CLOSING ENTRIES (ACCT 1110/1235)

One of the final steps in the accounting cycle is to prepare closing entries. To close entries means to close the following temporary accounts: Revenues/Gains, Expenses/Losses, and Owner Withdrawals so that everything ends up in the Owner Capital account. This handout will detail the final steps for closing entries, as seen in the following chart:

![Diagram showing the flow from Revenues to Income Summary, then to Owner, Capital, and Owner, Withdrawal]

When closing these temporary accounts, you “close” or “empty-out” each account by bringing the balance in the account to 0. This means that the number you report in the closing entry (see the example below) will be the remaining balance.

**Revenues/Gains**

An account with a regular credit balance must have an equal and opposite entry (debit) to “cancel-out” the existing balance. For example:

<table>
<thead>
<tr>
<th>Service Revenue</th>
<th>50,000</th>
<th>0</th>
</tr>
</thead>
<tbody>
<tr>
<td>closing entry</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>(to Income Summary)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

This means that each journal entry must have two equal components at all times: a debit and a credit. In the example above, we have a credit balance of 50,000 in the Service Revenue account. So, we must also enter a debit for the same amount, 50,000. When closing entries, we do this “cancelling out” in the Income Summary account.

<table>
<thead>
<tr>
<th>Income Summary</th>
<th>50,000</th>
<th>0</th>
</tr>
</thead>
<tbody>
<tr>
<td>closing credit entry to balance debit entry</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

So, how would this look in a journal entry?

<table>
<thead>
<tr>
<th>Service Revenue</th>
<th>50,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Summary</td>
<td>50,000</td>
</tr>
</tbody>
</table>
Expenses/Losses*

A similar, but opposite, process would occur to close any expense or loss account. For example:

<table>
<thead>
<tr>
<th>Rent Expense</th>
<th>Wages Expense</th>
<th>Income Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>10,000</td>
<td>15,000</td>
<td>25,000*</td>
</tr>
<tr>
<td>10,000</td>
<td>15,000</td>
<td>25,000</td>
</tr>
<tr>
<td>0</td>
<td>0</td>
<td>Expenses Closed</td>
</tr>
</tbody>
</table>

*Note that when you close multiple different accounts of the same type (e.g. expenses), you should group them together for the Income Summary entry as one amount.

So, how would this look in a journal entry?

Income Summary 25,000
Rent Expense 10,000
Wages Expense 15,000

As seen above, the debits are equal to the credits and the expenses now show up in the Income Summary.

Income Summary

The final balance in the Income Summary account represents Net Income (if a credit balance) or Net Loss (if a debit balance), which you then transfer to the Owner's Capital account.¹

- Net Income (Positive Balance)

<table>
<thead>
<tr>
<th>Income Summary</th>
<th>Owner, Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>25,000</td>
<td>40,000**</td>
</tr>
<tr>
<td>50,000</td>
<td>25,000</td>
</tr>
<tr>
<td>25,000</td>
<td>25,000</td>
</tr>
<tr>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Balance is "cancelled-out" to close Income Summary

**balance from previous year

So, how would this look in a journal entry?

Income Summary 25,000
Owner, Capital 25,000 (Owner, Capital ↑)

¹ This is called Retained Earnings for a corporation.
You can see that the Net Income (Revenues - Expenses) now appears in the balance of the “Owner, Capital” account.

- Net Loss (Negative Balance)

Now, what would this look like if there is a loss?

\[
\begin{array}{c|c}
\text{Owner, Capital} & 10,000 \\
\hline
\text{Income Summary} & 20,000 \\
\hline
\end{array}
\]

Balance is “cancelled-out” to close Income Summary, and is then transferred to Owner, Capital

\[
\begin{array}{c|c}
\text{Owner, Capital} & 40,000** \\
\hline
\text{Income Summary} & 10,000 \\
\hline
\end{array}
\]

**balance from previous year

**

Owner Withdrawals

Your last step is to close Owner, Withdrawals to Owner, Capital.²

Owner Withdrawals do not show up on the Income Statement and do not affect Net Income, so this account will not be closed to the Income Summary. Instead, this account will be closed directly to Owner, Capital. This is the situation for a sole proprietorship or partnership.³

For example:

\[
\begin{array}{c|c}
\text{Owner, Withdrawals} & 1,000 \\
\hline
\end{array}
\]

\[
\begin{array}{c|c}
\text{Owner, Capital} & 40,000 \\
\hline
\text{Income Summary} & 10,000 \\
\hline
\end{array}
\]

Our Net Income and any withdrawals that the owner makes are reflected in the new Owner, Capital balance.

