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Accounting Cycle Summary

by Sophia

WHAT'S COVERED

This tutorial will cover the topic of the accounting cycle, which is a series of steps followed when processing and reporting accounting information.

Our discussion breaks down as follows:

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1. The Accounting Cycle

There are six phases in **the accounting cycle**, and we will discuss each phase individually.

TERM TO KNOW

Accounting Cycle
A series of steps followed when processing and reporting accounting information.

1a. Step 1: Analyzing

The first step in the accounting cycle is to identify business events--both internal and external--that need to be documented in the accounting or financial system. These events can be identified by using source documents, which are an aid in determining what events took place that need to be documented. Once documented, it's important to assess the impact of those events: do they increase certain accounts, or do they decrease certain accounts?

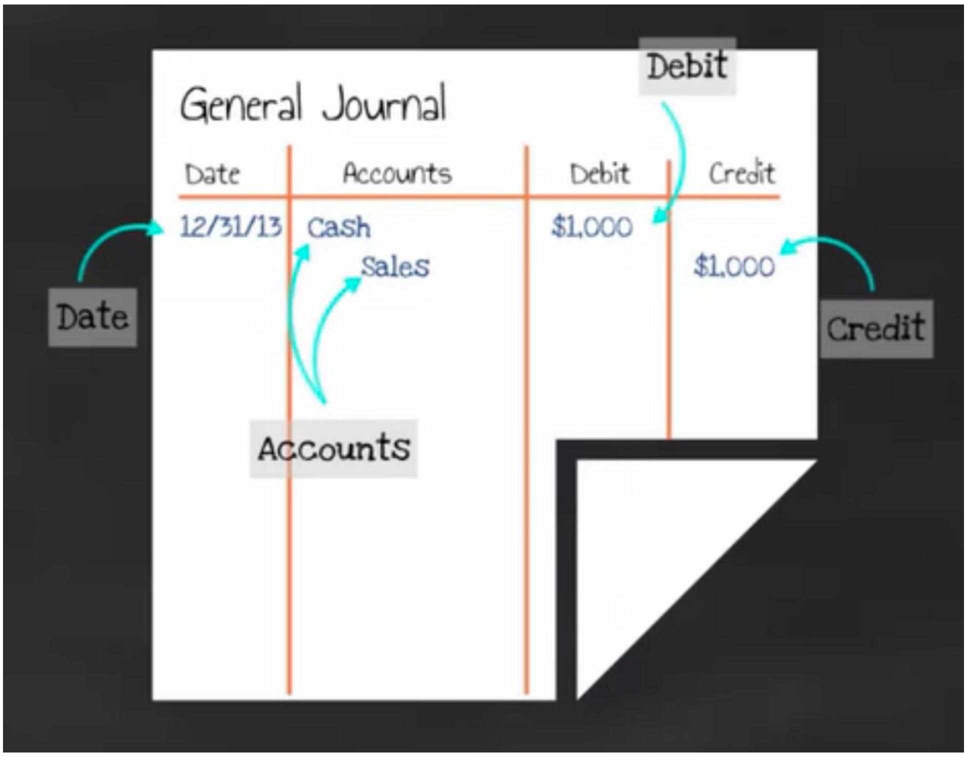
1b. Step 2: Journalizing

Next, we move onto journalizing. In this phase, we use the general journal, which is a record of accounting events. Again, those source documents mentioned above are used to identify the specific accounts involved, debits and credits, and this information is all detailed in the general journal.

HINT

Note, in the journalizing phase, those events are not in the actual accounting system yet.

Here is an example of a general journal. As you can see, it is a chronological order of all the accounting events that have been identified as needed to be captured in the system. For each event identified, the general journal will detail the date and the specific accounts that are involved, as well as listing the debits and credits to those specific accounts.



1c. Step 3: Posting

Now we can move on to posting. In this phase, we move those transactions from the general journal into the general ledger. When we do this, those events are now transferred to the accounting system. These events have been posted to the system, and the general ledger is used to review and track activity throughout the period.

1d. Step 4: Adjusting

After the events have been posted, we move on to making adjustments. Adjustments take place at the end of the period. Why are these adjustments made? Well, there are several important reasons:

- We need to make certain corrections--rectifying any mistakes, errors, or omissions that were made.
- We need to match activity-based events to the correct period, meaning revenues and expenses need to be matched to the correct period.
- We need to make adjustments for accruals and prepaids, accounting for any prepaid expenses or unearned revenue.

1e. Step 5: Reporting

After all adjustments are made, it's time to move on to the next step. Reporting is the final product that comes out of the accounting cycle. It is important to note that it is not the final *phase*, but rather it is the final *product*. What is this product? It is the financial statements, which tell the story of a business for the reporting period. There are four main financial statements:

- Income statement
- Statement of retained earnings, or the statement of changes in owner's equity
- Balance sheet
- Statement of cash flows

Again, this is the final product of the accounting cycle, and it is important information for both internal and external users.

1f. Step 6: Closing

After we've produced the financial statements and finished reporting, it's time to move on to the last phase, which is closing. Now, what gets closed in the accounting cycle? Well, it is the temporary accounts, which represent revenues and expenses. These accounts get closed to owner's equity, or retained earnings. We close these revenue and expense accounts because they are used to track activity for a specific period. Therefore, they must be reset for the beginning of the next period so that we can capture the revenues and expenses for only that period being reporting on.

After the closing phase has been completed, the accounting cycle starts all over again, working through all six phases and continuing perpetually.

SUMMARY

Today we learned about **the accounting cycle**, which is a series of steps followed when processing and reporting accounting information. We learned about each step in this six step process:

1. Analyzing
2. Journalizing
3. Posting (to the general ledger)
4. Adjusting (correcting errors and mistakes)
5. Reporting (creating financial statements)
6. Closing (closing the temporary accounts)

Source: Adapted from Sophia instructor Evan McLaughlin.

TERMS TO KNOW

Accounting Cycle
A series of steps followed when processing and reporting accounting information.