



Session 5 – Correction of Errors

Learning Objectives



Identify the different types of errors

Understand the basic process of errors management

Appreciate the relationship between errors and profits

Explain the process of rectification of errors after finalisation of accounts

Introduction

- Error: An error is an unintentional mistake and it can occur at any stage of business transaction processing.

- Two types of errors can broadly be identified:



1.

- Those that do not affect the agreement of the Trial Balance (total debits equal to total credits)

2.

- Those that affect the agreement of the trial balance (total debits not equal to total credits)

Errors Not Affecting Trial Balance Agreement

These are errors which when committed, the trial balance will still agree because the two-fold effect would not be affected.

1. Error of Omission

This is where a transaction is not recorded in the books of the business at all. It is said that the transaction is completely omitted from the books. An example is where sale to Jane, GH¢2,000 is not recorded in the books of K Ltd at all.

2. Error of Commission

This is where the correct amount is entered but in the wrong account. An example is Cheque paid to Amina for GH¢300 but is debited to Anima's account.

Errors Not Affecting Trial Balance Agreement

3. Error of Principle

This is where a transaction is posted to the wrong class of account, thereby breaking the accounting principle. For instance, cash received from the disposal of a fixed asset is credited to sales account of a buying and selling business.

4. Error of Original Entry

This error is said to have been committed when the figure used to pass entries into the books is different from the original correct figure. Here, the double entry is adhered to but the figure used is wrong. Example is, Rent paid GH¢350 was recorded in the books as GH¢500 (i.e. for debit and credit)

5. Complete Reversal of Entry

In this situation, the correct figures are used but the entries are posted to the wrong sides of the two accounts involved. For example, sales on credit to Ama is debited to Sales account (instead of credit) and credited to Ama's account (instead of debit). The entries are said to have been reversed completely.

Note: if the reversal is in respect of only one account, the trial balance will not agree.



Errors Not Affecting Trial Balance Agreement



6. Error of Transposition

This form of error occurs where there is a wrong sequence of the individual characters within a number when recording. Eg; GHC132 recorded as GHC123

Correction of these errors is done by either reversing the wrong entries and posting the correct ones or finding the differences and passing the correct entries. Suspense account will not be affected as the Trial Balance was not affected.

7. Compensating errors

This error involves situations where errors cancel each other out. If the sales account was added up to be GH¢10 too much and the purchases account was also added up to be GH¢10 too much, then these two errors would cancel out in the trial balance. This is because the totals of both the debit side and the credit side of the trial balance will be GH¢10 too much.

Errors Affecting the Trial Balance Agreement

Examples include:

- Casting Errors-“over-adding” or “over-subtracting”.
- Single Entries-One debit/credit without corresponding credit/debit.
- Two debits or two credits for one transaction.
- Over/understatements in one account only.
- Others

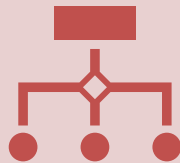


CORRECTION OF ERRORS

We make corrections to double entry accounts by preparing journal entries.



1. Show the corrections by means of journal entries, then...



2. Show the corrections in the double entry set of accounts, by posting these journal entries to the ledger accounts affected.

Suspense Account

- This account is introduced anytime the Trial Balance fails to agree and efforts to locate the error have not been fruitful.
- That is to say, suspense account is an interim account introduced to ensure the agreement of the Trial Balance pending the finding of the error.
- This means that in correcting any error that affected the Trial Balance, suspense account will be involved.
- The introduction of a suspense account becomes necessary when interim or final accounts need to be prepared but efforts to identify errors affecting the agreement if the Trial Balance have proved futile.

Suspense Account

- The principle is that when the error could not be traced and the Trial Balance was not agreeing, suspense account stood in for the entry to ensure agreement.
- Therefore, if the error has now been identified, then the Suspense Account must leave the books for the right entry to occupy its rightful place.
- **Note:** Suspense account should only be opened after efforts to locate the error had not yielded the desired results and not to be used as a safe haven for dumping imbalances.
- The structure of the suspense account is like any T-account.

Suspense Account

Difference in trial balance xxx	Difference in trial balance xxx
Discount received xxx	Purchases xxx
Sales xxx	Creditors xxx

- **Note:** Two balances cannot happen at the same time but to show that it could be a debit or credit balance b/fwd.

Correction of Errors and Financial Statements

- If the errors are not found before the financial statements are prepared, the suspense account balance will be included in the **statement of financial position**.
- Where the balance is a credit balance, it should be included on the capital and liabilities side of the statement of financial position.
- When the balance is a debit balance it should be shown on the assets side of the statement of financial position.
- **Reported profit** may not be correct if the errors have effect on items that appear in the computation of profit. After the errors have been corrected, the profit arrived at earlier should be adjusted to show the true performance of the business.
- The general principle is that if the transaction had the effect of reducing the profit, then the figure must be added to the “incorrect profit”. On the other hand if it increased the profit unduly, then it must be subtracted from the “incorrect profit” on item by item basis so that in the final analysis the profit will come to what it ought to be, the True Profit.

Correction of Net Profit

	GH¢	GH¢
Net Profit per draft account		XXXXX
Add: Revenue understated	XXXX	
Income/gain understated	XXXX	
Cost/expense overstated	<u>XXXX</u>	<u>XXXXX</u>
		XXXXX
Less: Revenue overstated	XXXX	
Income/gain overstated	XXXX	
Cost/expense understated	<u>XXXX</u>	<u>XXXXX</u>
Corrected Net Profit for the Year		<u>XXXXX</u>

Redrafting the Statement of Financial Position

- Redrafting the statement of financial position is done by adjusting the affected assets, liabilities and capital as well as the corrected profit above to arrive at the balance that shows the true financial position of the business as at the given date.

Example

Worksheet 3

