

3

Balancing accounts and the trial balance

this chapter covers...

With the 'traditional' form of account (the 'T' account) that we have used so far, it is necessary to calculate the balance of each account from time-to-time, according to the needs of the business, and at the end of each financial year.

The balance of an account is the total of that account to date, eg the amount of wages paid, the amount of sales made. In this chapter we shall see how this balancing of accounts is carried out.

We shall then use the balances from each account in order to check the double-entry bookkeeping by extracting a trial balance, which is a list of the balances of all the general ledger accounts, including cash book (which contains bank account and cash account).

BALANCING THE ACCOUNTS

At regular intervals, often at the end of each month, 'T' accounts are balanced in order to show total amounts to date, for example:

- owing to each trade payable
- owing by each trade receivable
- cash and credit sales (referred to in total as 'revenue' or 'sales revenue')
- purchases
- sales returns (returns in)
- purchases returns (returns out)
- expenses incurred by the business
- non-current assets, eg premises, machinery, etc owned by the business
- bank and cash
- capital and drawings of the owner of the business
- liabilities, eg loans

The reason for balancing accounts is to enable the balances to be used in the trial balance (see page 43), which is a check on the accuracy of the double-entry bookkeeping and also the starting point for the preparation of year-end financial statements.

METHOD OF BALANCING ACCOUNTS

Set out below is an example of a traditional format double-entry account which has been balanced at the month-end:

Dr	Bank account		Cr
20-1	£	20-1	£
1 Sep Capital	5,000	2 Sep Computer	1,800
4 Sep J Jackson: loan	2,500	7 Sep Purchases	500
10 Sep Sales	750	11 Sep Drawings	100
		15 Sep Wages	200
		30 Sep Balance c/d	5,650
	<u>8,250</u>		<u>8,250</u>
1 Oct Balance b/d	5,650		

The steps involved in balancing accounts are shown on the next page.

Step 1 The entries in the debit and credit money columns are totalled; these totals are not recorded in ink on the account at this stage, but can be written either as sub-totals in pencil on the account, or noted on a separate piece of paper. In the example on the previous page the debit side totals £8,250, while the credit side is £2,600.

Step 2 The difference between the two totals is the balance of the account and this is entered on the account:

- on the side of the smaller total
- on the next available line
- with the date of balancing (often the last day of the month)
- with the description 'balance c/d', or 'balance carried down'

In the example shown, the balance carried down is $£8,250 - £2,600 = £5,650$, entered in the credit column.

Step 3 Both sides of the account are now totalled, including the balance which has just been entered, and the totals (the same on both sides) are entered **on the same line** in the appropriate column, and double underlined. The double underline indicates that the account has been balanced at this point using the figures above the total: the figures above the underline should not be added in to anything below the underline.

In the example shown, the totals on each side of the account are £8,250.

Step 4 As we are using double-entry bookkeeping, there must be an opposite entry to the 'balance c/d' calculated in Step 2. The same money amount is entered **on the other side of the account** below the double underlined totals entered in Step 3. We have now completed both the debit and credit entry. The date is usually recorded as the next day after 'balance c/d', ie often the first day of the following month, and the description can be 'balance b/d' or 'balance brought down'.

In the example shown, the balance brought down on the bank account on 1 October 20-1 is £5,650 debit; this means that, according to the business's accounting records, there is £5,650 in the bank.

a practical point

When balancing accounts, use a pen and not a pencil (except for Step 1). If any errors are made, cross them through neatly with a single line, and write the corrected version on the line below. Avoid using correcting fluid – it may hide errors, but it can also conceal fraudulent transactions.

further examples of balancing accounts

Dr		Wages account		Cr	
20-1		£	20-1		£
9 Apr	Bank	750	30 Apr	Balance c/d	2,250
16 Apr	Bank	800			
23 Apr	Bank	700			
		<u>2,250</u>			<u>2,250</u>
1 May	Balance b/d	2,250			

This wages account has transactions on one side only, but is still balanced in the same way. The account shows that the total amount paid for wages is £2,250.

Dr		B Lewis Limited		Cr	
20-1		£	20-1		£
10 Apr	Purchases returns	30	7 Apr	Purchases	280
27 Apr	Bank	250			
		<u>280</u>			<u>280</u>

This trade payable's account has a 'nil' balance after the transactions for April have taken place. The two sides of the account are totalled and, as both debit and credit side are the same amount, there is nothing further to do, apart from entering the double underlined total.

