the report is distributed to the users. The financial reports present a historical picture of the past operations of the entity.	Management reports can be both a historical record and a projection, e.g. a budget.
3. Level of detail	Most financial reports are of a quantitative nature. The reports represent the entity as a whole, consolidating income and expenses from different segments of the business.	Much more detailed and can be tailored to suit the needs of management. Of both a quantitative and qualitative nature.
4. Main users	Prepared to suit a variety of users including management, suppliers, consumers, employees, banks, taxation authorities, interested groups, investors, and prospective investors.	Main users are the managers in the entity; hence the term management accounting.

- Financial accounting provides information for external parties to make economic decisions regarding the entity and can be used by management for internal decision making.
- Management accounting is the creation of reports for use by management in internal planning and decision making.
- Differences between financial and management accounting include accounting rules, timeliness, level of detail and range of users.

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Give examples of the limitations of accounting information.

LIMITATIONS OF ACCOUNTING INFORMATION

Accounting information provides a wide range of information for both internal and external users. However, for decision-making purposes, other factors need to be considered. For example, if a prospective investor were considering purchasing shares in a company, they would spend some time perusing the financial reports of the company. To make an informed judgment, they would also need to consider other sources of information, such as the company's position in the market in which it operates, how long the company has been in existence and the company's environmental policies.



When making investment decisions, investors are increasingly evaluating a company's environmental credentials as well as its financial situation.

Additionally, users of accounting information need to consider carefully a number of limitations of the information provided, especially in the financial reports. These limitations include the time lag in the distribution of the information to the various users, the historical nature of accounting information, and the subjective nature of the financial reports. These will now be discussed in more detail.

Time lag

There is a significant time delay from the end of the financial year until the information reaches users in the form of a financial report. Although the Internet has assisted in decreasing the time lag, there is often a delay of up to three months from the end of the financial year until the information is published.

Historical information

Despite one of the major roles of accounting information being an assessment of the future performance of the entity, the information in financial reports is based on past transactions and therefore does not provide forecast information. Nevertheless, a review of the past is often the best guide to future performance.

Subjectivity of information

Accounting information is prepared based on generally accepted accounting principles (GAAP), but there is much subjectivity involved in the inclusion of items to be reported and the choice of accounting policies to adopt. For example, entities can choose whether to use a particular method of depreciation, whether to adopt a new accounting standard in the preceding year before its mandatory implementation, or whether to voluntarily disclose a large amount of additional financial information. Additionally, each country has its own accounting standards and, while there are convergence projects currently in process between various countries and the International Accounting Standards Board (IASB), there are still important differences between the reporting regimes of those countries. Several differences make it difficult to compare financial reports from different countries and also make it problematic for entities that are listed and subject to reporting requirements on multiple stock exchanges.

Potential costs of providing accounting information

Providing accounting information to various users involves potential costs. The two types of costs discussed here are information costs and the cost of releasing information to competitors.

Information costs

Various costs are involved in gathering, summarising and producing the information contained in the financial report. The implementation of accounting software programs has assisted in decreasing these costs, but there are still substantial collating and printing costs to be met in order to produce this information.

Release of competitive information

The information disclosed in an entity's financial report potentially contains proprietary information that could be used by competitors to strengthen their market position.

Examples of this information include the disclosure of segment data that is found in the notes to the financial reports.

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Outline how corporate collapses and the growth of the multinational entity have changed the role of accountancy.

CHANGES IN ACCOUNTING

In recent years, entities have become larger, more diversified and multinational. Consequently, they require more complicated accountancy and auditing services. Accountants must ensure that they remain up to date with current accounting standards, including knowledge of international accounting standards. This is especially important given the growth in multinational companies and the large amount of business involving foreign currency transactions.

As entities have become bigger and more complex, entity liquidation has become a more widespread issue with far-reaching consequences. In recent years, a number of large-scale corporate collapses have impacted greatly on the different stakeholders with an interest in the companies involved. One of the major corporate collapses concerned the United States energy trader Enron and the 100-year-old accounting entity Arthur Andersen. Enron was the seventh-largest entity in the United States at the time and Arthur Andersen was one of the 'big five' accounting entities. Much has been written in the financial press and the accounting academic literature about the demise of Enron and Arthur Andersen's role in the subsequent bankruptcy. This resulted in large numbers of investors and creditors seeking damages in the law courts from Arthur Andersen. In the years leading up to Enron's bankruptcy, it was later found that the company had been reporting inflated profits and understating liabilities. Arthur Andersen, in its position of auditor, had checked Enron's accounts and reassured investors and other stakeholders that the accounts accurately reflected the financial performance and position of the entity. Arthur Andersen also provided a management consulting role to Enron and had advised the company to proceed with a number of negative financial investments.

