

Correction of Errors & Suspense Accounts.

2008 Question 7.

Correction of Errors & Suspense Accounts is pretty much the only topic in Leaving Cert Accounting that requires some knowledge of how 'T' Accounts work. For this reason some people get turned off the topic but it's actually easier than it appears. First of all, there's a few fairly straightforward principles that can get you through most of the topic and also the questions that come up tend to be very repetitive (and therefore not that hard to prepare for).

Before we start it's important to have a basic understanding of debits and credits. A trial balance (which is the sheet you get for doing a Question One 'Final Account') shows a list of all the accounts and splits all of the figures into one of two columns – Just look at any Leaving Cert Question 1 and you'll see what a trial balance looks like.

The figures in the left (debit) column are all either ASSETS or EXPENSES.

The figures in the right (credit) column are all either LIABILITIES or GAINS.

Once you can drill that into your head, then this topic will never stress you too much. Remember...

**Debit Assets and Expenses / Credit Liabilities and Gains.**

If it helps to remember it, the two vowels (Asset and Expenses) are together in the first column and the two consonants (Liabilities and Gains) are together in the second.

Anyway, hopefully it will help to have a read through the 2008 solution below...

**Part (A): Journalise the necessary corrections.**

Part (a) is the biggie, it's where almost all the work is done and if we get this right, the rest of the answer is easy. Essentially, we're being asked to look at the five errors (you'll see them labeled (i) to (v) under the balance sheet in the question) and to decide what needs to be done to fix each of these errors in the accounts. For each of these errors we need to ask ourselves two questions...

- What *should have* happened?
- What *did* happen?

So let's have a go at the first one...

(i) In this error a bank overdraft was recorded on the wrong side of the trial balance (don't let the fancy wording of it put you off). Remember we need to ask ourselves two things...

- What should have happened?  
(a bank overdraft is a liability so €400 should have been recorded on the credit side of the trial balance).
- What did happen?  
(the €400 was instead recorded on the wrong side – i.e. the debit side).

To fix the problem therefore we need to put €800 on the credit side. This is because if we only put €400 on the credit side it merely cancels out the error. By putting €800 on the credit side we are cancelling out the mistake of putting €400 on the debit side and then also actually recording €400 on the credit side as should have happened.

So the answer to part (i) should look like this (don't worry if it looks weird, I'll explain it below):

(i) Journal Entry.	€	€
Bank		800
Suspense	800	

Being the correction of an overdraft incorrectly recorded

Ok it's important to understand why the answer looks like that so that everything else we do will then make sense. First of all you might remember the question asked us to 'Journalise the necessary corrections'. This means writing the corrections we need to make and then showing whether the related amounts are debits or credits. The first line of our answer above should

therefore make sense because as we worked out, we need to put €800 on the credit side of the bank account in order to fix the error that had been made.

The obvious question then is why are there two other lines in my answer? First of all it's vital (for reasons that aren't hugely important at the moment) that whenever you fix an error, the debit and credit side of your little answer should be the same. Because we have put €800 on the right of the bank account in our journal, we have to put €800 on the left (I know this probably seems weird, but it will make sense in a while I promise). In this particular case we don't need to fix any other account (because the only error they made was to do with the bank account), so when we put €800 in the debit column, we simply write the word 'suspense' beside it.

Lastly, you'll see a short line at the bottom of the journal entry in italics. We are required to add a 'narration' to each journal entry (a really quick summary of what the figures we've put in relate to). There's nothing definite that you have to write but you just have to write *something* and it should in some very brief way explain what the figures you've recorded mean.

Ok, ready for number (ii)?

(ii) A quick look at the second error in the question will tell you that there is some problem to do with the sale of jewelry. Remember we always need to ask ourselves first of all "What *should* have happened"? In this case, O'Shea sold private jewelry to a debtor on credit. As you might have noticed the crucial part of the statement is the word private – i.e. Even though this is a jewelry shop the owner for some reason brought in some of his own personal jewelry and sold it for the business. So what should have happened in the accounts was...

