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How to identify errors in trial balance

Steps to Locate Errors: Even if there is only a very small difference in the trial balance, the errors leading to it must be located and rectified. A small difference may be the result of a number of errors. The following steps will be useful in locating errors: Whenever there is a difference in the trial balance even by a small amount, the mistakes involved must be located. A small amount may be the net result of a number of mistakes and it is not safe to ignore a difference in trial balance however small it may be. The following steps are suggested to find out errors: Steps to Locate Errors The two columns of the trial balance should be totaled again. If in place of a number of accounts, only one amount has been written in the trial balance the list of such accounts should be checked and totaled again. List of Trade receivables is the example from which Trade receivable balance is derived. (i) Total the debit and credit columns of the trial balance again. If one amount has been shown for a group of accounts (for example, in place of all customers individually, only one amount against "Sundry Debtors" may be shown), recheck the total of the list of such accounts. (ii) See that the balances of all accounts including the cash, bank balances have been written in the trial balance. (iii) See that there is no mistake in the balancing of the various accounts. (iv) Find out the exact difference in the trial balance. Look for such accounts which show the same amount. It is possible that the balance of the particular account has been omitted from the trial balance. Accounts showing a balance equal to half the difference should also be checked; the amount may have been written on the wrong side of the trial balance (v) Recheck the totals of the subsidiary books. (vi) If the difference is a large one, compare the figures with the trial balance of the corresponding date of the previous year. Any account showing a rather large difference over the figures of the corresponding trial balance of the previous year should be rechecked. (vii) Posting of all the amounts corresponding to the difference or half the difference should be checked. (viii) If the difference is still not traced, posting of the accounts will have to be checked. For this, it is better, first of all, to check the posting of the totals of subsidiary books such as sales book, purchases book, returns books etc. The subsidiary books should then be gone through to see if any items have not been posted. It should also be checked whether the various accounts have been opened with correct balances. Nominal accounts should be checked first, then real accounts and then personal accounts should be taken up. If there is still a difference in the trial balance, a complete checking will be necessary. The posting of all the entries including the opening entry should be check. It may be better to begin with the nominal accounts. Rectification of Errors: Errors should never be corrected by overwriting. If immediately after making an entry it is clear that an error has been committed, it may be corrected by neatly crossing out the wrong entry and making the correct entry. If however the errors are located after some time, the correction should be made by making another suitable entry, called rectification entry. In fact the rectification of an error depends on at which stage it is detected. An error can be detected at any one of the following stages: a) Before preparation of Trial Balance(b) After Trial Balance but before the final account are drawn.c) After final accounts, i.e., in the next accounting period. Errors Disclosed by Trial Balance: The following errors are disclosed by Trial balance: a) Posting of transaction in wrong side of the account.b) Posting of transaction on correct side with wrong amount.c) Errors in totaling.d) Error is made in carrying forward.e) Wrong balancing in the ledger account.f) Posting of one aspect of journal entry in Ledger account.g) Recording of one aspect of entry twice. Recording in subsidiary book and not posted to the concerned amount. Recommended The objective of preparing trial balance is to a counter check process to test the accuracy of posting. If the trial balance agrees it proves that the books are arithmetically accurate, and the two aspects of the transactions (Debit and Credit) have been recorded in the books of original entry as well as in the ledger. In this article, we will discuss errors in the trial balance and steps to locate errors. We know when the sum total of two columns of Trial Balance tallies, then it means that the Trial Balance is in agreement with books of accounts. But it also means that the accounting entries have been arithmetically correct and has been correctly posted in the ledger. But if the