
Correction of errors

Chapter Notes

TRIAL BALANCE

A Trial balance is a list of all the balance figure taken from the ledger accounts - General ledger, Debtors and creditors. If the balance figure is on the debit side in the ledger it goes on the debit side in the Trial Balance and if the balance figure is on the credit side in the ledger it goes on the credit side of the Trial Balance.

It is very important the debits equal credit in the trial balance. If not, a suspense account is created to make each side the same. This suspense will stay there until the errors are found.

In general

| | |
|--------------------------|---|
| Debit expense and Credit | Gains they go the Profit and loss account |
| Debit assists and Credit | Liabilities they go in the balance sheet |

TRIAL BALANCE ERRORS

Some errors can be identified easily, and some are more challenges to notice

Errors revealed by the Trial Balance

The following are some of the errors the Trial balance identifies and can be asked as part of a theory question

1. **Mathematical** Error of adding and subtracting
2. **Double entry** Not doing the double entry properly
3. **Misplace entries** entering a credit as a debit

Errors not revealed by the trial balance

The follow are some of the errors that are not revealed by the trial balance and can be asked as part of a theory question

1. **Errors of omission** This is when an entry has been left out completely. No double entry has been made
2. **Errors of Principle** This is when the debits and credit are correct, but the wrong type of account has been used to record the transaction (repair to vehicles in the vehicle account instead of Repairs) Correction of errors - suspense Accounts

- 3. Errors of Commission** This is when the debits and credit are correct, but the wrong account has been used to record the transaction (sale for J. Smith recorded in P. Smith)
- 4. Compensating Errors** This is when you record the correct Debit and Credit but use the wrong figure in both (Insurance is for 400 but you record 40 in insurance and bank)
- 5. Errors of original entry** This is when an errors in made in the books of First entry and then brought across to the ledger
- 6. Complete reversal of entry** This is when the transaction is record on the incorrect side of the t -Account

SUSPENSE ACCOUNT

This is a figure that is included on the smaller side of the Trial balance. This will result in the Debit side and credit side being the same figure.

The errors mention above don't affect the trial balance but if the trial balance doesn't agree a suspense account is used to temporarily balance the debit and credit side. If the final accounts are prepared before the error has been found the suspense will be included as an asset in the Current Assets or as a liability in the Current Liability.

Some errors that affect the balancing of the trial balance include the following

1. Errors of addition and using the wrong figure
2. Not completing the double entry and only posting to one side
3. Not using the same figure when completing the double entry

EFFECTS OF ERRORS ON NET PROFIT

Errors will either affect the profit and loss account or the balance sheet. If an expense or gain account is affected the profit and loss account will be adjusted. To adjust the account you will prepare a Statement of Corrected Net Profit. The following layout will be used

| | | | |
|---|--|--------------|--------------|
| Profit as per the draft account (taken form the Question) | | | X |
| Add | (Increases the Net Profit) | | |
| | any expense account credit in the journal | X | |
| | Any gain account credited in the journal | <u>(+) X</u> | <u>(+) X</u> |
| | | | X |
| Less | (Decreases the Net Profit) | | |
| | any expense account debited in the journal | X | |
| | Any gain account debited in the journal | <u>(-) X</u> | <u>(-) X</u> |
| | | | X |

Steps to answer this part

1. Using a different colour pen work down the journal entries and put a dot beside the items that go in the profit and loss account
2. If the item is an expense and is on the credit side, you add it on. This is because this expense has not happened so the net profit will increase
3. If the item is an income and is on the credit side, you add it on. This is because this is extra income that we will receive and will increase the net profit figure
4. remember to get the total for all these figures first before you add them on
5. If the item is an expense and is on the debit side, you subtract the figure. This is because the expense has occurred so the net profit will decrease
6. If the item is an income and is on the debit side - you subtract the figure. This is because the income has not happened so the net profit will decrease

EFFECT OF ERRORS ON THE BALANCE SHEET (HL)

We use the following layout to adjust the Balance Sheet

| | Debit | Credit |
|----------------------------|---------------------------|----------------------------|
| Asset will increase if | We debit the asset a/c | |
| Asset will decrease if | | we credit the asset a/c |
| Liability will increase if | we credit a liability a/c | |
| Liability will decrease if | | we debit the liability a/c |

Steps to prepare the corrected balance sheet

1. Using a different colour pen work down the journal entries and put Asterix beside the items that go in the Balance sheet
2. If the item is an asset and is on the debit side, you add it on. This is because this asset is increasing, and we have received it
3. If the item is a liability and is on the debit side, you subtract it on. This is because this extra income was not received so the income will decrease
4. If the item is an asset and is on the credit side, you subtract the figure. This is because the asset is decreasing
5. If the item is a income and is on the credit side, you add the figure. This is because the extra income has occurred so will increase
6. Using the figures from the balance sheet in the question you will re-write it out in your booklet and adjust the figures (if needed) using the information identified from above

Rule of thumb

Debit the receiver

Credit the Giver

VERY IMPORTANT FOR DOUBLE ENTRY

1. There are 4 different types of accounts - Assets, Liabilities, Expenses and Income
2. For double entry we do the following to increase and decrease each one of these 4 different accounts
 - a. Assets - to increase an asset we put the figure on the debit side and to decrease an asset put in on the credit side
 - b. Liabilities - to increase a liability we put the figure on the credit side and to decrease a liability we put the figure on the debit side
 - c. Expense- to increase an asset we put the figure on the debit side and to decrease an asset put in on the credit side
 - d. Income - to increase a liability we put the figure on the credit side and to decrease a liability we put the figure on the debit side

| | | | | | | | |
|----------|----------|-------------|----------|----------|----------|----------|----------|
| Asset | | Liabilities | | Expense | | Income | |
| + | - | - | + | + | - | - | + |
| Increase | Decrease | Decrease | Increase | Increase | Decrease | Decrease | Increase |

TIP - If you are finding it hard to remember if an item goes on the debit side or credit side have a look at the Trial balance in Question 1. The trial balance gives you a list of debits and credit balance

| Expense | | Income | |
|---------|--|---------|--|
| Due | Current Liability (has to be paid - we owe it) | Due | Current Asset (We are owed it) |
| Prepaid | Current Asset (We have it paid already) | Prepaid | Current Liability (We have received the money now we owe it to the business) |