FINANCIAL ACCOUNTING
WEEK 6 (LECTURE SIX)

THE ACCOUNTING CYCLE

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Learning Objectives:
Upon completion of this chapter, you will be able to:
Identify the steps in the accounting cycle
Describe a ledger account and a ledger
State the rules of debit and credit for balance sheet events
Explain the double entry system of accounting
Explain the purpose of a journal and its relationship to a ledger
Explain the nature of net income, revenue and expenses
Apply the realization and matching principles in recording revenues and expenses
Prepare a Trial Balance and explain its uses and limitations
Bank Reconciliation
Explain the errors in Financial Accounting that affect and do not affect the Trial Balance
Distinguish between accounting cycle procedures and the knowledge of accounting

Accounting Cycle

Accounting cycle is a step by step process of recording, classification and summarization of economic transactions of a business. it generates a useful financial information in the form of financial statements including income statement, balance sheet, cashflow statements and statement of changes in equity. the accounting cycle is followed once during each accounting period. accounting starts from the recording of individual transactions and ends on the preparation of financial statements and closing entries.

The following are the major steps involved in the accounting cycle.

1.Record Journal Entries – analyse and record transactions via journal entries
2.Post Entries to Ledger Accounts – post the journal entries to ledger accounts
3. Prepare Unadjusted Trial Balance
4. Adjust Journal Entries – prepare adjusting entries at the end of the period. their main purpose is to match incomes and expenses to appropriate accounting periods i.e. accruals, prepayments etc.
5. Prepare Adjusted Trial Balance

6. Prepare Financial Statements
7. closing temporary accounts via closing entries i.e. Revenue, income and gain acc, expense and loss acc, dividends, drawings, withdrawals, income summary accounts e.t.c.
8. Prepare post-closing trial balance.

The previous lessons have been mentioned about double entry, the ledger and ledger accounts. In this lesson we shall delve deeper into this topic and expand on the subject matter on accounts, ledger accounts and the ledger.

An account is a chronological record that is used to keep track of the increases and decreases in financial statement items. These increases and decreases happens through transactions which happen in an entity day in day out.
The ledger accounts are categorized as either Asset accounts, Liability accounts, Shareholder Equity accounts, Revenue accounts and Expenses accounts.

ASSET ACCOUNTS

As learned earlier, assets are resources that have future economic benefits for the business. The primary purpose of assets is that they be used in day to day operating activities in order to generate revenue either directly or indirectly. A separate account is established for each asset. Example of asset accounts include:

- **Cash** has future purchasing power. Coins, currency, cheques, and bank account balances are examples of cash.
- **Accounts receivable** occur when products or services are sold on credit. When a sale occurs on account or on credit, the customer has not paid cash but promises to pay in the future.
- **Notes receivable** are formal promises to pay accounts receivable on a specific future date along with a predetermined amount of interest.
- **Unused supplies** are things like paper, staples, and other business stock to be used in the future. If the supplies are used before the end of the accounting period or immaterial in amounts, they are considered an expense of the period rather than an asset.
- **Merchandize inventory** are items to be sold in the future.
- **Prepaid insurance** represents an amount paid in advance for insurance. The prepaid insurance will be used in the future.
- **Prepaid rent** represents an amount paid in advance for rent. The prepaid rent will be used in the future.
- **Buildings** indirectly help a business generate revenue over future accounting periods since they provide space for day-to-day operating activities.
- **Land** cost must be in a separate account from any building that

LIABILITY ACCOUNTS

From the previous lessons, a liability is an obligation to pay for an asset in the future. Among the benefits of liabilities, is to finance the purchase of assets like machinery, buildings, land, fixtures, equipment among other assets. Examples of liabilities are listed below;

- Accounts payable are debts owed to suppliers for goods purchased or services received as a result of day-to-day operating activities. An example of a service received on credit might be a plumber billing the business for a repair.
- Wages payable are wages owed to employees for work performed but not paid at the balance sheet date.
- Bank loans are debts owed to a bank or other financial institution.
- Unearned revenues are payments received in advance of the product or service being provided. If a customer pays $1,000 for an automobile repair to be done in the next accounting period, this is recorded as a liability.

