

ACCOUNTING

INFORMATION FOR BUSINESS DECISIONS

Billie M Cunningham

Loren A Nikolai

John D Bazley

Marie Kavanagh

Sharelle Simmons

Christina James



4TH EDITION

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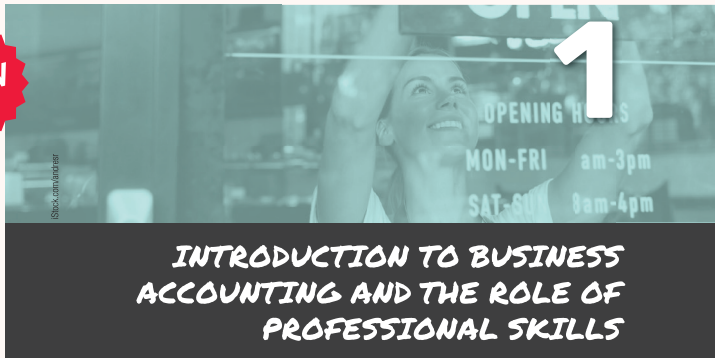
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Guide to the text

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

NEW



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

Thomas J Watson Sr*

Learning objectives

After reading this chapter, students should be able to do the following:

- 1.1 Have an understanding of business, and the skills and knowledge required for success in a complex business environment.
- 1.2 Explain the categories of business.
- 1.3 Know the three common business structures and the regulations faced by each.
- 1.4 Outline how accounting systems play a role in providing information to enable informed business decisions.

Key questions

- 1 Why is it necessary to have an understanding of business before trying to learn about accounting?
- 2 What factors are affecting the complexity of a changing business environment?
- 3 What are three characteristics that someone might require to become a successful businessperson in a complex business environment?
- 4 What are the three main categories of business enterprise?
- 5 What are the three most common forms of business organisation and their basic characteristics?
- 6 What types of regulations do businesses face?
- 7 What information does the accounting system provide to support management activities?
- 8 How does accounting provide support and information to people who are external to the business when they are making decisions?
- 9 What roles do ethics and sustainability play in the business environment?
- 10 What skills are required from accountants of the twenty-first century?
- 11 How can people learn to think critically?
- 12 How can critical thinking help people to make better business decisions?
- 13 What are the logical stages in problem solving and decision making?

Although, in this scenario, you were directly involved with five businesses, you were also probably affected by hundreds of others. For example, two different businesses manufactured the calculator you purchased from the bookshop and the coffee you purchased from Café Revive. Suppose DeFlava Coffee Corporation roasted and ground the coffee beans used in the cappuccino you purchased. As we illustrate in **Case Exhibit 1.1**, DeFlava purchased the ingredients from other businesses (suppliers). Each supplier provided DeFlava with particular goods. Shipping businesses (carriers) moved the goods from the suppliers' warehouses to DeFlava's factory, where the coffee beans were roasted and ground. A different carrier then moved the coffee from the factory to DeFlava's outlets, such as Café Revive.

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

Identify the key concepts you will engage with through the **Learning objectives** at the start of each chapter.

Enhance your understanding of the learning objectives by answering the accompanying **key questions**.

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

FEATURES WITHIN CHAPTERS

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

Stop & think



With reference to the three most common forms of business organisation and their basic characteristics, what sort of business do you think Café Revive is? What sort of business do you think DeFlava Coffee is? Why?

Challenge the theory you have learnt by considering the **Discussion questions**, perhaps in a group discussion.

Discussion



Have you ever shared the purchase and use of an item with someone? Maybe you share a computer or an apartment. How do you decide how much money each person contributes? How do you split the costs of software, rent or insurance?

Explore the real-world ethical and environmental issues faced by businesses in the **Business issues and values** boxes.

Business issues and values: a billion here, a billion there



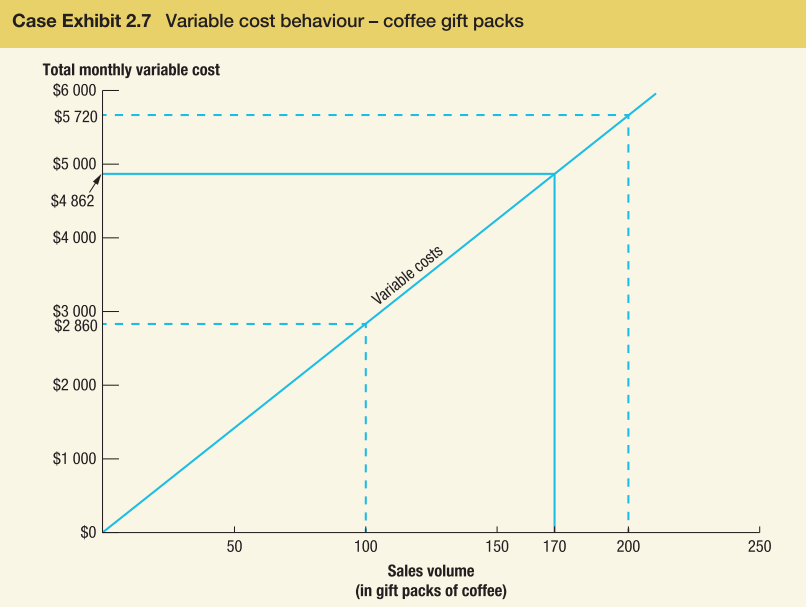
In one year, US fund manager [Fidelity Investments](http://www.fidelity.com.au) (<http://www.fidelity.com.au>) estimated that it would make a year-end distribution of \$4.32 per share to shareholders in its Magellan Fund. But the company then admitted to an error. Included in a letter sent to shareholders was the following statement: ‘the error occurred when the accountant omitted the minus sign on a net capital loss of \$1.3 billion and incorrectly treated it as a net capital gain on [a] separate spreadsheet. This meant that the dividend estimate spreadsheet was off by \$2.6 billion.’^b The error had no effect on the fund’s results or on the shareholders’ taxes, but was clearly an embarrassment to the company’s management!



