

TRIAL BALANCE

After posting the journal entries into the ledger and balancing all accounts, we prepare a statement called Trial Balance. This statement shows the balances of all the accounts which appear in the ledger. The debit balances are shown in one column and the credit balances in the other. It is usually prepared just before preparing the final accounts. The purpose is to check the arithmetical accuracy of the books of account.

Under the Double Entry System for every debit there is an equal and corresponding credit. So, the total of debits given to different accounts must be equal to the total of credits given to different accounts. Similarly, the total of debit balances in different accounts must be equal to the total of credit balances in different accounts. Now if the Trial balance tallies i.e., the total of its debit balances column is equal to the total of its credit balances column, it would mean that both the aspects of each transaction have been correctly recorded in the ledger. If, however, the two totals do not tally it implies that some errors have been committed while posting the transactions into ledger.

There are two methods of preparing the Trial Balance: (i) Totals Method, and (ii) Balances Method. Under the first method we show the totals of each side of an account in the Trial Balance. The debit side total of an account is shown in the debit column of the Trial Balance and the credit side total of the account in the credit column. Under the second method we show only the balances of each account in the Trial Balance. The second method is more convenient and commonly used because it eliminates all those accounts which have nil balance.

Definition of Trial Balance

According to J.R. Batliboi, —Trial Balance is a statement prepared with the debit and credit balances of ledger accounts to verify the arithmetical accuracy of the books. ||

PERFORMA OF TRIAL BALANCE

Name of the Firm.....

Trial Balance as on.....

S.No.	Name of the Ledger account	L.F.	Dr.	Cr.

Steps in Making of Trial Balance

In order to prepare a trial balance following steps are taken:

- Ascertain the balances of each account in the ledger.
- List each account and place its balance in the debit or credit column, as the case may be. (If an account has a zero balance, it may be included in the trial balance with zero in the column for its normal balance).
- Compute the total of debit balances column.
- Compute the total of the credit balances column.
- Verify that the sum of the debit balances equal the sum of credit balances.

If they do not tally, it indicate that there are some errors. So one must check the correctness of the balances of all accounts. It may be noted that all assets expenses and receivables account shall have debit balances whereas all liabilities, revenues and payables accounts shall have credit balances.

Objectives of Preparing the Trial Balance

The trial balance is prepared to fulfill the following objectives:

1. To ascertain the arithmetical accuracy of the ledger accounts.
2. To help in locating errors.
3. To help in the preparation of the financial statements. (Profit & Loss account and Balance Sheet).

To Ascertain the Arithmetical Accuracy of Ledger Accounts : As stated earlier, the purpose of preparing a trial balance is to ascertain whether all debits and credit are properly recorded in the ledger or not and that all accounts have been correctly balanced. As a summary of the ledger, it is a list of the accounts and their balances. When the totals of all the debit balances and credit balances in the trial balance are equal, it is assumed that the posting and balancing of accounts is arithmetically correct. However, the tallying of the trial balance is not a conclusive proof of the accuracy of the accounts. It only ensures that all debits and the corresponding credits have been properly recorded in the ledger.

To Help in Locating Errors : When a trial balance does not tally (that is, the totals of debit and credit columns are not equal), we know that at least one error has occurred. The error (or errors) may have occurred at one of those stages in the accounting process: (

totalling of subsidiary books,

- posting of journal entries in the ledger,
calculating account balances,
- carrying account balances to the trial balance, and
- totalling the trial balance columns.

It may be noted that the accounting accuracy is not ensured even if the totals of debit and credit balances are equal because some errors do not affect equality of debits and credits. For example, the book-keeper may debit a correct amount in the wrong account while making the journal entry or in posting a journal entry to the ledger. This error would cause two accounts to have incorrect balances but the trial balance would tally. Another error is to record an equal debit and credit of an incorrect amount. This error would give the two accounts incorrect balances but would not create unequal debits and credits. As a result, the fact that the trial balance has tallied does not imply that all entries in the books of original record (journal, cash book, etc.) have been recorded and posted correctly. However, equal totals do suggest that several types of errors probably have not occurred.