Trial Balance does not tally, then there could be errors in transaction entry. Such errors are called 'Errors affecting trial balance'. These can be: Where only one effect of a transaction is posted to ledger e.g. for rent paid in cash, if entry is posted to cash but not to rent account, then obviously the Trial balance will not match Wrong posting of the amount in one of the ledger accounts e.g. rent of ` IDR 1,000 is paid in cash. The posting to Rent A/c is done for ` IDR 1,000, Cash A/c is recorded at ` IDR 10,000. Then too the Trial balance will not tally If one of the postings is entered twice, then too the Trial balance will not match If the balance in a ledger is not correctly taken to the trial balance. e.g. the Rent A/c has a balance of ` IDR 1,000, but while taking it to the Trial Balance, it is taken as ` IDR 100, then the Trial Balance will throw up differences Taking balance to the wrong side in the Trial Balance e.g. a debit balance of ` IDR 5,00,000 in Debtors A/c is taken as credit balance in the Trial Balance, then there will be a mismatch Wrong carry forwards also will result in the trial balance. mismatch There are certain types of errors that will not affect tallying of the Trial Balance. i.e. it will tally but still there will be errors. These are as follows: The error of omission: If any entry is totally missed, the Trial Balance will tally but will be incorrect and incomplete Compensating error: If there are two errors that are compensating each other, still, the Trial Balance will tally but not accurate Wrong Account head: If entry for insurance paid is wrongly debited to Commission A/c, tallying of Trial Balance will not be affected The error of duplication: If a transaction is recorded twice, again the Trial Balance will match. The error of principle: If interest received is wrongly entered as debit to interest and credit to cash, there won't be any mismatch in the Trial Balance For the type of errors mentioned above, the identification process is very time-consuming. Only strict vigil and ongoing audit of entries could minimize such errors. Of course, the computerized accounting packages such as Tally,ERP 9 systems do provide built mechanisms to avoid occurrence of these mistakes. After preparation of Trial Balance, if the difference not major, it is temporarily transferred to "Suspense A/c" until the errors are located and corrected. There are also errors which cannot be detected by a Trial Balance: They are as follows:- Error of Omission: When the transaction is not at all recorded in the books of accounts, i.e. neither in the debit side nor in the credit side of the account - trial balance will agree. Error of Commission: Where there is any variation in figure/amount, e.g. instead of ` IDR 800 either ` IDR 80 or ` IDR 8,000 is recorded, in both sides of ledger accounts - trial balance will agree. Error of Principal: When accounts are prepared not according to double-entry principle e.g. Purchase of a Plant wrongly debited to Purchase Account - Trial balance will agree. Error of Posting in Wrong Leger: When wrong posting is made to a wrong account instead of a correct one although the amount is correctly recorded, e.g., sold goods to B but wrongly debited to C's Account - trial balance will agree. Error of Compensation: When one error is compensated by another error e.g. Discount Allowed ` IDR 100 not debited to Discount Allowed Account, whereas interest received ` IDR 100, but not credit to Interest Account trial balance will agree. If the Trial Balance does not tally, the following procedure should carefully be followed: At first, check all ledger account balance one by one. Addition of both the columns (Debit and Credit) should be checked. If any difference, divide the same by 2 and see whether the said figure appears on the correct side or not. Additions of the subsidiary books, and ledger accounts to be checked up. Posting from subsidiary books to the ledger to be checked up. Read More on Trial Balance What is Trial Balance, How to Prepare Trial Balance, Methods to Prepare Trial Balance, Rules & Examples of Trial Balance Suspense accounts and error correction are popular topics for examiners because they test understanding of bookkeeping principles so well. A suspense account is a temporary resting place for an entry that will end up somewhere else once its final destination is determined. There are two reasons why a suspense account could be opened: A bookkeeper is unsure where to post an item and enters it to a suspense account pending instructions There is a difference in a trial balance and a suspense account is opened with the amount of the difference so that the trial balance agrees (pending the discovery and correction of the errors causing the difference). This is the only time an entry is made in the records without a corresponding entry elsewhere (apart from the correction of a trial balance error - see error type 8 in Table 1). Financial Accounting (previously F3) tested a candidate's working knowledge of these types of error. Financial Reporting (FR - previously F7) tests how these errors are corrected and the suspense account is eliminated before financial statements are prepared. Types of error Before we look at the operation of suspense accounts in error correction, we need to think about types of error because not all types of error affect the balancing of the accounting records and hence the suspense account. Refer to Table 1. Table 1: Types of error Error type Suspense account involved? 