Ethics and sustainability

Analyse in-depth **Cases** that present issues in context, encouraging you to integrate the concepts discussed in the chapter and apply them to the workplace.

Important **Key terms** are marked in bold in the text and **defined in the margin** when they are used for the first



FEATURES WITHIN CHAPTERS

Important **Key terms** are marked in bold in the text and **defined in the margin** when they are used for the first time. A full list of key terms is also available in the **glossary**.

A **manufacturing business** makes products and then sells these products to their customers. Therefore, a basic difference between merchandising businesses and manufacturing businesses involves the products that they sell. Merchandising businesses *buy* products that are physically ready for sale and then sell these products to their customers, whereas manufacturing businesses *make* their products first and then sell the products to their customers. For example, the university café is a merchandising business that uses the coffee it purchased from DeFlava, a manufacturing business. The DeFlava factory, though, purchases (from

manufacturing business
A business that makes its products and then sells these products to its customers



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

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 objectives.

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

Summary

1.1 Have an understanding of business, and the skills and knowledge required for success in a complex business environment.

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

Accounting involves identifying, measuring, recording, summarising and communicating economic information about a business for decision making. It focuses on the resources and activities of businesses. Therefore, it is important to understand businesses and the business environment in which they exist before trying to learn how to account for their resources and activities.

2 What factors are affecting the complexity of a changing business environment?

The business environment is dynamic and is becoming increasingly complex. More information is being generated than ever before, and this information is available to more people than ever before. Technology is advancing rapidly, affecting not only the products we use but also the ways in which products are manufactured and business is conducted. Business activities and economies are becoming globalised, the number of regulations is escalating, business transactions are becoming more complex and new forms of business are emerging.

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

Integrated business and accounting situations

Answer the following questions in your own words.

Testing your knowledge

- 2-1 Since the future is uncertain and circumstances are likely to change, why should the managers and owners of a business bother to plan?
- 2-2 How are 'risk' and 'return' each defined? Do you think there is a relationship between them?
- 2-3 Describe the three main functions of a business plan.

Applying your knowledge

- 2-20 Imagine that you are going to start your own business. Think about the concept for a minute.
Required:
What will you call your business? What kind of product or service will you sell? What price will you charge for your product(s) or service? Why? What variable costs and what fixed costs do you think you will incur?
- 2-21 Suppose you want to start a business that sells sports equipment.
Required:
Go to the reference section of your library or use internet resources. What type of information can you find through [Moody's](#) or [Standard & Poor's](#) to help you prepare projected financial statements for your business?

Making evaluations

- 2-47 Suppose your wealthy aunt gave you and your cousins \$10 000 each. Assume for a moment that you are not associated with Café Revive, and that you are considering loaning the \$10 000 to Café Revive.
Required:
From the information included in Café Revive's business plan so far, do you think this would be a wise investment on your part? Why or why not? What else would you like to know before making a decision? (You don't have to limit your thinking to Café Revive.)

END-OF-CHAPTER FEATURES

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

Online research activity

This activity provides an opportunity to gather information online about real-world issues related to the topics in this chapter. For suggestions on how to navigate various businesses' websites to find their financial statements and other information, see the related discussion in the Preface.

- ◆ Go to <http://www.business.gov.au>. What is the aim of this website? What types of loans or grants are available? How do you get access to these funds?
- ◆ Go to <http://www.business.gov.au>. Investigate the starting a business guide. What key decisions are suggested? How is it suggested that you plan for success? How do these compare with what we discussed in this chapter?
- ◆ Go to <https://www.business.gov.au/assistance/entrepreneurs-programme>. What are the four elements of support for businesses mentioned?

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

Dr Decisive

Yesterday, you received the following letter for your advice column at the local paper:

Dear Dr Decisive,

What do you think about this situation? My boyfriend refuses to meet me for lunch until I admit I am wrong about this, which I'm not. The other day, when we went to lunch at the Pizza Place, a restaurant on campus, he noticed that they had raised the price of Hawaiian pizzas. He got mad because he thinks the only reason they raised the price was to increase their profit. I told him that, first of all, their profit might not increase. And second, he was basing his conclusion on some assumptions that might not be true, and if he would just open up his mind, he might see how those assumptions were affecting his conclusion. Well, then he got mad at me. I'm really upset because I know I'm right and because now I have to buy my own lunch. Will you please explain why I'm right? I know he'll listen to you (he reads your column daily). Until you answer, I'll be ...

'Starving'



Required:

Meet with your Dr Decisive team and write a response to 'Starving'.

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.

