

CHAPTER 6

THE EXPENDITURE CYCLE – Part II

As mentioned in the prior chapter, the *expenditure cycle* is concerned with the acquisition of fixed assets, raw materials or manufactured components, and the use of employee labor to yield a finished product.

This chapter examines the *payroll subsystem* and the *fixed asset subsystem*.

The objectives of this chapter are:

- to recognize the fundamental tasks that constitute the payroll and fixed asset processes;
- to be able to identify the functional departments involved in payroll and fixed asset activities and trace the flow of expenditure transactions through the organization;
- to be able to specify the documents, journals, and accounts that provide audit trails, promote the maintenance of historical records, and support internal decision making and financial reporting;
- to understand the exposures associated with payroll and fixed asset activities and to recognize the controls that reduce these risks; and
- to be aware of the operational features and control implications of technology used in payroll and fixed asset systems.

I. Overview of Payroll Procedures

Payroll processing is extremely important to organizations and their employees. It is also very complex, given the necessity of tax withholding and employer payroll taxes. It is probable that everyone has, at some point, been an employee of some business and has been paid. In that position, you have been exposed to many elements of the payroll cycle. Build on your experience.

Fig. 6-1, on page 302, is a DFD of the payroll process. Pay attention to what is occurring.

A. Manual Payroll System

Fig. 6-2, on pages 304-5, is the matching document flow chart. Walk through the steps carefully. Sort out carefully what must occur in each functional area involved: *production, cost accounting, payroll, accounts payable, cash disbursements, and general ledger.*

There are also some excellent examples of forms used in a typical payroll system. You may have seen some of these where you work. Organizations do not produce paper work for the fun of it. Each of the documents presented (with sample figures) serves a very real purpose. Read carefully to learn the purpose of the *personnel action form, time card, job ticket, paycheck register, employee payroll record, and paycheck.*

B. Payroll Controls

Think of the way in which a payroll system could be abused. This will make the controls discussed more meaningful.

II. Computer-Based Payroll Systems

A. Automating the Payroll System with Batch Processing

The importance of payroll explains the fact that the first automated accounting application was payroll, at GE in Louisville, in 1954. One of the indications of the complexity lies in the amount of data involved and the number of files that must be maintained. Follow the discussion in the book carefully. This is important information that will tie in with your understanding of both cost and tax accounting. Payroll was the most obvious target for early

automation. A basic batch system really **fits** with a payroll operation. See **Fig. 6-9, on page 313.**

B. Reengineering the Payroll System

This discussion ties payroll to **human resource management** systems which require real-time features that are not needed by a free-standing payroll system. **Fig. 6-10, on page 315,** shows the payroll part of such a system. As more and more elements of information systems are linked, this integrated approach will become more common place.

III. The Fixed Asset System

Because of the high investment that firms have in their fixed assets, the structure and functioning of the fixed asset system is extremely important. It must be able to properly record the acquisition, maintenance, and disposition of all fixed assets. This includes control of acquisitions, recording of depreciation, and retirement and disposal. Your book compares the fixed asset system to the expenditure cycle. Note both the similarities and the differences. In particular, fixed asset acquisitions are *nonroutine* and the items acquired must be *capitalized*, not *expensed*.

A. The Logic of a Fixed Asset System

Fig. 6-11, on page 318, is a data flow diagram of a fixed asset system. It focuses attention on the three tasks of *asset acquisition*, *asset maintenance*, and *asset disposal*. Be sure that you understand the concerns in each phase. The value of assets that leads to their being capitalized, not expensed, adds complexity to the system. Refer also to what you learned about the accounting for fixed assets in your intermediate accounting course.

IV Computer-Based Fixed Asset System

Fig. 6-13, on page 321, shows a computer-based fixed asset system. Only the activities in dataprocessing and fixed asset departments are shown. However, to emphasize the three tasks of acquisition, maintenance, and disposal, the diagram is organized differently.

A. Controlling the Fixed Asset System

The controls discussed here are in addition to those that affect expenditures in general. Of particular importance are *authorization*, *supervision*, and

Notes

independent verification. The value of fixed assets makes control extremely important.

Review Questions for Chapter 6: 1-20.

Discussion Questions for Chapter 6: 1, 2, 7-14.