CRAIG DEEGAN

AN INTRODUCTION TO ACCOUNTING

ACCOUNTABILITY IN ORGANISATIONS AND SOCIETY

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CENGAGE

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BRIEF CONTENTS

CONTENTS

Guide to the text

As you read this text you will find a number of features in every chapter to enhance your study of accounting and help you understand how the theory is applied in the real world.

CHAPTER-OPENING FEATURES

Identify the key concepts that the chapter will cover with the **Learning objectives** at the start of each chapter.

LEARNING OBJECTIVES

After completing this chapter, readers should be able to:

- LO1.1 provide a definition of accounting and explain that the accounting process provides information about the financial, social and environmental performance of an organisation
- LO1.2 explain the meaning of accountability, as well as the relationship between accounting and accountability
- LO1.3 identify the possible audiences of the accounts generated by accounting, and understand that accounting generates information for use by people both inside and outside an organisation
- LO1.4 explain who does accounting and who might be considered to be an accountant
- LO1.5 describe the qualitative characteristics that accounting information should possess if it is to be useful in allowing different stakeholders to make informed decisions
- LO1.6 describe how we can use the accountability model introduced in this chapter to explain the practice of accounting within different organisations
- LO1.7 explain the evolutionary nature of the accountant's role
- LO1.8 explain why accounting can be considered both a technical and a social practice.

Check your understanding of accounting concepts with the **Opening questions**. Responses to these questions can be found at the end of the chapter so you can check how your understanding has changed.

OPENING QUESTIONS

Below are a number of questions that we want you to consider before reading this chapter. We will ask these same questions again at the end of the chapter, in the 'Study tools' section. Each chapter is organised in this manner so that you can assess whether your views have changed, and therefore whether your knowledge has been advanced, as a result of reading the material provided within the chapter. Please spend some time now briefly answering these questions.

1. What aspects of an organisation's performance are measured by accounting?
2. What factors are likely to influence the types of accounts being presented by an organisation?
3. Who are the users of accounting reports?
4. Is accounting likely to be at all interesting?
5. Is accounting really that relevant to many people in society, other than perhaps shareholders (or the owners of an organisation) and managers?

FEATURES WITHIN CHAPTERS

Examine how theoretical accounting concepts can be used in practice through the **Learning Exercise** boxes, many of which present important worked examples.

3.3 Learning Exercise

The benefits of clear plans

What are some of the benefits that might arise as a result of carefully planning future organisational activities? In answering this question, we can note that creating plans requires the managers of an organisation to think about the future in terms of:

- what the organisation might produce
- who it might sell it to
- where it will obtain its funding
- what other resources are needed
- what costs and impacts should arise
- what is the relevant legislation
- what are the expectations of various stakeholders
- what is the availability and expectations of employees?

This all means that the managers of an organisation need to gain an appreciation of what their organisation is doing and whether the plans are viable before they actually do anything. Establishing plans and related targets also enables managers to assess subsequent performance in terms of whether or not the targets have been achieved, and if not, why not. This control aspect will then facilitate learning and revisions to plans, and the cycle will continue. By analogy, without planning, an organisation is effectively sailing along without a map, and at some stage it is likely to run onto rocks!

Revise critical accounting concepts with the **Key concept** boxes.

Feedback from interested stakeholders can also be used in terms of how they have responded to the actual process/outputs of an organisation. For example, the organisation should consider implementing stakeholder surveys, or social audits. Customers might, for instance, be surveyed to ask how satisfied they are with the products and services being provided. Or an organisation might employ an independent third party to enter a factory of the organisation, or of a supplier (with approval), to provide an account of the treatment of employees and the safety of the work environment (audits of workplaces are often referred to as an example of a social audit).

Key concept

Feedback from stakeholders can be used to determine how satisfied stakeholders are with an organisation, and can provide the accountant with information so they can revise and adjust processes.

Accountants are central to the successful operations of an organisation. As should now be clear, an accountant is much more than somebody who provides an account of the financial costs that have been incurred within a set period, or the income that has been earned in that period; that is, a good accountant is much more than simply a record keeper. Accountants should play a key role in planning activities, suggesting innovative ways of doing things, and putting in place (governance) policies that encourage an organisation to achieve its goals. This important role of accountants was reflected in a report released by the International Federation of Accountants (IFAC) entitled *Competent and versatile: How professional accountants in business drive sustainable organisation success*. According to IFAC (2011, p. 6), professional accountants in all organisations have a significant role in:

- *framing business models* – that is, determining the appropriate way to run a business in terms of where it might earn its revenue, what costs it could and should incur, and how it should manage its risks together with considerations of when, throughout the process, decisions

END-OF-CHAPTER FEATURES

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

Review your understanding of the key chapter topics with the **Summary**.

