

ACCOUNTING FOR CLOSING ENTRIES

Key Terms and Concepts to Know

Types of Accounts:

- All accounts are classified as either Temporary (Nominal) accounts or Permanent (Real) accounts.
- Temporary accounts accumulate activity for a fiscal year and are closed or zeroed-out at the end of each fiscal year. They begin each fiscal year with a zero balance.
- All income statement accounts and dividends are temporary accounts.
- Permanent accounts accumulate activity since the inception of the business. They are not closed or zeroed-out at the end of each fiscal year. The balance in the account carries forward from one fiscal year to the next.
- All balance sheet accounts except dividends are permanent accounts.

Closing Process:

- Records the current year's net income and dividends in Retained Earnings
- Zeros-out the balance in all revenue, expense and dividend accounts at year-end.
- Revenue and expense account balances are transferred into the Income Summary account.
- The balance in the income summary represents net income which is then transferred into Retained Earnings.
- Dividends are transferred directly into retained earnings, bypassing the income summary because dividends are not part of the calculation of net income and do not appear on the income statement.
- Closing entries are journalized and posted once per year at year-end after financial statements have been prepared.

Trial Balances:

- The closing process begins with the adjusted trial balance.
- After the closing entries have been journalized and posted to the ledger, a Post-Closing trial balance is prepared.
- The post-closing trial balance should have only permanent account balances. It should also reflect the retained earnings balance as shown on the Statement of Retained earnings.

- If any temporary account balances appear on the post-closing trial balance, there is an error in the closing entries and they must be corrected.

The Accounting Cycle (steps 8 and 9):

- Prepare and post closing entries
- Prepare post-closing trial balance

Key Topics to Know

Closing Process

- Closing prepares the general ledger for the next accounting cycle or year. The general ledger is closed after financial statements have been prepared.
- All general ledger accounts are classified as Permanent or Temporary for purposes of the closing process.
- Permanent Accounts are Balance Sheet accounts whose balances are carried forward from year to year.
- Temporary accounts are the revenue, expense and dividend accounts which measure activity for a specific time period. Temporary accounts are closed at the end of the year.
- Income Summary is a special temporary account used only during the closing process to summarize net income.
- The closing process involves four entries:
 - 1) Zeroing-out the balance in each revenue account and transferring the total revenues to the Income Summary account as a credit.
 - 2) Zeroing-out the balance in each expense account and transferring the total revenues to the Income Summary account as a debit.
 - 3) Zeroing-out the balance in Income Summary, the net income (credit) or net loss (debit) for the period, to the Retained Earnings account.
 - 4) Zeroing-out the balance in each dividend account and transferring the total dividends directly into retained earnings as a debit. Income Summary is not used because dividends are not used to determine Net Income.
- After closing, only asset, liability and permanent stockholders' equity accounts should have balances.

Example #1

G Company supplied the following adjusted trial balance as of December 31.

G Company
Adjusted Trial Balance
December 31

Cash	\$8,700	
Accounts Receivable	25,450	
Prepaid Insurance	1,500	
Supplies	400	
Land	45,000	
Building	134,500	
Accumulated Depreciation-Bldg.		\$88,450
Equipment	80,100	
Accumulated Depreciation-Equip.		67,100
Accounts Payable		7,500
Salaries & Wages Payable		2,300
Unearned Revenue		2,000
Capital Stock		15,300
Retained Earnings		54,000
Dividends	8,000	
Fees Earned		208,250
Salaries and Wages Expense	72,500	
Utilities Expense	23,200	
Advertising Expense	18,000	
Repairs Expense	11,500	
Depreciation Expense-Equipment	5,800	
Depreciation Expense-Bldg	1,750	
Miscellaneous Expense	4,050	
Insurance Expense	2,900	
Supplies Expense	1,550	
Totals	\$444,900	\$444,900

- Required:
- a) Prepare closing entries
 - b) Prepare a post-closing trial balance

