

## CHAPTER-6 RECTIFICATION OF ERRORS

### 1. INTRODUCTION

Errors are common in the process of recording transactions and can occur due to various unintentional mistakes. These errors may arise during the collection of financial data used for preparing financial statements or during the recording stage. They can result from mathematical errors, incorrect application of accounting policies, misinterpretation of facts, or oversight. To ensure the accuracy of the journal and ledger accounts, a trial balance is prepared. If the trial balance does not balance, it indicates the presence of errors that need to be rectified. While some errors impact the trial balance, others may affect the determination of profit or loss, as well as the assets and liabilities of the business, without directly affecting the trial balance itself.

#### Example of Errors

After preparing ledger accounts and obtaining a trial balance, discrepancies between the debit and credit totals indicate the presence of errors. In order to understand the types of errors that can occur and how to rectify them, we will examine the following illustrative cases. By carefully analyzing these cases, we can gain insights into the nature of errors and their appropriate solutions.

#### Examples of Errors in Financial Transactions

- (a) **Wrong Entry:** Let's begin by examining the initial stage of the accounting process, where errors can occur in recording the values of transactions and events in subsidiary books, the Journal Proper, and the Cash Book.

**Example 1:** Credit sales of ₹12,320 are entered in the Sales Day Book as ₹12,230. Credit purchases of ₹7000 gross less 2% trade discount are wrongly recorded in Purchase Day Book at ₹6,000.

- (b) **Wrong casting of subsidiary books:** Periodically, the values recorded in subsidiary books are added up and transferred to the respective ledger accounts. During this process, there is a possibility of encountering totalling errors. These errors can arise due to incorrect entries or they can occur independently as separate errors.

**Example 2:** For the month of February, 2021 total of credit purchases are ₹2015500, this is wrongly totaled as ₹220500 and posted to sales account as ₹220500.

- (c) **In case of cash book,** wrong calculation of the balance c/d may arise due to wrong casting.
- (d) **Wrong posting from subsidiary books:** In this scenario, there is a possibility of incorrect posting in the ledger account. The wrong amount may be entered, or the amount may be posted on the wrong side or to an incorrect account. For example, Sales to X may be posted to Y's account.
- (e) **Wrong casting of ledger balances:** Similarly, just like the Cash Book, errors can occur in casting the balances of ledger accounts. Incorrect postings can result in an incorrect balance, but that is different from a casting error in the balances. When there is an independent error in casting, it is referred to as a wrong casting of ledger balances.

**Example 3:** Following is the list of credit purchase transactions for M/s. Kumar Bros.:

2021

June. 7 Purchases from M/s. Shakti & Co.- gross ₹50,000 less 2% trade discount.

June. 8 Purchases from M/s. Nikunj & Co.- gross ₹35,000 less 2% trade discount.

June. 11 Purchases from M/s. Shakti & Co.- gross ₹30,000 less 2% trade discount

Now let's prepare M/s. Shakti & Co.'s Account:

Dr.		M/s Saurabh & Co. Account		Cr.	
Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
2021			2021		
Jan. 1	To Balance c/d	85400	Jan. 1	By Purchases A/c	49000
			Jan. 6	By Purchases A/c	29400
		<b>85400</b>			<b>85,400*</b>

\* An error has been made while calculating the credit side, leading to an incorrect balance in the account.

## 2. STAGES OF ERRORS

Mistakes can happen during various stages of the accounting process, including:

### During the process of recording transactions in the journal

Various types of errors can occur at this stage:

- (i) Errors of principle,
- (ii) Errors of omission,
- (iii) Errors of commission.

### During the process of posting the entries in ledger

- (i) Errors of omission:
  - (a) Partial omission,
  - (b) Complete omission.
- (ii) Errors of commission:
  - (a) Posting to wrong account,
  - (b) Posting on the wrong side,
  - (c) Posting of wrong amount.

### During the process of balancing the ledger accounts

- (a) Wrong Totaling of accounts,
- (b) Wrong Balancing of accounts.

### During the process of preparing the Trial Balance

- (a) Errors of omission,
- (b) Errors of commission:
  1. Taking wrong account,
  2. Taking wrong amount,
  3. Taking to the wrong side.

Based on the mentioned criteria, we can categorize errors into four general classifications.:

1. Errors of Principle,
2. Errors of Omission,
3. Errors of Commission,
4. Compensating Errors.

### 3. TYPES OF ERRORS

Basically errors are of two types:

- (a) **Errors of principle:** When a transaction is recorded in violation of accounting principles, such as incorrectly treating the purchase of an asset as an expense, it is considered an error of principle. In this situation, although the amounts are placed on the correct side, they are allocated to the wrong account. As a result, there is no impact on the trial balance, and it will still reconcile. For instance, if the purchase of a machine is debited to the building expenses account, the trial balance will remain unaffected.
- (b) **Clerical errors:** These errors occur due to mistakes made during the regular accounting process. They can be categorized into three types:
  - i) **Errors of Omission:** These errors occur when a transaction is either completely or partially omitted from the books of account. For example, not recording a credit purchase of furniture or failing to post an entry in the ledger.
  - ii) **Errors of Commission:** These errors occur when an amount is posted in the wrong account, recorded on the wrong side, incorrect totals are calculated, or an incorrect balance is struck. These errors involve incorrect actions taken during the accounting process.
  - iii) **Compensating Errors:** Compensating errors refer to errors where their effects offset each other, resulting in the trial balance still agreeing. For instance, if an amount of 1000 received from customer X is not credited to their account, but the sales book shows an excess credit of 1000, the omission of credit to x's account is compensated by the increased credit in the Sales Account.

It's important to identify and rectify these errors to ensure accurate financial reporting.

