

FINANCIAL ACCOUNTING (PART - 17)

TRIAL BALANCE AND RECTIFICATION OF ERRORS

1. INTRODUCTION

Hello Viewers,

Welcome to the lecture series on financial accounting. Today in this lecture we shall cover the topic Trial balance and the rectification of the errors. Trial balance is the third important step of the financial accounting which also amounts to summarization of all the accounts. We shall learn to prepare trial balance by both the method that is total method and the balance method.

The objective of this lecture is to have an understanding the conceptual framework of summarizing the financial transactions in the books of accounts and for that we are going to prepare the trial balance either by total method or by balance method We shall also learn how while preparing trial balance we come across certain sorts of errors that is error of principles, errors of omission and errors of commission, one-sided errors as well as two-sided errors. There is a list of errors which we are going to analyze and further under rectification of errors we shall learn how to rectify these errors.

2. MEANING OF TRIAL BALANCE

So first of all let us understand what we mean by trial balance.

Trial balance is a statement which is giving us the records of all the accounts that is on the debit side as well as on the credit side. We can

say that the Trial balance is a statement of the debits and credits of the accounts which are being taken from the ledger. So it is a summary because we know that the financial accounting is the art of the recording, classifying, summarizing and analyzing and interpreting the financial transactions and providing the financial information to the end users for taking up their decisions. So we have already covered the first two steps that is recording and classifying. Now it is the third step where the summary of the entire ledger posting is made under this statement. It is not an account first, it is a statement. It is being prepared where the debit balances are written on debit column and credit balance is written on credit column. So trial balance is not but an index of all the accounts with their balances that is the important feature of trial balance. As in our books we keep summary of the things, this is the name of the chapter and this has come from this book etc.

Any summary which is giving us the relevant information as to the accuracy of the posting in the books of account is known as Trial balance. So the objective of preparing trial balance is to know the accuracy of the posting being made in ledger.

We can assume that we know the meaning of the posting. Posting means to record the transaction into the ledger. So now we need to check whether debit has been posted on debit side and credit details have been posted on credit side so we will consolidate all these data and find out accuracy of the posting with the help of Trial balance plus there is time and labor saving when preparing trial balance we need not to go into particular accounts to find out the balances and we can directly see the trial balance and can ascertain what is the balance of cash account, what is the balance of Bank account how much are the creditors outstanding . It is the base of preparing final account. With the help of trial balance we can easily prepare the trading and profit and loss account while with the ledger account it is very difficult to prepare the final account because the summary is not being prepared out there. One more important feature of the trial balance is that it is prepared as on date and not for the period. Because we are going to check the accuracy

So we will open the corresponding accounts like capital, Ram and sales

Now we shall open the ledger accounts

Dr. CAPITAL ACCOUNT
Cr.

Date	Particulars	Amount	Date	Particulars	Amount
			Ap 1	By Cash	10,000

So posting is being done. In the capital account cash is credited and in the cash account to capital is written on debit side

Dr. RAM'S ACCOUNT
Cr.

Date	Particulars	Amount	Date	Particulars	Amount
			Ap 5	By Cash	5000

Similarly we are going to prepare Ram's account with date, particulars and amount. It will be on Apr 5 by Rs. 2000. A cross reference of cash is given on the credit side of Ram account

Dr. SALES ACCOUNT
Cr.

Date	Particulars	Amount	Date	Particulars	Amount
				By Cash	2,000

Now we have opened Sales account. Now the debit side posting is completed.

Now we shall open balancing standing on the credit side of Cash account. So first of all we will open Shyam's account

Dr. SHYAM'SACCOUNT
Cr.

Date	Particulars	Amount	Date	Particulars	Amount
	To cash	5000			

Dr. SALARIES ACCOUNT
Cr.

Date	Particulars	Amount	Date	Particulars	Amount
	To cash	2000			

Then similarly we are opening salaries and purchases account.

Dr. PURCHASES ACCOUNT
Cr.

