Chapter 2

Transaction Processing in the AIS

Outline

- Expected outcomes

- Accounting and bookkeeping

- The accounting cycle

- Internal control in the accounting cycle

- Coding systems

- Human judgment and information technology

Expected outcomes

- Differentiate accounting and bookkeeping.

- List, discuss and complete, in order, the steps in the accounting cycle.

- Identify common internal controls associated with the accounting cycle.

- Describe common chart of accounts coding systems.

- Explain how human judgment and information technology impact the accounting cycle.

Accounting and bookkeeping

- ## Accounting

  The process of
  - Identifying
  - Measuring
  - Communicating

  Economic information to permit
  - Informed judgments
  - Decisions

  By users of the information.

- ## Bookkeeping

  The elements of accounting associated with
  - Identifying
  - Measuring

- Thus, bookkeeping is **part** of accounting— not its totality.

The accounting cycle

- Steps completed each period to:
  - Identify recordable transactions.
  - Measure related dollar amounts.
  - Record transactions in the AIS.
  - Prepare general purpose financial statements.

- Two "big" pieces
  - Steps that occur throughout the fiscal year
  - Steps that occur at the end of the fiscal year
- Ten total steps in the accounting cycle

The accounting cycle

- Throughout the fiscal year
  - Obtain transaction information from source documents.
  - Analyze transactions.
  - Record transactions in the journal.
  - Post to the ledger.
  - Prepare a trial balance.

- End-of-year steps
  - Record and post adjusting entries.
  - Prepare adjusted trial balance.
  - Prepare financial statements.
  - Record and post closing entries.
  - Prepare post-closing trial balance.

The accounting cycle

- **Lecture break 2-1**

  How would you record these transactions in the journal?

  - Issued 5,000 shares of $1 par capital stock for $15 per share.
  - Signed $10,000, 6-month, 6% note payable.
  - Purchased inventory on account, $7,000.

- Sold inventory on account, $8,000. Cost of the inventory, $3,000.
- Purchased equipment with a list price of $12,000 by paying 20% down, financing the rest with a 10-month, 8% note payable.
- Paid current month's rent, $1,500.

The accounting cycle

- **Adjusting entries**
  - Purpose
    - To account for timing differences between cash flow and accrual basis revenue & expense
  - Three groups
    - Accruals
    - Deferrals
    - Estimates

- **Accruals**
  - Service first, cash second

- **Deferrals**
  - Cash first, service second

- **Estimates**
  - Fixed asset depreciation
  - Bad debts

The accounting cycle

- General purpose financial statements
  - **Balance sheet**: financial position at a point in time.
  - **Income statement**: financial activity on the accrual basis for a period of time.

  - **Statement of changes in equity**: changes in equity accounts for a period of time.
  - **Statement of cash flows**: receipts and payments of cash for a period of time.

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The accounting cycle

- Closing entries
  - Prepare the AIS for a new fiscal year
  - Balances in nominal accounts transferred to retained earnings
  - Nominal accounts: items on the income statement

- **Lecture break 2-2**

  Working with a partner, write down two things you remember about the accounting cycle from your previous coursework. Also write down two things you don't remember.

Internal control in the accounting cycle

- **Discussed in the chapter**
  - Sequential numbering of source documents
  - Physical security for source documents
  - Transaction limits

- **Other internal controls**
  - Proper authorizations and supervision
  - Audits
    - Internal audit
    - Financial statement audit
  - Information technology controls
    - Physical controls
    - Technical controls
    - Administrative controls

Coding systems

- Commonly applied to:
  - Source documents
  - Inventory items
  - Chart of accounts
- Four types
  - Sequential
  - Block
  - Hierarchical
  - Mnemonic

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Coding systems

- ## Sequential
  - Numbers in order
  - Often used for source documents
    - Checks
    - Invoices
    - Purchase orders

- ## Block
  - Codes assigned in blocks
  - Often used for chart of accounts
    - Cash, 1001
    - Land, 2005
    - Accounts payable, 3001
    - Bonds payable, 4004
    - Retained earnings, 5003

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Coding systems

- Hierarchical
  - Specialized form of block coding
  - Used for more complex chart of accounts
  - Example 15.25.03.122
    - 15 = geographic location
    - 25 = department
    - 03 = financial statement element
    - 122 = specific account

- Mnemonic
  - Code is a memory aid
  - Often used for inventory items
    - PPR = paper
    - FSD = flash drive
    - CLGF = ceiling fan

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Coding systems

- **Lecture break 2-3**

  Which coding system(s) does your university

  use for course designations?

Human judgment and information technology

- **Human judgment**
  - Essential in the accounting cycle
  - Used to:
    - Recognize recordable transactions
    - Record transactions
    - Make estimates
    - Create chart of accounts
    - Design source documents

- **Information technology**
  - Useful and common, but not essential in the accounting cycle
  - Used to:
    - Post transactions
    - Close nominal accounts
    - Generate financial statements and other reports

Classroom assessment

- In this lecture, we've examined five topics:
  - Accounting vs. bookkeeping
  - Accounting cycle
  - Internal control in the accounting cycle
  - Coding systems
  - Human judgment and information technology
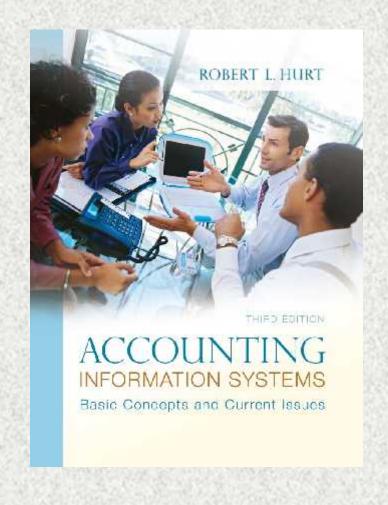
- Work with a partner to debate one of the assertions on the next slide.

Classroom assessment

- Debate one of these assertions with a partner:

  - All bookkeeping is accounting, but not all accounting is bookkeeping.

  - The accounting cycle is obsolete because of information technology.

  - Human judgment weakens internal control in the accounting cycle.

  - The general purpose financial statements provide all necessary information for decisions.