

Closing Entries and the Postclosing Trial Balance



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Since the TSS *Mardi Gras* made its first voyage in 1972, Carnival

Corporation has grown to become the most popular cruise line in the world, attracting four million guests annually. Carnival Cruise Lines is the flagship company of Carnival Corporation & plc, the largest cruise vacation group in the world, with a portfolio of cruise brands in North America, Europe, Australia, and Asia. Headquartered in Miami, Florida, and London, England, Carnival Corporation & plc generated \$15.4 billion in revenues in 2012 and realized a total net income of over \$1.3 billion.

When a company has been around as long as Carnival much of their success is dependent on being able to compare their revenues and expenses from one year to the next. In order to do this, Carnival needs to separate revenues and expenses into separate accounting periods so that they can “start fresh” each year. This separation enables the company to evaluate how they are performing from one year to the next. It can help the company pinpoint problem areas—for example, higher ship-to-shore excursion costs—but it can also spotlight improvements—for example, increased revenues in the onboard casinos.

thinking critically

How do Carnival's managers use financial statements to evaluate performance? How might these evaluations affect business policies or strategies?

LEARNING OBJECTIVES

- 6-1. Journalize and post closing entries.
- 6-2. Prepare a postclosing trial balance.
- 6-3. Interpret financial statements.
- 6-4. Review the steps in the accounting cycle.
- 6-5. Define the accounting terms new to this chapter.

NEW TERMS

- | | |
|-------------------------------|---------------------------|
| closing entries | interpret |
| <i>Income Summary</i> account | postclosing trial balance |

Section 1

SECTION OBJECTIVE

>> 6-1. Journalize and post closing entries.

WHY IT'S IMPORTANT

A business ends its accounting cycle at a given point in time. The closing process prepares the accounting records for the beginning of a new accounting cycle.

TERMS TO LEARN

closing entries
Income Summary account

Closing Entries

In Chapter 5, we discussed the worksheet and the adjusting entries. In this chapter, you will learn about closing entries.

The Closing Process

The seventh step in the accounting cycle is to journalize and post closing entries. **Closing entries** are journal entries that:

- transfer the results of operations (net income or net loss) to owner's equity,
- reduce revenue, expense, and drawing account balances to zero.

THE INCOME SUMMARY ACCOUNT

The **Income Summary account** is a special owner's equity account that is used only in the closing process to summarize results of operations. **Income Summary** has a zero balance after the closing process, and it remains with a zero balance until after the closing procedure for the next period.

FIGURE 6.1 Worksheet for Wells' Consulting Services

Wells' Consulting Services									
Worksheet									
Month Ended December 31, 2016									
ACCOUNT NAME	TRIAL BALANCE				ADJUSTMENTS				
	DEBIT		CREDIT		DEBIT		CREDIT		
1 Cash	111	3 5 0	00						
2 Accounts Receivable	5	0 0 0	00						
3 Supplies	1	5 0 0	00				(a)	5 0 0	00
4 Prepaid Rent	8	0 0 0	00				(b)	4 0 0	00
5 Equipment	11	0 0 0	00						
6 Accum. Dep.—Equipment							(c)	1 8 3	00
7 Accounts Payable				3	5 0 0	00			
8 Carolyn Wells, Capital				100	0 0 0	00			
9 Carolyn Wells, Drawing	5	0 0 0	00						
10 Fees Income				47	0 0 0	00			
11 Salaries Expense	8	0 0 0	00						
12 Utilities Expense	6	5 0	00						
13 Supplies Expense							(a)	5 0 0	00
14 Rent Expense							(b)	4 0 0	00
15 Dep. Expense—Equipment							(c)	1 8 3	00
16									
17 Totals	150	5 0 0	00	150	5 0 0	00	4	6 8 3	00
18 Net Income									
19									

Income Summary is classified as a temporary owner’s equity account. Other names for this account are *Revenue and Expense Summary* and *Income and Expense Summary*.

STEPS IN THE CLOSING PROCESS

There are four steps in the closing process:

1. Transfer the balance of the revenue account to the *Income Summary* account.
2. Transfer the expense account balances to the *Income Summary* account.
3. Transfer the balance of the *Income Summary* account to the owner’s capital account.
4. Transfer the balance of the drawing account to the owner’s capital account.

The worksheet contains the data necessary to make the closing entries. Refer to Figure 6.1 as you study each closing entry.

>> 6-1. OBJECTIVE

Journalize and post closing entries.

STEP 1: TRANSFER REVENUE ACCOUNT BALANCES

On December 31, the worksheet for Wells’ Consulting Services shows one revenue account, *Fees Income*. It has a credit balance of \$47,000. To *close* an account means to reduce its balance to zero. In the general journal, enter a debit of \$47,000 to close the *Fees Income* account. To balance the journal entry, enter a credit of \$47,000 to the *Income Summary* account. This closing entry transfers the total revenue for the period to the *Income Summary* account and reduces the balance of the revenue account to zero.

The analysis of this closing entry is shown on the next page. In this chapter, the visual analyses will show the beginning balances in all T accounts in order to illustrate closing entries.

ADJUSTED TRIAL BALANCE				INCOME STATEMENT				BALANCE SHEET										
DEBIT		CREDIT		DEBIT		CREDIT		DEBIT		CREDIT								
111	350	00						111	350	00		1						
	500	00							500	00		2						
	100	00							100	00		3						
	400	00							400	00		4						
	110	00							110	00		5						
			183								183	6						
			350								350	7						
			100								100	8						
	500	00							500	00		9						
			470			470						10						
	800	00		800	00							11						
	650	00		650	00							12						
	500	00		500	00							13						
	400	00		400	00							14						
	183	00		183	00							15						
												16						
150	683	00	150	683	00	13	333	00	47	000	00	137	350	00	103	683	00	17
						33	667	00							33	667	00	18
						47	000	00	47	000	00	137	350	00	137	350	00	19

CLOSING ENTRY

important!**Income Summary Account**

The *Income Summary* account does not have an increase or decrease side and no normal balance side.

First Closing Entry—Close Revenue to Income Summary

ANALYSIS

The revenue account, **Fees Income**, is decreased by \$47,000 to zero. The \$47,000 is transferred to the temporary owner's equity account, **Income Summary**.

DEBIT-CREDIT RULES

DEBIT Decreases in revenue accounts are recorded as debits. Debit **Fees Income** for \$47,000.

CREDIT To transfer the revenue to the **Income Summary** account, credit **Income Summary** for \$47,000.

T-ACCOUNT PRESENTATION

Fees Income		Income Summary	
Closing	47,000	Closing	47,000

GENERAL JOURNAL ENTRY

DATE		DESCRIPTION	POST. REF.	DEBIT	CREDIT
1	2016	Closing Entries			
2	Dec. 31	Fees Income		47 000 00	
3		Income Summary			47 000 00
4					

Write "Closing Entries" in the Description column of the general journal on the line above the first closing entry.

Safeway Inc. reported sales of \$44.2 billion for the fiscal year ended December 31, 2012. To close the revenue, the company would debit the **Sales** account and credit the **Income Summary** account.

STEP 2: TRANSFER EXPENSE ACCOUNT BALANCES

The Income Statement section of the worksheet for Wells' Consulting Services lists five expense accounts. Since expense accounts have debit balances, enter a credit in each account to reduce its balance to zero. Debit the total of the expenses, \$13,333, to the **Income Summary** account. This closing entry transfers total expenses to the **Income Summary** account and reduces the balances of the expense accounts to zero. This is a compound journal entry; it has more than one credit.

CLOSING ENTRY

Second Closing Entry—Close Expenses to Income Summary

ANALYSIS

The five expense account balances are reduced to zero. The total, \$13,333, is transferred to the temporary owner's equity account, **Income Summary**.

DEBIT-CREDIT RULES

DEBIT To transfer the expenses to the **Income Summary** account, debit **Income Summary** for \$13,333.

CREDIT Decreases to expense accounts are recorded as credits. Credit **Salaries Expense** for \$8,000, **Utilities Expense** for \$650, **Supplies Expense** for \$500, **Rent Expense** for \$4,000, and **Depreciation Expense—Equipment** for \$183.