	€	€
Debtor	2,800	
Capital		2,800

Normally we'd expect to see 'sales' on the right but since the jewelry was his own, it has to be recorded as 'Capital' (i.e. the owner putting in his own stuff into the business).

Right, that's what *should* have happened but have a look at the question and see what *did* happen "this sale had been treated as a cash sale of stock". In other words the accounts show that it was a cash sale (but no money changed hands because it was in fact on credit) and that it was a sale of stock (but it wasn't because the owner in fact owned the goods). So our answer will look like this...

(ii) Journal Entry.	€	€
Cash		2,800
Sales	2,800	
Debtor	2,800	
Capital		2,800

Being the recording of capital introduced and sold on credit.

Does that make any sense?

In the first two lines we are removing the things that were done incorrectly. Remember the accounts wrongly showed that there had been cash sales. In other words €2,800 was recorded in cash (which is an asset and would have gone on the left since assets always go on the debit side) and €2,800 was recorded as sales (which would have gone on the credit side since sales are a gain). The first two lines of our answer therefore are undoing these mistakes by putting the relevant figures on the opposite sides.

Now if that's all we did, we'd only have undone the mistake rather than actually fixing the problem, so we still need to add into our answer what *should* have happened. The bottom two lines of our answer are simply the two things that *should* have happened in this transaction.

You'll also see the usual 'narration' – quick one line explanation of what happened.

(iii) This third error seems quite a long-winded story but really the problem is in the third sentence. First of all we're told that someone who owed us money paid us and that we recorded this correctly – there's therefore no need to do anything with this information (since there's been no error). The third sentence however tells us that the cheque the Debtor gave us was subsequently dishonoured and that we never recorded this. Since this situation was left out of the accounts, we now need to record it:

(iii) Journal Entry.	€	€
Bank		550
Debtors	600	
Debtors		600
Bad Debt	600	
Discount Disallowed		50

Being the recording of a payment received and subsequently dishonoured.

Any idea of what's going on here? Let's go through it line by line. Remember in this particular error the problem is that *nothing* was recorded (in relation to the dishonouring of the cheque). So we're basically putting into the accounts whatever should have been entered once the cheque was dishonoured. Here's the explanation...

The first thing we do is put €550 on the right of bank. This is because we thought that there was a €550 cheque in our account but now we've found out that it actually isn't there. Since bank is an asset and should be on the debit (left) side (remember the rule: Debit Assets and Expenses, Credit Liabilities and Gains), we now put the €550 on the opposite side – this has the effect of taking the €550 *out* of our bank records.

Equally we need to record the fact that a debtor who we thought paid us money now hasn't. We were told he gave us a cheque for €550 and we recorded this, but now we need to add the amount back on to our debtors figure because it turns out that he hasn't in fact paid us (the cheque was dishonoured) and so now owes us the money again. Debtors is an asset and should appear in the debit column so we should put the amount we are now owed by the debtor in the debit column (because we need to record that we are now owed *more* than the records currently show).

If you're on the ball you'll be wondering why the second line of the answer has €600 on the left of Debtors instead of €550. The explanation is that the Debtor originally owed us €700. The question tells us he paid us a cheque of €550 and cash of €100 "in full settlement". So he owed us €700 but only gave us €650 – in other words we must have given him a discount of €50. In accounting rules, if you give someone a discount and their payment is subsequently dishonoured, they lose the right to the discount. This guy therefore doesn't just owe us the €550, he now owes us €600 (we still have his €100 in cash so he doesn't owe us that again).

The third line of the answer is explained in the last 10 words of the question – Not only did this guy's cheque bounce but we've also found out that he in fact is *never* going to pay us (we've "written off the remaining debt in full"). So on the second line of the answer we *increased* debtors by €600 to show that we are now owed an extra €600 by someone and now on the third line we need to *decrease* debtors by €600 to show that in fact we're never going to get that money. (Since these entries cancel each other out, could we leave them out altogether? It's best not to because there's marks for showing what you've done and you'd lose out on these if you didn't put the entries in).

