Learning objectives

After studying this chapter, you should be able to:

1. understand the theoretical foundation to accounting information systems (AISs)
2. distinguish data from information, discuss the characteristics of useful information, and explain how to determine the value of information
3. explain what decisions an organisation makes and the information needed to make them
4. identify the information that passes between internal and external parties and an AIS
5. describe the major business processes present in most companies
6. explain what an AIS is and describe its basic functions
7. discuss how an AIS can add value to an organisation
8. explain how an AIS and corporate strategy affect each other
9. explain the role an AIS plays in a company’s value chain
10. explain why accountants need to be knowledgeable about AISs
11. understand how ethics are important in AISs and how to analyse an ethical issue.

INTEGRATIVE CASE S&S

After working for years as a regional manager for a retail organisation, Scott Parry opened his own business with Susan Green, one of his district managers, as his partner. They formed S&S to sell appliances and consumer electronics. Scott and Susan pursued a ‘clicks and bricks’ strategy by renting a building in a busy part of town and adding an electronic shopfront.
Scott and Susan plan to invest enough money to see them through the first six months. They will hire 15 employees within the next two weeks—three people to stock shelves, four sales representatives, six sales assistants, and two people to develop and maintain the electronic shopfront.

Scott and Susan will host S&S’s grand opening in five weeks. To meet that deadline, they have to address the following issues:

1. What decisions do they need to make to be successful and profitable? For example:
   a. How should they price products to be competitive yet earn a profit?
   b. Should they extend credit and, if so, on what terms? How can they accurately track what customers owe and pay?
   c. How should they hire, train, and supervise employees? What compensation and benefits package should they offer? How should they process the payroll?
   d. How can they track cash inflows and outflows to avoid a cash squeeze?
   e. What is the appropriate product mix? What inventory quantities should they carry, given their limited showroom space?

2. What information do Scott and Susan need to make these decisions?
   a. What information do external entities, such as suppliers and banks, need?
   b. What information do management and other employees need?
   c. How can they gather, store, and disseminate that information?

3. What business processes are needed, and how should they be carried out?

4. What functionality should be provided on the website?

5. What controls are required to secure the firm’s resources and counter agency effects?

Although Scott and Susan could use an educated guess or ‘gut feeling’ to make these decisions, they know they can make better decisions if they obtain additional information. A well-designed accounting information system (AIS) can solve these issues and provide information they need to make any remaining decisions and control their business.
Information systems exist because they are an integral part of a modern organisation. Understanding the reason for information systems and justification for their existence flows from an understanding of why a modern organisation exists. Coase (1937) provided one answer in his *Theory of the Firm*. His argument was relatively simple. Firms are established because it is profitable to do so; firms organise to reduce the transaction costs of repeated and complicated activities involved in creating, selling and distributing goods and services.

While the market system has proven both enduring and robust, there are costs in using the *price mechanism*. A firm saves on these costs. The most obvious cost of organising production through the price mechanism is negotiating and writing a contract every time you want a new one. If, in our case of Scott and Susan’s retailing venture, they wished to sell clothing then to do so without other firms’ involvement, such as selling ready-to-wear clothes, would be difficult even prohibitive if they had to make clothes themselves.

First, they would need to purchase cotton from growers in northern New South Wales. They would need to organise for yarn manufacturers to make the thread; weavers to make the cloth; dyers to dye the cloth; and tailors or dressmakers to make the clothing. Setting aside designer and transport contracts, the process of ‘making’ their own clothing while being part of every aspect of the cost of the process would be prohibitive.

The main reason why it is profitable to establish a firm is the huge cost in doing everything for oneself. We can see that Susan and Scott face the obvious cost of ‘organising’ production through the price mechanism, which is the cost of what relevant prices are. They have to find suppliers and negotiate contracts including delivery terms. This cost may be reduced but it will not be eliminated by the emergence of specialist firms. There are specialist growers who contract to supply seed, fertilisers, water, labour, and as suppliers or intermediaries for capital. There are specialist yarn makers who contract with growers to provide the cotton and with labour and capital to fabricate cloth, and so on. There are specialist clothes designers and manufacturers. These firms reduce S&S’s costs of contracting allowing them to specialise in ‘retailing’.

It is true that contracts are not eliminated for Scott and Susan when they become a specialist retailer but they are greatly reduced. As owners, they do not have to make a series of contracts with resources they employ within the firm. This would be the case if they were working purely within the price system. Every time they wished to vary an employee’s task, they would need to write a new contract. For this series of contracts one contract is substituted. At this stage, it is important to note the character of an employee’s contract; for example, the employee agrees, for certain remuneration (which may be fixed or fluctuating), to obey the directions of Scott and Susan within certain limits. The essence of the contract is that it should only state the limit to the powers of the employer.

Here we see the efficiency of the firm as an organising mechanism over the market. Indeed some firms such as BHP-Billiton and Microsoft have larger turnovers than do many of the world’s smaller nations. They manage huge resources, continually allocating and reallocating these resources all outside the market system. A pertinent question to ask would be: If by organising, one can eliminate certain costs and in fact reduce the cost of production, why are there any market transactions at all? Why isn’t all production carried out by one big firm? There are three plausible explanations.

First, as a firm gets larger, there may be decreasing returns to the entrepreneurial function. That is, costs of organising additional transactions within a firm may rise. Second, as a firm grows, an entrepreneur fails to place resources in uses where their value is greatest; that is, fails to make the best use of resources available. Finally, the supply price of one or more of production resources may rise because ‘other advantages’ of a small firm are greater than those of a large firm. The actual point where the expansion of a firm ceases is determined by a combination of the above three factors. Figure 1.1 depicts these costs of organising. Note that the graph is rising; this reflects the ‘diminishing returns to management’. Figure 1.1 also depicts the costs of organising through the market mechanism. It shows the point where the loss through waste of resources is equal to the ‘market costs’ of exchange transactions in the open market. This is the optimum size for a firm.

Firms compete with each other in the market for resources and customers. The efficiency of the entrepreneurial decision-making is, in part, based on the relevance and efficiency of its
information system. The more efficient management decision-making is with respect to resource allocation within the firm, the lower its organising costs and the larger it can grow.

While an information system is paramount to the success and growth of a firm, it also has a role in managing managers of a firm. The existence of a firm can lead to agency costs where ownership of a firm is separate from its management as postulated in Agency Theory. Such would be the case if Susan and Scott chose to hire a manager and removed themselves from day-to-day operations. Scott and Susan as the owners want to extract maximum performance for minimum remuneration while a manager wants maximum remuneration for minimum effort. The owners will sensibly adjust a manager’s remuneration downwards to compensate for their poor performance and consumption of benefits or perks. To maximise their remuneration, managers have incentives to bond themselves to owners by writing contracts which constrain managers’ actions. Inclusive in managers’ contracts will be a need for monitoring and this monitoring function is performed or supported by information systems. The demand for information systems is also a function of contracting relationships between various principals (owners) and agents (managers). Contracts will often be written to use outputs of an information system—for example, management bonuses based on accounting profits. The key point is that the nature of agency relationships will determine the nature of the information system.

**FIGURE 1.1**
Transaction costs and costs of organising

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**Introduction**

We began this chapter by providing a theoretical framework for AISs to show that, although AIS is a practical subject, it has underlying concepts supported by research. It is an emerging area of applied science with a burgeoning body of literature.

Next we will explain important terms and discuss the kinds of information that organisations need as well as business processes used to produce that information. We will continue with an exploration of what an accounting information system (AIS) is, how an AIS adds value to an organisation, how an AIS and corporate strategy affect each other, and the role of an AIS in a value chain.