SHAREHOLDERS' EQUITY ACCOUNTS

Equity represents the net assets owned by the owners of an entity. This is made up of; Share capital, Retained Earnings, dividends, revenues and expenses. Share capital represents the investments made by the real owners of an entity through the resources committed into the corporation while retained earnings represents the total of all net incomes earned over the life of a corporation to the present less any dividends paid out to the shareholders over the given period. These accounts include:

- Share capital account
- Retained earnings account
- Dividends account
- Revenue accounts
- Expenses account.

THE DOUBLE ENTRY SYSTEM OF ACCOUNTING

The Accounting equation forms the basis of double entry and therefore it should always be maintained. Any change in assets, liabilities or capital will have a double effect such that assets will always be equal to liabilities plus capital. If the owners put in additional capital then this will increase the cash at bank and the capital amount therefore the equation is still maintained. A ledger account is normally referred to as a T-account due to the shape of its structure. Below is an illustration of a typical ledger account.

Debit (Dr.) **NAME OF ACCOUNT** **Credit (Cr.)**

Date	details	Folio (LF)	Amount ($)		Date	Details	Folio (LF)	Amount ($)
			Total					Total

In this account the date will show the opening period of the asset, liability or capital i.e. the balance brought forward. It will also show the date when a transaction took place (i.e. either an asset was bought or liability incurred). The detail column (also called the particulars column) shows the nature of the transaction and reference to the corresponding account. The Folio Column for purposes of detailed recording shows the reference number of the corresponding account. The amount column shows the amount of the asset, liability or capital.

The left side of the account is called the debit side and the right side is called the credit side. All assets are shown or recorded on the debit side while all the liabilities and capital are recorded on the credit side. Each type of asset or liability must have its own account whereby all transactions affecting them are recorded in this account. Therefore, there should be an account for Premises, Plant and Machinery, Stock, Debtors, Creditors etc. Under the accounting equation if all assets are represented by liabilities and capital therefore all debits should be the same as credits. For the double entry to be reflected in the accounts, every debit entry must have a corresponding credit entry. The transactions affecting these accounts are posted in the account as debit entry and credit entry to complete the double entry.

When we make a debit entry we are either:

i. Increasing the value of an asset.
ii. Reducing the value of a liability.
iii. Reducing the value of capital.

When we make a credit entry we are either:

i. Reducing the value of an asset.
ii. Increasing the value of a liability.
iii. Increasing the value of capital.

NB: To record a transaction in the ledger accounts, the following steps or principles can be helpful to ensure the process is properly done and correctly.

1. Take one transaction at a time starting with the first one in the season.
2. In each transaction taken, identify the accounts involved, i.e. assets, liabilities. Capital, expenses or revenues so that you know which account to debit or credit.
3. In the accounts identified, identify whether they both increase or decrease or is an increase and a decrease.
4. Finally Debit or Credit the respective accounts involved.

EXAMPLE 6.1

The following transactions relate to Poncon Enterprises for the month of July 2022. Record the transactions in their respective ledger accounts, balance them off and extract a trial balance for the business.

2022:

July	1	Started business with $ 2,000,000 in the bank.
"	2	Purchased goods $ 175,000 on credit from ABC limited.
"	3	Bought furniture and fittings $ 150,000 paying by cheque.
"	5	Sold goods for cash $ 275,000.
"	6	Bought goods on credit $ 114,000 from Southern Enterprises.
"	10	Paid rent by cash $ 15,000.
"	12	Bought stationery $ 27,000 paying in cash.
"	18	Goods returned to Southern Enterprises worth $ 23,000.
"	21	Let off part of the premises receiving rent by cheque of $5,000.
"	23	Sold goods on credit to Ban's Traders for $ 77,000.
"	24	Bought a business trucks paying by cheque for $ 300,000.

