The ledgers of income statement accounts

Lesson 50

The ledgers of income statement accounts are handled differently vis-à-vis those of balance sheet accounts. The major difference is that the balances of these accounts are made to equal zero using closing entries (which we will show later). This means that a debit or a credit is posted so that the ending balance is zero. In effect, the balances in the income statement accounts are "removed" and "transferred" to the Retained earnings account of the balance sheet. This step happens when financial statements are prepared, usually at the end of the year. (For our illustration later, we shall do this step at the end of the month of January, because we will be eventually generating an income statement for one month only.)

In Lesson 31, we showed that the profits (or Net income) gained within a period are added to the Retained earnings as of the beginning of the period in order to get the Retained as of the end of the period. For example, the Retained earnings as of December 31, 2010 is computed as follows:

Retained earnings as of December 31, 2009
Plus: Net income for the Year 2010
Equals: Retained earnings as of December 31, 2010

Since Net income is made up of Revenues minus Expenses, we can rewrite the above computation as follows:

Retained earnings as of December 31, 2009
Plus: Revenue for the Year 2010
Minus: Expenses for the Year 21010
Equals: Retained earnings as of December 31, 2010

This computation essentially happens at the point when the balances in the ledgers of the revenue and expense accounts are transferred to the Retained earnings
ledger.

A revenue account normally gets credit entries apart from debits due to revenue reversals, and a closing debit entry that will zero (or close) its balance. An expense account, on the other hand, normally gets debit entries, apart from credits due expense reversals, and a closing credit entry that will zero (or close) its balance.

4.01 Sales revenue

Debit	Credit
	Beginning
- Decrease	+ Increases
- Closing debit	

	Ending = 0

5.01 Cost of good sold

Debit	Credit
Beginning	
+ Increases	- Decrease
	- Closing debit

Ending = 0	

The balance of income statement accounts having been reduced to zero, each of them starts with a zero beginning for the next accounting cycle, as against the carry-over balance of balance sheet accounts from one accounting cycle to the next. For example, if Sales ends up with a credit balance of $100,000 just before financial statements are prepared, a debit of $100,000 will be posted under Sales, thus reducing its balance to zero, and the corresponding credit will be posted to Retained earnings. The Sales book then starts with zero for the next accounting cycle.