**Drivers of business and information system change**

Having established the importance and role of information systems, we now turn to address some of the issues that drive change in information systems. As an information system is the primary
source of information for managerial decision-making, drivers of systems’ changes are the same drivers of changes in the business itself. Figure 1.2 describes the cycle of business pressures as well as corporate and technological responses and their impacts on information systems. These pressures and responses in turn drive changes in technology placing further pressure on business. Drivers of change can also lead to rewards for an organisation. Some of these pressures derive from the push from globalisation, moves to deregulate business and capital markets, advances in technology, the trend to outsourcing, and the push to downsize organisations in order to contain costs.

**Globalisation**

The force behind the push of globalisation is technology. It is the enabler that has changed the way we communicate, transport goods and services, and travel. Technology has raised expectations of the isolated and the impoverished. The result is recognition by management of a new commercial technology that incorporates the benefits and risks of a global marketplace. Corporations who recognise this benefit from economies of scale in production, distribution, marketing and management of global markets may translate these economies into reduced world prices to the benefit of consumers and to the detriment of their competitors. But enhanced use of technologies has enabled organisations to interact with partners, suppliers, customers and joint venturers in a non-physical environment—a virtual environment. Even within a large multinational organisation, such as IBM, BHP-Billiton, Shell or Pepsi, various regional business units are acting locally but doing business globally in a virtual organisation. Our information systems have to adjust to this virtual business space so that appropriate collection, storage and processing of data can produce separate and consolidated reports for local and headquarter management decision-making. Firms also recognise the need and capability to use systems’ costs as a way of reducing organising costs (Figure 1.1) if they are to stay in business in a globalised market.

**Deregulation**

While globalisation is a trend in modern markets, the focus of legislators is the deregulation of markets. Australia and other countries in Asia and South America have moved a long way over the past 20 years to deregulate their financial, labour and business markets. The focus of this deregulation is the removal of constraints on competitive market forces through bi-lateral and multi-lateral free trade agreements, for example Australia–China, Australia–New Zealand, Australia–USA. Controls over commercial and financial systems have been relaxed and business competition has increased. Foreign exchange controls have been abolished; the Australian currency is one of the few that floats in response to competition and demand, with international trade barriers halved in that time. Import quotas have been abolished while transport and communication competition has increased. The effect is increased competition and the resultant need for companies to be more efficient both with their product markets and their information systems.

**Advances in technology**

While advances in information technology (IT) and communications have enabled the virtual organisation, the impact of technological change is best described by two laws: Metcalfe’s Law and
Moore’s Law. Metcalfe’s Law is often cited as a description of the rapid growth of the World Wide Web. Together with Moore’s Law about the rate at which computer power is accelerating, Metcalfe’s Law can be used to explain the rising wave of IT that we are riding through the 21st century.

Metcalfe’s Law is related to the fact that the number of unique connections in a network of a number of nodes (n) can be expressed mathematically as the triangular number n(n−1)/2, which is proportional to $n^2$ asymptotically. Simply put, the value of a network doubles with every new connection (node n). The more interconnected people are, the more valuable the network. Moore’s Law argues that chip density doubles every 18 months. However, there are no laws currently describing increases in storage capacity or increases in the speed of communication.

Describing the change of pace in technology as ‘rapid’ is an understatement. What we do know is that there is no sign of a slowdown in the pace of change. While changes in technology are partly in response to the needs of the business community, developments in technology also place pressure on businesses. In 2011, the placement in receivership of one of Australia’s largest book-sellers (Borders and Angus and Robertson) was initially attributed to the trend in buyers’ habits to make their purchases over the internet rather than in stores. This is a classic example of technology enabling consumers to undertake transactions more cheaply via the web than through traditional corporations. Thus companies need to use information systems to be more efficient and reduce costs of transacting with customers, such as an enterprise resource planning (ERP) system which integrates all aspects of an organisation’s activities into one system, including its traditional AIS.

Outsourcing and downsizing

Outsourcing and downsizing are two organisational responses to business pressures. Almost all of Australia’s communications and banking companies have outsourced their customer relations to offshore call centres. Telstra, Australia’s largest telecommunications company, has downsized its programming functions and outsourced much of that activity to cheaper labour countries such as India. Again we see the need for information systems that can support virtual organisations.

We have now laid the theoretical foundation and concepts for information systems in general; future chapters will relate these concepts to accounting information systems and, where appropriate, to aspects of control, cycles and other issues. Before we go on to these areas, we need to have a clear understanding of systems, data and information, and how modern organisations can gain value from these resources, which cost firms a lot of money to acquire and use.

Systems, data, information and its value

Good design can be defined as the process of inventing objects or items that display a new physical order in response to function. Good design is the successful execution of the following three components of design:

1. Determine objectives (not always an easy task).
2. Determine what needs to be done to achieve those objectives.
3. Choose the ‘best’ components to execute the actions needed to achieve objectives.

These components of good design also need to be applied when designing non-physical things such as systems.

A system is a set of two or more interrelated components that interact to achieve a goal. Most systems are composed of smaller subsystems that support the larger system. For example, a faculty of business is a system composed of various departments, each of which is a subsystem. Moreover, a faculty itself is a subsystem of a university.

Each subsystem is designed to achieve one or more organisational goals. Changes in subsystems cannot be made without considering the effect on other subsystems and on the system as a whole. Goal conflict occurs when a subsystem is inconsistent with the goals of another subsystem or with the system as a whole. Goal congruence occurs when a subsystem achieves its goals while contributing to the organisation’s overall goal. The larger the organisation and the more complicated the system, the more difficult it is to achieve goal congruence.

In designing a system we need to focus on a few system aspects. Simplicity is desirable, but is usually at variance with the range of components that can be used. Performance is best if we
choose the best components but this often makes interfacing components (jointing) more difficult. *Economy* is desirable, but is usually at variance with performance. Good design results in a system that delivers these key aspects in combination with the system’s environment. The question is, ‘How do we know good design?’ To specify all that is good in a system is a Herculean task. What good designers in other fields have recognised is that good design is an absence of ‘wrong things’.

*Data* is a set of facts that are collected, recorded, stored and processed by an information system. Businesses need to collect several kinds of data, such as activities that take place, resources affected by activities, and people who participate in activities. For example, a business needs to collect data about a sale (date, total amount), the resource sold (good or service, quantity sold, unit price), and the people who participated (customer, salesperson).

*Information* is data that has been organised and processed to provide meaning and improve decision-making processes. As a rule, users make better decisions as the quantity and quality of information increase.

There are limits to the amount of information a human mind can absorb and process. Information overload, or more correctly, *data overload*, occurs when those limits are passed, resulting in a decline in decision-making quality and an increase in the cost of providing that information. Information system designers use IT to help decision-makers more effectively filter and condense information. For example, Wal-Mart has over 500 terabytes (trillions of bytes) of data in its data warehouse. That is equivalent to 3200 kilometres of bookshelves, or about 100 million digital photos. McKinsey Global Institute estimates that in 2009, nearly all companies in the United States with at least 1000 employees on average stored at least 400 terabytes of data — twice the size of Wal-Mart’s data warehouse in 1999. Wal-Mart has invested heavily in IT so it can effectively collect, store, analyse and manage data to provide useful information.

The value of information is the benefit produced by the information minus the cost of producing it. Benefits of quality information are reduced uncertainty, improved decisions, and improved ability to plan and schedule activities, resulting in lower organising costs. The costs are the time and resources spent to produce, store and distribute information. Information costs and benefits can be difficult to quantify, and it is difficult to determine the value of information before it has been produced and utilised. Nevertheless, the expected value of information should be calculated as effectively as possible so that costs of producing information do not exceed its benefits.