Solution #1

1. Fees Revenue	208,250	
Income Summary		208,250
2. Income Summary	141,250	
Salaries and Wages Expense		72,500
Advertising Expense		23,200
Utilities Expense		18,000
Repairs Expense		11,500
Miscellaneous Expense		5,800
Insurance Expense		1,750
Supplies Expense		4,050
Depreciation Expense-Bldg		2,900
Depreciation Expense-Equipment		1,550

Balance in Income Summary account = Net Income

3. Income Summary	67,000	
Retained Earnings		67,000
4. Retained Earnings	8,000	
Dividends		8,000

G Company
Post-Closing Trial Balance
December 31

Cash	\$8,700	
Accounts Receivable	25,450	
Prepaid Insurance	1,500	
Supplies	400	
Land	45,000	
Building	134,500	
Accumulated Depreciation-Bldg.		\$88,450
Equipment	80,100	
Accumulated Depreciation-Equip.		67,100
Accounts Payable		7,500
Salaries & Wages Payable		2,300
Unearned Revenue		2,000
Capital Stock		15,300
Retained Earnings		113,000
Totals	\$295,650	\$295,650

Practice Problems

Practice Problem #1

Following is a list of 20 accounts.

- | | |
|---------------------------------|------------------------|
| 1. Accounts Payable | 2. Prepaid Advertising |
| 3. Accounts Receivable | 4. Rental Income |
| 5. Fees Earned | 6. Unearned Fees |
| 7. Dividends | 8. Supplies |
| 9. Insurance Expense | 10. Prepaid Insurance |
| 11. Accumulated
Depreciation | Wages and Salary |
| 12. Expense | 12. Expense |
| 13. Cash | 14. Accrued Wages |
| 15. Land | 16. Interest Income |
| 17. Retained Earnings | 18. Income Summary |
| 19. Interest Expense | 20. Notes Payable |

Required: Identify each account as
(IS) – Closed to Income Summary
(RE) – Closed to Retained Earnings
(P) – A permanent account and not closed

Practice Problem #2

	Adjusted Trial Balance	
	Debit	Credit
Notes Receivable	17,000	
Supplies	1,000	
Prepaid Rent	9,000	
Equipment	65,000	
Accumulated Depreciation	0	8,000
Capital Stock	0	15,000
Retained earnings		45,000
Dividends Payable		44,000
Wages Payable	0	3,000
Dividends	22,000	
Unearned Fees	0	7,000
Fees Earned	0	210,000
Interest Income		17,000
Cost of Goods Sold	146,000	
Wages Expense	44,000	
Rent Expense	11,000	
Interest Expense	9,000	
Depreciation Expense	13,000	
Supplies Expense	12,000	
	\$349,000	\$349,000

- Required:
- a) Prepare closing entries
 - b) Prepare a post-closing trial balance

Practice Problem #3

Foley Staples Co. provided the adjusted trial balance as of year-end, August 31.

	Adjusted Trial Balance	
	Debit	Credit
Accounts Receivable	17,610	
Supplies	800	
Prepaid Rent	9,000	
Equipment	75,800	
Accumulated Depreciation- Equipment	0	28,100
Capital Stock	0	20,480
Wages Payable	0	2,500
Unearned Fees	0	1,500
Fees Earned	0	110,910
Wages Expense	44,700	0
Rent Expense	11,000	0
Depreciation Expense	3,400	0
Supplies Expense	1,180	0
	<u>163,490</u>	<u>163,490</u>

Required: Prepare closing entries and the Post-Closing Trial Balance.

Practice Problem #4

The following are the steps in the accounting cycle.

- Prepare adjusted trial balance
- Post transactions
- Prepare an unadjusted trial balance
- Journalize transactions
- Prepare the financial statements
- Close the temporary accounts
- Adjust the ledger accounts
- Prepare a post-closing trial balance
- Analyze transactions

Required: List the steps in the order in which they are completed

Practice Problem #5

G Company provided the following information from its adjusted but not closed general ledger in T-account form.

