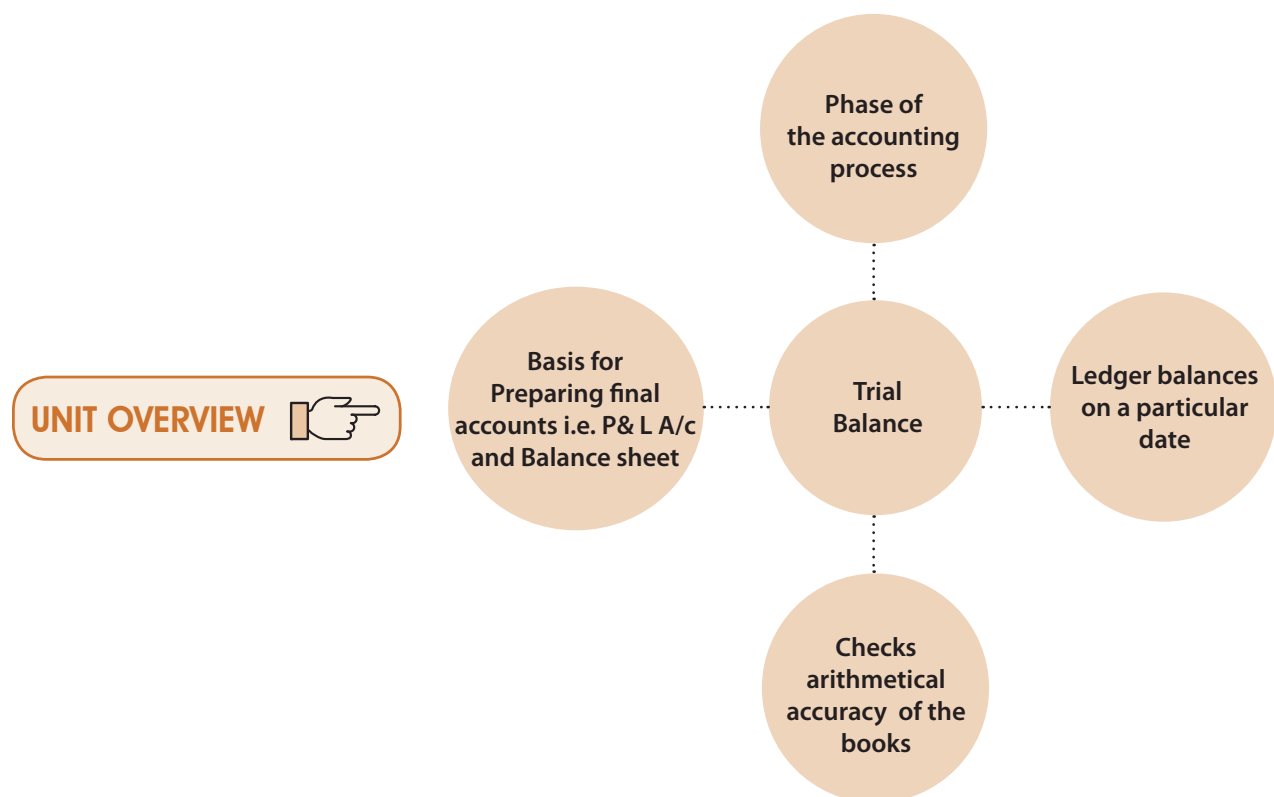


UNIT 3 : TRIAL BALANCE

LEARNING OUTCOMES

After studying this unit, you will be able to :

- ◆ Learn the technique of taking balances from ledger accounts to prepare trial balance.
- ◆ Understand what is trial balance and what purposes it can serve.



Trial balance contains various ledger balances on a particular date. It forms the basis for preparing final statement i.e. profit and loss statement and balance sheet. If it tallies, it means that the accounts are arithmetically accurate but certain errors may still remain undetected. Therefore, it is very important to carefully journalise and post the entries, following the rules of accounting.

3.1 INTRODUCTION

Preparation of trial balance is the third phase in the accounting process. After posting the accounts in the ledger, a statement is prepared to show separately the debit and credit balances. Such a statement is known as the trial balance. It may also be prepared by listing each and every account and entering in separate columns the totals of the debit and credit sides. Whichever way it is prepared, the totals of the two columns should agree. An agreement indicates reasonable accuracy of the accounting work; if the two sides do not agree, then there is simply an arithmetic error(s).