From a different perspective, errors can be categorized into two groups:

- (a) **Errors affecting the trial balance:** These errors result in the trial balance not agreeing. They include:
  - (i) Incorrect totaling of subsidiary books.
  - (ii) Incorrect balancing of an account.
  - (iii) Posting an amount on the wrong side.
  - (iv) Posting the wrong amount.
  - (v) Omitting to post an amount from a subsidiary book.
  - (vi) Omitting to post the totals of subsidiary books.
  - (vii) Failing to include cash book balances in the trial balance.
  - (viii) Failing to include the balance of an account in the trial balance.
  - (ix) Writing a balance in the wrong column of the trial balance.
  - (x) Incorrectly totaling the trial balance.

**(b) Errors not impacting the trial balance:** These errors include:

- (i) Completely omitting an entry from the subsidiary book.
- (ii) Recording an entry with an incorrect amount in the subsidiary book.
- (iii) Posting an amount in the wrong account but on the correct side. For example, debiting an amount intended for account A to account B. In this case, the trial balance will still agree.

It is crucial to identify and rectify these errors to ensure accurate financial records and a balanced trial balance.

#### **4. STEPS TO LOCATE ERRORS**

It is essential to identify and rectify errors even if there is only a minor discrepancy in the trial balance. Such a small difference could be indicative of multiple errors that need to be identified and addressed. To locate errors, the following steps can be helpful:

- (i) Recalculate the totals of both columns in the trial balance. If only one amount is written instead of multiple accounts, recheck and recalculate the list of such accounts. For example, verify the Trade Receivables list to ensure the Trade Receivables balance is derived correctly.
- (ii) Verify that cash and bank balances are correctly included in the trial balance.
- (iii) Determine the exact difference in the trial balance and carefully review the ledger. It's possible that a balance equal to the difference has been omitted from the trial balance. Also, consider halving the difference, as a balance equal to half the difference might have been recorded in the wrong column.
- (iv) Rebalance the ledger accounts.
- (v) Review the casting of subsidiary books, especially when the difference is in amounts such as 1 or 10 or 1000.
- (vi) In case of a significant difference, compare the balances in various accounts with the corresponding accounts from the previous period. If the figures differ significantly, investigate potential errors. For example, if the Sales Account balance for the current year is 35,52,000, whereas it was 34,35,000 last year, there might be an error in the Sales Account.
- (vii) Double-check postings of amounts equal to the difference or half the difference. It's possible that an amount was omitted or posted on the wrong side.
- (viii) If there is still a difference in the trial balance, a thorough verification is necessary. Check all entries, including the opening entry. It may be beneficial to start with the nominal accounts.

#### **5. RECTIFICATION OF ERRORS**

Errors should never be corrected by overwriting. If immediately after making an entry it is clear that an error has been committed, it may be corrected by neatly crossing out the wrong entry and making the correct entry. If however the errors are located after some time, the correction should be made by making another suitable entry, called rectification entry. In fact the rectification of an error depends on at which stage it is detected. An error can be detected at any one of the following stages:

- (a) Before preparation of Trial Balance.
- (b) After Trial Balance but before the final accounts are drawn.
- (c) After final accounts, i.e., in the next accounting period.

## 5.1 Before preparation of Trial Balance

There are certain errors that affect one side of an account or multiple accounts in a way that a complete rectification entry cannot be made. In such cases, the errors can be rectified by making a rectification statement on the appropriate side(s) of the respective account(s). It is important to note that these errors may involve a single account or multiple accounts. Let's look at the following examples:

- (i) The sales book for January is undercast by 500, resulting in the Sales Account being credited short by 500. Since the customers' accounts are posted with individual sales amounts and are correct, only the Sales Account needs correction. This can be done by making a credit entry of 500 on the credit side: "By undercasting of Sales Book for January 500".
- (ii) While posting in the discount column on the dr side of the cash book a discount of ₹ 50 allowed to Suresh has not been posted. cash book is correct, It can be assumed that the total of the discount column has been mistakenly debited to the discount account. The error of not crediting Ramesh by 50 can be rectified by crediting Suresh by 50.

Hence, based on the provided examples, we can conclude that the general rule stating that errors impacting two accounts can be rectified through a journal entry is not universally applicable.

Up until now, we have explored how to rectify errors that impacted either a single account or multiple accounts, without requiring complete journal entries for correction. Now, let's delve into the correction of errors that affect multiple accounts in a way that necessitates complete journal entries for rectification. Please refer to the following example:

The purchase of a furniture for ₹10,000 has been wrongly entered in the purchases book. Although, The account of the vendor (Shyam & co) has been credited by 10,000 which is correct, But the debiting the purchase account is wrong. Furniture Account should be debited. To rectify this, the debit in the purchases Account has to be transferred to the Furniture account So, now the rectifying entry will be to Credit Purchases Account and debit the Furniture account. As seen below:

<b>Wrong Entry:</b>		₹	₹
Purchases Account	Dr.	10,000	
To Shyam & Co.			10,000
<b>Correct Entry:</b>			
Furniture Account	Dr.	10,000	
To Shyam & Co.			10,000
<b>Rectifying Entry:</b>			
Furniture Account	Dr.	10,000	
To Purchases Account			10,000

### ILLUSTRATION 2

The following is the list of errors found in the book of Keshav & Sons. Give the rectifying entries.

- (1) ₹7000 paid for Machinery purchased has been charged to Purchases Account.
- (2) Electricity expenses incurred were debited to Building Account for ₹1700.
- (3) Drawings by partner of ₹2000 were debited to General Expenses Account.
- (4) ₹5000 paid for showroom rent debited to Landlord's Account.

