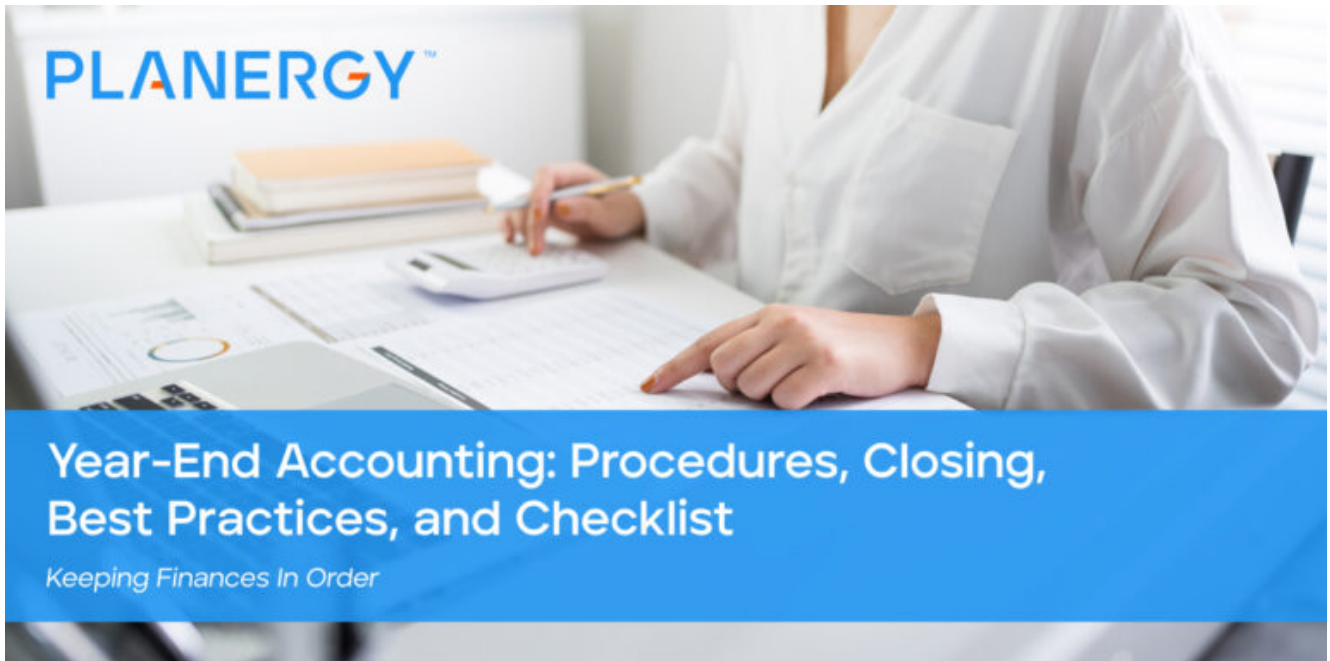


Year-End Accounting: Procedures, Closing, Best Practices, and Checklist



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Year-end closing is the process where business owners review and update their records to reflect current totals.

The end of the fiscal year can be a challenging time for accounting and bookkeeping professionals, particularly if company accounting is done manually.

But even with a manual system in place, with careful planning and a checklist to

refer to, your accounting department should be able to complete year-end closing accurately and on time.

What Does Year-End Mean in Accounting?

Whether you're using a calendar year or a fiscal year for your business, year-end is the conclusion of twelve months of doing business, which requires certain tasks to be completed as part of accrual accounting requirements.

Completing these tasks prepares business owners for the new fiscal year, by ensuring that all account balances are accurate and discrepancies are addressed appropriately.

A similar financial close process is followed at the end of each financial period throughout the year. Often, this will be at the end of a calendar month for the month-end closing process.

This is avoided if you are using a continuous accounting process and managing with a continuous close.

What Are the Procedures To Follow in Year-End Accounting?

Though year-end encompasses several different areas, it's mainly centered around two main tasks.

• Preparing Adjusting Entries

Preparing adjusting entries starts with running an income statement and balance sheet for the year-end.

For example, if you're billed quarterly for cleaning services, but you haven't received a bill for the last quarter, you will need to accrue the accounts payable expense for year-end, debiting operating expenses for the quarterly bill amount while crediting your accruals account.

Similarly, if you have received goods but are awaiting the invoice you

should accrue for these. Carrying out a goods received not invoiced reconciliation at year end is an important step.