Australia has also witnessed a number of large-scale corporate collapses, including entities such as Harris Scarfe, HIH Insurance, One.Tel and Ansett Airlines. The 1999 bankruptcy of HIH resulted in debts of \$5.3 billion owed to investors and creditors.

Again, the accountants and auditors of the entity were closely examined for their role in the demise of the entity. Arthur Andersen was again implicated, as it acted as both the auditor for HIH and as the management consultant providing advice to the board of directors of HIH to acquire another insurer, FAI. The takeover of FAI was not as fortuitous as had been hoped because the company soon suffered massive debts and went bankrupt, leaving thousands of investors and creditors with amounts owed to them.

The 1999 bankruptcy of HIH resulted in debts of \$5.3 billion owed to investors and creditors.

Corporate governance and ethics

The recent corporate collapses in Australia and overseas have raised many questions about the integrity and ethics of the accounting profession, and the quality of financial reporting. A simple definition of **ethics** is 'a system of moral principles, by which human actions and proposals may be judged good or bad or right or wrong' (*Macquarie dictionary*). Maintaining ethics in an entity means complying with the rules and policies of the entity, and having an awareness of the different needs of the stakeholders in the entity. Increasing expectations

from consumers, shareholders, banks and creditors (among others) are forcing entities to address ethics effectively. The corporate governance structure in an entity specifies the distribution of rights and responsibilities among different participants in the entity — such as the board, managers, shareholders and other stakeholders — and spells out the rules and procedures for making decisions on an entity's affairs. Corporate governance and business ethics are explored in more detail in chapter 3.

The reality check 'The distinguished profession' talks about the profession of accounting, its responsibilities to the community and some of the skills that are required by today's accountant.



Reality check

The distinguished profession

Doing things the right way distinguishes the accounting profession from a 'business' — it also ensures Chartered Accountants are viewed favourably by the public.

Wind back the clock a couple of hundred years and the word 'profession' meant you had one of three jobs: doctor, lawyer or priest.

All three required specialised knowledge and all demanded their members 'profess' a higher standard of accountability than the common ruck of humanity. All had codes of ethics and members were expected to swear an oath to uphold them.

Time mutates language. The list of professions has grown and the word is now, often, interchangeable with business. And, without wishing to disparage those who work in businesses, its etymology shows it is rooted in the much more prosaic idea of simply being busy.

So, what distinguishes a profession from a business, and how does accountancy stack up? The more you scratch the surface of this question, the more you realise that accountancy is drawing deeply from the past in framing its present and future.

In the public's interest

Three experts contacted by *Charter* all had slightly different takes on what made a modern professional, from the timeless constant of specialised knowledge to personal qualities, such as selflessness. All three, however, agreed that ethical standards were at the core of professionalism.

The International Federation of Accountants' Ethics Committee Code says. 'A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest.'

It is a view heartily endorsed by Robert MC Brown FCA, regular contributor to *Charter*. The idea of accountancy being a vocation comes naturally to Brown, who is also on the board of the St James Ethics Centre in Sydney. What does being a professional mean to him?

'Fundamentally, it comes down to doing things the right way, the ethical way, reflecting excellence and independence,' Brown says. 'Transparency, openness and disclosure, that flows from a fundamental foundation of ethical practice, however you might define that. The bottom line is, if we don't have an ethical framework within which we operate then we can't distinguish ourselves from anyone else.'

Brown has recently been re-reading the works of the father of modern economics, Adam Smith. Although people see Smith as the 'high priest of capitalism', Brown believes that is a limited way of understanding the man.

Interestingly, Smith trained for the ministry but decided to become a philosopher after he was caught reading what was considered to be a heretical work, David Hume's *Treatise of Human Nature*.