**SOLUTION****Journal**

	<b>Particulars</b>	<b>L.F.</b>	<b>Dr.</b> ₹	<b>Cr.</b> ₹
(1)	Machinery A/c To Purchases A/c (Rectifying the incorrect debit entry in the Purchases Account for the purchase of machinery)	Dr.	7000	7000
(2)	Electricity expenses A/c To Building A/c (Rectification of the erroneous debit entry in the Building Account for electricity expenses incurred.)	Dr.	1700	1700
(3)	Drawings A/c. To General Expenses A/c (Correction of wrong debit to Trade Expenses A/c for cash withdrawn by the proprietor for his personal use)	Dr.	2000	2000
(4)	Showroom Rent A/c To Landlord's A/c (Rectifying the erroneous debit entry in the Landlord's Account for the payment of rent.)	Dr.	5000	5000

**ILLUSTRATION 3**

Give rectifying entries for the following errors:

- (1) Purchase of stock from Shyam amounting to ₹800 has been wrongly entered in the Sales Book.
- (2) A Credit sale of ₹280 to Suresh has been wrongly entered in the Purchase Book.
- (3) Goods worth ₹500 were returned by Som and were taken stock on the same date but no entry was recorded in the books.
- (4) A sum of ₹900, which was previously written off as a Bad Debt in a prior year, has been unexpectedly recovered from Sachin. However, it was mistakenly posted to Sachin's personal account.
- (5) A cheque worth ₹5000 received from Mohit was not honored and was incorrectly posted as a debit to the Sales Returns Account.

**SOLUTION****Journal**

	<b>Particulars</b>	<b>L.F.</b>	<b>Dr.</b> ₹	<b>Cr.</b> ₹
(1)	Purchases A/c Sales A/c To Shyam (Rectification of an incorrect entry in the sales book for the purchase of goods from Shyam)	Dr. Dr.	800 800	1600
(2)	Suresh A/c To Purchases A/c To Sales A/c (Rectification of an erroneous entry in the Purchases Book involving a credit sale of goods to Suresh.)	Dr.	560	280 280

	Particulars	L.F.	Dr. ₹	Cr. ₹
(3)	Returns Inwards A/c To Som A/c (Entry for goods returned by Som and taken in stock omitted from the records)	Dr.	500	500
(4)	Sachin A/c To Bad Debts Recovered A/c (Rectification of erroneous credit to Personal Account for the recovery of previously written off bad debts.)	Dr.	900	900
(5)	Mohit A/c To Sales Return A/c (Rectification of erroneous debit to Sales Returns Account for the dishonour of a cheque received from Mohit.)	Dr.	5000	5000

Hence, it can be concluded that errors identified prior to the creation of the trial balance can be rectified either by using rectification statements (not entries) or by rectification entries.

## 5.2 After Trial Balance but before Final Accounts

The approach for rectifying errors discussed thus far is suitable when errors are identified before the end of the accounting period. By making the necessary corrections, the trial balance will become balanced. However, in some cases, the trial balance may be artificially balanced by creating a suspense account and including the difference in the trial balance. If the credit column exceeds the debit column, the suspense account will be debited, and vice versa.

It is important to note that this artificial balancing of the trial balance is not a true reconciliation. Efforts should be made to locate and rectify the errors instead of relying on the suspense account.

The rule for rectifying errors detected at this stage is straightforward. Errors that couldn't be rectified through complete journal entries in the earlier stage (before the trial balance) can now be rectified by including journal entry(s) with the assistance of the suspense account. These errors are the ones that led to the creation of the suspense account in the trial balance. Other types of errors that affect multiple accounts and can be rectified through complete journal entries will follow the same process as in the earlier stage (before the trial balance).

In summary, every error detected at this stage can only be rectified by a complete journal entry. Errors that previously couldn't be rectified through journal entries will now be addressed using journal entry(s), with the suspense account accounting for the difference or the unknown side. Errors that could be rectified through entries at the earlier stage will be rectified in a similar manner.

Suppose, the sales book for May, 2020 is cast ₹500 short; as a result the trial balance will not agree. The credit column in the trial balance will have a shortfall of 500, leading to a credit entry of 500 in the Suspense Account. To rectify this error, the Sales Account will be credited to adjust the credit to the correct amount. With only one remaining error, it is necessary to close the Suspense Account by debiting it.

The entry will be:

Suspense Account To Sales Account (Rectification of error of undercasting the sales Book for May 2020)	Dr.	₹500	₹500
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#### ILLUSTRATION 4

Pass the rectifying entries for the following errors (i) without opening a Suspense Account and (ii) by opening a Suspense Account:

- The Sales Book has been totalled ₹500 short.
- The return of goods valued at ₹800 by Vihaan & Co. has been omitted from all the records.
- Goods purchased for ₹500 have been posted to the debit of the supplier Sharma & Co.
- Furniture purchased from Gulab & Bros, ₹1,000 has been entered in Purchases Day Book.
- Discount received from Red & Black ₹15 has not been entered in the Discount Column of the Cash Book.
- Discount allowed to G. Mohan & Co. ₹18 has not been entered in the Discount Column of the Cash Book. The account of G. Mohan & Co. has, however, been correctly posted.

#### SOLUTION

If a Suspense Account is not opened.

- As a result of an undercast of ₹500 in the sales book, the Sales Account has also been credited ₹500 less than it should be. To correct this error, the Sales Account will be credited with an additional ₹500 using the entry: "By incorrect totaling of the Sales Book, ₹500."
- To correct the omission, the Returns Inwards Account needs to be debited and Vihaan & Co.'s account credited. The entry:

Returns Inward Account To Vihaan & Co. (Goods returned by the firm, previously omitted from the Returns Inward Book)	Dr.	₹800	₹800
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- Instead of being credited, Sharma & Co. has been debited with 500. To correct this error, the account should be credited by 1000 to rectify the wrong debit and provide the correct debit. The entry will be recorded on the credit side as follows: "By posting errors ₹1000".

If a Suspense Account is opened :

	Particulars		L.F.	Dr. ₹	Cr. ₹
(a)	Suspense Account To Sales Account (This correction arises due to the under-casting of the Sales Day Book.)	Dr.		500	500
(b)	Return Inward Account To Vihaan & Co (This correction involves recording previously unrecorded returns.)	Dr.		800	800
(c)	Suspense Account To Sharma & Co. (This entry represents the correction made to rectify the error of debiting Sharma & Co. instead of crediting it with 500.)	Dr.		1000	1000



### Suspense Account

Dr. Date	Particulars	Amount ₹	Date	Particulars	Cr. Amount ₹
	To Sales A/c	500		By Difference in Trial Balance	1500
	To Sharma & Co.	1000			
		1500			

**Notes:**

- (i) It is important to acknowledge that the initial balance in the Suspense Account will match the difference observed in the trial balance.
- (ii) In case the information regarding the existence of a Suspense Account is not provided, the student should establish their assumption, clearly state it, and then continue accordingly.