MINDTAP

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MindTap for Accounting: Information for Business Decisions is full of innovative resources to support critical thinking, and help your students move from memorisation to mastery! Includes:

- Accounting: Information for Business Decisions eBook
- 'Dr Decisive' polling activities
- Revision quizzes
- Videos

MindTap is a premium purchasable eLearning tool. Contact your Cengage learning consultant to find out how *MindTap* can transform your course.



SOLUTIONS MANUAL

The **Solutions manual** provides detailed answers to every question in the text.

COGNERO® TEST BANK

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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.

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

CASES

Analyse in-depth **Cases** that present issues in context, encouraging you to integrate the concepts discussed in the chapter and apply them to the workplace

FOR THE STUDENT

MINDTAP

MindTap is the next-level online learning tool that helps you get better grades!

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PREFACE

For students

There is a saying that ‘knowledge is power’, and in business and our own personal lives this is true. Those who have knowledge hold a competitive advantage over those who don’t. Those who understand business information, and know how to interpret and use it, make the best business decisions. Furthermore, what we know continually evolves as new information and ideas emerge through media and technology. Change is a very exciting and necessary component of our business life.

Financial reports, generated by the accounting system of a business, are a major source of business information for both business and personal use. When reading these reports, you must evaluate the information they contain by looking for supporting evidence, assumptions and bias, and by considering other points of view. Furthermore, you must know how to *interpret* the information contained in these reports and be able to analyse and project future change and growth to manage sustainability of your business or your own personal finances. To do this, you must understand how a business’s accounting system develops these reports, and what concepts, principles and assumptions underlie the accounting process used to produce the information in these reports. With this in mind, we designed this book to address these issues.

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

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

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

We hope you find this book interesting and easy to read, and that the examples based around coffee add relevance to your accounting experience! We also hope you find the book useful not only by increasing your personal capacity to manage financially through an appreciation of the power of being financially literate, but also by enhancing your ability as a business professional now and in the future.



For educators

Caution – hot contents

This textbook has a number of themes that revolve around coffee, and this preface is no exception. As well as the brew of all the classic accounting topics that you will need, this book also percolates a blend of a number of phrases and terms well known to coffee lovers (and we know that includes accountants!). We hope that this preface serves as an enticing aroma, that once inhaled, draws you to take measured sips from the chapters beyond, guiding your students to extract knowledge along the way.

Two great ingredients that brew one great text

In the real world, today's students face an accounting environment where management accounting and financial accounting issues are integrated and inter-related every day. Modern textbooks need to emphasise accounting information as a basis for general business decisions, maintain students' interest through relevant case scenarios, and dispense with the perception that accounting is best left solely to accountants. In fact, financial literacy skills are life skills that we all need.

This textbook integrates management accounting and financial accounting topics in a way that is more reflective of the world the students in your first year accounting class will face outside of the classroom.

Sometimes you feel like a debit, sometimes you don't

A major focus of this textbook is about understanding and applying information in various business settings. We wrote this book at a non-technical level for all business and non-business students – not just those intending to be accounting majors. Because all of the authors are heavily involved in teaching first, second and third level accounting, we are aware of the needs of your accounting majors. So we discuss recording, storing and reporting accounting information.

We begin with a non-procedural approach to explain transactions in terms of the accounting equation (with entries into account columns) to illustrate the effect of these transactions on the financial statements. In Chapter 5 we discuss the rules for double entry and cover the accounting cycle, from journal entries (using debits and credits) through the post-closing trial balance. We designed it so that you may use it in as much depth as you see fit in the process of teaching from this book. Accounting majors who have used this elementary accounting text are well prepared to enter second and third level accounting classes. For non-accounting students they will have a basic understanding of the process behind the financial reports produced by accounting systems.

The house roast (the approach of this text)

An introduction to business approach

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

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

Professional skills

Another unique feature of this book is the introduction it gives students to professional skills such as critical thinking, and demonstrates how they are used in decision making and problem solving. This book emphasises the type of analytical and critical thinking that successful accountants and other business people use in a world that is constantly changing and increasing in complexity.

'Stop questions' throughout the textbook ask students to take a break from reading to think about an issue and/or consider the outcome of a situation. We also ask them why they think what they think. The end-of-chapter materials include both structured and unstructured questions and problems that strengthen students' problem-solving capabilities by emphasizing the use of reflective and critical thinking skills. Therefore, some of the questions and problems do not have a 'correct' answer; rather the focus is on the approach or process that students use to solve them.

With the increasing complexity of business activities, the inclusion of critical thinking materials better prepares students to understand the substantive issues involved in new or unusual business practices, and guides them to understand that today's accountants need to 'think outside the box'.

New 'Sustainability' icons draw attention to sections that discuss environmental and ethical issues and how they relate to students' understanding of triple bottom line accounting.

First things first

The chapters are designed to reflect actual practice in that a business must plan and understand its activities before it communicates its plans to external users, and it must perform and evaluate its operations (internal decision making) before it communicates the results of its operations to external users. Therefore, in keeping with the 'introduction to business' theme and the logical sequencing of business activities, we discuss accounting for planning first, and then operating and evaluating (controlling) – discussing management accounting and financial accounting where they logically fit into this framework.