Smith would write in *The Theory of Moral Sentiments* that: 'To restrain our selfish, and to indulge our benevolent affections, constitutes the perfection of human nature.'

'He was a moral philosopher,' Brown says. 'He talked a lot about the role of government. He said that it's very important that business does things for the general good of the community, and I think a lot of people have lost sight of that.'

The idea of professions working for the community is long standing, but there appears to be growing cynicism about it. Perhaps one of the reasons for this is that we live in a post-Enron world. Maybe it is hard to view the accounting profession in quite the same way since that spectacular fall from grace.

'It's easy to demonstrate from time to time that we've failed,' admits Brown. 'Human beings do that, but it doesn't mean to say that the fundamental foundation is wrong. Unfortunately, human beings are human beings, and, from time to time, people let down the side due to pressure that might be on them or their lack of thought in what they are doing.'

Knowledge is power

The chief executive of Professions Australia, Bev Clarke, agrees that ethics are a distinguishing mark of the professional, but adds that so is knowledge. Maintaining and enhancing professional standards is essential, but it presents real difficulties.

'When people are time poor, how do they manage things like continuing professional development?' questions Clarke. 'How do they ensure that it adds value?'

There are also skills that were never considered part of professional training years ago that have become part of the weft and weave of the modern world.

'A study of the medical profession has shown that 70% of complaints stem from poor communication skills,' Clarke says. 'So, people have to develop skills that they may not have picked up 20 years ago.'

There are also personal qualities expected of professionals that escape easy definition. In trying to pin some down, the institute's general manager in Western Australia, Con Abbott FCA, draws on the favourite saying of a colleague: 'A profession is a group of people who invest something today for tomorrow.'

Professional people are able to discern benefits that are over the horizon — benefits that may have little or no value in the short-term, but great long-run value.

'A great example of that is liability reform,' Abbott says. 'That was a 20- to 25-year fight for the profession and the major benefits are long-term. There are some benefits up front, but most flow in the future as case law is established and re-established over the next five, ten and 20 years. The people who were working on it 25 years ago contributed something for the future membership, not themselves.'

Abbott believes accounting as a profession stacks up well against others, but is concerned about some of the stresses on Chartered Accountants and wonders if too much is being expected from the profession.

'There has been a huge movement by government to shift more regulatory burden on to the profession,' Abbott says. 'For example, the tax office has outsourced a lot of its regulatory work to us. And oversight by government has grown exponentially since I joined the profession in 1980 and, with that, there has been a shift in the cost burden because nothing comes for free.'

Abbott says a lot of the cost shifting can't be recovered from clients, 'so there is zero benefit for us and zero benefit for the client'.

'We just hope there is a public benefit, and I say "hope"' says Abbott.

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'Another challenge is, I believe, that in some senses the appetite for the profession in the young has waned. We do have a healthy growth rate, but I just think that some young people see how hard we work and ask: "Should I aspire to that" or "Should I aim to be that kind of person in 2020?"'

Drawing the line

Clarke agrees that the demand for professionals to put public over private interest can be very 'tricky', no matter what your level of expertise or how true your moral compass. Some issues are simply not clear-cut.

'Public interest is not always well defined and some areas that are quite controversial, like the environment, are the subject of a lot of debate,' Clarke says. 'Where does a professional draw the line when the issue is not settled in public debate? That is why professional bodies are important: providing mentoring, resources and people to talk to.'

It is why, in Brown's view, the institute is so vital. It sets the standard and should be, and be seen to be, acting as the champion of professionalism. 'We can have all the benefits programs and professional development activities and seminars and all the rest of it, but, in the end, it comes down to a set of ethical standards and the institute standing up for those and supporting our members in making decisions for the greater good,' Brown concludes.

Source: This article appeared in *Charter*.

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Describe traditional and new career opportunities for accountants.

CAREERS IN ACCOUNTING

The three traditional areas of employment for accountants have been in public accounting, the private sector, and the government and not-for-profit sector. Public accountants can provide advice on the design of an accounting system such as MYOB, and on investment, audit and tax issues. Private sector accountants may work in a number of positions, such as management accounting, e-commerce, or as chief financial officers (CFOs) in a private sector company such as Coles Myer or Intergraph. Accountants working in the government and not-for-profit sector could work for a government entity such as the Department of Defence, and would maintain government records and prepare government financial reports. Other public sector accountants could be employed by the Australian Taxation Office and would be responsible for checking company taxation returns and ensuring compliance with taxation laws. An accountant working in the not-for-profit sector could be employed at a public hospital and be responsible for setting up the hospital accounting system to record individual patient revenue and patient expenses.

