Lecture 1: A model for Processing Accounting Information

Learning Objectives

1. To learn the objectives of accounting information systems.
2. To review the steps in the accounting cycle.
3. To review how accounting information systems produce reports for external use.

Accounting Information System (AIS)

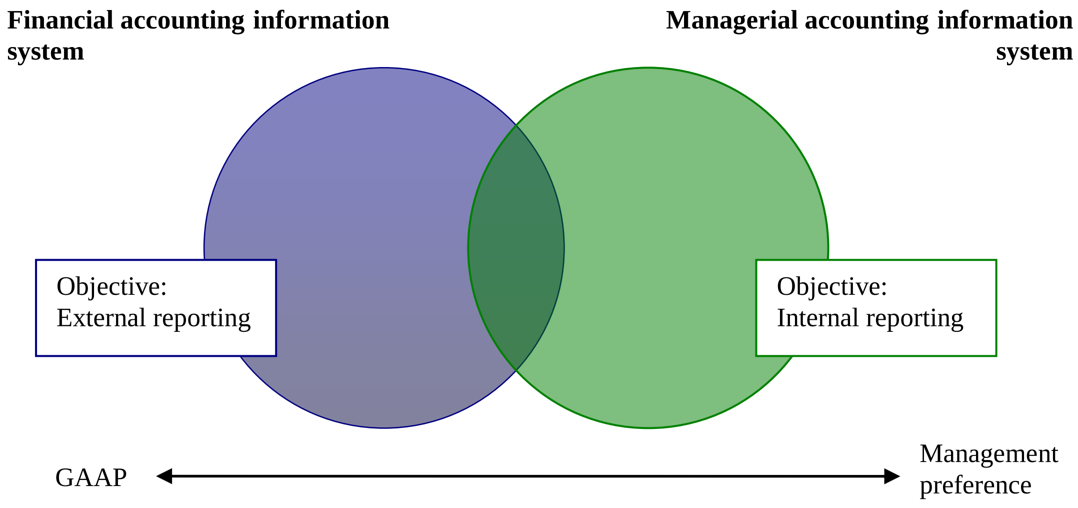
The AIS is a subsystem of Management Information System[1] that records, processes and reports information related to the financial aspects of business events. All AISs report events using accounting methods to achieve accounting objectives which determine the system's scope:

Financial accounting information system – an accounting system whose objective is to record, process and report past transactions in accordance with generally accepted accounting principles (GAAP) or international financial reporting standards (IFRS).

Managerial accounting information system – an accounting system that records, processes and reports financial information for internal use in accordance with the preferences of management. The scope of this system is usually broader than that required by GAAP or IFRS.

Both the financial and the managerial systems are interconnected. The following illustration 1.1 depicts AIS as two overlapping circles. The area where the circles overlap shows how these systems share certain components. For example, GAAP requires that the total AIS maintain data on accounts receivable. Management uses these data to decide which customers are creditworthy. Thus, these data are used for both external and internal reporting.

Illustration 1.1: Scope of the Accounting Information System



Source: BOCKHOLDT, J. L. *Accounting Information Systems: transaction processing and controls.* 5th edition, Boston: McGraw Hill Education 1999, ISBN 0-07-116098-1

[1] Management Information System (MIS) is a combination of people, procedures and machines intended to provide information for management decision making.

The Accounting Process

The accounting process starts when an economic event is recognized by AIS, which records this event as an accounting transaction. For financial accounting information systems, the activities that process a transaction constitute the **accounting cycle** with following six steps:

1. **Journalize.** Journalizing is the recording the transaction. Someone analyzes the event, determines the account it affects, identifies whether each account is debited/credited and enters the transactions chronologically in a journal.

2. **Post.** AIS transfers journal entries to ledgers. A ledger is a summary, by account, of all transactions affecting that account.

3. **Prepare a Trial Balance.** The trial balance is a summary of all the accounts in a general ledger and the balances in those accounts.

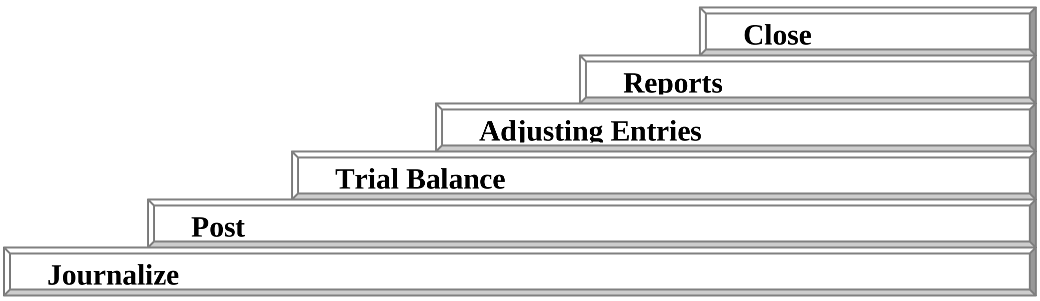
4. **Prepare Adjusting Entries.** The adjusting entries are accounting entries made at the end of financial reporting period to recorded accruals and deferrals and to correct previous errors.

5. **Prepare Accounting Reports.** The **income statement** and the **balance sheet** are the main accounting reports produced by a financial accounting information system. These reports are prepared from the adjusted trial balance, which reflected the adjusting entries.

6. **Close the Books.** After preparing the accounting reports, accountants prepare the accounting records for the next reporting period. This includes the posting of closing and reversing journal entries.

Nowadays the accounting data are processed in modern computer systems. Computer programs post entries and prepare the accounting reports. Accountants control this process by providing inputs and by determining how these programs work.

Illustration 1.2: Steps in the Accounting Cycle



Source: own design

Lecture 1 - Questions and exercises

Q 1-1: How does a transaction differ from an event?

Q 1-2: Distinguish between the scope and the objectives of the following accounting information systems:

a) Financial accounting information system
b) Managerial accounting information system

Q 1-3: The journal is sometimes known as a book of original entry. Suggest a reason for the journal's being so known.

Q 1-4: What is the purpose of preparing adjusting entries? How often must they be prepared?

Q 1-5: Describe an accounting process.

E 1-1: Ledger account

The following list contains accounting transactions and their effect on ledger account. Identify the items that are incorrect and write a correct solution.

Transaction	*Debit*	*Credit*
1. Introduction of cash as capital	Capital	Cash
2. Purchase of goods for cash	Purchases	Cash
3. Receipt of cash as loan	Cash	Loan
4. Purchase of goods on credit	Accounts payable	Purchases
5. Payment for credit supplies	Cash	Accounts payable
6. Sale of goods on credit	Accounts receivable	Sales revenue
7. Purchase of non-current asset for cash	Current asset	Cash
8. Sale of goods for cash	Cash	Sales revenue
9. Receipt from credit customer	Cash	Accounts payable
10. Payment of expense in cash	Expense	Cash

The main source:

BOCKHOLDT, J. L. *Accounting Information Systems: transaction processing and controls.* 5th edition, Boston: McGraw Hill Education 1999, ISBN 0-07-116098-1

The supplementary sources:

GELINAS, U. J., DULL, R. B. *Accounting Information Systems.* 8th edition, Mason: Cengage Learning, 2010, ISBN 978-0-324-66380-8

HALL, J. A. *Accounting Information Systems.* 7th edition, Mason: Cengage Learning, 2010, ISBN 978-1-4390-7857-0