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2. Register for the CMA Exam (page 8 of the CMA handbook, available on the IMA website [www.imanet.org/ima-certifications/cma-certification/cma-handbook](https://www.imanet.org/ima-certifications/cma-certification/cma-handbook))
3. Plan to complete certification requirements, discussed throughout the CMA handbook available on the IMA website.





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## CMA Exam Review

# Part 1

### Financial Planning, Performance, and Analytics

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# PART 1

## Introduction

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## Becker's CMA Exam Review—Course Introduction

Becker Professional Education developed its CMA Exam Review products to give you the best chance for success. Our integrated learning materials—including textbooks, multiple-choice questions, essays, concept videos, flashcards, and course software—prepare you to pass the exam.

We don't want you to be surprised on exam day. That's why Becker partners with the Institute of Management Accountants (IMA) to ensure the most current content is always available to you. Moreover, our CMA course provides 100 percent coverage of CMA Learning Outcome Statements, so you never need to worry about studying out-of-date concepts.

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# CMA Certification and Exam Overview

## Certification Basics

The CMA credential is bestowed by the IMA, the Institute of Management Accountants, the governing body for management accounting.

Earning a CMA entails certain education prerequisites, proven work experience, an active IMA membership, and other requirements. Candidates must pass the two parts of the CMA Exam in order to become fully certified. The CMA Exam tests across different disciplines related to management accounting and passing the exam sections helps to validate your understanding of key financial processes. Part 1 of the CMA Exam focuses largely on aspects of financial planning, while Part 2 is centered on financial management.

## Eligibility Requirements

### CMA Exam requirements

To be eligible for the CMA certification, you need to meet certain eligibility requirements. These requirements include:

#### Active membership with the Institute of Management Accountants (IMA)

Active membership with the IMA grants you access to the CMA certification process. Once you're a member, you can track your CMA Exam score and access your certificate online. Membership in IMA gives you access to the tools, information, and peer networks you need to enrich your career and add value to your organization. By joining the IMA network, you can benefit from CMA certification, CSCA certification, continuing education, leadership opportunities, informative thought leadership, networking, and community.

#### Education

You can meet the CMA education requirement with a bachelor's degree from an accredited college or university or with certain professional certifications. CMA candidates must submit verification of education to the IMA within seven years of completing the CMA Exam in order to earn certification.

#### Experience

To earn your CMA certification, you must complete two continuous years of professional experience in management accounting or financial management. This requirement can be met before or within seven years of passing the CMA Exam. Internships and nontechnical positions do not meet the experience requirement, but the IMA shares a full list of qualifying roles in the CMA handbook.

## **Pass the CMA Exam**

You must pass both parts of the CMA Exam. In order to apply and take the CMA Exam, you must pay a CMA entrance fee. If both exam parts are not successfully completed within three years of paying the entrance fee, any passed part will expire and the entrance fee will need to be paid again. For more information on the CMA entrance fee, visit the CMA handbook.

## **Continuing professional education**

To maintain your CMA certification, you must complete 30 hours of Continuing Professional Education (CPE), including two hours of ethics courses each year.

## **Exam Schedule**

The CMA Exam is administered by Prometric testing centers. Both CMA Exam parts are offered in three testing windows: January/February, May/June, and September/October. Registrations for these testing windows close after the 15th of February, June, and October, respectively. Don't forget—you have three years to pass both parts of the exam. This time period begins with your date of entry into the CMA program.

## **Exam Pass Rate and Study Time Recommendation**

According to the IMA, passing the CMA Exam typically takes "12–18 months to complete both parts, on average," and has a "global pass rate of 50%" across Parts 1 and 2.

The IMA recommends studying approximately 130–170 hours per exam section. In addition to passing the exams, candidates who want to become certified must fulfill the education requirements of a bachelor's degree or a professional accounting certification and two years of relevant work experience.

