

# TEMPORARY VERSUS PERMANENT ACCOUNTS

## TEMPORARY (NOMINAL)

These accounts are closed

All revenue accounts

All expense accounts

Owner's drawing

## PERMANENT (REAL)

These accounts are not closed

All asset accounts

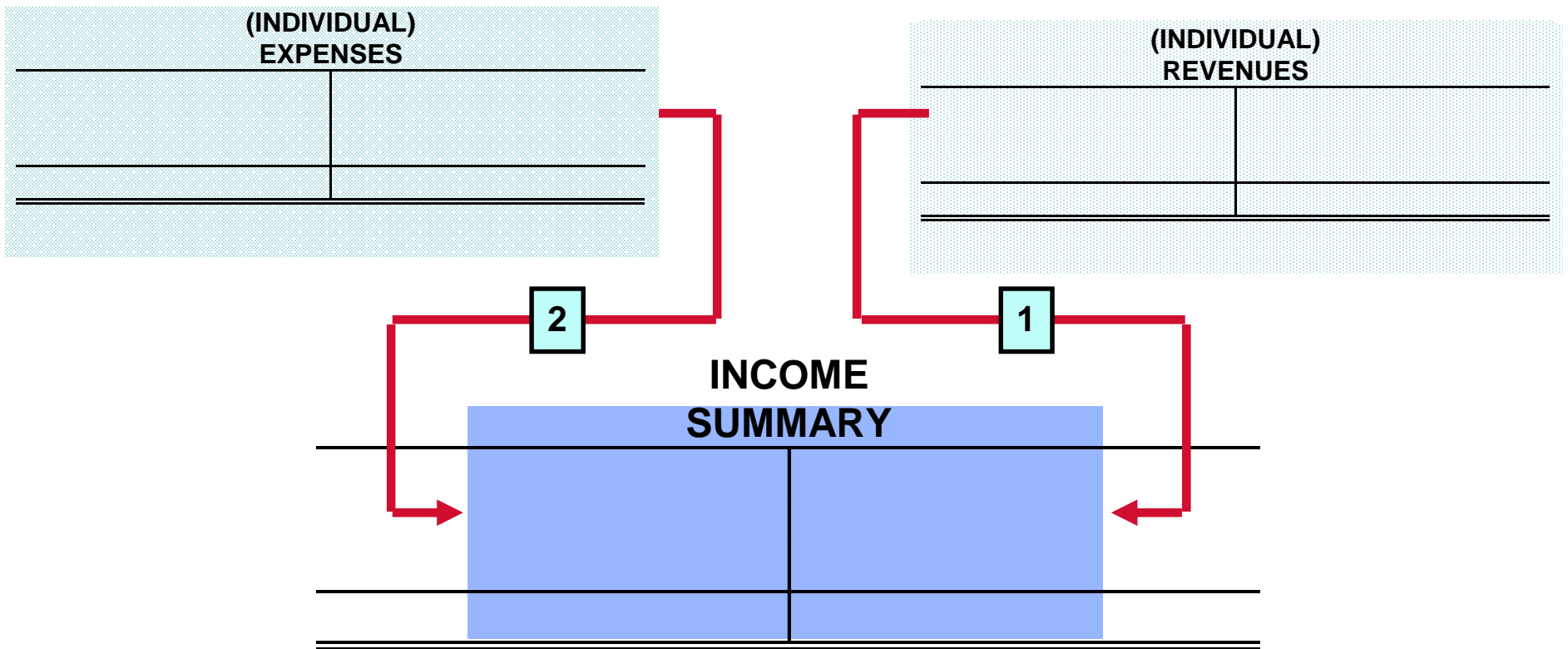
All liability accounts

Owner's capital account

# CLOSING ENTRIES

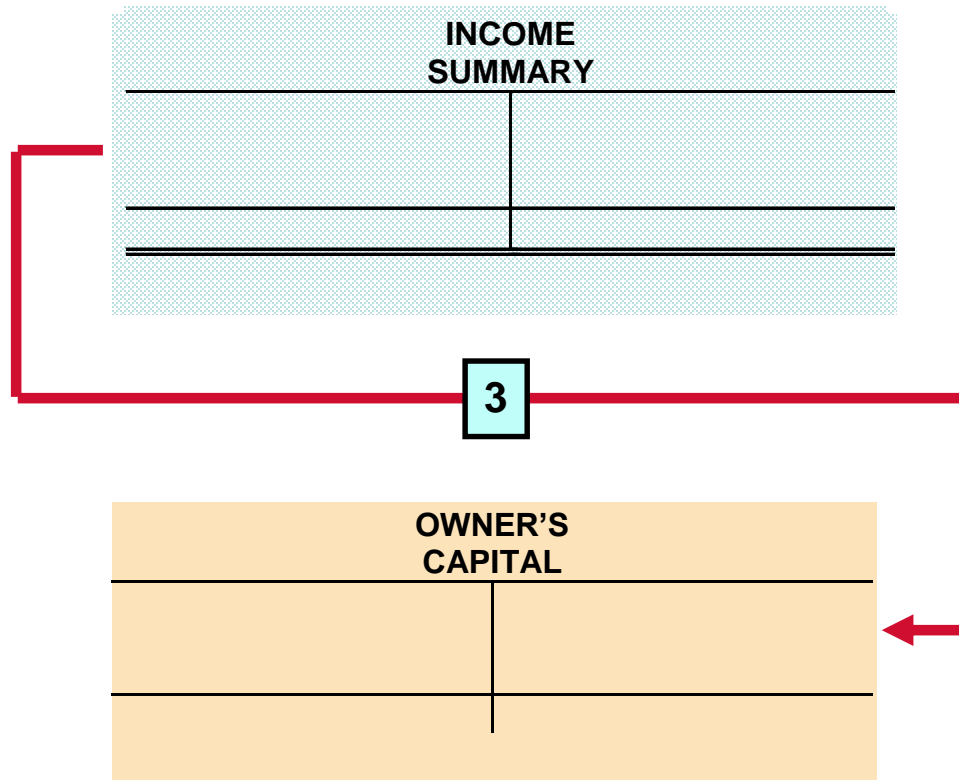
- **Closing entries**
  - Formally transfers net income (loss) and owner's drawings to owner's capital
