



Completing the Accounting Cycle

At the end of the accounting cycle, the final steps are to journalize and post closing entries and to prepare a post-closing trial balance. There may also need to be correcting entries made if mistakes are discovered in the recordings of previous transactions.

To prepare correcting entries, first determine the entries that should have been made for the transaction. Then write down the entries that were actually made and compare. Make a correcting entry that results in the correct amounts posted to the right accounts.

Example: Javier found the following errors in his bookkeeper's work after the transactions had been journalized and posted. A collection on account for \$300 of service provided was posted as a credit to service revenue for \$300 and a debit to cash for \$300.

Solution: First, figure out what the entry that SHOULD have been and then compare it to the entry that was ACTUALLY recorded:

Correct Entry		Actual Entry	
Cash	\$300	Cash	\$300
A/R	\$300	Service Revenue	\$300

The cash debit was correct, but service revenue was incorrectly credited. The correcting entry would must undue incorrect entries and add missing entries:

Correcting Entry			
Service Revenue	\$300	(debit revenue to cancel the recorded credit)	
A/R	\$300	(credit A/R since that's the missing entry)	

To journalize and post closing entries is a four-step process of closing *temporary* accounts:

- 1) Close revenue accounts (service revenue, sales, rent revenue, etc.) to a temporary account called "Income Summary". We do this by debiting the revenue account its total value, and crediting Income Summary the same value.
- 2) Close expense accounts (utilities, wages, tax, interest, etc.) to "Income Summary". We do this by crediting the expense accounts and debiting the total value of expenses to Income Summary.
- 3) Close Income Summary (IS) to Retained Earnings. *If IS has a debit balance* after the two transactions above, we credit IS the difference of the two transactions and debit Retained Earnings the same amount. *If IS has a credit balance* after the two transactions above, we debit IS the difference of the two transactions and credit Retained Earnings by the same amount.
- 4) Close Dividends to Retained Earnings. We do this by crediting dividends and debiting Retained Earnings.

Retained Earnings will need to be adjusted by the amounts debited/credited in steps 3 and 4. After that, we can prepare the post-closing trial balance. Note there should be no revenue, expense, or dividend line items appearing in the post-closing trial balance.



Practice Problems

1. At Quality Sweets Shop, the following errors were discovered by the manager:
 - a. A collection on account from a customer for \$450 was recorded as a debit to cash \$540 and credit to service revenue \$450.
 - b. The purchase of supplies on account for \$1292 was recorded as a debit to supplies \$1229 and a credit to cash \$1229.
 - c. A \$300 refund to a customer who paid on account was incorrectly debited to Sales Revenue \$300 and credited to cash \$30.

Prepare the correcting entries for these mistakes.

2. Shown below is the adjusted trial balance at the end of fiscal for Rock n Rolla Music Inc. :

Adjusted Trial Balance
July 31, 2009

Account No.	Account	Debit	Credit
100	Cash	\$ 14,940	
110	Accounts Receivable	8,780	
135	Office Equipment	15,900	
136	Accumulated Depreciation - Office Equipment		\$5,400
200	Accounts payable		4,220
230	Unearned Service Revenue		1,800
311	Common Stock		20,000
320	Retained Earnings		25,200
332	Dividends	14,000	
400	Commission Revenue		65,100
510	Rent Revenue		6,500
530	Depreciation Expense	4,000	
540	Salaries Expense	55,700	
550	Utilities Expense	14,900	
	Total	\$ 128,220	\$ 128,220

Instructions:

- a. Prepare the closing entries.
- b. Post to Retained Earnings and No. 350 Income Summary accounts.
- c. Prepare a post-closing trial balance at July 31, 2009.
- d. Prepare an Income Statement and Retained Earnings Statement for the year ended July 31, 2009.
- e. Prepare a classified balance sheet at July 31, 2009.



Solutions

1.	Account	Dr.	Cr.
a)	Service Revenue.....	\$450	
	Accounts Receivable.....		\$450
	Cash		90
b)	Cash.....	\$1229	
	Supplies (\$1292 - \$1229 = \$63).....	\$63	
	Accounts Payable.....		\$1292
c)	Sales Returns and Allowances.....	\$300	
	Accounts Receivable.....		300
	Cash.....	30	
	Sales Revenue.....		300

2. a) General Journal (J1)

Date	Account Title & Explanation	Ref.	Debit	Credit
July 31	Commission Revenue	400	65,100	
	Rent Revenue	510	6,500	
	Retained Earnings	350		71,600
July 31	Retained Earnings	350	74,600	
	Depreciation Expense	530		4,000
	Salaries Expense	540		55,700
	Utilities Expense	550		14,900
July 31	Retained Earnings	320	14,000	
	Dividends	332		14,000

b)

Retained Earnings			No. 320		
Date	Account Title & Explanation	Ref.	Debit	Credit	Bal.
July 31	Balance				25,200
	Close Revenues	J1		71,600	96,800
	Close Expenses	J1	74,600		22,200
	Close Dividends	J1	14,000		8,200



Post-Closing Trial Balance
July 31, 2009

Account No.	Account	Debit	Credit
100	Cash	\$ 14,940	
110	Accounts Receivable	8,780	
135	Office Equipment	15,900	
136	Acc Deprec - Office Equipment		\$5,400
200	Accounts payable		4,220
230	Unearned Service Revenue		1,800
311	Common Stock		20,000
320	Retained Earnings		8,200
	Total	\$39,620	\$39,620

d) **Income Statement**
For the year ended July 31, 2009

Revenues.....		
Commission Revenue.....		\$ 65,100
Rent Revenue.....		6,500
Total Revenues.....		71,600
Expenses		
Depreciation Expense.....	\$ 4,000	
Salaries Expense.....	55,700	
Utilities Expense.....	14,900	
Total Expenses.....		74,600
Net Loss.....	(\$3,000)	

Retained Earnings Statement
For the year ended July 31, 2009

Retained Earnings, August 1, 2008.....	\$25,200
Less: Net Loss.....	3,000
Dividends.....	14,000
Retained Earnings, July 31, 2009.....	<u>\$8,200</u>

e) **Balance Sheet**
July 31, 2009

Current Assets		
Cash	\$ 14,940	
Accounts Receivable.....	8,780	
Total Current Assets.....		23,720
Property, Plant, Equipment		
Office Equipment.....	15,900	
Less: Accumulated Depreciation - Office Equipment	5,400	10,500
Total Assets.....		<u>\$34,220</u>
Current Liabilities		
Accounts payable.....	\$4,220	
Unearned Service Revenue.....	1,800	
Total Current Liabilities.....		6,020
Stockholders' Equity		
Common Stock.....	\$20,000	
Retained Earnings.....	8,200	
Total Stockholders' Equity.....		28,200
Total Liabilities and Stockholders' Equity.....		<u>\$34,220</u>