STUDY TOOLS

SUMMARY

In providing a summary of this chapter, we will also reflect on where we are now in terms of the contents of Chapters 1 and 2. As a result of reading the first two chapters of this book, you have been exposed to a different perspective on, or idea of, accounting than you might have anticipated. We have now extended the idea of accounting beyond what you might have previously considered constituted accounting. To this point, we have considered:

- the broad nature of accounting and its necessary relationship to perspectives on responsibility and accountability
- how the different perspectives on responsibility and accountability held by internal and external stakeholders will influence the form of accounting undertaken by an organisation
- how accounting is ever-evolving as community expectations about organisational responsibilities and accountabilities change
- how accounting can be undertaken in a way that either has a broad or a narrow reach; for example, we may or may not have an accounting system that has a relatively broad reporting boundary that considers the impacts an organisation's products have on the health and safety of consumers or those employees in the supply chain
- how organisations utilise various resources, which can be measured or described in a variety of ways (or in some organisations, ignored altogether)
- how organisations create a variety of impacts and outputs which can be measured (or not) in a variety of ways, depending on the reporting and measurement frameworks that might be used
- how reporting is influenced by a variety of factors, including legal issues, perspectives on accountability, the demands of powerful stakeholders, management strategies, the desire to look legitimate, and so forth
- how accounts generated for managing an organisation (management accounts) might also be released externally
- how reporting can address financial, social and environmental issues (or a combination thereof)
- how the organisations that generate accounts can take on a variety of forms and have a variety of aims, all of which influence what type of accounting is undertaken
- how organisations can take different forms, each with their own implications for accountability and reporting.

What will be emphasised throughout this book, and hopefully throughout your education, is that accounting is both a technical and social practice which has widespread importance to,

Refer to the **Answers to the opening questions** to assess whether your views have changed and, therefore, whether your knowledge has been advanced, as a result of reading the material provided within the chapter.

ANSWERS TO THE OPENING QUESTIONS

At the beginning of the chapter we asked the following two questions. As a result of reading this chapter, you should now be able to provide informed answers to these questions – ours are shown below.

1 What do we mean by 'reporting boundary', and why would managers of similar organisations potentially adopt different reporting boundaries?

When we are discussing the reporting boundary of an organisation, we are referring to the judgements that have been made by its managers in respect of how far the responsibilities of the organisation have been extended: both in terms of which stakeholders it owes accountability to, and for what aspects of performance it should be accountable. Because different managers will have different perceptions of organisational responsibilities, this means they will have different perceptions of which accountabilities an organisation should accept and the types of accounts it should prepare. So although two organisations might be very similar, the perspectives of their managers might be very different, and therefore the accounts the respective organisations decide to produce might be very different.

2 Why would we argue that accounting is not a one-size-fits-all practice?

We argue that accounting is not a one-size-fits-all practice because how we account for an organisation depends on factors such as:

- the various resources it uses, which can create different types of impacts for different stakeholders and therefore different accountabilities
- where its operations are being conducted, which may be in highly populated areas with many potentially affected stakeholders, or in areas of significant environmental or cultural importance
- the differing perceptions of managers on why they should be reporting, which in turn will influence to whom they have accountability, and to which aspects of performance the accounts should relate

Read about the chapter case for each chapter In the **Case link** box that connects the chapter to the integrated and innovative case study. Ask your Instructor for access to the case study file.

ONLINE RESOURCES

Accompanying the book is an innovative online case study that follows an organisation initially established by two friends, which grows into a large and successful company. Acquire this chapter's case study from your instructor.

CASE LINK

Armadillo Surf Designs: Too early to throw in the towel

A recent market and data analysis indicates that approximately 85% of Armadillo Surf Designs' (ASD) sales are from their men's lines and just 15% of sales are from their female lines. As a result, the business is launching a new beach towel range in order to broaden their appeal to the female market.

Prepare the operating budgets for the new beach towel range and consider the positive and negative impacts that may arise from the proposed reward system for manufacturing staff. Following the launch of the beach towel range, monitor favourable and unfavourable sales and cost variances and identify the potential causes of such variances.

Test your knowledge and consolidate your learning through the **End-of-chapter questions**.

END-OF-CHAPTER QUESTIONS

4.1 Why should an organisation prepare budgets?

4.2 Why might there be a difference between sales revenue and cash received from customers, in a given period?

4.3 What is a master budget?

4.4 Why would a sales budget typically be the first budget prepared within a master budget?

4.5 Why would the cash budget be prepared after all the operating budgets have been prepared?

4.6 If the cash budget projects a lot of cash on hand in future periods, is this actually a problem? Clearly justify your answer.

4.7 What is a budget variance, and should both favourable and unfavourable variances be investigated?

4.8 If a university is preparing a master budget, what would be the nature of the first budget prepared as part of this master budget?

4.9 If a budget creates goals or targets that are extremely hard to achieve, would this be good for motivating managers? Provide the reasoning for your answer.

4.10 What are some of the differences between the budgets prepared for a manufacturing organisation and those prepared for a retail organisation that buys and sells completed goods?

4.11 If Lennox Head and Co has projected sales of 25 000 units for the year, has 1000 units in opening stock, and seeks to increase closing stock to 4000 units, how many units does it need to produce in the year?