Depending on your billing practices, you may also need to accrue income for services rendered but not yet invoiced.

Finally, you'll need to calculate depreciation for any fixed assets for the year and debit the depreciation expense account for the amount of depreciation while crediting accumulated depreciation.

Additionally, creating accurate accounting journal entries ensures that all temporary accounts are properly closed out and reflected in permanent accounts, providing a clear financial picture for the new fiscal year.

• **Create Closing Entries**

Next, you'll need to complete closing entries, which are used to move balances from temporary accounts which are used to temporarily record revenues and expenses, into a permanent account.

This works to zero out the balance of the temporary account, ensuring that these balances are not carried forward into a new accounting period.

Temporary accounts that will need to be adjusted include:

- **Revenue Account** - which is closed to the income summary account
- **Expense Account** - which is closed to the income summary account
- **Income Summary Account** - which is closed to the retained earnings account
- **Dividends Account** - which is closed to the retained earnings account

If you're using a manual accounting system, you'll need to create and post these year-end journal entries manually.

However, if you're using an automated accounting software application, most closing journal entries will be made for you automatically, except accrual entries for things such as expenses incurred that you have not yet

received an invoice for, or depreciation and amortization expenses.

■ The Two Main Tasks in Year-End Accounting



Preparing
Adjusting Entries



Create Closing
Entries

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What Are the Challenges With Year-End Accounting?

Some of the biggest challenges with year-end closing present themselves during the review stage of the closing process.

Depending on the preparations made ahead of time and the thoroughness of your accounting staff, the following issues may impact your year-end close.

• **Unexpected Delays and Surprises**

Surprises can be great, but not in business accounting. In most cases, these surprises will pop up during the initial review of your general ledger accounts and can be dealt with at that time.

However, there may be occasions when an unexpected balance or an out-of-place transaction needs to be researched, resulting in delays.

While careful planning and regular account monitoring helps reduce delays and eliminate surprises, both will likely continue to pop up occasionally.

• **Poor Communication**

A lack of communication can directly impact all departments, but nowhere is it felt more deeply than in accounting. Information not shared or

documents not provided to the accounting department can be a major issue throughout the year.

But may only become obvious during the year-end closing process. Improving communication throughout the course of the year can go a long way toward creating a much smoother year-end closing process.

Better collaboration with finance throughout the year can help reduce the strain at financial close. Alignment between procurement and finance is particularly helpful to identify what expenses need to be accrued.

▪ **Last Minute or Incorrect Information**

No matter how well deadlines are communicated, there's always someone that will send that invoice or payment request past the deadline.

Aside from notifying all the appropriate staff, vendors, and suppliers about closing deadlines, there's not a lot you can do to prepare for receiving last-minute data, other than expecting that it will happen.

▪ **Lack of Finance Automation**

Year-end procedures can pull staff away from their regular responsibilities. This is particularly true for businesses that have not moved towards automating the finance function.

With an automated accounting software all closing transactions will be completed manually.

Instead of struggling to stay current, consider implementing an automated accounting application that will keep staff up to date on their responsibilities while also handling year-end closing.

Challenges with Year-End Accounting



Unexpected Delays
and Surprises



Poor
Communication



Last Minute or
Incorrect Information



Lack of Finance
Automation

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What Are Best Practices for Year-End Accounting?

Ironically, best practices for year-end accounting should start at the beginning of the year, since many of the issues that present themselves at year-end are a result of issues incurred earlier in the year that only come to light during the year-end closing process.

These best practices should include the following:

• Eliminate Manual Processes

One of the best ways to streamline the year-end closing process is to eliminate manual processes and switch to an automated accounting application.

This one change can trim significant time off both month-end and year-end closing. An automated system can also increase accuracy, eliminate the need to manually match documents, and can significantly reduce stress for your accounting team.

• Implement a Better Month-End Closing Process

If your month-end closing process is sound, chances are that your year-

end closing will be relatively quick and painless.

When a solid month-end (or quarter-end closing for smaller businesses) is in place, any issues that arise can be promptly addressed, eliminating any surprises down the road.

Like year-end closing, a good month-end closing process should include a review of all account balances and making any necessary adjustments at the time the issue is identified so that they don't show up at the end of the year.

• **Create a Year-End Closing Checklist**

Having a checklist in place helps keep you on track and ensures that nothing of importance is overlooked. We'll have more on what a checklist is and what should be on the checklist shortly.