T-ACCOUNT PRESENTATION

Income Summary				Salaries Expense					
	Closing	13,333	Balance	47,000	Balance	8,000	Closing	8,000	
Utilities Expense				Supplies Expense					
		Balance	650	Closing	650	Balance	500	Closing	500
Rent Expense				Depreciation Expense—Equip					
		Balance	4,000	Closing	4,000	Balance	183	Closing	183

GENERAL JOURNAL ENTRY

GENERAL JOURNAL					PAGE	4
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT		
4 Dec. 31	Income Summary		13 333 00			4
5	Salaries Expense			8 000 00		5
6	Utilities Expense			6 500 00		6
7	Supplies Expense			5 000 00		7
8	Rent Expense			4 000 00		8
9	Depreciation Expense—Equip.			1 83 00		9
10						10

recall

Revenue

Revenue increases owner's equity.

recall

Expenses

Expenses decrease owner's equity.

After the second closing entry, the **Income Summary** account reflects all of the entries in the Income Statement columns of the worksheet.

Income Summary			
	Dr.		Cr.
Closing	13,333	Closing	47,000
		Balance	33,667

For the year ended December 31, 2012, operating expenses for Safeway, Inc., totaled \$11.1 million. At the end of the year, accountants for Safeway, Inc., transferred the balances of all expense accounts to the *Income Summary* account.

STEP 3: TRANSFER NET INCOME OR NET LOSS TO OWNER'S EQUITY

The next step in the closing process is to transfer the balance of *Income Summary* to the owner's capital account. After the revenue and expense accounts are closed, the *Income Summary* account has a credit balance of \$33,667, which is net income for the month. The journal entry to transfer net income to owner's equity is a debit to *Income Summary* and a credit to *Carolyn Wells, Capital* for \$33,667. When this entry is posted, the balance of the *Income Summary* account is reduced to zero and the owner's capital account is increased by the amount of net income.

CLOSING ENTRY

Third Closing Entry—Close Income Summary to Capital

ANALYSIS

The *Income Summary* account is reduced to zero. The net income amount, \$33,667, is transferred to the owner's equity account. *Carolyn Wells, Capital* is increased by \$33,667.

DEBIT-CREDIT RULES

DEBIT To reduce *Income Summary* to zero, debit *Income Summary* for \$33,667.

CREDIT Net income increases owner's equity. Increases in owner's equity accounts are recorded as credits. Credit *Carolyn Wells, Capital* for \$33,667.

T-ACCOUNT PRESENTATION

Income Summary				Carolyn Wells, Capital			
Closing	33,667	Balance	33,667	—		Balance	100,000
						Closing	33,667

GENERAL JOURNAL ENTRY

GENERAL JOURNAL						PAGE	4
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT			
12 Dec. 31	Income Summary		33 667 00				12
13	Carolyn Wells, Capital			33 667 00			13

After the third closing entry, the **Income Summary** account has a zero balance. The summarized expenses (\$13,333) and revenue (\$47,000) have been transferred to the owner's equity account (\$33,667 net income).

Income Summary				Carolyn Wells, Capital			
Dr.		Cr.		Dr.		Cr.	
Expenses	13,333	Revenue	47,000	—	+	Balance	100,000
Closing	33,667					Net Inc.	33,667
Balance	0					Balance	133,667

STEP 4: TRANSFER THE DRAWING ACCOUNT BALANCE TO CAPITAL

You will recall that withdrawals are funds taken from the business by the owner for personal use. Withdrawals are recorded in the drawing account. Withdrawals are not expenses of the business. They do not affect net income or net loss.

Withdrawals appear in the statement of owner's equity as a deduction from capital. Therefore, the drawing account is closed directly to the capital account.

When this entry is posted, the balance of the drawing account is reduced to zero and the owner's capital account is decreased by the amount of the withdrawals.

recall

Withdrawals

Withdrawals decrease owner's equity.

CLOSING ENTRY

Fourth Closing Entry—Close Withdrawals to Capital

ANALYSIS

The drawing account balance is reduced to zero. The balance of the drawing account, \$5,000, is transferred to the owner's equity account.

DEBIT-CREDIT RULES

DEBIT Decreases in owner's equity accounts are recorded as debits. Debit **Carolyn Wells, Capital** for \$5,000.

CREDIT Decreases in the drawing account are recorded as credits. Credit **Carolyn Wells, Drawing** for \$5,000.

T-ACCOUNT PRESENTATION

Carolyn Wells, Capital				Carolyn Wells, Drawing							
Closing	—	5,000	+	Balance	133,667	Balance	+	5,000	Closing	—	5,000

GENERAL JOURNAL ENTRY

GENERAL JOURNAL					PAGE	4
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT		
15 Dec. 31	Carolyn Wells, Capital		5 0 0 0 00			15
16	Carolyn Wells, Drawing			5 0 0 0 00		16

The new balance of the *Carolyn Wells, Capital* account agrees with the amount listed in the Owner's Equity section of the balance sheet.

Carolyn Wells, Drawing				Carolyn Wells, Capital			
Dr.		Cr.		Dr.		Cr.	
+		-		-		+	
Balance	5,000	Closing	5,000	Drawing	5,000	Balance	100,000
Balance	0					Net Inc.	33,667
						Balance	128,667

Figure 6.2 shows the general journal and general ledger for Wells' Consulting Services after the closing entries are recorded and posted. Note that:

- "Closing" is entered in the Description column of the ledger accounts;
- the balance of *Carolyn Wells, Capital* agrees with the amount shown on the balance sheet for December 31;
- the ending balances of the drawing, revenue, and expense accounts are zero.

This example shows the closing process at the end of one month. Usually businesses make closing entries at the end of the fiscal year only.

FIGURE 6.2

Closing Process Completed:
General Journal and General Ledger

- Step 1**
Close revenue.
- Step 2**
Close expense accounts.
- Step 3**
Close Income Summary.
- Step 4**
Close Drawing account.

GENERAL JOURNAL										PAGE	4	
DATE	DESCRIPTION	POST. REF.	DEBIT				CREDIT					
1 2016	Closing Entries										1	
2 Dec. 31	Fees Income	401	47	0	0	0	00				2	
3	Income Summary	309						47	0	0	00	3
4											4	
5 31	Income Summary	309	13	3	3	3	00				5	
6	Salaries Expense	511						8	0	0	00	6
7	Utilities Expense	514						6	5	0	00	7
8	Supplies Expense	517						5	0	0	00	8
9	Rent Expense	520						4	0	0	00	9
10	Depreciation Expense—Equip.	523						1	8	3	00	10
11											11	
12 31	Income Summary	309	33	6	6	7	00				12	
13	Carolyn Wells, Capital	301						33	6	6	7 00	13
14											14	
15 31	Carolyn Wells, Capital	301	5	0	0	0	00				15	
16	Carolyn Wells, Drawing	302						5	0	0	00	16
17											17	

ACCOUNT Carolyn Wells, Capital										ACCOUNT NO.	301
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE						
					DEBIT	CREDIT					
2016											
Nov. 6		J1		100	0	0	00		100	0	00
Dec. 31	Closing	J4		33	6	6	7 00		133	6	67 00
	31 Closing	J4	5	0	0	0 00			128	6	67 00

ACCOUNT Carolyn Wells, Drawing ACCOUNT NO. 302

DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
2016						
Dec. 31		J2	5 0 0 0 00		5 0 0 0 00	
	31 Closing	J4		5 0 0 0 00	- 0 -	

ACCOUNT Income Summary ACCOUNT NO. 309

DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
2016						
Dec. 31	Closing	J4		47 0 0 0 00		47 0 0 0 00
	31 Closing	J4	13 3 3 3 00			33 6 6 7 00
	31 Closing	J4	33 6 6 7 00			- 0 -

ACCOUNT Fees Income ACCOUNT NO. 401

DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
2016						
Dec. 31		J2		36 0 0 0 00		36 0 0 0 00
	31	J2		11 0 0 0 00		47 0 0 0 00
	31 Closing	J4	47 0 0 0 00			- 0 -

ACCOUNT Salaries Expense ACCOUNT NO. 511

DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
2016						
Dec. 31		J2	8 0 0 0 00		8 0 0 0 00	
	31 Closing	J4		8 0 0 0 00	- 0 -	

ACCOUNT Utilities Expense ACCOUNT NO. 514

DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
2016						
Dec. 31		J2	6 5 0 0 00		6 5 0 0 00	
	31 Closing	J4		6 5 0 0 00	- 0 -	

ACCOUNT Supplies Expense ACCOUNT NO. 517

DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
2016						
Dec. 31	Adjusting	J3	5 0 0 0 00		5 0 0 0 00	
	31 Closing	J4		5 0 0 0 00	- 0 -	

(continued)

FIGURE 6.2 (continued)

ACCOUNT <i>Rent Expense</i>						ACCOUNT NO. <i>520</i>					
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE						
					DEBIT	CREDIT					
2016											
Dec. 31	Adjusting	J3	4 0 0 0 00			4 0 0 0 00					
	31	Closing		4 0 0 0 00		- 0 -					
ACCOUNT <i>Depreciation Expense—Equipment</i>						ACCOUNT NO. <i>523</i>					
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE						
					DEBIT	CREDIT					
2016											
Dec. 31	Adjusting	J3	1 8 3 00			1 8 3 00					
	31	Closing		1 8 3 00		- 0 -					

You have now seen seven steps of the accounting cycle. The steps we have discussed are (1) analyze transactions, (2) journalize the transactions, (3) post the transactions, (4) prepare a worksheet, (5) prepare financial statements, (6) record adjusting entries, and (7) record closing entries. Two steps remain. They are (8) prepare a postclosing trial balance, and (9) interpret the financial information.

