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Bachelor of Business Administration (BBA) | Fifth Semester | UK5DSCMGT302

Basics of Financial Accounting

Course Code: UK5DSCMGT302 • Module 4 Notes

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Module 4: Trial Balance and Error Rectification

Basics of Financial Accounting • Course Code: UK5DSCMGT302

Chapter 1: The Trial Balance: Meaning, Objectives, and Preparation Methods

1.1 Meaning, Concept, and Nature of the Trial Balance

In double-entry bookkeeping, every commercial transaction requires an equal debit and credit entry across ledger accounts. Consequently, at the end of an accounting period, the aggregate sum of all debit balances across the entire general ledger must mathematically equal the aggregate sum of all credit balances. A **Trial Balance** is an extraction statement or schedule drawn up on a specific calendar date, listing the titles and debit or credit balances of all ledger accounts (including the Cash Book cash and bank balances) to verify their arithmetical equality.

The definitive conceptual definition formulated by J.R. Batliboi states: *"A Trial Balance is a statement prepared with the debit and credit balances of ledger accounts to test the arithmetical accuracy of the books of accounts."* It is critical to recognize that a Trial Balance is an internal working **Statement**, not a formal ledger account. It does not possess a debit or credit side with "To" or "By" prepositions; rather, it contains parallel monetary columns headed "Debit Balances" and "Credit Balances." Furthermore, a Trial Balance is drawn up at a specific point in time (e.g., *"As on 31st March 2024"*), capturing the instantaneous balances of the ledger on that specific date.

Primary Objectives of Preparing a Trial Balance:

- *Testing Arithmetical Accuracy:* Verifies whether the mathematical equality of debits and credits has been maintained during journalizing, posting, and ledger balancing.
- *Facilitating Preparation of Final Accounts:* Serves as the organized, consolidated bridge between thousands of scattered ledger pages and the final financial statements (Trading Account, Profit & Loss Account, and Balance Sheet).
- *Providing a Consolidated Account Summary:* Provides management and internal auditors with a bird's-eye view of all enterprise asset, liability, capital, expense, and revenue balances in a single organized document.
- *Aiding in Error Detection:* Highlights unilateral clerical mistakes, casting errors, and posting omissions that prevent the two monetary columns from balancing.

1.2 Methods of Preparing the Trial Balance

Accountants prepare the Trial Balance using three recognized structural methods:

1. Balances Method (Net Balance Method): The universally deployed standard method. Only the **net closing balance** of each ledger account (the difference between total debits and total credits) is extracted and recorded in the Trial Balance. Accounts showing a net debit balance are entered in the Debit column; accounts showing a net credit balance are entered in the Credit column. Accounts

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whose debits exactly equal credits (zero balance) are completely omitted. This method provides the direct empirical foundation for drafting final accounts.

2. Totals Method (Gross Trial Balance): Under this method, the **gross total of the Debit side** and the **gross total of the Credit side** of every ledger account are extracted without computing net balances. Both gross totals are entered in parallel columns. While mathematically verifying casting, it is rarely deployed in practice because gross totals cannot be used directly to prepare financial statements.

3. Totals and Balances Method (Compound Method): Combines both methods into a single expansive statement featuring four monetary amount columns (two for gross totals and two for net balances). Highly redundant and largely obsolete in modern accounting.

1.3 Comprehensive Worked Demonstration of Trial Balance Preparation

To demonstrate the preparation of a Trial Balance under the standard Balances Method, consider the extracted ledger balances of Shaurya Enterprises as on March 31, 2024:

S.No.	Heads of Accounts (Ledger Accounts)	L.F.	Debit Balance (Rs)	Credit Balance (Rs)
1	Capital Account (Owner's Equity)	1	-	5,00,000
2	Drawings Account	3	40,000	-
3	Plant and Machinery Account	5	2,50,000	-
4	Office Furniture and Fixtures Account	8	60,000	-
5	Opening Stock of Merchandise Account	12	85,000	-
6	Purchases Account	15	4,20,000	-
7	Sales Account	18	-	7,80,000
8	Purchases Returns (Returns Outward) Account	20	-	15,000
9	Sales Returns (Returns Inward) Account	22	12,000	-
10	Sundry Debtors (Trade Receivables) Account	26	1,60,000	-
11	Sundry Creditors (Trade Payables) Account	30	-	1,10,000
12	Bills Receivable Account	34	35,000	-
13	Bills Payable Account	38	-	25,000
14	Wages of Factory Labour Account	42	50,000	-

