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Know the Steps of the Accounting Cycle

Is accounting a mystery to you? Does the mere mention of accounting make you wonder why you can’t get your financial statements on time? Many, if not most contractors feel that way at times.

Do you have problems getting your time cards filled out legibly? Or getting service invoices to have parts accurate compared to what was used? Or just getting the service invoice priced properly? You are not alone in these quests, and the good news is there are answers to these questions.

First and foremost, comes your understanding of **the basic steps of accounting** for a business. Once you understand how accounting is supposed to work, and can work, then you can be more effective at putting place the disciplines it takes to get the financial structure you deserve as a business.

*The function of accounting is to provide financial controls, and information that is timely, accurate, and meaningful to those who need it to operate the business.*

Follow these steps to understand the accounting cycle:

1. Understand the goals of accounting and the importance of **everyone understanding the goals**!
2. **Controls & Disciplines** – Accounting practices are designed so transactions are checked and balanced. If properly handled, the disciplines allow for audit trails so theft or mishandling of company assets can be quickly identified and dealt with by the owner. If controls and disciplines are not applied, it is just a matter of time before something bad happens to the company assets. An example of this is cash transaction on service invoices, where a technician can write an invoice to the homeowner for $150, collect the cash, and then write out a 2nd invoice for $100, and return $ 100 to the company with the bogus invoice, and pocket the other $ 50. Invoices must have sequenced numbers, and be called in and logged into accounting. Any invoice out of sequence must be turned in voided. There are many more disciplines and controls, this is just one that happens all the time.
3. **Provide timely, accurate and meaningful information to operate the business.**

The accounting system should produce data that is going to be needed for legal purposes, and also data that is needed for leadership and management purposes. Both are critical, and both must be thought-out. The three operating statements for any business are Profit and Loss, Balance Sheet, and Cash Flow Statements. All three serve different functions, and are quite necessary, yet it is surprising how often the P&L is late (past 5 days after close), and there is no cash flow statement at all, where the owner runs the business by looking at a profit and loss statement that is late (by the time you get it 10 days late, it is 30-45 after what has happened to the business) and what the checkbook says. **This is just the same as driving**

**your car staring at the rear-view mirror and NEVER looking away from it!** So the accounting cycle only works for you when it is done well, and the entire company as a team is organized to get the information accounting requires!

1. The flow is simple – all transaction, invoices, purchase orders, labor time cards, supplier accounts payable invoices all begin by being entered into a journal. Each journal entry is logged in as a transaction record, what type of transaction it was and how much, revenues, expenses everything is a journal entry. These journal entries are then posted to what are called ledgers, and these ledgers match-up with the company chart of accounts. So if you have multiple departments for revenues and costs, there will be a ledger matching each and every one of those chart-of-accounts. So when we say departmentalization, this means ledgers that contain the accounting information for the account in that specific department, like service sales. At the end of the months accounting period, those ledgers and their transactions make up what will become our company financial statements, and remember, they are now a historical account of what happened, not what will happen, so we need to deal with the future as well. Refer to the accounting cycle chart on the following page.
2. Your forms and paper work flow should match your accounting chart of accounts to insure transactions are accurately placed.

The Accounting Cycle – Information Flow of Company

**Step 2:** Journal entries are copied to various ledgers (market segments)

**Step 3:** Account Balances summary from ledgers

**Step 1:** Financial transactions

posted daily to journal entries

**P.O.#’s & Supplier Invoices**

**Labor Tickets**

**Sales Invoices**

**Various Account Journals**

**Various Ledgers**

**Accounting Period**

**New Accounting Period**

**Cash**

**Ledgers**

**Service Sales**

**Cost of Sales Equipment**

**Labor**

Step 4: Prepare Financial Statements

**Income Statement**

**Cash Flow Statement**

**Balance Sheet**

Why is a basic understanding of the accounting cycle important?

* The vast majority of contractors are not CPA’s, nor do they have to be. However, you are in business, and one of the primary functions of any business is to account for what operations do. That means as an owner or stakeholder, you are responsible for knowing the numbers, even if you didn’t count them yourself! You can’t trust the numbers if you didn’t know where they came from, or how they were derived! Knowing the basics of accounting help you lead the business.
* One of the goals of an effective leader is to have everyone understand the vision, the mission, and their respective roles. This includes the financial performance. Having a basic understanding of the accounting transactions is the foundation of that understanding. This understanding of how accounting is supposed to work creates trust in the numbers, and is one of the most important steps when you ask that time cards be legible and timely. That service invoices be coded properly, and that a purchase order system is used under any and all circumstances. If people do not understand, it is very difficult to get them to follow!
* If you don’t understand the transactions, and the financial numbers, how can you improve? Understanding the transactions allows you to lead more effectively.
* Having an understanding of the accounting cycle allows you to be certain that you are measuring, and tracking meaningful information and performance. How many times have we tracked information that was not utilized for anything? What a waste of precious time, resources, and PROFITS! When you understand it, you can make better decisions about what to really measure, track, report, and know when to discard it as times change.
* Improving your understanding of the accounting transactions will allow you to **MAKE MORE MONEY!**