Section 1 Self Review

QUESTIONS

1. How is the *Income Summary* account classified?
2. What are the four steps in the closing process?
3. What is the journal entry to close the drawing account?

EXERCISES

4. After closing, which accounts have zero balances?
 - a. asset and liability accounts
 - b. liability and capital accounts

- c. liability, drawing, and expense accounts
 - d. revenue, drawing, and expense accounts
5. After the closing entries are posted, which account normally has a balance other than zero?
 - a. *Capital*
 - b. *Fees Income*
 - c. *Income Summary*
 - d. *Rent Expense*

ANALYSIS

6. The business owner removes supplies that are worth \$900 from the company stockroom. She intends to take them home for personal use. What effect will this have on the company's net income?

(Answers to Section 1 Self Review are on page 184.)

Section 2

SECTION OBJECTIVES	TERMS TO LEARN
<p>>> 6-2. Prepare a postclosing trial balance.</p> <p>WHY IT'S IMPORTANT The postclosing trial balance helps the accountant identify any errors in the closing process.</p> <p>>> 6-3. Interpret financial statements.</p> <p>WHY IT'S IMPORTANT Financial statements contain information that can impact and drive operating decisions and plans for the future of the company.</p> <p>>> 6-4. Review the steps in the accounting cycle.</p> <p>WHY IT'S IMPORTANT Proper treatment of data as it flows through the accounting system ensures reliable financial reports.</p>	<p>interpret postclosing trial balance</p>

Using Accounting Information

In this section, we will complete the accounting cycle for Wells' Consulting Services.

Preparing the Postclosing Trial Balance

The eighth step in the accounting cycle is to prepare the postclosing trial balance, or *after-closing trial balance*. The **postclosing trial balance** is a statement that is prepared to prove the equality of total debits and credits. It is the last step in the end-of-period routine. The postclosing trial balance verifies that:

- total debits equal total credits;
- revenue, expense, and drawing accounts have zero balances.

On the postclosing trial balance, the only accounts with balances are the permanent accounts:

- assets
- liabilities
- owner's equity

Figure 6.3 shows the postclosing trial balance for Wells' Consulting Services.

>> 6-2. OBJECTIVE

Prepare a postclosing trial balance.

FIGURE 6.3**Postclosing Trial Balance**

Wells' Consulting Services				
Postclosing Trial Balance				
December 31, 2016				
ACCOUNT NAME	DEBIT		CREDIT	
Cash	111	350	00	
Accounts Receivable	5	000	00	
Supplies	1	000	00	
Prepaid Rent	4	000	00	
Equipment	11	000	00	
Accumulated Depreciation—Equipment				183
Accounts Payable				350
Carolyn Wells, Capital				128667
Totals	132	350	00	132350
				00

FINDING AND CORRECTING ERRORS

If the postclosing trial balance does not balance, there are errors in the accounting records. Find and correct the errors before continuing. Refer to Chapter 3 for tips on how to find common errors. Also use the audit trail to trace data through the accounting records to find errors.

>> 6-3. OBJECTIVE

Interpret financial statements.

Interpreting the Financial Statements

The ninth and last step in the accounting cycle is interpreting the financial statements. Management needs timely and accurate financial information to operate the business successfully. To **interpret** the financial statements means to understand and explain the meaning and importance of information in accounting reports. Information in the financial statements provides answers to many questions:

- What is the cash balance?
- How much do customers owe the business?
- How much does the business owe suppliers?
- What is the profit or loss?

Managers of The Home Depot, Inc., use the corporation's financial statements to answer questions about the business. How much cash does our business have? What net earnings did our company report this year? For the fiscal year ended February 3, 2013, The Home Depot, Inc., reported an ending cash balance of \$2.5 billion and net earnings of \$4.5 billion.

Figure 6.4 shows the financial statements for Wells' Consulting Services at the end of its first accounting period. By interpreting these statements, management learns that:

- the cash balance is \$111,350,
- customers owe \$5,000 to the business,
- the business owes \$3,500 to its suppliers,
- the profit was \$33,667.

Wells' Consulting Services					
Income Statement					
Month Ended December 31, 2016					
<i>Revenue</i>					
Fees Income				47	0 0 0 00
<i>Expenses</i>					
Salaries Expense	8	0 0 0 00			
Utilities Expense		6 5 0 00			
Supplies Expense		5 0 0 00			
Rent Expense	4	0 0 0 00			
Depreciation Expense—Equipment		1 8 3 00			
Total Expenses				13	3 3 3 00
Net Income for the Month				33	6 6 7 00

Wells' Consulting Services					
Statement of Owner's Equity					
Month Ended December 31, 2016					
Carolyn Wells, Capital, December 1, 2016				100	0 0 0 00
Net Income for December	33	6 6 7 00			
Less Withdrawals for December	5	0 0 0 00			
Increase in Capital				28	6 6 7 00
Carolyn Wells, Capital, December 31, 2016				128	6 6 7 00

Wells' Consulting Services					
Balance Sheet					
December 31, 2016					
<i>Assets</i>					
Cash				111	3 5 0 00
Accounts Receivable				5	0 0 0 00
Supplies				1	0 0 0 00
Prepaid Rent				4	0 0 0 00
Equipment	11	0 0 0 00			
Less Accumulated Depreciation		1 8 3 00		10	8 1 7 00
Total Assets				132	1 6 7 00
<i>Liabilities and Owner's Equity</i>					
<i>Liabilities</i>					
Accounts Payable				3	5 0 0 00
<i>Owner's Equity</i>					
Carolyn Wells, Capital				128	6 6 7 00
Total Liabilities and Owner's Equity				132	1 6 7 00

FIGURE 6.4

End-of-Month Financial Statements

ABOUT ACCOUNTING

Professional Consultants

Professionals in the consulting field, such as accountants and lawyers, need to understand accounting so they can bill for services performed. Because clients have different billing rates depending on the service performed, specialized software is used to manage the paperwork and keep track of the billings and payments.

>> 6-4. OBJECTIVE

Review the steps in the accounting cycle.

The Accounting Cycle

You have learned about the entire accounting cycle as you studied the financial affairs of Wells' Consulting Services during its first month of operations. Figure 6.5 summarizes the steps in the accounting cycle.

- Step 1. Analyze transactions.** Analyze source documents to determine their effects on the basic accounting equation. The data about transactions appears on a variety of source documents such as:
- sales slips,
 - purchase invoices,
 - credit memorandums,
 - check stubs.
- Step 2. Journalize the transactions.** Record the effects of the transactions in a journal.
- Step 3. Post the journal entries.** Transfer data from the journal to the general ledger accounts.
- Step 4. Prepare a worksheet.** At the end of each period, prepare a worksheet.
- Use the Trial Balance section to prove the equality of debits and credits in the general ledger.
 - Use the Adjustments section to enter changes in account balances that are needed to present an accurate and complete picture of the financial affairs of the business.
 - Use the Adjusted Trial Balance section to verify the equality of debits and credits after the adjustments. Extend the amounts from the Adjusted Trial Balance section to the Income Statement and Balance Sheet sections.
 - Use the Income Statement and Balance Sheet sections to prepare the financial statements.
- Step 5. Prepare financial statements.** Prepare financial statements to report information to owners, managers, and other interested parties.
- The income statement shows the results of operations for the period.
 - The statement of owner's equity reports the changes in the owner's financial interest during the period.
 - The balance sheet shows the financial position of the business at the end of the period.

