

**Introduction to Business Accounting**

**Chapter 11 - Completing the Accounting  
Cycle**

**WORKBOOK**

## Temporary vs. Permanent Accounts

Recall that the Balance Sheet (B/S) goes on and on forever as long as a business continues and the Income Statement (I/S) measures a performance over a period of time, a year to be exact. As a result, these statements use two different kinds of accounts.

- Permanent Accounts (Real Accounts) are essentially B/S accounts that are carried forward from year to year. They don't close unless the business closes.
- Temporary Accounts (Nominal Accounts) are essentially I/S accounts and draw accounts used in one reporting period (one year) and they are not carried forward from year to year but rather zeroed out annually during the closing process.

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## Closing Entries – Journalizing & Posting

This is the process for closing the Temporary Accounts during annual closing cycle:

- Transfer the Revenue and Expense account balances to the Income Summary.
- The balance of Income Summary (net income/loss) is then transferred to the Retained Earnings for corporations or Owner's Capital account for proprietorships and partnerships.
- If the account is used, the balance of the Dividends account is also transferred to the Retained Earnings account or the Draws account is closed to the Owner's Capital.

*Note:* The Income Summary Account is only used during closing.

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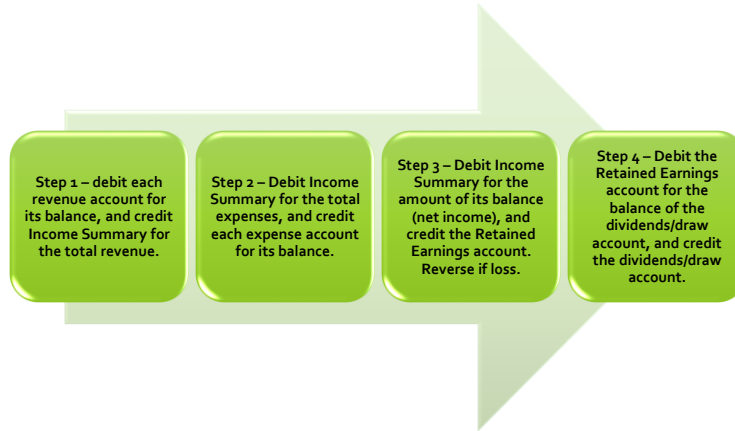
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## Closing Entries – Journalizing & Posting



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## Closing Entries – Journalizing & Posting

Step 1 – Debit each revenue account for its balance, and credit Income Summary for the total revenue.

FEES EARNED	
18,000	Balance 18,000

RENT REVENUE	
10,000	Balance 10,000

$18000 + 10000 = 28000$  (the total of the two accounts)

INCOME SUMMARY	
	28,000

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- Step 2 – Debit Income Summary for the total expenses, and credit each expense account for its balance.

INCOME SUMMARY	
5,975	28,000

## Closing Entries – Journalizing & Posting

- Step 3 – Debit Income Summary for the amount of its balance (net income), and credit the Retained Earnings account. (The accounts debited and credited are reversed if there is a net loss.)

INCOME SUMMARY		
22,025	5,975	28,000

$$28000 - 5975 = 22,025$$

RETAINED EARNINGS	
	Balance 30,000
	22,025
	Balance 52,025

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## Closing Entries – Journalizing & Posting

Step 4 – Debit the Retained Earnings account for the balance of the dividends account, and credit the dividends account.

RETAINED EARNINGS		DIVIDENDS	
2,000	Balance 52,025	Balance 2,000	2,000

Status of accounts after completing Step 4.

RETAINED EARNINGS		DIVIDENDS	
	Balance 50,025	Balance 0	

Note: When journalizing closing entries, they should be dated as of the last date of the accounting period.

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## Closing Entries – Journalizing

When journalizing closing entries, they should be dated as of the last date of the accounting period. A brief description of “Closing the temporary accounts” should be used.

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## The Post-Closing Trial Balance

As the last step in the process, a Post-Closing Trial Balance should be prepared in order to verify that total debits and credits still balance.

A Post-Closing Trial Balance will also help verify that all Revenue, Expense and Dividend/Draw accounts have a \$0 balance and are ready for the next years transactions.

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## Closing Entries – Post-Closing Trial Balance

XYZ Company Post Closing Trial Balance Period Ending: December 31, 2015		
Account	Debit Balances	Credit Balances
10 Cash	48,500	
12 Accounts Receivable	8,000	
14 Office Supplies	275	
18 Buildings	20,000	
19 Accumulated Depreciation - Buildings		1,000
40 Accounts Payable		500
42 Wages Payable		3,250
44 Unearned Rent		20,000
62 Retained Earnings		52,025
	76,775	76,775

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Questions

and

Answers

## Review Questions:

1. True or False: Asset accounts are zeroed out during the closing of temporary accounts.
  - A. True
  - B. False
2. Which of the following are temporary accounts?
  - A. Fees earned
  - B. Utilities expense
  - C. Draw
  - D. All of the above
3. True or False: The Income Summary account is used every month end to prepare financial statements.
  - A. True
  - B. False
4. Which of the following is a permanent account?
  - A. Fees earned
  - B. Dividends
  - C. Retained Earnings
  - D. All of the above
5. True or False: If there is a Net Loss, you must credit the Income Summary account to close it out.
  - A. True
  - B. False

## **Answer Key:**

1. B  
False. Only revenues and expense accounts are zeroed out during the closing of temporary accounts.
2. D  
Fees earned, utilities expense, and draw are all temporary accounts.
3. B  
False. The Income Summary account is used at the end of the year to prepare financial statements.
4. C  
Fees earned and Dividends are temporary accounts.
5. A  
True. If there is a Net Loss, you must credit the Income Summary account to close it out.