

Module 5

Closing the Accounts

The **closing process** prepares accounts for recording the transactions and the events of the *next* period. In the closing process we must (1) identify accounts for closing, (2) record and post the closing entries, and (3) prepare a post-closing trial balance.

The purpose of the closing process is twofold. First, it resets revenue, expense, and withdrawals account balances to zero at the end of each period. This is done so that these accounts can properly measure income and withdrawals for the next period. Second, it helps in summarizing a period's revenues and expenses.

Temporary and Permanent Accounts

Temporary (or *nominal*) **accounts** accumulate data related to one accounting period. They include all income statement accounts, the withdrawals account, and the Income Summary account. They are temporary because the accounts are opened at the beginning of a period, used to record transactions and events for that period, and then closed at the end of the period. *The closing process applies only to temporary accounts.*

Permanent (or *real*) **accounts** report on activities related to one or more future accounting periods. They carry their ending balances into the next period and generally consist of all balance sheet accounts. These asset, liability, and equity accounts are not closed.

Recording Closing Entries

To record and post **closing entries** is to transfer the end-of-period balances in revenue, expense, and withdrawals accounts to the permanent capital account. Closing entries are necessary at the end of each period after financial statements are prepared because:

- Revenue, expense, and withdrawals accounts must begin each period with zero balances.
- Owner's capital must reflect prior periods' revenues, expenses, and withdrawals.

Steps in Closing Temporary Accounts

- Step 1: Close Credit Balances in Revenue Accounts to Income Summary
- Step 2: Close Debit Balances in Expense Accounts to Income Summary
- Step 3: Close Income Summary to Owner's Capital
- Step 4: Close Withdrawals Account to Owner's Capital

Post-Closing Trial Balance

A **post-closing trial balance** is a list of permanent accounts and their balances from the ledger after all closing entries have been journalized and posted. It lists the balances for all accounts not closed. These accounts comprise a company's assets, liabilities, and equity, which are identical to those in the balance sheet. The aim of a post-closing trial balance is to verify that (1) total debits equal total credits for permanent accounts and (2) all temporary accounts have zero balances.