• **Complete Account Reconciliations**

Year-end is the best time to review your accounts payable and accounts receivable financial transactions for both accuracy and collectability.

For AR balances, this may include an assessment of prior collection attempts and whether the balance is worth leaving on the books or if it should be written off as bad debt.

Reviewing AP accounts is just as important, making sure that unpaid balances are accurate and that all invoices for outstanding balances have been received. This also allows you to follow up with vendors if an invoice is missing.

• **Closely Review Financial Statements**

Once all adjusting entries have been completed, the CFO or finance department manager will want to spend time reviewing current year-end totals against previous year totals for potential red flags.

Carrying out vertical analysis of the balance sheet and horizontal analysis

of the balance sheet can identify issues for further investigation.

For example, if your rent expense was \$12,000 for 2021 and \$45,000 for 2022, and you're in the same building, the account will need to be reviewed to determine why the two totals are so different.

• Examine Financial Results

Once adjustments have been made, it's a great time to analyze your financial results using accounting ratios. When calculated regularly, these ratios can help identify business trends and assist when making business decisions.

Best Practices for Year-End Accounting



Eliminate Manual Processes



Implement a Better Month-End Closing Process



Create a Year-End Closing Checklist



Complete Account Reconciliations



Closely Review Financial Statements



Examine Financial Results

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What Is a Year-End Accounting Checklist?

Before beginning the year-end closing process, it can be helpful to create a checklist of tasks that will need to be completed.

Checking off each item on the list can streamline the entire closing process, ensure that you don't skip an important task, and ultimately provide you with accurate year-end totals for your financial statements.

The most important thing you'll need to do is create a closing schedule that you and your staff can easily refer to throughout the entire process.

A sample schedule for 2023 year-end could look like this:

Year-End Accounting Schedule for 2023

November 2023

- Initiate a collection effort for all past-due accounts receivable balances as of November 1.
- Create and communicate deadline dates to vendors, suppliers, customers, and co-workers for submitting invoices and payment requests.
- Enter all approved invoices for payment in December.
- Assign closing tasks to various staff members with a specific due date included.

December 2023/January 2024

- Ensure that all customers have been invoiced for purchases made through December.
- Review the remaining accounts receivable balances for accuracy and collectability.
- Review accounts payable balances and follow up with vendors and suppliers regarding any outstanding invoices, duplicate payments, or credit memos.
- Review fixed assets for accuracy and make any updates using adjusting entries.
- Reconcile bank and credit card statements through December.
- Bill customers for goods and services.
- Post payments received from customers.
- Determine which remaining accounts receivable balances should be written off as bad debt.
- Write off bad debt.
- Review prepaid accounts for accuracy, posting any relevant expenses for the month, quarter, or year.
- Review depreciation and amortization schedules and update depreciation/amortization expense if it hasn't been completed monthly.
- Complete an inventory count and make any necessary adjustments if needed.
- Complete adjusting entries which should include expense accruals for payroll or other expenses that have been incurred but not yet paid, such as bank charges.

- Run an adjusted trial balance reflecting all adjusting entries.
- Complete closing entries, which are used to move account balances from temporary accounts to permanent accounts.
- Run a final set of financial statements for the year which should include a balance sheet, income statement, or cash flow statement.

Year-End Accounting Checklist

Second-to-last Month of the Financial Year

- Initiate a collection effort for all past-due accounts receivable balances as of the first day of the second-to-last month the year
- Create and communicate deadline dates to vendors, suppliers, customers, and co-workers for submitting invoices and payment requests
- Enter all approved invoices for payment in final month of the fiscal year
- Assign closing tasks to various staff members with a specific due date included

Last Month of the Financial Year

- Ensure that all customers have been invoiced for purchases made through final month of the fiscal year
- Review the remaining accounts receivable balances for accuracy and collectability
- Review accounts payable balances and follow up with vendors and suppliers regarding any outstanding invoices, duplicate payments, or credit memos
- Review fixed assets for accuracy and make any updates using adjusting entries
- Reconcile bank and credit card statements through final month of the fiscal year
- Bill customers for goods and services
- Post payments received from customers
- Determine which remaining accounts receivable balances should be written off as bad debt
- Write off bad debt
- Review prepaid accounts for accuracy, posting any relevant expenses for the month, quarter, or year
- Review depreciation and amortization schedules and update depreciation/amortization expense if it hasn't been completed monthly
- Complete an inventory count and make any necessary adjustments if needed
- Complete adjusting entries including expense accruals for payroll or other expenses that have been incurred but not yet paid, such as bank charges
- Run an adjusted trial balance reflecting all adjusting entries
- Complete closing entries, which are used to move account balances from temporary accounts to permanent accounts
- Run a final set of financial statements for the year including a balance sheet, income statement, or cash flow statement

What Are Year-End Journal Entries?

