

6TH EDITION

# Accounting

BUSINESS REPORTING FOR DECISION MAKING

BIRT  
CHALMERS  
MALONEY  
BROOKS  
OLIVER



WILEY



# Accounting: Business Reporting for Decision Making

6TH EDITION

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# PREFACE

While this new edition of *Accounting: Business Reporting for Decision Making* covers both preparer and user issues of business reporting, it predominantly explores and reinforces the principles of financial and management accounting from a user perspective. Accounting is presented as a decision-making tool for business rather than a record-keeping function.

In developing this new edition of the text, we have carefully considered the positioning of the chapters and the flow of the learning objectives, and we believe that the order of the topics presented will suit the sequence of topics covered in most accounting courses. In the majority of chapters, we have used JB Hi-Fi Ltd either as an illustrative case or as a basis for the chapter's exercises or problems, which provides students with interesting real world examples to which they can relate and understand.

This text is most suitable for introductory accounting units that focus on financial decision making in business, rather than the preparation of financial reports. It is also highly suited to first-year units in accounting in business degrees, MBA introductory accounting units and accounting service units.

## Key features

The text has several unique features.

- References to JB Hi-Fi Ltd's annual report enhance the understanding of the concepts covered in the chapters. Each of the chapters on financial reporting provides a step-by-step illustration of the components of the financial statements and how to prepare and use the financial statements.
- Relevant, interesting and contemporary articles and reality checks enhance coverage of concepts in the chapters.
- The interrelationship between accounting information, business decisions and sustainable business practices is considered.
- Running cases are integrated throughout the text focusing on two small businesses — a service provider and a manufacturer.

## Learning toolkit

Each chapter contains the following pedagogical tools to support you with your studies.

- *Learning objectives* at the start of each chapter highlight the learning targets for the chapter.
- A *chapter preview* introduces the major topics to be covered in each chapter.
- *Value to business* vignettes positioned at the end of each main section in the text reiterate key issues and processes presented in the chapter.
- *Illustrative examples* located throughout the chapter aid in the conceptual understanding of the content. Examples provide a worked solution and explain the process.
- *Decision-making examples* located throughout the chapter emphasise the decision-making process rather than computation and provide students with experience in financial decision making.
- *Reality check* vignettes apply concepts to real-world business events.
- A *summary* of the key points covered in the chapter is provided at the end of each chapter. Phrased as a question, they provide a short summary under each question.
- A list of *key terms* is provided in alphabetical order at the end of each chapter.
- *Comprehension questions* review the chapter content and help students understand the key concepts. Questions include multiple-choice questions, fill-in-the-blanks and review.
- *Self-evaluation activities* provide a worked solution as a model for the workings of the exercises that follow.
- *Exercises* test student knowledge of the concepts presented in the chapter and develop analytical, comparative, communication and reporting skills. They are graded according to difficulty: ★ basic, ★★ moderate and ★★★ challenging.

- *Problems* build knowledge and skill development and are graded according to difficulty: ★ basic, ★★ moderate and ★★★ challenging.
- *Decision-making activities* focus on developing awareness of accounting information and various generic professional skills. They cover a range of scenarios such as communication, preparing presentations, teamwork, financial interpretation, internet-based research and ethical issues.