4.12 If Crescent Head and Co starts the year with 10 000 units that cost \$85 000, produces 100 000 units during the year at a cost of \$900 000, and ends the financial year with 5000 units that cost \$45 000 to produce, then how many units did it sell and what were the costs of sales for the year?

Guide to the online resources

FOR THE INSTRUCTOR

Cengage is pleased to provide you with a selection of resources that will help you prepare your lectures and assessments.
These teaching tools are accessible via cengage.com.au/instructors for Australia or cengage.co.nz/instructors for New Zealand.

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Premium online teaching and learning tools are available on the *MindTap* platform – the personalised eLearning solution.

MindTap is a flexible and easy-to-use platform that helps build student confidence and gives you a clear picture of their progress. We partner with you to ease the transition to digital – we're with you every step of the way.

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MindTap for Craig Deegan's *An Introduction to Accounting: Accountability in Organisations and Society* is full of innovative resources to support critical thinking, and help your students move from memorisation to mastery! Includes:

- Craig Deegan's *Accounting: Accountability in Organisations and Society* eBook
- Videos, a chapter case study, concept clips, revision quizzing, and more.

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SOLUTIONS MANUAL

The **Solutions Manual** provides detailed solutions to every question in the text.

ARMADILLO CASE STUDY

The Armadillo Surf Company is a premium case study, with Introductory video, developed specifically for delivery alongside each chapter of the book.

ARTWORK FROM THE TEXT

Add the digital files of graphs, pictures and flow charts into your course management system, use them in student handouts, or copy them into your lecture presentations.

COGNERO TEST BANK

A bank of questions has been developed in conjunction with the text for creating quizzes, tests and exams for your students. Create multiple test versions in an instant and deliver tests from your LMS, your classroom, or wherever you want using Cognero. Cognero test generator is a flexible online system that allows you to import, edit and manipulate content from the text's test bank or elsewhere, including your own favourite test questions.

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Use the chapter-by-chapter **PowerPoint slides** to enhance your lecture presentations and handouts by reinforcing the key principles of your subject

FOR THE STUDENT

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PREFACE

About this book

The decision to write this book was initiated as a result of a view held by the author, and other colleagues, that existing introductory accounting books do not properly consider the many roles that accounting plays within organisations and the broader society. With this is mind, the author of this book initiated a project within his employer University (RMIT University) to totally revamp how introductory accounting was being taught, particularly within larger 'common core' units. Subsequently, a new approach was trialled at RMIT University with several thousand students, and the overwhelming result was very positive with students and staff being extremely supportive of the new approach taken. The material developed and tested across a number of semesters by the author then formed the foundation for the material included within this book. In generating the material that ultimately was included the author drew on many years of his own research, and the research of others, which explores the roles and impacts of organisations within society, and the responsibilities and accountabilities organisations are perceived as having.

Embracing a much broader view of accounting than is commonly accepted in other introductory books, this book provides insights into the meaning and role of accounting and of accountants in the larger context, and of a changing and interconnected world of people, organisations and the changing planet upon which we live. The concepts of sustainability and social responsibility are embedded across the chapters and – unlike most other accounting texts - not treated as a separate stand-alone consideration of organisations.

This book identifies key ideas and concepts that students need to reflect upon and understand in order to appreciate the role of accounting in society – hence the book goes beyond the 'technical' aspects of accounting. Readers will appreciate accounting's strong influence in organisations and society. Throughout the text many references/links are provided to 'real life' organisations to emphasise that the discussion throughout the chapters can be related to the 'real world'.

This book instils a broad knowledge base that can be returned to throughout an accounting course/program. It provides a necessary foundation for various topics that are studied in an accounting program, including: auditing, financial accounting, external reporting, management accounting, business advising, strategic accounting, and governance and ethics.

The book's structure, content and learning activities provide readers with an understanding of accounting's pervasive and transformative role as a social practice and organisational driver. It will show that environments, ideas, values and so forth change; that the world is interconnected; that the planet is a key resource; and that people are affected/influenced by the information they receive and the way it is presented. It is emphasised that accounting and accountability are key aspects of every person's life and that the practice of accounting, whilst often being seen as very technical in nature, has many social implications. The book shows that rather than being a mundane number-crunching activity, accounting is actually very interesting, vital, thought provoking and, dare we say it … exciting!

How is this book different to other books?

From the very start, we explore the relationship between organisational responsibilities and the associated accountabilities. While the book does include necessary technical material, we do not initially launch into debits and credits, the regulation of accounting, or the definitions of the elements of accounting as is common in many introductory accounting texts. Accounting has a much richer context than this that students need to understand.

The book emphasises the link between the responsibilities accepted by the managers of an organisation and how these responsibilities in turn influence the accepted accountability, which in turn affects the way the 'accounting' is undertaken (and therefore, the 'accounts' that are ultimately produced). Throughout the chapters we utilise an accountability model that emphasises four major issues for consideration/evaluation, these being:

- **Why** is the organisation providing an account?
- **Who** is that account being provided to?
- **What** information is included within the account?
- **How** should that account be presented?