New opportunities

There are exciting new opportunities for today's accounting graduates. These include positions in the exciting area of forensic accounting, where accountants help to solve such crimes as computer hacking and the theft of large amounts of money through hoax schemes on the Internet. In recent years, several Australian banks have been the targets of this type of crime, where customers have been sent an email supposedly from the bank, requesting them to provide confidential personal banking details. Customers have been misled and supplied personal details that have resulted in unauthorised individuals accessing their personal funds. The burgeoning area of e-commerce also provides opportunities, as accountants are required to assist in designing web-based payment systems such as BPay and helping to ensure the security of these systems. There are also opportunities in the administration of insolvency, where accountants may help failing companies by offering

advice to improve an entity's future prospects or assist in selling the entity's assets if a decision is made to wind up the company. Another important growth area is environmental accounting, where accountants advise on expenditure of environmental systems and the disclosure of these costs in financial reports. The growth of multinational entities has also led to opportunities in international accounting.

1.2

Figure 1.2
Accounting opportunities in Australia

Forensic Accountant
\$100K package

Exciting growth area with promotional opportunities. International top-tier firm.

Your role would include preparing expert reports, investigating business transactions and monitoring new developments in legislation.

Internal Auditor—Gold Coast
\$120K package

This position is based in the head office of a leading surfwear wholesaler. In this role, you would be responsible for the implementation of the audit program and ensuring that records complying with accounting standards and relevant legislation are maintained. A CPA/CA qualification is necessary as well as prior audit experience with a professional services firm or a large corporation.

National Payroll Manager—Perth
\$140K package

A leading multinational firm has an opportunity for a national payroll manager. The primary responsibility will focus on the accurate and timely processing of weekly and monthly payroll and also leading and developing the team.

ASSISTANT ACCOUNTANT—BAYSIDE
\$55K PACKAGE

An established, successful and growing company is looking for an Assistant Accountant working directly as an understudy to the financial controller. This position would see you working closely with the Financial Controller and involved with all aspects of the accounting and finance function, including financial and operational reporting, analysis and interpretation of results, budgeting and forecasting and stock control.

Fund Accountant
\$75K package
Sydney CBD

A leading global investment banking firm has an opportunity for an experienced fund accountant to join its team. The responsibilities include calculation of unit prices and the preparation of financial statements, and will include monthly reports, tax accounting and liaising with key stakeholders.

You should have experience in unit pricing and have a good knowledge of accounting and taxation issues relating to funds accounting. You need an accounting degree and CPA/CA/PNA membership.

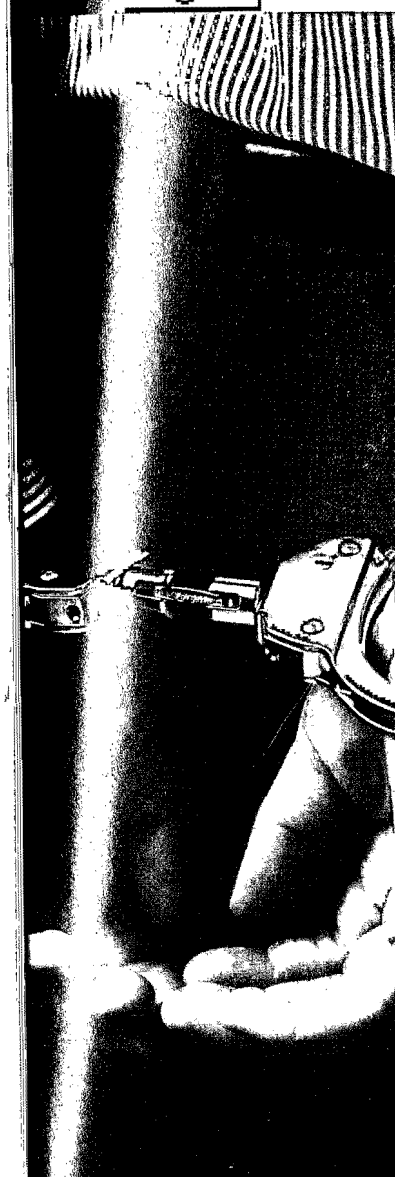
A background in accounting is beneficial for people working at various positions in the entity. There are many well-known accounting techniques that will be discussed later in the text that are extremely important for management to understand and implement. Tools such as break-even analysis allow management to determine the selling point where total revenue will equal total costs. The process of capital investment decision making enables management to screen and analyse different capital projects to determine which projects should be undertaken by the entity to maximise return on investment. Chapters 11 and 13 will examine these topics in detail.