If you've followed even a bit of what's gone on above the last two lines of the answer will probably make sense. First of all we need to record a bad debt (the fact that a guy who owes us €600 is never going to pay us). Bad debts are an expense and so go in the debit column. Equally you might remember that we originally gave a guy a discount and he is no longer entitled to it. This is called a

‘Discount Disallowed’ and goes in the credit column (a regular Discount Allowed is an expense and would go on the left so this Discount ‘Disallowed’ goes on the opposite side).

(iv) A classic error in this topic appears in part four. You’ll probably spot two things here – the fact that the owner *put* something into the business and that he also *took* something out of the business (i.e. Capital and Drawings). Let’s do it one by one:

First of all he put a vehicle into the business worth €20,000 so the accounts should show

	€	€
Capital		20,000
Vehicles	20,000	

(Vehicles are an asset and go on the left, Capital always goes on the right).

Equally he took a van worth €8,000 out of the business so the accounts should show

	€	€
Drawings	8,000	
Vehicles		8,000

(In this case are vehicles are being reduced so appear on the right. Drawings always go on the left).

The rule about drawings and capital is DD/CC – Drawings is always on the debit side and Capital is always on the credit side).

Don’t forget though that what’s written above is what *should* have happened. Now we need to see what *actually* happened. In this case the only thing they did was to put €8,000 on the left of the Cash account (which has nothing to do with what happened and is a complete mess-up). So in our answer we simply undo the mistake they made (by putting €8,000 on the right of the cash account) and then put in what should have happened in the first place.

(iv) Journal Entry	€	€
Cash		8,000
Capital		20,000
Vehicles	20,000	
Drawings	8,000	
Vehicles		8,000



(v) Journal Entry.	€	€
Creditors	260	
Vehicles	260	
Cash		160
Repairs	160	
Cash		100
Drawings	100	
Suspense		520
(Being the recording of payments made for the business and private vehicles).		

(Don't forget – The suspense figure of €520 above was only included in the answer because without it the two sides would not have added up to be the same).

**Part B: Show the Suspense Account.**

The easiest way to explain part (b) is to show you the answer...

Suspense Account			
Bank (i)	800	Creditors (v)	520
Bank (iv)	8000	<i>Difference</i>	8280
	<hr/>		<hr/>
	8800		8800

So what's happening here is just a simple 'T' Account. We look back at our five corrections above and see can we find anywhere that we had to put a 'Suspense' figure in. In error (i) we put an €800 suspense figure on the left of our answer so we put it on the left of the 'T' Account above. Equally in error (iv) we put an €8000 suspense figure on the left so we do the same above. And in error (v) we had a €520 suspense figure, this time on the right-hand side so we do the same above. The



words written beside these figures ('Bank', 'Bank' and 'Creditors') don't really matter – They just provide a one-word idea of what the figure or error was about so write pretty much anything sensible here.

The only figure that needs any explaining is the one for €8,280 that says 'Difference'. By now you may realise that everything in this topic is meant to balance so once all of the suspense figures are in the 'T' Account we simply have to put in whatever it takes to make the account balance and then call it the 'Difference'.

### **Part C: Prepare A Statement Showing the Correct Net Profit.**

If you look at the Balance Sheet in the question you'll see a figure for the Net Profit in the Financed By section, of €15,000. Part C is asking us to work out what effect the corrections we've made would have on this Net Profit.

What we need to do therefore is go back and look at the five answers we prepared for Part (A) – the five shaded boxes above. Each of these contains corrections to figures based on the errors we were told about. In order to answer this part of the question we need to ask ourselves which of these corrections would have any effect on the Net Profit?

Now if we understand that the Net Profit is found at the bottom of the Trading and Profit and Loss Account, then we know that figures from the Balance Sheet won't have any effect on it (in other words if we changed a figure for premises for example, it wouldn't have an effect on the Net Profit because Fixed Assets appear in the Balance Sheet and therefore aren't part of the account (T&P&L A/C) that works out the Net Profit.