That is, we are adopting a conceptual approach to writing this book – one that is grounded in the notion of 'accountability'. The book encourages students to consider what 'accounts' they believe should be produced in given circumstances and encourages them to reflect upon why and how they would make such judgements.

Established frameworks for financial accounting, social and environmental accounting and management accounting are addressed, and their role in demonstrating organisational accountability explained and assessed.

The intent is to make the material interesting and conceptual in focus, and to show students that accounting is actually a very thought-provoking activity that can be utilised to foster greater accountability and to generate positive financial, social and environmental benefits for organisations and society. Nevertheless, instances are also highlighted where various accounting practices – possibly poorly conceived – have been linked ultimately to various negative outcomes for a variety of 'stakeholders' (that is, at times, particular accounting practices can be implicated in contributing to adverse social and environmental outcomes). By the end of the book students will understand the central role that 'accounting' plays in all of our lives.

Accompanying the book is an innovative online case study. The case study follows an organisation that is initially established by two friends, and which grows into a large company. As students finish reading each chapter, the case study will provide them with additional information about the organisation and will require them to undertake particular tasks that relate to the material covered within the respective chapter. By using one organisation, students will see how the 'accountability' and 'accounting' changes as the organisation itself changes and adapts to different environments with different expectations and accountabilities. The case study is available from your instructor.

How to use this book

The expectation is that each chapter of this book could be studied within a traditional teaching term/semester of around 12 weeks. Further, this book has been written with an expectation that students study the chapters in the order in which they have been presented. As the 'Contents' pages show, we initially address (Chapters 1 and 2) fundamental concepts relating to organisational responsibilities, organisational responsibilities, 'accounting' and the role of 'accountants'. Having set this important foundation, the book then addresses issues necessarily considered in the formative stages of an organisation. Topics explored in Chapters 3 to 5 include an analysis of the roles of managers, the need to understand future 'costs', the use and behavioural implications of budgeting, value chain analysis, lifecycle analysis and tools for planning capital investments.

The book then moves to exploring how to report the result/impacts of the operations. Chapter 6 explores various issues associated with social and environmental performance, and Chapters 7 to 11 explore how to account for the financial performance and financial position of an organisation. Chapter 8 provides a detailed explanation of the use of the double entry system (debits and credits). However, for those instructors who do not want to go into such detail, the balance of the book can be studied without prescribing Chapter 8.

Reflecting the logical flow of the book, the final chapter – Chapter 12 – provides various useful tools for analysing the reports (financial, social, and environmental, sustainability) that organisations release to stakeholders.

ABOUT THE AUTHOR

Craig Deegan, BCom (University of NSW), MCom (Hons) (University of NSW), PhD (University of Queensland), FCA, is Professor of Accounting in the School of Accounting at RMIT University in Melbourne. Craig has taught at both undergraduate and postgraduate level for many years and has supervised 20 PhDs to completion. Prior to working in the university sector Craig worked as a chartered accountant. His research focuses on various social and environmental accountability and financial accounting issues, and has been published in a number of leading international accounting journals, including: *Accounting, Organizations and Society; Accounting and Business Research; Accounting, Accountability and Auditing Journal; Accounting and Finance; British Accounting Review; Critical Perspectives on Accounting; Journal of Business Ethics; Australian Accounting Review; Australian Journal of Management;* and *The International Journal of Accounting*. According to Google Scholar, Craig's work has attracted in excess of 20 000 citations making him one of the most highly cited researchers internationally within the accounting and/or finance literature. On 28 September, 2018, and reflective of the extent to which Craig's research has been relied upon by many researchers and practitioners, the leading national newspaper, *The Australian* (within its annual feature on research) identified Craig as being *Australia's Research Field Leader* in the Field of Accounting and Taxation.

Craig has regularly provided consulting services to corporations, government and industry bodies on issues pertaining to financial accounting, stakeholder engagement and corporate social and environmental accountability. He was former Chairperson of the Triple Bottom Line Issues Group of the Institute of Chartered Accountants in Australia and for many years was involved in developing the CPA Program of CPA Australia, as well as being a judge on the *Australasian Sustainability Reporting Awards*. He is on the editorial board of a number of academic accounting journals and has been the recipient of various teaching and research awards, including teaching prizes sponsored by KPMG, and the Institute of Chartered Accountants in Australia. He was the inaugural recipient of the Peter Brownell Manuscript Award, an annual research award presented by the Accounting and Finance Association of Australia and New Zealand. He was also awarded the University of Southern Queensland Individual Award for Research Excellence.

Craig is also the author of the leading corporate accounting textbook, *Financial Accounting*, now in its ninth edition (McGraw Hill), as well as being the author of the leading financial accounting theory textbook, *Financial Accounting Theory*, now in its fourth edition (McGraw Hill). Both books are widely used throughout Australia as well as in many other countries.