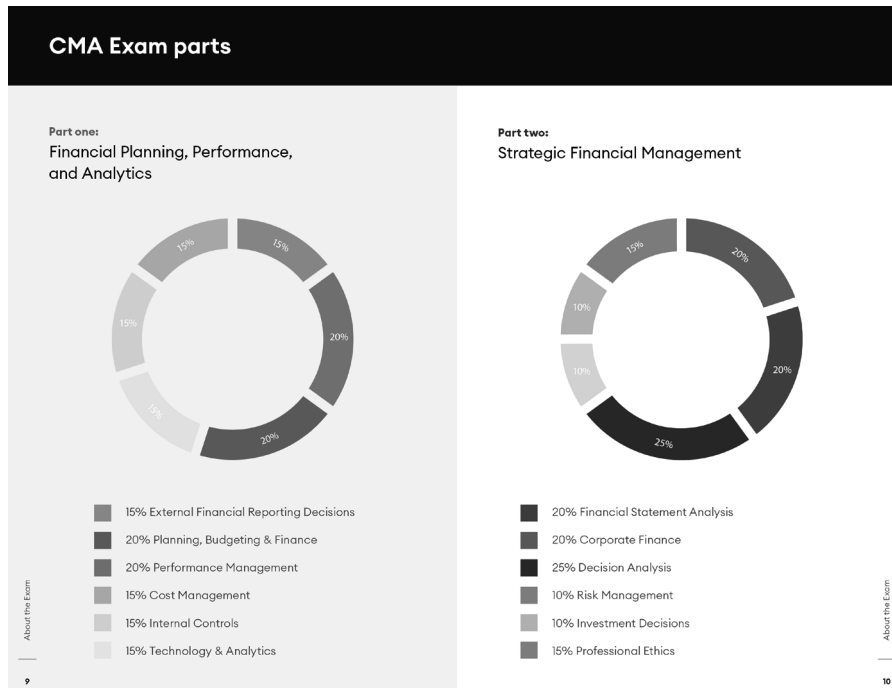
## **Exam Topics**

The CMA Exam includes two 4-hour parts: Part 1: Financial Planning, Performance, and Analytics and Part 2: Strategic Financial Management. Both parts include 100 multiple-choice questions and two 30-minute essays. The essay section includes 10–12 written response or calculation questions based on two scenarios, describing a typical business situation.

You will have three hours to complete the multiple-choice section and one hour to complete the essays. The essays will be presented after you have completed the multiple-choice section of the exam or after three hours, whichever comes first. Once you complete and exit the multiple-choice section of the exam, you cannot go back. You must remain in the essay section to complete the exam.

**Note:** You must answer at least 50 percent of the multiple-choice questions correctly to be eligible for the essay section.

Here is a breakdown of each part's key topics, their score weighting, and level of coverage.



**Note:** Changes in GAAP and/or IFRS are reflected on the CMA Exam one year after the effective date.

## Exam Scoring

To pass the CMA Exam, you must earn a score of at least 360 out of 500. All scores on the CMA Exam parts are expressed as scaled scores to maintain consistency and fairness across candidates.

If you fail the CMA Exam, Prometric will email a performance report detailing your performance in each key topic area. This report is emailed about two weeks after you receive your exam results. This is a great way to assess your most challenging areas and prepare more effectively for your next attempt. You cannot take an exam part more than one time during a testing window, so you'll have at least one full month to regroup and study again.

CMA candidates are eligible for exam awards based on the total score of Parts 1 and 2. To qualify for an award, you need to pass each of the two parts on the first attempt and complete both parts within one two-month testing window.

## 1A. External Financial Reporting Decisions

### Module

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## NOTES

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This section is designed to provide an overview of the accounting cycle and provide a refresher on fundamental concepts. Although specific questions related to the accounting cycle may not be seen on the exam, the concepts here are foundational to accounting and are assumed to be known and understood by exam candidates.

## 1 Accounting Cycle

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The primary objective of the accounting cycle is to capture the economic activity of a business. The accounting cycle can be broken down into the following steps:

1. Journalize transactions.
2. Post transaction to the general ledger.
3. Prepare an unadjusted trial balance.
4. Record adjusting entries.
5. Prepare an adjusted trial balance.
6. Prepare the financial statements.
7. Prepare closing entries.
8. Prepare the post-closing trial balance.