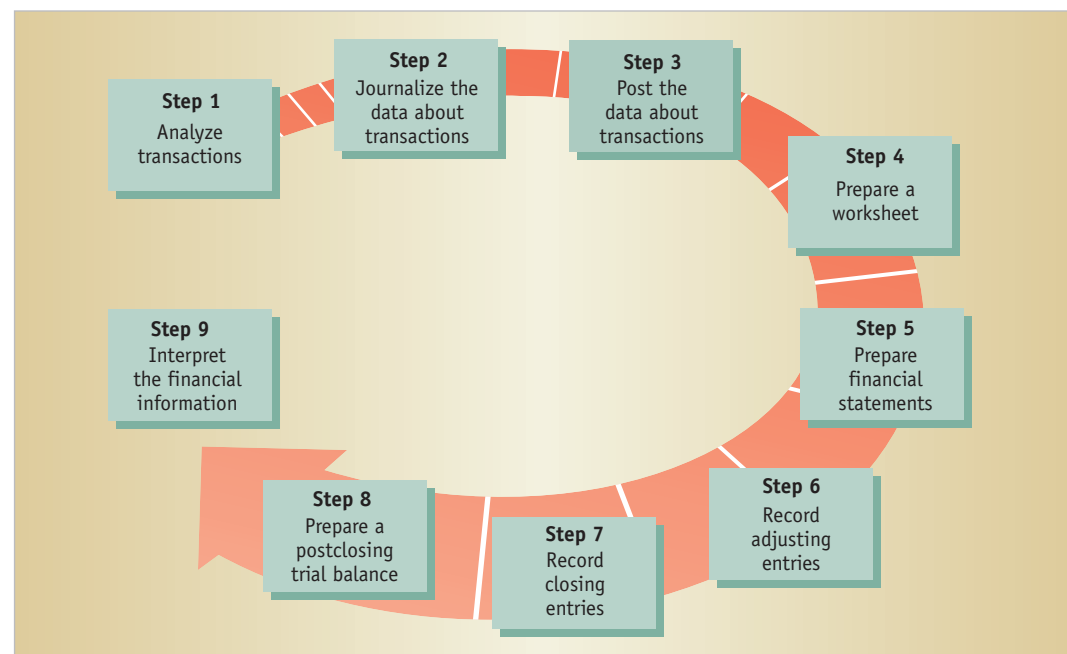
recall

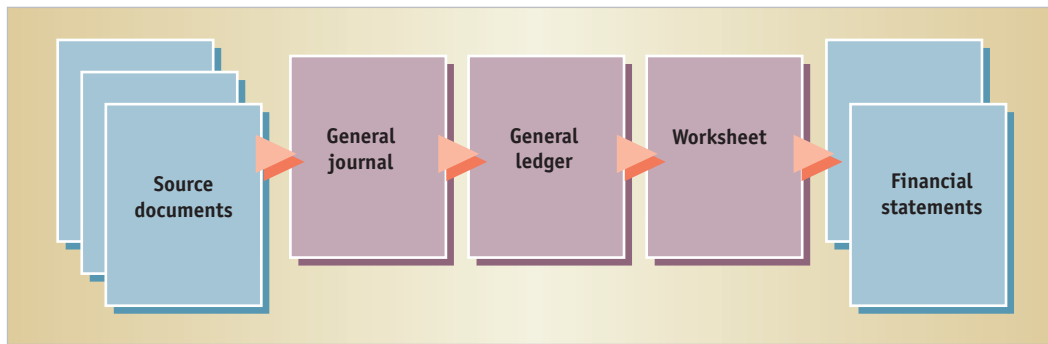
The Accounting Cycle

The accounting cycle is a series of steps performed during each period to classify, record, and summarize data to produce needed financial information.

FIGURE 6.5

The Accounting Cycle



**FIGURE 6.6**

Flow of Data through a Simple Accounting System

- Step 6. Record adjusting entries.** Use the worksheet to journalize and post adjusting entries. The adjusting entries are a permanent record of the changes in account balances shown on the worksheet.
- Step 7. Record closing entries.** Journalize and post the closing entries to:
- transfer net income or net loss to owner's equity;
 - reduce the balances of the revenue, expense, and drawing accounts to zero.
- Step 8. Prepare a postclosing trial balance.** The postclosing trial balance shows that the general ledger is in balance after the closing entries are posted. It is also used to verify that there are zero balances in revenue, expense, and drawing accounts.
- Step 9. Interpret the financial information.** Use financial statements to understand and communicate financial information and to make decisions. Accountants, owners, managers, and other interested parties interpret financial statements by comparing such things as profit, revenue, and expenses from one accounting period to the next.

In addition to financial statements, Adobe Systems Incorporated prepares a Financial Highlights report. This report lists total assets, revenue, net income, and the number of worldwide employees for the past five years.

After studying the accounting cycle of Wells' Consulting Services, you have an understanding of how data flows through a simple accounting system for a small business:

- Source documents are analyzed.
- Transactions are recorded in the general journal.
- Transactions are posted from the general journal to the general ledger.
- Financial information is proved, adjusted, and summarized on the worksheet.
- Financial information is reported on financial statements.

Figure 6.6 illustrates this data flow.

As you will learn in later chapters, some accounting systems have more complex records, procedures, and financial statements. However, the steps of the accounting cycle and the underlying accounting principles remain the same.

MANAGERIAL IMPLICATIONS <<

FINANCIAL INFORMATION

- Management needs timely and accurate financial information to control operations and make decisions.
- A well-designed and well-run accounting system provides reliable financial statements to management.
- Although management is not involved in day-to-day accounting procedures and end-of-period processes, the efficiency of the procedures affects the quality and promptness of the financial information that management receives.

THINKING CRITICALLY

If you owned or managed a business, how often would you want financial statements prepared? Why?

Section 2 Self Review

QUESTIONS

1. Why is a postclosing trial balance prepared?
2. What accounts appear on the postclosing trial balance?
3. What are the last three steps in the accounting cycle?

EXERCISES

4. Which of the following accounts will not appear on the postclosing trial balance?
 - a. *H.D. Hill, Drawing*
 - b. *Cash*
 - c. *H.D. Hill, Capital*
 - d. *Accounts Payable*

5. After the revenue and expense accounts are closed, *Income Summary* has a debit balance of \$30,000. What does this figure represent?
 - a. net profit of \$30,000
 - b. net loss of \$30,000
 - c. owner's withdrawals of \$30,000
 - d. increase in owner's equity of \$30,000

- Is there enough cash to purchase new equipment?
- What were the expenses?
- Do customers owe money to the business?

(Answers to Section 2 Self Review are on page 185.)

ANALYSIS

6. On which financial statement would you find the answer to each question?
 - What were the total fees earned this month?
 - How much money is owed to suppliers?
 - Did the business make a profit?

REVIEW Chapter Summary

Chapter 6

After the worksheet and financial statements have been completed and adjusting entries have been journalized and posted, the closing entries are recorded and a postclosing trial balance is prepared.

Learning Objectives

6-1 Journalize and post closing entries.

Journalizing and posting the closing entries is the seventh step in the accounting cycle. Closing entries transfer the results of operations to owner's equity and reduce the balances of the revenue and expense accounts to zero. The worksheet provides the data necessary for the closing entries. A temporary owner's equity account, *Income Summary*, is used. There are four steps in the closing process:

1. The balance of the revenue account is transferred to the *Income Summary* account.
Debit *Revenue*
Credit *Income Summary*
2. The balances of the expense accounts are transferred to the *Income Summary* account.
Debit *Income Summary*
Credit *Expenses*
3. The balance of the *Income Summary* account—net income or net loss—is transferred to the owner's capital account.
If *Income Summary* has a credit balance:
Debit *Income Summary*
Credit *Owner's Capital*
If *Income Summary* has a debit balance:
Debit *Owner's Capital*
Credit *Income Summary*
4. The drawing account is closed to the owner's capital account.
Debit *Owner's Capital*
Credit *Drawing*

After the closing entries have been posted, the capital account reflects the results of operations for the period. The revenue and expense accounts, with zero balances, are ready to accumulate data for the next period.