Dr		A Holmes		Cr	
20-1		£	20-1		£
1 Apr	Balance b/d	105	10 Apr	Bank	105
10 Apr	Sales	125	13 Apr	Sales returns	25
		<u>230</u>	30 Apr	Balance c/d	100
1 May	Balance b/d	100			<u>230</u>

This trade receivable's account has a debit balance at the start of the month of £105 brought down from March. After the various transactions for April, there remains a debit balance of £100 owing at 1 May.

Dr	Office equipment account		Cr
20-1	£	20-1	£
13 Apr Bank	2,000		

This account has just the one transaction and, in practice, there is no need to balance it. The account clearly has a debit balance of £2,000, which represents office equipment (a non-current asset).

Dr	Malvern Manufacturing Company		Cr
20-1	£	20-1	£
29 Apr Bank	<u>250</u>	17 Apr Purchases	<u>250</u>

This trade payable's account has a 'nil' balance, with just one transaction on each side. All that is needed here is to double underline the amount on both sides.

CONTROL ACCOUNTS

There is one further type of account to mention before looking at the accounts listed in the trial balance – a control account.

A control account is a summary account or master account, which records the totals of entries to a particular set of accounts.

Sales ledger control account shows the total of all the trade receivables' accounts in the sales ledger and tells the owner of the business how much in total is owing from trade receivables.

Purchases ledger control account shows the total of all the trade payables' accounts in the purchases ledger and tells the owner of the business how much in total is owing to trade payables.

Value Added Tax control account (also known as sales tax control account) brings together totals of VAT from books of prime entry, such as the day books and cash books, and tells the owner of the business how much in total is owing to (the usual situation for most businesses), or owing from, HM Revenue & Customs.

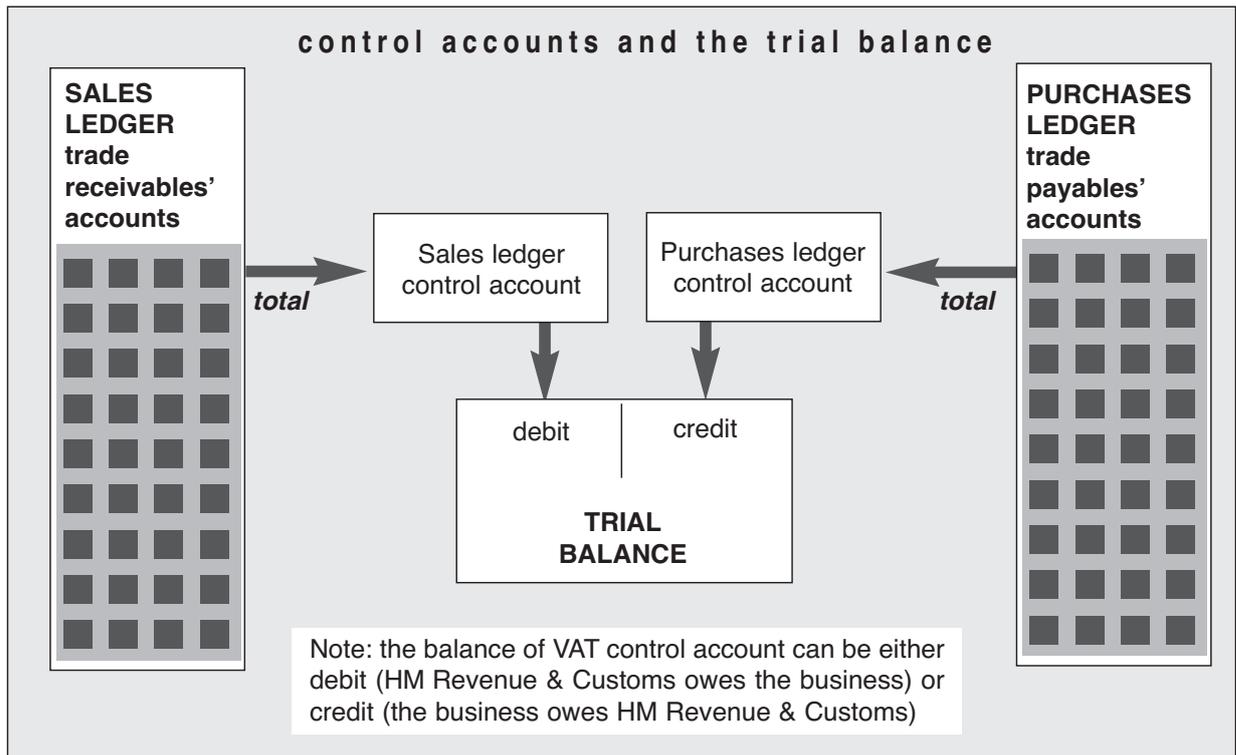
Payroll control account (also known as wages control account) brings together transactions from payroll accounts.