Year-end journal entries are adjustments made to various general ledger accounts to ensure that financial statements reflect accurate balances.

Most year-end journal entries result from reviewing various aspects of your business, such as loan or mortgage balances, fixed assets, bank charges not recorded, or prepaid expenses that haven't been properly accounted for.

When preparing adjusting journal entries, you'll want to look closely at these areas:

• **Business Expenses Not Yet Recorded**

Purchasing items and services at year-end often results in delayed billing. For example, Dave ordered \$10,000 worth of supplies on December 8 but hasn't received the invoice yet.

Before he can close the month and the year, he'll need to accrue that expense. The same goes for any payroll expenses for employees that will not be paid until January.

• **Depreciation and Amortization**

Some businesses may record depreciation and amortization monthly, while smaller businesses often wait until year-end to record these expenses.

Either way, they'll need to be recorded. Year-end is also a good time to make sure that any new fixed assets have a depreciation schedule set up.

• **Adjustments to Prepaid Expenses**

Again, if you make these entries monthly, you'll only have to be concerned with the December entry, but for those that manage prepaid expenses annually, you'll need to account for any prepaid expenses.

For instance, if you prepaid insurance for the year, you'll have to make

sure that it's been properly expensed throughout the year before you can close.

• Adjustments to Accounts Receivable

Your accounts receivable account should always be reviewed at year-end to make sure that any open balances are still collectible.

For those that are not, you can make a year-end adjustment for bad debt, leaving you with a more realistic AR balance going forward.

• Inventory Adjustments

If you regularly perform a year-end inventory, you may need to adjust your inventory totals up or down based on your findings.

Year-End Journal Entries



Business Expenses
Not Yet Recorded



Depreciation And
Amortization



Adjustments to
Prepaid Expenses



Adjustments to
Accounts Receivable



Inventory
Adjustments

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What Is an Example of an Accounting Year-End Process?

After making adjusting journal entries for payroll and depreciation, AAA Shipping runs an adjusted trial balance, which prepares the company to complete year-end closing by preparing closing entries.

For this example, let's say that AAA Shipping has revenue of \$570,000, with payroll expenses of \$155,000, Utility expenses of \$18,000, and Rent Expenses of

\$22,000. AAA Shipping also paid dividends to shareholders of \$35,000 for 2022.

Using these totals, your journal entries would be as follows:

Date	Account Name	Debit	Credit
12-31-2022	Revenue	\$570,000	
12-31-2022	Income Summary		\$570,000
Date	Account Name	Debit	Credit
12-31-2022	Income Summary	\$195,000	
12-31-2022	Payroll Expense		\$155,000
12-31-2022	Utility Expense		\$18,000
12-31-2022	Rent Expense		\$22,000

Since we have a credit of \$570,000 and a debit of \$195,000, the balance in the income summary account is now \$375,000. This amount will need to be transferred to your retained earnings account.

Date	Account Name	Debit	Credit
12-31-2022	Income Summary	\$375,000	
12-31-2022	Retained Earnings		\$375,000

This transaction zeroes out the temporary income summary account and updates your retained earnings account.

Because AAA Shipping also paid dividends to shareholders, you'll also have to close that account to retained earnings as well, which reduces the retained earnings balance for the year.

Date	Account Name	Debit	Credit
12-31-2022	Retained Earnings	\$35,000	
12-31-2022	Dividends		\$35,000

Why Is Year-End Accounting So Important

for Your Business?

Completing year-end closing is part of doing business and ensures that financial reports like your balance sheet, profit and loss statement or income statement, and cash flow statement are an accurate reflection of your business.

Even small businesses need accurate financial statements, but for publicly held companies, it's essential.

Year-end closing also prepares businesses for possible audits, while providing owners and managers the information they need to make informed decisions about their business.

For a more streamlined closing process, consider incorporating PLANERGY Spend Management software and AP Automation software with full tracking of committed spend and where goods or services have been received but the invoice has not arrived yet.

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