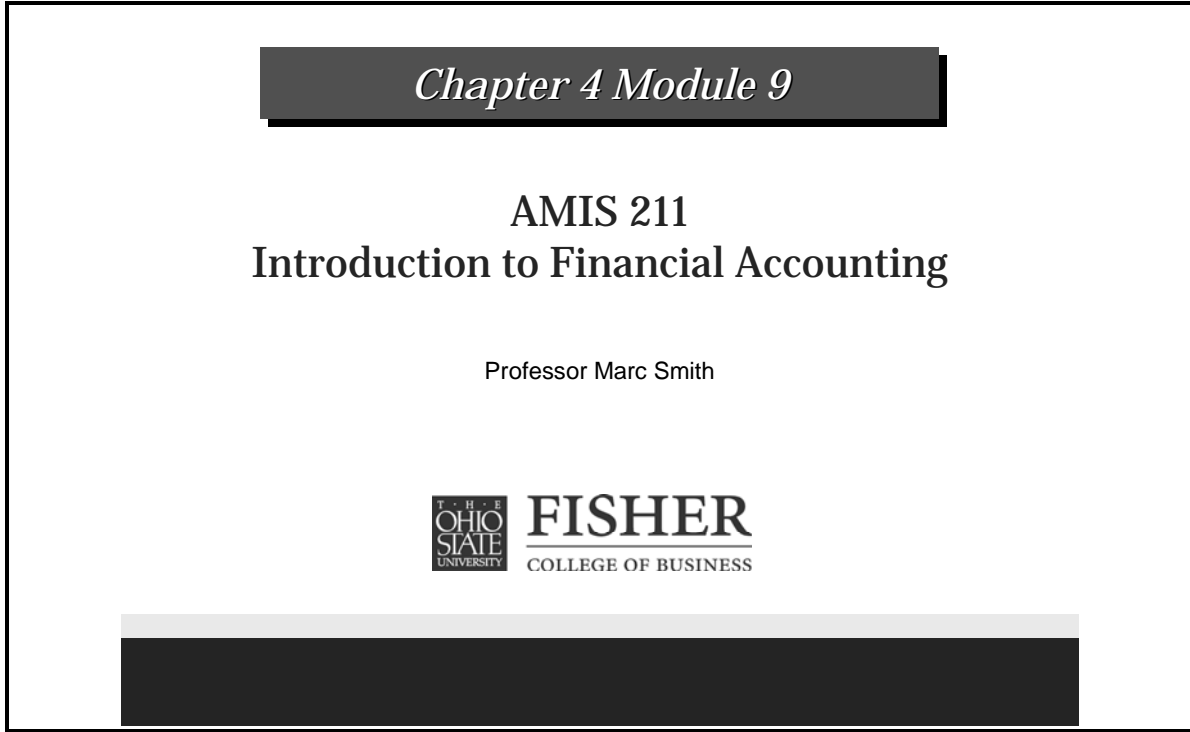


**Chapter 4, Module 9 – Closing Entries**


**Slide 1**

A rectangular box with a black border containing the slide content. At the top, a dark grey bar contains the text "Chapter 4 Module 9" in white italicized font. Below this, the text "AMIS 211" and "Introduction to Financial Accounting" is centered in a bold serif font. Underneath, "Professor Marc Smith" is centered in a smaller serif font. The Fisher College of Business logo is centered below that, featuring a square with "T · H · E OHIO STATE UNIVERSITY" and "FISHER COLLEGE OF BUSINESS" to its right. At the bottom, there are two horizontal bars: a light grey one above a dark grey one.

*Chapter 4 Module 9*

**AMIS 211**  
**Introduction to Financial Accounting**

Professor Marc Smith

 **FISHER**  
COLLEGE OF BUSINESS

Hi everyone. Welcome back.

Let's go through our last module on the Accounting Cycle.

We have one more step to deal with.

And, let's go ahead right into it.

And, move to the next slide with me.

Slide 2

*Chapter 4 Module 9: Accounting Cycle*

**Accounting Cycle – Basic Steps:**

- 1. Record transactions in the journal**
- 2. Post from the journal to the ledger**
- 3. Prepare an unadjusted trial balance**
- 4. Record and post year-end adjusting entries**
- 5. Prepare an adjusted trial balance**
- 6. From the adjusted trial balance, prepare financial statements**
- 7. Record closing entries**

And, there (on Slide 2) are the steps that we have talked about for the Accounting Cycle.