  - Journalizing and posting is a required step in the **accounting cycle**
- **Income Summary**
  - A temporary account
  - Used in closing revenue and expense accounts
  - Minimizes the details in the permanent owner's capital account

# DIAGRAM OF CLOSING PROCESS PROPRIETORSHIP



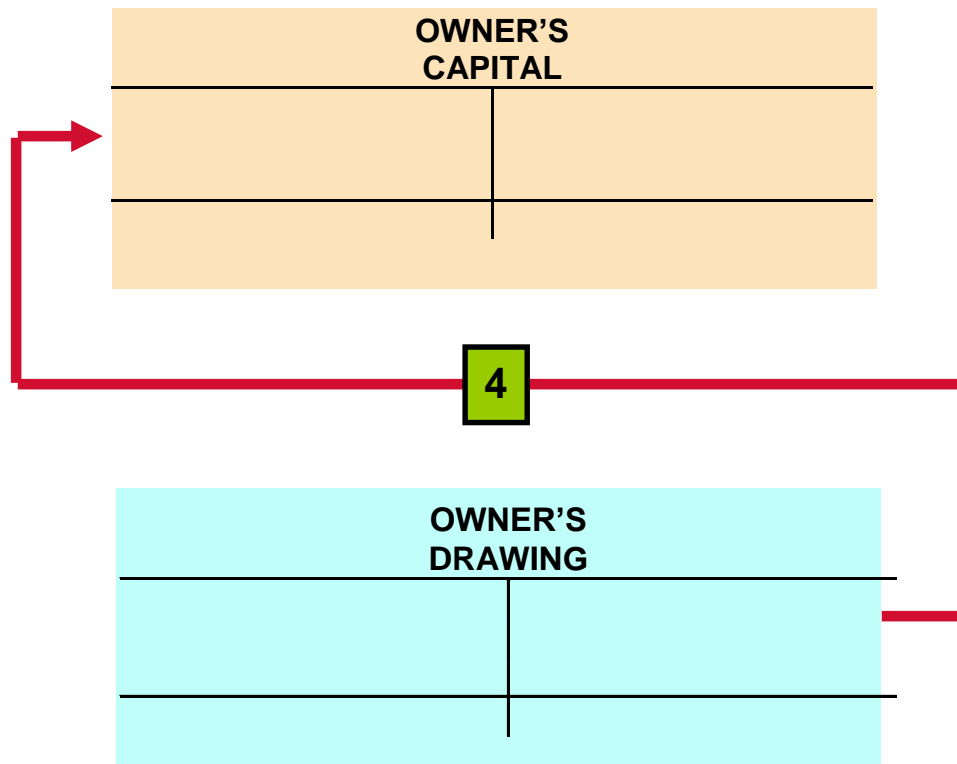
- 1** Debit each revenue account for its balance, and credit Income Summary for total revenues.
- 2** Debit Income Summary for total expenses, and credit each expense account for its balance.