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S.No.	Heads of Accounts (Ledger Accounts)	L.F.	Debit Balance (Rs)	Credit Balance (Rs)
15	Office Salaries Account	45	75,000	-
16	Rent, Rates, and Taxes Account	48	30,000	-
17	Carriage Inward (Freight on Purchases) Account	51	14,000	-
18	Carriage Outward (Freight on Sales) Account	54	8,000	-
19	Insurance Premium Account	57	12,000	-
20	Discount Allowed Account (Loss)	60	5,000	-
21	Discount Received Account (Gain)	62	-	4,000
22	Cash in Hand Account (Cash Book balance)	CB	18,000	-
23	Cash at Bank Account (SBI Current A/c)	CB	1,44,000	-
Total	**Grand Balancing Equality**	-	**Rs 14,34,000**	**Rs 14,34,000**

Treatment of Closing Inventory: Closing Stock does not appear in the Trial Balance because it represents unsold merchandise on March 31 that has not yet been processed through ledger purchase accounts. It is recorded as an adjustment note outside the Trial Balance. (Exception: If Opening Stock and Purchases have already been adjusted by closing stock to compute "Cost of Goods Sold," Closing Stock appears inside the Trial Balance as an asset debit, and Opening Stock is completely omitted).

Chapter 2: Classification of Accounting Errors and Limitations of the Trial Balance

2.1 The Nature of Accounting Errors

An agreement between the total debit and total credit columns of a Trial Balance provides mathematical proof that debits equal credits. However, **an agreed Trial Balance is NOT conclusive proof of absolute bookkeeping accuracy**! Numerous serious accounting errors can exist in books of accounts without upsetting the mathematical equality of the Trial Balance.

Accounting errors are classified into two structural categories based on their diagnostic visibility:

1. **Errors Disclosed by the Trial Balance:** One-sided errors that cause the debit column total to diverge from the credit column total, actively preventing the Trial Balance from agreeing.
2. **Errors Not Disclosed by the Trial Balance:** Two-sided or symmetrical errors that affect debits and credits equally, allowing the Trial Balance to agree despite serious underlying book

errors.

2.2 Errors NOT Disclosed by the Trial Balance (Undetected by Trial Balance)

These errors represent the most dangerous accounting distortions because they hide behind a mathematically balanced statement:

Error Typology	Bookkeeping Mechanism	Concrete Practical Illustration
1. Errors of Complete Omission	A transaction is completely omitted from being recorded in the journal or subsidiary books. Neither debit nor credit entry is made anywhere in the accounting system.	A credit purchase of raw materials from Tata Steel for Rs 50,000 was completely omitted from the Purchases Book. Debits and credits are equally absent by Rs 50,000; the Trial Balance still balances perfectly.
2. Errors of Principle	A fundamental violation of Generally Accepted Accounting Principles (GAAP), specifically the misclassification between **Capital Expenditure** and **Revenue Expenditure**, or between Capital Receipts and Revenue Incomes.	Wages of Rs 10,000 paid to mechanics for installing a new lathe machine were debited to regular *Wages Account* (revenue expense) instead of being capitalized to *Machinery Account*. Debits and credits remain equal; net profit is distorted, but the Trial Balance agrees.
3. Compensating Errors	Two or more independent accounting errors that arise on opposite sides of different accounts and accidentally offset or neutralize each other's monetary effect.	Rohan's account was over-debited by Rs 1,000, and simultaneously the Salaries Account was under-debited by Rs 1,000. The two errors cancel out; the total debit sum remains completely unaffected.
4. Errors of Commission (Two-Sided)	Recording a transaction in the correct subsidiary book but with an incorrect monetary amount throughout, or posting to the correct side of an entirely wrong person's account within the same category.	Goods sold on credit to Ramesh for Rs 5,400 were entered in the Sales Book as Rs 4,500. Ramesh was debited with Rs 4,500 and Sales credited with Rs 4,500. Symmetrical error of Rs 900; Trial Balance agrees. Or, debiting Suresh instead of Ramesh.
5. Errors of Complete Duplication	An identical transaction is accidentally recorded twice in the primary journal and posted twice to the ledger accounts.	An office rent payment of Rs 20,000 was journalized and posted twice. Debits and credits are both inflated by Rs 20,000; equality is maintained.

