

Closing Process

by Sophia



WHAT'S COVERED

This tutorial will cover the closing process, the last phase in the accounting cycle.

Our discussion breaks down as follows:

1. Closing Process

Let's begin our discussion on the closing process by looking at the trial balance worksheet, specifically the adjusted trial balance. As you can see in the trial balance worksheet below, we have already worked through any adjustments, made the adjusted trial balance, and created the financial statements. Now it's time to close it out.

Accounts	Trial Balance		Adjustments		Adjusted Trial Balance	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	100,000				100,000	
Accounts Receivable	10,000				10,000	
Supplies	1,000			500		500
Prepaid Insurance	5,000			1,000		4,000
Buildings	50,000				50,000	
Accumulated Depreciation - Buildings		10,000		1,000		11,000
Accounts Payable		5,000				5,000
Notes Payable		25,000				25,000
Common Stock		100,000				100,000
Retained earnings, 1/1/12		12,000				12,000
Owner Drawings	2,000				2,000	
Sales		150,000				150,000
Salaries Expense	121,500				121,500	
Advertising Expense	10,000				10,000	
Interest Expense	2,500				2,500	
Totals	302,000	302,000				
Depreciation Expense-Buildings			1000			1000
Insurance Expense			1000			1000
Supplies Expense			500			500
Totals			2,500	2,500	303,000	303,000

The next step is to look at the adjusted trial balance and clear out the temporary accounts, which are the revenues and expenses. If we populate the closing entries below, you'll see that we need to zero out the balances in all of the temporary accounts.

For example, if you look at owner drawings, we have a \$2,000 debit balance in the adjusted trial balance. Therefore, we need to clear it out with a closing entry of \$2,000 to the credit side. Similarly, if you take a look at sales, we have a \$150,000 credit balance in the adjusted trial balance, so we need to enter a \$150,000 debit as a closing entry.

Now, we complete this process for all of our revenue and expense accounts, as well as our drawing account, and any difference is put to income summary.

Accounts	Trial Balance		Adjustments		Adjusted Trial Balance		Closing Entries	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.		
Cash	100,000				100,000			
Accounts Receivable	10,000				10,000			
Supplies	1,000			500	500			
Prepaid Insurance	5,000			1,000	4,000			
Buildings	50,000				50,000			
Accumulated Depreciation - Buildings		10,000		1,000		11,000		
Accounts Payable		5,000				5,000		
Notes Payable		25,000				25,000		
Common Stock		100,000				100,000		
Retained earnings, 1/1/12		12,000				12,000		
Owner Drawings	2,000				2,000			2,000
Sales		150,000				150,000	150,000	
Salaries Expense	121,500				121,500			121,500
Advertising Expense	10,000				10,000			10,000
Interest Expense	2,500				2,500			2,500
Totals	302,000	302,000						
Depreciation Expense-Buildings			1,000		1,000			1,000
Insurance Expense			1,000		1,000			1,000
Supplies Expense			500		500			500
Totals			2,500	2,500	303,000	303,000		
Income Summary								11,500
Totals							150,000	150,000

Then, we also have to close out the income summary account. If we close out the income summary account, you can see that there is now a debit and a credit, so there is going to be no balance in that account. The difference is put to the retained earnings for the end of the year.

Accounts	Trial Balance		Adjustments		Adjusted Trial Balance		Closing Entries	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.		
Cash	100,000				100,000			
Accounts Receivable	10,000				10,000			
Supplies	1,000			500	500			
Prepaid Insurance	5,000			1,000	4,000			
Buildings	50,000				50,000			
Accumulated Depreciation - Buildings		10,000		1,000		11,000		
Accounts Payable		5,000				5,000		
Notes Payable		25,000				25,000		
Common Stock		100,000				100,000		
Retained earnings, 1/1/12		12,000				12,000		11,500
Owner Drawings	2,000				2,000			2,000
Sales		150,000				150,000	150,000	
Salaries Expense	121,500				121,500			121,500
Advertising Expense	10,000				10,000			10,000
Interest Expense	2,500				2,500			2,500
Totals	302,000	302,000						
Depreciation Expense-Buildings			1,000		1,000			1,000
Insurance Expense			1,000		1,000			1,000
Supplies Expense			500		500			500
Totals			2,500	2,500	303,000	303,000		
Income Summary							11,500	11,500
Totals							161,500	161,500

2. Closing Entries

Now that we've gone through organizing the closing entries on the trial balance worksheet, let's look at journalizing those transactions--getting the closing entries into the general journal and ultimately posted to the ledger.

2a. General Journal

Remember, this is what the general journal looks like, below.

General Journal			J201	
Date	Account Title	Ref	Debit	Credit
12/31/12	Revenue	7001	150,000	
	Income Summary	7999		150,000
12/31/12	Income Summary	7999	136,500	
	Salaries Expense	9001		121,500
	Advertising Expense	9002		10,000
	Interest Expense	9003		2,500
	Depreciation Expense	9004		1,000
	Insurance Expense	9005		1,000
	Supplies Expense	9006		500
12/31/12	Income Summary	7999	2,000	
	Owner Drawings	6200		2,000
12/31/12	Income Summary	7999	11,500	
	Retained Earnings	6300		11,500

We need to enter all of the entries that we identified on the trial balance worksheet, starting with revenue. We are closing out the revenue account to income summary. Since revenue has a credit balance, we are going to debit it for the \$150,000, to zero out the revenue account.

