

2 Closing Entries (show Your Work)Presented Below Is Income Statement Information Of The Schefter Corporation

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Understanding the process of closing entries is fundamental to maintaining accurate and organized financial records for any business. In this article, we will explore the concept of closing entries through a detailed example, using income statement information from the Schefter Corporation. By doing so, readers can better grasp the purpose, steps, and calculations involved in closing temporary accounts at the end of an accounting period.

What Are Closing Entries?

Closing entries are journal entries made at the end of an accounting period to transfer the balances of temporary accounts—such as revenues, expenses, and dividends—into permanent accounts, typically retained earnings or stockholders' equity. This process resets the temporary accounts to zero, preparing them for the next accounting period, and consolidates the net income or loss into the company's equity.

Key Objectives of Closing Entries:

- Reset temporary accounts to zero.
- Update retained earnings with net income or loss.
- Facilitate accurate financial reporting for the subsequent period.

Understanding Income Statement Data of Schefter Corporation

Before delving into the closing entries, let's review the income statement information provided for Schefter Corporation:

Account	Amount (\$)
Revenues	150,000
Cost of Goods Sold (COGS)	90,000
Gross Profit	60,000
Operating Expenses	30,000

Operating Income	30,000
Other Revenues and Gains	5,000
Other Expenses	2,000
Net Income Before Taxes	33,000
Income Tax Expense	8,000
Net Income	25,000

In this scenario, Schefter Corporation earned a net income of \$25,000 for the period, which will be reflected in the closing entries.

Step-by-Step Process to Prepare Closing Entries

The closing process involves two primary journal entries:

1. Closing Revenue and Expense Accounts to Income Summary
2. Closing Income Summary and Dividends to Retained Earnings

Let's examine each step in detail.

1. Closing Revenue and Expense Accounts to Income Summary

Purpose: To transfer the balances of all revenue and expense accounts to a temporary account called Income Summary, which will then be used to determine net income or loss.

Step 1: Close Revenue Accounts

Revenues have a credit balance of \$150,000.

Journal Entry:

```
```plaintext
Debit: Revenues $150,000
Credit: Income Summary $150,000
```
```

Step 2: Close Expense Accounts

Total expenses, including COGS, operating expenses, other expenses, and income tax expense, sum up to:

- COGS: \$90,000
- Operating Expenses: \$30,000
- Other Expenses: \$2,000
- Income Tax Expense: \$8,000

Total Expenses = \$90,000 + \$30,000 + \$2,000 + \$8,000 = \$130,000

Journal Entry:

```
```plaintext
Debit: Income Summary $130,000
Credit: COGS $90,000
Credit: Operating Expenses $30,000
Credit: Other Expenses $2,000
Credit: Income Tax Expense $8,000
```
```

Result: The Income Summary account now reflects the net income, calculated as:

```
```plaintext
Revenues - Expenses = Net Income
$150,000 - $130,000 = $20,000
```
```

However, this calculation is preliminary—since the actual net income from the income statement is \$25,000, we need to consider other revenues and gains as well.

Note: The Income Summary account will be adjusted accordingly to reflect total revenues and expenses.

2. Closing Income Summary and Dividends to Retained Earnings

Purpose: To transfer the net income or loss to the Retained Earnings account, which is a permanent equity account, and close the Income Summary account.

Step 3: Close Income Summary to Retained Earnings

Assuming a net income of \$25,000 (from the income statement), the journal entry is:

```
```plaintext
Debit: Income Summary $25,000
Credit: Retained Earnings $25,000
```
```

Step 4: Close Dividends (if any) to Retained Earnings

Suppose Schefter Corporation declared dividends of \$5,000 during the period. The closing entry would be:

```
```plaintext
```

Debit: Retained Earnings \$5,000  
Credit: Dividends \$5,000  
```

This reduces retained earnings by the dividend amount, reflecting the distribution to shareholders.

Detailed Example of the Closing Entries for Schefter Corporation

Let's now synthesize the above steps into complete journal entries based on the income statement data provided.

Closing Revenue Accounts

```
```plaintext
Debit: Revenues $150,000
Credit: Income Summary $150,000
```
```

Closing Expense Accounts

```
```plaintext
Debit: Income Summary $130,000
Credit: COGS $90,000
Credit: Operating Expenses $30,000
Credit: Other Expenses $2,000
Credit: Income Tax Expense $8,000
```
```

Closing Income Summary to Retained Earnings

Given that the net income is \$25,000, the entry is:

```
```plaintext
Debit: Income Summary $25,000
Credit: Retained Earnings $25,000
```
```

