

1. Details of Module and its structure

Module Detail	
Subject Name	Accountancy
Course Name	Accountancy 01 (Class XI, Semester - 1)
Module Name/Title	Trial Balance and Rectification of Errors – Part 1
Module Id	keac_10401
Pre-requisites	Basic knowledge of Accounting process, Journalizing Posting and Balancing
Objectives	After going through this lesson, the learners will be able to understand the <ul style="list-style-type: none">• Concept of Summarizing• Preparation of Trial Balance• Process of identifying errors and their type
Key words	Trial Balance, Errors

2. Development Team

Role	Name	Affiliation
National MOOC Coordinator (NMC)	Prof. Amarendra P. Behera	CIET, NCERT, New Delhi
Program Coordinator	Dr. Mohd. Mamur Ali	CIET, NCERT, New Delhi
Course Coordinator (CC) / PI	Prof. Shipra Vaidya	DESS, NCERT, New Delhi
Subject Matter Expert (SME)	Shri T.S. Bedi	New Era Public School Mayapuri Delhi -110064
Review Team	Prof. Surinder Kumar	PGDAV College, University of Delhi

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1. Introduction

In the earlier modules, you have learnt about the basic principles of accounting that for every debit there will be an equal credit. It implies that if the sum of all debits equals the sum of all credits, it is presumed that the posting to the ledger in terms of debit and credit amounts is accurate. The trial balance is a tool for verifying the correctness of debit and credit amounts. It is an arithmetical check under the double entry system which verifies that both aspects of every transaction have been recorded accurately. This module explains the process of preparing trial balance and the types of errors which may occur during the process of posting.

2. Trial Balance

A trial balance is a statement showing the balances, or total of debits and credits, of all the accounts in the ledger with a view to verify the arithmetical accuracy of posting into the ledger accounts. Trial balance is an important statement in the accounting process as it shows the final position of all accounts and helps in preparing the final statements. The task of preparing the statements is simplified because the accountant can take the balances of all accounts from the trial balance instead of going through the whole ledger. It may be noted that the trial balance is usually prepared with the balances of ledgers accounts. If the total of debit side is equal to the credit side then one can assume that the ledgers are accurate.

It is normally prepared at the end of an accounting year. However, an organisation may prepare a trial balance at the end of any chosen period, which may be monthly, quarterly, half yearly or annually depending upon its requirements.

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.
- If the debit side balance is more than the credit side balance, then that account has debit balance.
- If the credit side balance is more than debit side balance, then that account has credit balance.

For example, all the expenses accounts will have debit balance and all the revenue accounts will have credit balance.

Verify that the sum of the debit balances equal to the sum of the credit balances. If they do not tally, it indicates that there is some error. 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.

<i>Account Title</i>	<i>L.F.</i>	<i>Debit Balance</i>	<i>Credit Balance</i>
		(₹)	(₹)
• Capital			
• Land and Buildings			
• Plant and Machinery			
• Equipment			
• Furniture and Fixtures			
• Cash in Hand			
• Cash at Bank			
• Debtors			
• Bills Receivable			
• Stock of Raw Materials			
• Stock of Finished Goods			
• Purchases			
• Carriage Inwards			
• Carriage Outwards			
• Sales			
• Sales Return			
• Purchases Return			
• Interest Paid			
• Commission/Discount Received			
• Salaries			
• Long Term Loan			
• Bills Payable			
• Creditors			
• Advances from Customers			
• Drawings			
Total		xxx	xxx

Objectives of trial balances

1. To Ascertain the Arithmetical Accuracy of Ledger Accounts

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(debit or credit). 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.

2. 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: (1) totaling of subsidiary books, (2) posting of journal entries in the ledger, (3) calculating account balances, (4) carrying account balances to the trial balance, and (5) totaling 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.

3. 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.

3. Methods of Preparing Trial Balance

Theoretically spreading, a trial balance can be prepared in the following three ways :

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

1. Totals method

Under this method, total of each side in the ledger (debit and credit) is ascertained separately and shown in the trial balance in the respective columns. The total of debit column of trial balance should agree with the total of credit column in the trial balance because the accounts are based on double entry system. However, this method is not widely used in practice, as it does not help in assuming accuracy of balances of various accounts and preparation of the financial statements.