For instance, Chapter 2 covers cost–profit–volume (CVP) analysis for planning purposes. After students have an understanding of cost and revenue relationships, we introduce them to budgeting in Chapter 3. The discussion of the master budget includes projected financial statements, which links the coverage back to the financial statements in Chapter 1. Chapter 4 then introduces accounting for the operations of a business. Chapters 7 to 9 describe a business' major financial statements, and discuss how internal and external users would use these statements to analysis the business. Chapters 1, 10 and 11 evaluate results and use short and long term financing and investment tools to plan for sustainable growth of the business.

Factors affecting a business and its reputation such as sustainable practice and business ethics are highlighted throughout the chapters. This approach reinforces the idea that societal, environmental and global issues are not topics that can or should be dealt with separately from the other issues, but rather are an integral and significant part of business in a world where immediate access to information is available.



The simpler things

Earlier we mentioned a ‘non-technical’ approach. Although we explain identifying, measuring, recording and reporting of economic information, we discuss these activities at a basic level in Chapter 4 (increases and decreases in account balances) and do not include a discussion of debit and credit rules and journal entries in the main body of the text.

We use account columns to record transactions, but we explain the increases or decreases in relation to the accounting equation ($\text{Assets} = \text{Liabilities} + \text{Owners' equity}$), rather than as debits and credits. At the same time, we also emphasise the effects of the transactions on a business’ financial statements and the impact they have on analysis of the business, for example its risk, liquidity, financial flexibility, and operating capability. We chose this approach to better help students gain an understanding of the logic of the accounting system and its interrelationships, the effects of transactions on a business’s financial statements, and the use of accounting information in decision making without getting ‘bogged down’ in the mechanics of the system.

For those wanting to incorporate the mechanics of the system we do provide thorough coverage of the double entry system, through the use of the accounting equation and its linkage to the income equation ($\text{Income} = \text{Revenues} - \text{Expenses}$), as well as the complete accounting cycle in Chapter 5.

Short black or cappuccino with extra foam (a scaffolded approach)

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

Likewise, we use a scaffolded approach to arranging the end-of-chapter materials according to levels of learning. To indicate these levels, we have divided these materials into sections on *Testing your knowledge*, *Applying your knowledge*, and *Making evaluations*. These categories are arranged so that the answers to questions require students to use increasingly higher-order thinking skills as they move from one category of question to the next.

- The *Testing your knowledge* section includes questions that test students’ knowledge of specifics – terminology, specific facts, concepts and principles, classifications, and so forth.
- The *Applying your knowledge* section includes questions, problems, and situations that test students’ abilities to translate, interpret, extrapolate and apply their knowledge.

- The *Making evaluations* section includes questions, problems, and cases that not only test students' abilities to apply their knowledge but also their abilities to analysis elements, relationships and principles, to synthesise a variety of information, and to make judgments based on evidence and accounting criteria.

New and improved flavour

In this new edition, and as a result of our own use of the book and feedback from other users, we have further developed the key features of the textbook including:

- 1 The opportunity for students to experience what it is like to start up, run, and grow a small business as they assist Emily Della to operate and make decisions about her business, Café Revive. Each chapter scaffolds knowledge about financial records and reports of the business and the decision-making processes that flow from evaluation of the results. Students assist Emily to plan, operate and evaluate the business as though it was their own.
- 2 Issues and real-life examples relating to ethical issues in triple bottom line accounting have been woven into this new edition. The sustainability theme that runs through the text is another key feature that differentiates it from other introductory accounting texts.
- 3 Chapter 10 has been specifically designed to give students a taste of the impact of environmental and energy issues on business, and how to record and manage them. It also broadens their perspectives by introducing them to the Global Reporting Initiative (GRI) to make them truly aware of the knowledge and skills they will need in the global business arena.
- 4 This edition of the text highlights the importance of developing a range of skills other than technical skills, such as judgement, critical thinking, ethical and sustainability skills, self-management and teamwork using activities throughout each chapter, the end-of-chapter materials and case studies.
- 5 We moved some topics to chapter appendices to keep them available to those who wish to teach them, including periodic and perpetual inventory.
- 6 We have revised 'real' business examples in the text, and have updated the 'real' business problems in the end-of-chapter materials.

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

Real-world/worldwide/total world

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

Students will navigate to various sections of a business's website such as pages titled: About Us, Business Information, Investors, Investor Information, Financial Statements, Annual Reports and other financial information. They will be able to read about real world businesses and their activities for each financial year.

Navigating to the financial information of an organisation, such as the CPA, can follow a less logical path and may involve more trial and error.

Orientation of the Book

In the rapidly changing business environment, the businessperson must interpret, evaluate, synthesise and apply new information and technology. With this new information and technology come new problems, many of which have several reasonable solutions and many of which may not have obvious solutions, or in fact any solutions at all. In this environment, businesspeople and accountants are not operating in a 'textbook world' where there are clearcut, right-and-wrong answers, and where the relevant facts for making decisions are neatly laid out. Therefore, to help you prepare for this challenging environment, throughout this book we will illustrate the use of critical thinking and judgement skills for solving accounting-related problems. Then, in the 'Integrated business and accounting situations' at the end of each chapter, we will give you the opportunity to enhance your own thinking and judgement skills.

In addition to solving problems that have specific 'correct' solutions, we will ask you to make decisions and to solve problems that may have several reasonable solutions or obscure solutions. We will also ask you to interpret, evaluate and synthesise information, and to apply new information to new and different situations.