“ 30 Paid the month’s wages by cash $ 117,000.

“ 31 The proprietor took cash for himself for $ 44,000.

Debit (Dr.) **Capital A/C** **Credit (Cr.)**

Date	details	(LF)	$ (000)		Date	Details	(LF)	$ (000)
31/7/22	**Balance c/d**		**2,000**		1/7/22	Bank	CB	2,000
			2,000					2,000

Debit (Dr.) **BANK ACCOUNT** **Credit (Cr.)**

Date	details	(LF)	$ (000)		Date	Details	(LF)	$ (000)
1/7/22	Capital	GL	2,000		3/7/22	Furniture & Fittings	GL	150
5/7/22	Sales	GL	275		10/7/22	Rent	GL	15
21/7/22	Rent	GL	5		12/7/22	Stationery	GL	27
					24/7/22	Motor Vehicles	GL	300
					30/7/22	Wages	GL	117
					31/7/22	Drawings	GL	44
					31/7/22	**Balance c/d**		**1627**
			2280					2280

Debit (Dr.) **ABC LIMITED ACCOUNT** **Credit (Cr.)**

Date	details	(LF)	$(000)		Date	Details	(LF)	$(000)
31/7/22	**Balance c/d**		**175**		2/7/22	Purchases	GL	175
			175					**175**

Debit (Dr.) **PURCHASES ACCOUNT** **Credit (Cr.)**

Date	details	LF	$(000)		Date	Details	(LF)	$(000)

2/7/22 6/7/22	ABC Limited Southern Enterprises	PL PL	175 114		**31/7/22**	**Balance c/d**		**289**
			289					289

Debit (Dr.) **FURNITURE & FITTINGS ACCOUNT** **Credit (Cr.)**

Date	details	(LF)	$(000)		Date	Details	(LF)	$(000)
3/7/22	Bank	CB	150		**31/7/22**	**Balance c/d**		**150**
			150					150

Debit (Dr.) **SALES ACCOUNT** **Credit (Cr.)**

Date	details	(LF)	$(000)		Date	Details	(LF)	$(000)
31/722	**Balance c/d**		**352**		5/7/22 23/7/22	Bank Ban's Traders	CB SL	275 77
			352					352

Debit (Dr.) **SOUTHERN ENTERPRISES ACCOUNT** **Credit (Cr.)**

Date	details	(LF)	$(000)		Date	Details	(LF)	$(000)
18/7/22 **31/7/22**	Returns Out **Balance c/d**	GL	23 **91**		6/7/22	Purchases	PL	114
			114					114

Debit (Dr.) **RENT EXPENSE ACCOUNT** **Credit (Cr.)**

Date	details	(LF)	$(000		Date	Details	(LF)	$(000
10/7/22	Bank/Cash	CB	15		**31/7/22**	**Balance c/d**		**15**
			15					**15**

Debit (Dr.) **STATIONERY ACCOUNT** **Credit (Cr.)**

Date	details	(LF)	$(000		Date	Details	(LF)	$(000
12/7/22	Bank/Cash	CB	27		**31/7/22**	**Balance c/d**		**27**
			27					27

Debit (Dr.) **RETURNS OUT ACCOUNT** **Credit (Cr.)**

Date	details	LF)	$(000		Date	Details	LF	$(000
31/7/22	**Balance c/d**		**23**		18/7/22	Southern Enterprises	PL	23
			23					**23**

Debit (Dr.) **RENT INCOME ACCOUNT** **Credit (Cr.)**

Date	details	(LF)	$(000		Date	Details	(LF)	$(000
31/7/22	**Balance c/d**		**5**		21/7/22	Bank/Cash	GL	5
			5					**5**

Debit (Dr.) **BAN'S TRADERS ACCOUNT** **Credit (Cr.)**

Date	details	(LF)	$(000		Date	Details	(LF)	$(000
23/7/22	Sales	GL	77		**31/7/22**	**Balance c/d**		**77**
			77					**77**