## Executive summary – key features of each chapter

Chapter	Key features
<b>Chapter 1</b> Introduction to accounting and business decision making	<ul style="list-style-type: none"> <li>• Introduces the process of accounting and illustrates the difference between bookkeeping and accounting</li> <li>• Outlines the role of accounting for various decision makers</li> <li>• Discusses the role of accounting information in the business planning process</li> <li>• Provides examples of the differences between financial and management accounting</li> </ul>
<b>Chapter 2</b> Accounting in society	<ul style="list-style-type: none"> <li>• Discusses business sustainability, its key drivers and principles</li> <li>• Appraises CSR reporting frameworks and the accountant's role in CSR</li> <li>• Examines corporate governance guidelines and practices</li> </ul>
<b>Chapter 3</b> Business structures	<ul style="list-style-type: none"> <li>• Defines the four different forms of business structure (sole trader, partnership, company and trust)</li> <li>• Outlines the advantages and disadvantages of each of the business structures</li> </ul>
<b>Chapter 4</b> Business transactions	<ul style="list-style-type: none"> <li>• Explains the differences between business transactions, personal transactions and business events</li> <li>• Describes the concept of duality and illustrates the impact of the application of duality to the accounting equation and worksheet</li> <li>• Provides examples of common errors on the worksheet</li> </ul>
<b>Chapter 5</b> Balance sheet	<ul style="list-style-type: none"> <li>• Explains the nature and purpose of the balance sheet</li> <li>• Outlines the criteria for identifying assets and liabilities</li> <li>• Illustrates the classification and format of the balance sheet</li> <li>• Describes possible limitations of the balance sheet</li> </ul>
<b>Chapter 6</b> Statement of profit or loss and statement of changes in equity	<ul style="list-style-type: none"> <li>• Explains the reporting period concept and the differences between accrual accounting and cash accounting</li> <li>• Outlines the criteria for identifying income and expenses</li> <li>• Illustrates the classification of items in the statement of profit or loss</li> <li>• States the relationship between the statement of profit or loss, the balance sheet, the statement of comprehensive income and the statement of changes in equity</li> </ul>
<b>Chapter 7</b> Statement of cash flows	<ul style="list-style-type: none"> <li>• Explains the purpose of a statement of cash flows</li> <li>• Illustrates the direct method of preparing a statement of cash flows and explains the purpose of reconciling profit with cash flows from operating activities</li> <li>• Provides the steps to analyse the statement of cash flows</li> </ul>
<b>Chapter 8</b> Analysis and interpretation of financial statements	<ul style="list-style-type: none"> <li>• Explains the nature and purpose of financial analysis</li> <li>• Describes ratios relative to profitability, asset efficiency, liquidity, capital structure and market performance</li> <li>• Explains the limitations of ratio analysis</li> </ul>
<b>Chapter 9</b> Budgeting	<ul style="list-style-type: none"> <li>• Illustrates the key steps in the budgeting process</li> <li>• Links the budgeting process to strategic planning</li> <li>• Describes the different types of budgets and outlines the components of a production and cash budget</li> </ul>

Chapter	Key features
<b>Chapter 10</b> Cost–volume–profit analysis	<ul style="list-style-type: none"> <li>• Looks at cost behaviour and its impact on profit planning</li> <li>• Illustrates the concept of CVP analysis and outlines the key assumptions underlying CVP analysis</li> <li>• Explains how to analyse make or buy decisions and special orders</li> </ul>
<b>Chapter 11</b> Costing and pricing in an entity	<ul style="list-style-type: none"> <li>• Defines and classifies cost objects into direct and indirect costs</li> <li>• Provides illustrations of the allocation process for indirect costs</li> <li>• Explains pricing issues for products and services</li> </ul>
<b>Chapter 12</b> Capital investment	<ul style="list-style-type: none"> <li>• Describes the different techniques to use when analysing capital investment decisions</li> <li>• Explains the advantages and disadvantages of each of the capital investment techniques</li> </ul>
<b>Chapter 13</b> Financing the business	<ul style="list-style-type: none"> <li>• Explains and illustrates the different sources of finance for entities</li> <li>• Discusses issues of managing debtors and inventories</li> </ul>
<b>Chapter 14</b> Performance measurement	<ul style="list-style-type: none"> <li>• Presents performance measurement techniques for an organisation</li> <li>• Discusses characteristics of contemporary measurement systems</li> </ul>

# ABOUT THE AUTHORS

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Dr Jacqueline Birt, BEd Melb, BBus RMIT, MBus RMIT, PhD ANU, CPA, is a Senior Lecturer in Accounting at the University of Queensland. Prior to the University of Queensland she held appointments at Monash University, the Australian National University, the University of Amsterdam and the University of Melbourne. Jacqueline's teaching and research is in the area of financial accounting, and her PhD focused on segment reporting and examined issues such as value relevance and voluntary segment disclosures. She has published in journals such as the *Journal of Business Ethics*, *Australian Journal of Management, Accounting and Finance*, *Accounting in Europe*, *Australian Journal of Adult Learning*, the *Australian Accounting Review* and *Accounting Education*. Jacqueline has been the recipient of the Pearson Education Accounting/Finance Lecturer of the Year Award and also the ANU Faculty of Economics and Commerce Award for Teaching Excellence.