### ILLUSTRATION 5

Rectify the following discrepancies discovered in Mr. Subhash's records. The Trial Balance exhibited an excess credit of 345. Consequently, the difference has been recorded in a Suspense Account.

- (a) A sum of ₹500 received from Naman, was inadvertently omitted from being recorded in the Cash Book.
- (b) The total of the Returns Inward Book for the month of May is 50 less than it should be due to an undercasting error.
- (c) A furniture purchase amounting to ₹250 has been recorded in the Purchases Day Book.
- (d) The purchase of 75 was erroneously recorded as 70 in the trade payables' account.
- (e) The cheque received from K Sharma amounting to ₹100 was dishonoured and erroneously debited to the "Allowances Account".
- (f) The amount of 800 paid for the purchase of a motor cycle for Mr. Subhash was wrongly recorded under the "Miscellaneous Expenses Account".
- (g) Goods with a value of 200 were returned by a customer and included in the inventory, but no entry was made in the books to account for this transaction.
- (h) Rectifying the error where a sale of 150 to Vishal & Co. was erroneously credited to their account instead of being correctly recorded in the sales book.

### SOLUTION

(a) **Journal Entries**

Particulars	L.F.	₹	₹
(a) Cash Account	Dr.	500	500
To Naman (entry passed for amount received)			
(b) Returns Inward Account	Dr.	50	50
To Suspense Account (Correcting the error in totalling the Returns Inward Book.)			

Particulars		L.F.	₹	₹
(c)	Furniture Account To Purchases Account (Rectifying the mistake of recording the purchase of furniture in the Purchases Book and incorrectly debiting it to the Purchases Account.)	Dr.	250	250
(d)	Suspense Account To Creditors Account (The Trade Payables Account was mistakenly credited 5 less, which has now been rectified.)	Dr.	5	5
(e)	K Sharma To Allowances Account (The cheque issued by K Sharma which was dishonoured, was incorrectly debited to the Allowances Account, now rectified)	Dr.	100	100
(f)	Drawings Account To Miscellaneous Expenses (Rectifying entry for charging motorcycle amount to drawings instead of miscellaneous expenses)	Dr.	800	800
(g)	Returns Inward Account To Debtors (Personal) Account (rectifying entry for recording return inwards)	Dr.	200	200
(h)	Vishal & Co. To Suspense Account (Rectifying the error where the account of Vishal & Co. was mistakenly credited by 150 instead of being debited, the correction is made to debit the account of Vishal & Co. by 150.)	Dr.	300	300

#### Suspense Account

Dr.					Cr.
Date	Particulars	Amount	Date	Particulars	Amount
**	To Difference in Trial Balance	₹ 345	**	By Returns Inwards A/c By Singh & Co.	₹ 50
“ “	To Trade Payables A/c	5	“ “		300
		350			350

## ILLUSTRATION 6

Pass Journal Entries to rectify the following errors:

- I) Goods costing ₹500 have been purchased on credit from Mohan, but no entry has been made in the books, although the goods were taken into stock.
- II) Goods amounting to ₹2000 have been sold on credit, but no entry has been made in the books.
- III) No entry has been made for Purchases Return of ₹100.
- IV) No entry has been made for Sales Return of ₹225.
- V) Goods purchased from Kamlesh on Credit for ₹2500 was recorded in the purchase book as ₹250.
- VI) Sales of ₹300 to Tarun were recorded as ₹30 in the Sales Book.
- VII) Goods purchased on Credit from Rajan for ₹200 was recorded as ₹2000 in the purchase book.

## SOLUTION

Date	Particulars	L.F	Debit (₹)	Credit (₹)
1.	Purchases A/c To Mohan (Goods purchased from Mohan , not entered in the books)		500	500
2.	Debtors A/c To Sales A/c (Goods sold on credit, not entered in the books)		2000	2000
3.	Creditors A/c To Purchase Return A/c (Purchase Return not recorded in the books)		100	100
4.	Sales Return A/c To Debtors A/c (Sales Return not recorded in the books)		225	225
5.	Purchases A/c To Kamlesh ( Less amount recorded in the Purchase book )		2250	2250
6.	Tarun A/c To Sales A/c ( Less amount recorded in the Sales book )		270	270
7.	Rajan To Purchases A/c ( Excess amount recorded in the Purchase book )		1800	1800

## ILLUSTRATION 7

Rectify the following errors which were detected before preparing the Trial Balance:

- (i) Purchase book has been undercast by ₹5,000.
- (ii) Purchase from X ₹7500 has been omitted to be posted to his account.
- (iii) Purchase from Y ₹20,000 has been wrongly posted to his account as ₹30,000
- (iv) Purchase from Z ₹40,000 has been posted to the wrong side of his account.

### SOLUTION

- (i) The error occurred during the totaling of the Purchase Book and not during the initial entry in the book. As the amounts recorded in the Purchase Book are accurate, the individual creditors' accounts will also be correct. However, the mistake affects only the Purchase Account, where a short posting of ₹ 5,000 has been made on the debit side. To rectify this, the following notation will be written on the debit side of the Purchase Account:

"To undercasting of Purchase Book ..... ₹5,000."

