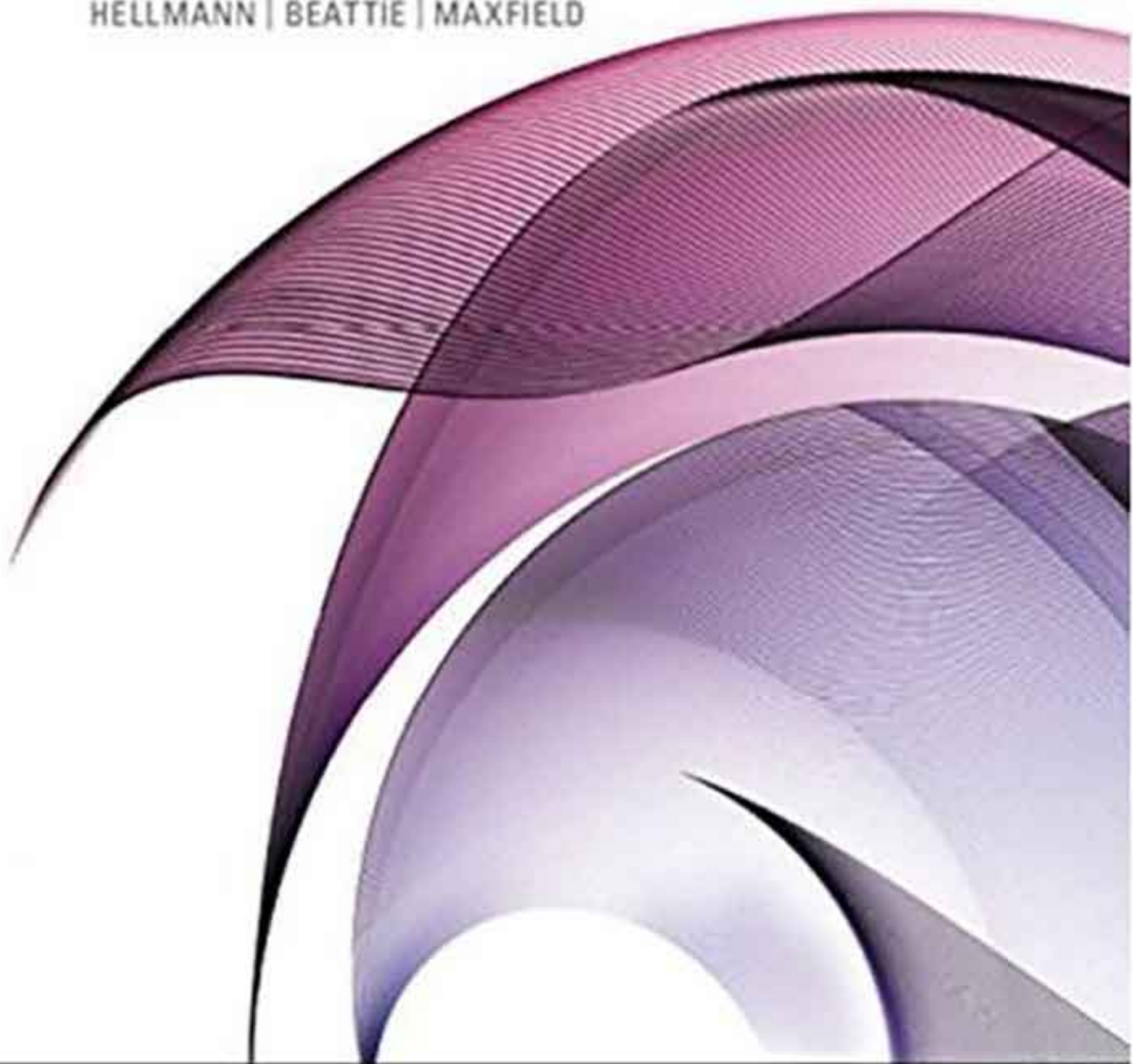


FINANCIAL Accounting

9TH
EDITION

HOGGETT | MEDLIN | EDWARDS | CHALMERS
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Preface

Our main purpose in writing this book is to provide an introductory but comprehensive description of the purpose, practice and process of contemporary international financial accounting in an Australian context. With the increased emphasis on the globalisation of business, the material is ideal for the study of introductory accounting in a broad international context.