To illustrate the value of information, consider the case of 7-Eleven. In 1973, a Japanese company licensed the very successful 7-Eleven name from Southland Corporation in America. As it opened its stores, 7-Eleven Japan invested heavily in IT, but the USA stores did not. Each 7-Eleven store in Japan was given a computer that:

- kept track of the 3000 items sold in each store and determined what products were moving, at what time of day, and under what weather conditions
- kept track of what and when customers bought to make sure it had in stock products most frequently purchased
- ordered sandwiches and rice dishes from suppliers automatically; orders were placed and filled three times a day so that stores always had fresh food; in addition, 7-Eleven allowed its suppliers to access sales data in its computers so that they could forecast demand
- coordinated deliveries with suppliers; this reduced deliveries from 34 to 12 a day, resulting in less clerical receiving time
- prepared a colour graphic display that indicated which store areas contributed the most to sales and profits.

Average daily sales of 7-Eleven Japan were 30% higher and its operating margins almost double those of its closest competitor. What happened to Southland and its 7-Eleven stores in the United States? Profits declined, and Southland eventually had to file for bankruptcy. Who came to the company’s rescue? Along with its parent company, 7-Eleven Japan purchased 64% of Southland.

Table 1.1 presents 10 characteristics that make information useful and meaningful. These characteristics can also be viewed as the ‘wrongness’ that must be avoided to achieve a good system design. One.Tel Limited is an example of where these characteristics went wrong. One.Tel was a mobile phone company expected to make considerable inroads into the Australian market. Its information system failed to meet the first three characteristics of a good system that provides useful information. The system failed to capture all its sales (lack of completeness), it
failed to reliably report amounts owing by its customers (lack of reliability) because it failed to measure customers’ transactions accurately (measurability), and it failed to inform management of the cash position of the company as a result of these problems (lack of relevance).

When designers design, whether it is a building or an information system, it is not possible to specify all of the things that make the product, building or system effective and efficient. The list of things that must be right is almost infinite. Designers deal with this problem by changing the perspective of a problem. They seek to eliminate all the things that can go wrong. Architects have specifications that apply to all buildings in terms of safety, ventilation, etc. Systems’ designers have the list specified in Table 1.1 to guide them about the things that may go wrong.

If we design an AIS that only processes real transactions the system will be more relevant and reliable. The situation of the National Safety Council of Victoria is one where the bulk of the organisation was fictitious. Assets did not exist and transactions were faked. If we design a system where only valid transactions are processed, we are unlikely to face the problems associated with the demise of Clive Peeters Limited, which was stung in 2010 by a $20 million employee fraud.

If we design a system that produces timely information, that information will be more relevant to a decision-maker. If we design a system that measures its transactions accurately, presents its information in an understandable form, and allows that information to be audited and accessible to authorised users, we will have a relevant and reliable system. For designers, relevance and reliability are necessary end products, and it is the other characteristics—existence, valid, complete, timely, measurable, understandable, verifiable, and accessible—that allow us to achieve these higher level objectives.

**Information needs and business processes**

All organisations need information in order to make effective decisions. In addition, all organisations have certain business processes that they are continuously engaged in. A *business process* is a set of related, coordinated, and structured activities and tasks that are performed by a person, or by a computer or a machine, and help accomplish a specific organisational goal.

To make effective decisions, organisations must decide what decisions they need to make, what information they need to make decisions, and how to gather and process data needed to produce information. This data gathering and processing is often tied to basic business processes in an organisation. To illustrate the process of identifying information needs and business processes, let’s return to our case study of S&S.

**TABLE 1.1 Characteristics of useful information**

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relevant</td>
<td>Reduces uncertainty, improves decision-making, or confirms or corrects prior expectations.</td>
</tr>
<tr>
<td>Reliable</td>
<td>Free from error or bias; accurately represents organisation events or activities.</td>
</tr>
<tr>
<td>Existence</td>
<td>The transactions, assets, obligations and equity generated in the system exist.</td>
</tr>
<tr>
<td>Valid</td>
<td>Only those transactions and reports that are authorised by the firm should be processed.</td>
</tr>
<tr>
<td>Complete</td>
<td>Does not omit important aspects of the events or activities it measures.</td>
</tr>
<tr>
<td>Timely</td>
<td>Provided in time for decision-makers to make decisions.</td>
</tr>
<tr>
<td>Measurable</td>
<td>Transactions, assets, liabilities, and equities processed in the system are measured accurately.</td>
</tr>
<tr>
<td>Understandable</td>
<td>Presented in a useful and intelligible format.</td>
</tr>
<tr>
<td>Verifiable</td>
<td>Two independent, knowledgeable people can produce the same information.</td>
</tr>
<tr>
<td>Accessible</td>
<td>Available to users when they need it and in a format they can use.</td>
</tr>
</tbody>
</table>
Information needs
Scott and Susan decide they must understand how S&S functions before they can identify the information they need to manage S&S effectively. Then they can determine the types of data and procedures they will need to collect and produce that information. They created Table 1.2 to summarise part of their analysis. It lists S&S’s basic business processes, some key decisions that need to be made for each process, and information they need to make decisions.

Scott and Susan realise that the list is not exhaustive, but they are satisfied that it provides a good overview of S&S. They also recognise that not all information needs listed in the right-hand column (Table 1.2) will be produced internally by S&S. Information about payment terms for merchandise purchases, for example, will be provided by vendors. Thus, S&S must effectively integrate external data with internally generated data so that Scott and Susan can use both types of information to run S&S.

### TABLE 1.2 Overview of S&S’s business processes, key decisions and information needs

<table>
<thead>
<tr>
<th>Business process</th>
<th>Key decisions</th>
<th>Information needs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquire capital</td>
<td>How much</td>
<td>Cash flow projections</td>
</tr>
<tr>
<td></td>
<td>Find investors or borrow funds</td>
<td>Pro forma financial statements</td>
</tr>
<tr>
<td></td>
<td>If borrowing, obtaining best terms</td>
<td>Loan amortisation schedule</td>
</tr>
<tr>
<td>Acquire building and equipment</td>
<td>Size of building</td>
<td>Capacity needs</td>
</tr>
<tr>
<td></td>
<td>Amount of equipment</td>
<td>Building and equipment prices</td>
</tr>
<tr>
<td></td>
<td>Rent or buy</td>
<td>Market study</td>
</tr>
<tr>
<td></td>
<td>Location</td>
<td>Tax tables and depreciation regulations</td>
</tr>
<tr>
<td></td>
<td>How to depreciate</td>
<td></td>
</tr>
<tr>
<td>Hire and train employees</td>
<td>Experience requirements</td>
<td>Job descriptions</td>
</tr>
<tr>
<td></td>
<td>How to assess integrity and competence of applicants</td>
<td>Applicant job history and skills</td>
</tr>
<tr>
<td></td>
<td>How to train employees</td>
<td></td>
</tr>
<tr>
<td>Acquire inventory</td>
<td>What models to carry</td>
<td>Market analyses</td>
</tr>
<tr>
<td></td>
<td>How much to purchase</td>
<td>Inventory status reports</td>
</tr>
<tr>
<td></td>
<td>How to manage inventory (store, control, etc.)</td>
<td>Vendor performance</td>
</tr>
<tr>
<td></td>
<td>Which vendors</td>
<td></td>
</tr>
<tr>
<td>Advertising and marketing</td>
<td>Which media</td>
<td>Cost analyses</td>
</tr>
<tr>
<td></td>
<td>Content</td>
<td>Market coverage</td>
</tr>
<tr>
<td>Sell merchandise</td>
<td>Mark-up percentage</td>
<td>Pro forma income statement</td>
</tr>
<tr>
<td></td>
<td>Offer in-house credit</td>
<td>Credit card costs</td>
</tr>
<tr>
<td></td>
<td>Which credit cards to accept</td>
<td>Customer credit status</td>
</tr>
<tr>
<td>Collect payments from customers</td>
<td>If offering credit, what terms</td>
<td>Customer account status</td>
</tr>
<tr>
<td></td>
<td>How to handle cash receipts</td>
<td>Accounts receivable ageing report</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Accounts receivable records</td>
</tr>
<tr>
<td>Pay employees</td>
<td>Amount to pay</td>
<td>Sales (for commissions)</td>
</tr>
<tr>
<td></td>
<td>Deductions and withholdings</td>
<td>Time worked (hourly employees)</td>
</tr>
<tr>
<td></td>
<td>Process payroll in-house or use outside service</td>
<td>Payroll summary</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Costs of external payroll service</td>
</tr>
<tr>
<td>Pay taxes</td>
<td>Payroll tax requirements</td>
<td>Government regulations</td>
</tr>
<tr>
<td></td>
<td>Goods &amp; services/value added tax requirements</td>
<td>Total wage expense</td>
</tr>
<tr>
<td>Pay vendors</td>
<td>Whom to pay</td>
<td>Total sales</td>
</tr>
<tr>
<td></td>
<td>When to pay</td>
<td></td>
</tr>
<tr>
<td></td>
<td>How much to pay</td>
<td>Vendor invoices</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Accounts payable records</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Payment terms</td>
</tr>
</tbody>
</table>