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## **Judy Oliver**

Dr Judy Oliver, BBus, MBus, PhD, joined Swinburne University in 2008 as a Senior Lecturer in Accounting. Over the past 24 years, she has also held appointments at Victoria University and the University of Tasmania. Judy teaches first-year accounting and management accounting at both the undergraduate and postgraduate levels. Her research interests are in the area of management accounting control systems and corporate governance. She has published in journals such as the *Australian Accounting Review*, *International Journal of Quality & Reliability Management*, and the *Journal of Accounting & Organizational Change*.



## CHAPTER 1

# Introduction to accounting and business decision making

### LEARNING OBJECTIVES

---

After studying this chapter, you should be able to:

- 1.1 explain the process of accounting
  - 1.2 outline the importance of accounting and its role in decision making by various users
  - 1.3 explain the differences between financial accounting and management accounting
  - 1.4 explain the role of accounting information in the business planning process
  - 1.5 discuss the globalisation of financial reporting
  - 1.6 identify the sources of company regulation in Australia
  - 1.7 explain the current standard-setting framework and the role of the professional accounting associations in the standard-setting process
  - 1.8 evaluate the role of the *Conceptual Framework* and illustrate the qualitative characteristics of financial statements
  - 1.9 give examples of the limitations of accounting information
  - 1.10 provide examples of exciting opportunities for careers in accounting.
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## Chapter 1 preview

What is accounting's role in business decision making? How can you use accounting to plan a business? What are the opportunities for careers in accounting? These questions and more will be answered in this first chapter of this text. People in all walks of life rely on accounting information to make daily decisions concerning the allocation of scarce resources. For example, a retired rugby player may rely on accounting information to help guide investment decision making on the allocation of his earnings as a professional sportsman; a student might use budgeting tools to help fund an overseas trip to Vietnam at the end of the university year; and knowledge of expected costs could help a construction company quote for a job on a large-scale, multimillion-dollar building project. All of these scenarios would benefit from the input of accounting information to help reach the best decision based on the available resources.

In recent years, the responsibilities of the accounting profession have changed dramatically. The Enron Corporation and Arthur Andersen financial scandal at the start of the millennium resulted in major changes to public expectations of the accountant and reiterated the importance of good accounting practices in companies. Recent collapses of well-known companies such as Pie Face, The Cupcake Bakery and Borders Group, Inc. have again raised questions about the role of accounting information and/or the integrity of the financial reporting in these companies.

Changes in the structure of business entities, including the growth of the multinational and diversified entity, have also had consequences for the accounting profession. The role of the accountant is continually evolving and comprises a lot more than just the rudimentary preparation of financial statements and the traditional work areas of management and financial accounting. Accountants can work in exciting new growth areas such as forensic accounting, carbon accounting, water accounting, sustainability accounting, procurement and insolvency.

In addition to explaining the importance of accounting information in decision making, such as planning a business, this chapter outlines the globalisation of financial reporting, the sources of company regulation in Australia, the role of professional accounting associations, the *Conceptual Framework for Financial Reporting (Conceptual Framework)*, the limitations of accounting information, and new careers in accounting.

### 1.1 The accounting process

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**LEARNING OBJECTIVE 1.1** Explain the process of accounting.