# DIAGRAM OF CLOSING PROCESS



**3 Debit (credit) Income Summary and credit (debit) owner's capital for the amount of net income (loss).**

# DIAGRAM OF CLOSING PROCESS



**4 Debit owner's capital for the balance in the owner's drawing account and credit owner's drawing for the same amount.**

# CLOSING ENTRIES JOURNALIZED

GENERAL JOURNAL				
Date	Account Titles and Explanation	Ref.	Debit	Credit
Oct. 31	Service Revenue Income Summary (To close revenue account)	400 350	10,600	10,600

INCOME SUMMARY				No. 400
Date	Explanation	Debit	Credit	Balance
Oct. 31			10,600	10,600

SERVICE REVENUE				No. 350
Date	Explanation	Debit	Credit	Balance
Oct. 31		10,600		10,600 -0-

# CLOSING ENTRIES JOURNALIZED

GENERAL JOURNAL				
Date	Account Titles and Explanation	Ref.	Debit	Credit
2005 Oct. 31	Income Summary	350	7,740	
	Salaries Expense	726		5,200
	Advertising Supplies Expense	631		1,500
	Rent Expense	729		900
	Insurance Expense	722		50
	Interest Expense	905		50
	Depreciation Expense	911		40
	(To close expense accounts)			

INCOME SUMMARY				No. 350
Date	Explanation	Debit	Credit	Balance
Oct. 31			10,600	10,600
31		7,740		2,860

# CLOSING ENTRIES JOURNALIZED

GENERAL JOURNAL				
Date	Account Titles and Explanation	Ref.	Debit	Credit
2005 Oct. 31	(3) Income Summary C. R. Byrd, Capital (To close net income to capital)	350 301	2,860	2,860

INCOME SUMMARY No. 350				
Date	Explanation	Debit	Credit	Balance
2005 Oct. 31			10,600	10,600
31		7,740		2,860
31		2,860		-0-

C. R. BYRD, CAPITAL No. 301				
Date	Explanation	Debit	Credit	Balance
Oct. 31			10,000	10,000
31			2,860	12,860



# CLOSING ENTRIES JOURNALIZED

GENERAL JOURNAL				
Date	Account Titles and Explanation	Ref.	Debit	Credit
2005 Oct. 31	(4) C. R. Byrd, Capital C. R. Byrd, Drawing (To close net income to capital)	350 301	500	500

C. R. BYRD, DRAWING				No. 350
Date	Explanation	Debit	Credit	Balance
2005 Oct. 31		500		500
31			500	-0-

C. R. BYRD, CAPITAL				No. 301
Date	Explanation	Debit	Credit	Balance
Oct. 31			10,000	10,000
31				12,860
31		500		12,360