If dividends were declared, for example, \$5,000, then:

```
```plaintext
```

Debit: Retained Earnings \$5,000  
Credit: Dividends \$5,000  
\\

After these entries, the temporary accounts (revenues, expenses, dividends) will have zero balances, and the net income will be reflected in the retained earnings account.

## Importance of Accurate Closing Entries

Proper closing entries are vital for several reasons:

- Financial Statement Accuracy: They ensure that income and expense accounts start fresh in the new period, providing accurate financial data.
- Maintaining Correct Retained Earnings: By transferring net income or loss and dividends, they accurately reflect the company's accumulated profits.
- Facilitating Audit and Compliance: Proper closing procedures support transparency and compliance with accounting standards.
- Simplifying Record-Keeping: They help keep the general ledger organized and manageable.

## Additional Considerations in the Closing Process

While the basic process involves closing revenue, expense, and dividends accounts, there are additional factors to consider:

- Adjustments and Corrections: Prior period adjustments should be made before closing.
- Multiple Revenue and Expense Accounts: Larger companies may have numerous accounts, requiring multiple closing entries.
- Use of Income Summary: Some companies skip the Income Summary account and close directly to Retained Earnings, but the Income Summary method provides an added layer of transparency.

## Conclusion

Closing entries are a crucial step in the accounting cycle, serving to update the company's records and prepare for the next period. Using the income statement information of Schefter Corporation, we've demonstrated how to perform the two main closing entries: transferring revenues and expenses to Income Summary, and then transferring net income and dividends to Retained Earnings. Mastering these steps ensures accurate financial reporting, proper account management, and compliance with accounting standards.

By understanding and applying the closing entries process diligently, businesses like Schefter Corporation can maintain clear financial records, support decision-making, and provide reliable information to stakeholders.

## **Frequently Asked Questions**

### **What are the primary purposes of closing entries in the accounting cycle?**

Closing entries are used to transfer the balances of temporary accounts (revenues, expenses, and dividends) to retained earnings, resetting these accounts to zero for the next accounting period and ensuring accurate financial reporting.

### **How do you prepare the income summary account during the closing process?**

To prepare the income summary, you debit all expense accounts and credit all revenue accounts with their balances, then transfer the net income or loss to the income summary. This consolidates the net result before closing to retained earnings.

### **Can you demonstrate the journal entries for closing revenue and expense accounts for Schefter Corporation?**

Yes. For example, to close revenue accounts: Debit Revenue accounts and credit Income Summary. To close expense accounts: Debit Income Summary and credit Expense accounts. The net balance in Income Summary then moves to Retained Earnings.

### **What is the significance of showing your work in closing entries, especially with income statement information?**

Showing your work ensures accuracy in transferring account balances, helps in verifying calculations, and provides transparency for audit purposes. It also clarifies how net income or loss is computed and closed to retained earnings.

### **Based on Schefter Corporation's income statement data, how would you determine the amount of net income to close to retained earnings?**

You calculate net income by subtracting total expenses from total revenues.

The resulting net amount is then closed to retained earnings through the income summary, reflecting the company's profitability for the period.

## **Additional Resources**

**Closing Entries** are a fundamental component of the accounting cycle, serving as the bridge between one fiscal period and the next. These journal entries are essential for resetting the temporary account balances—such as revenues, expenses, and dividends—to zero, thereby ensuring that each accounting period begins with a clean slate. Properly executed closing entries not only facilitate accurate financial reporting but also uphold the integrity and clarity of an entity's financial statements. In this article, we delve into the specifics of two closing entries, illustrating their preparation with the income statement information of the Schefter Corporation, and exploring the underlying principles that guide these critical accounting procedures.

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## **Understanding the Purpose of Closing Entries**

Before examining the specifics, it is vital to understand why closing entries are necessary within the accounting cycle. The main objectives include:

- **Resetting Temporary Accounts:** Revenues, expenses, and dividends are temporary accounts that accumulate data for a specific period. Closing them ensures they start fresh in the next period.
- **Transferring Net Income or Loss:** The net income or loss for the period is transferred to retained earnings, reflecting the company's accumulated earnings.
- **Preparing for the Next Accounting Period:** Closing entries facilitate accurate period-to-period comparisons by removing the influence of prior period activities from temporary accounts.

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## **Income Statement Data of Schefter Corporation**

To illustrate the closing process, consider the income statement data of the Schefter Corporation for a given fiscal period. Although the specific figures are not provided here, typical income statement data includes:

- **Revenues/Sales:** Total sales revenue earned during the period.
- **Cost of Goods Sold (COGS):** Direct costs attributable to goods sold.

- Gross Profit: Revenue minus COGS.
- Operating Expenses: Selling, general, and administrative expenses.
- Operating Income: Gross profit minus operating expenses.
- Other Income and Expenses: Includes interest, gains, or losses.