Framework of the Book

Now that you have been introduced to business and accounting, and to the skills required to be a good business manager or accountant in a global business environment, it is time to begin a more in-depth study of the use of accounting information in the business environment. Beginning in Chapter 2, we will discuss in more depth accounting and its use in the management activities of planning, operating and evaluating, starting with a simple business. In later chapters, we will progress through more complex businesses. We will also discuss the use of accounting by decision makers outside the business.

As you read through the book, you will begin to notice that the same topics re-emerge, but each time a topic recurs, it is refined or enhanced by a different business structure, a different type of business or a different user perspective. You will also notice that we frequently discuss ethical and sustainability considerations. That is because these considerations exist in all aspects of business and accounting. By constantly practising critical thinking, judgement and problem solving, you will also be developing self-management skills.

You will also notice that international issues appear again and again. Many businesses operating in Australia and New Zealand have home offices, branches and subsidiaries in other countries, or simply trade with businesses in foreign countries. Managers must know the implications of conducting business in foreign countries and with foreign businesses. External users of accounting information must also know the effects of these business connections.



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Marie is an active member of several NFP Boards and remains a member of the Accounting Education Special Interest Group for the Accounting and Finance Association of Australia and New Zealand (AFAANZ) after chairing that group for 10 years. She has been engaged for 18 years as an academic advisor for Enactus (Entrepreneurship and Action through Us) Australia working with teams of students from several universities to deliver relevant entrepreneurial projects in their communities. She has won individual and national team awards for Contribution to Student Learning and Student Support. She is a Fellow of the Business Educators Association of Queensland and an active member of local Chambers of Commerce, and delivers community outreach projects that develop financial literacy skills in young people.

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INTRODUCTION TO BUSINESS ACCOUNTING AND THE ROLE OF PROFESSIONAL SKILLS

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

Thomas J Watson Sr^a

Learning objectives

After reading this chapter, students should be able to do the following:

- 1.1** Have an understanding of business, and the skills and knowledge required for success in a complex business environment.
- 1.2** Explain the categories of business.
- 1.3** Know the three common business structures and the regulations faced by each.
- 1.4** Outline how accounting systems play a role in providing information to enable informed business decisions.
- 1.5** Understand how ethics and sustainability impact business outcomes.
- 1.6** Discuss the skills required by accountants and those involved in business to solve problems and make decisions.

Understanding the learning objectives is assisted in the chapter by asking key questions:

Key questions

- 1 Why is it necessary to have an understanding of business before trying to learn about accounting?
- 2 What factors are affecting the complexity of a changing business environment?
- 3 What are three characteristics that someone might require to become a successful businessperson in a complex business environment?
- 4 What are the three main categories of business enterprise?
- 5 What are the three most common forms of business organisation and their basic characteristics?
- 6 What types of regulations do businesses face?
- 7 What information does the accounting system provide to support management activities?
- 8 How does accounting provide support and information to people who are external to the business when they are making decisions?
- 9 What roles do ethics and sustainability play in the business environment?
- 10 What skills are required from accountants of the twenty-first century?
- 11 How can people learn to think critically?
- 12 How can critical thinking help people to make better business decisions?
- 13 What are the logical stages in problem solving and decision making?

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

Business affects almost every aspect of our lives. Think for a moment about your normal daily activities. How many businesses do you usually encounter? How many did you directly encounter today? Suppose you started the day with a quick trip to the local convenience store for milk and eggs. While you were out, you noticed that your car was low on petrol so you stopped at the local petrol station. On the way to class, you dropped off some clothes at the dry-cleaners. After your first class, you skipped lunch so that you could go to the bookshop and buy the calculator you needed; then, after buying a cappuccino from Café Revive to keep yourself awake in lectures, you headed to your next class. In just half a day, you have already interacted with five businesses – the convenience store, the petrol station, the drycleaners, the bookshop and the campus café. You have also managed your own personal financial requirements – that is, had enough money to pay for these things.

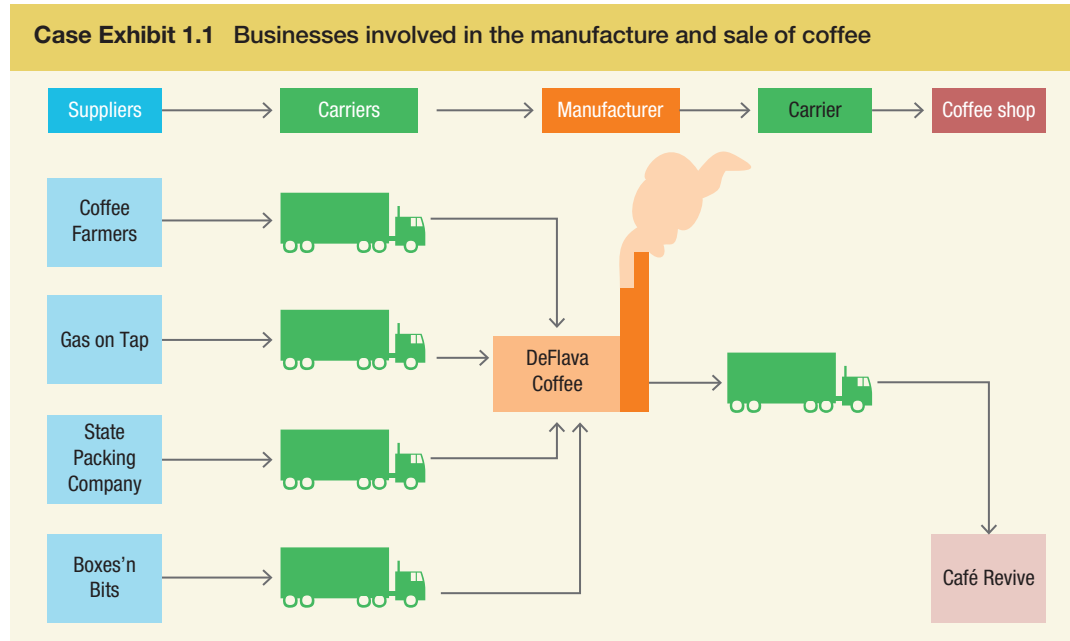
Discussion

Do you view your university as a business? Why or why not?



