

Chapter Two

Accounting Cycle for Service Businesses

Accounting cycle is the sequence of accounting procedure during a particular period or fiscal year. It is a chronological order used to record, classify, summarize and report accounting information. The cycle begins with analyzing and recording of business transactions or journalizing and ends with preparation of post closing trial balance.

1. Transactions are analyzed and recorded in the journal.
2. Transactions are posted to the ledger.
3. An unadjusted trial balance is prepared.
4. Adjustment data are assembled and analyzed.
5. An optional end-of-period spreadsheet (work sheet) is prepared.
6. Adjusting entries are journalized and posted to the ledger.
7. An adjusted trial balance is prepared.
8. Financial statements are prepared.
9. Closing entries are journalized and posted to the ledger.
10. A post-closing trial balance is prepared

In chapter 1, we recorded transactions related with sole proprietorship using accounting equation format. However, this format is not efficient or practical for companies that have to record thousands or millions of transactions daily. As a result, accounting systems are designed to show the increases and decreases in each accounting equation element as a separate record. This record is called an account.

2.1 Characteristics of an account

Account – a form of record that shows increases and decreases in each element of accounting equation as separate record or a separate record designed to show the increases and decreases in asset, liability and owners equity. The simplest form of an account is “T” account and it has 3-parts.

1. A title, which is the name of the item recorded in the account.
2. A space for recording increases in the amount of the element.
3. A space for recording decreases in the amount of the element.

Title		
Example, asset	liability + Capital	A = L + C
Left side	Right side	Left side = right side
		Debit side = Credit side

Recording transactions in accounts must follow certain rules. For example, increases in assets are recorded on the debit (left side) of an account. Likewise, decreases in assets are recorded on the credit (right side) of an account. The excess of the debits of an asset account over its credits is the balance of the account.

2.2 Classification of accounts

There are two major groups of an account

- A. Balance sheet account
- B. Income statement account

► **Balance sheet accounts**- consists assets, liabilities and owner's equity.

Assets: A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity. Examples assets include accounts receivable, prepaid expenses (such as insurance), patent rights, copyrights, trademarks, Buildings, Equipment, and land. Assets can be classified as

- ✓ **Current assets** – Cash and other assets that are expected to be converted to cash or sold or used up usually within one year or less, through the normal operations of the business are called current assets. Example account receivable, note receivable, supplies, prepaid insurance...e.t.c. Notes receivable are amounts that customers owe. They are written promises to pay the amount of the note and interest. Accounts receivable are also amounts customers owe, but they are less formal than notes. Accounts receivable normally result from providing services or selling merchandise on account. Notes receivable and accounts receivable are current assets because they are usually converted to cash within one year or less.
- ✓ **Property, Plant and Equipment or plant assets** - are physical resources that are controlled and used by a business and are permanent or have a long life. Examples of

fixed assets include land, buildings, and equipment. In a sense, fixed assets are a type of long-term prepaid expense. Because of their unique nature and long life, they are discussed separately from other prepaid expenses, such as supplies and prepaid insurance.

Liabilities are debts of a business owed to outsiders or creditors. Liabilities are often identified on the balance sheet by titles that include the word payable. Cash received before services are delivered creates a liability to perform the services. The two most common classes of liabilities are;

- ✓ Current liabilities – the liabilities that will be due within a short time usually within one year or less. Example: Account payable, Note payable, Tax payable, interest payable.
- ✓ Long term liabilities - liabilities that will not be due for a long time usually more than one year. Example: bond payable, mortgage payable, Loan Payable.

Owner's equity - the residual claim of the owner against the assets of the business.

- Capital – accumulated investment by the owner
- Drawing – amount of cash withdrawn by the owner
- Income summary - used to summarize the effects of revenue and expense on capital
- ▶ **Income statement accounts** - includes revenues and expenses

Revenues are increases in owner's equity as a result of selling services or products to customers. Example: fees earned, fares earned, commissions revenue, and rent revenue.