The reality check 'Crime scene accountants' highlights some of the skills valued in the growing forensic accounting sector.



Reality check

Crime scene accountants



Forensic accounting is one of the accounting profession's fastest-growing disciplines and integrates accounting, auditing and investigative skills to help solve business dilemmas or build a legal case in contentious matters. Litigation support and fraud investigation are core tasks. IT-related services are also increasingly in demand. The primary aims of a forensic accountant are typically two-fold: to solve a puzzle that is affecting a client and, in many cases, to assess the damages or losses suffered as a result of an incident.

The range of services is diverse: tracking paper and electronic trails, provision of expert witnesses in legal cases, ensuring legislative compliance, monitoring third-party business corruption, computer forensics, anti-money laundering assistance, and running background checks on prospective clients.

Estimates suggest the Australian forensic accounting business is worth up to \$100m a year, with growth in the range of 10 per cent to 15 per cent. As a consequence, firms are recruiting more specialists. Many have a background in law, law enforcement and IT, while others start in auditing or insolvency roles.

Andrew Ross FCA, a partner in forensic services at Ernst & Young and national chair of the Institute's Forensic Accounting Special Interest Group (FASIG), confirms that the sector has witnessed a dramatic rise in the number of providers and the range of services in recent years.

Boutique specialist firms such as Cully Gower, Lonergan Edwards and CRA International are taking on the larger practices, while service lines such as fraud investigation and IT data gathering and analysis are growing rapidly. A more proactive approach is being taken to tackle the risk associated with fraud.

'Not even where there's any suspicion of fraud occurring; just a company wanting to make sure they have proper controls in place,' says Ross, who notes that a spate of corporate collapses has led to a greater focus on financial statement fraud. Another likely growth area is anti-money laundering. The rise of email and Internet-based activity in offices is also driving demand for forensic accountants. An ability to retrieve and analyse data has led to greater detection of fraud — and created nightmares for staff who still do not realise that the delete key does not guarantee data will be removed from a computer's hard drive. 'Many professionals look very perturbed when that is pointed out to them,' he says.

Ross cites a recent case of an investigation into a government employee's allegations that another staff member was sending harassing emails. Forensic data checks discovered the complainant was the originator of the offending emails after getting a US-based hacker to access the colleague's email account. The hacker charged \$US200 — and the hoax emailer was fired.



Ross says cases involving intellectual property theft and the manipulation of financial statements represent a huge growth area. Ernst & Young was recently involved in a three-continent investigation into financial statement fraud after auditors refused to sign off on a financial report. An analysis of emails spanning five years from the company's financial department revealed financial fraud.

Ross says: 'That is part of the future that we are going to see in Australia — allegations of financial statement fraud are going to be very significant because there are a number of different stakeholders who will have an interest in a case.'

Source: This is an excerpt from an article that appeared in *Charter*.

Professional associations

Many countries have a professional accounting association. In Australia, there are three professional accounting associations: CPA Australia, the Institute of Chartered Accountants in Australia (ICAA) and the National Institute of Accountants. In New Zealand, it is the New Zealand Institute of Chartered Accountants.

CPA Australia

CPA Australia provides education, guidance and support to students, accountants and business in Australia. A certified practising accountant (CPA) is a business graduate who has completed the CPA program and three years of approved work experience, and who undertakes continuing professional development each year. To be admitted to the CPA program, you need to have completed prescribed accounting units in an undergraduate or post-graduate degree. A CPA can work in various areas, including public accounting and public sector accounting.