Although, in this scenario, you were directly involved with five businesses, you were also probably affected by hundreds of others. For example, two different businesses manufactured the calculator you purchased from the bookshop and the coffee you purchased from Café Revive. Suppose DeFlava Coffee Corporation roasted and ground the coffee beans used in the cappuccino you purchased. As we illustrate in **Case Exhibit 1.1**, DeFlava purchased the ingredients from other businesses (suppliers). Each supplier provided DeFlava with particular goods. Shipping businesses (carriers) moved the goods from the suppliers' warehouses to DeFlava's factory, where the coffee beans were roasted and ground. A different carrier then moved the coffee from the factory to DeFlava's outlets, such as Café Revive.

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



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

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

Stop & think



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

In this chapter, we will introduce you to accounting by first looking at different forms of business enterprise and the environments within which they operate. Regulatory issues associated with forming, operating and reporting on the activities of a business, and the role of ethics and sustainability in the management of a business, are discussed. We will highlight the need to understand the language of business in order to develop and apply business knowledge and build a range of skills to enable you to practise professionally in business. The role that accounting information plays in problem solving, making judgements and decision making within a business will be outlined.

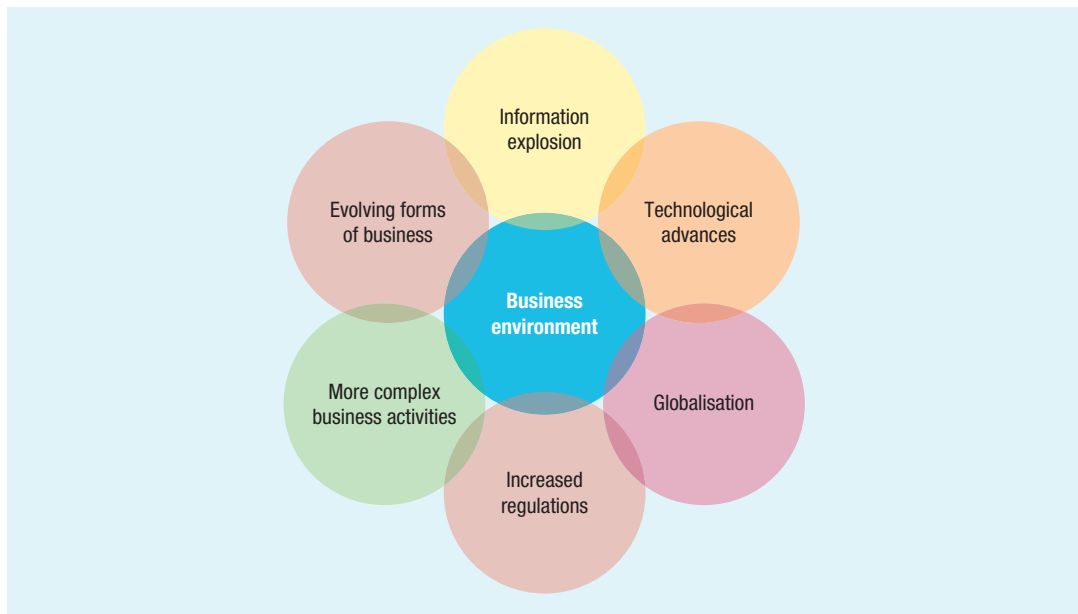


What factors are affecting the complexity of a changing business environment?

1.1 Factors affecting the complexity of a changing business environment

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

Exhibit 1.2 Factors affecting the complexity of the business environment



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

Consider how technological advances have affected the transmission and sharing of information. Most businesspeople have adapted their workday habits to include the use of smartphones, text messaging, web conferences or online meetings using Zoom, and Skype or WhatsApp for conducting business online. Email, SMS, scanners and online data-drop boxes for sharing documents facilitate information transmission to and from multiple global sites. Huge databases, such as airline flight schedules and rate structures, are now stored online and accessed by millions of users around the world every day. The impact of social media has changed the ways firms communicate and involve their clients and customers using Facebook and other social media. All these developments have made the world more competitive. Businesses and individuals who in the past had difficulty travelling or communicating internationally (perhaps because the infrastructures of their countries could not accommodate their needs) have enthusiastically ‘thrown their hats in the ring’.

Technological advances have affected not only the products we use and the way business is conducted but also how products are manufactured. For example, advanced technologies have allowed the production process in many businesses to become fully automated. In many modern factories, computers are used to plan, operate and monitor manufacturing processes, and to make adjustments to these as

needed. Robots are now common workers on many production lines. Apps are now a popular means of capturing customer or client interest, securing business and delivering goods or services.