Expenses result from using up or consuming assets or using of services in the process of generating revenues. Examples of expenses include wages expense, rent expense, utilities expense, supplies expense, and miscellaneous expense. Income statement accounts are temporary accounts or nominal accounts since they are closed to a summary accounts i.e income summary at the end of accounting period.

2.3 Chart of accounts

A group of account for a business entity is called ledger. A list of accounts in the ledger is called chart of accounts. It is listing of the account and account number being used by a given business. Accounts are usually arranged in the ledger in the financial statements order. The accounts are normally listed in the order in which they appear in the financial statements. The balance sheet accounts are listed first, in the order of assets, liabilities, and owner's equity. The income

statement accounts are then listed in the order of revenues and expenses. Example, chart of account for Mesfin Company is given below

Balance Sheet Accounts

1. Assets

- 11 Cash
- 12 Accounts Receivable
- 14 Supplies
- 15 Prepaid Insurance
- 17 Land
- 18 Office Equipment

2. Liabilities

- 21 Accounts Payable
- 23 Unearned Rent

3. Owner's Equity

- 31 Mesfin, Capital
- 32 Mesfin, Drawing

Income Statement Accounts

4. Revenue

- 41 Fees Earned

5. Expenses

- 51 Wages Expense
- 52 Rent Expense
- 54 Utilities Expense
- 55 Supplies Expense
- 59 Miscellaneous Expense

A chart of accounts should meet the needs of a company's managers and other users of its financial statements. The accounts within the chart of accounts are numbered for use as references. A flexible numbering system is normally used, so that new accounts can be added without affecting other account numbers.

Note: Designing of chart of account differs from company to other company. It depends on the type of the business, size or on the nature of operation. In the chart of account for Mesfin garage each account number has two digits.

First digit indicates the major classification of the ledger in which the asset account is located. Example; the account number one indicates assets i.e. the major division. Second digit indicates the location the account within its class (within major division).

Note: numbering of the accounts in the ledger is used to facilitate record keeping process, to meet information needs of management and users of financial statements, to identify the

accounts in the business document. The new account can be inserted whenever necessary without affecting the other account number.

2.4 Rules of Debit and Credit

Debit is the left side of an account while Credit is the right side of an account. The amounts entered on the left side of an account are called debits and the account is said to be debited or charged. The amounts entered on the right side are credits and the account is said to be credited.

The sum of the increases in an account is usually equal to or greater than the sum of the decreases in the account. Thus, the normal balance of an account is either a debit or credit depending on whether increases in the account are recorded as debits or credits. The normal balance for an account is always the same as the increase side of an account. Example, for assets increase side is left or Dr, for liabilities and owner's equity the increase side is right or Cr. The assignment of normal balance for asset, liability and owner's equity is based on the position of an account on the basic equation. The normal balance for revenue, expense and withdrawal is assigned based on the effect on the owner's equity.

Note: Revenue increases owner's equity and recorded in the credit side so the normal balance for revenue is credit side. Expense and withdrawal decreases owner's equity and recorded in the debit side so the normal balance for expense and withdrawal is debit side.

Account type	Increase	Decrease	Normal balance
Asset	debit	credit	debit
Liability	credit	debit	credit
Capital	credit	debit	credit
Revenue	credit	debit	credit
Expense	debit	credit	debit
Withdrawal	debit	credit	debit

2.5 Analyzing and recording transactions in journal

Transactions that initially recorded in accounting record called journal. Journal is also known as the book of original entry since the journal is the accounting record in which transactions first recorded. It is chronological order that shows the effect of each transaction in a specific account. The process of recording the transaction in journal is called journalizing. Two types of journals:

Special journal - used to record specific types of transaction such as sales journal, cash journal

General journal - used to record all types of transaction.

Steps for recording transactions in a journal;

Step 1. The date of the transaction is entered in the Date column.

Step 2. The title of the account to be debited is recorded at the left-hand margin under the Description column, and the amount to be debited is entered in the Debit column.