This follows from the fact that under the Double Entry System, the amount written on the debit sides of various accounts is always equal to the amounts entered on the credit sides of other accounts and vice versa. Hence the totals of the debit sides must be equal to the totals of the credit sides. Also total of the debit balances will be equal to the total of the credit balances. Once this agreement is established, there is reasonable confidence that the accounting work is free from clerical errors, though it is not proof of cent per cent accuracy, because some errors of principle and compensating errors may still remain. Generally, to check the arithmetic accuracy of accounts, trial balance is prepared at monthly intervals. But because double entry system is followed, one can prepare a trial balance any time. Though a trial balance can be prepared any time but it is preferable to prepare it at the end of the accounting year to ensure the arithmetic accuracy of all the accounts before the preparation of the financial statements. It may be noted that trial balance is a statement and not an account.



3.2. OBJECTIVES OF PREPARING THE TRIAL BALANCE

The preparation of trial balance has the following objectives:

- (i) Trial balance enables one to establish whether the posting and other accounting processes have been carried out without committing arithmetical errors. In other words, the trial balance helps to establish arithmetical accuracy of the books.
- (ii) Financial statements are normally prepared on the basis of agreed trial balance; otherwise the work may be cumbersome. Preparation of financial statements, therefore, is the second objective.
- (iii) The trial balance serves as a summary of what is contained in the ledger; the ledger may have to be seen only when details are required in respect of an account.

The form of the trial balance is simple as shown below:

Trial Balance

as at.....

S.No	Ledger Accounts	L.F.	Dr. Amount	Cr. Amount
			(Total or Balance)	(Total or Balance)
			₹	₹

The under mentioned points may be noted:

- (i) A trial balance is prepared as on a particular date which should be mentioned at the top.
- (ii) In the second column the name of the account is written.
- (iii) In the fourth column the total of the debit side of the account concerned or the debit balance, if any is entered.
- (iv) In the next column, the total of the credit side or the credit balance is written.
- (v) The two columns are totalled at the end.
- (vi) The first and third column needs no explanation.

3.3 LIMITATIONS OF TRIAL BALANCE

One should note that the agreement of Trial Balance is not a conclusive proof of accuracy. In other words, in spite of the agreement of the trial balance some errors may remain. These may be of the following types:

- (i) Transaction has not been entered at all in the journal.
- (ii) A wrong amount has been written in both columns of the journal.
- (iii) A wrong account has been mentioned in the journal.
- (iv) An entry has not at all been posted in the ledger.
- (v) Entry is posted twice in the ledger.

Still, the preparation of the trial balance is very useful; without it, the preparation of financial statement, the profit and loss account and the balance sheet, would be difficult.

3.4 METHODS OF PREPARATION OF TRIAL BALANCE

1. TOTAL METHOD

Under this method, every ledger account is totalled and that total amount (both of debit side and credit side) is transferred to trial balance. In this method, trial balance can be prepared as soon as ledger account is totalled. Time taken to balance the ledger accounts is saved under this method as balance can be found out in the trial balance itself. The difference of totals of each ledger account is the balance of that particular account. This method is not commonly used as it cannot help in the preparation of the financial statements.

ILLUSTRATION 1

Given below is a ledger extract relating to the business of X and Co. as on March, 31, 2016. You are required to prepare the Trial Balance by the Total Amount Method.

Dr.	Cash Account		Cr.
Particulars	₹	Particulars	₹
To Capital A/c	10,000	By Furniture A/c	3,000
To Ram's A/c	25,000	By Salaries A/c	2,500
To Cash Sales	500	By Shyam's A/c	21,000
		By Cash Purchases	1,000
		By Capital A/c	500
		By Balance c/d	7,500
	35,500		35,500

Dr.		Furniture Account		Cr.	
Particulars	₹	Particulars	₹		
To Cash A/c	3,000	By Balance c/d	3,000		
	3,000		3,000		

Dr.		Salaries Account		Cr.	
Particulars	₹	Particulars	₹		
To Cash A/c	2,500	By Balance c/d	2,500		
	2,500		2,500		