# **CAUTIONS RELATING TO CLOSING ENTRIES**

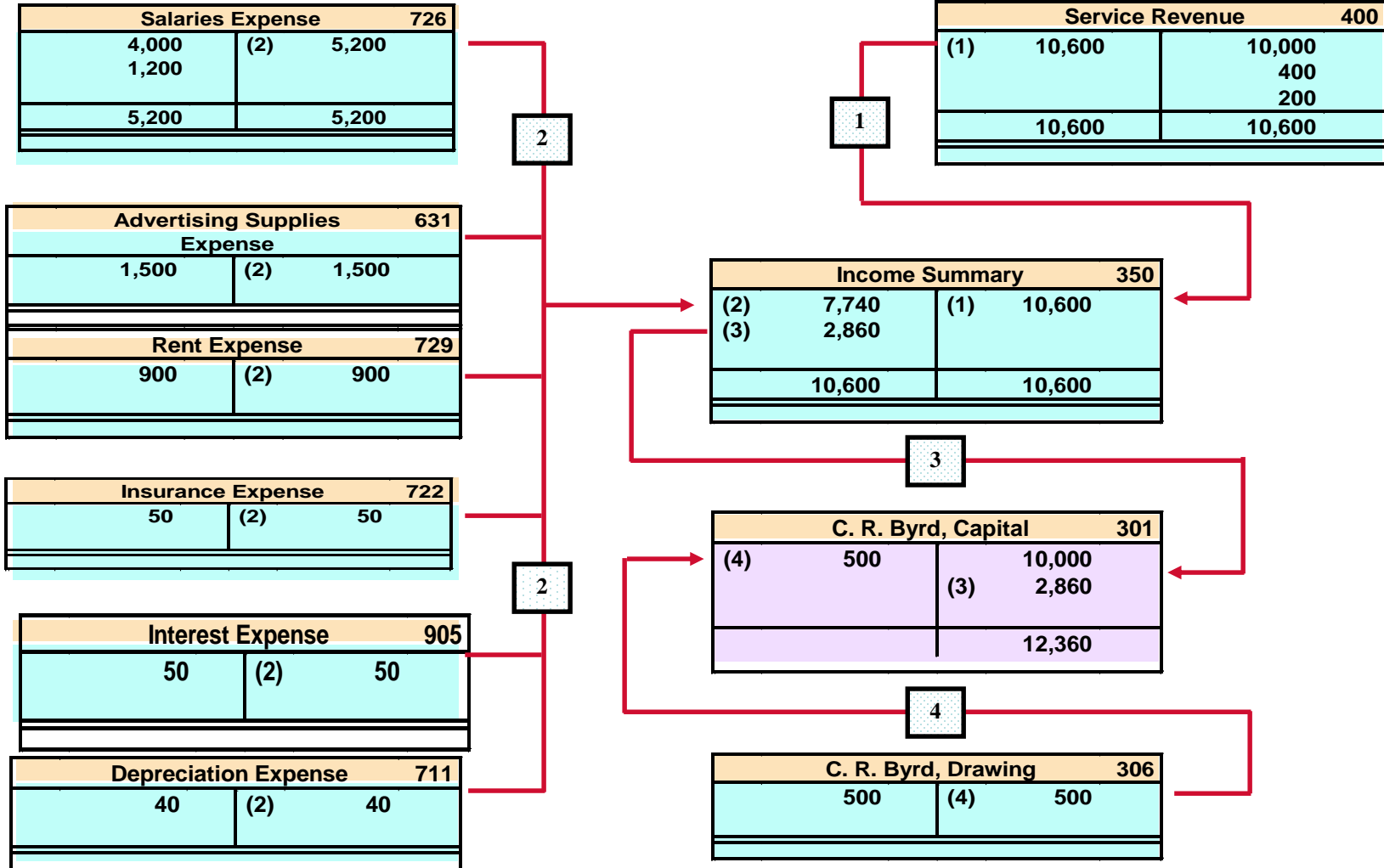
## **Caution:**

- **Avoid doubling revenue and expense balances**
- **Owner's Drawing does not move to the Income Summary account. Owner's drawing is not an expense and it is not a factor in determining net income.**

# **POSTING CLOSING ENTRIES**

- **Temporary accounts**
  - All temporary accounts will have zero balances after posting the closing entries
  - Temporary accounts (revenues and expenses) are totaled, balanced and double ruled
- **Owner's capital**
  - Total equity of the owner at the end of the accounting period
  - No entries are journalized and posted to owner's capital during the year
- **Permanent accounts (assets, liabilities, and owner's capital) not closed**

# POSTING OF CLOSING ENTRIES



# **POST-CLOSING TRIAL BALANCE**

After all closing entries have been journalized the **post-closing trial balance** is prepared from the ledger.

**The purpose of this trial balance** is to prove the equality of the permanent account balances that are carried forward into the next accounting period.