Date	Particulars	Amount	Date	Particulars	Amount
Apr 30	To Cash	3000			

Now there are two methods of preparing Trial balance one is

Total Method

Balance Method

Under Total method we will need to take up the total of debit side and credit side so we are going to prepare the trial balance we will write cash account and in debit side we will write on debit side Rs. 17,000 and on credit side Rs. 10,000. Again for capital account we will write on credit side Rs. 10,000 , for Ram credit side will show the amount as Rs. 3,000 and Sales would show the credit side amount as Rs. 2,000.

Similarly for purchases on debit side we will write Rs.5000 on debit side and for salaries and Shyam account we will write on debit side Rs.2000 and Rs. 3,000 respectively.

4. PREPARATION OF TRIAL BALANCE

Now we are preparing Trial Balance by Total Method.

Let see the format having Serial Number, Particulars and Dr and Cr column of amount.

S.NO	PARTICULARS	FOLIO NO.	DEBIT	CREDIT
1	Cash account		17,000	10,000
2	Capital			10,000
3	Ram's Account			2,000
4	Sales account			5,000
5	Shyam's account		5000	
6	Salaries		2000	
7	Purchases		3000	
	TOTAL		27,000	27,000

It is coming as Rs. 27,000 on both the side. So we can say that our posting is correct. The accounts are showing correct , amounts are showing properly.

Another method is known as Balance account, now we will balance the ledger accounts first.

Now we shall balance the accounts by using the terms by balance c/d or to balance c/d. By balance c/d written on credit side represents the debit balance of the account while To balance c/d written on debit side of the accounts depicts the credit balance of the account.

Dr. CAPITAL ACCOUNT
Cr.

Date	Particulars	Amount	Date	Particulars	Amount
Apr 30	To balance c/d	10,000	Ap 1	By Cash	10,000
			May1	By Balance b/d	10,000

Dr. RAM'S ACCOUNT
Cr.

Date	Particulars	Amount	Date	Particulars	Amount
Apr 30	To balance c/d	5,000	Ap 5	By Cash	5000
			May 1	By balance b/d	5000

Dr. SALES ACCOUNT
Cr.

Date	Particulars	Amount	Date	Particulars	Amount
Apr 30	To balance c/d	2000		By Cash	2,000
			Ap 30	By balance b/d	2,000

Shyam's account

Dr. SHYAM'S ACCOUNT
Cr.

Date	Particulars	Amount	Date	Particulars	Amount
	To cash	5000	Apr 30	By balance c/d	5000
May 1	To balance b/d	5000			

Dr. SALARIES ACCOUNT
Cr.

Date	Particulars	Amount	Date	Particulars	Amount
	To cash	2000	Apr 30	By balance c/d	2000
May 1	To Balance b/d	2000			

Similarly, salary will also show debit balance the balance is closed.

Dr. PURCHASES ACCOUNT
Cr.

Date	Particulars	Amount	Date	Particulars	Amount
Apr 30	To Cash	3000	Apr 30	By balance c/d	3000
May 1	To balance b/d	3000			

Purchases account shall be balance as by balance c/d and will be closed for the period.

When the credit is excess over the debit side it means the credit balance shall be there. And it shall be brought down in the next month and we shall write by balance b/d in the beginning of the next period.

In each account, in the subsequent year the balance shall be carried forward.

In cash account the debit side is exceeding which is Rs. 17,000 and the credit is showing Rs. 10,000 as we will balance this account as 17000-10,000 that is Rs. 7000 it will have a debit balance and will be closed as By balance c/d

Dr.
Cr.

CASH

ACCOUNT

Date	Particulars	Amount	Date	Particular	Amount
	To Capital	10,000		By Shyam	5000
	To Ram	2,000		By Salaries	2000
	To Sales	5,000		By Purchases	3,000
				By balance c/d	7,000
		17,000			17,000
	To balance b/d	7,000			

Since we have taken very simple example, it can be possible that we have to balance all the account.