Dr.		Shyam's Account		Cr.	
Particulars	₹	Particulars	₹		
To Cash A/c	21,000	By Purchases A/c	25,000		
To Purchase Returns A/c	500	(Credit Purchases)			
To Balance c/d	3,500		–		
	25,000		25,000		

Dr.		Purchases Account		Cr.	
Particulars	₹	Particulars	₹		
To Cash A/c (Cash Purchases)	1,000	By Balance c/d	26,000		
To Sundries as per Purchases Book (Credit Purchases)	25,000		–		
	26,000		26,000		

Dr.		Purchases Returns Account		Cr.	
Particulars	₹	Particulars	₹		
To Balance c/d	500	By Sundries as per Purchases Return Book	500		
	500		500		

Dr.		Ram's Account		Cr.	
Particulars	₹	Particulars	₹		
To Sales A/c (Credit Sales)	30,000	By Sales Returns A/c	100		
		By Cash A/c	25,000		
		By Balance c/d	4,900		
	30,000		30,000		

Dr.		Sales Account		Cr.	
Particulars	₹	Particulars	₹		
To Balance c/d	30,500	By Cash A/c (Cash Sales)	500		
		By Sundries as per Sales Book (Credit sales)	30,000		
	30,500		30,500		

Dr.		Sales Returns Account		Cr.	
Particulars	₹	Particulars	₹		
To Sundries as per Sales Returns Book	100	By Balance c/d	100		
	100		100		

Dr.		Capital Account		Cr.	
Particulars	₹	Particulars	₹		
To Cash A/c	500	By Cash A/c	10,000		
To Balance c/d	9,500				
	10,000		10,000		

SOLUTION

Trial Balance of X and Co. as at 31.03.2016

Sl. No.	Name of Account	Total Debit Items ₹	Total Credit Items ₹
1.	Cash A/c	35,500	28,000
2.	Furniture A/c	3,000	
3.	Salaries A/c	2,500	
4.	Shyam's A/c	21,500	25,000
5.	Purchases A/c	26,000	
6.	Purchases Returns A/c		500
7.	Ram's A/c	30,000	25,100
8.	Sales A/c		30,500
9.	Sales Returns A/c	100	
10.	Capital A/c	500	10,000
		1,19,100	1,19,100

2. BALANCE METHOD

Under this method, every ledger account is balanced and those balances only are carried forward to the trial balance. This method is used commonly by the accountants and helps in the preparation of the financial statements. Financial statements are prepared on the basis of the balances of the ledger accounts.

ILLUSTRATION 2

Taking the same information as given in Illustration 1, prepare the Trial Balance by Balance Method.

SOLUTION

Trial Balance of X and Co. as at 31.03.2016

Sl. No.	Name of Account	Debit Balance ₹	Credit Balance ₹
1.	Cash A/c	7,500	
2.	Furniture A/c	3,000	
3.	Salaries A/c	2,500	
4.	Shyam's A/c		3,500
5.	Purchases A/c	26,000	
6.	Purchases Returns A/c		500
7.	Ram's A/c	4,900	
8.	Sales A/c		30,500
9.	Sales Returns A/c	100	
10.	Capital A/c	–	9,500
		44,000	44,000

3. TOTAL AND BALANCE METHOD

Under this method, the above two explained methods are combined. Under this method statement of trial balance contains seven columns instead of five columns. This has been explained with the help of the following example using the data given in illustration 1:

Trial Balance of X as at 31.03.2016

Sl. No.	Heads of Account	L.F.	Debit Balance (₹)	Credit Balance (₹)	Debit Total (₹)	Credit Total (₹)
1.	Cash Account		7,500		35,500	28,000
2.	Furniture Account		3,000		3,000	
3.	Salaries Account		2,500		2,500	
4.	Shyam's Account			3,500	21,500	25,000
5.	Purchases Account		26,000		26,000	
6.	Purchase Returns Account			500		500
7.	Ram's Account		4,900		30,000	25,100
8.	Sales Account			30,500		30,500
9.	Sale Returns Account		100		100	
10.	Capital Account			9,500	500	10,000
	Total		44,000	44,000	1,19,100	1,19,100

3.5 ADJUSTED TRIAL BALANCE (THROUGH SUSPENSE ACCOUNT)

If the trial balance does not agree after transferring the balance of all ledger accounts including cash and bank balance and also errors are not located timely, then the trial balance is tallied by transferring the difference of debit and credit side to an account known as suspense account. This is a temporary account opened to proceed further and to prepare the financial statements timely.