Let's just hear them one more time.

Step 1: Record transactions in the Journal.

Step 2: Post them over to the Ledger—move the debits and credits into the T-Accounts.

From the Ledger, we can figure out the Ending Balance and then...

Step 3: Prepare an Unadjusted Trial Balance.

Once we have done that; we can then...

Step 4: Record and post our year-end adjustments—our Adjusting Entries (AJEs).

And then...

Step 5: Prepare another Trial Balance—this one incorporating the Adjusting Entries (AJEs)—referred to as the Adjusted Trial Balance.

From the Adjusted Trial Balance, we can then go ahead and...

Step 6: Prepare our major financial statements.

The last step in the Accounting Cycle—the last thing that we have to do is:

Step 7: Record and post our Closing Entries.

Now, let's go ahead to the next slide.

### Slide 3

#### *Chapter 4 Module 9: Closing Process*

##### **Nominal (Temporary) Accounts**

Nominal accounts are closed to a zero balance at the end of every year.

→ include revenues, expenses, dividends

##### **Permanent (Real) Accounts**

Permanent accounts are never closed to zero as part of the year-end closing process.

→ include assets, liabilities, equity

Let's talk a little bit about these Closing Entries.

And, in order to understand what Closing Entries are, we need to have two terms defined and be comfortable and have a working definition of them.

The two terms are your Nominal accounts—also referred to as Temporary accounts and your Permanent or Real accounts.

Your Nominal accounts are accounts that are closed to a zero balance at the end of every year.

So, at the end of every year we take these Nominal accounts—whatever the balance may be—and we make the balance zero. That is what it means to “close” the account; that is: make the balance zero.

Our Permanent or Real accounts are accounts that are never closed at year-end. They are not part of the Year-End Closing Process. Their balances are not “zeroed-out” as part of that process.

So, only the Nominal ones are going to be part of the Closing Process.

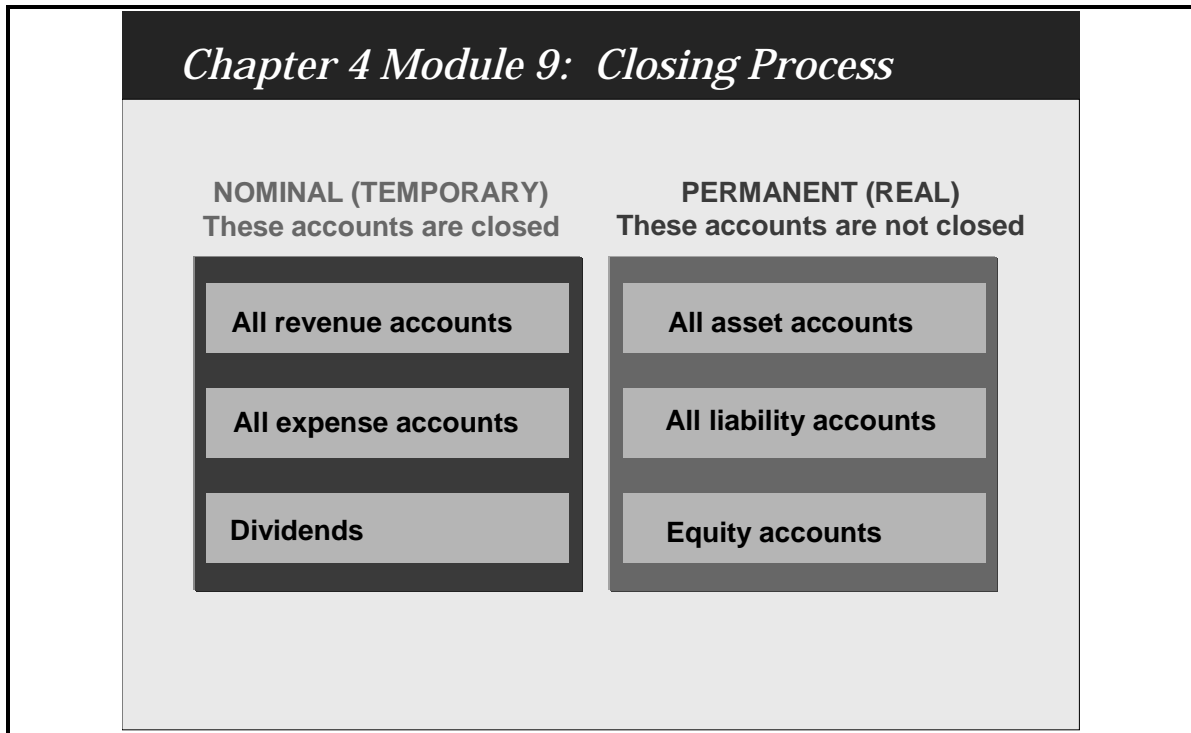
Those accounts that are classified as Nominal; those accounts that are closed in this Closing Process—include all Revenue accounts, all Expense accounts, and our Dividends.

