

Correcting Errors

Types of Accounting Errors

- **Omission** – failing to record an event
- **Accrual error** – accruing the wrong amount or failing to make accrual (interest, salary expense or interest, rent revenue)
- **Deferral error** – deferring wrong amount or failing to make deferral (adjustment to supplies, prepaid rent, unearned rev)
- **Classification error** (debiting rent to insurance expense)
- **Arithmetic mistake** – (incorrect total on invoice)
- **Incorrect accounting principle** (expensing long-lived asset instead of capitalizing it)
- **Improper estimate** (using 2% of sales rather than 4% sales for bad debts expense)
- **Transposition** (reversal of two digits) \$38 as \$83.
- **Slide** (decimal point in wrong place) \$250 as \$25.
- **Posting error** (crediting instead of debiting an account)

Finding Errors

- **Bank Reconciliation** – discrepancies between bank and book and other errors.
- **Trial Balance** – debits don't equal credits
- **Review of Periodic Adjustments** – discover depreciation expense omitted or incorrect amount recorded.
- **Routine Internal Audit** – reviews to ensure reliability of accounting procedures
- **Year-End Financial Audit** – performed by external auditors to assure financial statements fairly presented.

Correcting Errors

- Treatment depends on when the error was found and which accounts are affected.
 - Current period errors - those discovered before books are closed – simply require a correcting entry
 - Prior period errors - discovered after books are closed (temporary accounts closed into retained earnings)
 - If prior period error affected net income, then a ***prior period adjustment*** made to retained earnings (temporary accounts already closed).

Bank Reconciliation

- Process of bringing bank and cash accounts into balance.
- Journalize adjustments to book balance.

Differences Between Book & Bank

- Transactions recorded on company's books but not the bank statement.
 - Deposits in transit
 - Outstanding checks
 - *Undeposited cash* aka "*cash on hand*" (record receipts daily but deposit weekly)
- Transactions recorded by bank but not yet on company's books.
 - Credit memos – additions to bank balance
 - Debit memos – deductions from bank balance
 - Authorized payments by the bank to third party (auto deductions)
- Errors in bank or company records

Bank Reconciliation –Practice Co.

- 3/31 bank statement balance \$5,000
- 3/31 cash account balance \$4,250
- Feb deposits in transit recorded on March bank statement: \$225
- 3/31 deposit in transit \$500
- Feb outstanding check deducted on March bank statement \$450.
- Feb outstanding checks not deducted on March bank statement \$250
- Another Co's check deducted from Practice Co's bank statement \$55
- Checks issued in March & outstanding \$880
- Service charge recorded on March bank statement \$45
- Interest earned on checking account per March bank statement \$35
- NSF check from D.P. Krapft \$150
- Note collected by bank and recorded on statement \$500
- Canceled check for \$555 was credited to Cash as \$510
- Practice Co's cash on hand (undeposited cash) \$120

Bank Bal.	5,000	Book Bal.	4,250
<u>Add:</u>		<u>Add:</u>	
Deposit in transit	500	Interest	35
Another Co Ck	55	Note	500
Undeposited cash	120		
		<u>Deduct:</u>	
<u>Deduct:</u>		Service Charge	(45)
Outstanding Cks - March	(880)	NSF	(150)
Outstanding Cks - Feb	<u>(250)</u>	Error cancelled check	<u>(45)</u>
Adjusted Bank Balance	4,545	Adjusted Book Balance	4,545

Steps for Locating Trial Balance Errors

- 1) Make sure account balances correctly transferred from GL to trial balance
 - No ledger accounts with abnormal balance
 - Each GL account matches one on trial balance
 - Every ledger account with a balance is on trial balance
- 2) Check if ledger account balances were calculated correctly
- 3) Check journal entries and postings for errors
 - Work from journal to ledger to see that journal entries were posted correctly.
 - Review journal entries for obvious errors (unequal debits and credits)

Checking Trial Balance for Errors

(These tricks work when there is only one error.)

- **Doubling** (post a debit as credit or vice versa)
 - The difference between the debit and credit column totals is double the amount of the error.
 - Divide by two to find account balance out of place.

Checking Trial Balance for Errors

(These tricks work when there is only one error.)