Step 3. The title of the account to be credited is listed below and to the right of the debited account title, and the amount to be credited is entered in the Credit column.

Step 4. A brief description may be entered below the credited account.

Step 5. The Post. Ref. (Posting Reference) column is left blank when the journal entry is initially recorded.

Regardless of the account numbers that are affected, the sum of Dr and Cr is always the same in a journal entry. Example, in this section we use Mesfin Company transaction. During June 2013, Mesfin Company completed the following transactions.

June 5. Mesfin deposits birr 25,000 in bank account in the name of Mesfin Company.

June 5. Mesfin Company paid office rent for June, birr 1,700.

June 7. Purchased office equipment on account from ABC Company, birr 10,500

June 8. Purchased Truck \$18,000 paying in cash birr 10,000 and the remaining on Notes payable.

June 10. Purchased supplies birr 1,315 for cash.

June 12. Received fees of birr 3,300 from customers for services.

June 20. Paid a premium of birr 800 for a comprehensive insurance policy covering liability, theft and fire. The policy covers the two years period.

June 22. Fees earned on account totaled, birr 1,950 for June.

June 24. Received an invoice for truck expenses, to be paid in June, birr 290.

June 29. Paid birr 490 telephone bill for the month.

June 29. Paid birr 195 for news paper and advertisement

June 30. Received birr 1,200 from customers in payment of their accounts.

June 30. Paid for its employees birr 1,900 for two weeks wage.

June 30. Paid birr 3,000 for its supplies purchased on account.

June 30. Withdrew birr 2,500 for personal use.

Journalize each transaction in to two column- step 2

General Journal

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Date		Description	Post reference	Debit	Credit
June 2013	5	Cash	11	25,000	
		Mesfin capital	31		25,000
		Invested cash in Mesfin company			
	5	Rent expense	52	1,700	
		Cash	11		1,700
		Paid rent for June			
	7	Office Equipment	18	10,500	
		Account payable	21		10,500
		Purchased office Equipment			

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	8	Truck	17	18,000	
		Cash	11		10,000
		Notes payable	22		8,000
	10	Supplies	14	1,315	
		Cash	11		1,315
	12	Cash	11	3,300	
		Fees earned	41		3,300
	20	Prepaid insurance	15	800	
		Cash	11		800
	22	Account receivable	12	1,950	
		Fees earned	41		1,950
	24	Truck expense	55	290	
		Account payable	21		290
	29	Utility expense	54	490	
		Cash	11		490
	29	Miscellaneous expense	19	195	

		Cash	11		195
	30	Cash	11	1,200	
		Account receivable	12		1,200
	30	Wage expense	51	1,900	
		Cash	11		1,900
	30	Account payable	21	3,000	
		Cash	11		3,000
	30	Mesfin withdrawal	32	2,500	
		Cash	11		2,500

Posting the accounts to the ledger (4-column account)

The process of transferring journal entries to the proper ledger account is called posting.

Account cash

Account number 11

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
June	1		1	25,000		25,000	
2013							
	5		1		1,700	23,300	
	8		1		10,000	13,300	
	10		1		1,315	11,985	
	12		1	3,300		15,285	
	20		1		800	14,485	
	29		2		490	13,995	
	29		2		195	13,800	
	30		2	1,200		15,000	
	30		2		1,900	13,100	

	30		2		3,000	10,100	
	30		2		2,500	7,600	

Account –accounts receivable

Account number 12

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
June 2013	22		1	1,950		1,950	
	30		2		1,200	750	

Account –supplies

Account number 14

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
June 2013	10		1	1,315		1,315	

Account –prepaid insurance

Account number 15

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
June 2013	20		1	800		800	

Account –office equipment

Account number 18

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
June 2013	7		1	10,500		10,500	

Account –truck

Account number 17

Date		Item	Post	Debit	Credit	Balance	
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		reference					
						Debit	Credit
June 2013	8		1	18,000		18,000	