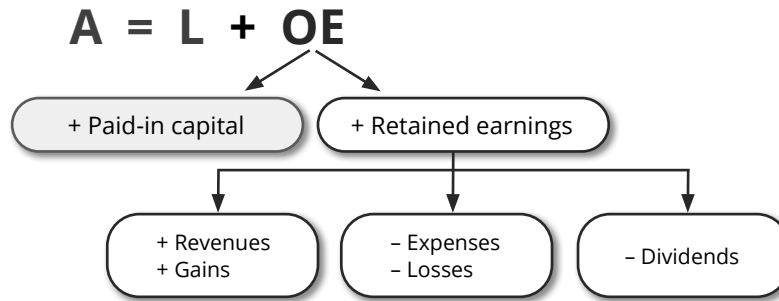
Each economic transaction captured by the accounting system has an effect on the accounting equation. The accounting equation can be expressed as follows:

$$\text{Assets} = \text{Liabilities} + \text{Owners' equity (or Stockholders' equity)}$$

This equation and any transaction captured by the accounting system demonstrates the equality of total economic resources (assets) and the claims against those resources (liabilities and ownership).

Properly recorded journal entries maintain equilibrium in the accounting equation.

The equity portion of the accounting equation is further broken down to demonstrate the relationship of an owner's equity to the income statement. Contributed capital and retained earnings are the two primary categories of equity. Contributed capital represents investments made by owners to the business. Retained earnings represent accumulated profits after the business has paid all expenses, dividends, and distributions. These retained earnings may be reinvested back into the company.

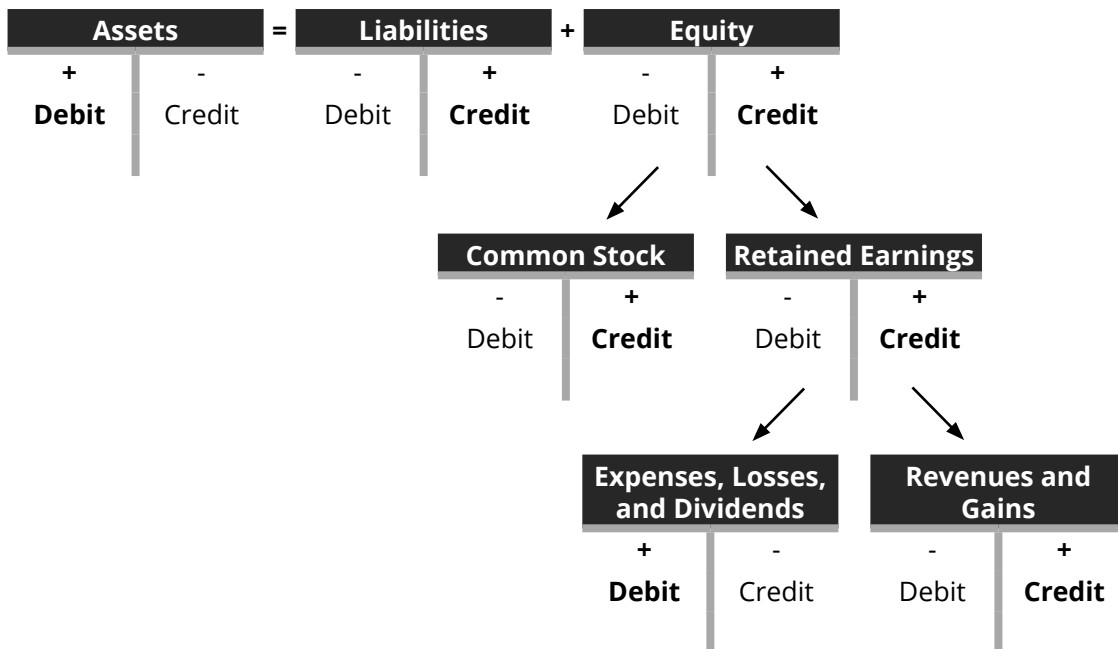


Every transaction of a business should be analyzed to determine the effect on the accounting equation. In any transaction, a minimum of two accounts will be affected. When analyzing the effects of each transaction, follow the steps indicated below:

1. Identify which accounts are involved in the transaction (remember there will be at least two).
2. Determine if the accounts are increasing or decreasing.
3. Ensure the accounting equation balances after the transaction is analyzed.