The use of control accounts is covered in more detail in Chapter 10.

control accounts and the trial balance

The trial balance (see next page) is the listing of all the account balances in two columns: debit balances on the left, credit balances on the right.

It is the balances of the control accounts which are taken to the trial balance rather than the individual trade receivables and trade payables account balances, which would clutter it up and make it very long. The description in the trial balance is 'sales ledger control account' (debit balance on the left) and 'purchases ledger control account' (credit balance on the right). This is illustrated in the following diagram.



EXTRACTING A TRIAL BALANCE

The purpose of a trial balance, which is taken from the accounting records – either manually or by generation of a computer report – is to:

- check the accuracy of the double-entry bookkeeping, ie that the total of debit entries equals the total of the credit entries
- form the basis for the preparation of the year-end financial statements of the business

A trial balance is a list of the balances of every account from the general ledger, (including cash book) setting out debit balances and credit balances in separate columns.

A trial balance is extracted at regular intervals – often at the end of each month. An example is shown on the next page.

Note the following points:

- The debit and credit columns have been totalled and are the same amount. Thus the trial balance proves that the accounting records are **arithmetically** correct – the total of the debits equals the total of the credits. (For types of errors, see page 47.)
- The heading for a trial balance gives the name of the business whose accounts have been listed and the date on which it was extracted.
- The balance for each account listed in the trial balance is the figure brought down after the accounts have been balanced.
- Most of the trial balances that you will see in Assessments are listed with the accounts in alphabetical order. There is no need for you to do this when preparing trial balances – unless, of course, you are instructed to do so, or are given an accounts list already in alphabetical order with the amounts to be filled in.

TARA SMITH, TRADING AS "THE FASHION SHOP"		
Trial balance as at 31 December 20-4		
	Dr	Cr
	£	£
Opening inventory	12,500	
Purchases	105,000	
Sales revenue		155,000
Administration expenses	6,200	
Wages	23,500	
Rent paid	750	
Telephone	500	
Interest paid	4,500	
Travel expenses	550	
Premises	100,000	
Shop fittings	20,000	
Sales ledger control (trade receivables)	10,500	
Bank	5,450	
Cash	50	
Capital		75,000
Drawings	7,000	
Loan from bank		50,000
Purchases ledger control (trade payables)		14,500
Value Added Tax		2,000
	296,500	296,500

DEBIT AND CREDIT BALANCES – GUIDELINES

Certain accounts always have a debit balance, while others always have a credit balance. You should already know these, but the lists set out below will act as a revision guide, and will also help in your understanding of trial balances.

debit balances

- cash account
- purchases account
- sales returns account (returns in)
- non-current asset accounts, eg computers, vehicles, machinery, etc
- depreciation charges account (see Chapter 6)
- expenses accounts, eg wages, telephone, rent paid, discounts allowed, carriage in, carriage out, prepaid expenses; also income accrued (see Chapter 5)
- drawings account
- loan account, eg money lent by the business to another person or business
- sales ledger control account (the total of the trade receivables' accounts)

credit balances

- sales or sales revenue account
- purchases returns account (returns out)
- income accounts, eg rent received, discounts received, fees received, accrued expenses; also income prepaid (see Chapter 5)
- accumulated depreciation account (see Chapter 6)
- capital account
- loan account, eg money borrowed from a bank
- purchases ledger control account (the total of the trade payables' accounts)

Note that:

- **Bank account** can be either debit or credit – it will be debit when the business has money in the bank, and credit when it is overdrawn.
- **Value Added Tax account** (or sales tax account) can be either debit or credit – it will be debit when VAT is due to the business and credit when the business owes VAT to HM Revenue & Customs.
- Other account balances that can be either debit or credit include asset disposals (see Chapter 6), allowance for doubtful debts: adjustments, irrecoverable debts (see Chapter 7), and loan (noted above).