S&S will interact with many external parties, such as customers, vendors and governmental agencies, as well as with internal parties such as management and employees. To get a better handle on the more important interactions with these parties, they prepared Figure 1.3.
Business processes
Scott decides to reorganise the business processes listed in Table 1.2 into groups of related transactions. A transaction is an agreement between two entities to exchange goods or services or any other event that can be measured in economic terms by an organisation. Examples include selling goods to customers, buying inventory from suppliers and paying employees. The process that begins with capturing transaction data, then storing data and ends with informational output, such as financial statements, is called transaction processing. Transaction processing is covered in more depth in Chapter 2.

Many business activities are pairs of events involved in a ‘give-get’ exchange. Most organisations engage in a small number of ‘give-get’ exchanges, but each type of exchange happens many times. For example, S&S will have thousands of sales to customers every year in exchange for cash. Likewise, S&S will continuously buy inventory from suppliers in exchange for cash. These exchanges, sometimes called the ‘nexus of contracts’ (Figure 1.4) can be grouped into five major business processes or transaction cycles and form the subsystems of the total accounting information system:

- **Revenue cycle**, where goods and services are sold for cash or a future promise to receive cash. This cycle is discussed in Chapter 7.
- **Expenditure cycle**, where companies purchase inventory for resale or raw materials to use in producing products in exchange for cash or a future promise to pay cash. This cycle is discussed in Chapter 8.
- **Human resources management (HRM) cycle/payroll subcycle**, where employees are hired, trained, compensated, evaluated, promoted, and terminated. This cycle is discussed in Chapter 9.
- **Production** or conversion cycle, where raw materials are transformed into finished goods. This cycle is discussed in Chapter 10.
- **Financing cycle**, where shares of a company are sold to investors, where companies borrow money, and where investors are paid dividends and interest is paid on loans. This cycle is not covered in detail in this text but is referred to in various chapters.
- **General ledger and reporting cycle** brings together the data processed through the other cycles. This is discussed in Chapter 11.

These cycles process a few related transactions repeatedly. For example, most revenue cycle transactions are either selling goods or services to customers or collecting cash for those sales. Figure 1.5 shows the main transaction cycles and the ‘give-get’ exchange inherent in each cycle.
These basic ‘give-get’ exchanges are supported by a number of other business activities. For example, S&S may need to answer a number of customer enquiries and check inventory levels before it can make a sale. Likewise, it may have to check customer credit before a credit sale is made. Accounts receivable will have to be increased each time a credit sale is made and decreased each time a customer payment is received. Figure 1.6 shows the major activities in each transaction cycle.

Notice that the last activity in Figure 1.6 for each transaction cycle is ‘Send appropriate information to other cycles’. Figure 1.7 shows how these various transaction cycles relate to one another and interface with the general ledger and reporting cycle, which is used to generate information for both management and external parties.

In many accounting software packages, the various transaction cycles are implemented as separate modules. Not every organisation needs to implement every module. Retail stores like S&S, for example, do not have a production cycle and would not implement that module. Moreover, some types of organisations have unique requirements. Financial institutions, for example, have demand deposit (deposit of money that can be withdrawn without prior notice) and instalment-loan (a loan that is paid back in several payments, or instalments, rather than all at once) cycles that relate to transactions involving customer accounts and loans, respectively. In addition, the nature of a given transaction cycle differs across different types of organisations. For example, the expenditure cycle of a service company, such as a public accounting firm or a law firm, does rarely involve processing transactions related to the purchase, receipt and payment for merchandise that will be resold to customers.

Each transaction cycle can include many different business processes or activities. Each business process can be relatively simple or quite complex. Focus 1.1 shows how Toyota’s attention to continuously improving its business processes has helped it become the largest and one of the most profitable automobile manufacturers in the world.

**FIGURE 1.6**
Activities of each transaction cycle
After preparing Table 1.2 and Figure 1.3, Scott and Susan believe that they understand S&S well enough to begin shopping for an information system. Susan recalled a previous employer that had several separate information systems, because their software was not designed to accommodate the information needs of all managers. She also vividly recalled attending one meeting where she witnessed the negative effects of having multiple systems. The head of marketing had one report on year-to-date sales by product, the production manager had a different report that
Improving business processes helps drive Toyota’s success

Toyota builds three models—Camry, Hybrid Camry and Aurion—in Australia. The fully integrated Altona manufacturing plant incorporates state-of-the-art weld, paint and assembly shops to produce cars that have been independently recognised as Australia’s best quality locally built vehicles. Toyota Australia manufactured a record 119,455 vehicles and 88,864 engines at the Altona plant in 2010.13

A major factor in its success is the Toyota Production System (TPS), which is a set of philosophies, principles and business processes supported by IT. Its goal is to improve continually so Toyota has the most effective and most efficient manufacturing and business processes possible. Toyota willingly shares the TPS and its manufacturing and business processes with its suppliers to help them improve their quality and efficiency. It also shares the TPS with its competitors, knowing that by the time they duplicate it Toyota will have a greatly improved TPS.14

The following are some of the principles and business processes on which the TPS is built and which Toyota’s information systems must support and enable.

- Performance-monitoring software warns assembly line workers of equipment problems. Workers stop production whenever necessary to prevent or correct defects.
- Its just-in-time (JIT) inventory system is one of the most sophisticated in the world. Driverless carts take parts to assembly stations when they are needed so that inventory does not pile up. Suppliers must meet rigid delivery standards. Four hours before they are needed, Toyota software electronically notifies Johnson Controls of exactly what kind of car seats are needed for each car and the exact order in which they must be shipped.

- Continuous improvement is a critical and ongoing process. No process or detail is too small or insignificant to improve. Technology is especially important in the continuous improvement process. This emphasis on continuous improvement creates a culture that values continuous learning and embraces change.
- Electronic displays connected to the manufacturing equipment help workers monitor the assembly line. Information is communicated by light colours (green means the process is operating correctly, yellow means a problem is being investigated and red means the assembly line has stopped) and by printed messages (which machine malfunctioned, its speed and temperature when it broke down, and who was operating the machine).
- Electronic quality control devices, such as an electronic sensor on a tool or a beam of light, monitor a process. These devices let a computer know when a tool is not used or a required part is not picked up and used at the appropriate time.
- More than half of Toyota’s information systems employees work in operations at its plants so they can accompany executives, team leaders and factory workers when they go to solve assembly line problems.

In summary, Toyota has a very clear and in-depth understanding of the business processes that make it successful, continuously improves those processes, and understands the role information systems play in managing, supporting and facilitating those processes.

contained different sales figures, and the controller’s report, which was produced by the general ledger cycle, had yet a third version of year-to-date sales. Over an hour was wasted trying to reconcile those different reports! Susan vowed that she would make sure that S&S did not ever find itself in such a mess. She would make sure that any system selected would have the capability to integrate both financial and non-financial data about S&S’s various business processes so that everyone could pull information from the same system.