### 1.1 Journal Entries

Accountants record transactions using the double-entry accounting system using debits (on the left) and credits (on the right). A T-account is used to graphically represent each account used in the general ledger. The side an account increases on (shown in bold, below) is considered the normal balance.





## Illustration 1 Journal Entries

**Required:** For each of the following transactions, record the journal entry.

1. February 1: The corporation issued an additional 10,000 shares of capital stock to Harris Corp. in exchange for \$15,000 cash.
2. February 1: Purchased a building from Sweeney Enterprise for \$150,000. A cash payment of \$25,000 was made at the time of the purchase, and a note payable was issued for the remaining balance.
3. February 1: Paid \$7,800 for fire insurance on building for next 3 years.
4. February 9: Purchased additional supplies on account for \$3,500.
5. February 11: Billed students \$35,840 for tutoring services provided during the first half of February.
6. February 16: Paid \$12,300 in salaries earned by employees during the first half of February.
7. February 18: Received \$10,500 cash in advance from students for tutoring services to be provided in the future.
8. February 22: Collected cash from accounts receivable of \$40,000.
9. February 25: Paid \$3,330 for utilities during period.
10. February 25: Paid \$6,250 cash on accounts payable.
11. February 28: Declared and paid a \$2,000 dividend.

*February 1 journal entry:* Assets (cash) and equity (common stock) increased by \$15,000.

DR	Cash	\$15,000	
CR	Common stock		\$15,000

*February 1 journal entry:* Assets (building and cash) and liabilities (note payable) increased by \$125,000.

DR	Building	\$150,000	
CR	Cash		\$25,000
CR	Note payable		125,000

*February 1 journal entry:* Assets increased (prepaid insurance) and decreased (cash) by \$7,800.

DR	Prepaid insurance	\$7,800	
CR	Cash		\$7,800

*February 9 journal entry:* Assets increased (supplies) and liabilities decreased (accounts payable) by \$3,500.

DR	Supplies	\$3,500	
CR	Accounts payable		\$3,500

(continued)

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*February 11 journal entry:* Assets (accounts receivable) and revenues (sales revenue) increased as a result of the credit sale. The increase in revenue increases net income and eventually increases retained earnings.

DR	Accounts receivable	\$35,840	
CR	Sales revenue		\$35,840

*February 16 journal entry:* Assets (cash) decreased and expenses (wage expense) increased as a result of wages paid to employees. The increase in expenses decreases net income and eventually decreases retained earnings.

DR	Wage expense	\$12,300	
CR	Cash		\$12,300

*February 18 journal entry:* Assets (cash) and liabilities (unearned revenue) increased as a result of the advanced cash payment for tutoring services to be provided in the future by the company.

DR	Cash	\$10,500	
CR	Unearned revenue		\$10,500

*February 22 journal entry:* Assets (cash) increased and decreased (accounts receivable) by \$40,000.

DR	Cash	\$40,000	
CR	Accounts receivable		\$40,000

*February 25 journal entry:* Assets (cash) decreased and expenses (utilities) increased as a result of the utilities payment. The increase in expenses decreases net income and eventually decreases retained earnings.

DR	Utilities expense	\$3,330	
CR	Cash		\$3,330

*February 25 journal entry:* Assets (cash) decreased and liabilities (accounts payable) decreased by \$6,250.

DR	Accounts payable	\$6,250	
CR	Cash		\$6,250

*February 28 journal entry:* Assets (cash) decreased and dividends increased as a result of the dividend payment. The increase in dividends decreases retained earnings at the end of the period.

DR	Dividends	\$2,000	
CR	Cash		\$2,000

## 1.2 General Ledger

Each transaction journalized requires an update to the general ledger. The general ledger shows the debits and credits recorded for each account and shows the account balance at any point in time.

### Illustration 2 Posting to the General Ledger

For each of the following transactions, post the activity recorded in the journal (in the previous illustration) into the ledger.

