LET'S GET TECHNICAL

Birthday boy Gareth John explains all you need to know about the Trial Balance concept – as befitting a Libran

It's my birthday in early October. I say that not because I expect lots of presents from eager readers (although PQ magazine will be quite happy to pass them on) but because it means that my star sign is Libra. I am not a big believer in astrology and horoscopes (although now I think about it, there was a full moon when I met my wife) but I do sometimes wonder if being a Libran, the sign of balance which is represented by a set of scales, played a part in leading me into a career as an accountant.

Double entry, the fundamental language of accountancy, has to involve balance; the total of the debits being posted must equal the total of the credits being posted. And if every single double entry posted in a period balances, then no matter how many transactions are processed the total of the debits in the general ledger should always equal the total of the credits. This is exactly what is shown in the Trial Balance. It is literally a 'trial' to see if the debits and the credits 'balance'.

Making entries in a trial balance

Entering account balances into a trial balance is essentially a test of basic double entry principles. I use the common DEAD CLIC mnemonic to remind myself which side of the trial balance different types of ledger account will go on.

DEAD stands for:
Debits can be
Expenses, such as rent or salaries
Assets, such as cash or trade receivables
Drawings, when a sole trader takes money out of the business

CLIC stands for:
Credits can be
Liabilities, such as a bank loan or trade payables
Income, such as sales or interest received
Capital, when a sole trader puts money into the business

Let's say that we have the following ledger account balances in the general ledger at the end of a period: cash £9,000, capital £5,000, purchases £3,500, sales £4,500 and bank loan £3,000. The trial balance will look like this:

LEDGER ACCOUNT	DEBIT £	CREDIT £
Cash (an asset so part of DEAD)	9,000	
Capital (capital so part of CLIC)		5,000
Purchases (an expense so part of DEAD)	3,500	
Sales (income so part of CLIC)		4,500
Bank loan (a liability so part of CLIC)		3,000
	12,500	**12,500**

And you can see that this trial balance does indeed balance.

You should be able to follow these same basic rules no matter how many ledger account balances you are dealing with.

A few ledger account balances to be careful with!

Let's consider some account balances that students often have problems with:

Returns: Returns can be thought of as the opposite of the transaction that they relate to.

Sales are a form of income so go on the credit side of the trial balance. 'Sales returns' will reduce the income generated from sales (as some of the customers sent the goods back) so go on the debit side.

Purchases are an expense which would go on the debit side of the trial balance. 'Purchases returns' will reduce the expense so go on the credit side.

Discounts: 'Discounts allowed' to customers reduce the actual income received and will reduce the profit of the business. They are therefore an expense of the business so would go on the debit side of the trial balance.

'Discounts received' from suppliers will reduce the expense suffered for purchases and will increase the profit of the business. This reduction to an expense would therefore go on the credit side of the trial balance.

VAT: The balance on the VAT control account can potentially be on the debit or the credit side of the trial balance depending upon whether output VAT is greater than input VAT or vice versa.

'VAT owed **to** HMRC' (a net payment position) is a liability which would be on the credit side of the trial balance.

'VAT owed **from** HMRC' (a net reclaim position) is an asset (similar to trade receivables) so should be on the debit side.

Sundry income: Although sales made to customers are normally the main form of income that a business will generate there may also be income from other sources. Whether it is 'rent received', 'interest received', 'commission received' or 'birthday money received' (hint, hint!) it is income for the business and therefore goes in the credit column of the trial balance.

Here's one for you to attempt. Once you have had a go watch me working through my solutions at www.firstintuition.co.uk/blog/aat-blog.html

Draw up a trial balance for the following ledger account balances; sales £12,000, purchases £5,000, rent £2,000, salaries £1,000, cash £1,500, machinery £3,500, sales returns £500, purchases returns £400, discounts received £200, discounts allowed £300, capital £1,000, rent received £150, VAT owed to HMRC £1,500, sales ledger control account £3,000, purchases ledger control account £1,200, bank loan £350.

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