6-2 Prepare a postclosing trial balance.

Preparing the postclosing trial balance is the eighth step in the accounting cycle. A postclosing trial balance is prepared to test the equality of total debit and credit balances in the general ledger after the adjusting and closing entries have been recorded. This report lists only permanent accounts open at the end of the period—asset, liability, and the owner's capital accounts. The temporary accounts—revenue, expenses, drawing, and *Income Summary*—apply only to one accounting period and do not appear on the postclosing trial balance.

6-3 Interpret financial statements.

The ninth step in the accounting cycle is interpreting the financial statements. Business decisions must be based on accurate and timely financial information.

6-4 Review the steps in the accounting cycle.

The accounting cycle consists of a series of steps that are repeated in each fiscal period. These steps are designed to classify, record, and summarize the data needed to produce financial information.

The steps of the accounting cycle are:

1. Analyze transactions.
2. Journalize the transactions.
3. Post the journal entries.
4. Prepare a worksheet.
5. Prepare financial statements.
6. Record adjusting entries.
7. Record closing entries.
8. Prepare a postclosing trial balance.
9. Interpret the financial information.

6-5 Define the accounting terms new to this chapter.

Glossary

Closing entries (p. 156) Journal entries that transfer the results of operations (net income or net loss) to owner's equity and reduce the revenue, expense, and drawing account balances to zero

Income Summary account (p. 156) A special owner's equity account that is used only in the closing process to summarize the results of operations

Interpret (p. 166) To understand and explain the meaning and importance of something (such as financial statements)

Postclosing trial balance (p. 165) A statement that is prepared to prove the equality of total debits and credits after the closing process is completed

Comprehensive Self Review

1. What is the last step in the accounting cycle?
2. Is the following statement true or false? Why? "All owner's equity accounts appear on the postclosing trial balance."
3. What three financial statements are prepared during the accounting cycle?
4. A firm has the following expenses: **Rent Expense**, \$7,200; **Salaries Expense**, \$14,000; **Supplies Expense**, \$3,000. Give the entry to close the expense accounts.
5. A firm has \$60,000 in revenue for the period. Give the entry to close the **Fees Income** account.

(Answers to Comprehensive Self Review are on page 185.)

Discussion Questions

1. Where does the accountant obtain the data needed for the adjusting entries?
2. Why does the accountant record closing entries at the end of a period?
3. Where does the accountant obtain the data needed for the closing entries?
4. How is the **Income Summary** account used in the closing procedure?
5. Briefly describe the flow of data through a simple accounting system.
6. What three procedures are performed at the end of each accounting period before the financial information is interpreted?
7. Name the steps of the accounting cycle.
8. What is the accounting cycle?
9. What accounts appear on a postclosing trial balance?
10. Why is a postclosing trial balance prepared?

APPLICATIONS

Exercises



Exercise 6.1 Objective 6-1

► Journalize closing entries.

On December 31, 2016, the ledger of Hernandez Company contained the following account balances:

Cash	\$33,000	Maria Hernandez, Drawing	\$26,000
Accounts Receivable	2,900	Fees Income	53,750
Supplies	2,100	Depreciation Expense	2,750

Equipment	26,000	Salaries Expense	17,000
Accumulated Depreciation	2,500	Supplies Expense	3,000
Accounts Payable	3,000	Telephone Expense	2,600
Maria Hernandez, Capital	48,250	Utilities Expense	4,650

All the accounts have normal balances. Journalize the closing entries. Use 4 as the general journal page number.

Accounting cycle.

Following are the steps in the accounting cycle. Arrange the steps in the proper sequence.

1. Record closing entries.
2. Interpret the financial information.
3. Prepare a postclosing trial balance.
4. Prepare financial statements.
5. Prepare a worksheet.
6. Record adjusting entries.
7. Analyze transactions.
8. Journalize the transactions.
9. Post the journal entries.

Postclosing trial balance.

From the following list, identify the accounts that will appear on the postclosing trial balance.

ACCOUNTS

1. Cash
2. Accounts Receivable
3. Supplies
4. Equipment
5. Accumulated Depreciation
6. Accounts Payable
7. John Martin, Capital
8. John Martin, Drawing
9. Fees Income
10. Depreciation Expense
11. Salaries Expense
12. Supplies Expense
13. Utilities Expense

Financial statements.

Managers often consult financial statements for specific types of information. Indicate whether each of the following items would appear on the income statement, statement of owner's equity, or the balance sheet. Use *I* for the income statement, *E* for the statement of owner's equity, and *B* for the balance sheet. If an item appears on more than one statement, use all letters that apply to that item.

1. Accumulated depreciation on the firm's equipment
2. Amount of depreciation charged off on the firm's equipment during the period
3. Original cost of the firm's equipment
4. Book value of the firm's equipment
5. Total expenses for the period
6. Accounts payable of the business
7. Owner's withdrawals for the period
8. Cash on hand



Exercise 6.2

Objective 6-4



Exercise 6.3

Objective 6-2



Exercise 6.4

Objective 6-3

9. Revenue earned during the period
10. Total assets of the business
11. Net income for the period
12. Owner's capital at the end of the period
13. Supplies on hand
14. Cost of supplies used during the period
15. Accounts receivable of the business

Exercise 6.5**Objective 6-1**► **Closing entries.**

The *Income Summary* and *Levi Simmons, Capital* accounts for Simmons Production Company at the end of its accounting period follow.

ACCOUNT <i>Income Summary</i>			ACCOUNT NO. <u>399</u>											
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE									
					DEBIT			CREDIT						
2016														
Dec. 31	Closing	J4		67 000 00									67 000 00	
	31	Closing	J4	35 900 00									31 100 00	
	31	Closing	J4	31 100 00									- 0 -	

ACCOUNT <i>Levi Simmons, Capital</i>			ACCOUNT NO. <u>301</u>											
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE									
					DEBIT			CREDIT						
2016														
Dec. 1		J1		120 000 00									120 000 00	
	31	Closing	J4		31 100 00								151 100 00	
	31	Closing	J4	11 000 00									140 100 00	

Complete the following statements:

1. Total revenue for the period is _____.
2. Total expenses for the period are _____.
3. Net income for the period is _____.
4. Owner's withdrawals for the period are _____.

Exercise 6.6**Objective 6-1**► **Closing entries.**

The ledger accounts of I-Cloud Internet Company appear as follows on March 31, 2016:

ACCOUNT NO.	ACCOUNT	BALANCE
101	Cash	\$80,000
111	Accounts Receivable	58,820
121	Supplies	10,600
131	Prepaid Insurance	25,000
141	Equipment	118,000
142	Accumulated Depreciation—Equipment	41,320
202	Accounts Payable	13,000
301	Lee Retha Hale, Capital	130,000
302	Lee Retha Hale, Drawing	13,000
401	Fees Income	374,460
510	Depreciation Expense—Equipment	21,160

511	Insurance Expense	11,400
514	Rent Expense	33,000
517	Salaries Expense	166,000
518	Supplies Expense	5,600
519	Telephone Expense	6,800
523	Utilities Expense	9,400

All accounts have normal balances. Journalize and post the closing entries. Use 4 as the page number for the general journal in journalizing the closing entries. Use account number 399 for the Income Summary Account.

Closing entries.

On December 31, the *Income Summary* account of Davison Company has a debit balance of \$37,000 after revenue of \$39,000 and expenses of \$76,000 were closed to the account. *Michelle Davison, Drawing* has a debit balance of \$4,000 and *Michelle Davison, Capital* has a credit balance of \$58,000. Record the journal entries necessary to complete closing the accounts. What is the new balance of *Michelle Davison, Capital*?

Accounting cycle.

Complete a chart of the accounting cycle by writing the steps of the cycle in their proper sequence.

◀ **Exercise 6.7**
Objective 6-1

◀ **Exercise 6.8**
Objective 6-4

PROBLEMS

Problem Set A

Adjusting and closing entries.