Accounting information systems

It has often been said that accounting is the language of business. If that is the case, then an AIS is the intelligence—the information-providing vehicle—of that language.

Accounting is a data identification, collection and storage process as well as an information development, measurement and communication process. By definition, accounting is an information system, since an AIS collects, records, stores, and processes accounting and other data to produce information for decision-makers. This is illustrated in Figure 1.8.

An AIS can be a paper-and-pencil manual system, a complex system using the latest in IT, or something in between. Regardless of the approach taken, the process is the same. An AIS must collect, enter, process and store data as well as report information. Paper and pencil or computer hardware and software are merely tools used to produce information.

This text does not distinguish an AIS from other information systems. Instead, our viewpoint is that an AIS can and should be an organisation’s primary information system and that it provides users with information they need to perform their jobs.

There are six components of an AIS:

1. **people** who use a system
2. **procedures and instructions** used to collect, process and store data
3. **data** about an organisation and its business activities
4. **software** used to process data
5. **IT infrastructure**, including computers, external devices (e.g. printers, external hard drives), and network communications devices used in an AIS
6. **internal controls and security measures** that safeguard AIS data.

These six components enable an AIS to fulfil three important business functions:

1. Collect and store data about organisational activities, resources and personnel—organisations have a number of business processes, such as making a sale or purchasing raw materials, which are repeated frequently
2. Transform data into information so management can plan, execute, control and evaluate activities, resources and personnel—decision-making is discussed later in this chapter
3. Provide adequate controls to safeguard an organisation’s assets and data—control concepts are overviewed in Chapter 5 and discussed in detail in Chapters 12 to 17.

**FIGURE 1.8**
An AIS processes data to produce information for decision-makers

How an AIS can add value to an organisation

A well-designed AIS can add value to an organisation by:

1. **improving the quality and reducing costs of products or services**—for example, an AIS can monitor machinery so that operators are notified immediately when performance falls outside acceptable quality limits; this helps maintain product quality, reduces waste and lowers costs
2. **improving efficiency**—for example, timely information makes a just-in-time manufacturing approach possible, as it requires constant, accurate, up-to-date information about raw materials inventories and their locations.

3. **sharing knowledge**—sharing knowledge and expertise can improve operations and provide a competitive advantage; for example, certified practicing accountant (CPA) firms use their information systems to share best practices and to support communication between offices; employees can search the corporate database to identify experts to provide assistance for a particular client; thus, a CPA firm’s international expertise can be made available to any local client.

4. **improving efficiency and effectiveness of its supply chain**—for example, allowing customers to directly access inventory and sales order entry systems can reduce sales and marketing costs, thereby increasing customer retention rates.

5. **improving the internal control structure**—an AIS with the proper internal control structure can protect systems from fraud, errors, system failures and disasters.

6. **improving decision-making**—improved decision-making is vitally important and is discussed below in more detail.

Decision-making is a complex, multi-step activity: identify the problem, collect and interpret information, evaluate ways to solve the problem, select a solution methodology, and implement the solution. An AIS can provide assistance in all phases of decision-making. Reports can help to identify potential problems. Decision models and analytical tools can be provided to users. Query languages can gather relevant data to help make decisions. Various tools, such as graphical interfaces, can help a decision-maker interpret decision model results, evaluate them, and choose among alternative courses of action. In addition, an AIS can provide feedback on results of actions.

An AIS can help improve decision-making in several ways:

- it can identify situations requiring management action—for example, a cost report with a large variance might stimulate management to investigate and, if necessary, take corrective action.
- it can reduce uncertainty and thereby provide a basis for choosing among alternative actions.
- it can store information about results of previous decisions, which provides valuable feedback that can be used to improve future decisions—for example, if a company tries a particular marketing strategy and the information gathered indicates that it did not succeed, a company can use that information to select a different marketing strategy.
- it can provide accurate information in a timely manner—for example, Wal-Mart, Coles and Myer have enormous databases that contain detailed information about sales transactions at each store; they use this information to optimise the amount of each product carried at each store.
- it analyses sales data to discover items that are purchased together, and it uses such information to improve the layout of merchandise to encourage additional sales of related items—in a similar vein, Amazon.com uses its database of sales activity to suggest additional books for customers to purchase.

### AIS and corporate strategy

Since most organisations have limited resources, it is important to identify AIS improvements likely to yield the greatest return. Making a wise decision requires an understanding of an organisation’s overall business strategy. To illustrate, consider the results of a survey of Australian chief information officers (CIOs) conducted by a CIO magazine. Asked to identify the most important CIO management priorities, aligning IT and strategic goals of the organisation was one of the top priorities in 2008 and second in 2010. Long-term strategic thinking and planning was the most critical leadership capability.15

Figure 1.9 shows three factors that influence the design of an AIS: developments in IT, business strategy and organisational culture. It is also important to recognise that the design of an AIS can influence an organisation’s culture by controlling the flow of information within an organisation. For example, an AIS that makes information easily accessible and widely available is likely to increase pressures for more decentralisation and autonomy.

IT developments can affect business strategy. For example, the internet has profoundly affected ways many activities are performed, significantly affecting both strategy and strategic
The internet dramatically cuts costs, thereby helping companies to implement a low-cost strategy. If every company used the internet to adopt a low-cost strategy, then the effects might be problematic. Indeed, one possible outcome may be intense price competition among firms, with the likely result that most cost savings provided by the internet get passed on to an industry’s customers, rather than being retained in the form of higher profits. Moreover, because every company can use the internet to streamline its activities, a company is unlikely to gain a sustainable long-term competitive advantage.

Many other technological advances affect company strategy and provide an opportunity to gain a competitive advantage. An example is predictive analysis, which uses data warehouses and complex algorithms to forecast future events, based on historical trends and calculated probabilities. Predictive analysis provides an educated guess of what one may expect to see in the near future, allowing companies to make better business decisions and improve their processes. FedEx uses predictive analysis to predict, with 65% to 90% accuracy, how customers respond to price changes and new services. Stock market analysts are using predictive analysis to predict short-term trends in the stock market.

An organisation’s AIS plays an important role in helping it adopt and maintain a strategic position. Achieving a close fit among activities requires that data be collected about each activity. It is also important that an information system collects and integrates both financial and non-financial data about an organisation’s activities.

Focus 1.2 shows how an information system that was used to create and implement a balanced scorecard helped the Ministry of Work Bahrain define and execute its strategy.

Role of an AIS in a value chain
To provide value to their customers, most organisations perform a number of different activities. Figure 1.10 shows that those activities can be conceptualised as forming a value chain consisting of five primary activities that directly provide value to customers:

1. **Inbound logistics** consist of receiving, storing and distributing materials an organisation uses to create services and products it sells. For example, an automobile manufacturer receives, handles and stores steel, glass and rubber.
2. **Operations** activities transform inputs into final products or services. For example, motor vehicle assembly line activities convert raw materials into a finished car.
3. **Outbound logistics** activities distribute finished products or services to customers. An example is shipping automobiles to car dealers.
4. **Marketing and sales** activities help customers buy an organisation’s products or services. Advertising is an example of a marketing and sales activity.
5. **Service** activities provide post-sale support to customers. Examples include repair and maintenance services.

**Support activities** allow the five primary activities to be performed efficiently and effectively. They are grouped into four categories:

1. **Firm infrastructure** is usually made up of accounting, finance, legal and general administration activities that allow an organisation to function. An AIS is part of a firm’s infrastructure.
2. Human resources activities include recruiting, hiring, training and compensating employees.

3. Technology activities improve a product or service. Examples include research and development, investments in IT, and product design.