1. February 1: The corporation issued an additional 10,000 shares of capital stock to Harris Corp. in exchange for \$15,000 cash.
2. February 1: Purchased a building from Sweeney Enterprise for \$150,000. A cash payment of \$25,000 was made at the time of the purchase, and a note payable was issued for the remaining balance.
3. February 1: Paid \$7,800 for fire insurance on building for next 3 years.
4. February 9: Purchased additional supplies on account for \$3,500.
5. February 11: Billed students \$35,840 for tutoring services provided during the first half of February.
6. February 16: Paid \$12,300 in salaries earned by employees during the first half of February.
7. February 18: Received \$10,500 cash in advance from students for tutoring services to be provided in the future.
8. February 22: Collected cash from accounts receivable of \$40,000.
9. February 25: Paid \$3,330 for utilities during period.
10. February 25: Paid \$6,250 cash on accounts payable.
11. February 28: Declared and paid a \$2,000 dividend.

Assets		
Cash		
Date	Debit	Credit
Beg. Bal.	\$32,000	
Feb. 1	15,000	
Feb. 1		\$25,000
Feb. 1		7,800
Feb. 16		12,300
Feb. 18	10,500	
Feb. 22	40,000	
Feb. 25		3,330
Feb. 28		6,250
Feb. 28		2,000
End. Bal.	<b>\$40,820</b>	

Liabilities		
Accounts Payable		
Date	Debit	Credit
Beg. Bal.		\$4,200
Feb. 9		3,500
Feb. 25	\$6,250	
End. Bal.		<b>\$1,450</b>

Unearned Revenue		
Date	Debit	Credit
Beg. Bal.		\$ 0
Feb. 18		10,500
End. Bal.		<b>\$10,500</b>

(continued)

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**Assets**

Accounts Receivable		
Date	Debit	Credit
Beg. Bal.	\$11,000	
Feb. 11	35,840	
Feb. 22		\$40,000
End. Bal.	<b>\$ 6,840</b>	

Supplies		
Date	Debit	Credit
Beg. Bal.	\$5,600	
Feb. 9	3,500	
End. Bal.	<b>\$9,100</b>	

Prepaid Insurance		
Date	Debit	Credit
Beg. Bal.	\$ 0	
Feb. 1	7,800	
End. Bal.	<b>\$7,800</b>	

Land		
Date	Debit	Credit
Beg. Bal.	\$68,000	
End. Bal.	<b>\$68,000</b>	

Building		
Date	Debit	Credit
Beg. Bal.	\$ 0	
Feb. 1	150,000	
End. Bal.	<b>\$150,000</b>	

**Expenses**

Wage Expense		
Date	Debit	Credit
Feb. 16	\$12,300	
End. Bal.	<b>\$12,300</b>	

Utility Expense		
Date	Debit	Credit
Feb. 25	\$3,330	
End. Bal.	<b>\$3,330</b>	

**Liabilities**

Notes Payable		
Date	Debit	Credit
Beg. Bal.		\$ 0
Feb. 1		125,000
End. Bal.		<b>\$125,000</b>

**Equity**

Common Stock		
Date	Debit	Credit
Beg. Bal.		\$ 85,000
Feb. 1		15,000
End. Bal.		<b>\$100,000</b>

Retained Earnings		
Date	Debit	Credit
Beg. Bal.		\$27,400
End. Bal.		<b>\$27,400</b>

Dividends		
Date	Debit	Credit
Feb. 28	\$2,000	
End. Bal.	<b>\$2,000</b>	

**Revenue**

Revenue		
Date	Debit	Credit
Feb. 11		\$35,840
End. Bal.		<b>\$35,840</b>

### 1.3 Unadjusted Trial Balance

The unadjusted trial balance reflects the balances in each financial statement account at a point in time. This trial balance is prepared at the end of the period, prior to any adjusting entries necessary to ensure total debits posted equal total credits posted and serve as a basis for determining any adjusting entries needed.

#### Illustration 3 Unadjusted Trial Balance

The unadjusted trial balance below reflects activity journalized and posted during the month of February.