Consumer Research Associates, owned by Sam Hill, is retained by large companies to test consumer reaction to new products. On January 31, 2016, the firm's worksheet showed the following adjustments data: (a) supplies used, \$2,340; (b) expired rent, \$13,000; and (c) depreciation on office equipment, \$4,580. The balances of the revenue and expense accounts listed in the Income Statement section of the worksheet and the drawing account listed in the Balance Sheet section of the worksheet are given below:

REVENUE AND EXPENSE ACCOUNTS	
401 Fees Income	\$100,000 Cr.
511 Depr. Expense—Office Equipment	4,580 Dr.
514 Rent Expense	13,000 Dr.
517 Salaries Expense	49,500 Dr.
520 Supplies Expense	2,340 Dr.
523 Telephone Expense	1,350 Dr.
526 Travel Expense	10,390 Dr.
529 Utilities Expense	1,250 Dr.
DRAWING ACCOUNT	
302 Sam Hill, Drawing	11,000 Dr.

INSTRUCTIONS

- Record the adjusting entries in the general journal, page 3.
- Record the closing entries in the general journal, page 4.

Analyze: What closing entry is required to close a drawing account?

◀ **Problem 6.1A**
Objective 6-1



Sage 50
Complete Accounting

401 Fees Income	163,600 Cr.
511 Advertising Expense	5,800 Dr.
514 Depreciation Expense—Equip.	1,000 Dr.
517 Rent Expense	4,600 Dr.
519 Salaries Expense	38,800 Dr.
523 Utilities Expense	7,720 Dr.

INSTRUCTIONS

- Record the balances in the ledger accounts as of December 31.
- Journalize the closing entries in the general journal, page 4. Use account number 399 for the Income Summary Account.
- Post the closing entries to the general ledger accounts.

Analyze: What is the balance of the *Salaries Expense* account after closing entries are posted?

Worksheet, journalizing and posting adjusting and closing entries, and the postclosing trial balance.

◀ **Problem 6.4A**
Objectives 6-1, 6-2

A partially completed worksheet for Home Auto Detailing Service, a firm that details cars and vans, follows on page 178.

INSTRUCTIONS

- Record balances as of December 31 in the ledger accounts.
- Prepare the worksheet.
- Journalize (use 3 as the journal page number) and post the adjusting entries. Use account number 131 for Prepaid Advertising and the same account numbers for all other accounts shown on page 186 for Wells’ Consulting Services chart of accounts.
- Journalize (use 4 as the journal page number) and post the closing entries.
- Prepare a postclosing trial balance.

ADJUSTED TRIAL BALANCE				INCOME STATEMENT				BALANCE SHEET				
DEBIT		CREDIT		DEBIT		CREDIT		DEBIT		CREDIT		
93	400							93	400			1
13	000							13	000			2
4	600							4	600			3
28	000							28	000			4
85	000							85	000			5
		3	400							3	400	6
		13	000							13	000	7
		142	000							142	000	8
9	400							9	400			9
		103	500			103	500					10
3	400			3	400							11
4	000			4	000							12
3	400			3	400							13
15	400			15	400							14
2	300			2	300							15
261	900	261	900	28	500	103	500	233	400	158	400	16
				75	000					75	000	17
				103	500	103	500	233	400	233	400	18
												19

Home Auto Detailing Service									
Worksheet									
Month Ended December 31, 2016									
	ACCOUNT NAME	TRIAL BALANCE				ADJUSTMENTS			
		DEBIT		CREDIT		DEBIT		CREDIT	
1	Cash	32	0 5 0 00						
2	Accounts Receivable	5	4 5 0 00						
3	Supplies	6	0 0 0 00					(a)	2 1 0 0 00
4	Prepaid Advertising	4	0 0 0 00					(b)	1 9 0 0 00
5	Equipment	21	0 0 0 00						
6	Accumulated Depreciation—Equipment							(c)	5 8 0 00
7	Accounts Payable			6	0 0 0 00				
8	Clifton Davis, Capital			45	5 0 0 00				
9	Clifton Davis, Drawing	3	0 0 0 00						
10	Fees Income			26	6 0 0 00				
11	Salaries Expense	5	8 0 0 00						
12	Utilities Expense		8 0 0 00						
13	Supplies Expense					(a)	2 1 0 0 00		
14	Advertising Expense					(b)	1 9 0 0 00		
15	Depreciation Expense—Equipment					(c)	5 8 0 00		
16	Totals	78	1 0 0 00	78	1 0 0 00	4	5 8 0 00	4	5 8 0 00
17									
18									
19									

Analyze: What total debits were posted to the general ledger to complete all closing entries for the month of December?

Problem Set B

Problem 6.1B ► Adjusting and closing entries.

Objective 6-1

Sanford Cleaning and Maintenance, owned by Fred Sanford, provides cleaning services to hotels, motels, and hospitals. On January 31, 2016, the firm's worksheet showed the following adjustment data. The balances of the revenue and expense accounts listed in the Income Statement section of the worksheet and the drawing account listed in the Balance Sheet section of the worksheet are also given.

ADJUSTMENTS

- Supplies used, \$4,290
- Expired insurance, \$2,220
- Depreciation on machinery, \$1,680

REVENUE AND EXPENSE ACCOUNTS

401 Fees Income	\$49,200 Cr.
511 Depreciation Expense—Machinery	1,680 Dr.
514 Insurance Expense	2,220 Dr.
517 Rent Expense	4,500 Dr.
520 Salaries Expense	24,000 Dr.
523 Supplies Expense	4,290 Dr.
526 Telephone Expense	315 Dr.

529 Utilities Expense	960 Dr.
DRAWING ACCOUNT	
302 Fred Sanford, Drawing	3,600 Dr.

INSTRUCTIONS

1. Record the adjusting entries in the general journal, page 3.
2. Record the closing entries in the general journal, page 4. Use account numbers provided on page 186 for any account number not given.

Analyze: What effect did the adjusting entry for expired insurance have on the *Insurance Expense* account?

Journalizing and posting adjusting and closing entries and preparing a postclosing trial balance.

◀ **Problem 6.2B**
Objectives 6-1, 6-2

A completed worksheet for Cedar Valley Nursery and Landscape is shown on pages 180–181.

INSTRUCTIONS

1. Record the balances as of December 31 in the ledger accounts.
2. Journalize (use 3 as the page number) and post the adjusting entries. Use account number 131 for Prepaid Advertising and the same account numbers for all other accounts as shown on page 186 for Wells' Consulting Services chart of accounts.
3. Journalize (use 4 as the page number) and post the closing entries.
4. Prepare a postclosing trial balance.

Analyze: What total credits were posted to the general ledger to complete the closing entries?

Journalizing and posting closing entries.

◀ **Problem 6.3B**
Objective 6-1

On December 31, after adjustments, The Jackson Family Farm's ledger contains the following account balances.

101 Cash	\$85,500 Dr.
111 Accounts Receivable	21,600 Dr.
121 Supplies	9,000 Dr.
131 Prepaid Rent	69,300 Dr.
141 Equipment	108,000 Dr.
142 Accumulated Depreciation—Equip.	2,700 Cr.
202 Accounts Payable	29,250 Cr.
301 Taylor Jackson, Capital (12/1/2016)	172,350 Cr.
302 Taylor Jackson, Drawing	10,800 Dr.
401 Fees Income	162,000 Cr.
511 Advertising Expense	9,900 Dr.
514 Depreciation Expense—Equip.	2,700 Dr.
517 Rent Expense	6,300 Dr.
519 Salaries Expense	32,400 Dr.
523 Utilities Expense	10,800 Dr.

INSTRUCTIONS

1. Record the balances in the ledger accounts as of December 31.
2. Journalize the closing entries in the general journal, page 4. Use account number 399 for the Income Summary Account
3. Post the closing entries to the general ledger accounts.

Analyze: List the accounts affected by closing entries for the month of December.

Cedar Valley Nursery and Landscape
Worksheet
Month Ended December 31, 2016

	ACCOUNT NAME	TRIAL BALANCE		ADJUSTMENTS	
		DEBIT	CREDIT	DEBIT	CREDIT
1	Cash	32 4 0 0 00			
2	Accounts Receivable	6 0 0 0 00			
3	Supplies	6 0 0 0 00			(a) 3 0 0 0 00
4	Prepaid Advertising	9 0 0 0 00			(b) 1 2 0 0 00
5	Equipment	60 0 0 0 00			
6	Accumulated Depreciation—Equipment				(c) 1 5 0 0 00
7	Accounts Payable		9 0 0 0 00		
8	Scott Jeremy, Capital		82 2 0 0 00		
9	Scott Jeremy, Drawing	8 4 0 0 00			
10	Fees Income		46 8 0 0 00		
11	Supplies Expense			(a) 3 0 0 0 00	
12	Advertising Expense			(b) 1 2 0 0 00	
13	Depreciation Expense—Equipment			(c) 1 5 0 0 00	
14	Salaries Expense	14 4 0 0 00			
15	Utilities Expense	1 8 0 0 00			
16	Totals	138 0 0 0 00	138 0 0 0 00	5 7 0 0 00	5 7 0 0 00
17	Net Income				
18					
19					
20					

Problem 6.4B
Objectives 6-1,
6-2, 6-4

► **Worksheet, journalizing and posting adjusting and closing entries, and the postclosing trial balance.**

A partially completed worksheet for Christopher Cobb, CPA, for the month ending June 30, 2016, is shown below.