Account –accounts payable

Account number 21

Date		Item	Post Reference	Debit	Credit	Balance	
						Debit	Credit
June 2013	7		1		10,500		10,500
	24		2		290		10,790
	30		2			3,000	7,790

Account – Notes payable

Account number 14

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
June 2013	8		1		8,000		8,000

Account –Mesfin capital

Account number 31

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
June 2013	1		1		25,000		25,000

Account – Mesfin drawing

Account number 32

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
June 2013	30		2	2,500		2,500	

Account –fees earned**Account number 41**

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
June 2013	7		1		3,300		3,300
	22		1		1,950		5,250

Account –wage expense**Account number 51**

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
June 2013	30		2	1,900		1,900	

Account –rent expense**Account number 52**

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
June 2013	5		1	1,700		1,700	

Account –utility expense**Account number 54**

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
June 2013	29		2	490		490	

Account –truck expense**Account number 55**

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
June 2013	24		2	290		290	

Account –miscellaneous expense**Account number 55**

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
June1	29		2	195		195	
999							

2.6 Preparing trial balance

Errors may occur in posting debits and credits from the journal to the ledger. One way to detect such errors is by preparing a trial balance. Double-entry accounting requires that debits must always equal credits. The trial balance verifies this equality. The steps in preparing a trial balance are as follows:

Step 1: List the name of the company, the title of the trial balance, and the date the trial balance is prepared.

Step 2: List the accounts from the ledger and enter their debit or credit balance in the Debit or Credit column of the trial balance.

Step 3: Total the Debit and Credit columns of the trial balance.

Step 4: Verify that the total of the Debit column equals the total of the Credit column

Mesfin Company**Unadjusted Trial balance****June 30, 2013**

	Debit balances	Credit balances
Cash.....	7,600	
Account receivable.....	750	
Supplies.....	1,315	
Prepaid insurance.....	800	
Equipment.....	10,500	
Truck.....	18,000	
Accounts payable.....		7,790
Notes payable.....		8,000
Mesfin, capital.....		25,000
Mesfin, drawing		2,500

Fees earned.....	5,250	
Wage expense.....	1,900	
Rent expense.....	1,700	
Utility expense.....	490	
Truck expense.....	290	
Miscellaneous expense.....	<u>195</u>	
	<u>46,040</u>	<u>46,040</u>

Note: the sum total of Dr and Cr should be equal unless we have error. The trial balance does not provide complete proof of the accuracy of the ledger. It indicates only that the debits and the credits are equal. This proof is of value, however, because errors often affect the equality of debits and credits.

The Usefulness and limitation of trial balance

Even though the trial balance helps to check the equality between Debit and Credit sides, it has the following limitations:

1. Failure to record or to post the transaction
2. Recording the same wrong amount for both Dr and Cr parts of transaction
3. Recording the same transaction more than ones
4. Posting a part of transaction as a debit and credit but to the wrong amount

Trial balance errors: there are three types of errors that cause a trial balance to be unequal:

A. Trial balance preparation errors – errors will occur in journalizing and posting transactions.

- One of the columns of trial balance was incorrectly added or computed
- The balance was incorrectly recorded on trial balance when we post the end balance of an account from ledger to trial balance we may record incorrectly.
- A debit balance was recorded on the trial balance as credits or vice versa or balance was omitted

B. Errors determining the account balances or account balance errors

- ▶ A balance was incorrectly computed- when we compute the end balance of each account we may add or subtract incorrectly.
- ▶ A balance was posted in the wrong balance column

C, Errors in recording transaction in the ledger or posting errors

- ✓ Wrong amount posted to an account
- ✓ Debit posted as credits or vice versa
- ✓ Debit or credit posting omitted

Errors can be detected

- ❖ By audit procedures (reviewing source document, posting journal)
- ❖ By chance
- ❖ By looking trial balance - observing the sum total of Debit and Credit

The two most common types of errors:

Transposition errors - reversing the digits in a number or incorrect rearrangement of digits or when the order of the digit is changed.