² For corporations, you close Dividends to Retained Earnings.

³ Similarly, for corporations, dividends do not show up on the Income Statement and do not affect Net Income, so you should not close this account to the Income Summary. Instead, you should close this account directly to Retained Earnings.
To summarize:

1. Close all revenue and gain accounts to the Income Summary (credit)
2. Close all expense and loss accounts to the Income Summary (debit)
3. Close the Income Summary to Owner, Capital (or Retained Earnings)
4. Close Owner Withdrawals to Owner Capital (or Dividends to Retained Earnings)

**Exercise:**

Based on the Income Statement below, find Total Expenses, Net Income, and prepare closing entries for the year ended 2014. Remember to calculate the ending balance of the owner’s capital account.

Owner Withdrawals for 2014 were 900,000. Owner’s Capital was 450,000 at year end 2013.

### ABC Services

**Income Statement**

For the year ended Dec. 31, 2014

<table>
<thead>
<tr>
<th>Revenues:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Service revenue</td>
<td>$2,000,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenses:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Wages Expense</td>
<td>$11,000</td>
</tr>
<tr>
<td>Rent Expense</td>
<td>8,000</td>
</tr>
<tr>
<td>Utilities Expense</td>
<td>7,000</td>
</tr>
<tr>
<td>General and Administrative Expense</td>
<td>1,500</td>
</tr>
<tr>
<td>Supplies Expense</td>
<td>800</td>
</tr>
<tr>
<td>Advertising Expense</td>
<td>4,250</td>
</tr>
<tr>
<td>Total Expenses</td>
<td>?</td>
</tr>
</tbody>
</table>

Net Income

$??

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Try the journal entries as well:

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
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<tbody>
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</tr>
</tbody>
</table>

Finish by calculating Owner’s Capital:

- **Beginning balance, Owner’s Capital**: $________________
- **Add: Net Income/ Net Loss**: ________________
- **Subtract: Withdrawal**: ________________
- **Ending Balance, Owner’s Capital**: $________________
### Answer Key:

<table>
<thead>
<tr>
<th>Service Revenue</th>
<th>Expenses</th>
<th>Income Summary</th>
<th>Owner, Capital</th>
<th>Withdrawal</th>
</tr>
</thead>
<tbody>
<tr>
<td>2,000,000</td>
<td>2,000,000</td>
<td>32,550</td>
<td>2,000,000</td>
<td>450,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>32,550</td>
<td>1,967,450</td>
<td>900,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>900,000</td>
<td>1,517,450</td>
<td>900,000</td>
</tr>
</tbody>
</table>

### Step 1: Closing Service Revenue
- **Service Revenue**: $2,000,000
- **Income Summary**: $2,000,000

### Step 2: Closing Expenses
- **Income Summary**: $32,550
  - **Wages Expense**: $11,000
  - **Utilities Expense**: $7,000
  - **Rent Expense**: $8,000
  - **General and Administrative Expense**: $1,500
  - **Supplies Expense**: $800
  - **Advertising Expense**: $4,250

### Step 3: Closing Income Summary
- **Income Summary**: $1,967,450
- **Owner’s Capital**: $1,967,450

### Step 4: Closing Withdrawal
- **Owner’s Capital**: $900,000
- **Withdrawal**: $900,000

### Owner’s Capital:
- **Beginning balance, Owner’s Capital**: $450,000
- **Add: Net Income/ Net Loss**: $1,967,450
- **Subtract: Withdrawal**: $(900,000)
- **Ending Balance, Owner’s Capital**: $1,517,450