COLLEGE OF ACCOUNTING

FINANCIAL REPORTING | BASIC

Video Transcription: Balancing/Closing Off Ledger Accounts

Hallo there, my name in Jacqui and in this video we are going to look at how to balance or close off ledger accounts in the general ledger of a business.

A ledger account allows the business to record all increases and/or decreases affecting individual assets, equity or liability items in a single area – the ledger account. Remember when we are using a 2 column ledger account (or T-Account as it is also referred to), the left hand side of the account records the debit entries and the right hand side of the account records the credit entries that affect that account for example the bank, capital or loan account.

At each month end the business will want to extract a trial balance (a list of all of the accounts in the general ledger and their balances). At the end of the financial year, the business will close off all the income and expense accounts so that they can start the new year with a nil balance on the account. So, how do we balance and/or close off a ledger account?

Let's look at two examples - a bank account and a salaries expense account. The bank account (other than in the first month of business) will start with an opening balance, in our example the balance is on the debit side of the account which means that at the start of the month the business had a bank asset or had money in the bank. This opening balance is the closing balance as recorded at the end of the prior period.

All the entries on the debit side of the bank account represent cash coming into the business during the month, or transactions that lead to an increase in the bank asset. The entries on the credit side of the bank account represent cash leaving the business during the month, or transactions that lead to a decrease in the bank asset.

The business started the month with R5 000 in the bank and has received an additional R1 500 (R800 + 700), in other words has total debits of R6 500 in the bank account. The business spent R2 200 (R1 000 + R1 200) - the total amount on the credit side of the account.

The amount left in the bank at the end of the month – or closing balance - amounts to R 4 300 – the difference between the total DR of R6 500 and the total CR of R2 200. Note how the ledger account has been balanced to make sure that the debits equal the credits – in this case, R6 500. A credit of R4 300 is required to make the debits equal the credits – which means that the balance on the ledger account is R4 300 – the amount by which the debits exceeded the credits.

Assets, liabilities and permanent equity accounts such as capital and retained earnings will be balanced at the end of each month. The closing balance calculated at the end of a month represents the amount in the asset, equity or liability account at the beginning of the following month or opening balance.

The opening and closing balances indicate the amount that represents the asset, equity or liability account at a point in time for example the beginning or the end of the month.

The balance calculated at the end of one period, is the opening balance at the end of the next period. In this ledger account, the opening balance was R5 000 and the closing balance R4 300. In the next period, the opening balance will be R4 300. The difference between the opening balance (R5 000) and the closing balance (R4 300) represents the movement in the account during the month.

Income and expense accounts are totaled or balanced during the year – in other words in the February trial balance the business should show salaries expense with a balance of R2 400 as R1 200 per month has been incurred for 2 months.

At the end of the year, we calculate the total expense for the year. We add up the amounts incurred for salaries for the 12-month period. R14 400 will be the total salary expense for the year. This is the amount that will be recognised as an expense for the current period. Did you notice that the balance at the beginning of the year was nil? This is because we will not want to recognise any salaries expense incurred last year in this year's salary expense.

The salaries expense will form part of the profit or loss calculation – in other words, as an expense it will reduce the amount of profit generated. The business will use a profit or loss account to record all the income and expense accounts that impact on the profit that is generated by the business. In the following year the business will use the same ledger account to calculate salaries expense, but must start the year with a zero balance. That means that we have to get rid of the current year's balance and record how we have done this.

We do this by crediting the expense account with the amount that will be recognised as an expense and the profit or loss account is debited by this amount. The journal entry that records that is known as a closing entry, as it closes the balance off at the end of the year. The expense account now has a zero balance, so the expense account will not have an opening balance carried forward to the following year.

Let's go back to the bank account and think about how we would balance this account if the business spent more money than they had in the bank account – in other words, the bank has lent you money, or what is often referred to as an overdraft. So, assume that the monthly salary expense amounted to R11 200, this is what the ledger account would like.
We can see that the total debits amount to R6 500 and the total credits amount to R12 200. Can you see that the balance at the beginning of the next period – the R5 700 is a credit balance, which is the amount by which the credits exceed the debits.

A ledger account can also be presented in a 3-column format. This is the format generally used by accounting software packages. Debit entries are recorded in the first column (or left hand column) and credit entries in the second (or right hand column). The final column reflects the balance.

In this format the balance is updated after each transaction. As the bank account is an asset, debit entries show that the bank account is increasing so we add debit entries to the balance (we can see this happening with the entries on the 10th and 26th of January). Credit entries are processed when the bank account is decreasing so these entries are subtracted from the balance (we can see this happening with the entries on the 11th and 28th of January).

The closing balance on the bank account as at 31 January, therefore, amounts to R4 300.

Hope this video has helped with understanding how and why we balance or close off ledger accounts. Thanks for watching.