IF THE TRIAL BALANCE DOESN'T BALANCE . . .

If the trial balance fails to balance, ie the two totals are different, there is an error (or errors):

- **either** in the addition of the trial balance
- **and/or** in the double-entry bookkeeping

The procedure for finding the error(s) is as follows:

- check the addition of the trial balance
- check that the balance of each account has been correctly entered in the trial balance, and under the correct heading, ie debit or credit
- check that the balance of every account from the general ledger (including cash book) has been included in the trial balance
- check the calculation of the balance on each account
- calculate the amount that the trial balance is wrong, and then look in the accounts for a transaction for this amount: if one is found, check that the double-entry bookkeeping has been carried out correctly
- halve the amount by which the trial balance is wrong, and look for a transaction for this amount: if it is found, check the double-entry bookkeeping
- if the amount by which the trial balance is wrong is divisible by nine, then the error may be a reversal of figures, eg £65 entered as £56, or £45 entered as £54
- if the trial balance is wrong by a round amount, eg £10, £100, £1,000, the error is likely to be in the calculation of the account balances
- if the error(s) is still not found, it is necessary to check the bookkeeping transactions since the date of the last trial balance, by going back to the prime documents (invoices, cheques, etc) and the books of prime entry (day books and cash book)
- we will look at how to correct errors shown by the trial balance in Chapter 11, for example:
 - one-sided entry (ie only one of the two parts of a double-entry transaction has been recorded)
 - entry duplicated on one side, nothing on the other (ie two debits or two credits have been recorded for a transaction)
 - unequal entries (ie different amounts have been recorded for the debit and credit entries)
 - account balance incorrectly transferred to the trial balance

ERRORS NOT REVEALED BY A TRIAL BALANCE

As mentioned earlier, a trial balance does not prove the complete accuracy of the accounting records. The following are the main errors that are not revealed by a trial balance.

error of principle

This is when a transaction has been entered in the wrong type of account. For example, the cost of fuel for vehicles has been entered as a debit to vehicles account, and as a credit to bank account. The error is that vehicles account is a non-current asset and the transaction should have been debited to the vehicle expenses account. If not corrected, such an error of principle will show a false financial position for the business.

error of commission

Here, a transaction is entered to the wrong account. For example, a sale of goods on credit to A T Hughes entered as a debit to A J Hughes' account. The double-entry bookkeeping has been completed, but the error will be discovered when A J Hughes complains about the incorrect charge.

This error can also occur between other accounts, such as expenses or non-current assets.

error of original entry

Here, the correct accounts have been used, and the correct sides: what is wrong is that the amount has been entered incorrectly in **both** accounts. This could be caused by a 'bad figure' written on a financial document, eg an invoice, or it could be caused by a 'reversal of figures', eg an amount of £45 being entered in both accounts as £54. Note that where both debit and credit entries have been made incorrectly the trial balance will still balance; if one entry has been made incorrectly and the other is correct, then the error will be revealed.

error of omission

Here a transaction has been completely omitted from the accounting records, ie both the debit and credit entries have not been made.

reversal of entries

With this error, the debit and credit entries have been made in the accounts but on the wrong side of the two accounts concerned. For example, a cash sale has been entered wrongly as a debit to sales account, and as a credit to cash account. (This should have been entered as a debit to cash account, and a credit to sales account.)

Correction of errors is covered fully in Chapter 11.

IMPORTANCE OF THE TRIAL BALANCE

A business will extract a trial balance on a regular basis to check the arithmetical accuracy of the bookkeeping. More importantly, the trial balance is used as a basis for the preparation of the **financial statements** of a business. These financial statements, which are prepared once a year (often more frequently) comprise:

- statement of profit or loss
- statement of financial position

The financial statements show the owner(s) how profitable the business has been, what the business owns, and how the business is financed. The preparation of financial statements is an important aspect of accounting and one which we shall be developing further in this book.

In the next chapter we will see how the two-column trial balance is extended and the figures entered into further columns as a method of preparing the financial statements.