Now we shall prepare the Trial Balance by Balance Method

S.NO	PARTICULARS	FOLIO NO.	DEBIT	CREDIT
1	Cash account		7,000	
2	Capital			10,000
3	Ram's Account			2,000
4	Sales account			5,000
5	Shyam's account		5000	
6	Salaries		2000	
7	Purchases		3000	
	TOTAL		17,000	17,000

So instead of 27,000 we are getting total of Trial balance as Rs. 17,000. All the debit balance have been written on debit sides of Trial balance and the accounts having credit balance will be written on credit column of the Trial Balance

We have learnt to prepare both trial balances by Total Method as well as Balance Method.

This is basic method of preparing the trial balance

Bank account can have credit balance and it is known as bank over draft.

Capital account will have a credit balance always.

Similarly other liabilities items will be on credit side similarly sales will be on credit side.

So we can say liabilities and revenues will be on credit balance expenses, purchases cash and the real accounts and nominal accounts will be generally on the debit side of the trial balance.

Now we are going to learn the limitations posed by Trial balance so we are going to learn about such limitation.

5. LIMITATIONS OF TRIAL BALANCE

Now we have seen the salient features of trial balance that how the posting is being done and we have also analyzed that it will help to check the arithmetical accuracy of the posting.

Now there are some limitation of trial balance sometimes the trial balance is not able to locate the error and sometimes it is able to locate the error.

So let us see when the trial balance agrees even if there are some mistakes and when the trial balance disagrees and show the error.

First of all we will take up the example when trial balance does not match. So let us see

Reasons of mismatch of the trial balance

1. Only one aspect of the account is posted. The implication of it is that we know that accounting is made on double entry system each debit should have a credit.

So while posting the entry in the ledger we have done posting in one account only and forgot to post in the second account in the ledger. Where ever posting is not done that is either debit side or credit side then the trial balance would not agree.

2. Wrong posting of the account- Instead of debit we have posted on the credit side so it will show the error and that too with the double amount. For example,

We had to post

Ram account Dr 500

To Cash 500

While posting we have posted on the credit side, so the double amount get posting.

In order to mitigate this error we have to do the rectification we have to post the rectified entry by double amount.

This is the second important feature which we need to know while locating the error in the trial balance.

3. Posting the wrong amount-

Instead of posting Rs. 500 we have posted only Rs. 50 but the original entry was written as Rs. 500 but while doing posting we have wrongly written it as Rs. 50

4. Another error is that of + and - that is wrong calculation is done

5. Carry forward is done wrong.

6. If posting is done with wrong amount, wrong side, and to wrong parties account but in case of wrong parties account posting if it is made on the same side it shall not disturb the trial balance.

Expenses Account Dr.

To Cash

So it was a balance sheet but it has gone into Profit and loss account as expenses. Such errors are not able to be located in the trial balance but they are errors. Because real account has a feature that has debit balance and nominal accounts are also having debit balance if they are expenses or loss. So in that case of loss is treated as an asset or If asset is treat as loss or expense in that case we are not able to find out error. So these are the errors by which trial balance may get agreed but they remain in the books of account.

On the other hand, there are some errors which can be located and tell us there is disagreement in the trial balance and we can rectify them.

The method of rectifying these errors that is Error of omission, Error of Commission, Error of principle, compensatory error is known as Rectification of error and we have to post the entries to rectify them.

When the trial balance does not match and the errors can be located they can be rectified with the account called suspense account. And the effect of these errors can be taken up to suspense account and finally it is closed.

So wherever our trial balance is not matching an account called suspense account will be opened and it can have debit balance or credit balance depending upon the type of error we have made.

7. SUMMARY

So here we have learnt in detail what is trial balance what are its limitation and what are the objectives of preparing trial balance? So in today's lecture we have learnt in detail trial balance and effect of errors on trial balance. With this we are completing our lecture of today,

Thanks you!!