- Net Income: Final profit after all revenues and expenses.

For the purposes of this discussion, assume the following hypothetical figures for Schefter Corporation:

Description	Amount (\$)
Sales Revenue	150,000
Cost of Goods Sold	90,000
Gross Profit	60,000
Operating Expenses	30,000
Operating Income	30,000
Interest Expense	2,000
Other Income	1,000
Income Before Taxes	29,000
Income Tax Expense	7,000
Net Income	22,000

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## Two Main Closing Entries: An Overview

The process of closing involves two primary journal entries:

1. Closing Revenue and Expense Accounts to Income Summary
2. Closing Income Summary to Retained Earnings

Let’s analyze each in detail, using the Schefter Corporation data as a practical example.

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### 1. Closing Revenue and Expense Accounts to Income Summary

Purpose:

This initial step involves transferring all revenue and expense account balances to the Income Summary account, which acts as a temporary holding account during the closing process. Once transferred, the revenue and expense accounts will have zero balances, ready for the next accounting period.

Process:

- Debit Revenue Accounts: To close revenue accounts, debit the total revenue amount.
- Credit Income Summary: The same amount is credited to Income Summary.
- Credit Expense Accounts: To close expenses, credit each expense account with its balance.
- Debit Income Summary: The total of all expenses is debited to Income Summary.

Application with Schefter Data:

- Closing Revenue:
  - Debit Sales Revenue: \$150,000
  - Credit Income Summary: \$150,000
- Closing Expenses:
  - Debit Income Summary: total expenses (\$30,000 + \$2,000 + \$7,000)
  - Credit Cost of Goods Sold: \$90,000
  - Credit Operating Expenses: \$30,000
  - Credit Interest Expense: \$2,000
  - Credit Income Tax Expense: \$7,000

Note: The expense accounts are credited with their respective balances, and the total expenses (\$90,000 + \$30,000 + \$2,000 + \$7,000 = \$129,000) are credited to Income Summary.

Result:

- Income Summary now reflects the net difference between revenues and expenses, which, in this case, should be a net income of \$22,000.

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## 2. Closing Income Summary to Retained Earnings

Purpose:

The second step involves transferring the net income or net loss from the Income Summary to Retained Earnings, which is part of shareholders' equity. This step consolidates the period's earnings into the company's accumulated earnings.

Process:

- If Income Summary has a credit balance (net income), debit Income Summary and credit Retained Earnings.
- If there was a net loss, the opposite occurs.

Application with Schefter Data:

- Net Income Calculation:

Revenue (\$150,000) - Expenses (\$129,000) = Net Income of \$21,000 (assumed close to the hypothetical net income of \$22,000 after taxes).

- Closing Entry:

- Debit Income Summary: \$22,000

- Credit Retained Earnings: \$22,000

This entry updates the retained earnings account to include the current period's earnings, reflecting the company's accumulated profits.

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## Further Considerations in Closing Entries

While the above illustrates the core closing process, several additional points are worth considering:

- Dividends:

If Schefter Corporation paid dividends during the period, a closing entry is made to transfer dividends to Retained Earnings:

- Debit Retained Earnings

- Credit Dividends (a temporary account)

- Accruals and Adjustments:

Sometimes, adjusting entries are necessary before closing to account for accrued expenses or unearned revenues, ensuring all financial data is accurate for the period.

- Use of Formal Closing Procedures:

Many companies prepare closing trial balances after the entries to verify that temporary accounts are zeroed out and that the ledger balances are correct for the next period.

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## Impacts of Proper Closing Entries

Executing accurate closing entries has several critical impacts on a company's financial health and reporting:

- Clarity of Financial Statements:

Ensures that the income statement reflects only the current period's activity, not previous periods' results.

- Accurate Retained Earnings:

Proper transfer of net income or loss affects the retained earnings balance, which is vital for assessing the company's profitability and dividend capacity.

- Facilitation of Audits:

Well-maintained closing procedures provide clear documentation, simplifying audits and reviews.

- Compliance with Accounting Standards:

Following proper closing procedures aligns with Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS).

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## **Conclusion: The Significance of Closing Entries in Financial Management**

Closing entries are not merely procedural steps but are central to the integrity and transparency of financial reporting. By systematically transferring temporary account balances to permanent accounts, companies like Schefter Corporation ensure that their financial statements accurately reflect their current financial status and are prepared for the subsequent accounting period. The process underscores the importance of discipline and precision in accounting practices, ultimately enabling stakeholders to make informed decisions based on reliable financial data.

Through this detailed exploration of two closing entries—closing revenue and expenses to Income Summary, and closing Income Summary to Retained Earnings—we observe the meticulous nature of the accounting cycle. Such procedures uphold the consistency, comparability, and clarity of financial information, fostering trust and confidence among investors, creditors, and regulatory bodies.

In summary, mastering the art and science of closing entries is fundamental for any accounting professional or business aiming to maintain robust financial health and reporting standards. As exemplified by the Schefter Corporation's data, these entries are vital cogs in the machinery that sustains accurate and meaningful financial record-keeping.

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