Chapter Summary

- The traditional 'T' account needs to be balanced at regular intervals – often at the month-end.
- When balancing accounts, the bookkeeper must adhere strictly to the rules of double-entry bookkeeping.
- When each account in the ledger has been balanced, a trial balance can be extracted.
- A trial balance does not prove the complete accuracy of the accounting records; errors not revealed by a trial balance are:
 - error of principle
 - error of commission
 - error of original entry
 - error of omission
 - reversal of entries
- The trial balance is used as the starting point for the preparation of a business's financial statements.

Key Terms		
	balance of account	the total amount of the account to date
	control account	summary or master account which records the totals of entries to a particular set of accounts; examples are: <ul style="list-style-type: none"> – sales ledger control account – purchases ledger control account – Value Added Tax control account – payroll control account
	trial balance	list of the balances of every account forming the general ledger (including cash book), distinguishing between those accounts which have debit balances and those which have credit balances
	error of principle	transaction entered in the wrong type of account
	error of commission	transaction entered into the wrong account
	error of original entry	wrong amount entered incorrectly in accounts
	error of omission	business transaction completely omitted from the accounting records
	reversal of entries	debit and credit entries made on the wrong side of the accounts

Activities

3.1 A business's bank account is as follows:

Dr	Bank account		Cr
20-7	£	20-7	£
1 Jan Capital	1,000	9 Jan Computer	500
19 Jan Sales	650	12 Jan Purchases	400
		27 Jan Purchases	350
		29 Jan Electricity	75

At 31 January 20-7, the balance of the account is:

(a) Credit £325	
(b) Debit £1,650	
(c) Debit £325	
(d) Credit £1,325	

3.2 Which **one** of the following accounts normally has a debit balance?

(a) Capital account	
(b) Purchases account	
(c) Sales account	
(d) Purchases returns account	

3.3 Which **one** of the following accounts normally has a credit balance?

(a) Purchases account	
(b) Premises account	
(c) Capital account	
(d) Wages account	

3.4 The following are the business transactions of Andrew Johnstone, a retailer of computer software, for the months of January and February 20-4:

Transactions for January

1 Jan	Started in business with £10,000 in the bank
4 Jan	Paid rent on premises £500, by cheque
5 Jan	Bought shop fittings £1,500, by cheque
7 Jan	Bought stock of computer software £5,000, on credit from Comp Supplies Limited
11 Jan	Software sales £1,000 paid into bank
12 Jan	Software sales £1,250 paid into bank
16 Jan	Software sales £850 on credit to Rowcester College
20 Jan	Paid Comp Supplies Limited £5,000 by cheque
22 Jan	Software sales £1,450 paid into bank
25 Jan	Bought software £6,500 on credit from Comp Supplies Limited
27 Jan	Rowcester College returns software £100

Transactions for February

2 Feb	Paid rent on premises £500 by cheque
4 Feb	Software sales £1,550 paid into bank
5 Feb	Returned faulty software, £150 to Comp Supplies Limited
10 Feb	Software sales £1,300 paid into bank
12 Feb	Rowcester College pays the amount owing by cheque
15 Feb	Bought shop fittings £850 by cheque
19 Feb	Software sales £1,600 paid into bank
22 Feb	Paid Comp Supplies Limited the amount owing by cheque
24 Feb	Bought software £5,500 on credit from Comp Supplies Limited
25 Feb	Software sales £1,100 paid into bank
26 Feb	Software sales £1,050 on credit to Rowcester College

You are to:

- (a) Record the January transactions in the double-entry accounts, and balance each account at 31 January 20-4
- (b) Draw up a trial balance at 31 January 20-4
- (c) Record the February transactions in the double-entry accounts, and balance each account at 28 February 20-4
- (d) Draw up a trial balance at 28 February 20-4

Notes:

- Andrew Johnstone is not registered for Value Added Tax
- day books are not required
- Andrew Johnstone's accounting system does not use control accounts
- make sure that you leave plenty of space for each account – particularly sales, purchases and bank

- 3.5** Prepare the trial balance of Samantha Wilkes as at 31 March 20-4. **You are to** fill in the missing figure for her capital in order to balance the trial balance.

	£
Bank overdraft	2,750
Purchases	14,890
Sales revenue	35,680
Purchases returns	440
Purchases ledger control	2,360
Office equipment	8,000
Vehicle	14,000
Opening inventory	2,810
Sales returns	550
Sales ledger control	3,840
Administration expenses	12,060
Value Added Tax owing	1,420
Carriage out	740
Discount received	210
Capital	?