Many students about to embark on a first course in accounting not only have the wrong idea about what the course content is going to be, but also a misconception of what an accountant actually does! Some anticipate that the course is going to be about recording transactions in journals and ledgers; others think that the course is all about balancing books. Some people associate accountants with repetitive tasks such as data entry and see the role as being rather dull. There is, however, a lot more to accounting and the role of an accountant than this. In accounting, we learn not only how to record and report transactions, but also the purpose for the information created and the many uses of accounting information in everyday living and business. Accounting provides users with financial information to guide them in making decisions such as planning a business. An understanding of accounting and its various roles in decision making will equip you with some important tools and techniques for understanding a broad range of accounting and business issues. Some of the accounting and business issues we will be exploring throughout this text include the following.

- What is the difference between financial and management accounting?
- What type of management accounting reports does accounting provide?
- What is an SME?
- What type of financial reports do business entities prepare?
- What is meant by sustainability accounting?
- What is the meaning of IFRS?
- What does it mean to be ethical in business?
- What is governance and does it apply to all business entities?

- What are the burgeoning areas of accounting?
- How has accounting changed since corporate collapses such as Enron?

The word account derives from the Latin words ‘ad’ and ‘computend’, which mean ‘to reckon together’ or ‘to count up or calculate’. **Accounting** can be defined as the process of identifying, measuring and communicating economic information about an entity to a variety of users for decision-making purposes. The first component of this definition is the process of identifying business transactions. A business transaction is an event that affects the financial position of an entity and can be reliably measured and recorded. **Business transactions** include such events as withdrawals of cash by the owner(s), payment of wages and salaries, earning of fees revenue, purchase of an office photocopier, purchase of stationery, capital contribution by owners, incurring of interest on a bank loan and payment of quarterly GST (goods and services tax).

The second component is the measuring of information, which refers to the analysis, recording and classifying of business transactions. This component identifies how transactions will affect the entity’s position, and groups together similar items such as expenses and income. For example, the contribution of capital by the owners will have the effect of increasing the cash at bank (asset) of the entity and increasing the capital (equity) of the entity. The earning of fees revenue will have the effect of increasing the income of the entity and increasing the entity’s assets. Depending on whether the fees earned were cash fees or on credit, the cash at bank or debtors of the entity respectively will increase. Throughout the accounting period, individual assets, expenses, income, equity and liabilities will be grouped (classified) together to summarise the information. For example, land, buildings, machinery, equipment and vehicles will be grouped together under the subheading ‘property, plant and equipment’. The final component is the communication of relevant information through accounting reports, such as the statement of profit or loss and the balance sheet, for decision-making purposes for the various users. For example, the total of the property, plant and equipment account will be reported on the balance sheet. The different users require accounting information for making important decisions such as whether to invest in a business, what type of business structure would be appropriate, whether the entity should continue to manufacture a product or outsource this process to another entity, and whether the entity has the resources to pay debts on time. All these decisions involve making the most of the scarce resource — money. The process of accounting assists users in the allocation of this scarce resource.

The practices of accounting and bookkeeping date back to ancient civilisations in China, Egypt, Greece and Rome, where families had to keep personal records of their receipts and payments. The title ‘Father of accounting’ belongs to Italian mathematician Fra Luca Pacioli who, in 1494, produced *Summa de Arithmetica, Geometrica, Proportioni et Proportionalita*, which included chapters based entirely on how to record business transactions using a double-entry system. Table 1.1 summarises the process of accounting.

**TABLE 1.1** The process of accounting

Identifying	Measuring	Communicating	Decision making
Transactions that affect the entity’s financial position are taken into consideration. They must be able to be reliably measured and recorded.	This stage includes the analysis, recording and classifying of business transactions.	Accounting information is communicated through various reports such as statements of profit or loss, balance sheets and statements of cash flows.	Accounting information is used for a range of decisions by external and internal users.

**VALUE TO BUSINESS**

- Accounting is the process of identifying, measuring and communicating economic information about an entity for decision making by a variety of users.

## 1.2 Accounting information and its role in decision making

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**LEARNING OBJECTIVE 1.2** Outline the importance of accounting and its role in decision making by various users.

