- The accounting cycle is eight basic steps that ensure a business fulfills its bookkeeping tasks accurately.
- Perform the process monthly, quarterly or annually based on how often your company needs financial reports.
- Companies can modify steps in the accounting process to fit their business model and accounting procedures.
- **This article is for business owners, accountants and bookkeepers who want to accurately process their company's bookkeeping tasks.**

When preparing financial statements, businesses perform a series of meticulous steps designed to convert basic financial data into cohesive, complete and accurate reports. This systematic process is called the accounting cycle, and it helps make financial reporting easier and more straightforward for business owners.

Here's an in-depth look at the accounting cycle, including the eight primary steps involved and how the best accounting software can automate this process.

What is the accounting cycle?

The accounting cycle is a comprehensive process designed to make a company's financial responsibilities easier for its owner, accountant or bookkeeper. The accounting cycle breaks down a bookkeeper's responsibilities into eight essential steps to identify, analyze and record financial information. It serves as a clear guideline for accurately completing bookkeeping tasks.

Editor's note: Looking for the right accounting software for your business? Fill out the below questionnaire to have our vendor partners contact you about your needs.

The accounting cycle is a holistic process that records a business's transactions from start to finish, helping businesses stay organized and efficient. The cycle incorporates all the company's accounts, including T-accounts, credits, debits, journal entries, financial statements and book closing.

One of the accounting cycle's main objectives is to ensure all the finances during the accounting period are accurately recorded and reflected in the statements. It's like a checklist to complete when an accounting period ends.

A business can conduct the accounting cycle monthly, quarterly or annually, based on how often the company needs financial reports.

FYI

Even after choosing the right accounting software to automate the accounting cycle's steps, it's still essential for business owners and bookkeepers to know and understand the process.

Modifying the accounting cycle

Companies also modify the accounting cycle's steps to fit their business models and accounting procedures. One of the major modifications is made according to the type of accounting method a business uses. Companies may follow cash accounting or accrual accounting, or choose between single-entry and double-entry accounting.

Double-entry accounting is ideal for companies that create all the major accounting reports, including the balance sheet, cash flow statement and income statement.

Did You Know?

In case you're wondering whether to use cash or accrual accounting, cash accounting is suitable for freelancers, small businesses and sole proprietorships. But all businesses with inventories or revenues exceeding $1 million must follow the accrual method.

The accounting cycle's 8 steps

Here's an in-depth look at the eight steps in the accounting cycle. Once you check off all the steps, you can move to the next accounting period.

1. Identify and analyze transactions during the accounting period.

A business starts its accounting cycle by identifying and gathering details about the transactions during the accounting period. When identifying a transaction, you'll need to determine its impact. Transactions include expenses, asset acquisition, borrowing, debt payments, debts acquired and sales revenues.

Tip

Consider using receipt-tracking software to organize transactions and expenses correctly.

2. Record transactions in a journal.

The next step is to record your financial transactions as journal entries in your accounting software or ledger. Some companies use point-of-sale technology linked with their books, combining steps one and two. Still, it's essential for businesses to keep track of their expenses.

Your accounting type and method determine when you identify expenses and income. For accrual accounting, you'll identify financial transactions when they are incurred. Cash accounting, on the other hand, involves looking for transactions whenever cash changes hands.

Double-entry accounting suggests recording every transaction as a credit or debit in separate journals to maintain a proper balance sheet, cash flow statement and income statement. On the other hand, single-entry accounting is more like managing a checkbook. It doesn't require multiple entries but instead gives a balance report.

Tip

Bookkeeping is essential for all transaction types. Be sure to record transactions throughout the accounting period instead of waiting until the end and struggling to find receipts and other relevant information.

3. Post transactions to the general ledger.

Once transactions are recorded in journals, they are also posted to the general ledger. A general ledger is a critical aspect of accounting, serving as a master record of all financial transactions.

The general ledger breaks down the financial activities of different accounts so you can keep track of various company account finances. A cash account is by far the most crucial account in a general ledger, as it gives an idea of the cash available at any time.

4. Calculate an unadjusted trial balance.

While earlier accounting cycle steps happen during the accounting period, you'll calculate the unadjusted trial balance after the period ends and you've identified, recorded and posted all transactions. The trial balance gives you an idea of each account's unadjusted balance. Such balances are then carried forward to the next step for testing and analysis.

Creating an unadjusted trial balance is crucial for a business, as it helps ensure that total debits equal total credits in your financial records. If they don't, something is either missing or misaligned. This step generally identifies anomalies, such as payments you may have thought were collected and invoices you thought were cleared but actually weren't.

Regardless of the scenario, an unadjusted trial balance displays all your credits and debits in a table. In the next step, you'll investigate what went wrong.

5. Analyze the worksheet to identify errors.

The accounting cycle's fifth step involves analyzing your worksheets to identify entries that need to be adjusted. As every transaction is recorded as a credit or debit, this step requires ensuring that the total credit balance and debit balance are equal. **[Read related article: Direct Costs vs. Indirect Costs]**

Apart from identifying errors, this step helps match revenue and expenses when accrual accounting is used. Any discrepancies should be addressed by making adjustments, which happens in the next step.

6. Adjust journal entries to fix errors.

When the accounting period ends, you'll adjust journal entries to fix any mistakes and anomalies found during the worksheet analysis. Since this is the final step before creating financial statements, you should double-check everything with the help of a new adjusted trial balance.

7. Create and produce financial statements.

Once the company has made all the adjusting entries, it creates financial statements. Most companies create balance sheets, income statements and cash flow statements.

The balance sheet and income statement depict business events over the last accounting cycle. Most businesses produce a cash flow statement; while it's not mandatory, it helps project and track your business's cash flow.

These financial statements are the most significant outcome of the accounting cycle and are crucial for anybody interested in comparing your business with others. They are also highly valuable for business owners. Interpreting financial statements helps you stay on top of your finances and devise growth strategies.

8. Close the books for the accounting period.

The last step in the accounting cycle is to make closing entries by finalizing expenses, revenues and temporary accounts at the end of the accounting period. This involves closing out temporary accounts, such as expenses and revenue, and transferring the net income to permanent accounts like retained earnings.

After you close the books, the financial statements produced provide a comprehensive performance analysis for the time frame. Then the accounting cycle starts again for the new reporting period.

This is a good time to file paperwork and plan for the next accounting period.

Did You Know?

Business owners and bookkeepers should understand accounting standards as well as the accounting cycle. Accounting standards can guide your financial recordkeeping and help your business comply with state and federal laws.

Accounting cycle time period

A business's accounting period depends on several factors, including its specific reporting requirements and deadlines. Many companies like to analyze their financial performance every month, while others focus on quarterly or annual reports.

At the end of the accounting period, companies must prepare financial statements. Public entities should comply with regulations and submit financial statements before specified deadlines.

Accounting cycle vs. the budget cycle

The accounting cy