The Institute of Chartered Accountants in Australia (ICAA)

The ICAA provides education to its members and input to debates affecting the accounting profession and influencing regulators. A chartered accountant (CA) can be employed in a range of organisations to provide advice on areas such as running a business, future directions and complying with accounting standards. To become a CA, you need to have completed an approved university degree, passed the CA program and completed three years of approved work experience.

The National Institute of Accountants (NIA)

The National Institute of Accountants (NIA) is a professional organisation for accountants, whose members (professional national accountants (PNA)) are known for their practical hands-on skills and a broad understanding of the total business environment. The NIA consults with business, government and public body committees and works to address issues affecting the accounting profession.

The New Zealand Institute of Chartered Accountants (NZICA)

The NZICA is the professional organisation for accountants in New Zealand and provides members with ongoing education, guidance and support on a range of professional and policy-related issues. A chartered accountant (CA) is employed in various roles in commerce, industry and government both in New Zealand and internationally.

SUMMARY OF LEARNING OBJECTIVES

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What is the accounting process?

The process of accounting is one of identifying, measuring and communicating economic information about an entity for decision making by a variety of users.

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What are the differences between accounting and bookkeeping?

Accounting involves the creation and management of the accounting system, the formulation of budgets and accounting policies, and the provision of budget and taxation advice to senior management. Bookkeeping entails the recording of transactions using a computerised accounting package, possibly recording payroll transactions and preparing bank reconciliations.

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What is the role of accounting in decision making by various users?

Accounting information is an important part of the information used by individuals and entities in decision making regarding investment and other business opportunities. The internal users (that is, management) use accounting information to make decisions concerning sales mix, which products to make or buy, and opportunities for expansion. Stakeholders (for example, suppliers, consumers, banks, investors and regulatory bodies) require accounting information to help decide whether to lend money to the entity, whether to invest in the entity and whether to purchase goods from the entity.

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What are the differences between management accounting and financial accounting?

Management accounting concerns the creation of reports for use by management in internal planning and decision making. The management accounting reports are much less formal than financial accounting reports, as they are not bound by regulatory requirements. The reports can also be tailored to suit the needs of management. There is no time lag with management reports, so they are up to date. Financial accounting provides information for the use of external parties so that they can make economic decisions about the entity. Financial accounting is bound by GAAP. There is usually a time lag from the date of the report to when it is distributed to the various users. The financial accounting information is concise, as unnecessary detail is disclosed in the notes to the financial reports. The users of financial accounting reports include suppliers, consumers, banks, investors and regulatory bodies.

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What are some of the limitations of accounting information?

The limitations of accounting information include the time lag between production of the report and distribution to the users, and the historical nature of financial reports. Costs associated with releasing accounting information include the costs of preparing and disseminating the information, and any losses from the potential release of proprietary information to competitors.

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How have corporate collapses and the growth of multinational entities changed the role of accountancy?

The recent spate of corporate collapses has affected both the role of accountants and the perception of accountants' integrity. Entities have become more diversified and multinational, which has led to a more complex business environment. Today's accountants need to possess a variety of skills to cope with a changing business environment. They need to be familiar with international accounting standards and changes in technology, and possess a good understanding of ethics.

List the professional associations for accountants in Australia and New Zealand.

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What career opportunities exist for accountants?

Accountants are employed in public accounting roles, private and public sector accounting roles and not-for-profit sector accounting roles. New opportunities for accountants exist in forensic accounting, environmental accounting, e-commerce, insolvency, and international accounting.

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What are the professional associations for accountants in Australia and New Zealand?

The professional associations are CPA Australia, the Institute of Chartered Accountants in Australia, the National Institute of Accountants and the New Zealand Institute of Chartered Accountants. These associations provide a range of services for their respective members — including training, products and services, and the right to use the designation after their names (i.e. CPA, CA and PNA) — and employment opportunities.