Christopher Cobb, CPA
Worksheet
Month Ended June 30, 2016

	ACCOUNT NAME	TRIAL BALANCE		ADJUSTMENTS	
		DEBIT	CREDIT	DEBIT	CREDIT
1	Cash	63 9 0 0 00			
2	Accounts Receivable	22 6 8 0 00			
3	Supplies	31 5 0 0 00			(a) 5 4 0 0 00
4	Computers	57 6 0 0 00			
5	Accumulated Depreciation—Computers		5 7 6 0 00		(b) 4 8 0 0 00
6	Accounts Payable		25 2 0 0 00		
7	Christopher Cobb, Capital		124 4 7 0 00		
8	Christopher Cobb, Drawing	24 0 0 0 00			
9	Fees Income		135 9 0 0 00		
10	Salaries Expense	75 4 5 0 00			
11	Supplies Expense			(a) 5 4 0 0 00	
12	Depreciation Expense—Computers			(b) 4 8 0 0 00	
13	Travel Expense	10 8 0 0 00			
14	Utilities Expense	5 4 0 0 00			
15	Totals	291 3 3 0 00	291 3 3 0 00	5 8 8 0 00	5 8 8 0 00
16					
17					

ADJUSTED TRIAL BALANCE		INCOME STATEMENT		BALANCE SHEET		
DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	
32 4 0 0 00				32 4 0 0 00		1
6 0 0 0 00				6 0 0 0 00		2
3 0 0 0 00				3 0 0 0 00		3
7 8 0 0 00				7 8 0 0 00		4
60 0 0 0 00				60 0 0 0 00		5
	1 5 0 0 00				1 5 0 0 00	6
	9 0 0 0 00				9 0 0 0 00	7
	82 2 0 0 00				82 2 0 0 00	8
8 4 0 0 00				8 4 0 0 00		9
	46 8 0 0 00		46 8 0 0 00			10
3 0 0 0 00		3 0 0 0 00				11
1 2 0 0 00		1 2 0 0 00				12
1 5 0 0 00		1 5 0 0 00				13
14 4 0 0 00		14 4 0 0 00				14
1 8 0 0 00		1 8 0 0 00				15
<u>139 5 0 0 00</u>	<u>139 5 0 0 00</u>	<u>21 9 0 0 00</u>	<u>46 8 0 0 00</u>	<u>117 6 0 0 00</u>	<u>92 7 0 0 00</u>	16
		24 9 0 0 00			24 9 0 0 00	17
		<u>46 8 0 0 00</u>	<u>46 8 0 0 00</u>	<u>117 6 0 0 00</u>	<u>117 6 0 0 00</u>	18
						19
						20

INSTRUCTIONS

- Record the balances as of June 30 in the ledger accounts.
- Prepare the worksheet.
- Journalize (use 3 as the journal page number) and post the adjusting entries. Use account number 121 for Supplies; 131 for Computers; 142 for the Accumulated Depreciation account; 309 for Income Summary; 517 for Supplies Expense; 519 for Travel Expense; and 523 for Depreciation Expense.
- Journalize (use 4 as the journal page number) and post the closing entries.
- Prepare a postclosing trial balance.

Analyze: What is the reported net income for the month of June for Christopher Cobb, CPA?

Critical Thinking Problem 6.1

The Closing Process

The Trial Balance section of the worksheet for 21st Century Fashions for the period ended December 31, 2016, appears on the next page. Adjustments data are also given.

ADJUSTMENTS

- Supplies used, \$7,200
- Expired insurance, \$4,800
- Depreciation expense for machinery, \$2,400

INSTRUCTIONS

- Complete the worksheet.
- Prepare an income statement.
- Prepare a statement of owner’s equity.

21st Century Fashions									
Worksheet									
Month Ended December 31, 2016									
	ACCOUNT NAME	TRIAL BALANCE				ADJUSTMENTS			
		DEBIT		CREDIT		DEBIT		CREDIT	
1	Cash	81	6 0 0 00						
2	Accounts Receivable	18	0 0 0 00						
3	Supplies	14	4 0 0 00					(a)	7 2 0 0 00
4	Prepaid Insurance	21	6 0 0 00					(b)	4 8 0 0 00
5	Machinery	168	0 0 0 00						
6	Accumulated Depreciation—Machinery							(c)	2 4 0 0 00
7	Accounts Payable			27	0 0 0 00				
8	Carolyn Davis, Capital			149	1 6 0 00				
9	Carolyn Davis, Drawing	12	0 0 0 00						
10	Fees Income			165	0 0 0 00				
11	Supplies Expense					(a)	7 2 0 0 00		
12	Insurance Expense					(b)	4 8 0 0 00		
13	Salaries Expense	22	2 0 0 00						
14	Depreciation Expense—Machinery					(c)	2 4 0 0 00		
15	Utilities Expense	3	3 6 0 00						
16	Totals	341	1 6 0 00	341	1 6 0 00	14	4 0 0 00	14	4 0 0 00
17									
18									
19									

- Prepare a balance sheet.
- Journalize the adjusting entries in the general journal, page 3.
- Journalize the closing entries in the general journal, page 4.
- Prepare a postclosing trial balance.

Analyze: If the adjusting entry for expired insurance had been recorded in error as a credit to *Insurance Expense* and a debit to *Prepaid Insurance* for \$4,800, what reported net income would have resulted?

Critical Thinking Problem 6.2

Owner's Equity

Demetria Davis, the bookkeeper for Home Interiors and Designs Company, has just finished posting the closing entries for the year to the ledger. She is concerned about the following balances:

Capital account balance in the general ledger:	\$97,100
Ending capital balance on the statement of owner's equity:	55,600

Davis knows that these amounts should agree and asks for your assistance in reviewing her work.

Your review of the general ledger of Home Interiors and Designs Company reveals a beginning capital balance of \$50,000. You also review the general journal for the accounting period and find the closing entries shown on the next page.

- What errors did Ms. Davis make in preparing the closing entries for the period?
- Prepare a general journal entry to correct the errors made.
- Explain why the balance of the capital account in the ledger after closing entries have been posted will be the same as the ending capital balance on the statement of owner's equity.

GENERAL JOURNAL					PAGE	15
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	
1	2016	<i>Closing Entries</i>				1
2	Dec. 31	<i>Fees Income</i>		98 0 0 0 00		2
3		<i>Accumulated Depreciation</i>		8 5 0 0 00		3
4		<i>Accounts Payable</i>		33 0 0 0 00		4
5		<i>Income Summary</i>			139 5 0 0 00	5
6						6
7	31	<i>Income Summary</i>		92 4 0 0 00		7
8		<i>Salaries Expense</i>			78 0 0 0 00	8
9		<i>Supplies Expense</i>			5 0 0 0 00	9
10		<i>Depreciation Expense</i>			2 4 0 0 00	10
11		<i>Thomas Richey, Drawing</i>			7 0 0 0 00	11
12						12
13						13
14						14

BUSINESS CONNECTIONS

Interpreting Financial Statements

1. An officer of Westway Corporation recently commented that when he receives the firm's financial statements, he looks at just the bottom line of the income statement—the line that shows the net income or net loss for the period. He said that he does not bother with the rest of the income statement because “it's only the bottom line that counts.” He also does not read the balance sheet. Do you think this manager is correct in the way he uses the financial statements? Why or why not?
2. The president of Brown Corporation is concerned about the firm's ability to pay its debts on time. What items on the balance sheet would help her to assess the firm's debt-paying ability?
3. Why is it important that a firm's financial records be kept up-to-date and that management receive the financial statements promptly after the end of each accounting period?
4. What kinds of operating and general policy decisions might be influenced by data on the financial statements?