For example:

Purchase A/c

Date	Particulars	Amount	Date	Particulars	Amount
	To undercasting of Purchase Book	5,000			

- (ii) The error occurred during the posting process in the ledger. As the entry in the Purchase Book is accurate, the total of the Purchase Book and the posting to the Purchase Account will be correct. However, the mistake affects only P's Account, where ₹ 7,500 has not been posted to the credit side. To rectify this, the following notation will be written on the credit side of P's Account:

"By omission in posting ..... ₹7500"

For example:

P's A/c

Date	Particulars	Amount	Date	Particulars	Amount
				By omission in posting	7500

- (iii) An error occurred during the ledger posting process. As the entry in the Purchase Book is accurate, the total of the Purchase Book and the posting to the Purchase Account will also be correct. However, the mistake only impacts Q's Account, where an excessive amount of ₹ 5,000 has been posted on the credit side. To rectify this, the following notation will be written on the debit side of Q's Account:

"To excess amount on the credit side ..... ₹5,000"

For example:

Q's A/c

Date	Particulars	Amount	Date	Particulars	Amount
	To excess amount on the credit side	5,000			

- (iv) An error occurred during the ledger posting process. Both the Purchase Book and the Purchase Account will be accurate. However, the mistake only affects R's Account, where ₹ 20,000 has been incorrectly debited instead of being credited. To rectify this, the correction will be made by doubling the amount of the entry. Therefore, ₹ 40,000 will be written on the credit side of R's Account :

"By Error in posting to the wrong side..... ₹40,000."

**For example:**

**R's A/c**

Date	Particulars	Amount	Date	Particulars	Amount
				By Error in posting to the wrong side	40,000

### 5.3 Correction in the next Accounting Period

The process of rectifying errors that have been discussed so far assumes that it was done before closing the books for the relevant year. However, there are instances where rectification occurs in the subsequent year, with the balance in the Suspense Account either carried forward or transferred to the Capital Account. Suppose, the Purchase Book was undercast by ₹500 in December, 2021 and a Suspense Account was created with the difference in the trial balance. If the error is then rectified in the next year and the entry is passed is to debit the Purchase Account and credit the Suspense Account, it will result in a situation where the Purchases Account for the year 2022 will be ₹500 more than the amount which relates to the year 2021 resulting in less profits than the actual profits for the year 2022. Thus, rectifying errors in this manner will inaccurately represent the Profit and Loss Account.

To prevent such inaccuracies, it is recommended to rectify all amounts related to nominal accounts, such as expenses and incomes, through a dedicated account known as the "Prior Period Items" or "Profit and Loss Adjustment Account." The balance in this account should then be transferred to the Profit and Loss Account. However, it is important to note that these Prior Period Items should be accounted for after calculating the net profit of the current year. Prior Period Items refer to significant income or expenses that arise in the current period due to errors or omissions in the preparation of financial statements from one or more periods. These items should be clearly disclosed in the current statement of profit and loss, providing details of their nature and amount, in a manner that allows for a clear understanding of their impact on the current profit or loss.

#### ILLUSTRATION 8

Last year, Mr. Vivek encountered difficulties in reconciling the Trial Balance and decided to write off the discrepancy in the Profit and Loss Account for that particular year. In the following year, he sought the assistance of a Chartered Accountant to review the previous books, and the accountant identified the following errors:

- (1) Purchase of a motorcycle was debited to transport expenses account 5,000.
- (2) The total of the Purchase Account was mistakenly overstated by 9,000.
- (3) There was an error in recording a credit purchase of goods from Mr. A for ₹3,000, which was mistakenly entered as a sale.
- (4) The cash of ₹2000 received from Mr. X was mistakenly posted to the account of Mr. Y.

- (5) Receipt of cash from Mr. Q was posted to the debit of his account ₹700.
- (6) ₹500 due by Mr. Q was omitted to be taken to the trial balance.
- (7) Sale of goods to Mr. R for ₹2,000 was omitted to be recorded.
- (8) Amount of ₹2,395 of purchase was wrongly posted as ₹2,593.

Mr. Roy used 10% depreciation on vehicles. Suggest the necessary rectification entries.

### SOLUTION

#### Journal Entries in the books of Mr. Vivek

Date	Particulars			Dr. ₹	Cr. ₹
(1)	Motor Vehicles Account To Profit and Loss Adjustment A/c (The erroneous debit entry made to the Transportation expense Account for the purchase of a motorcycle has now been corrected). -capitalisation of 4500, i.e., ₹5,000 - 10% depreciation)	Dr.		4,500	4,500
(2)	Suspense Account To Profit & Loss Adjustment A/c (In the previous year, there was an overcast error in the Purchase Account, which has now been rectified.)	Dr.		9,000	9,000
(3)	Profit & Loss Adjustment A/c To A's Account (error in recording a credit purchase of 3,000 from A, which was incorrectly entered as sales. This error has now been rectified.)	Dr.		6,000	6,000
(4)	Y's Account To X's Account (The amount received from X was incorrectly posted to Y's account. We have now rectified this error)	Dr.		2,000	2,000
(5)	Suspense Account To Q's Account (The amount of ₹700 received from Q was incorrectly debited to his account. We have now rectified this error)	Dr.		700	700
(6)	Trade receivables To Suspense Account (₹500 due by Q not taken into trial balance; now rectified)	Dr.		500	500

Date	Particulars			Dr. ₹	Cr. ₹
(7)	R's Account To Profit & Loss Adjustment A/c (Sales to R omitted last year; now adjusted)	Dr.		2,000	2,000
(8)	Suspense Account To Profit & Loss Adjustment A/c (Excess posting to purchase account last year, ₹2,593, instead of ₹2,395, now adjusted)	Dr.		198	198
(9)	Profit & Loss Adjustment A/c To Roy's Capital Account (Balance of Profit & Loss Adjustment A/c transferred to Capital Account)	Dr.		10,898	10,898
(10)	Roy's Capital Account To Suspense Account (Balance of Suspense Account transferred to the Capital Account)	Dr.		10,698	10,698

**Note :** Entries No. (2) and (8) may even be omitted; but this is not advocated.

**Profit and Loss Adjustment Account**  
(Prior Period Items)

	₹		₹
To A	6,000	By Motor Vehicles A/c	4500
To Vivek's Capital (transfer)	7500	By Suspense A/c	9,000
	13500		13500

