

TOPIC 3

BUSINESS CYCLES

Topic overview

The aim of this topic is to explain the various business cycles as part of the accounting system over which internal controls are implemented. A condensed example of the financial statements of a trading company is provided to illustrate the main components of financial statements to which the transactions and balances relate in the business cycles.

This topic is divided into the following learning units:

Learning unit	Title
3.1	Business cycles
3.1.1	The accounting system and business cycles
3.1.2	Financial statements

Learning outcomes

Learning unit	In this topic we focus on the following learning outcomes:	Level
3.1 Business cycles	<ul style="list-style-type: none">Identify the different business cycles.	1
	<ul style="list-style-type: none">Relate the transactions and balances in the statement of financial position and statement of comprehensive income to the various business cycles.	1

LEARNING UNIT 3.1

BUSINESS CYCLES

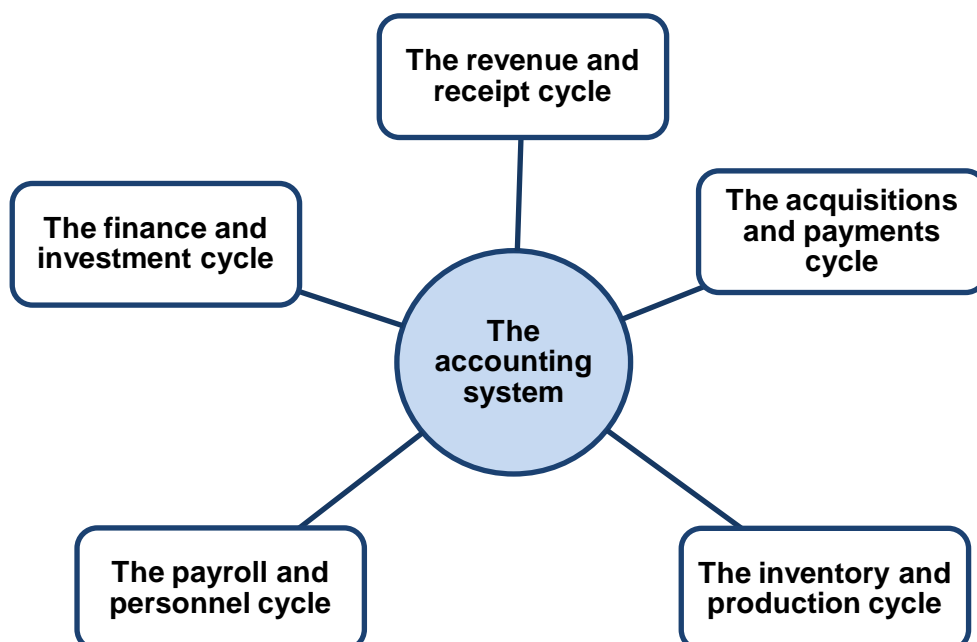
INTRODUCTION

In topic 2 we explained that management wants to achieve **reliable financial reporting** by ensuring that transactions which are initiated, recorded, processed and reported are **valid** (occurred and are authorised), **accurate** and **complete**. It is the **accounting system** which provides the foundation to achieve these objectives of internal financial control. In other words, internal control is designed and implemented over the accounting system.

3.1.1 THE ACCOUNTING SYSTEM AND BUSINESS CYCLES

Your textbook, Jackson & Stent (2014:5/12) describes an accounting system as a series or collection of tasks and records by means of which transactions are processed to create **financial records**. An accounting system identifies, assembles, analyses, calculates, classifies, records, summarises and reports transactions and other events. The major elements of the accounting system are **people**, who carry out **procedures**, for example write out a credit sales invoice, calculate a price, enter the invoice in a sales journal, et cetera, and **paper**, such as order forms, ledgers, lists, invoices, et cetera, which facilitates the initiation, execution and recording of the transaction.

DIAGRAM: Schematic representation of the five business cycles in relation to the accounting system



The functions and actions in the business cycles, as well as the control activities in each cycle, will be explained in detail in the topics to follow.

3.1.2 FINANCIAL STATEMENTS

As mentioned above, financial records relate to the business cycles. The financial records are summarised in a company's **financial statements**. In other words, the balances and totals of the transactions in the business cycles are reflected in the financial statements.

In your financial accounting courses, you may already have studied the drafting of company financial statements. To give you a complete picture, we have repeated a condensed example of the financial statements of a company which is trading as a commercial enterprise.

The purpose of the example is to indicate the transactions and balances in financial statements for the purpose of illustrating the business cycles. For the detailed financial statement and disclosure requirements, please refer to your financial accounting study material.