Managerial FOCUS

Timing of a Check

On the last day of the fiscal year, Stanley Carpenter comes to you for a favor. He asks that you enter a check for \$2,000 to CD Company for Miscellaneous Expense. You notice the invoice looks a little different from other invoices that are processed. Stanley needs the check immediately to get supplies today to complete the project for a favorite customer. You know that by preparing the closing entries tomorrow, Miscellaneous Expense will be set to zero for the beginning of the new year. Should you write this check and record the expense or find an excuse to write the check tomorrow? What would be the effect if the invoice to CD Company was erroneous and you had written the check?

Ethical DILEMMA

Income Statement

In 2012, CSX Corporation, which operates under the name Surface Transportation, reported operating expenses of \$8,299 million. A partial list of the company's operating expenses follows. CSX Corporation reported revenues from external customers to be \$11,756 million for the year.

Financial Statement ANALYSIS

Consolidated Income Statement*(Dollars in millions)*

Revenue \$11,756

Operating Expenses*(Dollars in millions)*

Labor and Fringe Benefits \$3,020

Materials, Supplies, and Other 2,156

Fuel 1,672

Depreciation 1,059

Equipment and Other Rents 392

Analyze:

1. If the given categories represent the related general ledger accounts, what journal entry would be made to close the expense accounts at year-end?
2. What journal entry would be made to close the revenue accounts?

Analyze Online: Locate the website for CSX Corporation (www.csx.com). Click on *CSX Corporation* and then click on *Investor Relations*. Within the *Financial Information* link, find the most recent annual report.

3. On the consolidated statement of earnings, what was the amount reported for operating expenses?
4. What percentage increase or decrease does this figure represent from the operating expenses reported in 2012 of \$8,299 million?

TEAMWORK**Accounting Cycle**

Understanding the steps in the accounting cycle is important to get accurate information about the condition of your company. In teams, make strips of paper with the nine steps of the accounting cycle. Give two or three strips to each member of the group. Each team member needs to put his or her strips in the proper order of the nine steps.

Internet CONNECTION**Certified Bookkeeper**

Certification in your field indicates you have a certain level of education and training. Go to the American Institute of Professional Bookkeepers website at www.aipb.com. From the certification program icon, determine the three requirements to become a certified bookkeeper.

Answers to Self Reviews**Answers to Section 1 Self Review**

1. A temporary owner's equity account.
2. Close the revenue account to *Income Summary*.
Close the expense accounts to *Income Summary*.
Close the *Income Summary* account to the capital account.
Close the drawing account to the capital account.
3. Debit *Capital* and credit *Drawing*.
4. d. revenue, drawing, and expense accounts
5. a. *Capital*
6. No effect on net income.

Answers to Section 2 Self Review

1. To make sure the general ledger is in balance after the adjusting and closing entries are posted.
2. Asset, liability, and the owner's capital accounts.
3. (7) Record closing entries, (8) prepare a postclosing trial balance, (9) interpret the financial statements.
4. a. *H.D. Hill, Drawing*
5. b. net loss of \$30,000
6. The income statement will answer questions about fees earned, expenses incurred, and profit. The balance sheet will answer questions about the cash balance, the amount owed by customers, and the amount owed to suppliers.

Answers to Comprehensive Self Review

1. Interpret the financial statements.
2. False. The *temporary* owner's equity accounts do not appear on the postclosing trial balance. The temporary owner's equity accounts are the drawing account and *Income Summary*.
3. Income statement, statement of owner's equity, and balance sheet.
4.

Income Summary	24,200	
Rent Expense		7,200
Salaries Expense		14,000
Supplies Expense		3,000
5.

Fees Income	60,000	
Income Summary		60,000

Mini-Practice Set 1

Service Business Accounting Cycle

Sage 50
Complete Accounting



INTRODUCTION

Wells' Consulting Services

This project will give you an opportunity to apply your knowledge of accounting principles and procedures by handling all the accounting work of Wells' Consulting Services for the month of January 2017.

Assume that you are the chief accountant for Wells' Consulting Services. During January, the business will use the same types of records and procedures that you learned about in Chapters 1 through 6. The chart of accounts for Wells' Consulting Services has been expanded to include a few new accounts. Follow the instructions to complete the accounting records for the month of January.

Wells' Consulting Services Chart of Accounts	
Assets 101 Cash 111 Accounts Receivable 121 Supplies 134 Prepaid Insurance 137 Prepaid Rent 141 Equipment 142 Accumulated Depreciation — Equipment	Revenue 401 Fees Income
Liabilities 202 Accounts Payable	Expenses 511 Salaries Expense 514 Utilities Expense 517 Supplies Expense 520 Rent Expense 523 Depreciation Expense — Equipment 526 Advertising Expense 529 Maintenance Expense 532 Telephone Expense 535 Insurance Expense
Owner's Equity 301 Carolyn Wells, Capital 302 Carolyn Wells, Drawing 309 Income Summary	

INSTRUCTIONS

- Open the general ledger accounts and enter the balances for January 1, 2017. Obtain the necessary figures from the postclosing trial balance prepared on December 31, 2016, which appears on page 166.
- Analyze each transaction and record it in the general journal. Use page 3 to begin January's transactions.
- Post the transactions to the general ledger accounts.
- Prepare the Trial Balance section of the worksheet.
- Prepare the Adjustments section of the worksheet.
 - Compute and record the adjustment for supplies used during the month. An inventory taken on January 31 showed supplies of \$4,200 on hand.
 - Compute and record the adjustment for expired insurance for the month.
 - Record the adjustment for one month of expired rent of \$4,000.
 - Record the adjustment for depreciation of \$183 on the old equipment for the month. The first adjustment for depreciation for the new equipment will be recorded in February.
- Complete the worksheet.
- Prepare an income statement for the month.
- Prepare a statement of owner's equity.

9. Prepare a balance sheet using the report form.
10. Journalize and post the adjusting entries.
11. Journalize and post the closing entries.
12. Prepare a postclosing trial balance.

Analyze: Compare the January 31 balance sheet you prepared with the December 31 balance sheet shown on page 167.

- a. What changes occurred in total assets, liabilities, and the owner's ending capital?
- b. What changes occurred in *Cash* and *Accounts Receivable* accounts?
- c. Has there been an improvement in the firm's financial position? Why or why not?

DATE	TRANSACTIONS
Jan. 2	Purchased supplies for \$6,000; issued Check 1015.
2	Purchased a one-year insurance policy for \$7,200; issued Check 1016.
7	Sold services for \$20,000 in cash and \$4,000 on credit during the first week of January.
12	Collected a total of \$4,000 on account from credit customers during the first week of January.
12	Issued Check 1017 for \$3,200 to pay for special promotional advertising to new businesses on the local radio station during the month.
13	Collected a total of \$3,500 on account from credit customers during the second week of January.
14	Returned supplies that were damaged for a cash refund of \$650.
15	Sold services for \$20,700 in cash and \$2,300 on credit during the second week of January.
20	Purchased supplies for \$4,600 from White's, Inc.; received Invoice 2384 payable in 30 days.
20	Sold services for \$12,500 in cash and \$3,350 on credit during the third week of January.
20	Collected a total of \$4,500 on account from credit customers during the third week of January.
21	Issued Check 1018 for \$6,075 to pay for maintenance work on the office equipment.
22	Issued Check 1019 for \$3,200 to pay for special promotional advertising to new businesses in the local newspaper.
23	Received the monthly telephone bill for \$925 and paid it with Check 1020.
26	Collected a total of \$1,600 on account from credit customers during the fourth week of January.
27	Issued Check 1021 for \$3,000 to Office Plus, as payment on account for Invoice 2223.
28	Sent Check 1022 for \$2,350 in payment of the monthly bill for utilities.
29	Sold services for \$19,000 in cash and \$2,750 on credit during the fourth week of January.
31	Issued Checks 1023–1027 for \$25,750 to pay the monthly salaries of the regular employees and three part-time workers.
31	Issued Check 1028 for \$15,000 for personal use.
31	Issued Check 1029 for \$4,150 to pay for maintenance services for the month.
31	Purchased additional equipment for \$15,000 from Contemporary Equipment Company; issued Check 1030 for \$10,000 and bought the rest on credit. The equipment has a five-year life and no salvage value.
31	Sold services for \$5,600 in cash and \$1,580 on credit on January 31.