2. Balances Method

This is the most widely used method in practice. Under this method trial balance is prepared by showing the balances of all ledger accounts and then totaling up the debit and credit columns of the trial balance to assure their correctness. The account balances are used because the balance summarizes the net effect of all transactions relating to an account and helps in preparing the financial statements. It may be noted that in trial balance, normally in place of balances in individual accounts of the debtors, a figure of sundry debtors is shown, and in place of individual accounts of creditors, a figure of sundry creditors is shown.

i. Trial Balance as at March 31, 2017 (Using Balances Method)

Account Title	L.F.	Debit Balance (₹)	Credit Balance (₹)
Rohit's Capital			60,000
Sohan's Capital			20,000
Machinery		17,000	
Rahul		20,000	
Sales			70,000
Cash		43,000	
Wages		5,000	
Depreciation		3,000	
Purchases		62,000	
Total		1,50,000	1,50,000

3. 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.

(i) Trial Balance as at March 31, 2017
(Using Totals-cum-Balances Method)

Account Title	L.F.	Debit	Credit	Debit	Credit
		Balance	Balance	Balance	Balance
		(₹)	(₹)	(₹)	(₹)
Rawat's Capital			60,000		60,000
Rohan		40,000	60,000		20,000
Machinery		20,000	3,000	17,000	
Rahul		75,000	55,000	20,000	
Sales			70,000		70,000
Cash		1,00,000	57,000	43,000	
Wages		5,000		5,000	
Depreciation		3,000		3,000	
Purchases		62,000		62,000	
Total		3,05,000	3,05,000	1,50,000	1,50,000

Illustration 1: From the following Ledger account balance extracted from the books of M/s Bhasin Ltd. Prepare a Trial Balance as on March 31, ,2017.

Particulars	Amount	Particulars	Amount
	(₹)		(₹)
Capital	33,000	Cash in Hand	500
Sales	20,000	Cash at Bank	5,000
Purchases	9,000	Interest paid	350
Investments	5,000	Return Inward	300
Discount allowed	1,500	Advertisement Expenses	550
Carriage Inward	300	Opening Stock	1,500
Salaries	4,500	Creditors	3,500
Land & Building	15,000	Debtors	6,500
Discount Received	500	Bank Overdraft	2,500
Machinery	8,000	Drawings	1,500

Solution: Trial Balance as on March 31, ,2017.

Perticulars	L.F	Dr. Balance	Cr. Balance
		(₹)	(₹)
Capital			33,000

Sales		20,000
Purchases	9,000	
Investments	5,000	
Discount allowed	1,500	
Carriage Inward	300	
Salaries	4,500	
Land & Building	15,000	
Discount Received		500
Machinery	8,000	
Cash in Hand	500	
Cash at Bank	5,000	
Interest paid	350	
Return Inward	300	
Advertisement	550	
Expenses	1,500	
Opening Stock		3,500
Creditors	6,500	
Debtors		2,500
Bank Overdraft	1,500	
Drawings		
Total	59,500	59,500

4. Agreement of Trial Balance

It is important for an accountant that the trial balance should tally. Normally a tallied trial balance means that both the debit and the credit entries have been made correctly for each transaction. However, as stated earlier, the agreement of trial balance is not an absolute proof of accuracy of accounting records. A tallied trial balance only proves, to a certain extent, that the posting to the ledger is arithmetically correct. But it does not guarantee that the entry itself is correct. There can be errors, which affect the equality of debits and credits, and there can be errors, which do not affect the equality of debits and credits. Some common errors include the following:

- Error in totaling of the debit and credit balances in the trial balance.
- Error in totaling of subsidiary books.
- Error in posting of the total of subsidiary books.
- Error in showing account balances in wrong column of the trial balance, or in the wrong amount.

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- Omission in showing an account balance in the trial balance.
 - Error in the calculation of a ledger account balance.
 - Error while posting a journal entry: a journal entry may not have been posted properly to the ledger, i.e., posting made either with wrong amount or on the wrong side of the account or in the wrong account.
 - Error in recording a transaction in the journal: making a reverse entry, i.e., account to be debited is credited and amount to be credited is debited, or an entry with wrong amount.
 - Error in recording a transaction in subsidiary book with wrong name or wrong amount.

4.1 Classification of Errors

Keeping in view the nature of errors, all the errors can be classified into the following four categories:

- Errors of Commission
- Errors of Omission
- Errors of Principle
- Compensating Errors

4.2 Errors of Commission

- These are the errors which are committed due to wrong posting of transactions, wrong totaling or wrong balancing of the accounts, wrong casting of the subsidiary books, or wrong recording of amount in the books of original entry, etc. For example: Raj Hans Traders paid Rs. 25,000 to Preetpal's Traders (a supplier of goods). This transaction was correctly recorded in the cashbook.
- But while posting to the ledger, Preetpal's account was debited with Rs. 2,500 only. This constitutes an error of commission. Such an error by definition is of clerical nature and most of the errors of commission affect in the trial balance.