**Suspense Account**

	₹		₹
To Profit & Loss Adjustment Account	9000	By Vivek's Capital Account (Transfer)	9700
To Q	700		
	9700		9700

## ILLUSTRATION 9

Ramesh drew a Trial Balance for the year ended 31.03.2021. There was a difference in the Trial Balance which he reflects in a Suspense Account. On a scrutiny by the Firm's Auditors, the following errors were found:

1. Purchases day book for the month of April, was undercast by ₹500.
2. Sales day book of October, was overcast by ₹5000.
3. A Computer purchased for ₹4050 was entered in the Computer Account as ₹405.
4. A bill for ₹5,000 drawn by Ramesh was not entered in the Bills Receivable Book.
5. A machinery purchased for ₹5,000 was entered in the Purchase book.

Pass necessary Journal Entries to rectify the same and ascertain the difference in the Trial Balance that was shown under the Suspense Account in respect of the above items.

## SOLUTION

Date	Particulars	L.F	Debit	Credit
1.	Purchase A/c To Suspense A/c	Dr.	500	500
2.	Sales A/c To Suspense A/c	Dr.	5000	5000
3.	Computer A/c To Suspense A/c	Dr.	3645	3645
4.	B/R A/c To Party A/c	Dr.	5,000	5,000
5.	Machinery A/c To Purchase A/c	Dr.	5,000	5,000

### Suspense A/c

To Difference in Trial Balance (Balancing figure)	9145	By Purchase A/c By Sales A/c By Furniture A/c	500 5000 3645
	<hr/> 9145		<hr/> 9145

### Comment:

- The debit side of the trial balance had a shortfall of ₹ 9145. To temporarily balance the trial balance, this difference was recorded on the debit side of the suspense account. However, after rectification, the balance in the suspense account has returned to zero, indicating that the trial balance now reconciles.
- Errors (iv) and (v) are double-sided errors, and their rectification does not require the involvement of the suspense account. On the other hand, errors (i), (ii), and (iii) are one-sided errors, and their rectification involves adjustments to the suspense account.
- (v) is Error of Principle, (iv) is Errors of Full omission and (i), (ii) & (iii) are Error of commission.



## TEST YOUR KNOWLEDGE

### True and False

1. When there is a complete omission error, the trial balance will not balance equally. **(ICAI Study Material)**  
**Sol. False:** In the event of a complete omission error, the trial balance will balance equally.
2. When errors are identified after the preparation of the trial balance, a suspense account is created.  
**Sol. True,** In order to reconcile the discrepancy in the balances of the trial balance, a suspense account is created. **(ICAI Study Material)**
3. When an expense is incorrectly categorized as the purchase of an asset, it is referred to as an error of principle. **(ICAI Study Material)**  
**Sol. True,** When the account being debited is fundamentally incorrect, it is referred to as an error of principle.
4. The trial balance agrees when compensating errors are present. **(ICAI Study Material)**  
**Sol. True:** Compensating errors occur when two different mistakes result in the same amount being credited and later debited, canceling each other out. As a result, when the trial balance is prepared, these errors do not affect its balance.
5. An error of principle occurs when an amount is mistakenly recorded on the wrong side of the account.  
**Sol. False,** An error of commission refers to the situation where an amount is mistakenly recorded on the wrong side of the account. **(ICAI Study Material)**
6. When purchasing furniture, the expenses incurred for repairs should be recorded by debiting the Repairs Account. **(ICAI Study Material)**  
**Sol. False,** When acquiring furniture, the amount allocated for repairs should be debited to the Furniture Account, considering it as a capital expenditure.
7. To rectify the errors identified in the current accounting period, an account named "Profit & Loss adjustment account" is opened. **(ICAI Study Material)**  
**Sol. False,** To correct the errors identified in the following accounting period, the "Profit & Loss adjustment account" is created.
8. Correcting errors in subsequent accounting periods invariably impacts the profit or loss of that specific period.  
**Sol. False,** Rectifying errors in subsequent accounting periods pertaining to Personal & Real Accounts will have no impact on the profit of that particular period.
9. Errors of principle occur when there is an incorrect allocation of expenditure or receipt between capital and revenue.  
**Sol. True,** An error of principle arises when a transaction is recorded in a fundamentally incorrect manner.
10. Incorrect totaling of subsidiary books does not have any impact on the trial balance.  
**Sol. False,** The trial balance is affected by the incorrect totaling of subsidiary books because it leads to inaccurate postings in the accounts and subsequently impacts the trial balance itself.
11. When an amount is erroneously posted in an incorrect account or written on the incorrect side of an account, it is referred to as an error of commission.  
**Sol. True,** Error of commission encompasses various mistakes such as incorrect posting, improper balancing, inaccurate carry forward, erroneous totaling, and similar errors.

- 12.** An instance of commission error can be illustrated by either undercasting or overcasting a subsidiary book.
- Sol.** True, Error of commission refers to an error that occurs due to incorrect posting, incorrect balancing, incorrect carry forward, incorrect totaling, and similar factors.
- 13.** If the general expenses account has been charged for the acquisition of computer, it results in a compensating error.
- Sol.** **False,** This error reflects error of principle as the capital nature (computer) item is treated as revenue nature.
- 14.** Error of principle can have an impact on the trial balance.
- Sol.** False, The trial balance remains unaffected by errors of principle when both debit and credit aspects of a transaction are recorded accurately
- 15.** The method for correcting errors is based on the point at which the errors are identified.
- Sol.** True, Errors can be identified at different stages, and the process of rectification depends on the stage of error detection. These stages include:
- (a) Before preparing the Trial Balance.
  - (b) After the Trial Balance but before final accounts are prepared.
  - (c) After final accounts have been prepared, in the subsequent accounting period.
- 16.** In case of complete omission, trial balance doesn't tally.
- Sol.** **False,** An error of omission arises when a transaction is unintentionally left unrecorded in the books of original entry.
- In the scenario of a complete error of omission, the trial balance still balances because the transaction is entirely omitted from the records.
- Detecting a complete omission error can be challenging since there are no corresponding debits or credits recorded. As a result, the overall balance appears to be correct.
- 17.** When errors are identified after preparation of trial balance, suspense account is created.
- Sol.** **True,** If errors are detected after the trial balance has been prepared, a suspense account is established to adjust for the difference in the trial balance caused by errors that cannot be rectified with complete journal entries.
- To put it simply, errors that were previously unresolvable due to the lack of suitable journal entries are now addressed by introducing one or more journal entries that account for the difference, utilizing the suspense account as a means of adjustment.