3.6 RULES OF PREPARING THE TRIAL BALANCE

While preparing the trial balance from the given list of ledger balances, following rules should be taken into care:

1. The balances of all (i) assets accounts (ii) expenses accounts (iii) losses (iv) drawings (v) cash and bank balances are placed in the debit column of the trial balance.
2. The balances of all (i) liabilities accounts (ii) income accounts (iii) profits (iv) capital are placed in the credit column of the trial balance.

ILLUSTRATION 3

From the following ledger balances, prepare a trial balance of Anuradha Traders as on 31st March, 2016:

Account Head	₹
Capital	1,00,000
Sales	1,66,000
Purchases	1,50,000
Sales return	1,000
Discount allowed	2,000
Expenses	10,000
Trade receivables	75,000
Trade payables	25,000
Investments	15,000
Cash at bank and in hand	37,000
Interest received on investments	1,500
Insurance paid	2,500

 **SOLUTION**
Trial Balance of Anuradha Traders as on 31.03.2016

Dr. balance	₹	Cr. balance	₹
Purchases	1,50,000	Capital	1,00,000
Sales return	1,000	Sales	1,66,000
Discount allowed	2,000	Trade payables	25,000
Expenses	10,000	Interest received on investments	1,500
Trade receivables	75,000		
Investments	15,000		
Cash at bank and in hand	37,000		
Insurance paid	2,500		
Total	2,92,500		2,92,500

 **ILLUSTRATION 4**

One of your clients, Mr. Singhania has asked you to finalise his accounts for the year ended 31st March, 2016. Till date, he himself has recorded the transactions in books of accounts. As a basis for audit, Mr. Singhania furnished you with the following statement.

	Dr. Balance (₹)	Cr. Balance (₹)
Singhania's Capital		1,556
Singhania's Drawings	564	
Leasehold premises	750	
Sales		2,750
Due from customers		530
Purchases	1,259	
Purchases return	264	
Loan from bank		256
Trade payables	528	
Trade expenses	700	
Cash at bank	226	
Bills payable	100	
Salaries and wages	600	
Inventories (1.4.2015)		264
Rent and rates	463	
Sales return		98
	5,454	5,454

The closing inventory on 31st March, 2016 was valued at ₹ 574. Mr. Singhania claims that he has recorded every transaction correctly as the trial balance is tallied. Check the accuracy of the above trial balance.

 **SOLUTION**
Corrected Trial Balance of Mr. Singhanian as on 31st March, 2016

Particulars	Dr. Amount ₹	Cr. Amount ₹
Singhanian's Capital		1,556
Singhanian's Drawings	564	
Leasehold premises	750	
Sales		2,750
Due from customers	530	
Purchases	1,259	
Purchases returns		264
Loan from Bank		256
Creditor/Suppliers		528
Trade expenses	700	
Cash at Bank	226	
Bills payable		100
Salaries and Wages	600	
Inventory (1.4.2015)	264	
Rent and rates	463	
Sales return	98	
	5,454	5,454

Reasons:

1. Due from customers is an asset, so its balance will be a debit balance.
2. Purchases return account always shows a credit balance because assets go out.
3. Balance in Creditors Account is a liability, so its balance will be a credit balance.
4. Bills payable is a liability, so its balance will be a credit balance.
5. Inventory (opening) represents assets, so it will have a debit balance.
6. Sales return account always shows a debit balance because assets come.



SUMMARY

- ◆ Trial balance contains various ledger balances on a particular date.
- ◆ It forms the basis for preparing final statement i.e. profit and loss statement and balance sheet.
- ◆ If it tallies, it means that the accounts are arithmetically accurate but certain errors may still remain undetected.
- ◆ It is very important to carefully journalize and post the entries, following the rules of accounting.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