XY LTD

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20X1

	Notes	20X1 R'000	20X0 R'000
ASSETS			
Non-current assets			
Property, plant and equipment		16 069	14 696
		<u>16 069</u>	<u>14 696</u>
Current assets			
Inventories		192 085	149 002
Trade receivables		418 465	222 833
Cash and cash equivalents		-	1 465
		<u>610 550</u>	<u>373 300</u>
Total assets		626 619	387 996
EQUITY AND LIABILITIES			
Equity attributable to owners of the parent			
Share capital		147 834	147 834
Revaluation surplus		8 500	-
General reserve		5 000	2 000
Retained earnings		22 192	18 375
		<u>183 526</u>	<u>168 209</u>
		40 125	32 000
Non-controlling interest		<u>223 651</u>	<u>200 209</u>
Total equity			
Non-current liabilities			
Long-term borrowings		236 000	108 297
Deferred taxation		28 875	23 100
		<u>264 875</u>	<u>131 397</u>

Current liabilities		35 990	20 145
Trade payables		83 042	24 639
Current portion of long-term borrowings		17 409	11 606
Shareholders for dividends		1 652	-
Bank overdraft		138 093	56 390
		402 968	187 787
Total liabilities			
		626 619	387 996
Total equity and liabilities			

XY LTD**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20X1**

	Notes	20X1 R'000	20X0 R'000
Revenue		1 287 052	902 052
Cost of sales		(1 098 187)	(819 939)
Gross profit		188 865	82 113
Distribution costs		(25 741)	(14 010)
Administrative expenses		(28 813)	(10 345)
Other expenses		(48 881)	(22 237)
Finance costs		(39 264)	(20 862)
Profit before tax		46 166	14 659
Income tax expense		(10 927)	(6 148)
Profit for the year		35 239	8 511
Other comprehensive income for the year after tax			
Revaluation surplus		10 625	-
Other comprehensive income for the year, net of tax		10 625	-
Total comprehensive income for the year		45 864	8 511
Profit attributable to:			
- Owners of the parent		28 039	1 711
- Non-controlling interest (given)		7 200	6 800
		35 239	8 511
Total comprehensive income attributable to:			
- Owners of the parent		36 539	1 711
- Non-controlling interest		9 325	6 800
		45 864	8 511

The following are components in the financial statements:

Statement of financial position:
income:

- property, plant and equipment
- investments
- loans granted
- inventories
- trade receivables

Statement of comprehensive

- revenue (credit and cash sales)
- cost of sales (inventory)
- purchases
- distribution costs
- administrative expenses

- cash and cash equivalents
- share capital
- reserves
- retained earnings
- long-term borrowings
- trade payables
- other expenses
- finance costs
- other income

Activity 1

1. Identify the five business cycles which are generally applicable to commercial enterprises.
2. Based on the business cycles in an accounting system, identify the statement of financial position balances and statement of comprehensive income classes of transactions that relate to one another.

Feedback on Activity 1

1. The business cycles which are generally applicable to commercial enterprises are
 1. the revenue and receipts cycle
 2. the acquisitions and payments cycle
 3. the inventory and production cycle
 4. the payroll and personnel cycle
 5. the finance and investment cycle
2. The balances in the statement of financial position and the classes of transactions in the statement of comprehensive income that relate to the business cycles are:

Business cycle	Statement of financial position (account balances)	Statement of comprehensive income (classes of transactions)
Revenue and receipts cycle	<ul style="list-style-type: none"> • Accounts receivable • Cash and cash equivalents 	<ul style="list-style-type: none"> • Credit sales • Sales returns • Discount allowed • Credit losses • Interest received • Cash sales • All receipts (revenue and other)
Acquisitions and payments cycle	<ul style="list-style-type: none"> • Accounts payable 	<ul style="list-style-type: none"> • Credit purchases • Cash purchases • Purchase returns

		<ul style="list-style-type: none"> • Discount received • Interest on late payments • Expenses
Inventory and production cycle	<ul style="list-style-type: none"> • Inventory 	<ul style="list-style-type: none"> • Cost of sales
Payroll and personnel cycle	<ul style="list-style-type: none"> • Bank and cash • Accounts payable (accumulated leave, unclaimed wages, SARS, pension funds, medical aids and other) 	<ul style="list-style-type: none"> • Wages and salaries (net of employee deductions such as PAYE, UIF, SDL, pension fund, medical aid and other)
Finance and investment cycle	<ul style="list-style-type: none"> • Share capital • Reserves • Long-term loans • Property, plant and equipment • Investments 	<ul style="list-style-type: none"> • Dividends paid • Profit or loss (reserves) • Interest paid • Profit or loss on sale of asset • Profit or loss on investment

CONCLUSION

In this topic, **Business Cycles**, we identified the various business cycles and explained what an accounting system entails. The balances in the statement of financial position and transactions in the statement of comprehensive income were related to the various business cycles.

In the next topic we will explain and apply the revenue and receipts business cycle as well as the applicable internal controls in the cycle.