- Trial balance difference is divisible by 9 then may be slide or transposition error.
 - **Slide Error** –unreasonable balance may indicate (\$20,036 instead of \$236)
 - **Transposition Error** – \$920 instead of \$290.
- **Finding Transposition Errors**
 - Take difference on trial balance and add 1 to 1st digit
(if difference = 520 then $5+1 = 6$)
 - Check accounts where the difference between the first and second digits = that difference + 1.
(cash balance = 1,350 & $1-3 = 2 \neq 6$ so don't investigate)
(A/P balance = 935 & $9-3 = 6$ so investigate)

Finding Transposition Error

Trial Balance – Oops Company

	<u>Dr.</u>	<u>Cr.</u>	
Cash	513		5-1 = 4 don't investigate
A/R	350		3-5 = 2 investigate
Equip	717		7-1 = 6 don't investigate
A/P		549	5-4 = 1 don't investigate
Capital		608	6-0 = 6 don't investigate
Drawing	258		2-5 = 3 don't investigate
Revenue		978	9-7 = 2 investigate
Ad Expense	425		4-2 = 2 investigate
Rent Expense	52		5-2 = 3 don't investigate
	2,315	2,135	

$180 / 9 = 20$

1st digit difference + 1
(1+1=2)

Check account balances
where difference between
1st & 2nd digits = 2

Trial Balance
Practice Corp.
12/31/09

Account	Dr.	Cr.
Cash	10	
A/R	15	
Allowance Doubtful Accounts	2	
Inventory	72	
Prepaid Rent	5	
Building	110	
Accumulated Deprec. - Bldg.	15	
Accounts Payable		10
Interest Payable		5
Bonds Payable		50
Discount Bonds Payable		5
Capital Stock		35
Retained Earnings		20
Sales		250
Sales Returns & Allowances	30	
Purchases		150
Purchase Discounts		5
Depreciation Expense	10	
Interest Expense	5	
Loss on Sale Equipment		25
Totals	274	555

Trial Balance
Practice Corp.
12/31/09

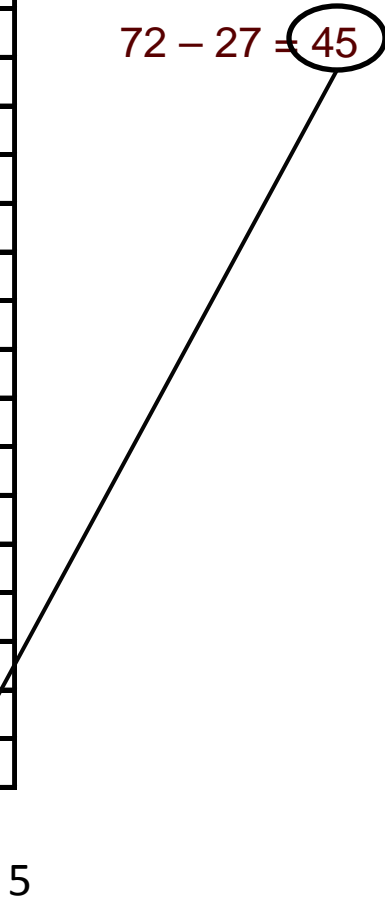
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Bonds Payable		50
Discount Bonds Payable	5	
Capital Stock		35
Retained Earnings		20
Sales		250
Sales Returns & Allowances	30	
Purchases	150	
Purchase Discounts		5
Depreciation Expense	10	
Interest Expense	5	
Loss on Sale Equipment	25	
Totals	437	392

1-0 = 1 don't investigate
 1-5 = 4 don't investigate
 can't transpose
 7-2 = 5 investigate

$72 - 27 = 45$

1st digit difference + 1
(4+1=5)

$45 \div 9 = 5$



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Capital Stock		35
Retained Earnings		20
Sales		250
Sales Returns & Allowances	30	
Purchases	150	
Purchase Discounts		5
Depreciation Expense	10	
Interest Expense	5	
Loss on Sale Equipment	25	
Totals	392	392

Errors Not Revealed by Trial Balance

- Transactions never recorded on company books
- Incorrect amount recorded in the debit and credit of an entry
- Amount recorded in the wrong account (debit office supplies instead of equipment)

Post-Closing Trial Balance

- Shows only permanent or balance sheet accounts.

Normal Account Balances

- Sales
- Sales Returns & Allowances
- Sales Discounts
- Cost of Goods Sold
- Purchases
- Purchase Discounts
- Purchase Returns & Allowances
- Long-Term Investments
- Bonds Payable
- Discount on Bond Payable
- Premium on Bond Payable
- Retained Earnings
- Capital
- Allowance Doubtful Accounts
- Common Stock
- Capital Stock
- Withdrawals or Drawing
- Accumulated Depreciation
- Patent
- Gain on Sale
- Loss on Sale
- Treasury Stock