Let's look at the first correction we did for example (the first shaded box at the top of this answer). Here it is again below...

(i) Journal Entry.	€	€
Bank		800
Suspense	800	

Being the correction of an overdraft incorrectly recorded

Neither of the two figures in here ('Bank' or 'Suspense') are figures that appear in a Trading, Profit and Loss Account and so they will not have an effect on the Net Profit.

Let's look at correction (ii) then...

(ii) Journal Entry.	€	€
Cash		2,800
Sales	2,800	
Debtor	2,800	
Capital		2,800

Being the recording of capital introduced and sold on credit.

Can you spot a figure in this one that does appear in a Trading and Profit and Loss Account? Hopefully you might have guessed that 'Sales' does appear in a T&P&L and therefore will affect the Net Profit.

Equally, if you scan through (iii), (iv) and (v) below you should see we end up with a total of four things that will change the net profit...

(iii) Journal Entry.	€	€
Bank		550
Debtors	600	
Debtors		600
Bad Debt	600	
Discount Disallowed		50

Being the recording of a payment received and subsequently dishonoured.

(iv) Journal Entry	€	€
Cash		8,000
Capital		20,000
Vehicles	20,000	
Drawings	8,000	
Vehicles		8,000
Suspense	8,000	

(Being the cancellation of an error and recording of capital and drawings transactions).

(v) Journal Entry.	€	€
Creditors	260	
Vehicles	260	

Cash		160
Repairs	160	
Cash		100
Drawings	100	
Suspense		520

(Being the recording of payments made for the business and private vehicles).

The four things are...

Sales from correction (ii), €2,800 Debit

Bad Debt from correction (iii), €600 Debit

Discount Disallowed from correction (iii), €50 Credit

Repairs from correction (v), €160 Debit.

The answer to Part (C) then is:

		€	€
	Original Net Profit		15,000
Plus:	Discount Disallowed	<u>50</u>	<u>50</u>
			15,050
Minus:	Sales	2,800	
	Bad Debt	600	
	Repairs	<u>160</u>	
		<u>3,560</u>	<u>3,560</u>
	Corrected Net Profit		11,490

Any idea why I added the €50 and subtracted the other three figures? It's really simple and is to do with our favourite accounting rule:

Debit Assets and Expenses, Credit Liabilities and Gains.

If you remember that what we're concerned about here is the Net Profit and that we don't care about anything in the Balance Sheet for the moment, we can therefore ignore the Assets and Liabilities. So now the rule is...

Debit Expenses, Credit Gains.

So once I identified the four things that had to go into my Part (C) answer, I then just checked to see whether they were on the debit or credit side of my answers in Part (A). Pretty quickly I saw that the Discount Disallowed came from the credit side of correction (iii) and that the other three figures (Sales, Bad Debts and Repairs) all came from the debit side of corrections (ii), (iii) and (v).

Because the debit side are the minuses we subtract them from the original Net Profit. The credits on the other hand are the good things and we add them to the original Net Profit.

#### **Part D: Prepare A Corrected Balance Sheet.**

As you might have guessed our last job is to do the reverse of Part (C). This time instead of fixing up the stuff from the Trading & Profit & Loss Account, we now have to fix the Balance Sheet. Our job is to re-write the Balance Sheet and to make any changes to it, based on our corrections of the errors in Part (A). Here's the corrections again...

(i) Journal Entry.	€	€
Bank		800
Suspense	800	

Being the correction of an overdraft incorrectly recorded

(ii) Journal Entry.	€	€
Cash		2,800
Sales	2,800	
Debtor	2,800	
Capital		2,800

Being the recording of capital introduced and sold on credit.

(iii) Journal Entry.	€	€
Bank		550
Debtors	600	
Debtors		600

Bad Debt	600	
Discount Disallowed		50

Being the recording of a payment received and subsequently dishonoured.