To Help in the Preparation of the Financial Statements : Trial balance is considered as the connecting link between accounting records and the preparation of financial statements. For preparing a financial statement, one need not refer to the ledger. In fact, the availability of a tallied trial balance is the first step in the preparation of financial statements. All revenue and expense accounts appearing in the trial balance are transferred to the trading and profit and loss account and all liabilities, capital and assets accounts are transferred to the balance sheet.

Advantages (Objectives of Trial Balance)

1. It ensures that the transactions recorded in the books of accounts have identical debit and credit amount.
2. Balance of each ledger account has been computed correctly.
3. Balance of each and every ledger account has been transferred accurately and on the correct side of the sheet on which trial balance has been prepared.
4. The debit and the credit columns of trial balance have been added up correctly.
5. Preparation of final accounts is not possible without preparing trial balance first.
6. Agreed trial balance is a prima facie evidence of the arithmetical accuracy of the accounting books maintained.
7. Errors which are revealed by preparing trial balance (listed below) are rectified even before the preparation of final accounts.

Trial Balance Limitations - Shortcomings of trial balance

An agreed trial balance does not prove by itself that :

1. All transactions have been correctly analyzed and recorded in proper accounts. For example wages paid for installation of fixed asset might have wrongly been debited to wages account.
2. All the transactions have been recorded and nothing has been omitted.
3. Certain types of errors remain undetected even after the preparation - of trial balance.

Thus it is quite well known and said that "agreement of trial balance is not the conclusive proof of the accuracy of the books maintained."

Errors revealed by (the preparation of) trial balance

If trial balance does not agree, the disagreement may be due to :

(1) **Omission to post an amount into ledger:** If an item is not posted from journal or subsidiary book to ledger, two sides of trial balance shall not agree, e.g., if goods sold on credit to A are recorded properly in sales book but not debited to A's account' in ledger, the debit side of trial balance shall fall short.

(2) **Omission to post an amount in trial balance:** It is natural if balance 'of an account is not recorded in trial balance the two sides of trial balance shall not agree which is an indication of error in accounts.

(3) **Wrong totaling or balancing of ledger account:** If any account in the ledger is wrongly totaled or balanced, then also the trial balance shall not agree.

(4) **Wrong totaling of subsidiary books:** If the total of any subsidiary book is wrongly cast, it would cause a disagreement in the trial balance, e.g., if purchase book totaled Rs. 2,500 instead of 2,050, the debit side of the trial balance shall exceed the credit side by Rs. 450.

(5) **Posting on the wrong side:** When an item is by mistake posted on the wrong side of the ledger account it would cause disagreement in the trial balance, e.g., if Rs. 200 have been allowed as discount and while posting into discount account the amount has been credited to discount account. It will result in a difference of Rs. 400 in two sides of trial balance.

(6) **Posting of wrong amount:** If wrong amount is posted in one of the two accounts while posting, it would immediately cause disagreement of trial balance e.g. goods worth Rs. 690 have been sold to 'X' but 'X's account has been debited with Rs. 960. It will increase the debit side of trial balance by Rs. 270.

Errors not revealed by (the preparation of) trial balance

Normally four types of errors are not revealed by mal balance. So two sides of trial balance will although agree, even then our accounts may not be free from errors. Such errors are :

(1) Errors of omission

If a transaction is not recorded in books of original entry then both debit and credit effects of the transaction will be omitted and trial balance shall not be effected, e.g. goods sold to John worth Rs. 1,000. The entry is not recorded in the books at all, it means neither John's account is debited nor sales account has been credited. As both sides have been effected by equal amount so the mal balance shall agree.