The book is designed for tertiary students interested in an accounting career and for those wanting a general understanding of the production and use of accounting information in the business sector. This ninth edition considers more fully the need for accounting knowledge by students undertaking business studies in areas other than accounting. The book is suited to a two-semester course at both the undergraduate level and the postgraduate level as it provides a general understanding of the role of financial accounting information systems in any business sector.

The ninth edition builds on the strengths of previous editions with a strong focus on the decision-making role of accounting as well as on a student's acquisition of generic skills such as communication, analysis and problem solving, critical thinking, judgement, and an appreciation of ethical issues. The opportunity to develop these generic skills is provided by the range of end-of-chapter activities. The authors, however, believe that competency in the technical skills of accounting should remain as the core objective, and the book therefore continues to provide appropriate discussion of key technical issues. It is our belief that a person equipped with knowledge of technical material in accounting possesses a powerful tool for making economic decisions and for analysing and solving business problems. These technical skills are used in the book to provide clear and detailed explanations of the accounting concepts that form the basis of the practice of accounting. The use of the technical skills of accounting in teaching concepts gives students a practical foundation from which to build their understanding.

The book is organised in six parts as follows, with emphasis on decision making in a business enterprise before consideration of external reporting issues.

Part 1: Accounting for decision making (chapters 1–2)

Part 2: Accounting systems and processes (chapters 3–7)

Part 3: Equity in business (chapters 8–9)

Part 4: Accounting regulation of assets and liabilities (chapters 10–16)

Part 5: External reporting and performance evaluation (chapters 17–19).

Based on feedback from users of the previous editions of this book, there remains in the ninth edition a strong focus on:

1. service organisations operating in the business and not-for-profit sectors
2. the use of accounting information by non-accountants, both in text examples and in end-of-chapter activities
3. the impact of the goods and services tax (GST) on business records in a number of exercises and problems
4. the effect of accounting information on decisions made in business (segments in each chapter provide links to business activities, and each chapter contains a scene setter)
5. the effect on accounting systems of improvements in information technology
6. the impact of developments in the regulation of accounting standards at national and international levels.

We have continued to improve the readability of the book without compromising the integrity of its theoretical and practical content, and have continued the policy of including detailed learning objectives.

Many chapters provide a discussion of the impact of the GST on business, especially on small business. However, instructors can ignore the effects of the GST if they wish to pay attention to the other accounting issues in each chapter. An introductory coverage of the GST is provided as an appendix to chapter 3. Many exercises and problems permit lecturers to select where GST is included and where it is excluded.

Changes from the previous edition

The major features of this ninth edition include the following.

- Material has been extensively rewritten in relation to the new regulatory arrangements for the development of accounting standards globally and in the Australian context.
- 'Scene setters' at the beginning of each chapter have been updated to help students understand the relevance of the accounting material in that chapter to the issues faced by accountants in practice.
- Additional and new 'business knowledge' vignettes in each chapter show the relevance of accounting to the practical world of business.
- Learning checks have been added to summarise the key points from the preceding section.
- Approximately half of the discussion questions, exercises and problems in many chapters are new.
- In the end-of-chapter case material, several decision analysis cases, critical thinking cases, communication and leadership activities and ethics and governance issues are either new or updated. Web-based activities are included in several chapters. In addition, the financial analysis is based on the latest JB Hi-Fi Limited annual report, which is available on its website, www.jbhifi.com.au.
- All the exercises and problems are now tagged by learning objective.

Supplementary materials

Financial Accounting 9th edition is supported with an extensive teaching and learning resources supplementary package.

- **WileyPLUS** is a research-based online environment for effective teaching and learning. With **WileyPLUS**, lecturers can prepare, assign and grade accounting activities simply and in a time efficient manner. **WileyPLUS** increases student confidence through an innovative design that allows greater engagement, which leads to improved learning outcomes. For more information, contact your John Wiley & Sons sales consultant or visit www.wileyplus.com.
- A solutions manual containing worked solutions to all end-of-chapter discussion questions, exercises, problems, case studies and activities is available for lecturers who prescribe this text. The solution manual has been thoroughly checked for accuracy and correctness.
- PowerPoint Presentation contains over 1000 slides with summaries of key concepts and processes presented in the chapter as well as key diagrams and worked examples from the text.