Harris Enterprise Unadjusted Trial Balance At February 28, Year 2		
Account	Debit	Credit
Cash	\$ 40,820	
Accts. receivable	6,840	
Supplies	9,100	
Prepaid insurance	7,800	
Land	68,000	
Building	150,000	
Accounts payable		\$ 1,450
Unearned revenue		10,500
Notes payable		125,000
Common stock		100,000
Retained earnings		27,400
Dividends	2,000	
Tutoring service revenue		35,840
Wage expense	12,300	
Utility expense	3,330	
<b>Total</b>	<b><u>\$300,190</u></b>	<b><u>\$300,190</u></b>

Note that total debits equal total credits.

### 1.4 Adjusting Entries

Adjusting journal entries are necessary under accrual accounting to ensure all revenues earned and expenses incurred are captured in the correct accounting period. The matching principle requires companies to record expenses when incurred to match them properly against the associated revenues. Because accrual accounting is based on the timing of revenue and expense recognition and not when cash is received or paid, adjusting entries are necessary at the end of each accounting period in order to ensure all revenues earned and expenses incurred are captured in the accounting system.

There are three broad categories of adjusting journal entries: prepayments/deferrals, accruals, and estimates.

### 1.4.1 Prepayments/Deferrals

Prepayments, also referred to as deferrals, are transactions in which cash flows precede the revenue or expense recognition. Examples of prepayments/deferrals include:

- Prepaid/Deferred Expense:** Represents assets associated with a cash distribution resulting in benefits to be received or to be used beyond the current reporting period. Common examples would include prepaid rent, prepaid insurance, and office supplies. As prepaid expenses (which are classified as assets) are used, an expense is recognized and the asset is reduced.
- Unearned Revenue:** Represents the receipt of cash prior to the providing of a good or service to a customer. Advance collections of cash from customers result in liabilities on the part of the company because there is a required future action or event that must take place before the business earns the revenue.

#### Illustration 4 Initial Entries With Year-end Adjusting Entries: Rent

Assume that on November 1, Year 1, Swift Corp. prepaid four months of rent by paying \$8,000.

*November 1 initial journal entry:*

DR	Prepaid rent	\$8,000	
CR	Cash		\$8,000

*December 31 adjusting journal entry:*

DR	Rent expense	\$4,000	
CR	Prepaid rent		\$4,000

November and December rent expense of \$2,000 per month must be recognized and the prepaid rent account needs to reflect only two months of prepaid rent remaining.

Prepaid Rent				Rent Expense					
Date	Debit	Credit	Balance		Date	Debit	Credit	Balance	
			Debit	Credit				Debit	Credit
Nov. 1	\$8,000		\$8,000		Dec. 31	\$4,000		\$4,000	
Dec. 31		\$4,000	\$4,000						

Assume that on January 1, Year 1, Swift purchases \$1,000 of supplies. A physical count of office supplies available at the end of the month showed that only \$200 in supplies remain.

*January 1 initial entry:*

DR	Office supplies	\$1,000	
CR	Cash		\$1,000

(continued)

(continued)

January 31 adjusting entry:

DR	Supply expense	\$800	
CR	Office supplies		\$800

The supplies that have been used during the period no longer have a benefit to the company (they are no longer an asset), therefore, an entry is necessary to record the expense associated with the use of the supplies and to adjust the office supplies account to reflect supplies still on hand at the end of the period.

Office Supplies					Supply Expense				
Date	Debit	Credit	Balance		Date	Debit	Credit	Balance	
			Debit	Credit				Debit	Credit
Jan. 1	\$1,000		\$1,000		Jan. 31	\$800		\$800	
Jan. 31		\$800		\$ 200					

When advance collections of cash create a liability (unearned revenue) on the part of a company, adjusting entries are necessary as services are earned.

Assume on May 1, Year 1, Swift receives \$600 in prepayments from customers for three events that Swift will host for \$200 per event. By the end of May, Swift has hosted two of the three events. Prepare both the initial and adjusting entries necessary.

May 1 initial journal entry:

DR	Cash	\$600	
CR	Unearned revenue		\$600

May 31 adjusting journal entry:

DR	Unearned revenue	\$400	
CR	Service revenue		\$400

Swift has earned the revenue by hosting two events and at May 31, Swift is only responsible for hosting one remaining event. Two of the three events hosted results in revenue of \$400 earned; the \$200 remaining balance in the liability account, unearned revenue, reflects the one remaining event.

