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Solutions Manual Chapter 2:

Organisations and their reporting boundaries

- 2.1 When we are discussing the reporting boundary of an organisation, we are referring to the judgements that have been made by its managers in respect of how far the responsibilities of the organisation have been extended both in terms of which stakeholders the organisation owes accountability to, and for what aspects of performance it should be accountable.

Because different managers will have different perceptions of organisational responsibilities, this means they will have different perceptions of which accountabilities an organisation should accept and the types of accounts it should prepare. So, although two organisations might be very similar, the perspectives of their managers might be very different, and therefore the accounts the respective organisations decide to produce might be very different which reflects a different perspective about the organisational boundary.

- 2.2 When we are discussing internal reporting we are referring to information that is collected for use within the organisation by managers to manage the organisation. When we discuss external reporting, we are referring to information that an organisation produces for the use of stakeholders outside the organisation. Some of the information used internally for management purposes might also be released externally to stakeholders.
- 2.3 A resource can be broadly defined as something that has value in the sense that it allows an organisation (or indeed, society) to undertake an activity so as to enable it to achieve a desired outcome. At issue is whether accountants should *only* record and report information about the usage of, and potential damage to, resources *controlled* by the organisation, or if we should consider impacts on the resources not owned or controlled by the organisation; for example, upon the environment (these resources might also be referred to as *shared resources* or *public resources*).

In the absence of any regulation requiring disclosure, the decision to measure and report particular social or environmental information is generally made by managers in consultation with their accounting teams. It would be hoped that if an organisation is causing significant impacts to particular resources (including natural, human-based and social-based resources), then it would provide some account of such impacts. Again, if the managers think they have a responsibility for ensuring that particular resources are not adversely impacted by their operations, then they are accepting an accountability with respect to that resource. Consequently, they should generate various accounts to enable them to monitor, control and improve their performance with regards to the respective resources, and to provide relevant information to stakeholders.

- 2.4 Management accounting is a broad term referring to information produced for internal decision making by managers; that is, information that is required for various decisions

pertaining to aspects associated with planning, monitoring and control, including information that relates to financial, social or environmental performance. The management accountant is somebody who collects, analyses and/or reports such information. The information necessarily collected for internal management decision-making (management accounting information) could also form the basis for reports that are to be released publicly.

- 2.5 Financial accounting is typically considered to be that branch of accounting that generates financial reports for use by people *outside* the organisation; for example, investors or lenders who want to monitor the performance of a company they have invested in, or loaned funds to. Financial accounting is very heavily regulated, whereas management accounting is basically unregulated.

The purpose of financial accounting/reporting is generally to provide information about the financial performance and position of an organisation. The main audience for these reports is generally considered to be the managers and owners of the organisation, as well as others with a financial stake in it, such as those who are owed money by the organisation (for example, lenders and creditors). There will also be other groups with an interest in the financial performance of an organisation. For example, employees will want to know how well the organisation is being managed financially in order to understand how secure their employment is, or perhaps whether the organisation can afford to pay higher wages. Customers will be interested in the financial performance of an organisation in order to assess whether the organisation will be able to continue supplying goods or services, or perhaps whether it appears that the organisation is too profitable and can therefore afford to reduce the selling prices of its goods and services.

- 2.6 We argue that accounting is not a one-size-fits-all practice because how we account for an organisation depends on factors such as:
- the various resources it uses, which can create different types of impacts for different stakeholders and therefore different accountabilities
 - where its operations are being conducted, which may be in highly populated areas with many potentially affected stakeholders, or in areas of significant environmental or cultural importance
 - the differing perceptions of managers on why they should be reporting, which in turn will influence to whom they have accountability, and to which aspects of performance the accounts should relate
 - managers' perceptions of the information demands, or needs, of different stakeholder groups.

Because different managers will have different views about the above questions, they will tend to provide sets of accounts that are different to those provided by other managers. Therefore, one approach to accounting that might be relevant to the managers of one organisation might not be relevant to the managers of another organisation. There is not a 'one-size-fits-all'.