1 Omission - a transaction is not recorded at all No 2 Error of commission - an item is entered to the correct side of the wrong account (there is a debit and a credit here, so the records balance) No 3 Error of principle - an item is posted to the correct side of the wrong type of account. As when cash paid for plant repairs (expense) is debited to plant account (asset) (errors of principle are really a special case of errors of commission, and once again there is a debit and a credit) No 4 Error of original entry - an incorrect figure is entered in the records and then posted to the correct account Example: Cash \$1,000 for plant repairs is entered as \$100; plant repairs account is debited with \$100 No 5 Reversal of entries - the amount is correct, the accounts used are correct, but the account that should have been debited is credited and vice versa Example: Factory employees are used for plant maintenance. Correct entry: Debit: Plant maintenance Credit: Factory wages Easily done the wrong way round No 6 Addition errors - figures are incorrectly added in a ledger account Yes 7 Posting error a. an entry made in one record is not posted at all b. an entry in one record is incorrectly posted to another Examples: cash \$10,000 entered in the cash book for the purchase of a car is: a. not posted at all b. posted to Motor cars account as \$1,000 Yes 8 Trial balance errors - a balance is omitted, or incorrectly extracted, in preparing the trial balance Yes 9 Compensating errors - two equal and opposite errors leave the trial balance balancing (this type of error is rare, and can be because a deliberate second error has been made to force the balancing of the records or to conceal a fraud). Yes, to correct each of the errors as discovered Yes, to correct each of the errors as discovered Correcting errors Errors 1 to 5, when discovered, will be corrected by means of a journal entry between the ledger accounts affected. Errors 6 to 9 also require journal entries to correct them, but one side of the journal entry will be to the suspense account opened for the difference in the records. Type 8, trial balance errors, are different. As the suspense account records the difference, an entry to it is needed, because the error affects the difference. However, there is no ledger entry for the other side of the correction - the trial balance is simply amended. An illustrative question The bookkeeping system of Turner is not computerised, and at 30 September 20X8 the bookkeeper was unable to balance the trial balance. The trial balance totals were: Debit \$1,796,100 Credit \$1,852,817 Nevertheless, he proceeded to prepare draft financial statements, inserting the difference as a balancing figure in the statement of financial position. The draft statement of profit or loss showed a profit of \$141,280 for the year ended 30 September 20X8. He then opened a suspense account for the difference and began to check through the accounting records to find the difference. He found the following errors and omissions: \$8,980 - the total of the sales returns book for September 20X8, had been credited to the purchases returns account. \$9,600 paid for an item of plant purchased on 1 April 20X8 had been debited to plant repairs account. The company depreciates its plant at 20% per annum on a straight line basis, with proportional depreciation in the year of purchase. The cash discount totals for the month of September 20X8 had not been posted to the general ledger accounts. The figures were: Discount allowed \$836 Discount received \$919. For discounts allowed, it was not anticipated that these customers would take advantage of these cash discounts when the invoices were first issued. \$580 insurance prepaid at 30 September 20X7 had not been brought down as an opening balance. The balance of \$38,260 on the telephone expense account had been omitted from the trial balance. A car held as a non-current asset had been sold during the year for \$4,800. The proceeds of sale were entered in the cash book but had been credited to the sales account in the general ledger. The original cost of the car \$12,000, and the accumulated depreciation to date \$8,000, were included in the motor vehicles