The Nine Steps in the Accounting Cycle: Verify Transactions and Prepare Business Financial Statements

By M.L. Miller

The accounting cycle refers to nine steps, repeated in each reporting period, to verify transactions and prepare financial statements for internal and external users.

All accounting systems use some variation of these nine steps to record, analyze and summarize business transactions and events. This procedure helps organizations ensure that their financial records are accurate, current, and reflect Generally Accepted Accounting Principles.

Entrepreneurs and business owners should understand the accounting cycle, even if they do not keep their own books. Accounting is used every day in business to make projections, secure financing, assess opportunities and more. Those unfamiliar with basic accounting principles and processes should take a distance education or community college course to help ensure their success in business.

Accounting Cycle Steps One to Three: Analyze, Journalize, and Post a Business Transaction

The first step in the accounting cycle is to first analyze a transaction and its source documents, then apply double-entry accounting to recognize its effect on account balances. Next, record transactions in a General Journal. Journalizing leaves a record of all transactions in one document, helping to prevent mistakes and linking the debits and credits for each transaction.

The third step in the accounting cycle is posting. After recording transactions in the journal, they are transferred and posted to the ledger. It is important to leave this paper trail (or in computerized accounting, electronic trail) to verify accuracy and troubleshoot later in the process if accounts are not adding up.

Accounting Cycle Step Four: Preparing the Unadjusted Trial Balance
In double-entry accounting, each transaction is recorded with equal debits and credits. If the sums of the debit and credit entries do not match, this points to an error in one of the first three steps. The fourth step, preparation of an unadjusted trial balance, checks these account balances and points to errors before moving to step five in the accounting cycle.

The unadjusted trial balance also compiles the information from the ledger for use in preparing financial statements. Once each account balance is identified from the ledger, they are recorded in the same order as the Chart of Accounts. Total up debit and credit balances and compare to verify that they are equal.

Accounting Cycle Steps Five & Six: Adjusting and Preparing the Adjusted Trial Balance

The first four steps of the accounting cycle recorded and verified external transactions, such as supply purchases and utility payments. The fifth step, adjusting, accounts for internal transactions, like the use of prepaid rent or unearned revenue.

The sixth step is the preparation of the adjusted trial balance, encompassing all internal and external transactions for the reporting period and again verifying their accuracy by ensuring the credit and debit sums are equal.

Accounting Cycle Step Seven: Preparing Business Financial Statements

From the adjusted trial balance, a number of important financial statements are created. The Income Statement and Statement of Owner's Equity are prepared first, followed by the Balance Sheet, which pulls information from the Statement of Owner's Equity. Organizations may choose to create other summaries or spreadsheets depending on how they intend to use the information.

Accounting Cycle Steps Eight & Nine: Closing and the Post-Closing Trial Balance

The eighth step in the accounting cycle is to close accounts in preparation for the next accounting period. Temporary or nominal accounts are closed, while permanent or real accounts carry their
balances into the next period. Many accountants and bookkeepers create a worksheet to assist in closing, so all relevant information from the financial statements is at hand.

Closing entries are recorded and posted to the owner's capital account after they are transferred to the income summary account. Once completed, all revenue, expense, withdrawal and Income Summary balances should be zero.

Finally, the post-closing trial balance lists the balances of the accounts that were not closed, such as assets, liabilities, and owner's equity. This trial balance helps verify that permanent accounts balance, with equal debit and credit sums, and that all temporary accounts were closed properly.

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More Information on the Accounting Cycle

The preceding overview of the accounting cycle is a brief introduction to the process. For more information, refer to Larson Jensen’s Fundamental Accounting Principles, Volume One (Larson Jensen, 2007).