Example,	correct	wrong
	\$690	\$960
	\$26	\$62
	\$452	\$425

Slide error - incorrect placement of decimal point or the number is moved one space or more to the right or left or moving the entire number either to the right or left.

Example,	correct	wrong
	\$845.00	\$84.50
	\$525.00	\$52.50
	\$442.00	\$4420.00

2.7 The adjusting process

Adjusting entries are required at the end of accounting period to bring the accounts up to date to assure the matching of the revenue and expense. All adjustments are internal transactions (they are not transactions with outsiders). All adjustments do not affect cash. All adjusting entries affect at least one income statement account and one balance sheet account.

Four items that require adjustment:

1. **Deferred expenses** are adjustments for goods or services collected or paid for in advance of benefits given or received. They are also items that have been initially recorded as assets but are

expected to become expenses over time or through the normal operation of the business.
Example: supplies and prepaid insurance

2. **Deferred revenue or unearned revenue** - are items that have been initially recorded as an liabilities but are expected to become revenues over time or through the normal operation of the business. Example: unearned rent, fees received from students by college or cash collected from customers in advance before providing services.

3. **Accrued expenses or accrued liabilities** - are expenses that have been incurred but not recorded or paid in the accounts. Example: accrued wage expenses that have been incurred but not recorded or paid. Accrued interest on note payable

4. **Accrued revenue or accrued assets** – revenues that have been earned but not recorded or collected in the accounts. Example fees for services rendered to customers.

Fixed assets - physical resource owned and used by a business and have long life. They are a type of long term deferred expenses. However, because of their nature and long life they are presented separately from other deferred expenses such as supplies and prepaid insurance. As time passes fixed assets lose their ability to provide useful service. This decrease in usefulness is depreciation. All fixed assets except land lose their usefulness. The process of allocating the cost of fixed assets to expense over their estimated life is depreciation expense. The contra-account for fixed asset is Accumulated depreciation. Example contra-account for Equipment- accumulated depreciation of Equipment, Building- accumulated depreciation of Building.

Summary of basic adjustment and the effect of omitting adjustment on the F/S.

<u>Type of adjustment</u>	<u>adjusting entry</u>	<u>effect of omitting adjusting entry on B/S and I/S</u>
1, Deferred expense	Dr Expense Cr asset	expenses understated & NI over stated assets overstated & owner's equity over stated
2, deferred revenue	Dr Liabilities Cr revenue	liability overstated & owner's equity understated NI understated & revenue understated
3, Accrued expenses	Dr expense Cr liability	expense under stated and NI over stated liability understated and OE overstated
4, Accrued revenue	Dr asset Cr revenue	asset understated & OE understated revenue & net income understated

5, fixed assets Dr expense under stated & NI over stated
 Cr contra- account asset & OE over stated

2.8 Preparing work sheet and Financial Statements

The work sheet is the working paper that accountants use to summarize adjusting entries and the balances for preparation of financial statements. Enable accountants for collecting and summarizing data that they need for preparing various analysis and reports. It doesn't consider as part of the formal accounting records. Useful device for understanding the flow of the accounting data from unadjusted trial balance to the financial statements.

Adjustments in preparation of final accounts and preparation of the work sheet for financial statements

Mesfin Company prepared the following trial balance at May 31, 2014 and the end of fiscal year or accounting year.