Debit (Dr.) **MOTOR VEHICLES ACCOUNT** **Credit (Cr.)**

Date	details	(LF)	$(000		Date	Details	(LF)	$(000
24/7/22	Bank/Cash	CB	300		**31/7/22**	**Balance c/d**		**300**
			Total					**Total**

Debit (Dr.) **WAGES ACCOUNT** **Credit (Cr.)**

Date	details	(LF)	$(000		Date	Details	(LF)	$(000
30/7/22	Bank/Cash	CB	117		**31/7/22**	**Balance c/d**		**117**
			117					**117**

Debit (Dr.) **DRAWINGS ACCOUNT** **Credit (Cr.)**

Date	details	(LF)	$(000		Date	Details	(LF)	$(000
31/7/22	Bank/Cash	CB	44		**31/7/22**	**Balance c/d**		**44**
			44					**44**

NB: After completing the Debits and Credits, the "Closing off" of the Accounts follows and thereafter, extract a Trial Balance for the Month of July for the Enterprise.

Balancing means; check each account totals both in Debit and Credit sides.

Whichever total is higher than the other side, it is recorded and the lesser side carries the balance carried down at the end of the season or moth.

Note the coloured balances carried down in the above ledger accounts.

THE TRIAL BALANCE

A trial balance is a financial statement that summarises all the transactions entries recorded in the ledger accounts. The summaries are in terms of debits and credits from the respective ledger accounts. A debit balance of an account means the debit side of that account is more than the credit side of that account e.g. the bank account has a debit balance from the example above and vice versa with a credit balance which means the credit side of that ledger account is more than the debit side of the same account e.g. the capital account in the illustration above has a credit balance.

Some ledger accounts always carry a debit balance at all times such as the cash account, Expenses, non-current assets accounts among others while other bear a credit balance always such as capital account, liabilities accounts. Revenue accounts among others. Some can bear a debit or a credit balance depending on the transactions for that period e.g. the bank account. A bank account with a credit balance is called an "Overdraft" or an over-drawn account where the entity with=draws more cash from the bank account than there is.

PURPOSE OF A TRIAL BALANCE IN FINANCIAL ACCOUNTING:

1. Checking Arithmetical Accuracy: The trial balance is used to verify the actual amount entered on the right side of the current account while migrating the figures from various ledger books like purchase books, sales books, cash books, etc. Trial Balance, aside from general ledger accounts, is also useful to check the accuracy of special-purpose accounting books.
2. Assist in Preparing Financial Statements: Profit and Loss Account, Balance Sheet, and Cash Flow Statement must be prepared at the end of each accounting year. The balances of all the ledger accounts used to prepare financial statements are already available in the trial balance. Hence, it makes the preparation and analysis of financial statements easier.
3. Assist in Rectifying errors: The debit total of the trial balance must equal to credit total of the trial balance. This checks the arithmetical accuracy of ledger postings. If this does not happen, it will make the accountant find and rectify the error. Accountants, therefore, feel relieved when the trial balance debit totals and credit totals match.
4. Assist in Adjustments: Adjustment accounts like prepaid expenses, outstanding liabilities, closing stock, etc., need to be prepared during the preparation of the trial balance. This assists in making adjustments only relevant to the current accounting year. Businesses prepare adjustment accounts generally at the end of the accounting year. However, there is no restriction to open these adjustment accounts as they occur.
5. Assist in Comparative Analysis: Preparation of Trial Balance helps to compare balances of the current year with past year balances and peer analysis. This helps the business to make important decisions regarding income, expenses, production costs, etc. It helps to recognize the trend in the business and take action wherever necessary.
6. Assist in preparation of Audit Reports: Trial Balance helps the auditors to locate the entries in the original books of accounts. Basically, the audit trail is what auditors need to audit, and this is what trial balance provides. Auditors are then able to comment on the preparation of financial statements in their audit report.
7. Assist in Decision Making regarding budget: As we have seen above, trial balance helps compare ledger balances with the past balances. Such comparison helps the management

to create a trend regarding the performance of the business. After analyzing the comparisons, the financial budget can be prepared for the upcoming accounting periods to assist the management.