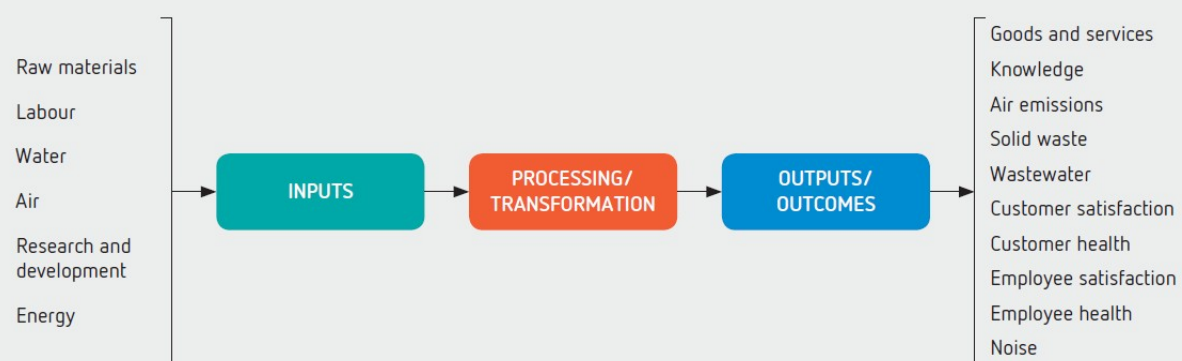
2.7

- (a) A sole trader – or, as it is also often called, a *sole proprietorship* – is considered to be in existence when one individual owns a business and is responsible for all of its debts. Sole traders, which are much more numerous than partnerships or companies, are generally established to generate a profit, but organisations that are sole traders might also have as their principal goals the achievement of various social or environmental outcomes. Relative to other forms of business, a sole trader usually is small in terms of total income, profits and the number of employees. Many small businesses – such as milk bars, restaurants, newsagents, landscapers, plumbers, painters and caterers – are sole traders. In a sole trader, the owner is also typically the manager. A sole trader is not a separate legal entity, so for legal purposes the business is not separate to the owner's non-business affairs. As such, the business is not separately taxed but rather the earnings are included in the owner's personal tax return. A sole trader is not difficult to set up. Apart from having to comply with certain tax obligations, there are generally no specific accounting requirements that apply to sole traders. Sole traders do not have to apply the multitude of accounting standards issued by organisations such as the IASB, and they can be flexible with their reporting, but like all organisations they still need to do some forms of accounting.
- (b) A partnership exists when two or more people come together with a common purpose, usually to make a profit. Like a sole trader, partnerships tend to be small businesses, although there can be exceptions; for example, some legal and accounting partnerships can be very large. Within a partnership, people with different skills and resources might come together. The profit is generally shared according to a partnership agreement, although in many jurisdictions there is no legal requirement for such a formal arrangement to exist. That is, depending on the actions of individuals, a partnership can be considered to be in existence even in the absence of a formal partnership agreement. A partnership is considered for accounting purposes to be a separate entity; that is, an entity that is separate to the individual partners such that the individual assets and liabilities of the partners, which have not been contributed to the partnership, are not considered to be part of the assets and liabilities of the partnership. However, like a sole trader, for legal purposes the partnership is not a separate legal entity. As such, the partners have unlimited liability for the obligations of the partnership, meaning that if the resources of the partnership are insufficient to meet its debts, then the partners' individual assets can, by law, be seized to pay those debts (and the assets will not necessarily be seized on the basis of the partners' percentage of ownership).
- (c) A company is an entity that has a separate legal identity from that of its owners. Each owner of a company owns shares in it and hence is considered to be a shareholder. Shareholders generally have no liability for debts other than if they still owe some amounts on the shares they have acquired. That is, the liability of a shareholder is generally limited to the amount they have agreed to pay for their shares. Hence, unlike sole traders and partnerships, companies are considered to be limited liability organisations. Limited liability encourages people to invest in a company even when they have very little, or nothing, to do with its ongoing management. That is, there is

usually a separation of ownership and management, particularly in larger companies. The shares are transferable to others and might be traded on a securities exchange (stock exchange) if they relate to public companies, which are allowed to offer their shares for sale to the public. Because there is generally a separation between the ownership and management of a company, the owners will often depend on receiving accounts from the company to inform them as to how the managers have used the shareholders' funds, as well as accounts about what the managers intend to do in the future. This can be contrasted with sole traders and partners in a partnership who, because they are usually involved in the ongoing management of the organisation, will not depend on some form of general-purpose financial statements being released by the organisation. Shareholders in large companies, however, will not have access to information particularly tailored to their own needs. Rather, they will receive general-purpose reports which meet the needs of all shareholders.

- 2.8 This might be because the different managers will have different perceptions (perhaps because of differences in the managers' age, background, culture, education, professional affiliations, and so forth) of organisational responsibilities and accountabilities. Nevertheless, there can be some level of uniformity of accounting practices between organisations within an industry as some disclosure practices within an industry effectively become 'institutionalised' and thereafter become accepted as the legitimate way to report. Also, within an industry, the organisations would have similar stakeholders, would use similar resources and would generate similar impacts, therefore there would be an expectation that reporting would be similar – but there would still be some differences.
- 2.9 We can refer to Figure 2.2, reproduced below. Arguably, it is a responsibility of managers to understand what resources are used as inputs, and what outputs are generated by an organisation. Without knowing this, the use of resources and their related impacts cannot be managed. Managers need to prioritise which resource inputs, and what outputs/outcomes/impacts are the most important to manage. Without some diagram – such as Figure 2.2, this would not be possible.