Unearned Revenue					Service Revenue				
Date	Debit	Credit	Balance		Date	Debit	Credit	Balance	
			Debit	Credit				Debit	Credit
May 1		\$600		\$600	May 31		\$400		\$400
May 31	\$400			\$200					

### 1.4.2 Accruals

Accruals involve transactions where the cash outflow or inflow takes place in the period following the adjusting entry. The adjusting entry for accruals happens first followed by the cash inflow in future periods.

Common examples of accruals include accruals for liabilities as well as for receivables at the end of a period.

- Accrued liabilities represent liabilities recorded when an expense has been incurred, but no cash has been paid yet. Common examples of accrued liabilities would include wages payable and interest payable. For example, when employees perform work associated with wages, at the end of the accounting period, the company must accrue earned wages for unpaid work. A corresponding liability is recognized at the time of the accrual. The liability is reversed when payments occur in the following period.
- Accrued receivables involve situations when revenue has been earned and is eligible for recognition, but cash has not yet been received. For example, when investments in debt made by a company result in the periodic receipt of interest payments, any interest earned at the end of the period is accrued and a receivable representing the right to receive the interest is reflected on the balance sheet.

#### Illustration 5 Initial Entries With Year-end Adjusting Entries: Interest

Assume Harris Investments has earned \$1,500 in interest on investments in Dawson Enterprises at December 31, Year 1. The interest payment will not be made until January 1, Year 2.

*December 31 adjusting journal entry:*

DR	Interest receivable	\$1,500	
CR	Interest revenue		\$1,500

*January 1 subsequent journal entry:*

DR	Cash	\$1,500	
CR	Interest receivable		\$1,500

The interest revenue is recognized in the period earned, regardless of the collection of cash. With revenue/receivable accruals, the adjusting entry precedes the collection of cash.

Interest Receivable				Interest Revenue					
Date	Debit	Credit	Balance		Date	Debit	Credit	Balance	
			Debit	Credit				Debit	Credit
Dec. 31	\$1,500		\$1,500		Dec. 31		\$1,500	\$1,500	
Jan. 1		\$1,500		—					

Assume employees earn wages of \$35,000 per week based on a five-day work week. December 31 is a Tuesday, and payday is Friday.

(continued)



(continued)

*December 31 adjusting entry:*

DR	Wage expense	\$14,000	
CR	Wage payable		\$14,000

*January 3 subsequent entry:*

DR	Wage expense	\$21,000	
DR	Wage payable	14,000	
CR	Cash		\$35,000

The wage expense incurred in December should be recognized in December regardless of cash payment in January.  $\$35,000 / 5 \text{ days} = \$7,000 \text{ per day} \times 2 \text{ days} = 14,000$  expense associated with December. With expense/liability accruals, the adjusting entry precedes the payment of cash.

Wages Payable					Wage Expense				
			Balance					Balance	
Date	Debit	Credit	Debit	Credit	Date	Debit	Credit	Debit	Credit
Dec. 31		\$14,000		\$14,000	Dec. 31	\$14,000		\$14,000	

### 1.4.3 Estimates

Many adjusting entries involve either prepayments or accruals; however, estimates made in the accounting process also result in adjusting entries. A common example of this is depreciation. When long-term assets are acquired, an allocation of the cost of the asset over period of benefit is used to match depreciation expense against revenues earned during the period.

Many estimates go into the calculation of the allocation process. For example, the purchase of equipment at a cost of \$10,000 on January 1, with an expected useful life of four years and no salvage value would be depreciated on a straight-line basis \$2,500 per year for four years ( $\$10,000 / 4 \text{ years} = \$2,500 \text{ per year}$ ). Depreciation is not an attempt to reflect market value of an asset, but merely to allocate cost over the period of expected benefit, matching the expense of the asset to the revenues generated during its use.

### Illustration 6 Initial Entries With Year-end Adjusting Entries: Depreciation

Assume Jones Co. purchased a \$50,000 building with a 25-year life on January 1, Year 1.