Illustration of A Trial Balance.

Using the above example on Ledger accounts, the Trial Balance for Poncon Enterprises for the month of July 2022 will be as shown below:

PONCON ENTERPRISES
TRIAL BALANCE
FOR THE YEAR ENDED 31ST JULY 2022

Items	**$**	**$**
Capital		2,000,000
Bank	1,627,000	
Rent income		5,000
Rent expense	15,000	
Drawings	44,000	
Sales		352,000
Purchases	289,000	
Returns outwards		23,000
Motor Vehicles	300,000	
Furniture & Fittings	150,000	
Accounts Payables		266
Accounts Receivables	77,000	
Stationery	27,000	
Wages	117,000	
TOTAL	**2646000**	**2,646,000**

NB: The totals of a Trial balance are always the same if the ledger accounts were recorded correctly. However, at times they do not implying that there was an error or errors that were made in the process of recording transactions.

THE BANK RECONCILIATION STATEMENT

It is a norm for a bank to send to its customer regularly a statement showing how his account stands. Usually, there is a regular little book through which the bank informs the customer as to what balance he has at the bank. This is the Bank Pass Book. It contains a copy of the customer's account at the bank. It stands to reason that the balance shown by the Pass Book should agree with the bank balance shown by the Cash Book. However, often there is a difference even if there is no mistake. The difference is due to the following reasons:

Cheques recorded in cash book but not yet credited by bank:

Cheque received are entered in the Cash book as soon as they are received. There may be a delay of a day or two in sending the cheques to the bank. Moreover, the bank, usually, does not credit the customer until the cheques are realised; if they are on other banks, it means delay. In the meantime, therefore, the Cash Book will show more balance than what the bank shows in the customer's account.

Cheques issued but not yet presented for payment:

As soon as cheques are issued, they are entered in the Cash Book, but the bank, again, makes no entry until the cheques are actually presented for payment and are paid. This makes no entry until the cheques are actually presented for payment and are paid. This

Bank charges:

The bank often makes charges for services it renders; these are known as bank charges. If there is an overdraft, the bank will also charge interest. These bank charges and interest are entered in the Pass Book and the entry is generally made in the Cash Book only when the Pass Book is received.

Direct collections by bank:

The bank is often entrusted with the task of collecting interest on securities or dividends on shares or even the collection of amounts due on bills of exchange or promissory notes. The bank will credit the customer as soon as the amounts are received but the entry by the customer in the Cash Book must await receipt of information by the customer from the bank.

Payments by bank as per standing instructions:

The bank may also make payments according to the standing instructions of the client or in respect of any special instruction such as payment on presentation of documents for supply of goods for which a letter of credit has been opened previously. Entries in the Cash Book in such cases are made on receipt of advice from the bank.

These delays do not ordinarily matter, as sooner or later, both the bank and the client will make entries. However, to know the position clearly and to be sure that no mistakes have been committed, there must be a statement to explain why there is a difference between the balance shown by the Pass Book and that shown by the Cash Book on a particular date. The statement is known as the Bank Reconciliation Statement. It should be prepared every month at the latest. If bank transactions are large in number, the statement may be prepared at the end of every week. It helps management to check the accuracy of the entries made in the Cash Book and keep track of cheques, etc., which may have been sent to the bank for collection. Preparation of the bank reconciliation statement is a very important control technique. It often reveals frauds committed by the staff handing cash and cheques.

Apart from misappropriation of cash, recorded as sent to the bank but not really sent, it may reveal teeming and lading also when cash meant to be banked is used by the cashier for his private purposes and the banking are done out of a later collection. The dates of entries in the Cash Book and the Pass Book in respect of cash should be the same or at the most different only by one day. Any cheque remaining uncleared for an unreasonable length of time should be traced and reasons ascertained for the delay.

