

SUSPENSE ACCOUNTS AND ERROR CORRECTION

Suspense accounts and error correction are popular topics for examiners because they test understanding of bookkeeping principles so well

A suspense account is a temporary resting place for an entry that will end up somewhere else once its final destination is determined. There are two reasons why a suspense account could be opened:

1. a bookkeeper is unsure where to post an item and enters it to a suspense account pending instructions
2. there is a difference in a trial balance and a suspense account is opened with the amount of the difference so that the trial balance agrees (pending the discovery and correction of the errors causing the difference). This is the only time an entry is made in the records without a corresponding entry elsewhere (apart from the correction of a trial balance error - see error type 8 in Table 1).

Types of error

Before we look at the operation of suspense accounts in error correction, we need to think about types of error - not all types affect the balancing of the records and hence the suspense account. Refer to Table 1.

Table 1: Types of error

Error type	Suspense account involved?
1 Omission - a transaction is not recorded at all	No
2 Error of commission - an item is entered to the correct side of the wrong account (there is a debit and a credit here, so the records balance)	No
3 Error of principle - an item is posted to the correct side of the wrong type of account, as when cash paid for plant repairs (expense) is debited to plant account (asset) (errors of principle are really a special case of errors of commission, and once again there is a debit and a credit)	No
4 Error of original entry - an incorrect figure is entered in the records and then posted to the correct account Example: Cash \$1,000 for plant repairs is entered as \$100; plant repairs account is debited with \$100	No

5 Reversal of entries - the amount is correct, the accounts used are correct, but the account that should have been debited is credited and vice versa

Example: Factory employees are used for plant maintenance:

Correct entry:

Debit: Plant maintenance

Credit: Factory wages

Easily done the wrong way round No

6 Addition errors - figures are incorrectly added in a ledger account Yes

7 Posting error

a an entry made in one record is not posted at all

b an entry in one record is incorrectly posted to another

Examples: cash \$10,000 entered in the cash book for the purchase of a car is:

a not posted at all

b posted to Motor cars account as \$1,000 Yes

8 Trial balance errors - a balance is omitted, or incorrectly extracted, in preparing the trial balance Yes

9 Compensating errors - two equal and opposite errors leave the trial balance balancing (this type of error is rare, and can be because a deliberate second error has been made to force the balancing of the records or to conceal a fraud) Yes, to correct each of the errors as discovered
Yes, to correct each of the errors as discovered

For examination purposes we are more often concerned with the second of these - differences and error correction.

Correcting errors

Errors 1 to 5, when discovered, will be corrected by means of a journal entry between the accounts affected. Errors 6 to 9 also require journal entries to correct them, but one side of the journal entry will be to the suspense account opened for the difference in the records. Type 8, trial balance errors, are different. As the suspense account records the difference, an entry to it is needed, because the error affects the difference. However, there is no ledger entry for the other side of the correction - the trial balance is simply amended.

An illustrative question

The bookkeeping system of Turner is not computerised, and at 30 September 20X8 the bookkeeper was unable to balance the accounts. The trial balance totals were:

Debit \$1,796,100

Credit \$1,852,817

Nevertheless, he proceeded to prepare draft financial statements, inserting the difference as a balancing figure in the balance sheet. The draft profit and loss account showed a profit of \$141,280 for the year ended 30 September 20X8.

He then opened a suspense account for the difference and began to check through the accounting records to find the difference. He found the following errors and omissions:

1. \$8,980 - the total of the sales returns book for September 20X8, had been credited to the purchases returns account.
2. \$49,600 paid for an item of plant purchased on 1 April 20X8 had been debited to plant repairs account. The company depreciates its plant at 20% per annum on a straight line basis, with proportional depreciation in the year of purchase.
3. The cash discount totals for the month of September 20X8 had not been posted to the general ledger accounts. The figures were:
Discount allowed \$836
Discount received \$919
4. \$580 insurance prepaid at 30 September 20X7 had not been brought down as an opening balance
5. The balance of \$38,260 on the telephone expense account had been omitted from the trial balance
6. A car held as a non-current asset had been sold during the year for \$4,800. The proceeds of sale were entered in the cash book but had been credited to the sales account in the general ledger. The original cost of the car \$12,000, and the accumulated depreciation to date \$8,000, were included in the motor vehicles account and the accumulated depreciation account. The company depreciates motor vehicles at 25% per annum on a straight line basis with proportionate depreciation in the year of purchase but none in the year of sale.