Mesfin Company		
Unadjusted trial balance		
May 31, 2014		
Cash.....	7,500	
Accounts receivable.....	16,500	
Prepaid insurance.....	2,600	
Supplies.....	1,950	
Land.....	60,000	
Building.....	100,500	
Accumulated depreciation of Building.....		81,700
Equipment.....	72,400	
Accumulated depreciation of Equipment.....		63,800
Accounts payable.....		6,100
Unearned rent.....		1,500
Mesfin, Capital.....		60,700
Mesfin, Drawing.....	4,000	
Fees revenue.....		161,200
Salaries and wage expense.....	60,200	
Advertising expense.....	19,000	
Utility expense.....	18,200	
Repair expense.....	8,100	
Miscellaneous expense.....	<u>4,050</u>	
	<u>375,000</u>	<u>375,000</u>

The data needed to determine yearend adjustments are as follows:

- a. fees revenue occurred at May 31 is birr 3,500
- b. Insurance expired during the year is birr 1,000
- c. supplies on hand at may 31 are birr 450
- d. depreciation of Building for the year is birr 1,620
- e. depreciation of Equipment for the year is birr 3,160
- f. accrued salaries and wages at may 31 are birr 1,700
- g. unearned rent at may 31 is birr 1,000

Instruction

- 1. Enter the trial balance at a 10 column work sheet and complete the work sheet
- 2. Prepare the financial Statements

Journalize adjusting entries

Account receivable.....3,500
 Fees revenue.....3,500
 Insurance expense..... 1,000
 Prepaid insurance.....1,000
 Supplies expense.....1,500
 Supplies.....1,500
 Depreciation expense.....1,620
 Accumulated depreciation of Building.....1,620
 Depreciation expense.....3,160
 Accumulated depreciation of Equipment....., 3160
 Salaries and wage expense....1,700
 Salaries and wage payable.....1,700
 Unearned rent500
 Rent revenue.....500

Un adjusted trial balance	Adjustments	Adjusted final	Income	Balance sheet
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					balance		statement			
	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr
Cash	7500				7500				7500	
Account receivable	16500		a+3500		20000				20000	
Prepaid insurance	2600			b-1000	1600				1600	
Supplies	1950			c-1500	450				450	
Land	60000				60000				60000	
Building	100500				100500				100500	
Acc. dep. Building		81700		d+1620		83320				83320
Equipment	72400		72400						72400	
Acc. dep E.		63800		e+3160		66960				66960
Account payable		6100				6100				6100
Unearned rent		1500	g-500			1000				1000
Mesfin, capital		60700				60700				60700
Mesfin, drawing	4000				4000				4000	
Fees revenue		161200		a+3500 g+500		165200		165200		
Salaries expense	60200		f+1700		61900		61900			
Advertising expense	19000				19000		19000			
utility expense	18200				18200		18200			
Miscellaneous expe	4050				4050		4050			
Insurance expense			b+1000		1000		1000			
supplies expense			c+1500		1500		1500			
Depreciation ex.B.			d+1620		1620		1620			
Depreciation ex.E.			e+3160		3160		3160			
Salaries payable				f+1700		1700				1700
			12980	12980	385220	385220	118530 NI46670	165200	266450	219780 NI46670

2.9 preparations of financial statements from work sheet

Mesfin Company

Income statement

For the year ended may 31, 2014

Fees revenue.....	165,200
Salaries and wage expense.....	61,900
Utility expense.....	18,200
Advertising expense.....	19,000
Prepaid expense.....	8,100
Insurance expense.....	1,000
Supplies expense.....	1,500
Depreciation expense of building.....	1,620
Depreciation expense of equipment.....	3,160
Miscellaneous expense.....	4,050
Total expense.....	<u>118,530</u>
Net income.....	<u>46,670</u>

Mesfin Company

Statement of owner's equity

For the year ended may 31, 2014

Beginning capital.....	60,700
<u>Add:</u> Net income.....	46,670
<u>Less</u> withdrawal.....	<u>(4,000)</u>
Increase in owner's equity	<u>42,670</u>
Ending capital	<u>103,370</u>

Mesfin Company

Balance sheet

May 31, 2014

Current assets

Cash	\$7,500
Account receivable.....	20,000
Prepaid insurance.....	1,600

Supplies.....450
Total current assets.....29550

Plant assets

Land60000
Building.....100500
Less accumulated dep .B.....83320.....17180
Equipment72400
Less accumulated dep .E.....66960.....5440
Total plant assets.....82620
Total asset.....112170