- A trial balance will not balance if _____
 - Correct journal entry is posted twice.
 - The purchase on credit basis is debited to purchases and credited to cash.
 - ₹ 500 cash payment to creditor is debited to Trade payables for ₹ 50 and credited to cash as ₹ 500.
- ₹ 1,500 received from sub-tenant for rent and entered correctly in the cash book is posted to the debit of the rent account. In the trial balance _____
 - The debit total will be greater by ₹ 3,000 than the credit total.
 - The debit total will be greater by ₹ 1,500 than the credit total.
 - Subject to other entries being correct the total will agree.
- After the preparation of ledgers, the next step is the preparation of _____
 - Trading accounts
 - Trial balance
 - Profit and loss account
- After preparing the trial balance the accountant finds that the total of debit side is short by ₹ 1,500. This difference will be _____
 - Credited to suspense account
 - Debited to suspense account
 - Adjusted to any of the debit balance account

5.	S.No.	Account heads	Debit (₹)	Credit (₹)
	1.	Sales		15,000
	2.	Purchases	10,000	
	3.	Miscellaneous expenses	2,500	
	4.	Salaries		2,500
		Total	12,500	17,500

The difference in trial balance is due to _____

- Wrong placing of sales account
- Wrong placing of salaries account
- Wrong placing of miscellaneous expenses account

Theory Questions

- What is the trial balance? And how it is prepared?
- Explain objectives of preparation of trial balance.
- Even if the trial balance agrees, some errors may remain. Do you agree? Explain.

Practical Question

1. An inexperienced bookkeeper has drawn up a Trial Balance for the year ended 30th June, 2017.

	Debit (₹)	Credit (₹)
Provision For Doubtful Debts	200	–
Bank Overdraft	1,654	–
Capital	–	4,591
Trade payables	–	1,637
Trade receivables	2,983	–
Discount Received	252	–
Discount Allowed	–	733
Drawings	1,200	–
Office Furniture	2,155	–
General Expenses	–	829
Purchases	10,923	–
Returns Inward	–	330
Rent & Rates	314	–
Salaries	2,520	–
Sales	–	16,882
Inventory	2,418	–
Provision for Depreciation on Furniture	364	–
Total	24,983	25,002

Required:

Draw up a 'Corrected' Trial Balance, debiting or crediting any residual errors to a Suspense Account.

ANSWERS/HINTS**MCQs**

1. (c) 2. (a) 3. (b) 4. (b) 5. (b)

Theoretical Questions

1. Preparation of trial balance is the third phase in the accounting process. After posting the accounts in the ledger, a statement is prepared to show separately the debit and credit balances. Such a statement is known as the trial balance.

Trial balance contains various ledger balances on a particular date. It forms the basis for preparing final statement i.e. profit and loss statement and balance sheet. If it tallies, it means that the accounts are arithmetically accurate but certain errors may still remain undetected. Therefore, it is very important to carefully journalise and post the entries, following are rules of accounting.

2. The preparation of trial balance has the following objectives:
 - (i) Trial balance enables one to establish whether the posting and other accounting processes have been carried out without committing arithmetical errors. In other words, the trial balance helps to establish arithmetical accuracy of the books.
 - (ii) Financial statements are normally prepared on the basis of agreed trial balance; otherwise the work may be cumbersome. Preparation of financial statements, therefore, is the second objective.
 - (iii) The trial balance serves as a summary of what is contained in the ledger; the ledger may have to be seen only when details are required in respect of an account.
3. In spite of the agreement of the trial balance some errors may remain. These may be of the following types:
 - (i) Transaction has not been entered at all in the journal.
 - (ii) A wrong amount has been written in both columns of the journal.
 - (iii) A wrong account has been mentioned in the journal.
 - (iv) An entry has not at all been posted in the ledger.
 - (v) Entry is posted twice in the ledger.

Practical Question

ANSWER 1

Trial Balance as on 30th June, 2017

Heads of Accounts	Debit ₹	Credit ₹
Provision for Doubtful Debts	–	200
Bank overdraft	–	1,654
Capital	–	4,591
Trade payables	–	1,637
Trade receivables	2,983	–
Discount Received	–	252
Discount allowed	733	–
Drawings	1,200	–
Office furniture	2,155	–
General Expenses	829	–
Purchases	10,923	–
Returns Inward	330	–
Rent & Rates	314	–
Salaries	2,520	–
Inventory	2,418	–
Provision for Depreciation on Furniture	–	364
Sales	–	16,882
Suspense Account (Balancing figure)	1,175	–
Total	25,580	25,580