Above all, Craig has a passion for emphasising the role of accounting in providing information about how managers of organisations have, or have not, fulfilled their responsibilities, and accountabilities, to various stakeholder groups. This passion is very well reflected and encapsulated within the contents of this new and very exciting book.

ACKNOWLEDGEMENTS

Throughout the process of preparing this book there were many people who provided valuable input. My early thoughts about the rationale and structure of the book were 'bounced around' with Rob Inglis, my former colleague and regular surfing buddy, who gave some great ideas that helped further shape the content and logic of the book. The Introductory Accounting Team at RMIT University provided many valuable insights. In particular, thanks go to the following members of the team: Paul Myers, Shannon Sidaway, Robert Inglis, Lina Xu and Hui Situ. Thanks also go to Darren Scammell, who was President of Chartered Accountants Australia and New Zealand at the time, as well as to many past and present students at RMIT who, as part of a panel, all provided useful comments on the contents of, and rationale for the book. Many thanks go to Sonia Magdziarz and Shannon Sidaway for reading carefully through each chapter as I completed it and identifying various important issues for further consideration. Their help and generosity of spirit in providing this time-consuming input is very appreciated. It is great to have colleagues like this.

Additional thanks go to Shannon Sidaway for preparing the innovative online case study that accompanies this book.

At a general level, I would like to thank RMIT University, School of Accounting, for providing an environment in which the writing of innovative books like this is encouraged. For a number of years, current and past Heads of the School have been supportive of work that projects the view that accounting is not only a technical practice, but also very much a social practice.

Thanks go to the team at Cengage too. In particular to Geoff Howard who, from our initial discussions, saw the merit of this book, which is unlike any other book on the market. He provided great encouragement and support. Thanks also to James Cole who provided significant and valuable help with regards to the development of the content within the book. Thanks also go to Nathan Katz, Paul Smitz and Debbie Gallagher.

I would like to thank the very many colleagues at other universities (too many to specifically identify) with whom I have discussed this book and who have provided encouragement and advice.

Lastly, I would like to thank my daughter Cassie for being supportive of what her Dad does and providing important love and encouragement. She is by far her Dad's most valuable asset.

MODULE 1

ORGANISATIONS, RESPONSIBILITIES, ACCOUNTABILITY AND ACCOUNTING

CHAPTER 1
What is accounting?

CHAPTER 2
Organisations and their reporting boundaries

CHAPTER 1

WHAT IS ACCOUNTING?

LEARNING OBJECTIVES

After completing this chapter, readers should be able to:

- LO1.1 provide a definition of accounting and explain that the accounting process can provide information about the financial, social and environmental performance of an organisation
- LO1.2 explain the meaning of accountability, as well as the relationship between accounting and accountability
- LO1.3 identify the possible audiences of the accounts generated by accounting, and understand that accounting generates information for use by people both inside and outside an organisation
- LO1.4 explain who does accounting and who might be considered to be an accountant
- LO1.5 describe the qualitative characteristics that accounting information should possess if it is to be useful in allowing different stakeholders to make informed decisions
- LO1.6 describe how we can use the accountability model introduced in this chapter to explain the practice of accounting within different organisations
- LO1.7 explain the evolutionary nature of the accountant's role
- LO1.8 explain why accounting can be considered both a technical and a social practice.

Introduction

It is tempting to accept the narrow definition of accounting that appears in many textbooks. According to this definition, accounting is simply the process of identifying, measuring and then reporting economic information about an organisation, to enable informed decisions to be made by those individuals or groups with a financial stake in that organisation. But in reality, accounting is a much richer, more interesting and exciting process than this! It is a process that continues to evolve as expectations of organisations' responsibilities and, importantly, their accountabilities themselves change. At its most dynamic and influential, accounting generates highly useful information not just about the financial performance of an organisation, but its social and environmental performance as well.

As you read through this chapter, you'll learn about the key ideas that underpin accounting, and more broadly the role of accounting within society. We will emphasise how the various accounts that the managers of an organisation compile internally, and potentially also present to external stakeholders, are influenced by the responsibilities and associated accountabilities that managers believe they have. To help you understand the strong connection between accounting and accountability, as well as the various facets of the practice of accounting, we will introduce a four-stage accountability model, which we will continue to refer to throughout this book.

The practice of accounting is continually developing in response to the various changes occurring within the community, so much so that while accounting can at times be very technical in nature, the use of the various accounts being generated can have a multitude of social effects. Indeed, as you work your way through this book, you'll see that we embrace the perspective that accounting is both a technical and a social practice.

OPENING QUESTIONS

Below are a number of questions that we want you to consider before reading this chapter. We will ask these same questions again at the end of the chapter, in the 'Study tools' section. Each chapter is organised in this manner so that you can assess whether your views have changed, and therefore whether your knowledge has been advanced, as a result of reading the material provided within the chapter. Please spend some time now briefly answering these questions.

1 What aspects of an organisation's performance are measured by accounting?
2 What factors are likely to influence the types of accounts being presented by an organisation?
3 Who are the users of accounting reports?
4 Is accounting likely to be at all interesting?
5 Is accounting really that relevant to many people in society, other than perhaps shareholders (or the owners of an organisation) and managers?

