

# CLOSING ENTRIES

## Key Topics to Know

### Purpose of Closing Entries

- Transfer revenues, expenses and dividends for the year into retained earnings
- Set the balances to zero.

### Types of Closing Entries

- The four closing entries are always prepared and recorded in the same order:
  - Revenue accounts are closed to Income Summary account
  - Expense accounts are closed to Income Summary account
  - The balance in Income Summary, which must equal net income, is closed to retained earnings.
  - Dividends are close to retained earnings.

### Income Summary Account

- Balances in the revenue and expense accounts are closed to Income Summary account
- Balance in Income Summary must equal Net Income
- Income Summary is then closed into Retained Earnings
- Dividends are never closed to Income Summary because they are not part of the calculation of (net) Income.

### Post-closing Trial Balance

- Prepare a post-closing trial balance
- Which accounts should and should not appear on it
- Why it is a necessary step in the accounting cycle.

## Practice Problems

### **Problem #1 – Temporary and Permanent Accounts**

The accounts listed below were taken from the trial balance of the Cola Company.

Accounts Payable	Fees earned
Accumulated Depreciation-Building	Land
Capital Stock	Retained Earnings
Depreciation Expense-Building	Salaries Expense
Dividends	Salaries Payable
Equipment	Unearned Fees
Supplies Expense	Supplies
Interest Receivable	Prepaid Insurance

Required: Identify the accounts that are temporary and would be closed at the end of the accounting period.

**Problem #2 - Closing Entries**

The following is the trial balance of A Corporation at December 31 after the year-end adjustments were made.

	<u>Debits</u>	<u>Credits</u>
Cash	13,750	
Accounts Receivable	10,250	
Supplies	1,950	
Office Equipment	42,500	
Accumulated Depreciation		8,250
Accounts Payable		3,250
Salaries and Wages Payable		1,150
Unearned Fees		1,250
Capital Stock		25,000
Retained Earnings		27,050
Dividends	20,000	
Fees Earned		92,250
Salaries And Wages Expense	31,420	
Rent Expense	24,000	
Depreciation Expense	2,750	
Supplies Expense	3,475	
Insurance Expense	2,400	
Telephone Expense	2,700	
Utilities Expense	2,600	
Miscellaneous Expense	405	

Required:            Journalize the necessary closing entries.

**Problem #3 - Closing entries**

The partial trial balance for the owners' equity accounts of the Jamison Company showed the following data on October 31.

	<u>Debit</u>	<u>Credit</u>
Common Stock		\$30,000
Retained Earnings		15,000
Fees Earned		20,000
Salaries Expense	10,400	
Rent Expense	3,000	
Supplies Expense	2,400	
Utilities expense	3,200	
Depreciation Expense	7,850	
Dividends	3,300	

Required:            Journalize the necessary closing entries.

**Problem #4 – Errors in closing entries**

The following is the post-closing trial balance of W Corporation at December 31.

	<b><u>Debits</u></b>	<b><u>Credits</u></b>
Cash	13,750	
Accounts Receivable	10,250	
Supplies	1,950	
Office Equipment	42,500	
Accumulated Depreciation		8,250
Accounts Payable		3,250
Salaries and Wages Payable		1,150
Unearned Fees		1,250
Capital Stock		25,000
Retained Earnings		40,950
Dividends	10,000	
Interest revenue		1,000
Insurance Expense	2,400	

Required:           What should be the post-closing balance in retained earnings?

## Multiple Choice Questions

1. Consider the following account balances of the Shattuck Law Firm as of December 31:

Accounts Payable	\$4,400
Salaries Expense	12,800
Cash	1,700
Common Stock	2,400
Service Revenue	8,300
Supplies	4,300
Retained earnings	1,100
Utilities Expense	5,000

How many of these accounts would appear in Shattuck's 2012 balance sheet?

