

TRIAL BALANCE, RECTIFICATION OF ERRORS AND ADJUSTING & CLOSING ENTERIES

TRIAL BALANCE

Multiple entries in various accounts will make a Ledger.

Taking all the ledger balances and presenting them in a single worksheet as on a particular date is Trial Balance.

- **Recording** of transaction is a Journal entry.
- **Summarizing** them and categorizing them are Ledgers.
- Creating a worksheet and classifying the ledgers is a Trial Balance.



A trial balance is a sheet recording all the ledger balances categorized into debit and credit. A typical trial balance will have name of ledger and the balances.

This is prepared as at a **particular date** 📅 which can be financial year end or calendar year.

Trial balance is a *statement* showing debit and credit balances taken from ledger including cash and bank balances as on a particular date.

Account	Debit	Credit
Purchases		
Sundry Debtors		
Stock (as on Apr, YYYY)		
Sales		
Cash at Bank		
Machinery		
Discount Received		
Bank Loan		
Bad Debts		
Sundry Creditors		
Carriage Outwards		
Capital		
Provision for Doubtful Debts		
Rent		
Discount Allowed		
TOTAL =		

TYPES OF TRIAL BALANCE AND PREPARATION OF TRIAL BALANCE

There are two types of trial balance:

1. **Gross** trial balance
2. **Net** trial balance

Gross Trial Balance

It is prepared in the following stages:

1. Take totals of debit and credit columns of each ledger account.



2. Take totals of receipts and payments of cashbook showing separately cash, bank and discount columns.
3. Write names of all accounts as per the ledger and cash, bank and discount accounts as per cash book onto a statement.
4. Enter the debit and credit totals against each item.
5. Finally take total of debit and credit columns.

All these steps should be taken as on a particular date.

Net Trial Balance

Under this trial balance, net balances of each account are drawn and shown in trial balance. If debit total of an account is more, it will show debit balance and if credit total of an account is more, it will show a credit balance.

DISAGREEMENT OF A TRIAL BALANCE

Trial balance is **prepared to verify arithmetical accuracy** of the transactions recorded in the books.

Under the double entry system of book-keeping, if all the transactions are correctly recorded through various books of prime entry, correctly posted there from to the ledger and if totaling is correct, then only the trial balance should tally.

But if there are a few mistakes committed by the persons entrusted with the work of Journalising and posting, **the trial balance will not tally.** ❌

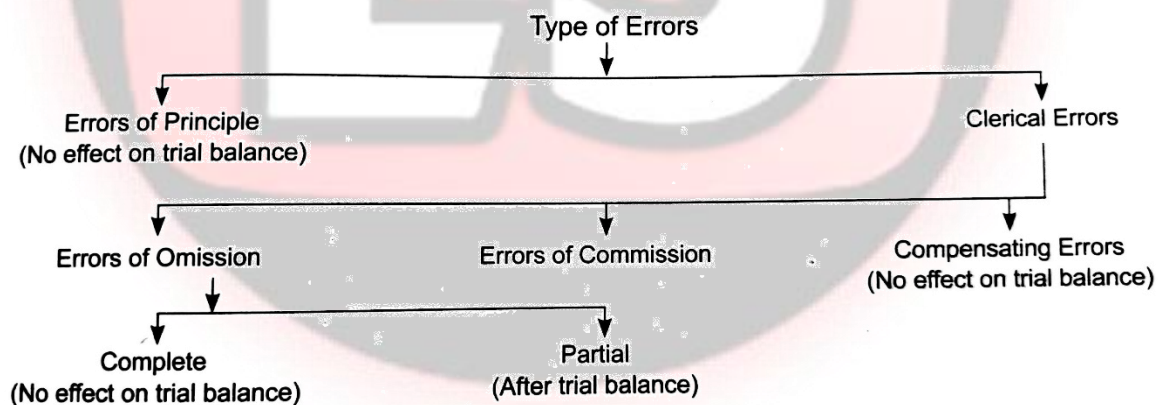
Also there are certain errors which are not disclosed even though the trial balance agrees.



CLASSIFICATION OF ERRORS

Errors can be broadly divided into two types:

1. Clerical errors
2. Principle errors



Clerical Errors

These errors can be divided into:

- (a) errors of **omission**
- (b) errors of **commission**



(c) **compensating** errors

ERRORS OF OMISSION

- When a transaction is completely or partially omitted to be recorded in books of account, it is called an "Error of omission".