Required:

(a) Open a suspense account for the difference between the trial balance totals. Prepare the journal entries necessary to correct the errors and eliminate the balance on the suspense account. Narratives are not required. (10 marks)

(b) Draw up a statement showing the revised profit after correcting the above errors. (6 marks)

Total (16 marks)

Discussion

The approach to the question should be:

1. Read the requirement paragraph at the end of the question.
2. Attack the question - note that narratives are not required. Begin by opening the suspense account. Which side? More debit is needed to balance the trial balance, so debit the suspense account with \$56,717.

Then deal with the errors in order:

1. Sales returns should have been debited to the sales returns account and they have been credited to the purchases returns account. There are two errors here - the wrong account has been used and

an entry which should have been a debit has been entered as a credit. The suspense account entry must therefore be for 2 x \$8,980 or \$17,960.

2. An error of principle - no suspense account entry. Depreciation must be adjusted.
3. Items have not been posted, therefore the suspense account is involved.
4. Effectively a posting error - the suspense account is again involved.
5. A trial balance error must affect the suspense account - but no ledger entry.
6. This one needs thought. Take it one sentence at a time. Is the suspense account involved? No, because we have an error of commission followed by some unrecorded transactions.

Attempt Part (a) of the question before studying the answer as detailed in Table 2. Let's now turn to Part (b). The most convenient format for the answer is two columns for - and +. Set them up and enter the adjustments appropriately. Which of the errors affect the profit? In fact they all do. Attempt Part (b) now before looking at the answer detailed in Table 3.

Table 2: Answer - Part (a)

Suspense Account			
	\$		\$
Difference	56,717	Sales returns	8,980
Discount received	919	Purchases returns	8,980
		Discount allowed	836
		--- Insurance	580
		Telephone (trial balance)	<u>38,260</u>
	57,636		57,636

Journal Entries			
	\$		\$
1 Sales returns account	8,980		
		Suspense account	8,980
Purchases returns account	8,980		
		Suspense account	8,980

2 Plant account	9,600	
Plant repairs account		9,600
Depreciation (income statement)	960	
Plant depreciation account		960
3 Discount allowed account	836	
Suspense account		836
Suspense account	919	
Discount received account		919
4 Insurance account	580	
Suspense account		580
5 Trial balance (no ledger entry)	38,260	
Suspense account		38,260
6 Sales account	4,800	
Motor vehicles disposal account		4,800
Motor vehicles disposal account	12,000	
Motor vehicles asset account		12,000
Motor vehicles depreciation account	8,000	
Motor vehicles disposal account		8,000
Motor vehicles disposal account	800	

Income statement 800

Table 3: Answer - Part (b)

Adjustment to profit	-	+
	\$	\$
Profit as in draft income statement		141,280
1 Sales returns adjustment (2 x \$8,980)	17,960	
2 Plant: reduction in repairs		9,600
depreciation - $6/12 \times 20\% \times \$9,600$	960	
3 Discount allowed	836	
Discount received		919
4 Insurance - opening balance omitted	580	
5 Telephone expense omitted	38,260	
6 Profit on sale of car		800
Proceeds taken out of sales	4,800	-----
	63,396	152,599
		(63,396)
Revised net profit		89,203

Some hints on preparing suspense accounts

- Does a correction involve the suspense account? The type of error determines this. Practice, and study of Table 1 should ensure that you see immediately which errors affect the balancing of the records and hence the suspense account.
- Which side of the suspense account must an entry go? This is one of the most awkward problems in preparing suspense accounts. The best way of solving it is to ask yourself which side the entry needs to be on in the other account concerned. The suspense account entry is then obviously to the opposite side.
- Look out for errors with two aspects. In the illustrative question earlier, error 1 is a case in point. An entry has been made to the wrong account, but also to the wrong

side of the wrong account. Both errors must be corrected. It is very easy to fall into the trap of correcting only one of the errors, especially when working quickly under examination conditions.