KEY TERMS

accounting, p. 4
accounting system, p. 5
auditing, p. 5
Australian Securities Exchange (ASX), p. 8
balance sheet (statement of financial position), p. 8
bookkeeping, p. 4
business transactions, p. 4
cash flow statement p. 8
Corporations Act, p. 6
ethics, p. 12
external users (stakeholders), p. 6
financial accounting, p. 8
financial reports, p. 8

general purpose financial reports (GPFR), p. 8
generally accepted accounting principles (GAAP), p. 8
historical cost, p. 8
income statement (statement of financial performance), p. 8
internal users, p. 6
Listing Rules, p. 8
management accounting, p. 8
profit, p. 8
relevant information, p. 4
reporting entities, p. 9
special purpose financial reports (SPFR), p. 8

DISCUSSION QUESTIONS

- 1.1 What is a business transaction and how does it relate to the accounting process?
- 1.2 Illustrate the differences between bookkeeping and accounting. Give an example of a situation where an accountant would perform both bookkeeping and accounting tasks.
- 1.3 Differentiate between financial and management accounting. Give an example of how management accounting reports would be incorporated into financial accounting reports.
- 1.4 Describe how accounting information helps different stakeholders to make decisions concerning the operations and performance of the entity.
- 1.5 Choose one of the job advertisements shown in figure 1.2 and discuss what you think would be the prerequisites for the position. Include in your answer the subjects the applicant would be expected to have taken during their tertiary studies, and any future study that would be beneficial to the applicant's career.
- 1.6 Why do you think ethical considerations should influence all areas of accounting and business?

- 1.7 Refer to the reality check 'Crime scene accountants' on pages 17–18. Define forensic accounting. Why do you think the last decade of corporate collapses has contributed to the growth of this new type of accounting?
- 1.8 List six stakeholders of accounting information. State the information requirements for each one — for example, employees would need information regarding job security and promotional opportunities within an entity.
- 1.9 What are three limitations on the usefulness of accounting information?
- 1.10 Assume you are considering the purchase of a small business such as a suburban newsagency. What financial and non-financial information would prove helpful in your decision-making process?
- 1.11 Give three reasons why it is important for a potential purchaser of a small business to seek advice from a professional person such as an accountant.
- 1.12 What assistance do the professional associations provide for the new accounting graduate?
- 1.13 What role does accounting information play in the allocation of scarce resources?
- 1.14 What are some of the opportunities and threats for the accounting profession resulting from the large number of corporate collapses in the early 1990s?
- 1.15 The reality check on pages 13–15 talks about the profession of accounting and the acceptance 'to act in the public interest'. What do you think is the meaning of 'to act in the public interest', and give examples of the tasks that accountants would perform that would meet this quality.
- 1.16 What is the purpose of professional indemnity insurance as it applies to professions such as accountants, lawyers and IT consultants?

CASE STUDIES

- CS1.1 Go to Nokia's website (www.nokia.com) and read the independent audit report from Nokia's latest financial statements.
 - a. What is the purpose of the audit report?
 - b. What does it mean by 'in our opinion the consolidated statements give a true and fair view'?
 - c. Why has Nokia prepared the financial reports in accordance with International Financial Reporting Standards (IFRSs) and Finnish regulations?
 - d. What tasks must PricewaterhouseCoopers perform in order to prepare the report?
- CS1.2 Refer to the latest financial report for Nokia. (The notes to the 2005 consolidated financial statements of Nokia Corporation appear in appendix A of this book, and the report is available online at www.nokia.com.) For each of the following stakeholders, give an illustration of a report or a note that would be useful for decision-making purposes, state why the information is useful, and give an example of how that information would be used.
 - a. Nokia's shareholders
 - b. European banks
 - c. Customers purchasing mobile phones
 - d. Employees of Nokia Corporation
 - e. Financial analysts
 - f. PricewaterhouseCoopers (auditors)
 - g. Finnish environmental groups
- CS1.3 Alexandra is just completing her final year of a commerce degree, majoring in accounting, and she wishes to become a member of a professional accounting association in

Australia or New Zealand. Access the websites of the four associations, CPA Australia (www.cpaaustralia.com.au), the Institute of Chartered Accountants in Australia (www.icaa.org.au), the National Institute of Accountants (www.nia.org.au) and the New Zealand Institute of Chartered Accountants (www.nzica.com).

Prepare a one-page memo to Alexandra advising her on the strategic mission of all of these associations, any prerequisites for becoming a member of each, and the areas and activities that each one is typically involved in.

REFERENCE

AICPA special committee on financial reporting, 'Improving business reporting: a customer focus (The Jenkins Report)', American Institute of Certified Public Accountants, New York, www.aicpa.org.