## Multiple Choice Questions

1. The error of recording goods purchased from Pankaj for 5,000 in the sales book will.....the gross profits:

- (a) Increase. (b) Decrease.  
(c) Will have no effect on. (d) Result cannot be measured. **(ICAI Study Material)**

**Sol.** (a) Increase.

2. If a purchase return of ₹500 has been erroneously debited to the sales returns account, but has been accurately recorded in the suppliers' account, the following situation arises :

- (a) In Trial balance, Debit side will be 500 more than the credit side.  
(b) In Trial balance, credit side will be 500 more than the debit side.  
(c) In Trial balance, Debit side will be 1000 more than the credit side.  
(d) None of the above **(ICAI Study Material)**

**Sol.** (c) In Trial balance, Debit side will be 1000 more than the credit side.

3. If the amount is mistakenly recorded in an incorrect account or written on the wrong side of the account, it is referred to as

- (a) Error of commission. (b) Error of commission.  
(c) Error of principle. (d) None of the above **(ICAI Study Material)**

**Sol.** (a)

4. Goods valued ₹100 given as charity should be recorded as a credit to

- (a) Cash account. (b) Charity account. (c) Purchase account. (d) None of the above

**Sol.** (c) Charity account. **(ICAI Study Material)**

5. Sales of office furniture should be credited to

- (a) Sales Account. (b) Furniture Account.  
(c) Depreciation account (d) Purchase Account. **(ICAI Study Material)**

**Sol.** (b) Furniture Account.

6. The purpose of preparing a trial balance is

- (a) To locate errors of commission. (b) To locate errors of principle.  
(c) To locate clerical errors. (d) None of the above **(ICAI Study Material)**

**Sol.** (c) To locate clerical errors.

7. Goods purchased from X for ₹ 25,000 passed through sales book. This error will

- (a) Increase gross profit (b) Decrease gross profit  
(c) No effect on profit (d) None of the above

**Sol.** (a) Increase gross profit

8. When an amount is recorded in an incorrect account or placed on the incorrect side of the account, it is referred to as-
- (a) Error of commission (b) Error of omission  
(c) Error is principle (d) Compensating Error
- Sol.** (a) Error of commission
9. The payment of ₹ 100 for erecting a machine should be recorded as a debit to
- (a) Wages A/c (b) Machinery A/c (c) Repair A/c (d) None of the above
- Sol.** (b) Machinery A/c
10. Goods given as free samples should be credited to:
- (a) Purchases A/c (b) Charity A/c (c) Profit and Loss A/c (d) None of the above
- Sol.** (a) Purchases A/c
11. Goods taken over by Owner of the business should be credited to:-
- (a) Purchases A/c (b) Drawings A/c (c) Profit and Loss A/c (d) None of the above
- Sol.** (a) Purchases A/c
12. Sale of office computer should be credited to:-
- (a) Sales A/c (b) Bank A/c  
(c) Office Computer A/c (d) None of the above
- Sol.** (c) Office Computer A/c
13. Trial Balance is prepared for:-
- (a) Finding clerical errors (b) Finding compensating errors  
(c) Finding errors of principle (d) All of the above
- Sol.** (a) Finding clerical errors
14. ₹ 500 received from Tarun whose account, was written off as a bad-debt should be credited to:-
- (a) Tarun A/c (b) Bad debts recovered Account  
(c) Cash A/c (d) None of the above
- Sol.** (b) Bad debts recovered Account

### Theory Questions

1. **What is the distinction between errors of omission and errors of commission?**
- Sol.** (i) **Errors of Omission:** Errors of omission occur when a transaction is completely or partially left out from the accounting records. This can happen when a credit purchase of furniture is not recorded or when an entry is not posted in the ledger.
- (ii) **Errors of Commission:** Errors of commission refer to situations where an amount is incorrectly posted in an account, written on the wrong side, or when there are mistakes in totals or balance calculations. These errors involve actions taken but done incorrectly, such as posting an amount in the wrong account or making errors in calculations.

**2. What is “error of principle”, and how does it impact the Trial Balance?**

**Sol. Errors of principle:** Errors of principle occur when a transaction is recorded in violation of accounting principles. For instance, if an asset purchase is mistakenly treated as an expense, it is considered an error of principle. Despite being recorded on the correct side, but in the wrong account, this type of error does not affect the trial balance. For example, if the purchase of a typewriter is erroneously debited to the office expenses account, the trial balance will still be in agreement.

The correction method discussed thus far is applicable when errors are identified before the end of the accounting period. After making the necessary corrections, the trial balance will be in balance. However, in some cases, errors are masked to make the trial balance artificially agree by using a suspense account. The difference in the trial balance is posted to the suspense account, debiting it if the credit column exceeds the debit column, or crediting it in the opposite case.

Every error detected requires a complete journal entry for correction. Errors that were not rectified earlier due to journal entry limitations are now addressed through one or more journal entries, with the suspense account accounting for the difference or unknown side. Errors that could have been corrected earlier will also be rectified using the same approach.