Revenue	Gas Expense	Wages Expense
?	25	45
100	?	?
Dividends	?	Retained Earnings
?	?	130
?	?	?
	?	40
		?
		?

Required: Solve for the missing information to complete the closing process.

True / False Questions

1. Closing entries transfer the balances of all temporary accounts (revenues, expenses, and dividends) to the balance of the Common Stock account.
True False
2. The closing entry for expense accounts includes a debit to Retained Earnings and a credit to all expense accounts.
True False
3. The closing entry for dividends includes a debit to the Dividends account and a credit to Retained Earnings.
True False
4. After closing entries are prepared, the balance of Retained Earnings is updated to reflect the activity in the revenue, expense, and dividend accounts for the period.
True False
5. The post-closing trial balance is a list of all accounts and their balances at a particular date after the account balances have been updated for closing entries.
True False
6. A post-closing trial balance is a list of all accounts and their balances after we have updated account balances for adjusting entries.
True False
7. Income Summary is a permanent account only used for the closing process.
True False
8. Closing entries are required at the end of each accounting period to close all ledger accounts.
True False
9. Closing entries are necessary so that retained earnings will begin each period with a zero balance.
True False
10. If there is a net loss, Income Summary account would have a credit balance.
True False

11. The post-closing trial balance contains balance sheet accounts only.
True False
12. The entry to transfer net income to the retained earnings account would include a debit to the retained earnings account.
True False
13. The entry to close the revenue account requires a debit to that account.
True False
14. The entry to close Prepaid insurance includes a credit to that account.
True False
15. Since a company prepares financial statements at the end of each month, closing entries are prepared at the end of each month.
True False

Multiple Choice Questions

1. Closing entries:
 - a) Need not be recorded in the journal
 - b) Need not be posted to the ledger
 - c) Must be journalized and posted
 - d) Are not needed if adjusting entries are prepared

2. Which of the following accounts should be closed to Income Summary?
 - a) Accumulated Depreciation
 - b) Supplies Expense
 - c) Prepaid Expenses
 - d) Dividends

3. Which of the following accounts appears in the post-closing trial balance?
 - a) Salaries Expense
 - b) Supplies Expense
 - c) Accumulated Depreciation
 - d) Fees Earned

4. The entry to close the income summary account when there is net income is:
 - a) Debit Retained Earnings; credit Income Summary
 - b) Debit Income Summary; credit Retained Earnings
 - c) Debit Income Summary; credit Dividends
 - d) Debit Dividends; credit Income Summary

5. In the normal manual accounting cycle the:
 - a) Financial statements are prepared after the adjusting entries are posted
 - b) Financial statements are prepared after the closing entries are posted
 - c) Adjusting and closing entries are journalized before financial statements are prepared
 - d) Post-closing trial balance is prepared before the closing entries are posted

6. After preparing and posting the closing entries for revenues and expenses, the income summary account has a debit balance of \$33,000. The entry to close the income summary account will be:
 - a) Debit Dividends \$33,000; credit Income Summary \$33,000
 - b) Debit Income Summary \$33,000; credit Dividends \$33,000
 - c) Debit Income Summary \$33,000; credit Retained Earnings \$33,000
 - d) Debit Retained Earnings \$33,000; credit Income Summary \$33,000

7. It is obvious that an error occurred in the preparation and/or posting of closing entries if:
 - a) all revenue and expense accounts have zero balances
 - b) all balance sheet accounts have zero balances
 - c) the income summary account is debited for the amount of net income for the period
 - d) the retained earnings account is debited for the amount of the net loss for the period