Liability

Account payable.....6100
Unearned rent.....1000
Salaries and wage payable.....1700
Total liability.....8800
Mesfin Garage capital.....103370
Total liabilities and capital.....112170

Posting of adjusting entries

Account –accounts receivable

Account number 12

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
May	31		1			16,500	
2014				3,500		20,000	

Account –supplies

Account number 14

Date		Item	Post Reference	Debit	Credit	Balance	
						Debit	Credit
May	31		1			1,950	
2000					1,500	450	

Account –prepaid insurance

Account number 15

Date		Item	Post	Debit	Credit	Balance
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			reference				
						Debit	Credit
May	31		1			2,600	
2000					1,000	1,600	

Account – accumulated depreciation of building

Account number

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
May	31		1				81,700
2000					1,620		83,320

2.9 Closing Entries and Post-Closing Trial Balance

Revenue, expense and drawing are temporary accounts. While all assets, liabilities and capitals are permanent accounts. Closing has four parts i.e revenue, expense, drawing and income summary.

➤ To close Revenues

May 31 fees revenue.....165,200
Income summary.....165,200

➤ To close expenses

May 31 Income summary.....118,530
Salaries and wage expense.....61,900
Utility expense.....18,200
Advertising expense.....19,000
Prepaid expense.....8,100
Insurance expense.....1,000
Supplies expense.....1,500
Depreciation expense of building.....1,620
Depreciation expense of equipment.....3,160
Miscellaneous expense.....4,050

- To close income summary or NI the account is credited for the amount of net income
Income summary.....46,670

Mesfin capital.....46,670

- Drawing is credited for the amount of its balance; the capital account is debited for the same amount. To close drawing

Mesfin capital.....4,000

Mesfin drawing.....4,000

Note: income summary is used only at the end of the period because it has the effect of clearing the expense and revenue accounts of their balance.

Posting closing entries

Account –Mesfin capital

Account number 31

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
May					60,700		60,700
2014	31	closing			46,670		107,370
		closing		4,000			103,370

Account –Mesfin drawing

Account number 32

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
May				4000		4000	
2014	31	closing			4000	=	

Account –income summary

Account number 323

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
May	31	closing			165,200		165,200
2014	31	closing		118,530			46,670
	31	closing		46,670			=

Account –fees revenue**Account number 41**

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
May 2014	31				161,200		161,200
	31	Adjustment			3,500		164,700
	31	Adjustment			500		165,200
	31	Closing		165,200			=

Account –salaries and wage expense**Account number 51**

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
May 2014	31			60,200		60,200	
	31	Adjustment		1,700		61,900	
	31	Closing			61,900	=	

Account –advertising expense**Account number 53**

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
May 2014	31			19,000		19,000	
	31	Closing		19,000		=	

Account –utility expense**Account number 5**

Date		Item	Post reference	Debit	Credit	Balance	
						Debit	Credit
May 2014	31			18,200		18,200	
	31	Closing		18,200		=	

After closing entries have been journalized and posted to the ledger they will have zero balances.

Post-closing trial balance

It is the last accounting procedure in the accounting cycle. A post-closing trial balance is prepared after the closing entries have been posted. The purpose of the post-closing (after closing) trial balance is to verify that the ledger is in balance at the beginning of the next period. The accounts and amounts should agree exactly with the accounts and amounts listed on the balance sheet at the end of the period.

Mesfin Company		
Post closing trial balance		
May 31, 2000		
Cash	7,500	
Account receivable.....	20,000	
Prepaid insurance.....	1,600	
Supplies.....	450	
Land	60,000	
Building.....	100,500	
Accumulated depreciation of Building.....	83,320	
Equipment	72,400	
Accumulated depreciation of Equipment.....	66,960	
Account payable.....	6,100	
Unearned rent.....	1,000	
Salaries and wage payable.....	1,700	
Mesfin capital.....	103,370	
	<u>262,450</u>	<u>262,450</u>