

# FINANCE AT A GLANCE

## The accounting cycle

## Lesson 38

At this stage, the relationship between two vital final statements --- the balance sheet and the income statement --- must be very clear to us. We know that they are not generated in isolation of one from the other. We know that there are transactions that impact both statements. Given this familiarity, we are now ready to walk through the process that generates them. This process involves a sequence of steps collectively known as the **accounting cycle**.

Our purpose in learning the accounting cycle is not to take over the job of the accountants. Our objective is to understand what is involved in coming up with financial statements, so that we shall be in position to query the work that the accountants deliver, and even disagree with the way they enter the transactions in the accounting books, bearing in mind that this affects the picture that the company projects through its financial statements.

In layman's vocabulary, the accounting cycle consists of the following steps, which will all become clear as we move on.

1. Analyze the transaction.
2. Record the transaction in a journal (which is like a "diary" of transactions) in the form of accounting entries.
3. Transfer the entries from the journal to the appropriate books (the book of Cash, the book of Accounts receivables, and so forth).
4. Verify that the books are balanced.
5. Make adjustments for items that need to be recognized as far as the accrual concept is concerned.
6. Verify once more that the books are balanced after the adjustments made in step 5.
7. Prepare the financial statements and transfer the balances of revenue and expense accounts to the Retained earnings book.
8. Verify again that the books are balanced after the transfer of balances made in step 7.

In the succeeding lessons, we shall walk through the accounting cycle in a very simplistic way. By the time we reach step 8, we shall have demystified whatever it is that accountants do.

Until the next lesson,

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