8. The Retained Earnings account has a credit balance of \$37,000 before closing entries are made. Total revenues for the period are \$55,200, total expenses are \$39,800, and dividends are \$9,000. What is the correct closing entry for the expense accounts?
 - a) Debit Income Summary \$39,800; credit Expense accounts \$39,800
 - b) Debit Expense accounts \$37,000; credit Retained Earnings \$37,000
 - c) Credit Expense accounts \$39,800; debit Retained Earnings \$39,800
 - d) Debit Expense accounts \$39,800; credit Income Summary \$39,800

9. J Company had revenues of \$75,000 and expenses of \$62,000 for the accounting period. The company paid \$8,000 cash in dividends to the owner (sole shareholder). Which of the following entries could not be a closing entry?
 - a) Debit Income Summary \$13,000; credit Retained Earnings \$13,000
 - b) Debit Revenues \$75,000; credit Income Summary \$75,000
 - c) Debit Income Summary \$75,000; credit Revenues \$75,000
 - d) Debit Retained Earnings \$8,000; credit Dividends \$8,000

10. When closing entries are made:
 - a) All ledger accounts are closed to start the new accounting period
 - b) All balance sheet accounts are closed to start the new accounting period
 - c) All income statement accounts are closed to start the new accounting period
 - d) All temporary accounts are closed but permanent accounts are not closed

11. Closing the temporary accounts at the end of each accounting period does all of the following *except*:
 - a) Serves to transfer the effects of these accounts to the retained earnings account on the balance sheet.
 - b) Prepares the dividends account for use in the next period
 - c) Has no effect on the retained earnings account
 - d) Causes retained earnings to reflect increases from revenues and decreases from expenses and dividends.

The next 3 questions refer to the following information.

T Company had annual revenues of \$185,000, expenses of \$103,700, and the company paid \$18,000 cash in dividends to the owner and sole stockholder.

The retained earnings account before closing had a balance of \$297,000.

12. The ending retained earnings balance after closing is:
 - a) \$185,000
 - b) \$63,300
 - c) \$81,300
 - d) \$360,300

13. The Net Income for the year is:
 - a) \$185,000
 - b) \$63,300
 - c) \$81,300
 - d) \$360,300

14. The entry to close the Income Summary account at the end of the year, after revenue and expense accounts have been closed, is:
 - a) Debit Retained Earnings \$297,000; credit Income Summary \$297,000
 - b) Debit Income Summary \$81,300; credit Retained Earnings \$81,300
 - c) Debit Income Summary \$63,300; credit Retained Earnings \$63,300
 - d) Debit Retained Earnings \$81,300; credit Income Summary \$81,300

15. The K Company paid \$5,700 cash in dividends to the stockholders. The entry to close the dividends account at the end of the year is:
 - a) Debit Retained Earnings \$5,700; credit Dividends \$5,700
 - b) Debit Dividends \$5,700; credit Retained Earnings \$5,700
 - c) Debit Retained Earnings \$5,700; credit Salary Expense \$5,700
 - d) Debit Income Summary \$5,700; credit Retained Earnings \$5,700

Solutions to Practice Problems

Practice Problem #1

1. P
2. P
3. P
4. IS
5. IS
6. P
7. RE
8. P
9. IS
10. P
11. P
12. IS
13. P
14. P
15. P
16. IS
17. P
18. RE
19. IS
20. P

Practice Problem #2

1.	Fees Earned	210,000	
	Interest Income	17,000	
	Income Summary		227,000
2.	Income Summary	235,000	
	Cost of Goods Sold		146,000
	Wages Expense		44,000
	Rent Expense		11,000
	Interest Expense		9,000
	Depreciation Expense		13,000
	Supplies Expense		12,000
3.	Retained Earnings	8,000	
	Income Summary		8,000
4.	Retained Earnings	22,000	
	Dividends		22,000

Post-Closing Trial Balance

	Debit	Credit
Notes Receivable	\$17,000	
Supplies	1,000	
Prepaid Rent	9,000	
Equipment	65,000	
Accumulated Depreciation		\$8,000
Capital Stock		15,000
Dividends payable		44,000
Wages Payable		3,000
Unearned Fees		7,000
Retained Earnings		15,000
Total	\$92,000	\$92,000