☞ Goods are purchased on credit from Mr. A. This transaction is not recorded in the purchase journal. This is called error of "Complete omission".

- If the above entry is recorded in purchase journal but remains to be posted to the supplier, Mr. A's account, then it will be called 'Partial omission'.

The error of complete omission does not affect the trial balance but the partial omission will result in disagreement of trial balance.

ERRORS OF COMMISSION

When an error is committed in recording a transaction with wrong amount or posting to wrong side of the account, it is called an 'Error of Commission'.

1. Posting of correct amount but on the **wrong side**
2. Posting of a **wrong amount** but on the correct side



3. Posting of a **wrong amount on wrong side** of an account
4. **Totaling error in subsidiary book**, i.e., purchase journal, sales journal, returns journal or totaling error in any ledger account.
5. A **mistake committed in balancing** of ledger account.

☞ Goods Sold to Mr A for Rs 5,000 recorded on credit side.

- A credit sale of goods to Mr. A for Rs 3,000 recorded correctly in the sales journal but while posting to A's account, it is posted as Rs 300.
- An amount received from a customer Ramesh 2,000 recorded correctly in the cash book but posted to the debit side of Ramesh's account in the ledger.

These errors will result in disagreement of trial balance.

COMPENSATING ERRORS

When one mistake nullifies the wrong effect of another, it is called a compensating error. These are two or more in number and balance each other. These are generally arithmetical errors.

E.g.

- Salary Paid Rs 25000 recorded as Rs 52000
- Goods Purchased 30000 recorded as Rs 3000.



ERRORS OF PRINCIPLE

These are errors arising from not observing the accounting principles correctly.

- ☛ Wages paid for installation of machinery debited to wages account,
- ☛ purchase of fixed asset on credit recorded in purchase journal.

Types of Errors that do not affect the Trial Balance

1. Error of complete omission
2. Error of Commission
3. Error of Principle
4. Compensating Error

RECTIFICATION OF ERRORS

ONE-SIDED ERRORS

One-sided errors, when located before preparing a trial balance, can be rectified by simply correcting the posting.

Salary paid Rs. 8,000 posted as Rs. 80,000

TWO-SIDED ERRORS

Two or more accounts are affected and mostly affected with equal amount.

SUSPENSE ACCOUNT AND RECTIFICATION

- **After preparation of a trial balance, if there is a difference**, it may be temporarily transferred to a new account called "**Suspense**".
- **Suspense account is a temporary account.**
- During the course of checking or audit, some one-sided errors may be found out. Now to rectify these one-sided errors, second account can be suspense account, as the difference is transferred to suspense account.

RECTIFICATION OF ERRORS WHEN BOOKS ARE CLOSED

When difference in trial balance remains even after applying various checks, it is carried forward to the balance sheet on the appropriate side, as preparation of final accounts cannot be delayed indefinitely.

Personal accounts balances, i.e, those of customers and suppliers are carried forward to the next year.

But nominal accounts (expenses and incomes accounts) are always closed by transferring these to trading and profit and loss account.



Any difference located in nominal accounts, in the next year, cannot be adjusted to the nominal accounts, as this will affect current year's profit and loss.

Therefore, a new account '**Profit and Loss Adjustment account**' will be opened to rectify the errors in nominal account. The balance in this account is then directly transferred to capital account.

ADJUSTING AND CLOSING ENTRIES

Adjusting Entries

- At the end of the accounting year, all ledger accounts are balanced and then a trial balance is prepared.
- From the trial balance, final accounts, i.e. trading, profit and loss account and balance sheet are drawn.
- **While preparing trading and profit and loss account, all expenses and incomes for the full period are to be taken into consideration.**

ADJUSTING ENTRIES: If expenses have been incurred but not paid or income is due but not received, necessary entries are required to be passed to show the correct picture of the business.

- Like accrued Income, Income received in advance, prepaid expenses, outstanding expenses.

 **Closing Entries**

- At the end of each year, all accounts of expenses and incomes must be closed.
- The balances of these accounts are transferred to trading account and profit and loss account. The entries passed to transfer these balances are called Closing Entries'.