4. Purchasing activities procure raw materials, supplies, machinery and buildings used to carry out primary activities.

The Kingdom of Bahrain, United Arab Emirates, aimed to achieve economic and social transformation. It knew that its oil reserves would eventually run out and it needed to become less dependent on the revenue it generated. An Office of Strategy Management was established to facilitate the strategic management process that included the creation and implementation of a world-class balanced scorecard system for which it was inducted into the prestigious Balanced Scorecard Hall of Fame in 2009.

The Office of Strategy Management used a long-range strategy called Bahrain Vision 2030, which took four years of consultation and was presented to the Kingdom by the Economic Development Board in November 2007. In 2008 the Ministry of Works with 1600 professional staff and responsibility for roads, utilities and construction of public works mapped its strategy against the Kingdom’s vision and integrated with the other 15 ministries. They used the balanced scorecard approach to do this mapping of strategy with the vision.

Implementing a sound process for prioritising initiatives is crucial as budgets are bound by initiatives and projects. These budgets need to be submitted to the Ministry of Finance in a timely fashion to be integrated into the Kingdom’s budget. After the creation of the overall budget checks need to be made to align it back to the Bahrain Vision 2030 using the balance scorecards of sectors and directorates.

Given the size of the strategic management and scorecard effort, the Office of Strategy Management (OSM) was formed. They adopted the evidence-based management framework and methodology described in Bernard Marr’s book *The Intelligent Company: Five Steps to Success with Evidence-Based Management*. The key steps in this model, which is fed with the business strategy and supported by the IT infrastructure and business intelligence applications, are:

1. define objectives and information needs
2. collect the right information
3. analyse the data and gain insights
4. present and communicate the information
5. make evidence-based decisions.

Automation played a critical role in improving strategic management. The balanced scorecard system improved decision-making, performance management and tracking progress of projects. It also handled the large documentation and reporting required. This had previously been handled by SharePoint but was found to be insufficient for the needs they had and the demands for strategic management information.

Using IT to redesign supply chain systems yields tremendous benefits and cost savings. For example, a power generator reengineered its supply chain and created an enterprise-wide system that provides up-to-the-minute information, rather than the ‘current once a day’ system that it replaced. The new system replaced 20 smaller and incompatible systems, reduced head count by 89 people, and saved $270 million in its first five years.

An organisation’s value chain is a part of a larger system called a supply chain. As shown in Figure 1.11, a manufacturing organisation interacts with its suppliers and distributors. By paying attention to its supply chain, a company can improve its performance by helping others in a supply chain to improve their performance. For example, S&S can improve its purchasing and inbound logistics activities by implementing a more efficient just-in-time inventory management system that reduces its costs and minimises the capital tied up in inventory. S&S can reap additional benefits if it links its new systems with its suppliers so they can perform their primary value chain activities more efficiently. For example, by providing more detailed and timely information about its inventory needs, S&S suppliers can more efficiently plan their production schedules. Part of the resultant cost reduction can be passed on to S&S in the form of lower product costs.

The problems created by an ineffective supply chain are illustrated by USA retail giant Limited Brands. Limited experienced explosive growth, including acquisitions of other retail companies such as Victoria’s Secret and Abercrombie & Fitch. These acquisitions left Limited with a tangled web of over 60 incompatible information systems. The problems came to a head one night when 400 delivery trucks converged on a distribution centre car park that could fit only 150 vehicles. The trucks blocked traffic along all the highways around the distribution centre and caused countless traffic and community problems. No one in Limited knew where all the delivery trucks came from, what the merchandise was, or where it was to be sent. Chaos reigned for some time, until the merchandise could be routed to stores and other distribution centres. Limited solved many of its problems by installing a new, integrated system that greatly improved its supply chain processes and technologies. Developing the new system was not easy. Limited has over a thousand suppliers and sells its merchandise using various platforms, including retail stores, the internet, catalogues and third-party retailers.

Why study accounting information systems?

Since accounting data comes from an AIS, AIS knowledge and skills are critical to an accountant’s career success. Interacting with an AIS is one of the most important activities that accountants perform. Other important AIS-related activities include designing internal control systems and business process improvements, topics covered in detail in this text. Here are some other reasons why you need a knowledge of AIS if you are going to practice as an accountant, chief financial officer (CFO) or even a chief executive officer (CEO).

Many of the courses you study in your accounting program focus on your role as a user or provider of information (e.g. preparing financial statements), such as financial, managerial, tax and auditing. Most of these courses assume that data has been collected and stored and you have access to that data. But these courses do not describe or discuss how the data is collected and protected. The information system is treated as a ‘black box’ into which data is poured and information comes out. Some people assume that if a computer has produced information ‘it must be right’. Even at this stage of your reading this text, you must have gathered the impression that this assumption is not valid; things can go wrong. As an accountant you need to provide advice, if not a full solution, to issues that arise from an AIS.

All accounting bodies in Australia, New Zealand and Asia require the inclusion of information systems design, development and applications in accredited accounting degrees. Some bodies make it compulsory where others recommend the AIS area to be included. The reason for this is that it is important if you are going to pursue a career in public accounting, industry, government, not-for-profit organisation or management consulting. As an auditor you need to be able to evaluate the accuracy and reliability of information produced from an AIS. To do so you need to understand how a system is developed, how it operates and how you can instigate controls. You will also now need to understand that an organisation’s AIS may be vulnerable to attack from inside and outside of the firm you audit as companies become more virtual due to the effects of globalisation and
competition. You or your peers may become an accountant in the private or public sector where you could eventually become involved in development of strategy. We showed in Figure 1.9 on page 18 the factors that influence the design of an AIS, one of which was IT. With continuous change in the IT sector, you need to keep up with future trends so that as the main advisor on accounting and finance matters, you can make suggestions and recommendations that do not lock your firm into outdated technologies in the medium to long term.

The other important reason that you need to understand accounting information systems is that as IT pervades all organisations, it makes it easier and easier for employees to act unethically by committing fraud, misappropriating assets, accepting bribes and misstating a company’s financial position. Ethics is a major issue for the accounting and auditing professions as they have been found to collude with management to sign-off statements that do not show a ‘true and fair’ view of a company’s position. In the next section we provide a framework for analysing an ethical issue to help you make an appropriate decision should you uncover unethical behaviours.

### Ethics in accounting and information systems

As you will discover when you read Chapters 5 and 12, fraud and corruption is mainly perpetrated by employees, ‘knowledgeable insiders’ who know the systems and controls in their organisation and see an opportunity to embezzle assets of their company. Some have manipulated the accounts to mislead shareholders and other stakeholders such as the share market, banks and governments. This latter form of unethical behaviour is called *earnings management*. Many notorious cases have been publicised of companies that produced financial statements that do not reflect actual profits and asset values. On a global scale, Enron and WorldCom in the USA are among the best known.

In Australia, HIH and One.Tel raised the consciousness of the accounting profession and the public to issues of ethical misconduct. More recently, Clive Peeters and the Queensland Health 22 fraud cases have shown that employees are still misappropriating assets of their organisations.

Stories relating to ‘golden handshakes’, ‘golden parachutes’ and share option schemes for senior management have exposed the ethical behaviour of managers to a high level of scrutiny and comment. Accountants can help to prevent unfair practices or corruption by presenting a complete and accurate record of business transactions. Ultimately, however, good practice depends upon people in business following acceptable standards of conduct.

### Corporate and professional codes of ethics

Most large businesses and governments have a code of ethics embodied in a set of principles of good corporate governance or code of conduct designed to encourage employees to behave ethically and responsibly. However, a set of general guidelines may not be specific enough to identify misbehaviour, and a list of dos and don’ts can lead to the false view that anything is okay if it isn’t specifically forbidden.

Accountants have incentives to behave ethically. As professionals, they are expected to maintain higher standards than society in general. Their ability to attract business depends entirely on their reputation. Codes of Conduct have been developed by the CPAA [www.cpaaustralia.com.au], ICAA, [www.charteredaccountants.com.au], IPA [www.publicaccountants.org.au] and CIMA [www.cimaglobal.com/Our-locations/Australia]. These documents set minimum standards of conduct for members. Unacceptable actions can result in expulsion from the organisation, which makes it difficult for the person to remain in the accounting profession.