WileyPLUS

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*John Hoggett, Lew Edwards, John Medlin, Keryn Chalmers,
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Part 1

Accounting for decision making

- 1 Decision making and the role of accounting
- 2 Financial statements for decision making

CHAPTER 1

Decision making and the role of accounting

The dynamic environment of accounting
Decisions in everyday life
Economic decisions
The nature of accounting
Users of accounting information
Using information in economic decisions
Accounting information and decisions
Management and financial accounting
Accounting as a profession — Australian perspective
Public accounting versus commercial accounting
Ethics and accounting

Key terms

Discussion questions

Exercises

Decision analysis

Critical thinking

Communication and leadership

Ethics and governance

Financial analysis

Learning Objectives

After studying this chapter you should be able to:

- 1** outline the dynamic environment in which accountants work (pp. 4–5)
- 2** discuss the nature of decisions and the decision-making process (pp. 5–6)
- 3** outline the range of economic decisions made in the marketplace (pp. 6–7)
- 4** explain the nature of accounting and its main functions (pp. 8–10)
- 5** identify the potential users of accounting information (pp. 10–11)
- 6** apply information to make basic economic decisions (pp. 11–13)
- 7** describe the role of accounting information in the decision-making process (pp. 13–14)
- 8** compare accounting information for management and external users (pp. 14–15)
- 9** summarise how the accounting profession is organised in Australia (pp. 15–16)
- 10** identify the different areas of the economy in which accountants work (pp. 16–20)
- 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 (pp. 20–2).



A natural fit

Simone Taylor is the financial controller for OrotonGroup. Never previously having considered a career as an accountant, her interest in the profession was sparked during a discussion with a careers advisor during secondary school.

Sold on the idea that the accounting profession would bring diversity of work opportunities, Taylor commenced as a cadet with KPMG's cadetship program after graduating from high school in 1998, working full time in the audit consumer and retail group for two years.

Taylor then worked as an internal auditor at confectionary giant Nestlé's head office in Switzerland, where she audited the organisation's factories and supply chain globally. After three years, a financial controller's role with British fashion powerhouse Burberry beckoned in London, before a stint in forensic accounting with the United Kingdom's Serious Fraud Office.

In 2009, Taylor accepted a position at OrotonGroup. The company has approximately 85 stores throughout Australia and Asia. Her role is to assist steering the finance function. The role is diverse, from an early morning sales meeting to product reports and cash flow, as well as rolling out a new Asia strategy, which includes setting up new structures from payroll through to audit.... The role also involves implementing finance support services for strategic decisions, such as online shopping, acquisitions and partnerships, to adapt to the business and economic environment to the brand's advantage.

Beyond OrotonGroup, Taylor foresees an eventual move into a chief financial officer role that represents the right mix of company culture and product mix. As with OrotonGroup, she sees any future role as adding to the business. 'I can't be at a company where it's just presenting a report at the end of the month — it has to be a business partner role.'

Source: Excerpts from Tydd, J 2012, 'A natural fit', *Charter*, November, pp. 66–7.

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 to 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 retail, as has Simone Taylor 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

LO 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), 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:

- 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, such as information about an entity's attention to occupational health and safety issues, social and equity diversity issues such as the employment of people with disabilities and indigenous people, and environmental considerations such as 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.

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 book is designed for all students studying accounting for the first time at a 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 book. 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 book 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 knowhow.
- ❑ 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

LO 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.

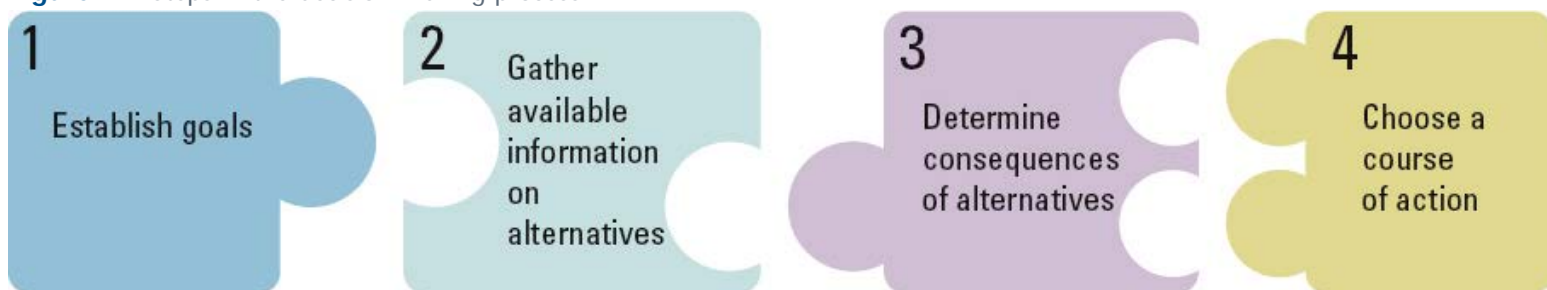
Steps in decision making

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 find eventually 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

LO 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 circumstance:

- **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, 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 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 also are traded in a marketplace.