**3. What are the various categories of errors and how do they impact the agreement of a trial balance?**

**Sol. Types of Errors and Their Impact on the Agreement of Trial Balance:**

**Errors of Principle:**

These errors occur when there is a deviation from accounting principles. They are double-sided errors and do not affect the agreement of the trial balance. Examples include treating revenue expenses as capital expenditures or recording the sale of a fixed asset as a regular sale.

**Clerical Errors:**

These errors result from mistakes in following accounting procedures. They may or may not affect the agreement of the trial balance. Clerical errors can be further classified as follows:

**(a) Errors of Omission:**

These errors involve completely omitting an entry from the subsidiary book. If an entry is fully omitted, the trial balance will agree. For example, failing to record a sale of ₹3,000 to A on 30.3.21.

**(b) Errors of Commission:**

These errors include writing the wrong amount in the subsidiary book or posting the wrong account in the ledger. The trial balance will still agree despite these errors. Examples include entering a purchase of ₹1,000 from A as ₹100 or debiting P's account by ₹4,000 instead of Q's account.

**(c) Compensating Errors:**

Compensating errors occur when two or more mistakes offset each other's effect on the trial balance, resulting in agreement. For instance, an excess debit of ₹4,000 to the Furniture account and an excess credit of ₹4,000 to the Sales account.

**Note:** Errors described in (b) (ii) to (vi) above will cause the trial balance to disagree.

**4. What is a suspense a/c? write a short note.**

**Sol.** When the trial balance doesn't balance, the difference is recorded in an account called Suspense account. The difference is:

debited (if the debit side of the trial balance is short) or

credited (if the credit side of the trial balance is short) to the Suspense account.

Thus, by utilizing the Suspense account, the trial balance is artificially balanced.

For rectifying one-sided errors, the affected amount (either debit or credit) is adjusted in the account where the mistake occurred, while the opposite effect is recorded in the Suspense account.

Once all one-sided errors are rectified, the balance in the Suspense account becomes zero.

In the case of rectifying double-sided errors, the Suspense account remains unaffected.

**5.** How can we define an error of principle, and what impact does it have on the Trial Balance?

**Sol.** An error of principle occurs when a transaction is recorded in violation of established accounting principles, such as incorrectly categorizing the purchase of an asset as an expense. Despite the misclassification, the trial balance remains unaffected because the amounts are placed correctly, despite being in the wrong account.

For instance, if a computer purchase is erroneously debited to the office expenses account, the trial balance will still reconcile.

**6.** The trial balance of XYZ & Sons failed to agree and the difference 10285 was put into suspense pending investigation which disclosed that:

- (i) Purchase returns day book had been correctly entered and totalled at 3080, but had not been posted to the ledger.
- (ii) Discounts received 660 had been debited to discounts allowed.
- (iii) The Sales account had been under added by 5,000.
- (iv) A credit sale of ₹ 735 had been debited to a customer account at 735.
- (v) A furniture bought originally for 3500 four years ago and depreciated to 600 had been sold for 750 in the beginning of the year but no entries, other than in the bank account had been passed through the books.
- (vi) An accrual of 280 for telephone charges had been completely omitted.
- (vii) A bad debt of 780 had not been written off and provision for doubtful debts should have been maintained at 10% of Trade receivables which are shown in the trial balance at 11695 with a credit provision for bad debts at 1160.
- (viii) Tools bought for 600 had been wrongly debited to purchases.
- (ix) The proprietor had withdrawn, for personal use, goods worth 980. No entries had been made in the books.

You are required to give rectification entries without narration to correct the above errors before preparing annual accounts

**Sol.**

S. No.	Particulars	Debit (₹)	Credit (₹)
i)	Suspense A/c Dr. To Purchase Returns A/c	3080	3080
ii)	Suspense A/c Dr. To Discount Allowed A/c To Discount Received A/c	1320	610 610



- (iv) Cash received from Kamal, ₹ 3100 was posted to the debit of Gaurav.
- (v) Goods worth ₹ 420 were dispatched to a customer before the close of the year but no invoice was made out.
- (vi) Goods worth ₹ 500 were sent on sale or return basis to a customer and entered in the Sales Book. At the close of the year, the customer still had the option to return the goods. The sale price was 25% above cost.

You are required to give journal entries to rectify the errors in a way so as to show the current year's profit or loss correctly.

**Sol.**

**Journal Entries**

S. No.	Particulars	Debit (₹)	Credit (₹)
i)	Suspense A/c To Profit and Loss Adjustment A/c  (Being Purchase A/c over debited last year by ₹ 45, now rectified)	Dr.   45	   45
ii)	Profit & Loss Adjustment A/c Customer's A/c To Suspense A/c  (Being correction of the entry- Sales A/c was over credited by ₹ 180 and Customer was credited by ₹ 863 instead of being debited by ₹683)	Dr. Dr.  180 683	   863
iii)	Suspense A/c To Profit & Loss Adjustment A/c  (Being Returns Inward Account was debited by ₹ 255 instead of Returns Outwards Account being credited by ₹ 255, now rectified)	Dr.   510	   510
iv)	Suspense A/c To Kamal A/c To Gaurav A/c  (Being cash received from Kamal, ₹ 620 was posted to the debit of Gaurav, now rectified)	Dr.   620	   310 310
v)	Customer's A/c To Profit & Loss Adjustment A/c  (Being goods worth ₹ 420 were dispatched to a customer before the close of the year but no invoice was made out, now rectified)	Dr.   420	   420



S. No.	Particulars	Debit (₹)	Credit (₹)
vi)	Profit & Loss Adjustment A/c Dr. Inventory A/c Dr. To Customer's A/c	100 400	500
vii)	Profit & Loss Adjustment A/c Dr. To Capital A/c  (Being transfer of Profit & Loss Adjustment A/c balance to the Capital A/c)	695	695

**Profit & Loss Adjustment A/c**

Particulars	Amount	Particulars	Amount
To Suspense A/c	180	By Suspense A/c	45
To Customer's A/c	100	By Suspense A/c	510
To Capital A/c (Balancing Figure)	695	By Customer's A/c	420
–			
	975		975