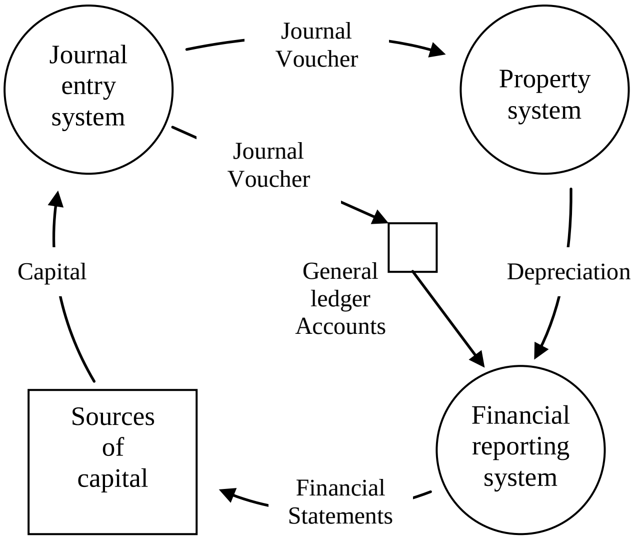
## Lecture 12: Financial Cycle Applications

### Learning Objectives

1. To learn the kinds of transactions processed in the financial cycle.
2. To find out which reports and records are produced in the financial cycle.

In the case of the financial cycle, the accounting system records two economic events: the acquisition of capital from creditors and owners and the use of that capital to acquire property to generate revenue. This cycle performs also a third function – the financial reporting function.

**Illustration 12.1:** The Financial Cycle




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

### Debt and Equity Capital

The sources of an organization's capital include its creditors and owners. Organizations distinguish three forms of capital transactions:

**1. Bank Loans.** These loans may be used for short-, medium- or long-term financing. Bank loans are usually secured by property or mortgages. The journal entry system records bank loans in the Notes Payable account.

**2. Bond Issues.** Large organizations acquire medium- and long-term capital by issuing bonds. The issue of bonds creates a contractual obligation to pay a fixed amount of interest at specified intervals. The journal entry system records each bond issue in a separate long-term liability account. The balance sheet summarizes bond issues under the heading Bonds Payable.

**3. Stock Issues.** Each share of stock represents an ownership interest in the corporation. A share of stock always has a *par* or *stated value*. Corporation use different Capital Stock accounts for each class of stock. They record the par or stated value of issued shares in Common Stock and Preferred Stock accounts.

***Accounting records for Debt and Equity Capital***

- **Notes Payable Ledgers** – these ledgers record outstanding notes. It identify the note, its holder, its maturity and current interest rate, and the original and current balance.

- **Bondholders Ledger** – this ledger maintain records of all the individuals and organizations that have purchased bonds.

- **Stockholders Ledger** – it maintains data on all individuals and organizations that have purchased stock.

**Property Systems**

The property system records all depreciable property, plant and equipment. This system records three types of transactions:

***1. Acquisition of property***

Companies use buildings and equipment when generating revenue. An example of an accounting entry is:

| Debit | | | Credit |
|---|---|---|---|
| Buildings | $xxx | Account Payable | $xxx |

***2. Depreciation***

Accountants use depreciation to approximate the consumption of property, plant and equipment as the firm produces goods or services. Accountants add each year's depreciation expense to an account called Accumulated Depreciation with an entry such as:

| Debit | | | Credit |
|---|---|---|---|
| Depreciation Expense | $xxx | Accumulated Depreciation | $xxx |

***3. Disposition of property***

Ultimately a business disposes of all of its revenue-producing property. If the property has value, they sell it; otherwise, they abandon it. The simplest form of accounting entry occurs when an asset is sold for its net book value:

| Debit | | | Credit |
|---|---|---|---|
| Cash | $xxx | Accumulated Depreciation | $xxx |
| | | Buildings | $xxx |

**The Journal Entry and Financial Reporting Systems**

Businesses record transaction in the general ledger using three types of accounting entries:

**1. Summaries of High-Volume Transactions.** High-volume transactions are those a business has many times each day (sales, purchases, manufacturing transactions)

**2. Low-Volume Transactions.** Low-volume transactions include those incurred to record changes in debt and equity capital, to dispose of depreciable property and to pay taxes.

**3. Closing entries.** Accountants make closing entries when preparing financial statements.

***Financial Statements***

The main reports in the financial reporting cycle are:

- The trial balance
- The balance sheet (The statement of financial position)
- The income statement (The statement of comprehensive income)
- The statement of cash flow

**Lecture 12 - Questions and exercises**

**Q 11-1:** Which economic events produce transaction in the financial cycle?

**Q 11-2:** What is the depreciation?

**Q 11-3:** Which three types of transactions are processed in the financial cycle?

**E 12-1: Low- and high-volume transacitons**

Application systems in the financial cycle process both low-volume transactions and summaries of high-volume transactions. Classify each accounting transaction in the following list as a low-volume or high-volume transaction:

a) Sell common stock.
b) Credit sale.
c) Receive bank loan.
d) Cash sale.
e) Reimburse payroll imprest account.
f) Increase allowance for doubtful accounts.
g) Acquire equipment.

**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