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

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

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

Individuals and entities need accounting information to assist in making decisions, such as planning a business, and subsequently capital investment decisions. Planning a business is introduced later in this chapter and the appendix to this chapter provides more in-depth coverage of the main aspects of the business planning process. Accounting information is designed to meet the needs of both internal users and external users of accounting information. Accounting information is extremely valuable to an entity's owner or management (i.e. **internal users**). It is used to help owner(s)/managers achieve the following.

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

**External users (stakeholders)** include such parties as employees, shareholders, suppliers, banks, consumers, taxation authorities, regulatory bodies and lobby groups, all of whom have their own information needs. They have a 'stake' or interest in the performance of the entity.

- Current shareholders of the entity will seek accounting information to help them evaluate whether the entity's managers have been appropriate stewards or custodians of the entity's assets. They will examine entity reports to glean how effectively management has invested the assets of the business entity, and whether it has made appropriate business decisions on behalf of the investors. This is known as the stewardship function of management. The information in an entity's annual report can explain to the investors what areas of business the entity has expanded into and what the entity's strategic plan is for the next 12 months, 5 years, 10 years.
- Prospective investors will seek information from entity reports to determine whether or not a particular entity is a sound investment. Information such as the financial structure of the entity (level of debts versus level of equity), current financial performance and its future growth prospects can help such external users to determine whether capital growth is expected for the entity.
- Suppliers and banks are interested in gauging the entity's ability to repay debt and the level of risk associated with lending funds to it. Statements such as the statement of cash flows and the balance sheet enable them to evaluate whether the entity has sufficient funds to meet debt repayments and to cover interest expense.

- Employees are most concerned about the future prospects of the entity. Is there a likelihood that the entity will expand, consequently creating additional job opportunities? Is there a possibility of promotion? Or, if the entity is performing poorly, are jobs at risk? What is the remuneration of the highest paid executives and what are the financial details of the employee share ownership plan? Particular sections in the annual report such as the chief executive officer's (CEO's) report, directors' report, statement of comprehensive income and statement of cash flows will provide useful information to the employees of the entity.
- Government authorities such as the Australian Taxation Office (ATO) will be interested in the reported profit for the year and the associated goods and services tax (GST) paid, in order to calculate the amount of tax payable or to be refunded in a particular financial year. Regulatory bodies such as the Australian Securities and Investments Commission (ASIC) will seek to identify whether the business has complied with requirements of the *Corporations Act 2001* (Cwlth); for example, whether a disclosing entity has complied with the Australian Accounting Standards.

Table 1.2 summarises the accounting information required by different stakeholders for their decision making.

**TABLE 1.2 Stakeholders and the accounting information they need for their decision making**

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

### VALUE TO BUSINESS

- Internal users are the owner(s) or management of the entity who use the information to assist with various decision-making activities.
- External users (also known as stakeholders) are groups outside the entity, who use accounting information to make decisions about the entity.

## 1.3 Financial accounting and management accounting

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**LEARNING OBJECTIVE 1.3** Explain the differences between financial accounting and management accounting.

In a typical accounting degree, you will undertake studies in both financial accounting and management accounting. **Financial accounting** is the preparation and presentation of financial information for all types of users to enable them to make economic decisions regarding the entity. General purpose financial statements (reports) are prepared to meet the information needs common to users who are unable to command reports to suit their own needs, while special purpose financial statements (reports) are prepared to suit a specific purpose and do not cater for the generalised needs common to most users. This information is governed by generally accepted accounting principles (GAAP), which provide accounting standards for preparing financial statements. Financial accounting is also guided by rules set out in the Corporations Act and the Listing Rules of the Australian Securities Exchange (ASX). Financial accounting is traditionally based on historical figures that stem from the original transaction; for example, the purchase of a building for \$500 000 would be shown in the financial statement (the balance sheet) as an asset of \$500 000. Even though the \$500 000 may not reflect the current market value of the building, the building is still shown at its **historical cost**, which is the original amount paid for the asset.