- a) Five.
  - b) Four.
  - c) Three.
  - d) Two.
2. The closing entry for expenses includes:
- a) A debit to Dividends and a credit to all expense accounts.
  - b) A debit to Retained Earnings and a credit to all expense accounts.
  - c) A debit to Revenues and a credit to Retained Earnings.
  - d) A debit to Revenues and a credit to all expense accounts.
3. The primary purpose of closing entries is to:
- a) Prove the equality of the debit and credit entries in the general journal.
  - b) Ensure that all assets and liabilities are recognized in the appropriate period.
  - c) Update the balance of Retained Earnings and prepare revenue, expense, and dividend accounts for next period's transactions.
  - d) Assure that adjusting entries balance.
4. The first two closing entries to the Income Summary account indicate a debit of \$53,000 and a credit of \$64,000. The third closing entry would be
- a) debit Capital Stock \$11,000; credit Income Summary \$11,000
  - b) debit Income Summary \$11,000; credit Retained Earnings \$11,000
  - c) debit Revenue \$64,000; credit Expenses \$53,000; credit debit Income Summary \$11,000
  - d) debit Revenue \$64,000; credit Expenses \$53,000; credit debit Retained Earnings \$11,000

5. Retained earnings had a beginning balance of \$40,000 and a post closing balance of \$65,000. If net income was \$37,000 dividends for the year were
  - a) \$68,000
  - b) \$62,000
  - c) \$12,000
  - d) \$68,000
  
6. One purpose of closing entries is to
  - a) Transfer the results of operations to owner's equity
  - b) Reduce the common stock balance to zero so that the account is ready for the next period
  - c) Adjust the general ledger accounts to provide complete and accurate balances for use on financial statements
  - d) Close all accounts so that the ledger is ready for the next accounting period
  
7. One purpose of closing entries is to give zero balances to
  - a) asset and liability accounts
  - b) liability and owners' equity accounts
  - c) revenue and expense accounts
  - d) expense and owners' equity accounts
  
8. After closing entries are posted to the ledger, an expense account will have a
  - a) Debit balance
  - b) Credit balance
  - c) Negative balance
  - d) Zero balance
  
9. The entry to close the Income Summary account may include a
  - a) debit to Income Summary and a credit to retained earnings
  - b) debit to Income Summary and a credit to common stock
  - c) debit to income summary and a credit to dividends
  - d) debit to Income Summary and a credit to fees earned
  
10. The closing entry for dividends does not include a debit to income summary because
  - a) Dividends has a normal credit balance
  - b) Dividends are not a revenue or expense account and not part of net income
  - c) Dividends is a permanent account
  - d) Dividends are not part of the closing entries

## Solutions to Practice Problems

### **Problem #1 - Permanent and Temporary Accounts**

The following accounts are temporary and would be closed:

- Depreciation Expense-Building
- Dividends
- Supplies Expense
- Fees Earned
- Salaries Expense

### **Problem #2 - Closing Entries**

Fees Earned	92,250	
Income Summary		92,250
Income Summary	69,750	
Salaries and Wages Expense		31,420
Rent Expense		24,000
Depreciation Expense		2,750
Supplies Expense		3,475
Insurance Expense		2,400
Telephone Expense		2,700
Utilities Expense		2,600
Miscellaneous Expense		405
Income Summary	22,500	
Retained Earnings		22,500
Retained Earnings	20,000	
Dividends		20,000



**Problem #3 - Closing Entries**

Fees Earned	20,000	
Income Summary		20,000
Income Summary	26,850	
Salaries Expense		10,400
Rent Expense		3,000
Depreciation Expense		7,850
Supplies Expense		2,400
Utilities Expense		3,200
Retained Earnings	6,850	
Income Summary		6,850
Retained Earnings	3,300	
Dividends		3,300

**Problem #4 – Errors in closing entries**

Retained earnings should be:  $\$40,950 + 1,000 - 10,000 - 2,400 = \$29,950$

## Solutions to Multiple Choice Questions

- |     |   |
|-----|---|
| 1.  | A |
| 2.  | B |
| 3.  | C |
| 4.  | B |
| 5.  | C |
| 6.  | A |
| 7.  | C |
| 8.  | D |
| 9.  | A |
| 10. | B |