

THE **A** **B** **C**s OF Accounting

Lesson 7: Working with Adjusting and Closing Entries

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Lesson Objectives

- After studying this lesson, you will be able to:
 - ▲ Explain the closing process
 - ▲ Explain why temporary capital accounts are closed at the end of the fiscal period
 - ▲ Explain the purpose of the income summary account
 - ▲ Analyze and journalize closing entries
 - ▲ Post closing entries to the general ledger
 - ▲ Prepare the post-closing trial balance

Step 8: Journalizing and Posting Closing Entries

■ Review:

- ▲ Permanent accounts continue from one accounting period to another
 - ◆ Assets, Liabilities, Owner's Equity
- ▲ Temporary accounts start each accounting period with a zero balance
 - ◆ Revenues, Expenses, Withdrawals

Why close temporary accounts?

- The balances of the temporary accounts are transferred to Owner's Equity account at the end of the accounting period
- When you start with zero and transfer a balance, you have a good idea of how much the business made

The Closing Process

- Procedure of transferring all balances from temporary capital accounts to the Income Summary account
- Entries are called closing entries
- No single account in the general ledger that shows the revenues and expenses combined in one account for the fiscal period

The Income Summary Account

- Combines the balances of revenues, expenses, and draws during the closing process
- Temporary capital account
- Also called the Profit and Loss Summary account
- Does not have a normal balance
- Does not have an increase or decrease side
- If the business has a net income, the account will have a credit balance



Steps in the Closing Process

- Transfer the balance of revenue accounts to the credit side of the Income Summary account
- Transfer the balance of expense accounts to the debit side of the Income Summary account
- Transfer the balance of the Income Summary account to the Capital account
- Transfer the balance of Owner's Drawing account to the debit side of the Capital account

Record in the Journal

- Write “Closing Entries” in the center of the Description column

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|-----------------|------|----|-----------------|---------------|-------|---|---|---|---|-------------------|---|---|---|---|
| | Date | | Description | Post. Ref. | Debit | | | | | Credit | | | | |
| 1 | 2009 | | Closing Entries | | | | | | | | | | | |
| 2 | Apr. | 30 | Dive Trip Sales | | 1 | 0 | 0 | 0 | 0 | | | | | |
| 3 | | | Service Sales | | 1 | 5 | 0 | 0 | 0 | | | | | |
| 4 | | | Income Summary | | | | | | | 2 | 5 | 0 | 0 | 0 |

Closing entries for Deep Divers

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|-----------------|---------|-------------------------|------------|-------|---------------|---|---|---|--------|---|---|---|---|---|
| | Date | Description | Post. Ref. | Debit | | | | | Credit | | | | | |
| 1 | 2009 | Closing Entries | | | | | | | | | | | | |
| 2 | Apr. 30 | Dive Trip Sales | 410 | 1 | 0 | 0 | 0 | 0 | | | | | | |
| 3 | | Service Sales | 401 | 1 | 5 | 0 | 0 | 0 | | | | | | |
| 4 | | Income Summary | 310 | | | | | | 2 | 5 | 0 | 0 | 0 | |
| 5 | | | | | | | | | | | | | | |
| 6 | 30 | Income Summary | 310 | 9 | 1 | 5 | 0 | | | | | | | |
| 7 | | Advertising Expense | 501 | | | | | | | | 6 | 0 | 0 | |
| 8 | | Salaries Expense | 510 | | | | | | | | 6 | 0 | 0 | |
| 9 | | Rent Expense | 520 | | | | | | | | 1 | 2 | 0 | 0 |
| 10 | | Supplies Expense | 530 | | | | | | | | 6 | 0 | 0 | |
| 11 | | Depreciation Expense | 540 | | | | | | | | 7 | 5 | 0 | |
| 12 | | | | | | | | | | | | | | |
| 13 | 30 | Income Summary | 310 | 1 | 5 | 8 | 5 | 0 | | | | | | |
| 14 | | Dave Diver, Capital | 301 | | | | | | 1 | 5 | 8 | 5 | 0 | |
| 15 | | | | | | | | | | | | | | |
| 16 | 30 | Dave Diver, Capital | 301 | 3 | 0 | 0 | 0 | | | | | | | |
| 17 | | Dave Diver, Withdrawals | 305 | | | | | | 3 | 0 | 0 | 0 | | |



Step 9: Preparing the Post-Closing Trial Balance

- The last step in the accounting cycle
- Prepared to show that total debits in the ledger accounts are equal to total credits after the posting of the closing entries
- Also verifies that the revenue, expense, and withdrawal accounts have zero balances
- Only permanent accounts appear here

Deep Divers Post-Closing Trial Balance

| Deep Divers | | | | | | | | | | | | | | |
|----------------------------|--|--|---|---|---|---|---|---|---|---|---|---|---|---|
| Post-Closing Trial Balance | | | | | | | | | | | | | | |
| April 30, 20-- | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | |
| Cash | | | 5 | 9 | 0 | 0 | 0 | | | | | | | |
| Accounts Receivable | | | 4 | 0 | 0 | 0 | | | | | | | | |
| Inventory | | | 2 | 4 | 0 | 0 | 0 | | | | | | | |
| Supplies | | | 1 | 0 | 1 | 5 | | | | | | | | |
| Prepaid Rent | | | 2 | 4 | 0 | 0 | | | | | | | | |
| Furniture & Equipment | | | 1 | 5 | 5 | 4 | 0 | 0 | | | | | | |
| Accumulated Depreciation | | | | | | | | | | 7 | 5 | 0 | | |
| Accounts Payable | | | | | | | | | 1 | 5 | 2 | 0 | 6 | 5 |
| Dave Diver, Capital | | | | | | | | | 9 | 3 | 0 | 0 | 0 | |
| | | | 2 | 4 | 5 | 8 | 1 | 5 | 2 | 4 | 5 | 8 | 1 | 5 |

Summary

- Last two steps of the accounting cycle were covered:
 - ▲ 8. Journalize and post closing entries
 - ▲ 9. Prepare a post-closing trial balance
- Closing process takes information from worksheet and transfers balances of temporary capital accounts to the Capital account
- Post-closing trial balance gives you the figures to begin the next accounting period

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