We're going to do the same thing with all of our expenses; now, all of our expenses are going to be credit entries in the closing process, because they have debit balances on the adjusted trial balance.

Now, we also have to close out the owner drawings, zeroing that account out because it is also an activity-based account. After we've zeroed all of those accounts out, we have one more entry to make, which is to close the income summary account to our cumulative equity or retained earnings.

2b. General Ledger

Now that we've listed all of general journal entries, we need to post them to the general ledger. Each individual account is going to have its own ledger.

Revenue					No. 7001
Date	Description	Ref	Debit	Credit	Balance
12/31/12	Closing entry - Revenue	J201	150,000		150,000 -0-

Owner Drawings					No. 6200
Date	Description	Ref	Debit	Credit	Balance
12/31/12	Closing entry - Drawing	J201		2,000	2,000 -0-

Income Summary					No. 7999
Date	Description	Ref	Debit	Credit	Balance
12/31/12	Closing entry - Revenue	J201		150,000	150,000
12/31/12	Closing entry - Expenses	J201	13,500		13,500
12/31/12	Closing entry - Drawing	J201	2,000		11,500
12/31/12	Close to Retained Earnings	J201	11,500		-0-

Retained Earnings					No. 6300
Date	Description	Ref	Debit	Credit	Balance
12/31/12	Close to Retained Earnings	J201		11,500	12,000 23,500

Revenue had a \$150,000 balance. We made our closing entry a debit of \$150,000 to bring the balance in revenue to zero.

Owner drawings had a balance of \$2,000, so we made our closing entry a credit for \$2,000, to zero out the owner drawings account.

Now, just as with the revenue and owner drawings accounts, each of those expense accounts that we had cleared out on the adjusted trial balance is going to have this same general ledger, with a debit balance. A closing entry, then, will be a credit, bringing the balance in that expense account to zero.

In the income summary, the closing entry for our revenue left us with a \$150,000 balance. Notice that we had no balance in the income summary account, because that is only used in the closing process. Next, we closed our expenses with a debit, bringing the balance in that income summary to \$13,500. The last closing entry was our drawing account, and we also closed that to income summary, bringing the balance to \$11,500. Finally, we have to clear that balance in our income summary account by closing it to retained earnings, bringing the balance in the income summary account to zero.



Remember, income summary is only used in the closing process.

Retained earnings started with \$12,000, and through all of our closing entries in the closing process we identified an additional \$11,500 credit to retained earnings, bringing the balance to \$23,500.

3. Post Closing Trial Balance

Once the entries have been posted to the general ledger, then we can move on to the post closing trial balance, which is another checkpoint in the accounting department to ensure that everything has proceeded accurately in the closing process. So, let's take a look at the post closing trial balance in the trial balance worksheet.

Note, we have taken our adjusted trial balance, identified our closing entries, journalized them, and posted them to the general ledger.

Accounts	Adjusted Trial Balance		Closing Entries			
	Dr.	Cr.				
Cash	100,000					
Accounts Receivable	10,000					
Supplies	500					
Prepaid Insurance	4,000					
Buildings	50,000					
Accumulated Depreciation - Buildings		11,000				
Accounts Payable		5,000				
Notes Payable		25,000				
Common Stock		100,000				
Retained earnings, 1/1/12		12,000		11,500		
Owner Drawings	2,000			2,000		
Sales		150,000	150,000			
Salaries Expense	121,500			121,500		
Advertising Expense	10,000			10,000		
Interest Expense	2,500			2,500		
Totals						
Depreciation Expense-Buildings	1,000			1,000		
Insurance Expense	1,000			1,000		
Supplies Expense	500			500		
Totals	303,000	303,000				
Income Summary				11,500	11,500	
Totals			161,500	161,500		

Now it's time to prepare the post closing trial balance. Looking at the post closing trial balance and all of the accounts that have balances remaining after we've entered our closing entries, you can see that it is only the permanent accounts--all of the assets, liabilities, and equity. All of the temporary accounts--drawings, revenues, and expenses--now have no balances in them. It is only the permanent accounts that carry forward to the next period.

Accounts	Adjusted Trial Balance		Closing Entries		Post Closing Trial Balance	
	Dr.	Cr.				
Cash	100,000				100,000	
Accounts Receivable	10,000				10,000	
Supplies	500				500	
Prepaid Insurance	4,000				4,000	
Buildings	50,000				50,000	
Accumulated Depreciation - Buildings		11,000				11,000
Accounts Payable		5,000				5,000
Notes Payable		25,000				25,000
Common Stock		100,000				100,000
Retained earnings, 1/1/12		12,000		11,500		23,500
Owner Drawings	2,000			2,000		
Sales		150,000	150,000			
Salaries Expense	121,500			121,500		
Advertising Expense	10,000			10,000		
Interest Expense	2,500			2,500		
Totals						
Depreciation Expense-Buildings	1,000			1,000		
Insurance Expense	1,000			1,000		
Supplies Expense	500			500		
Totals	303,000	303,000				
Income Summary				11,500	11,500	164,500
Totals			161,500	161,500		164,500



SUMMARY

Today we learned about the **closing process**. We examined the trial balance worksheet., starting with the adjusted trial balance. We identified the necessary **closing entries**, put them in our general journal, and posted them to our general ledger. Once they were posted, we prepared the **post closing trial balance**.

Source: Adapted from Sophia instructor Evan McLaughlin.