Practice Problem #3

1.	Fees Earned	110,910	
	Income Summary		110,910
2.	Income Summary	60,280	
	Wages Expense		44,700
	Rent Expense		11,000
	Depreciation Expense		3,400
	Supplies Expense		1,180
3.	Income Summary	50,630	
	Retained Earnings		50,630
4.	Retained Earnings	2,000	
	Dividends		2,000

Post-Closing Trial Balance

	Debit	Credit
Accounts Receivable	\$17,610	
Supplies	800	
Prepaid Rent	9,000	
Equipment	73,800	
Accumulated Depreciation-Equip		\$28,100
Capital Stock		20,480
Wages Payable		2,500
Unearned Fees		1,500
Retained Earnings		48,630
Total	<u>\$101,210</u>	<u>\$101,210</u>

Practice Problem #4

1. Analyze transactions
2. Journalize transactions
3. Post transactions
4. Prepare an unadjusted trial balance
5. Adjust the ledger accounts
6. Prepare adjusted trial balance
7. Prepare the financial statements
8. Close the temporary accounts
9. Prepare a post-closing trial balance

Practice Problem #5

G Company provided the following information from its adjusted but not closed general ledger in T-account form.

Revenue	Gas Expense	Wages Expense
a) 100 100	25 d) 25	45 e) 45
j) 40 i) 40	a) Income Summary f) 70 b) 100 g) 30	Retained Earnings 130 h) 30 40 k) 120

<u>Account</u>	<u>Entry</u>	<u>Missing Information</u>
a) Revenue	#1	\$100 represents normal activity; missing debit is \$100 to close account
b) Untitled Account		Income Summary Account
c) Income Summary	#1	Missing credit is \$100 from the Revenue closing entry
d) Gas Expense	#2	Missing credit is \$25 to close account
e) Wages Expense	#2	Missing credit is \$45 to close account
f) Income Summary	#2	Missing debit is \$70 from the Gas Expense and Wages Expense closing entry (\$25 + \$45)
g) Income Summary	#3	Missing debit is \$30 to close account. Represents Net Income for the period.
h) Retained Earnings	#3	Missing credit is \$30 from the Income Summary closing entry. Represents Net Income for the period.
i) Dividends	#4	Missing credit is \$40 from the Dividends closing entry
j) Dividends		If the closing entry was \$40 credit, then the pre-closing balance must have been \$40 as well.
k) Retained Earnings		Ending balance is a credit of \$120. Although this is the normal balance, a debit balance is possible there were net losses instead of net income.

Solutions to True / False Questions

1. False - balances of temporary accounts are transferred to Retained Earnings.
2. True
3. False - the closing entry for dividends includes a debit to Retained Earnings and a credit to the Dividends account
4. True
5. True
6. False - this is an adjusted trial balance.
7. False – Income Summary is a temporary account.
8. False – closing entries are required only at the end of the fiscal year
9. False – retained earnings is a permanent account and the balance carries over from one year to the next. Only revenues, expenses and dividends are zeroed out at year-end.
10. False – income summary would have a debit balance as expenses would exceed revenues
11. True
12. False – net income would be credited to retained earnings
13. False – since expense accounts have a normal debit balance, the closing entry would include a credit to the expense accounts and a debit to income summary
14. True
15. False – closing entries are prepared only at the end of the year

Solutions to Multiple Choice Questions

- | | |
|-----|---|
| 1. | C |
| 2. | B |
| 3. | C |
| 4. | B |
| 5. | A |
| 6. | D |
| 7. | B |
| 8. | A |
| 9. | C |
| 10. | D |
| 11. | C |
| 12. | D |
| 13. | C |
| 14. | B |
| 15. | A |