FIGURE 2.2 A simple input/output diagram



- 2.10 External costs are often referred to as externalities, which can be defined as impacts that an entity has on parties external to the organisation, where such parties are not the buyers

or sellers of particular goods or services, or did not agree to, or take part in, the activities causing the externality.

For example, the damage to a reef caused by an oil tanker would impact many people other than just the buyers or sellers of the oil, and these impacts will not all be measurable in monetary terms – they would be considered external costs.

When most manufacturers of goods produce something, they generally create some level of pollution that impacts people beyond either the producer or the customer – they create external costs. Because it is very problematic to try and attempt to place a monetary value on many external costs, they often are not reflected in the prices of particular goods or services. In a sense, this is a failing of many of our pricing systems – many externalities simply fail to be factored into the prices we pay.

If we were to consider the full costs to society of particular products, then we would need to consider both the private costs and the external costs. However, while external costs might be difficult to quantify in monetary terms, we can still provide a description of the costs that have arisen. That is, we can provide a description of the impacts an organisation's operations have had on particular environments and/or societies, even if we cannot place a monetary value on such costs. Not all organisations will try to account for their externalities.

2.11 In the book we have defined costs as:

A measure, either expressed in financial or non-financial terms, of the value of resources consumed or impacted as a result of the operations of an organisation. Costs can include both 'private costs' and 'social and environmental costs' ('external costs').

Some introductory accounting textbooks only consider those costs that can be measured in financial terms and which represent financial costs directly (privately) incurred by the organisation. The concept of 'costs' embraced in this book is much broader than this. We will also be considering many 'costs' that are not measured in financial terms. That is, we will also be considering costs that organisations create in relation to resources not directly controlled by the organisation.

2.12

- (a) There are many similarities between the accounting done by sole traders and partnerships. For the majority of sole traders and partnerships, the focus will be on financial measures of performance rather than on measures of social and/or environmental performance. There will also be no expectation that the financial reports will be prepared in accordance with accounting standards. Because there could be potential conflicts between partners, the accounts of a partnership are more likely to be audited than the accounts of a sole trader. Partnership accounts will provide details to the partners of their individual contributions, drawings, profit share and partnership balance.

- (b) There would tend to be many differences between the information required by a sole trader compared with the information required by a shareholder of a large public company. Because there is generally a separation between the ownership and management of a company, the owners will often depend on receiving accounts from the company to inform them as to how the managers have used the shareholders' funds, as well as accounts about what the managers intend to do in the future. This can be contrasted with sole traders and partners in a partnership who, because they are usually involved in the ongoing management of the organisation, will not depend on some form of general-purpose financial statements being released by the organisation. Shareholders in large companies, however, will not have access to information particularly tailored to their own needs. Rather, they will receive general-purpose reports which meet the needs of all shareholders. These reports will also typically be subjected to an audit by an independent third party.

2.13

- (a) Organisations rely on financial resources in order to meet the various expenses they incur. If an organisation is a business organisation, then information about profits is necessary. It provides an indication of how efficiently the assets of the organisation are being used.
- (b) Information about the use of water and its sources should arguably be collected for management and reporting purposes particularly if the organisation is operating in an area where the level of consumption of water by the organisation is important to other stakeholders. This would particularly be the case in areas or times of water shortage.
- (c) It is a matter of opinion how far the responsibilities and accountabilities of the organisation extend. From an ethical perspective an organisation should arguably provide an account of how workers within the supply chain are treated.
- (d) With growing awareness about the significance of climate change, managers are increasingly being expected to take actions to minimise CO₂ emissions. This would particularly be the case for organisations that generate large emissions of CO₂. Managers of organisations that emit high amounts of CO₂ would also be expected to report information about planned initiatives to reduce emissions together with information comparing past emissions with targeted emissions.
- (e) Again, this is a matter of opinion. Managers that embrace a high level of responsibility for the impacts of their operations will consider and report information about the emissions generated by its suppliers. This represents a broader 'life cycle' approach to managing the impacts of the organisation's goods and services. A number of organisations (in the minority at this stage) are starting to report information about the emissions generated across supply chains. One organisation to commence doing this is the large global miner, BHP.

- 2.14 The financial accounts prepared by a public company would be considered to be general purpose financial reports and would comply with accounting standards. The financial reports of a public company would be available on the organisation's website. The financial accounts prepared by a private company would typically not be prepared

in accordance with accounting standards and would not generally be available to the public on the organisation's website. The reports produced by a public company must also be audited by a qualified financial statement auditor. This is not a strict requirement for a private company unless a required number of shareholders vote for such an audit.