account and the accumulated depreciation account. The company depreciates motor vehicles at 25% per annum on a straight line basis with proportionate depreciation in the year of purchase but none in the year of sale. Required: (a) Open a suspense account for the difference between the trial balance totals. Prepare the journal entries necessary to correct the errors and eliminate the balance on the suspense account. Narratives are not required. (10 marks) (b) Draw up a statement showing the revised profit after correcting the above errors. (6 marks) Total (16 marks) Note: it is unlikely that this format of question will be used in either the FA or FR exam. Both of these exams can test any of the errors included in the above question but an FA or FR exam question is unlikely to test this learning outcome using such a high concentration of marks. Despite this, the above question is still considered useful for teaching purposes. The approach to the question should be: Read the requirement paragraph at the end of the question. Begin by opening the suspense account. Which side? More debit is needed to balance the trial balance, so debit the suspense account with \$56,717. Then deal with the errors in order: Sales returns should have been debited to the sales returns account and they have been credited to the purchases returns account. There are two errors here - the wrong account has been used and an entry which should have been a debit has been entered as a credit. The suspense account entry must therefore be for 2 x \$8,980 or \$17,960. An error of principle - no suspense account entry. Depreciation must be adjusted. Items have not been posted, therefore the suspense account is involved. Effectively a posting error - the suspense account is again involved. A trial balance error must affect the suspense account - but no ledger entry. This one needs thought. Take it one sentence at a time. Is the suspense account involved? No, because we have an error of commission followed by some unrecorded transactions. Attempt Part (a) of the question before studying the answer as detailed in Table 2. Let's now turn to Part (b). The most convenient format for the answer is two columns for - and +. Set them up and enter the adjustments appropriately. Which of the errors affect the profit? In fact they all do. Attempt Part (b) now before looking at the answer detailed in Table 3. Table 2: Answer - Part (a) Suspense Account \$ \$ Difference56,717 Sales returns8,980 Discount received919Purchases returns8,980 Revenue (customer cash discounts)836 ---Insurance 580 Telephone (trial balance)38,260 57,636 57,636 Journal Entries \$ \$ 1 Sales returns account 8,980 Suspense account 8,980 Purchases returns account 8,980 Suspense account 8,980 2 Plant account 9,600 Plant repairs account 9,600 Depreciation (statement of profit or loss) 960 Plant depreciation account 960 3 Revenue (customer cash discounts) 836 Suspense account 836 Suspense account 919 Discount received account 919 4 Insurance account 580 Suspense account 580 5 Trial balance (no ledger entry) 38,260 Suspense account 38,260 6 Sales account 4,800 Motor vehicles disposal account 4,800 Motor vehicles disposal account 12,000 Motor vehicles asset account 12,000 Motor vehicles depreciation account 8,000 Motor vehicles disposal account 8,000 Motor vehicles disposal account 800 Statement of profit or loss 800 Table 3: Answer - Part (b) Adjustment to profit+ \$ \$ Profit as in draft statement of profit or loss 141,280 1 Sales returns adjustment (2 x \$8,980)17,960 2 Plant: reduction in repairs 9,600 depreciation - 6/12 x 20% x \$9,600 960 3 Revenue (customer cash discounts)836 Discount received 919 4 Insurance - opening balance omitted580 5 Telephone expense omitted38,260 6 Profit on sale of car 900 Proceeds taken out of sales4,800--- 63,396152,599 (63,396) Revised net profit 89,203 Some hints on preparing suspense accounts Does a correction involve the suspense account? The type of error determines this. Practice, and study of Table 1 should ensure that you see immediately which errors affect the balancing of the records and hence the suspense account. Which side of the suspense account must an entry go? This is one of the most awkward problems in preparing suspense accounts. The best way of solving it is to ask yourself which side the entry needs to be on in the other account concerned. The suspense account entry is then obviously to the opposite side. Look out for errors with two aspects. In the illustrative question earlier, error 1 is a case in point. An entry has been asked for the wrong account, but also to the wrong side of the wrong account. Both errors must be corrected. It is very easy to fall into the trap of correcting only one of the errors, especially when working quickly under examination conditions.

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