# POST-CLOSING TRIAL BALANCE

## PIONEER ADVERTISING AGENCY

Post-Closing Trial Balance

October 31, 2005

	<u>Debit</u>	<u>Credit</u>
Cash	\$15,200	
Accounts Receivable	200	
Advertising Supplies	1,000	
Prepaid Insurance	550	
Office Equipment	5,000	
Accumulated Depreciation—Office Equipment		\$ 40
Notes Payable		5,000
Accounts Payable		2,500
Unearned Revenue		800
Salaries Payable		1,200
Interest Payable		50
C. R. Byrd, Capital		12,360
	<u><b>\$21,950</b></u>	<u><b>\$21,950</b></u>

# **STEPS IN THE ACCOUNTING CYCLE**

- 1 Analyze business transactions**
- 2 Journalize the transactions**
- 3 Post to ledger accounts**
- 4 Prepare a trial balance**
- 5 Journalize and post adjusting entries**

# **STEPS IN THE ACCOUNTING CYCLE**

- 6 Prepare an adjusted trial balance**
- 7 Prepare financial statements:  
Income Statement, Owner's  
Equity Statement, Balance Sheet**
- 8 Journalize and post closing entries**
- 9 Prepare a post-closing trial  
balance**



# **CORRECTING ENTRIES**

## **STUDY OBJECTIVE 5**

- **Correcting Entries**
  - errors should be corrected as soon as discovered
  - correcting entries are unnecessary if records are free of errors
  - can be journalized and posted whenever an error is discovered
  - involve any combination of balance sheet and income statement accounts

# ILLUSTRATIVE EXAMPLE OF CORRECTING ENTRY 1

<b>May 10</b>	<p><b><u>Incorrect Entry</u></b></p> <p>Cash</p> <p style="padding-left: 40px;">Service Revenue</p> <p style="text-align: center;"><b>(To record collection from customer an account)</b></p>	50	50
<b>10</b>	<p><b><u>Correct Entry</u></b></p> <p>Cash</p> <p style="padding-left: 40px;">Accounts Receivable</p> <p style="text-align: center;"><b>(To record collection from customer an account)</b></p>	50	50
<b>20</b>	<p><b><u>Correcting Entry</u></b></p> <p>Service Revenue</p> <p style="padding-left: 40px;">Accounts Receivable</p> <p style="text-align: center;"><b>(To correct entry of May 10)</b></p>	50	50



# Review

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The closing entry process consists of closing

- a. all asset and liability accounts
- b. out the owner's capital account
- c. all permanent accounts
- d. all temporary accounts

# Review

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- d. all temporary accounts

# STANDARD BALANCE SHEET CLASSIFICATIONS

- Financial statements become more useful when the elements are classified into significant subgroups.
- A **classified balance sheet** generally has the following standard classifications:

Assets	Liabilities and Owner's Equity
Current Assets	Current Liabilities
Long-Term Investments	Long-Term Liabilities
Property, Plant and Equipment	Owner's (Stockholders') Equity
Intangible Assets	

# CURRENT ASSETS

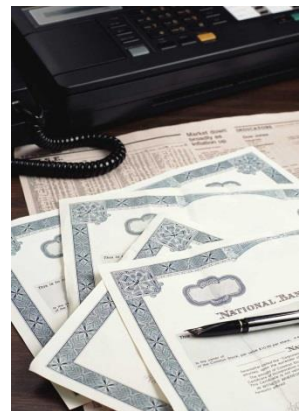
- **Current assets**
  - Cash and other resources that are reasonably expected to be realized in cash or sold or consumed in the business within one year of the balance sheet date or the company's operating cycle, whichever is longer
  - Current assets are listed in the order of their liquidity
- **Operating cycle of a company**
  - This is the average time required to go from cash to cash in producing revenues
- **Examples**
  - Inventory, accounts receivable and cash



# LONG-TERM INVESTMENTS

- **Long-term investments**
  - Resources which can be realized in cash
  - Their conversion into cash is not expected within one year or the operating cycle, whichever is longer
- **Examples**
  - Investments in bonds of another company or investment in land held for resale

**XYZ stock**





# PROPERTY, PLANT, AND EQUIPMENT

- **Property, plant, and equipment**
  - Tangible resources, relatively permanent nature, used in the business, and not intended for sale
- **Examples**
  - Land, buildings, and machinery