4.3 Errors of Omission

The errors of omission may be committed at the time of recording the transaction in the books of original entry or while posting to the ledger. These can be of two types:

- (i) error of complete omission
- (ii) error of partial omission

When a transaction is completely omitted from recording in the books of original record, it is an error of complete omission. For example, credit sales to Mohan Rs. 10,000, not entered in the sales book. When the recording of transaction is partly omitted from the books, it is an

error of partial omission. If in the above example, credit sales had been duly recorded in the sales book but the posting from sales book to Mohan's account has not been made, it would be an error of partial omission.

4.4 Errors of Principle

Accounting entries are recorded as per the generally accepted accounting principles. If any of these principles are violated or ignored, errors resulting from such violation are known as errors of principle. An error of principle may occur due to incorrect classification of expenditure or receipt between capital and revenue. This is very important because it will have an impact on financial statements. It may lead to under/over stating of income or assets or liabilities, etc. For example, amount spent on additions to the buildings should be treated as capital expenditure and must be debited to the asset account. Instead, if this amount is debited to maintenance and repairs account, it has been treated as a revenue expense. This is an error of principle. Similarly, if a credit purchase of machinery is recorded in purchases book instead of journal proper or rent paid to the landlord is recorded in the cash book as payment to landlord, these errors of principle. These errors do not affect the trial balance.

Example of Error of Principle: Purchase of Machinery recorded as purchase of goods. In such a case, Purchase A/c is debited instead of Machinery A/c. To rectify the error, Dr. Machinery A/c and Cr. Purchase A/c. Sale of Furniture recorded as sale of goods. In such a case, Sales A/c is credited instead of Furniture A/c. To rectify the error, Dr. Sales A/c and Cr. Furniture A/c.

4.5 Compensating Errors

When two or more errors are committed in such a way that the net effect of these errors on the debits and credits of accounts is nil, such errors are called compensating errors. Such errors do not affect the tallying of the trial balance. For example, if purchases book has been overcast by Rs. 10,000 resulting in excess debit of Rs. 10,000 in purchases account and sales returns book is under cast by Rs. 10,000 resulting in short debit to sales returns account is a case of two errors compensating each other's effect. One plus is set off by the other minus, the net effect of these two errors is nil and so they do not affect the agreement of trial balance.

4.6 Identification of Errors

If the trial balance does not tally, it is a clear indication that at least one error has occurred. The error (or errors) needs to be located and corrected before preparing the financial statements.

If the trial balance does not tally, the accountant should take the following steps to detect and locate the errors :

- Recast the totals of debit and credit columns of the trial balance.
- Compare the account head/title and amount appearing in the trial balance, with that of the ledger to detect any difference in amount or omission of an account.
- Compare the trial balance of current year with that of the previous year to check additions and deletions of any accounts and also verify whether there is a large difference in amount, which is neither expected nor explained.
- Re-do and check the correctness of balances of individual accounts in the ledger.
- Re-check the correctness of the posting in accounts from the books of original entry.
- If the difference between the debit and credit columns is divisible by 2, there is a possibility that an amount equal to one-half of the difference may have been posted to the wrong side of another ledger account. For example, if the total of the debit column of the trial balance exceeds by Rs. 1,500, it is quite possible that a credit item of Rs.750 may have been wrongly posted in the ledger as a debit item. To locate such errors, the accountant should scan all the debit entries of an amount of Rs. 750.
- The difference may also indicate a complete omission of a posting. For example, the difference of Rs. 1,500 given above may be due to omissions of a posting of that amount on the credit side. Thus, the accountant should verify all the credit items with an amount of Rs. 1,500.
- If the difference is a multiple of 9 or divisible by 9, the mistake could be due to transposition of figures. For example, if a debit amount of Rs. 459 is posted as Rs. 954, the debit total in the trial balance will exceed the credit side by Rs. 495 (i.e. $954 - 459 = 495$). This difference is divisible by 9. A mistake due to wrong placement of the decimal point may also be checked by this method. Thus, a difference in trial balance divisible by 9 (nine) helps in checking the errors for a transposed mistake.