So, the Income Statement accounts—the Revenues and Expenses and the Dividends—are Nominal; meaning: those ones are closed to zero balance at the end of every year.

The accounts on the Balance Sheet—the Assets, Liabilities, and Equity—those are Permanent accounts. Those accounts are not closed to a zero balance as part of the Year-End Closing Process.

Now that we know what Nominal and Permanent accounts are, please go to the next slide.

## Slide 4



And, here (on Slide 4) is just a little chart for you that will maybe help you visually understand what accounts will be closed and what accounts will not be closed as part of this Year-End Process.

As you can see in the first box there (on Slide 4), Nominal or Temporary accounts—those accounts that are closed—are the Revenues, Expenses, and Dividends. Those ones are going to be part of the Closing Process.

The Permanent accounts—the ones in the second box; those ones are never closed: Assets, Liabilities, and Equity accounts.

Now that we know, again, what Nominal and Permanent accounts are, let's go to the next slide.

Slide 5

***Chapter 4 Module 9: Closing Process***

**The purpose of closing entries is to transfer a net income or net loss and dividends to retained earnings.**

**3 Closing Entries that need to be made:**

1. Close revenues into retained earnings
2. Close expenses into retained earnings
3. Close dividends into retained earnings

And, let's talk a little bit about what Closing Entries need to be made.

Now, first of all, we should recognize that the purpose of doing Closing Entries is to move your Net Income, or Net Loss, and Dividends into Retained Earnings.

Remember what these three types of Nominal accounts have in common:

Nominal accounts: Revenues, Expenses, Dividends; all three of those effect Retained Earnings.

Revenues minus (-) Expenses equals (=) Net Income.

And by now, we know the effect on Net Income is the effect on Retained Earnings.

Dividends are a Contra-Equity account because it reduces Retained Earnings.

So all three Nominal account types—they all have one thing in common. That is: they all impact Retained Earnings.

And what we are doing here in this Year-End Closing Process is: we are simply moving, within the Journal, the Revenues, Expenses, and Dividends and zeroing those out and moving them into Retained Earnings.

The Year-End Process consists of three (3) Closing Entries.

The first one 1): You must close your Revenues accounts into Retained Earnings.

The second one 2): You must close your Expense accounts into Retained Earnings.

I'll give you a guess as to what the third one is going to be. You should be able to tell me.