# INTANGIBLE ASSETS

- **Intangible assets**
  - Non-current resources that do not have physical substance
- **Examples**
  - Includes patents, copyrights, trademarks, or trade names, gives the holder exclusive right of use for a specified period of time

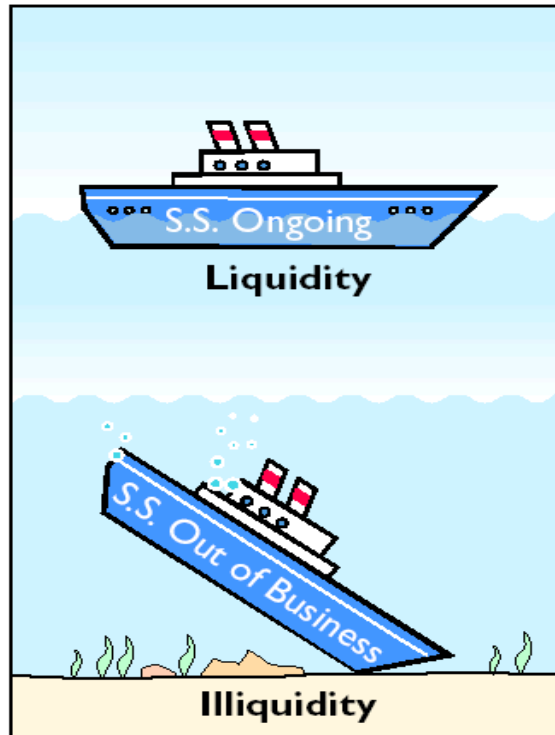
AOL TIME WARNER, INC.  
Balance Sheet (partial)  
(in millions)

<b>Intangible assets</b>	
Music catalogues and copyrights	\$ 2,935
Cable television and sports franchises	27,371
Brands and trademarks	10,650
Goodwill and other intangible assets	126,942

# **CURRENT LIABILITIES**

- **Current liabilities**
  - **Obligations reasonably expected to be paid from existing current assets or through the creation of other current liabilities within one year or the operating cycle, whichever is longer**
- **Examples**
  - **Accounts payable, wages payable, interest payable and current maturities of long-term debt**

# CURRENT LIABILITIES



**Liquidity** is the ability of a company to pay obligations that are expected to become due within the next year or operating cycle.

# **LONG-TERM LIABILITIES**

- **Long-term liabilities**  
**Obligations expected to be paid after one year**
- **Examples**
  - **Long-term notes payable, bonds payable, mortgages payable, and lease liabilities**

# OWNER'S EQUITY

- **The content of the owner's equity section**
  - **Varies with the form of business organization**
- **Proprietorship**
  - **A single owner's equity account called (Owner's Name), Capital**
- **Partnership**
  - **Separate capital accounts for each partner**
- **Corporation**
  - **Called stockholders' equity, and it consists of two accounts: **Capital Stock and Retained Earnings****

# CLASSIFIED BALANCE SHEET IN ACCOUNT FORM

## PIONEER ADVERTISING AGENCY

Balance Sheet  
October 31, 2005

<u>Assets</u>		
Current assets		\$ 15,200
Cash		200
Accounts receivable		1,000
Advertising supplies		550
Prepaid insurance		16,950
Total current assets		16,950
Property, plant, and equipment	\$5,000	
Office equipment		4,960
Less: Accumulated depreciation	40	
Total assets		\$21,910

**A classified balance sheet**

**1 availability of assets to meet debts**

**2 claims of short- and long-term creditors on total assets**

# CLASSIFIED BALANCE SHEET IN REPORT FORM

		<u>Liabilities and Owner's Equity</u>	
<b>Current liabilities</b>			<b>\$ 1,000</b>
Notes payable			2,500
Accounts payable			50
Interest payable			800
Unearned revenue			1,200
Salaries payable			<u>1,200</u>
<b>Total current liabilities</b>			<b>5,550</b>
<b>Long-term liabilities</b>			<b>4,000</b>
Notes payable			<u>4,000</u>
<b>Total liabilities</b>			<b>9,550</b>
<b>Owner's equity</b>			
C. R. Byrd, Capital			12,360
<b>Total liabilities and owner's equity</b>			<u><b>\$21,910</b></u>

The balance sheet is most often presented in the report form, with the assets above liabilities and owner's equity.