### Ethical issues in accounting

In many situations, the ethical choice is easy. For example, stealing cash is obviously unethical as well as illegal. If cashiers steal money from an employer, that action can land them in prison. In other cases, choices are more difficult. However, in every instance, ethical judgments boil down to a personal decision: What should I do in a given situation?

Let’s consider three ethical issues in accounting. The first two are easy to resolve. The third issue is more difficult.
**Situation 1** Gavin Finlay is preparing the income tax return of a client who has earned more income than expected. On 2 July, the client pays for advertising and asks Finlay to backdate the expense to the preceding financial year, which ends on 30 June. Backdating the deduction would lower the client’s immediate tax payments. After all, there is a difference of only two days between 2 July and 30 June. This client is important to Finlay. What should he do?

Finlay should refuse the request because the transaction took place in July of the new tax year.

**Situation 2** Kim Ho’s software company owes $40 000 to the ANZ Bank. The loan agreement requires Kim’s company to maintain a current ratio (current assets divided by current liabilities) of 1.50 or higher. At present, the company’s current ratio is 1.40. At this level, Kim is in violation of her loan agreement. She can increase the current ratio to 1.53 by paying off some current liabilities right before year-end. Is it ethical to do so?

Yes, because the action is a real business transaction. Kim should be aware that paying off the liabilities is only a delaying tactic. It will hold off the bank for now, but the business must improve in order to keep from violating the agreement in the future.

**Situation 3** David Duncan, the lead auditor of Enron Corporation, thinks Enron may be understating the liabilities on its balance sheet. Enron’s transactions are very complex, and outsiders may never figure this out. Duncan asks his firm’s Standards Committee how he should handle the situation. They reply, ‘Require Enron to report all its liabilities’. Enron is Duncan’s most important client, and Enron is pressuring him to certify liabilities. Duncan can rationalise that Enron’s reported amounts are okay. What should he do?

To make his decision, Duncan could follow the following outlined stakeholder analysis framework.

**Stakeholder analysis framework**

Weighing tough ethical judgments requires a decision framework, such as a stakeholder analysis framework. One way to do it is to follow a decision framework that takes all stakeholders’ effects into account before arriving at the most ethical action to take. Answering these four questions will guide you through tough decisions. Let’s apply them to David Duncan’s situation.

You can use this framework to analyse other ethical decisions, including those that have been presented throughout this text. See Exhibit 1.1 for an extract from the Code of Conduct for the Queensland Public Service.

**Ethical issues in information systems**

As we indicated earlier, computer technologies are revolutionising how organisations do business and disseminate information. But this proliferation of computers and information systems are creating ethical dilemmas. New issues need to be faced in relation to rights and responsibilities in the use of information. However, the law seems to lag behind the speed at which technologies are implemented and information is disseminated. This makes it difficult to capture, in standards and codes of conduct, what the right thing to do is. Thus employees may not have good guidelines on what is appropriate behaviour in their use of company computer resources.

There are moral choices to be made by staff in relation to data that is gathered from customers and suppliers as well as employees. These revolve around issues of control and access to private and confidential data, and misuse of data stored in large databases and data warehouses. These concerns are heightened when that type of data leaves an organisation across networks and when people other than employees have access to data, such as suppliers. With the use of the internet and cloud-based storage of data, accountants are faced with new challenges about control and access.

Another issue that produces ethical dilemmas is the proliferation of computers within an organisation. Everyone in a firm has a PC or terminal on their desk. Most business activities and processes are conducted through a digital device whether hand-held or on a desktop. This may mean that sometimes staff may use the technology for other than business purposes.
The question is what is acceptable use? The way to disseminate acceptable behaviour is to have a written policy outlining what is permitted and any restrictions. Thus a policy may include that during breaks (e.g. lunch time), firm computers can be used for private matters, provided that no illegal, disruptive or obscene activities or communications are undertaken. At the same time, companies have the ability to track staff’s activities on firms’ computers as well as tracking how much work is actually done to measure productivity. This throws up privacy issues and employees’ rights to know what is being tracked and accessed. Although many people don’t know it, all emails are stored on a company’s server and they can be read by anyone who has access to the mail server, such as IT staff. What is tracked needs to be included in the policy and all staff need to be reminded regularly about what is acceptable.

Some companies have a log-on screen which requires an employee to tick that they have read and understood the policy before they get access to the company’s network and information resources. In Part 3 we will discuss some of the controls required in accounting information systems to guard against misuse of system and technology resources.

Summary and case conclusion

Susan and Scott reflected on what they did to try and understand what decisions S&S would need to make and the information needed to make them. They began by obtaining an understanding of S&S’s basic business processes and of the key decisions that must be made to operate the

Exhibit 1.1   Extract from Queensland Public Service Code of Conduct

**Principle and values**

**Integrity and impartiality**

*The Public Sector Ethics Act 1994 states:*

- In recognition that public office involves a public trust, public service agencies, public sector entities and public officials seek to promote public confidence in the integrity of the public sector and –
  a. are committed to the highest ethical standards;
  b. accept and value their duty to provide advice which is objective, independent, apolitical and impartial;
  c. show respect towards all persons, including employees, clients and the general public;
  d. acknowledge the primacy of the public interest and undertake that any conflict of interest issue will be resolved or appropriately managed in favour of the public interest; and
  e. are committed to honest, fair and respectful engagement with the community.

**Standards of conduct**

1.1 Commit to the highest ethical standards

As public service employees we are required to ensure that our conduct meets the highest ethical standards when we are fulfilling our responsibilities.

We will:

- ensure any advice that we provide is objective, independent, apolitical and impartial
- ensure our decision-making is ethical
- engage with the community in a manner that is consultative, respectful and fair, and
- meet our obligations to report suspected wrongdoing, including conduct not consistent with this Code.

1.2 Manage conflicts of interest

A conflict of interest involves a conflict between our duty, as public service employees, to serve the public interest and our personal interests. The conflict may arise from a range of factors including our personal relationships, our employment outside the public service, our membership of special interest groups, or our ownership of shares, companies, or property.

As public service employees we may also experience conflicts of interest between our public service ethics and our professional codes of ethics (for example, as health care professionals or as lawyers), or with our personal beliefs or opinions.

Having a conflict of interest is not unusual and it is not wrongdoing in itself. However, failing to disclose and manage the conflict appropriately is likely to be wrongdoing.

As public service employees we are committed to demonstrating our impartiality and integrity in fulfilling our responsibilities and as such we will:

- always disclose a personal interest that could, now or in the future, be seen as influencing the performance of our duties. This will be done in accordance with our agency policies and procedures,
- actively participate with our agency in developing and implementing resolution strategies for any conflict of interest, and
- ensure that any conflict of interest is resolved in the public interest.

business effectively. They followed that with an analysis of the internal and external parties that the AIS would have to interact with and the information the AIS would have to provide them.

Since S&S is a retail merchandising company, its business processes could be described in terms of four basic transaction cycles:

1. **The revenue cycle** encompasses all transactions involving sales to customers and collections of cash receipts for those sales.
2. **The expenditure cycle** encompasses all transactions involving purchase of and payment for merchandise sold by S&S, as well as other services it consumes, such as rent and utilities.
3. **The HRM cycle/payroll subcycle** encompasses all transactions involving hiring, training and payment of employees.
4. **The financing cycle** encompasses all transactions involving investment of capital in the company, borrowing money, payment of interest and loan repayments.

These four cycles interface with the **general ledger and reporting cycle**, which consists of all activities related to preparation of financial statements and other managerial reports.