(2) Errors of commission

These errors are the result of carelessness of accounting staff and in some of the cases such errors do not effect the totals of mal balance, e.g. wrong recording in the books of original entry or posting to wrong account with correct amount and correct side e.g. goods sold for cash worth Rs. 1,000 but Cash Nc debited with Rs. 100 and sales credited with identical amount.

(3) Compensating errors

Such errors neutralize the effect of the errors committed earlier. When one error is committed which affects the total of mal balance but in the mean time another error of opposite effect is committed which neutralizes the effect of earlier error, e.g. forgetting to post Rs. 500 on the debit side of a certain account may be compensated by under posting of Rs. 500 on the credit side of some other account or by over posting of Rs. 500 in debit side of some other account.

(4) Errors of Principle

Whenever any income or expenditure is not properly allocated between capital and revenue, the mistake so made is called a mistake of principle, e.g. if furniture purchased is debited to purchases account, building sold is credited to sales account, wages paid for installation of machinery debited to wages account, then the error of principle is committed; the trial balance shall remain unaffected by such errors

How to Prepare a Trial Balance - An Example:

The trial balance is usually prepared on a loose sheet of paper. The ruling of trial balance is similar to

that of a journal. We may prepare a trial balance in one of the following forms:

- (i) Totals Method
- (ii) Balances Method
- (iii) Totals-cum-balances Method

1. Total Method:

According to total trial balance method two sides of each ledger account i.e., debit and credit side are added up and debit and credit totals so obtained are placed in the debit and credit columns of the trial balance respectively. Thus we may draw the following trial balance by taking out the debit side total and credit side total of each account in the ledger.

Trial Balance

Ledger Account	J.F	Total Debits	Total Credits
		Rs.	Rs.
Cash Account		12,453	8,436
Sundry Debtors Account		43,675	34,453
Sundry Creditors Account		23,654	31,298
Discount Account		430	550
Purchases Account		26,670	--
Sales Account		--	32,145
Machinery Account		10,000	--
Building Account		20,000	--
Capital Account		--	35,000
Rent Account		3,400	--
Wages Account		600	--
Salaries Account		1,000	--
		1,141,882	1,141,882

One clear defect of this method is that mistakes may be committed more often while preparing the trial balance, because large number of figures would be required to be enlisted. Thus, the process becomes unwieldy and cumbersome.

2. Balance Method:

The task of preparing a trial balance under balance - trial balance method is much simplified. There is well known axiom that if equals are subtracted from equals the remainders are equal. On this assumption, in place of writing against each account the debit as well as the credit total the balance alone is written. The difference between the two sides of an account is called the balance. If the debit side of an account is greater than the credit side, the balance falls on the debit side and is known as "debit balance." If the credit side of an account is greater than the debit, the the balance is on the credit side and is called "credit balance."

Rules of Balancing Accounts: Rules of balancing each account is as follows:

1. Add up both sides of the account
2. Find out the difference in a separate slip.
3. Put the difference on the lighter side.
4. Add up both sides again.
5. Rule off.

Trial Balance

Ledger Account	J.F	Dr. Balance	Cr. balance
		Rs.	Rs.
Cash Account		4,017	--
Sundry Debtors Account		9,222	--
Sundry Creditors Account		--	7,644
Discount Account		--	120
Purchases Account		26,670	--
Sales Account		--	32,145
Machinery Account		10,000	--
Building Account		20,000	--
Capital Account		--	35,000
Rent Account		3,400	--
Wages Account		600	--
Salaries Account		1,000	--
		74,909	74,909

Totals-cum-balances Method : This method is a combination of totals method and balances method. Under this method four columns for amount are prepared. Two columns for writing the debit and credit totals of various accounts and two columns for writing the debit and credit balances of these accounts. However, this method is also not used in practice because it is time consuming and hardly serves any additional or special purpose.

Types of errors

- 1. Errors of Principle:** When a transaction is recorded against the fundamental principles of accounting, it is an error of principle.