BUSINESS KNOWLEDGE

Job demand high in Asia

Qualified accountants have a long history of travelling to the UK and US for the career and lifestyle experiences on offer. While this trend is still occurring, the global financial downturn has placed Asia in the spotlight as an international destination of choice for Chartered Accountants due to the variety of employment opportunities on offer and the lifestyle reasons, and the chance to experience new cultures in Asia.

Given the ongoing weakness of the US and UK economies, global organisations are far more confident of investing in Asia than other parts of the world. There is a growing number of multinationals entering Hong Kong and Singapore, while those with an established presence are expanding operations to capitalise on opportunities in China. This creates demand for qualified Chartered Accountants.

China is the economic powerhouse of Asia, and the rate at which multinationals are entering the market is driving demand for Chartered Accountants in areas such as audit, management accounting and financial analysis. 'New career opportunities for professional accountants are abundant, especially in major cities such as Beijing, Shanghai and Guangzhou where many multinational companies set up their offices . . .' says Jesaline Huang, manager, Michael Page Finance China.

Global companies are also looking to southeast Asia as a core growth market. Singapore is regarded as a logical business hub with a well-qualified workforce and the required infrastructure to support international business activities. Government tax incentives have further encouraged multinationals to set up regional headquarters in Singapore and this is also having a positive effect. The sectors showing the highest levels of jobs growth are financial services, pharmaceutical and health care. Chartered Accountants are predominately needed for the international reporting and management of corporate finance. Opportunities are available for accounting professionals with experience in International Financial Reporting Standards (IFRS), Basel and accounting policy.

As a world-class business centre on the doorstep of China, Hong Kong is of particular strategic importance for companies looking to capitalise on emerging opportunities in China. Hong Kong also offers one of the lowest personal tax rates in the world, which is a compelling financial incentive to work there.

Source: Excerpts from Michael Page International 2011, 'Job demand high in Asia', 22 December, www.charteredaccountants.com.au.

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 the 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 engineering, marketing, human resource, or any other business decision makers. In the scene setter at the start of the chapter, Simone Taylor, as an accountant,

has been confronted with making many decisions about the design of reporting systems and structures to cope with the expansion of the Orotongroup into Asia and into apparel.

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, both locally, nationally and overseas.

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1.4 The nature of accounting

LO 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](#) (p. 6), 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 book.

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 book 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

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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 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.

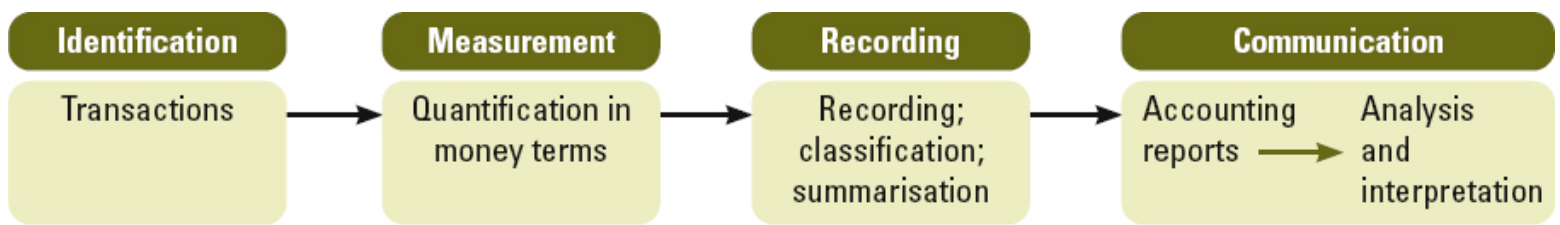
Recording provides a history of the economic activities of a particular entity. Recording is the process of systematically maintaining a file of all transactions which have affected the business entity after they have been identified and measured. Simply measuring and recording transactions, however, 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 chapter 2.

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.

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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 that is inputted. Full coverage of the manual system is given in this text to help understand the processes performed by computerised accounting systems. An introduction to computerised accounting systems is given in chapter 7.

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 other entity. Internal transactions are those economic events that take place within one entity.

1.5 Users of accounting information

LO 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:

- 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 is an accounting function 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, including 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 hence can 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:

- 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?

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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