*January 1 initial entry:*

DR	Building	\$50,000	
CR	Cash/note payable		\$50,000

*December 31 adjusting entry:*

DR	Depreciation expense	\$2,000	
CR	Accumulated depreciation—building		\$2,000

The year-end adjusting entries would include \$2,000 in depreciation expense for one year of benefit received out of the estimated 25-year life.

Accumulated Depreciation—Building					Depreciation Expense				
Date	Debit	Credit	Balance		Date	Debit	Credit	Balance	
			Debit	Credit				Debit	Credit
Dec. 31		\$2,000		\$2,000	Dec. 31	\$2,000		\$2,000	

## 1.5 Adjusted Trial Balance

After adjusting entries are made, the general ledger is updated to reflect the adjusted balances and an adjusted trial balance is prepared. The adjusted trial balance is the starting point for the preparation of the company's financial statements, because all transactions and financial changes for the period reported have been captured by the accounting system. The format of an adjusted trial balance is identical to the initial trial balance, but the title is updated to indicate "adjusted" because new revenue and expense items may exist as well as increases/decreases to related assets and liabilities after the adjustments are made.

**Illustration 7     Adjusted Trial Balance**

Based on adjusting entries, the adjusted trial balance for Harris Enterprises is shown below.

Harris Enterprises <b>Adjusted Trial Balance</b> February 28, Year 2		
<b>Account</b>	<b>Debit</b>	<b>Credit</b>
Cash	\$ 40,820	
Accts. receivable	6,840	
Supplies	1,500	
Prepaid insurance	7,583	
Land	68,000	
Building	150,000	
Accumulated depreciation		\$ 625
Accounts payable		1,450
Unearned revenue		5,750
Wage payable		11,600
Interest payable		1,250
Note payable		125,000
Common stock		100,000
Retained earnings		27,400
Dividends	2,000	
Tutoring service revenue		40,590
Wage expense	23,900	
Utility expense	3,330	
Insurance expense	217	
Supply expense	7,600	
Depreciation expense	625	
Interest expense	1,250	
<b>Total</b>	<b><u>313,665</u></b>	<b><u>313,665</u></b>

Note that total debits equal total credits.

## 1.6 Closing Entries and the Post-Closing Trial Balance

Once the adjusted trial balance is prepared, the financial statements can be prepared. At the end of a reporting period, all temporary accounts must be closed. Temporary accounts include all revenues, expenses, and dividends during the period. Revenues less expenses (net income) and dividends paid to shareholders during the period are then closed into the retained earnings account.

Only permanent accounts (assets, liabilities, and equity) remain after closing. Once all closing journal entries have been made, a post-closing trial balance is prepared to reflect assets, liabilities, and equity. The only permanent account that will have a change from the adjusted to post-closing trial balance is the retained earnings account.

### Illustration 8 Preparing Closing Entries

Use the information from Harris Enterprises Income Statement to prepare the closing entries.

*February 28 close revenue accounts to retained earnings:*

DR	Tutoring service revenue	\$40,590	
CR	Retained earnings		\$40,590

*February 28 close expense accounts to retained earnings:*

DR	Retained earnings	\$36,922	
CR	Wage expense		\$23,900
CR	Utility expense		3,330
CR	Insurance expense		217
CR	Supply expense		7,600
CR	Depreciation expense		625
CR	Interest expense		1,250

*February 28 close dividends to retained earnings:*

DR	Retained earnings	\$2,000	
CR	Dividends		\$2,000

(continued)

(continued)

Once the closing entries are prepared, the post-closing trial balance is checked to ensure only balance sheet accounts remain:

Harris Enterprises <b>Post-Closing Trial Balance</b> February 28, Year 2		
<b>Account</b>	<b>Debit</b>	<b>Credit</b>
Cash	\$ 40,820	
Accts. receivable	6,840	
Supplies	1,500	
Prepaid insurance	7,583	
Land	68,000	
Building	150,000	
Accumulated depreciation		\$ 625
Accounts payable		1,450
Unearned revenue		5,750
Wage payable		11,600
Interest payable		1,250
Note payable		125,000
Common stock		100,000
Retained earnings		<u>29,068</u>
<b>Total</b>	<b><u>\$274,743</u></b>	<b><u>\$274,743</u></b>

Note that total debits equal total credits.

**NOTES**

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