For eg; a revenue expenditure is treated as capital expenditure

- 2. Clerical errors:** these errors can be subdivided as follows:

- a) **Errors of Omission:** when a transaction is partially or wholly not recorded in the books, it is an error of omission.
- b) **Errors of Commission:** when an entry is incorrectly recorded either wholly or partially incorrect posting, calculation, casting or balancing. Some of the errors of commission effect the trial balance whereas others not.
- c) **Compensating errors:** Sometimes an error is counter balanced by another error in such a way that it is not disclosed by the trial balance. Such errors are called compensating errors.

RECTIFICATION OF ERRORS

Rectification of Errors

From the point of view of rectification, the errors may be classified into the following two categories :

- (a) errors which do not affect the trial balance.
- (b) errors which affect the trial balance.

This distinction is relevant because the errors which do not affect the trial balance usually take place in two accounts in such a manner that it can be easily rectified through a journal entry whereas the errors which affect the trial balance usually affect one account and a journal entry is not possible for rectification unless a suspense account has been opened. Such errors are rectified by passing a nullifying entry in the respective account as explained before under

Rectification of Errors which do not affect the Trial Balance

These errors are committed in two or more accounts. Such errors are also known as two sided errors. They can be rectified by recording a journal entry giving the correct debit and credit to the concerned accounts.

Examples of such errors are – complete omission to record an entry in the books of original entry; wrong recording of transactions in the book of accounts; complete omission of posting to the wrong account on the correct side, and errors of principle.

The rectification process essentially involves:

- Cancelling the effect of wrong debit or credit by reversing it; and
- Restoring the effect of correct debit or credit.

For this purpose, we need to analyse the error in terms of its effect on the accounts involved which may be:

- (i) Short debit or credit in an account ; and/or
- (ii) Excess debit or credit in an account.

Therefore, rectification entry can be done by:

- (i) debiting the account with short debit or with excess credit,
- (ii) crediting the account with excess debit or with short credit.

Rectification of Errors Affecting Trial Balance

The errors which affect only one account can be rectified by giving an explanatory note in the account affected or by recording a journal entry with the help of the Suspense Account. Suspense Account is explained later in this chapter. Examples of such errors are error of casting; error of carrying forward; error of balancing; error of posting to correct account but with wrong amount; error of posting to the correct account but on the wrong side; posting to the wrong side with the wrong amount; omitting to show an account in the trial balance.

An error in the books of original entry, if discovered before it is posted to the ledger, may be corrected by crossing out the wrong amount by a single line and writing the correct amount above the crossed amount and initialing it. An error in an amount posted to the correct ledger account may also be corrected in a similar way, or by making an additional posting for the difference in amount and giving an explanatory note in the particulars column. But errors should never be corrected by erasing or overwriting reduces the authenticity of accounting records and give an impression that something is being concealed. A better way therefore is by noting the correction on the appropriate side for neutralizing the effect of the error.

Every businessman is interested in finding the true profit and the financial position at the close of the trading year. But inspite of the best efforts of the accountant certain errors are committed in the recording of the transactions which affect the final accounts of the concern. It, therefore becomes utmost important for the accountant to locate such errors and rectify them so that the correct profit and the financial position may be ascertained.

The objectives of rectification of the errors are as follows:

- a) Preparing correct accounting records.
- b) Ascertaining correct profit or loss for the accounting period.
- c) Exhibiting the true financial position of the concern.

Rectification

All types of errors in accounts can be rectified at two stages:

- a. Before the preparation of the final accounts
- b. . After the preparation of final accounts

The following methods may be used for the rectification of the errors:

1. **By striking off wrong figure and replacing it by a correct one.** For example, the cashier pays Rs. 1,015 for the purchase of goods but by mistake he writes Rs.1,510 in the cash book.
2. **By passing a journal entry.** This method of rectification of errors is followed in case of those errors which take place in two accounts.