LO1.1 What does 'accounting' mean?

As this is a book about 'accounting', it probably makes sense to begin by being clear about what we mean by the term. At a very broad level, accounting can be defined as a process of collecting, summarising, analysing and communicating information to enable users of that information to make *informed decisions*. It involves the provision of information about aspects of the *performance* of an organisation to a particular group of people with an interest, or stake, in the organisation – we call these parties *stakeholders*.

The above definition makes reference to three key concepts that we shall now discuss:

- informed decisions
- performance
- stakeholders.

Informed decisions

informed decision
A decision based on reliable and relevant information

For somebody to make an **informed decision** in respect to an organisation, they, somewhat obviously, need information. The type of information someone needs will depend upon the decisions they want to make and the expectations they hold about what aspects of performance they believe are important to enable them to make those decisions. Information, if it is reliable and relevant, effectively provides us with the power to make informed decisions (we will consider the issues of relevance and reliability in more detail later in this chapter, when we discuss the qualitative characteristics of accounting information).

Accounting provides various people – inside and outside an organisation – with information to make decisions, and it is the role of the accountant to determine what information is most appropriate to enable those people to make informed decisions. Managers within an organisation, for example, might need information that helps them to understand the profitability of particular product lines, or whether certain products should be expanded or terminated. Or they might need information that enables them to determine whether they have the necessary cash available, or coming into the organisation, to repay additional borrowings. People outside an organisation might need information to determine whether they would want to invest in that organisation, work for it, supply goods to it, or purchase goods or services from it.

performance
The results, impacts, or accomplishments associated with completing a particular task or group of tasks

financial performance
A measure or assessment of an organisation's performance measured in financial terms, perhaps through the use of financial accounting standards

profit
The difference between the total income and total expenses of an organisation for a specified period of time

social performance
The impacts – both positive and negative – that an organisation's activities have on its stakeholders, including employees, customers and the wider community

Performance

In relation to **performance**, issues arise as to what aspects accounting should address. That is, for what aspects of performance should we produce an account in order to allow others to make informed decisions? Broadly speaking, we could categorise performance in three ways: financial performance, social performance and environmental performance (see **Figure 1.1**). Accounting can – and we will argue it should – address aspects of each of these broad performance categories.

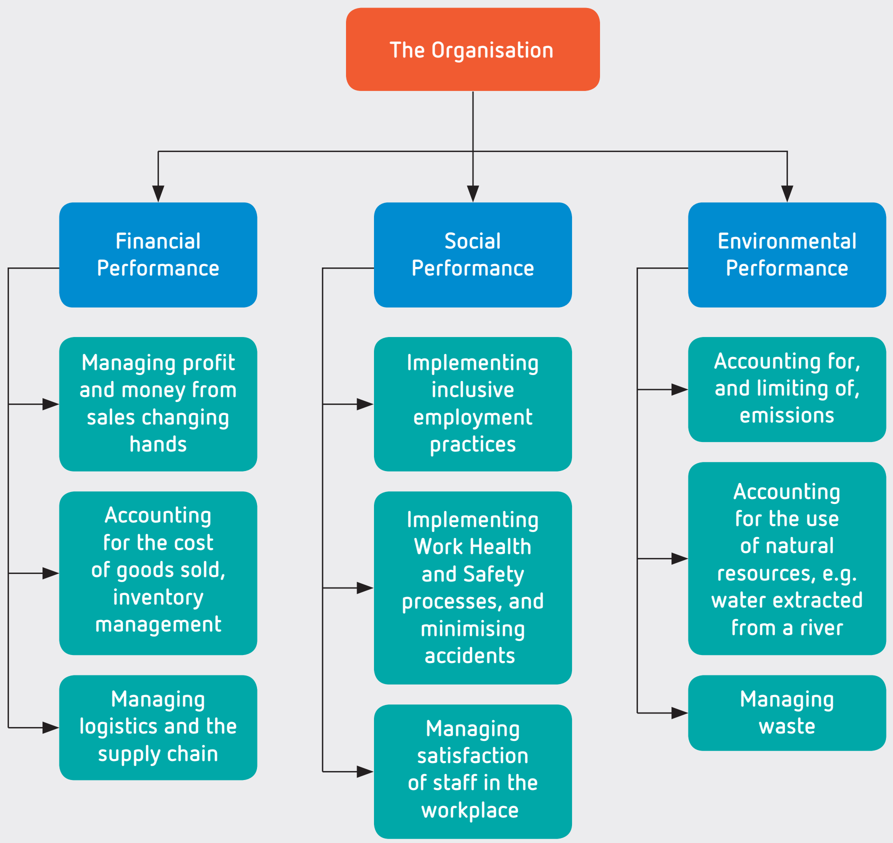
Financial performance

Financial performance can take various forms. For example, an organisation's total sales revenue, total cost of goods sold, total expenses, and **profit** are all measures of financial performance which might indicate how well the organisation is being managed in financial terms.