The *globalisation* of business activities and economies is providing more opportunities for businesses and individuals to conduct business by creating a larger, more diverse marketplace. At the same time, it is providing new business challenges. For example, when businesses begin to sell or source their products in other countries, they must translate their product names and advertising slogans into different languages. This is not as straightforward as it might first appear to be. Consider the dilemma [KFC](http://www.kfc.com.au) (<http://www.kfc.com.au>) faced when it tried to translate its slogan ‘finger-lickin’ good’ into Taiwanese: the literal translation was ‘Eat your fingers off.’^b Globalisation also means that pandemics like COVID-19 impact businesses all over the world.

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

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

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

Businesses also need to factor in the effect that climate change is having, and monitor the impact of business activities on greenhouse gas emissions. Businesses need to consider disclosure frameworks so as to keep their stakeholders informed about physical risks to the business associated with climate change, and details of any compliance obligations – for example, in Australia those dictated by the National Greenhouse and Energy Reporting Scheme introduced in 2007, and amended in 2017. In November 2019, the New Zealand Government passed the Climate Change Response (Zero Carbon) Amendment Bill to establish historic climate change laws. Similarly, in 2019 the Australian environment and climate change legislation was introduced.

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

This book uses alphabetic endnotes to denote reference material related to the discussion. Find the corresponding references at the end of the chapter.



Machines at work in an automated factory.

Getty Images/Monty Rakusen

e-commerce
A method of conducting business where companies and consumers buy and sell goods and services online



Ethics and Sustainability

Discussion



Has social media improved the way we conduct business? Give examples.

The successful businessperson

The factors discussed above not only contribute to the complexity and excitement of the business environment, but also challenge the assumptions on which businesses and their employees operate. For example, the assumption that a university graduate will go out into the world, pursue a lifelong career and never return to university is no longer valid. Many people now change careers – careers, not just jobs! –



What are three characteristics that someone might require to become a successful businessperson in a complex business environment?

several times before they retire. People live and work longer. Often, in order to make a change, they return to study between careers to 'retool' or expand their education to learn new skills. Even people who stay in the same career expand their education (through continuing professional education, short courses, conferences and seminars) in order to improve their knowledge and abilities.

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

Adapting to change

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

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

Stop & think



What qualities can people develop to better prepare themselves for problem solving and decision making in today's rapidly changing business environment?

To be able to adapt to change (or 'go with the flow'), the successful businessperson also needs to develop certain other qualities. They welcome others' viewpoints, appreciate differences among people, take educated and thoughtful risks, anticipate environmental trends – and identify the potential problems and opportunities associated with these trends – and willingly abandon old plans to pivot their business if new information, circumstances or technology makes existing methods less workable. This does not mean that the successful businessperson is a chameleon, changing colour every time the business environment changes, but it does mean that they are flexible and adaptable. In addition, the successful businessperson must understand the language of business as discussed in the next section and, more importantly, be able to develop a business plan to guide the operations and direction of their business.

The language of business

To be successful in business, you must also understand the language of business. For example, what is a 'transaction', or what does it mean when a car 'depreciates'? How do you know if a business is 'solvent'? For many people, the concepts and terminology of business are not part of their normal vocabulary. When you begin to study your first course in business, you will be engaged with many new words and terms. In some ways, learning the language of business can be compared with learning a foreign language.

Accounting and financial concepts may be alien to you. Still, the ability to understand and communicate financial information is critical not only to every entrepreneur and those engaged in business but to all of us, as a personal skill that allows us to survive our own financial journey through life. For example, if we borrow money to buy textbooks or a bigger asset such as a house, we become aware of the word 'debt'. Every debt we have, we will need to pay back. So communication among owners, managers and investors is essential. Accounting fills the need for a common language of business. It records and processes financial information into an easily accessible format that can be understood by any person in the business world. Many people's

first encounter with accounting might be completing and submitting a tax return. Accounting is what accountants or certified public accountants (CPAs) do to prepare your taxes. Bookkeeping is what bookkeepers or business owners do to keep your business running smoothly. Bookkeeping is made up of two things: (1) payables – that is, paying bills, and paying your employees, contractors and yourself; and (2) receivables – that is, sending invoices to people who owe you money (debtors or accounts receivable) and making sure your invoices get paid. You can add to it things like categorising income and/or expenses to see how you're spending money and how you're making money. Underpinning all these activities is the need to manage and monitor cash flow. Regardless, as you progress through this text, you will encounter and become familiar with many new terms as your business vocabulary grows.

1.2 Business enterprise categories

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

Service businesses

A **service business** performs services or activities that benefit individuals or business customers. The dry-cleaning establishment where you dropped off your clothes this provides the service of cleaning and pressing your clothes for you. Businesses like [Stefan Hair Fashions](http://www.stefan.com.au) (<http://www.stefan.com.au>), [LJ Hooker](http://www.ljhooker.com.au) (<http://www.ljhooker.com.au>) and [Qantas Airlines Limited](http://www.qantas.com.au) (<http://www.qantas.com.au>), and professional practices such as those in accounting, law, architecture and medicine, are all service businesses.



