

Lesson 12

TRIAL BALANCE - PREPARATION, LIMITATIONS AND METHOD OF PREPARING TRIAL BALANCE

12.1 Trial Balance

At the end of the given period, and after posting all the entries from the journal into individual ledger accounts, the ledgers are balanced and their net balances, debit or credit, are determined. One thing to be remembered in the double entry accounting system, is that, for every debit entry, there has to be a corresponding and equal credit entry, and vice versa. Hence, in a journal, the total of debit and credit column must be equal. Extending this logic further, we can also state that after balancing the ledger accounts, the total of ledgers having credit balance should be equal to the sum total of all the debit balance ledgers.

This is the main principle of the trial balance. A trial balance is a summary of various debit balances and various credit balances appearing in the individual ledger accounts. Hence, in short, a trial balance is a sheet which has two columns. In one column, the accounts that have a net debit balance are listed and in the other column, the accounts having net credit entries are listed. As in a double entry book keeping system, the debit column must be equal to the credit column. Therefore, a trial balance is correct if both the columns have the same total.

A trial balance is not a conclusive statement to verify the accuracy of the books of accounts maintained by a firm. However, a trial balance quickly and roughly gives an indication of whether the accounts are arithmetically correct or not. If the total of both the columns of the trial balance do not match, then it indicates that there is at least some kind of arithmetical error in the preparation of the accounts.

Table 12.1. The Ruling of A Trial Balance Is As Follows

Trial balance as on (date)			
Sr No	Name of the ledger account	net debit balance	net credit balance
1	Cash Account	---	
2	Capital Account		----
3	Bank Account	---	
		TOTAL	TOTAL

Looking at the ruling of a trial balance, it can also be seen that, the trial balance can also be prepared by using the total debit balance of a ledger account and the total credit balance in the ledger account. It gives the same result. The trial balance

preparation by using the total of the debit side and credit side of the given ledger is known as total method.

Trial Balance as on date...					
Sr No	Name of the Ledger Account	Totals method		Net Balance Method	
		Total of debit side	Total of credit side	Net balance of debit side	Net balance of credit side
1	CASH ACCOUNT	80	30	50	---
2	CAPITAL ACCOUNT	--	10000	--	10000
3	BANK ACCOUNT	4000	1000	3000	
		TOTAL A	TOTAL A	TOTAL B	TOTAL B

12.2 Advantages of Preparing a Trial Balance

- a) It proves the arithmetic accuracy of accounting entries in a ledger
- b) As it includes each and every account, which is maintained by the firm, it serves as a one place steady reference to view the balances in the ledger accounts.
- c) It can detect any error which can then be rectified.
- d) It summarizes the result of all the transactions during the period.
- e) It provides the base for preparing the final accounts, namely, profit and loss account and balance sheet.

12.3 Limitations of a Trial Balance

(Errors that are not disclosed by the trial balance) Even though if we have a trial balance, which agrees on the debit and the credit column, it may not be able to disclose the following type of errors:

Errors of Principle: If an entry which makes equal debit and credit into two concerned accounts, it will not mean any arithmetic error, because the amount on both sides is equal. But it is possible that the recording of the entry may be fundamentally wrong. For example, purchase of furniture is debited to the purchase account instead of the furniture account.

Compensating Errors: If one particular account is wrongly debited by say Rs 500 less, but at the same time another ledger is credited less by the same amount, then the errors will compensate each other and not shown in the trial balance.

Error of Recording: A Wrong Amount in the Books of Original Entry: As we know the ledger are prepared from the books of original entry. If the recording in the

original entry is incorrect, it will not lead to disagreement of trial balance and hence, the error will not be disclosed in the trial balance. For example, a sale of Rs 640 was recorded as 604 in the sales book.

Error of Omission: This means, if any financial transaction was completely forgotten and was not recorded in any of the books, then this error cannot be located in the trial balance. This is so because the entry is missing on both sides of the journal.

Posting into Wrong Accounts: For example, if cash paid to Mahesh was wrongly debited to Maheshwari's account, it cannot be disclosed in the trial balance. This is so because the amount being credited is equal to the amount being debited. Hence, the trial balance will agree.

12.4 Suspense Account

If at the end of the preparation of a trial balance, the total of both the credit and debit columns matches, then it is fine. Otherwise, if there is a disagreement, then attempts are made to identify and locate the errors and rectify them. Even after these efforts, if the trial balance does not agree, then the difference in the trial balance is temporarily transferred to a Suspense Account and the trial balance is tallied and completed. The suspense account automatically gets closed and disappears when the errors are located and rectified in the accounting books.

A few ways of locating errors in the trial balance are as follows

- a) Confirm that the cash balance and the bank balance are correct.
- b) Check whether all accounts have been brought to the trial balance or not
- c) Confirm that the opening balances have been correctly written in the ledger account.
- d) Check the totals of the sundry debtors and the sundry creditor.
- e) Compute the difference between the debit and the credit column and then divide it by two. Then check if the obtained figure appears on either sides of the trial balance, and then verify the corresponding entries' posting. If it is wrongly posted, say instead of debit, it is credited or vice versa, then it is possible that due to this error, it creates a difference equal to double the amount.
- f) Divide the difference by 9, if it is completely divisible, it indicates the possibility of transposition and transplacement error.

12.5 Transposition Error

If the correct entry is 4582
 And the wrongly written entry is 5482
 Then the difference will be $5482 - 4582 = 900$
 This 900 is divisible exactly by 9.
 So this is a transposition error.

12.6 Transplacement Error

If the correct entry is 42.8
 And the wrongly written entry is 4.28
 Then the difference is 38.52, which is exactly divisible by 9.
 So, the displacement of figures is called transposition. And, the movement of digits to the left or right of a decimal point is known as transplacement error.

Illustration 12.1

Prepare the trial balance from the ledgers prepared in illustration 8.1
 Extracting the net balances from individual ledger accounts, the trial balance has been prepared as follows-

Trial Balance

Sr. No.	Name of Account	Debit Balance	Credit Balance
1	Cash Ac	25250	
2	Capital Ac		120000
3	Bank Ac	35250	
4	Furniture and Fitting Ac	20000	
5	Scooter (Two Wheeler Ac)	30000	
6	Rent Ac	2500	
7	Goods Ac	37500	
8	ZK and Co Ac		7000
9	Sales Ac		17500
10	Wages Ac	2000	
11	Insurance Ac	250	
12	Returns Outward Ac		3000
13	RC and Co Ac		5500

14	Stationary Ac	250	
	Total	153000	153000