Scott and Susan will need a well-designed AIS to provide information they need to effectively plan, manage and control their business. Their AIS must be able to process data about sales and cash receipts, purchasing and paying for merchandise and services, payroll and tax-related

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**TABLE 1.3 Template to use when confronting an ethical issue**

<table>
<thead>
<tr>
<th>Question</th>
<th>Decision guidelines</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. What is the ethical issue?</strong></td>
<td>1. Recognise the ethical issue or dilemma. The root word of ethical is ethics, which the Oxford Dictionary defines as ‘a set of moral principles, especially ones relating to or affirming a specified group, field or form of conduct’. Duncan’s ethical dilemma is to decide what he should do with the information he has uncovered.</td>
</tr>
<tr>
<td><strong>2. What are the principle elements in this situation?</strong></td>
<td>2. Move towards an ethical resolution by answering these questions in sequence.</td>
</tr>
<tr>
<td>a. What parties (stakeholders) may be harmed?</td>
<td>a. Investor, financiers such as banks, creditor; in the long-run, employees</td>
</tr>
<tr>
<td>b. Whose rights or claims may be violated?</td>
<td>b. Investor, financiers, creditor</td>
</tr>
<tr>
<td>c. Which specific interests are in conflict?</td>
<td>c. To deliberately understate liabilities on the balance sheet is dishonest, possibly fraudulent and unethical. It contravenes most of the fundamental principles of the APES 110 Code of Ethics for Professional Accountants: Integrity, Objectivity, Professional Competence and Due Care, and Professional Behaviour.</td>
</tr>
<tr>
<td>d. What are Duncan’s (my) responsibilities and obligations?</td>
<td>d. Auditors are bound by their profession’s Code of Ethics and they have a duty of care that extends beyond the firm, colleagues and shareholders and includes other stakeholder groups who may not have a financial interest in the firm, including the community</td>
</tr>
<tr>
<td><strong>3. What are Duncan’s options and what are the consequences?</strong></td>
<td>3. Specify alternatives and weigh up impacts of each on various stakeholders</td>
</tr>
<tr>
<td>a. go along with Enron’s liabilities as reported; or</td>
<td>a. If Duncan certifies Enron’s present level of liabilities—and if no one ever objects— Duncan will keep this valuable client. But if Enron’s actual liabilities turn out to be higher than reported, Enron investors may lose money and take Duncan to court. That would damage his reputation as an auditor and hurt his firm.</td>
</tr>
<tr>
<td>b. force Enron to report higher amounts of liabilities.</td>
<td>b. If Duncan follows his company policy, he must force Enron to increase its reported liabilities. This will anger the company, and Enron may fire Duncan as its auditor. In that case, Duncan will save his reputation, but it will cost him some business in the short run.</td>
</tr>
<tr>
<td>Impact of alternatives on stakeholders include:</td>
<td></td>
</tr>
<tr>
<td>a. If Duncan certifies Enron’s present level of liabilities—and if no one ever objects— Duncan will keep this valuable client. But if Enron’s actual liabilities turn out to be higher than reported, Enron investors may lose money and take Duncan to court. That would damage his reputation as an auditor and hurt his firm.</td>
<td></td>
</tr>
<tr>
<td><strong>4. What shall I do?</strong></td>
<td>4. Select the best or most ethical alternative considering all the circumstances and consequences. In fact, Duncan went along with Enron and certified the company’s liabilities. He acted against his firm’s policies. Enron later admitted understating its liabilities. Duncan had to retract his audit opinion and Duncan’s firm, Arthur Andersen, was closed down. Duncan should have followed ethical principles as well as firm policy. Not doing so cost him and many others dearly.</td>
</tr>
</tbody>
</table>

transactions as well as acquiring and paying for fixed assets. The company’s AIS must also provide information needed to prepare financial statements.

Fortunately, there are many computer-based accounting packages available for the retail industry. As they begin looking at various software packages, however, Scott and Susan quickly learn that considerable accounting knowledge is required to choose the one that will best fit their business. Because neither has an accounting background, Scott and Susan decide that their next task will be to hire an accountant.

Key terms

accounting information system (AIS) (5)  goal conflict (7)  primary activities (18)
Agency Theory (5)  goal congruence (7)  production (conversion) cycle (11)
business process (11)  human resources  revenue cycle (11)
data (8)  management (HRM)  stakeholder analysis
data overload (8)  cycle/payroll subcycle  framework (22)
earnings management (21)  information (8)  support activities (11)
enterprise resource planning (ERP) system (7)  information technology (IT)  Theory of the Firm (4)
expenditure cycle (11)  Metcalfe’s Law (7)  transaction (11)
firm infrastructure (18)  Moore’s Law (7)  transaction cycle (11)
financing cycle (11)  outbound logistics (18)  transaction processing (11)
genral ledger and reporting cycle (11)  predictive analysis (18)  value chain (18)
'give-get' exchange (11)  price mechanism (4)  value of information (8)

AIS IN ACTION

Chapter quiz

Q1.1 Data differ from information in which way?
   a. data are output and information is input
   b. information is output and data are input
   c. data are meaningful bits of information
   d. there is no difference

Q1.2. Which of the following is NOT a characteristic that makes information useful?
   a. it is reliable
   b. it is timely
   c. it is inexpensive
   d. it is relevant

Q1.3. Which of the following is a primary activity in the value chain?
   a. purchasing
   b. accounting
   c. post-sales service
   d. HRM

Q1.4. Which transaction cycle includes interactions between an organisation and its suppliers?
   a. revenue cycle
   b. expenditure cycle
   c. HRM cycle/payroll subcycle
   d. general ledger and reporting cycle

Q1.5. Which of the following is NOT a means by which information improves decision-making?
   a. increases information overload
   b. reduces uncertainty
c. provides feedback about the effectiveness of prior decisions
d. identifies situations requiring management action

Q1.6. In the value chain concept, upgrading IT is considered to be what kind of activity?
a. primary activity  c. service activity
b. support activity  d. structured activity

Q1.7. In which cycle does a company ship goods to customers?
a. production cycle  c. revenue cycle
b. financing cycle  d. expenditure cycle

Q1.8. Which of the following is a function of an AIS?
a. reducing the need to identify a strategy and strategic position
b. transforming data into useful information
c. allocating organisational resources
d. automating all decision-making

Q1.9. A firm, its suppliers, and its customers collectively form which of the following?
a. supply chain  c. ERP system
b. value chain  d. AIS

Q1.10. A report telling how well all approved vendors have performed in the prior 12 months
is information that is MOST needed in which business process?
a. paying vendors  c. selling merchandise
b. acquiring inventory  d. paying employees

Ethical issue

Gavin Finlay is preparing the income tax return of a client who has earned more income than
expected. On 2 July, the client pays for advertising and asks Finlay to backdate the expense to
the preceding financial year, which ends on 30 June. Backdating the deduction would lower the
client’s immediate tax payments. After all, there is a difference of only two days between 2 July
and 30 June. This client is important to Finlay. What should he do?

Required
Use the stakeholder analysis framework described in this chapter to analyse the ethical dilemma
you identify and arrive at an ethical decision.

Discussion questions

D1.1. The value of information is the difference between benefits realised from using that
information and costs of producing it. Would you, or any organisation, ever produce
information if its expected costs exceeded its benefits? If so, provide some examples.
If not, why not?

D1.2. Can the characteristics of useful information listed in Table 1.1 on page 9 be met
simultaneously? Or does achieving one mean sacrificing another?

D1.3. You and a few of your classmates decided to become entrepreneurs. You come up with
a great idea for a new mobile phone application that you think will make lots of money.
Your business plan wins second place in a local competition, and you are using the
$10 000 prize to support yourselves as you start your company.
a. Identify the key decisions you need to make to be successful entrepreneurs, the
information you need to make them, and the business processes you will need to
engage in.
b. Your company will need to exchange information with various external parties. Identify
the external parties and specify the information received from and sent to each of them.