How to Prepare the Bank Reconciliation Statement:

The following principles will be useful when preparing a bank reconciliation statement:

1. Check the cash book receipts and payments against the bank statement
2. Items not ticked on either side of the cash book will represent those which haven't been captured by the bank statement.
3. Mark such items from the cash book
4. Items not ticked on either side of the bank statement represents those which haven't been passed through the cash book.
5. Mark such items on the bank statement.
6. Adjust the cash book by recording the items which do not appear in it but are found in the bank statement, hence calculating the correct balance of the cash book.
7. Prepare the reconciliation statement reconciling the bank statement balance and the corrected cash book balance using any of the following modes:

   (a) Starting with the Cash Book Balance.

   - If the cash balance is a debit balance, deduct from it all cheques, drafts among others paid into the bank but not collected and credited by the bank and added to it all cheques drawn on the bank but not yet presented for payment. The new balance obtained will be the same as the bank statement.
   - If the bank balance of the cash book is a credit balance, add to it all cheques, drafts and other transactions, paid into the bank but not collected by the bank and deduct from it all cheques drawn on the bank but not yet presented for payment. The new balance will be the same as that of the bank statement.

   (b) Starting With the Bank Statement Balance:

   - If the bank statement is a debit balance (overdraft), subtract from it all cheques, drafts paid into the bank but not collected and credited by the bank and add to it all cheques drawn on the bank but not yet presented for payment. The balance obtained here will be like that of the Cash Book.
   - If the bank statement is a credit balance, add to it all cheques, drafts paid into the bank but not collected and credited by the bank and deduct from it all the cheques drawn on the bank but not yet presented for payment. The balance will also be the same as the adjusted cash book balance.

ILLUSTRATION 1:

On October 2022, the balance of the cash at bank as shown by the cash book of the enterprise was $280,200 and the balance as shown by the bank statement was $450,600. On checking the bank statement with the cash book, it was discovered that a cheque for $ 23,200 paid in on the 31st October was not credited until the 1st November 2022 and the following cheques drawn prior to 31st October 2022 were not presented for payment until 4th November: Urban Enterprises $ 5,800, Modern Traders Ltd $160,200 Galton Ltd $1,200 and Mobias enterprises $26,400. Prepare a bank reconciliation statement for the two balances.

Suggested Solution:

Bank Reconciliation Statement on 31st October 2022:

Method 1:	**$**
Balance as per Cash Book:	280,200
Less: Cheques paid in but not collected:	(23,200)
	257,000
Add: Unpresented Cheques (Total)	193,600
Balance as per Bank Statement	450,600

Method 2:	
Balance as per the Bank statement (CR.)	450,600
Less: Unpresented cheques:	(193,600)
	257,000
Add: Cheques paid in but not collected:	23,200
Balance as per the Cash Book:	280,200

ERRORS THAT DO NOT AFFECT THE TRIAL BALANCE

The trial balance produced from the accounts appears to be okay/correct, i.e. the debits are the same as the credits. However, on taking a close check on the balances and transactions posted, errors may have been made and therefore the balances shown on the trial balance may be incorrect i.e. under/over stated.

There are 6 main types of errors that don't affect the trial balance and these are explained as follows:

a) **Error of omission**

Here, a transaction is completely omitted from the accounts and therefore the double entry is not made e.g. a sales invoice of **$**.400 is not posted in the sales journal therefore no entry is made in the debtor's account and the sales account i.e. both debit of **$**.400 in debtor's account and credit of **$**.400 in the sales account.

The effect of the error is understating both the debtors and the sales.

To correct this error, the transaction is posted in the books by:

Debiting debtors $.400
Crediting sales $.400

b) **Error of Commission**

This error occurs when a transaction is posted to a wrong account but the account is of the same class. Example: a credit sale to T Thompson is posted to L Thompson's account for an amount of **$**.200. Instead of a debit to T Thompson's account it is made to L Thompson's account and the corresponding credit in the sales account is correct.

Although the debit entry is made into the wrong account, the two accounts are of the same class i.e. debtors.