The **financial statements** consist of the entity's statement of cash flows, balance sheet and statement of profit or loss (for companies, the statement of profit or loss and other comprehensive income and the statement of changes in equity). The **statement of cash flows** reports on an entity's cash inflows and cash outflows, which are classified into operating, investing and financing activities. The **statement of profit or loss** reflects the profit for the entity for a specified time period. (Profit is the excess of income over expenses for a period.) An entity's assets and its liabilities at a point in time are reported in the **balance sheet** (also called the statement of financial position).

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

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

Ultimately, there will be an interaction between financial accounting and management accounting, because management accounting will provide economic information for internal users that is then reflected in the financial accounting statements for external users. One such example of the interaction between financial and management accounting is illustrated in the area of segment reporting by large and diversified companies. Large and diversified companies must disclose segment information as part of their accompanying notes to the financial statements. Reporting on segments assists users in helping to understand an entity's relative risks and returns of individual segments of the entity. The operating segments are reported according to how an entity is organised and managed and hence is known as the management approach. Therefore, management accounting determines the operating segments and financial accounting reports these operating segments to the various users of financial statements. Illustrative example 1.1 shows the reportable operating segments for the Qantas Group. As you can see, the revenue and result for the Qantas Group have been disaggregated into the operating segments of Qantas Domestic, Qantas International, Qantas Loyalty, Qantas Freight, Jetstar Group etc. There are also additional breakdowns for depreciation and amortisation, operating leases, and so on.



**ILLUSTRATIVE EXAMPLE 1.1**
**Operating segments for the Qantas Group**

 (C) ANALYSIS BY OPERATING SEGMENT<sup>1</sup>

2015 \$M	Qantas Domestic	Qantas International	Qantas Freight	Jetstar Group	Qantas Loyalty	Corporate	Unallocated Eliminations <sup>5</sup>	Consolidated
REVENUE AND OTHER INCOME								
External segment revenue and other income	5 291	4 878	1 059	3 283	1 244	49	12	15 816
Inter-segment revenue and other income	537	589	8	181	118	(40)	(1 393)	—
<b>Total segment revenue and other income</b>	<b>5 828</b>	<b>5 467</b>	<b>1 067</b>	<b>3 464</b>	<b>1 362</b>	<b>9</b>	<b>(1 381)</b>	<b>15 816</b>
Share of net profit/(loss) of investments accounted for under the equity method <sup>2</sup>	4	4	—	(37)	—	—	—	(29)
<b>Underlying EBITDAR<sup>3</sup></b>	<b>1 171</b>	<b>706</b>	<b>156</b>	<b>625</b>	<b>323</b>	<b>(149)</b>	<b>(8)</b>	<b>2 824</b>
Non-cancellable aircraft operating lease rentals	(219)	(42)	(5)	(229)	—	—	—	(495)
Depreciation and amortisation	(472)	(397)	(37)	(166)	(8)	(14)	(2)	(1 096)
<b>Underlying EBIT</b>	<b>480</b>	<b>267</b>	<b>114</b>	<b>230</b>	<b>315</b>	<b>(163)</b>	<b>(10)</b>	<b>1 233</b>
Underlying net finance costs						(258)		(258)
<b>Underlying PBT</b>						<b>(421)</b>		<b>975</b>
<b>ROIC %<sup>4</sup></b>								<b>16.2%</b>

1 Qantas Domestic, Qantas International, Qantas Freight, Jetstar Group, Qantas Loyalty and Corporate are the operating segments of the Qantas Group.

2 Share of net profit/(loss) of investments accounted for under the equity method excluding share of losses in Jetstar Hong Kong which have been recognised as items outside of Underlying PBT.

3 Underlying EBITDAR represents Underlying earnings before income tax expense, depreciation, amortisation, non-cancellable aircraft operating lease rentals and net finance costs.

4 ROIC % represents Return on Invested Capital (ROIC) EBIT divided by Average Invested Capital (Refer to Note 3(G)).

5 Unallocated/Eliminations represent other businesses of Qantas Group which are not considered to be significant reportable segments and consolidation elimination entries.

Source: Qantas Airways Ltd 2015, annual report, p. 57.