(iv) Journal Entry	€	€
Cash		8,000
Capital		20,000
Vehicles	20,000	
Drawings	8,000	
Vehicles		8,000
Suspense	8,000	

(Being the cancellation of an error and recording of capital and drawings transactions).

(v) Journal Entry.	€	€
Creditors	260	
Vehicles	260	
Cash		160
Repairs	160	
Cash		100
Drawings	100	
Suspense		520

(Being the recording of payments made for the business and private vehicles).

So for Part (D) we need to look at the five corrections above and to see which of them effect things from the Balance Sheet. From the list above there's 17 different entries that will have an effect on the Balance Sheet...

Bank from correction (i), €800 Credit

Cash from correction (ii), €2,800 Credit

Debtor from correction (ii), €2,800 Debit

Capital from correction (ii), €2,800 Credit

Bank from correction (iii), €550 Credit

Debtors from correction (iii), €600 Debit

Debtors from correction (iii), €600 Credit

Cash from correction (iv), €8,000 Credit  
 Capital from correction (iv), €20,000 Credit  
 Vehicles from correction (iv), €20,000 Debit  
 Drawings from correction (iv), €8,000 Debit  
 Vehicles from correction (iv), €8,000 Credit

Creditors from correction (v), €260 Debit  
 Vehicles from correction (v), €260 Debit  
 Cash from correction (v), €160 Credit  
 Cash from correction (v), €100 Credit  
 Drawings from correction (v), €100 Debit

With each of these we now re-write the Balance Sheet and when we get to each of the figures above we make a change to the original figure (from the Balance Sheet in the question). How do we know whether to add or subtract? It's back to our saying...

Debit Assets and Expenses, Credit Liabilities and Gains.

This time around, Expenses and Gains are irrelevant because we're only dealing with the Balance Sheet so actually we only need to remember...

Debit Assets, Credit Liabilities.

In other words if we're putting Motor Vehicles in for example it is obviously an Asset. Two corrections mentioned above for Vehicles (in correction (iv) and (v)) are Debits and therefore we ADD them to the original Vehicles figure. The one Credit (€8,000 from correction (iv)) is a Credit and so we subtract it.

Conversely because Liabilities are meant to be on the Credit side, we add any Liability corrections that say Credit and subtract any Liability corrections that say Debit.

The Balance Sheet therefore looks like this...

	€	€	€
<u>Fixed Assets</u>			
Premises			400000
Motor Vehicles (20,000 + 20,000 + 260 - 8000)			32260

Furniture and Equipment	<u>16000</u>
	448260

Current Assets

Stock	17000
Debtors (5,600 + 2,800 + 600 - 600)	8400
Cash (3,200 - 2,800 - 8,000 - 160 - 100)	<u>-7860</u>
	17540

Current Liabilities

Creditors (12,200 - 260 - 8,280)	3660	
Bank (5,600 + 800 + 550)	<u>6950</u>	
	<u>10610</u>	<u>10610</u>
		<u>6930</u>
		<u>6930</u>
		<u>455190</u>

Financed By

Capital (441,000 + 2,800 + 20,000)	463800
Net Profit	11490
Drawings (12,000 + 8,000 + 100)	<u>20100</u>
	<u>455190</u>

Two final figures probably need to be explained. First of all the Net Profit figure is not the original one but rather the new Net Profit we worked out in Part (C).

Secondly, you might be wondering where the €8,280 came from that I subtracted from Creditors in the Current Liabilities. This is just a little sneaky situation – Have a look at the question and beside Creditors you'll see it says, "including suspense". What we need to do therefore is have a look at our answer to Part (B), get the 'Difference' figure from this (i.e. the balance in the suspense account) and take it away from Creditors. It won't always be Creditors that says "including suspense" but one figure in the Balance Sheet always will.

**Part E: Explain with Examples What Is Meant By...**

Answers to these and all the other theory questions on the course are contained in the 'Accounting Theory' notes on my website.

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