To correct this error a transfer is made from L Thompson's account to T Thompson by:

		$
(i)	**Debit T Thompson a/c**	**200**
(ii)	**Credit L Thompson a/c**	**200**

c) **Error of principle**

In this type of error a transaction is posted not only to the wrong account but also of a different class e.g. Motor vehicle purchased for **$**.400 is posted to the motor vehicle expenses a/c. (Instead of debiting motor vehicles, we debited motor vehicle expenses a/c and the credit entry in the cashbook is correct)

The motor vehicles account is a non-current asset, and motor vehicles expenses a/c is an expense account. Therefore a capital expenditure has been posted as revenue expenditure.

To correct this error a transfer is made from the motor expenses account to the motor vehicles a/c by:

		$
(i)	**Debit Motor vehicles a/c**	**400**
(ii)	**Credit Motor expenses a/c**	**400**

d) Complete reversal of entries

A transaction is posted to the correct accounts but to the wrong sides of the accounts i.e. a debit is posted as a credit and a credit is posted as a debit. Example: cash drawn from the bank of **$**.150 for business use is posted as a debit in the bank account and credit in cash in hand.

To correct this error, two entries are made in the relevant accounts:

(i) Correct the error
(ii) Post the transaction correctly

The entries will therefore be as follows:

Debit Cash in hand by $.150
Credit bank by $.150

To correct the error of Sh.150 posted in the wrong sides of these account

Debit cash by	**$.150**
Credit bank by	**$.150**

To post the entries correctly

e) Error of Original entry

Here a transaction is posted to the correct accounts but the amount posted is not correct i.e. it is either under/over stated. In some cases, this is known as a transposition error e.g. cash received from a debtor of $.980 is credited/posted to the customer's account as $.890.

To correct this error, the amount understated or overstated is posted to these accounts to reflect the correct balance. In this case, we will:

	$.
Debit cash book	**90**
Credit debtors	**90**

f) Compensating Errors

These are errors that tend to cancel out each other i.e. if the effect of one error is to understate the debits or credits then another error may take place to overstate the debits or credits by the same amount, hence canceling out each other. E.g. if the balance c/d of the purchases a/c is $3,980 but shown in the trial balance as $3,890 and another error carried to the trial balance of fixture amounting to Sh.4,540 instead of $.4,450:

ERRORS THAT AFFECT THE TRIAL BALANCE AND THE SUSPENSE ACCOUNT

These types of errors are reflected on the trial balance because the debits will not be same as the credits. The debits may be more than the credits and vice versa.

Examples include:

1. Transaction is posted on one side of the accounts i.e. only a debit entry or a credit entry. Example cash received from a debtor is debited to the cashbook and no other entry is made in the account, i.e. no credit entry on the debtor's a/c.
2. A transaction is posted on one side of both the accounts i.e. two debits or two credits. Example a payment to a creditor of $.300 is credited in the cashbook and also credited in the creditor's accounts.
3. A transaction is posted correctly but different amounts i.e. debit is not the same as the credit. Example – cash received from a debtor of $.450 is debited in the cashbook as $.450 and credited as $.540 in the debtor's a/c.
4. Error on balances of accounts – i.e. understatement or overstatement of an account balance due to mathematical errors.
5. Balance on an account is shown on the wrong side of the account when opening the ledger accounts or when taken up to the trial balance. Example Bal c/d in the cash book for cash at bank of $2000 is shown as a credit i.e. an overdraft, instead of a debit in the trial balance. The balance may also be brought down as an overdraft instead of a debit balance in the trial balance.
6. A balance is omitted from the trial balance on the accounts in total.

To correct the above errors, the appropriate or the adjusting entries are made through an account called a suspense account.

The difference in the accounts is posted to this account and the entries to correct the accounts are posted here. The balance to be shown on the suspense accounts depends on which side the error is shown on the trial balance.

If the debits are greater than the credits, then an amount is included on the credit side of the trial balance so that the debits = credits. This is a credit balance and will be taken to the suspense account on the credit side.

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