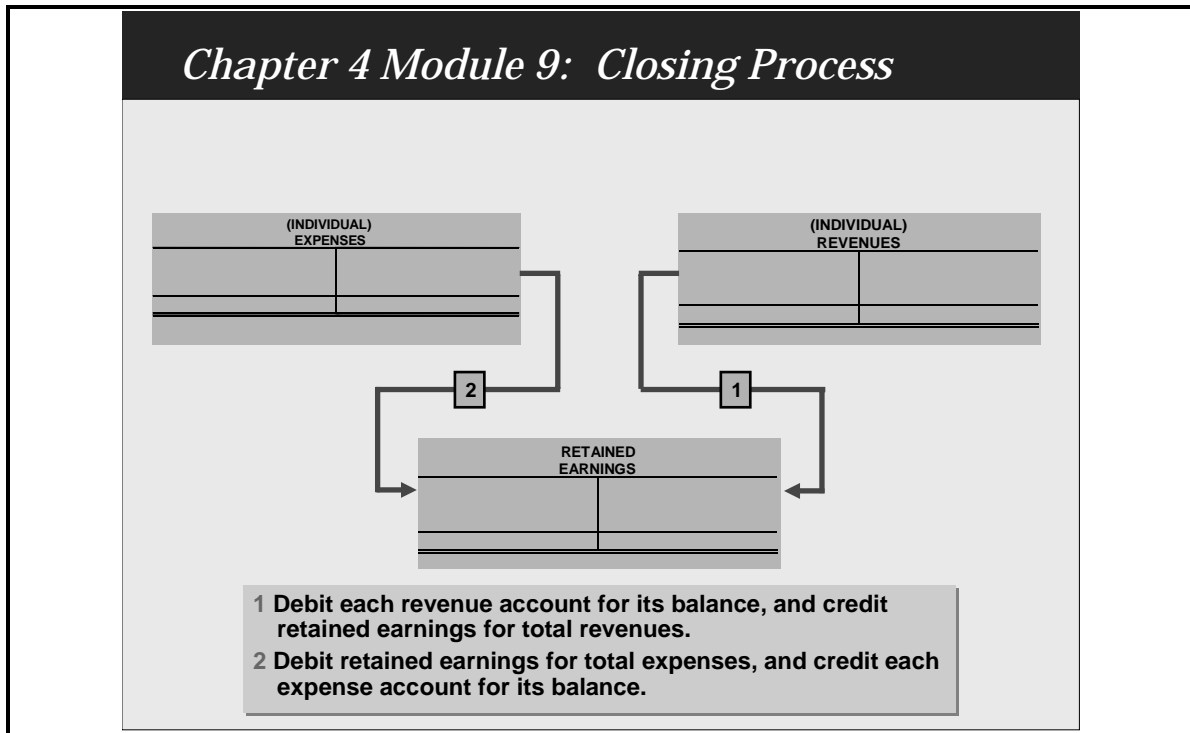
3): You need to close your Dividends into Retained Earnings.

Take all of the different Nominal accounts and move them into the Retained Earnings account.

So, that is the Closing Process.

Go to the next slide.

## Slide 6



And, I just drew some T-Accounts here (on Slide 6) for you to try to again visualize exactly what is going on.

Look at the upper left here (on Slide 6). We have our Expense accounts.

Expense accounts have a Normal Balance on the debit side. So, to close them, we are going to have to credit the accounts. We are going to have to credit them to get the balance to zero.

So, we credit our Expenses and we move them into Retained Earnings.

So, we credit the Expenses and debit the Retained Earnings.

On the other side, you see the Revenue accounts.

The Revenues have a Normal Balance on the credit side. So, to close the Revenues, you have to debit the Revenue account.

So, you debit your Revenue and you credit Retained Earnings to move the balance out of the Revenue accounts into Retained Earnings.