Public companies are typically very large with a diverse group of stakeholders, and they will create various economic, social and environmental impacts that will influence the lives of a vast array of people. As such, and because of the broader reach of the impacts of public companies relative to many other forms of organisations, they tend to report a variety of financial, social and environmental information to a large cross-section of stakeholders, and will use a variety of reporting frameworks. By contrast, private companies would typically not produce detailed social and environmental accounts.

Accounting for the range of social, environmental and financial impacts it creates for a diverse group of stakeholders means that a public company would tend to have a broad reporting boundary. Various aspects of the company's performance would be relevant to people both within the organisation (who need to manage these aspects) as well as those outside the organisation. By contrast, the 'reporting boundary' of a private company would be relatively narrow.

2.15 The information an organisation elects to report will depend on how far it extends its reporting boundary, and which impacted resources it believes it has responsibility for. Some of the information that could be publicly reported includes:

- what caused the leak and what was done to stop the leak
- what the financial costs associated with the oil leak have been.
- what environmental damage has occurred in both the short and long term (being very clear about the various types of negative impacts)
- the actions being taken to reduce these negative impacts
- the actions taken to ensure this type of event will not happen again
- what it has learned from the catastrophe
- what operating procedures failed
- how its emergency response procedures worked or did not work.

2.16 There could be various outputs or impacts of a museum. There will be a multitude of possible answers to this question. Museums are established to create various social benefits, including to contribute to knowledge and to preserve important historical and cultural artefacts. Some of the positive outputs and impacts would include:

- A contribution to knowledge
- Preservation of important historical and cultural artefacts
- Providing resources necessary for research
- Providing employment opportunities
- Providing enjoyment to various members of society
- A source of demand for local food and accommodation providers

Some negative outputs or impacts could include:

- Waste
- Noise
- Carbon emissions through use of energy within the museum and by people attending the museum.

For those outputs that can be measured in financial terms then, we would expect to find them recorded within the financial statements which would typically be made available on the organisation's website.

For those impacts that are not financial in nature we might expect to find details within social or environmental reports or on other dedicated pages on the museum's website. However, whether the information is collected and reported will depend upon whether the museum managers believe they have a responsibility and accountability for the particular impacts.

2.17

- (a) Different managers will have different demands for information depending upon what aspects of the performance of Dhaka Textiles that they believe are important. For example, apart from information about product quality and price they might also want to know about the social and environmental performance of the supplier. The types of information that might be demanded would include information about product costs; quality; delivery times; delivery costs; social policies; environmental policies; how the organisation monitors its compliance with policy; whether the organisation outsources production, and if so, what checks and monitoring practices does it have in place with regards to those organisations to which it outsources.
- (b) Again, different managers would collect different information. Some information would relate to ongoing checks of quality, price, and delivery times. If commitments have been made by the supplier that certain social and environmental policies would be applied, then it would be necessary to periodically monitor the compliance with these policies. It is also common for organisations such as T-shirt Tommy Ltd to organise regular factory audits of suppliers to check on the health and safety of workers, and these audits are often undertaken by independent third parties.
- (c) This information would generally be considered as management accounting because the information would be collected to inform decisions being made by managers.
- (d) If managers believe they have an accountability for various aspects of their supply chain, then they would tend to report related information to stakeholders outside the organisation. It has become very common for organisations to report information about how it is monitoring the activities of organisations within its supply chains, particular where the operations involve workers located within developing countries.

2.18 It is indeed bewildering that many universities pay very little attention to accounting issues associated with social and environmental performance. Also, many universities pay little attention within their accounting programs to issues associated with organisational responsibilities and accountabilities. This might reflect a view held by

some lecturers that the main responsibilities and accountabilities of organisations – particularly business organisations – are to general profits/wealth for the owners and to generate economic benefits within society. However, what we might argue is that the social and environmental performance of organisations is just as important (or more important?) than its financial performance. As such, perhaps equal time should be devoted to social and environmental performance reporting.

The other point to be made is that educational programs tend to become ‘institutionalised’. That is, a particular way of doing something (such as how ‘accounting’ is taught) becomes commonly accepted and it can be difficult for somebody to come along and try to make fundamental changes to how something is done.

- 2.19 Answers cannot be provided to this question as it depends upon what organisations were selected by the students. What students will hopefully see is that organisations are producing various ‘accounts’ of their social and environmental performance and that what one organisation reports can be very different from what other organisations report. Differences in the ‘reporting boundaries’ of the different organisations might also be apparent. Students will also see that particular reporting frameworks or guidance documents might be utilised or referred to (such as the GRI Sustainability Reporting Standards or the United Nations SDGs), and that some reports will be subject to independent third-party assurance/verification.