Social performance

Social performance can also take various forms. For example, the amount and type of training provided to employees, the satisfaction of staff, the satisfaction of customers, initiatives put in place for employees with disabilities, and the number of accidents in the workplace are

FIGURE 1.1 Categories of performance



all measures, or indicators, of the social performance of an organisation. What should be apparent here is that we do not have to measure aspects of performance in financial terms for this to still be considered as 'accounting'. This is an important point. The number of accidents in a workplace is a significant indicator – or 'account' – of how seriously an organisation is taking its occupational health and safety obligations, but this does not need to be presented in financial terms for it to be considered an account, and therefore a product of the accounting process.

Environmental performance

Environmental performance similarly takes various forms. For example, the amount and type of waste being generated, the amount of water being consumed, the amount of greenhouse gases being generated, or the occurrence of chemical spills are all indicators of environmental performance. Again, it needs to be emphasised that these measures do not necessarily need to be measured in financial terms for them to be considered part of an accounting process.

environmental performance
The impacts – positive and negative – that an organisation has on the physical and natural environments in which it operates

A broad perspective of accounting

This book regards accounting as a much broader process than just providing information about the financial (or economic) performance of an organisation, or simply presenting accounts in financial terms. Again, accounting systems can, and arguably should, be put in place to capture various aspects of an organisation's financial, social and environmental performance. So, from the outset, it needs to be appreciated that this book takes a much broader perspective on accounting than that adopted in many other introductory books on the topic, which tend to concentrate primarily on providing measures of financial performance.

For example, the introductory textbook *Accounting: Business Reporting for Decision Making* (Birt et al., 2018, p. 4) defines accounting as the 'process of identifying, measuring and communicating economic information about an entity to a variety of users for decision-making purposes'.

As another example, the accounting textbook *Principles of Financial Accounting* (Weygandt et al., 2018, p. 10) defines accounting as an 'information system that identifies, records and communicates the economic events of an entity to interested users'.

Again, for the purposes of this book, accounting provides information about economic (or financial) performance *as well as* information about social and environmental performance.

Stakeholders

stakeholder
Any group or individual who can affect, or is affected by, the achievement of an organisation's objectives

The other term we can now briefly consider (and to which we will return many times throughout this book) is **stakeholder**. A stakeholder is commonly defined as any group or individual who can affect, or is affected by, the achievement of an organisation's objectives. Therefore, the stakeholders of an organisation could include owners or investors, loan providers, employees, customers, suppliers, government and local communities. Broader definitions of stakeholders would also include the physical environment (including local ecosystems and the various inhabitants therein) and future generations. The question then arises as to which stakeholders (or their representatives or guardians) should be provided with accounts of organisational performance, and what aspects of performance those stakeholders should receive information about.

Please consider how you would answer the questions on this theme in **Learning exercise 1.1**. Note that, throughout this book, many learning exercises will be provided along with their associated solutions. To improve your learning experience, please take some time to consider how you might answer the exercises before reading the solutions that follow.

1.1 Learning Exercise

Stakeholders and their information needs

Different stakeholders have different information needs, but who is entitled to what information, and why? Let's explore a few examples.

Should investors receive information about the financial performance of the organisation they have invested in?

Investors would expect to be provided with enough information to monitor their investment, and hence they have a reasonable right to know about an organisation's financial performance. Further, it might be difficult for an organisation to attract new investors if they are unwilling to provide enough information for those investors to determine if an investment would be worthwhile!

Regardless, in this case, managers and organisations – particularly larger ones – do not have a choice when it comes to providing information about financial performance. In most jurisdictions, there are laws requiring that information about an organisation's financial performance and position be provided to investors.

Should competitors receive information about the organisation's financial performance?
Most managers would probably prefer not to disclose financial information to a competitor because this could result in competitive disadvantage. As managers are not legally required to share this information with competitors, it's sensible to assume that this information would not be disclosed.

Should local residents receive information about the chemicals being released into the air by an organisation operating within their community?
It is reasonable to suggest that local residents have a right to know about the chemicals being released by an organisation in their community. In the absence of regulations that require disclosure, whether or not management elects to provide this information will really be up to the managers' judgement. This will depend on whether they believe they have a responsibility to do so, or whether they believe there is a benefit to the organisation in doing so. Different managers will have different opinions about the responsibility to provide information about environmental performance to local residents.

Should employees be provided with information about how much money is being spent by their organisation on training?
It would also be reasonable to suggest that employees have a right to know about the extent to which their employer is supporting different training initiatives. Again, whether management elects to provide the information will depend upon whether they believe they have a responsibility to do so, or whether there are rules which require them to make such disclosures.

As evidenced by the examples given in Learning exercise 1.1, if there is regulation that specifically requires a certain group (or groups) of stakeholders to receive particular information, then that information will be expected to be disclosed. Matters which are not regulated are disclosed at a manager's discretion.