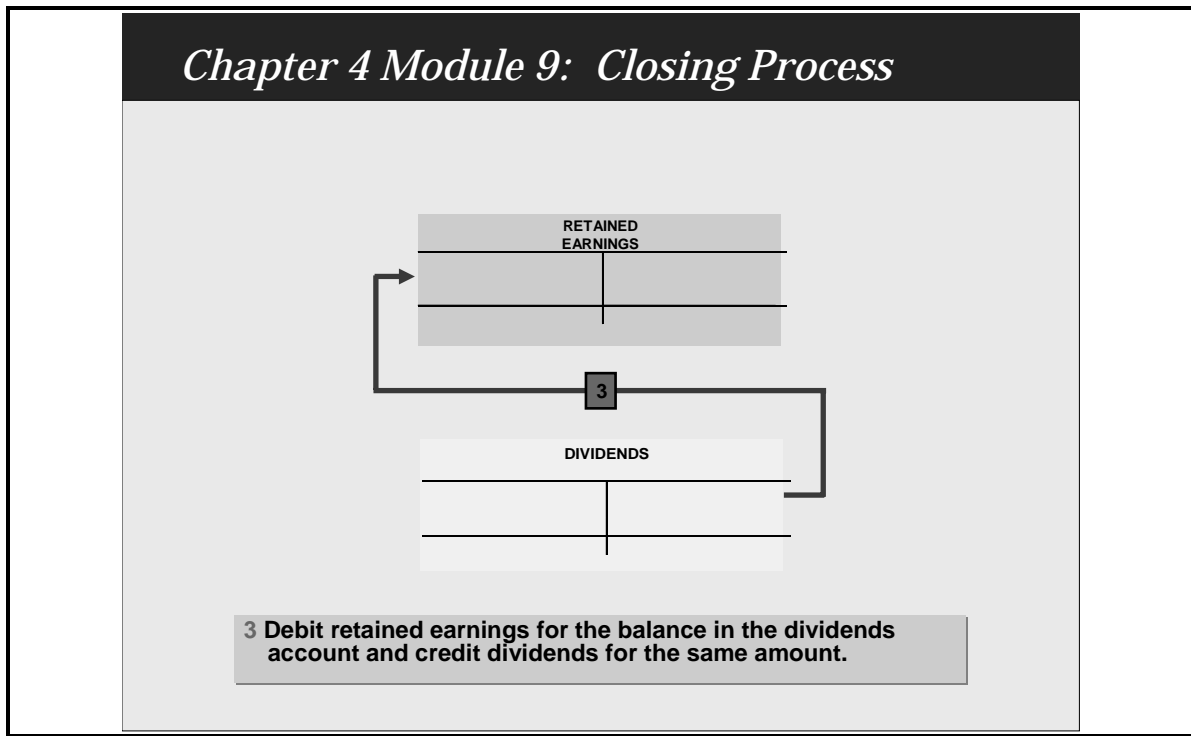
And, you can see down there at the bottom of the slide (Slide 6) what you see visually—what I just said—has been written out for you.

The first Closing Entry—closing Revenues to Retained Earnings—1) debit each Revenue account for its balance and credit Retained Earnings.

The second Closing Entry—2) you have to debit the Retained Earnings for the total amount of Expenses and credit each individual Expense account to close it.

And, if you go to the next slide...

**Slide 7**



We will see the picture for Dividends (on Slide 7).

It is the same idea.

Dividends are a Contra-Equity account. The Normal Balance is on the debit side of the T-Account.

Hence, to close our Dividends: 3) we have to credit the Dividends and debit the Retained Earnings to move that balance out of Dividends into Retained Earnings.

And, really what you have just seen on these last couple of slides is the Closing Process. You are simply transferring balances from Expenses, Revenues and Dividends into Retained Earnings.

Let's go to the next slide.

### Slide 8

<i>Chapter 4 Module 9: Example #2</i>			
<i>Close Revenues into Retained Earnings</i>			
		Debit	Credit
<b>Dec 31</b>	<b>Service Revenue</b>	<b>90</b>	
	<b>Rental Revenue</b>	<b>10</b>	
	<b>Retained Earnings</b>		<b>100</b>

And, let's see if we can do an example together.

Let's take a look at Example #2 from the Web site problems and work through a couple of Closing Entries.

Here is what it says:

“The following accounts were taken from the Adjusted Trial Balance of ABC Company at December 31<sup>st</sup> of 2002.”

And, you can see the Adjusted Trial Balance. They want us to prepare the three Closing Entries.

The first Closing Entry is: 1) Close Revenues into Retained Earnings.

So, look at that Adjusted Trial Balance.

And, tell me: What are the Revenue accounts?

Pick them out. I will give you a hint. There are two of them.

You can pick them out to yourself. Take a second and do that.

The two Revenue accounts are the Service Revenue and the Rental Revenue that are given. They both carry credit balances. You can see that from the Trial Balance there.

So, to close those Revenues, you have to debit the Revenue accounts.

You see we are going to debit: Service Revenue for \$90.00 and debit Rental Revenue for \$10.00.

The offset in the Entry—the credit—it is closed into Retained Earnings. So, we close, or credit, Retained Earnings for \$100.00 in order to close out the Revenues.

Closing Entry #1: Debit your Revenue accounts and credit Retained Earnings to move the Revenues into Retained Earnings.

Go to the next slide.

## Slide 9

**Chapter 4 Module 9: Example #2****Close Expenses into Retained Earnings**

	Debit	Credit
<b>Dec 31 Retained Earnings</b>	<b>90</b>	
<b>Salaries Expense</b>		<b>30</b>
<b>Advertising Expense</b>		<b>20</b>
<b>Insurance Expense</b>		<b>40</b>

And, let's do the second Closing Entry.