What are the three main categories of business enterprise?

service business

A business that performs services or activities that benefit individuals or business customers

Merchandising businesses

Other businesses in the private enterprise system produce or provide goods or tangible/physical products. These businesses can be either *merchandising businesses* or *manufacturing businesses*. A **merchandising business** purchases goods (sometimes referred to as *merchandise* or *products*) for resale to its customers. Some merchandising businesses, such as plumbing supply shops, electrical suppliers or beverage distributors, are *wholesalers*. Wholesalers primarily sell their goods to retailers or other commercial users, like plumbers or electricians. Some merchandising businesses, such as the bookshop where you bought your calculator and chocolate bar, or the convenience store where you bought your milk and eggs, are *retailers*. Retailers sell their goods directly to the final customer or consumer. [Woolworths Supermarkets](http://www.woolworths.com.au) (<http://www.woolworths.com.au>) and [The Good Guys](http://www.thegoodguys.com.au) (<http://www.thegoodguys.com.au>) are retailers. Other examples of retailers include shoe shops, furniture outlets, online bookshops and car dealerships.

merchandising business

A business that purchases goods (sometimes referred to as merchandise or products) for resale to its customers

Manufacturing businesses

A **manufacturing business** makes products and then sells these products to their customers. Therefore, a basic difference between merchandising businesses and manufacturing businesses involves the products that they sell. Merchandising businesses *buy* products that are physically ready for sale and then sell these products to their customers, whereas manufacturing businesses *make* their products first and then sell the products to their customers. For example, the university café is a merchandising business that uses the coffee it purchased from DeFlava, a manufacturing business. The DeFlava factory, though, purchases (from suppliers) the coffee beans, essences and other ingredients needed to make the coffee, which it then sells to the university café and other retail stores. [Ford Australia](http://www.ford.com.au) (<http://www.ford.com.au>), [Black & Decker](http://www.blackanddecker.com.au) (<http://www.blackanddecker.com.au>) and [BlueScope Steel Ltd](http://www.bluescopesteel.com.au) (<http://www.bluescopesteel.com.au>) are examples of manufacturing businesses.

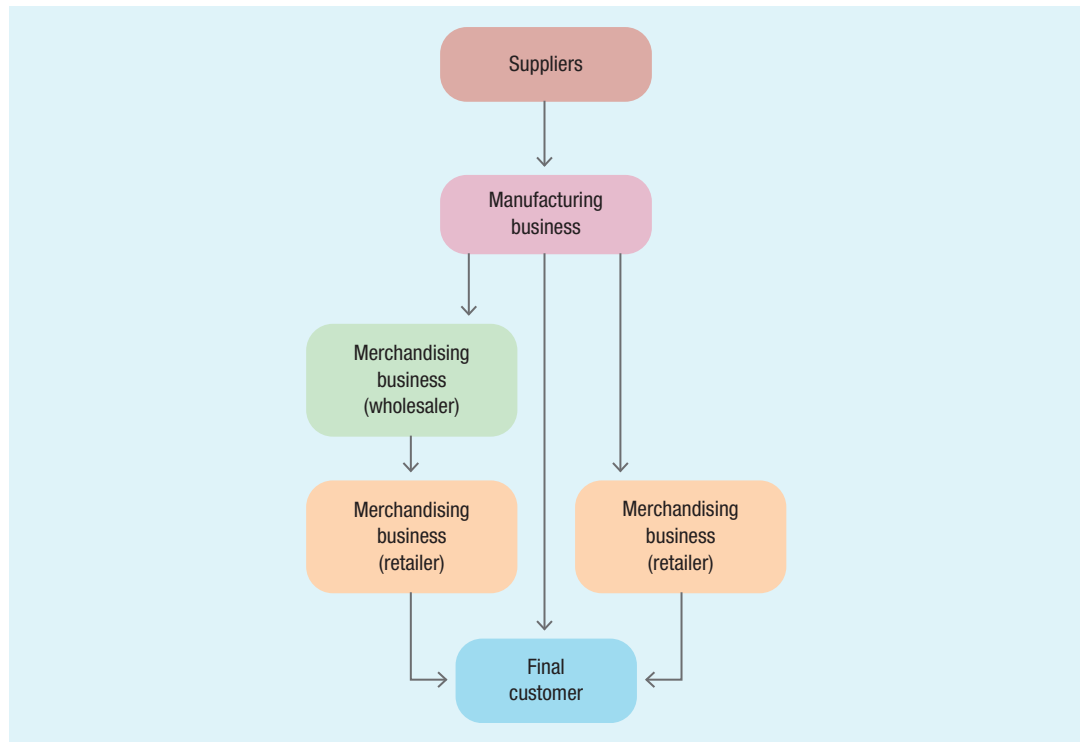
manufacturing business

A business that makes its products and then sells these products to its customers

The relationship between types of private enterprises

Exhibit 1.3 shows the relationship between manufacturing businesses and merchandising businesses and how these businesses relate to their customers.

Exhibit 1.3 Relationship of manufacturing and merchandising businesses



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

Stop & think



What sort of business do you think Café Revive is? Justify your decision.

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

Entrepreneurship and sources of capital

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

capital

Funds a business uses to operate or expand its operations

Entrepreneurship

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

entrepreneur
Individual who is willing to risk the uncertainty of starting a business in exchange for the reward of earning a profit (and the personal reward of seeing the business succeed)

Sources of capital

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

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

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

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

solvency
A business's long-term ability to pay off its debts

Stop & think



Why are accessible and affordable sources of capital important to the sustainability of a business?

1.3 Business structures

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