In the next section, on the relationship between accounting and accountability, we will reflect on when a manager might be expected to be responsible for disclosing information to a stakeholder.

The role of accounting

In respect to the role of accounting, we can now say this:

- Accounting provides information to guide decisions made by people both within (internal to) and outside (external to) the organisation.
- The information that is collected and reported will be influenced by what aspects of performance an organisation's management believes it needs to monitor, control and/or

improve, as well as what aspects of performance it believes it needs to disclose to people outside the organisation.

- Accounting provides the mechanism by which organisations can inform the relevant stakeholders about the extent to which the actions for which an organisation is deemed to be responsible have actually been fulfilled.
- Reporting provides a vehicle for an organisation to be accountable to various stakeholders, and the accounts being reported do not all have to be prepared in financial terms.

We will now consider the relationship between judgements about an organisation's responsibilities and its accountabilities, and how this in turn has implications for the accounts that an organisation will ultimately prepare and present. What shall be explained is that a manager's perceptions of the extent and nature of organisational accountability will influence what aspects of performance are measured and reported.

LO1.2 The relationship between accounting and accountability

accounts
Written records detailing an organisation's performance in relation to a specific aspect of performance

creditors
External parties to whom an organisation (or individual) owes a debt, often in relation to goods or services provided to the organisation on credit terms

The nature of the **accounts** (or reports) produced by an organisation, and the individuals or groups who will be given access to those accounts, will be influenced by judgements concerning an organisation's responsibilities and its associated accountabilities. For example, if we were to embrace the view that an organisation is only responsible for its financial performance, and that this responsibility is restricted to owners (shareholders) and loan providers (and other **creditors**), then organisations might decide to only produce financial accounts, and those accounts would only be distributed to owners and creditors. This would be considered a very restricted, or narrow, view of accountability.

By contrast, if an organisation's managers believe that they are also responsible for the organisation's social and environmental performance, and that this responsibility is extended to all affected stakeholders, then such an organisation will also produce various social and environmental accounts (as well as financial accounts) and will generally not restrict access to such accounts (for example, they might make the information available on their website). This would represent a broader view of accountability.

Some clothing companies, for example, will collect and disclose detailed information about where their clothes are being sourced, and what actions are being taken to ensure that the factories supplying the garments are providing a safe and healthy environment for employees. This could be in the absence of any regulations that require them to provide such accounts. By contrast, other clothing companies might disclose very little information. The managers of the organisations disclosing the detailed information have likely embraced the view that it is their responsibility to be accountable for the health and safety of employees in their

Source: Shutterstock.com/humphery

If a large multinational is buying some of its products from this factory, then should that multinational make publicly available accounts about how the factory's employees are being treated?

supply chain, whereas the managers of the other organisations might not have accepted such a responsibility and hence might disclose little information.

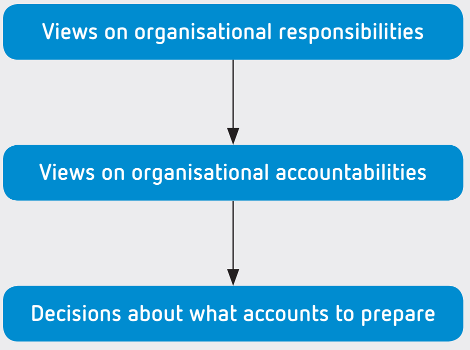
As another example, a decade or two ago it would have been very unusual for an organisation to collect and publicly disclose information about its emissions of greenhouse gases, which are known to contribute to climate change. However, as global concern about climate change has increased, it is now quite common for organisations – particularly large ones in carbon-intensive industries – to disclose information about their emissions, as well as the initiatives being undertaken to reduce them.

Source: Shutterstock.com/Milos Muller

Who is accountable for these emissions?

When it comes to the question of what accounts *should* be prepared, it really is a matter of opinion. Often, there is not one absolutely right answer. Nevertheless, there is a direct relationship between the responsibilities (or duties) that managers believe their organisation has, and the accepted accountabilities. The argument is that, if the managers of an organisation accept a responsibility to particular stakeholders for certain aspects of performance, then they also accept that those stakeholders have a right to information about those aspects of the organisation's performance. This is diagrammatically represented in **Figure 1.2**.

FIGURE 1.2 The relationship between responsibility, accountability and accounts



What do we mean by accountability?

A useful definition of **accountability** is provided by Gray, Adams and Owen (2014, p. 50): 'The duty to provide an account or reckoning of those actions for which one is held responsible'.

Again, we can see from the above definition that there is a direct linkage between perceptions of responsibilities, or duties, and the provision of accounts. Gray, Adams and Owen (2014) also emphasise that accountability involves two key responsibilities or duties:

1 to undertake certain actions (or to refrain from taking actions) in accordance with the expectations of a group of stakeholders
2 to provide a reckoning, or account, of those actions to the stakeholders.

accountability
The duty to provide an account of those actions for which an organisation is deemed to be responsible. The accounts can take a variety of forms and would be provided to those stakeholders most affected by the activities of the organisation