EFFECT OF ERRORS ON FINAL ACCOUNTS

1. Errors effecting Profit and loss account

If the errors lie in the nominal accounts then only the net profit will be effected. Errors in these accounts will either increase or decrease the net profit.

How the errors or their rectification effect the profit – following rules are helpful in understanding it:

- a) If because of an error a nominal account has been given some debit the profit will decrease or losses will increase, and when it is rectified the profits will increase and the losses will decrease.
- b) If because of an error the amount is omitted from recording on the debit side of a nominal account- it results in increase of profits or decrease in losses. The rectification of this error shall have reverse effect, which means the profit will be reduced and losses will be increased.
- c) Profit will increase or losses will decrease if a nominal account is wrongly credited. With the rectification of this error, the profits will decrease and losses will increase.
- d) Profits will decrease or losses will increase if an account is omitted from posting in the credit side of a nominal or goods account. When the same will be rectified it will increase the profit or reduce the losses.

2. Errors effecting balance sheet only

If an error is committed in a real or personal account, it will effect assets, liabilities, debtors or creditors of the firm and as a result it will have its impact on balance sheet alone, because these items are shown in balance sheet only and balance sheet is prepared after the profit and loss account has been prepared. So if there is any error in cash account, bank account, asset or liability account it will effect only balance sheet.

Illustration 7

Trial balance of Kailash did not agree. He put the difference to suspense account. The following errors were discovered :

- (i) Goods withdrawn by Kailash for personal use Rs. 500 were not recorded in the books.
- (ii) Discount allowed to Ramesh Rs. 60 on receiving Rs. 2,040 from him was not recorded in the books.
- (iii) Discount received from Rohan Rs. 50 on paying Rs. 3,250 to him was not posted at all.
- (iv) Rs. 700 received from Khalil, a debtor, whose account had earlier been written-off as bad, were credited to his personal account.
- (v) Cash received from Govil, a debtor, Rs. 5,000 was posted to his account as Rs. 500.
- (vi) Goods returned to Mahesh Rs. 700 were posted to his account as Rs. 70.
- (vii) Bill receivable from Narayan Rs. 1,000 was dishonoured and wrongly debited to allowances account as Rs. 10,000.

Give journal entries to rectify the above errors and prepare suspense account to ascertain the amount of difference in trial balance.

Solution.

(i)

Drawings A/c	Dr.	500	
	To Purchases A/c		500
(Goods withdrawn by proprietor for personal use not recorded, now rectified).			

(ii)

Discount allowed A/c	Dr.	60	
	To Ramesh's A/c		60
(Discount allowed to Ramesh not recorded, now rectified)			

(iii)

Rohan's A/c	Dr.	50	
	To Discount received A/c		50
(Discount received from Rohan not posted , now corrected)			

(iv)

Khalil's A/c	Dr.	700	
	To Bad debts recovered A/c		700
(Bad debts recovered wrongly credited to debtor's personal account, now corrected)			

(v)

Suspense A/c	Dr.	4,500	
To Govil's A/c			4,500

(Cash received from Govil Rs. 5,000 wrongly posted to his account as Rs. 500)

(vi)

Mahesh's A/c	Dr.	630	
To Suspense A/c			630

(Goods returned to Mahesh Rs. 700 wrongly posted to his account as Rs. 70, now corrected)

(vii)

Narayan's A/c	Dr.	1,000	
Suspense A/c	Dr.	9,000	
To Allowances A/c			10,000

(Bill receivables from Narayan Rs. 1,000 wrongly debited to allowances account as Rs. 10,000).

Suspense Account

Dr.

Cr.

Date	Particulars	J.F.	Amount Rs.	Date	Particulars	J.F.	Amount Rs.
	Govil		4,500		Mahesh		630
	Allowances		9,000		Difference as per trial balance		12,870
			<u>13,500</u>				<u>13,500</u>