

# FINANCIAL ACCOUNTING

## IS Trial Balance a proof of arithmetical accuracy



February 26, 2017

### What is trial balance? IS trial balance a proof of arithmetical accuracy? Explain .

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. which shows 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 account balances from the trial

balance instead of looking them up in the ledger.

**Trial Balance of .....as on March 31, 2005**

| <i>Account Title</i> | <i>L.F</i> | <i>Debit<br/>Amount<br/>Rs.</i> | <i>Credit<br/>Amount<br/>Rs.</i> |
|----------------------|------------|---------------------------------|----------------------------------|
|                      |            |                                 |                                  |
|                      |            |                                 |                                  |
| <b>Total</b>         |            |                                 |                                  |

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.
- 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.

#### *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:

- (1) totalling 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) 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. 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 totalling of the debit and credit balances in the trial balance.
- Error in totalling 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.
- 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.

#### *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

#### *Errors of Commission*

These are the errors which are committed due to wrong posting of transactions, wrong totalling or 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 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.

#### *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. There 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.

#### *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.

### *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 undercast 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.

### *Searching 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 helps in checking the errors for a transposed mistake.

### *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 neutralising the effect of the error.

A Trial Balance in which the credit and debit accounts match does not prove that, all transactions have been recorded in the proper accounts. To conclude, we can say that a trial balance should not be recorded as a conclusive proof of the correctness of the books of account.



**Prince raj** October 20, 2018 at 10:58 PM

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**Sadhana** March 7, 2020 at 12:54 AM

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