

OVERVIEW OF THE ACCOUNTING CYCLE

Note: This Overview, while written for the beginning student, will be more valuable with a second reading upon the completion of this book.

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INTRODUCTION

A business begins with an investment of cash and/or other personal assets. Then additional assets such as land, building, equipment, and supplies are acquired. Expenses such as salaries, advertising, and taxes are

Accounting is the process of tracking these financial activities and summarizing them for interested parties (owners, managers, creditors, potential investors, etc.). The process (accounting cycle) begins with the collec-

either paid or liabilities such as accounts payable, notes payable, and taxes payable incurred. Finally, revenue is generated as cash or a promise of payment (accounts receivable).

tion of financial data and ends with reports concerning financial activity (Income Statement) and financial position (Balance Sheet).

RECORDING TRANSACTIONS

The accounting cycle begins with Journal Entries. These are a chronological record of financial activity stored in a book of original entry called the General Journal. A storage area (data file) called an account is created for each type of Asset, Liability, Equity, Revenue, and Expense the company would like to track. Accounts are stored in a book called the General Ledger. Posting is the process of copying data from

the General Journal to each General Ledger account. For example, changes to Cash which are spread throughout the General Journal, are summarized in the General Ledger Cash account allowing for a cash balance to be calculated. This is done for all accounts. Finally, a check (Trial balance) of the dollar balances of all accounts in the General Ledger is made to assure accounts are in balance.

ADJUSTING ENTRIES

Adjusting Entries are required at the end of the cycle because some expenses have been estimated (taxes), others are more efficiently recorded at the end of the cycle (depreciation), and others require special analysis (supplies used). Non-expense adjustments are also

possible (Unearned Revenue). All adjustments are made in the General Journal, transposed to the appropriate ledger account, and a check (Adjusted Trial Balance) is made to assure accounts are still in balance.

WORKSHEET AND STATEMENTS

A preliminary informal calculation of the financial position of a company is accomplished with the preparation of a worksheet. Revenues and expenses are compared, with their difference representing income

(Profit or Loss). Assets are compared with liabilities and equity to assure everything is in balance. Once the worksheet balances are proven, a formal Income Statement and Balance Sheet are prepared.

COMPLETING THE ACCOUNTING CYCLE

Completing the accounting cycle requires lowering expense and revenue accounts to zero so the next cycle's income may be properly calculated. A final check (Post-Closing Trial Balance) is made to assure

accounts are in balance. Reversing entries, which simplify the adjusting process, and correcting entries, which are made whenever errors are determined, complete the accounting cycle.

THE ACCOUNTING EQUATION

Two concepts must be explained before we proceed to the first step of the accounting process, recording transactions. First, it will be necessary to understand the relationship between Assets, Liabilities, and Owner's Equity as demonstrated by the accounting equation.

Secondly, the system of debits and credits, designed to change the variables of the accounting equation, must be understood. Please turn to Quick's first learning unit, The Accounting Equation.

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