Qantas is widely regarded as the world's leading long-distance airline and one of the strongest brands in Australia.

The main differences between financial accounting and management accounting are summarised in table 1.3.

**TABLE 1.3** Differences between financial accounting and management accounting

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

### VALUE TO BUSINESS

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

## 1.4 Role of accounting information in business planning

**LEARNING OBJECTIVE 1.4** Explain the role of accounting information in the business planning process.

Accounting plays a crucial role in the business planning process. Starting and planning a business is a demanding task. Whether an individual or a group of investors buy an existing business or begin a brand new business entity, there are many issues to deal with. One of the most important questions that face prospective business owners is what type of business structure will suit the business? Will the business entity be a for-profit entity with the primary objective of making a profit from the resources the owners control to increase their wealth? Alternatively, is the entity's objective to maximise the services provided from the resources they control. This type of entity is known as a not-for-profit entity. Examples include sporting clubs, hospitals and charities. Profit-oriented business structures include sole traders, partnerships and companies. Most business entities are classified as SMEs (small to medium sized enterprises). SMEs are entities with annual revenue between \$2 million and \$250 million. In Australia, nearly

95 per cent of entities are SMEs, and SMEs employ approximately 70 per cent of the workforce. Larger business entities such as JB Hi-Fi Ltd, Qantas Ltd and BHP Billiton Ltd are listed on the Australian Securities Exchange (ASX). In New Zealand, companies such as Air New Zealand, Fisher & Paykel Healthcare and the Warehouse Group are listed on the New Zealand Exchange (NZX) and have special reporting requirements. Chapter 3 will consider each form of business structure and the type of decision making that goes into the business planning process to choose the right form of business.

When contemplating commencing a business, an effective way to deal with the complex issues that arise is to draw up a business plan. Accounting has many inputs to this process, particularly in the area of the financial projections. A business plan is a written document that explains and analyses an existing or proposed business. It explains the goals of the firm, how it will operate and the likely outcomes of the planned business. A business plan can be referred to as a ‘blueprint’, similar to the plans an architect would prepare for a new building, or a draft or specification that an engineer would prepare for a new machine.

## Benefits of a business plan

There are a number of benefits to be gained from developing a business plan. The business plan provides a clear, formal statement of direction and purpose. It allows management and employees of the entity to work towards a set of clearly defined goals in the daily operations of the business. It also assists the business entity in evaluating the business.

## Operation of the business

As stated, accounting information provides managers and owners with the tools they require to make decisions regarding the daily running of the business entity and whether the goals set by the business entity in the planning process are being achieved. For example, the owner/managers will be able to see if they are selling the correct products and work out the right product mix to achieve their sales targets. Chapter 11 includes a systematic consideration of cost behaviour and the subsequent impact on profit planning. Cost–volume–profit analysis assists management in understanding how profits will change in response to changes in sales volumes, costs and prices. Accounting information also provides key information relating to large asset purchases by the business entity. Entities regularly make decisions to invest in new assets or new projects and need to determine which particular investments offer the highest returns and produce the requisite cash flows. Chapter 12 provides a comprehensive discussion of the role of accounting information in capital investment decision making.

## Evaluation of the business plan

Accounting information provides management with the tools necessary to evaluate the business plan and encourages the management and owners to review all aspects of the operations. The evaluation process, along with the decision-making process, allows a more effective use of scarce resources such as staff, equipment and supplies, and improvement in coordination and internal communication. Strategic planning and budgeting will be discussed in detail in chapter 9. In the evaluation process, results are compared to budgeted results so that both favourable and unfavourable variances can be detected. Management of the business can then take action if necessary to make changes to the entity’s operating activities to ensure that they keep on track with the original business plan. Management may also modify the entity’s original goals. Further information on the business planning process and an illustration of a business plan for the fictitious company Murphy Recruiting Pty Ltd are provided in the appendix to this chapter.

### VALUE TO BUSINESS

- Accounting information plays a major role in business planning and in evaluating the business planning process.