2) We need to close our Expenses into Retained Earnings.

Again, go back to the problem.

And, we have three (3) Expenses listed at the very bottom: Salaries Expense, Advertising Expense, and Insurance Expense.

They all carry a Normal Balance—as you can see right from this Trial Balance—they all carry a Normal Balance on the debit side.

So, to close out those Expenses, you must credit those accounts.

So, to offset—the offsetting debit—is of course to Retained Earnings for the total amount of Expenses.

Let me just go through that one more time.

The Expenses have a Normal Balance on the debit side. To close them, you need to credit the Expenses just like we have done here on the slide (Slide 9).

The offset is a debit to Retained Earnings.

Let's go to the next slide.

### Slide 10

<i>Chapter 4 Module 9: Example #2</i>			
<i>Close Dividends into Retained Earnings</i>			
		Debit	Credit
Dec 31	Retained Earnings	20	
	Dividends		20

And, let's do the final Closing Entry:

3) Close Dividends into Retained Earnings.

Again, you can see here from our Trial Balance the Dividends have a Normal Balance on the debit side—it is a Contra-Equity.

So, to close your Dividends, you must credit the Dividends account.

Of course, the offset, the debit that we need in this Entry is to Retained Earnings.

All three (3) Closing Entries have Retained Earnings in them because we are moving all of this stuff into Retained Earnings.

That is the whole Closing Process.

You close Revenues, close Expenses, and close Dividends into Retained Earnings. And, by the term “close” we simply mean: make the balance in the Revenues, Expenses, and Dividends zero.

Let’s go to the next slide.

### Slide 11

#### *Chapter 4 Module 9: Closing Process*

##### **AFTER CLOSING ENTRIES ARE POSTED**

- 1. All temporary accounts have zero balances.**
- 2. The balance in retained earnings represents the accumulated undistributed earnings at the end of the accounting period. That is, the balance in retained earnings represents the net income earned by the company that has not been paid out as dividends to stockholders.**

**The permanent accounts are not closed.**

After all Closing Entries have been posted; there are a couple of key points to pick up on.

Key Point #1: All Nominal or Temporary accounts should have a zero balance. That is the whole purpose of closing—to zero those out and move them into Retained Earnings.

Another Key Point #2: The balance that is now in Retained Earnings—after we have closed everything out and moved everything into Retained

Earnings—the balance that is there is the undistributed Net Income earned by the company.

Let's say that another way:

What is in Retained Earnings—after the Closing Process—is the Net Income that the company has earned but not yet paid out as Dividends.

That is what Retained Earnings is: Income earned not paid out as Dividends but rather re-invested and used to grow the organization.

Of course, it is important to remember: Permanent accounts—those accounts on the Balance Sheet—are not part of the Closing Process and are never closed to a zero balance.

Let's wrap this module up. Go to the next slide.

**Slide 12**

*Chapter 4 Module 9: Closing Process*

**REVIEW QUESTION**  
**CLOSING ENTRIES**

Which of the following accounts will have a zero balance after the closing process?

1. Unearned Revenue
2. Cash
3. Cost of Goods Sold
4. Prepaid Insurance

**ANSWER**  
Cost of goods sold is a temporary account.  
All temporary accounts are closed and thus have a zero balance after the closing process.

And, we will just wrap it up with a review question.

Answer this question to yourself.

Which of the following accounts will have a zero balance after the Closing Process?

- 1) Unearned Revenue
- 2) Cash
- 3) Cost of Goods Sold
- 4) Prepaid Insurance

You answer the question.

Pause me if you need to. Answer it. And, see if you get the right answer.

And then, come back, and let's go to the answer.

The answer is 3) Cost of Goods Sold. It is an Expense.

Unearned Revenue—do not let the name fool you—it is a Liability. Cash is an Asset. Prepaid Insurance is an Asset. Those three accounts are all found on the Balance Sheet. Hence, they are all Permanent accounts.

Cost of Goods Sold is an Expense. It is found on the Income Statement. Hence, it is Nominal. It closes to a zero balance at the end of the period.

That is the Accounting Cycle—from the very beginning: Recording Transactions all the way through the Closing Process.