2.2.1 Detailed Comparison: Errors of Principle versus Errors of Commission

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Analytical Dimension	Error of Principle	Error of Commission
Fundamental Nature	Violation of core accounting principles (confusing Capital and Revenue items).	Clerical, mathematical, or procedural slip by bookkeeper without theoretical breach.
Impact on Net Profit	Directly misstates net operating profit and asset balance sheet valuations.	May or may not affect net profit (often affects only customer/vendor balances).
Trial Balance Status	**NEVER affects the agreement of the Trial Balance** (debits and credits match).	Two-sided errors do not affect TB; one-sided casting/posting errors cause TB disagreement.
Concrete Illustration	Debit Building Account for routine office wall repainting costs (treating revenue as capital).	Posting Rs 4,500 instead of Rs 5,400 to a customer's personal account.

2.3 Errors Disclosed by the Trial Balance (Causing Disagreement)

These one-sided clerical errors break the symmetry of debits and credits, creating an immediate numerical difference between the Trial Balance columns:

- *1. Omission of Posting One Aspect:* A transaction is journalized correctly, but only the debit entry is posted to the ledger while the credit posting is completely forgotten.
- *2. Posting an Entry on the Wrong Side:* Debiting an account when it should have been credited (e.g., posting cash received from a debtor on the debit side of the debtor's account, creating a double discrepancy).
- *3. Posting an Incorrect Amount to One Account:* Journal entry shows Debit A for Rs 8,000 and Credit B for Rs 8,000. Account A is posted correctly with Rs 8,000, but Account B is posted with Rs 800.
- *4. Casting (Addition) Errors in Subsidiary Books or Ledger:* Incorrectly adding up the total of the Purchases Book or miscalculating the balance of the Cash Book.
- *5. Listing Errors in the Trial Balance:* Writing an account balance in the wrong column of the Trial Balance (e.g., placing Salaries Rs 30,000 in the Credit column, or omitting an account balance entirely).

2.4 Systematic Audit Procedures for Locating Disagreements in the Trial Balance

When the Trial Balance columns fail to balance, skilled accountants do not search randomly; they follow a disciplined, systematic seven-step diagnostic sequence to rapidly isolate errors:

1. **Re-cast the Trial Balance Columns:** Re-add both the Debit and Credit columns of the Trial Balance to eliminate simple mathematical addition or carryover mistakes.

2. **Check the Difference against Cash Book:** Check whether the cash in hand and commercial bank balances from the Cash Book have been correctly transcribed into the Trial Balance.
3. **Divide the Difference by Two:** If an account balance has been placed on the wrong side of the Trial Balance (e.g., placing a debit balance of Rs 5,000 in the credit column), the resulting difference will equal exactly twice the amount of the misposted balance (Rs 10,000). Searching the ledger for an account with a balance equal to half the discrepancy often pinpoints the error immediately.
4. **Apply the Rule of Nine (Transposition and Transplacement Errors):** If the discrepancy is exactly divisible by 9, the error is almost certainly a *Transposition Error* (reversing digits, such as recording Rs 4,820 as Rs 4,280, difference = Rs 540, 540 / 9 = 60) or a *Transplacement (Slide) Error* (misplacing the decimal comma, such as recording Rs 50,000 as Rs 5,000, difference = Rs 45,000, 45,000 / 9 = 5,000).
5. **Verify Ledger Balances:** Review each ledger account individually to ensure that balances have been calculated correctly and carried down accurately.
6. **Verify Extraction from Ledger to Trial Balance:** Cross-check each account balance in the ledger against the Trial Balance schedule to ensure no account was omitted or listed in the wrong column.
7. **Re-audit Ledger Postings:** If all prior steps fail, re-trace postings from the journal and subsidiary books to the ledger accounts, placing pencil checkmarks adjacent to verified postings.

Chapter 3: The Suspense Account and Rectification of Errors

3.1 The Suspense Account: Nature and Temporary Status

When the two columns of a Trial Balance fail to agree at the close of an accounting period, and immediate auditing efforts fail to locate the discrepancy, accountants cannot halt the preparation of draft financial statements indefinitely. To achieve temporary mathematical balance, the net difference is transferred to a temporary clearing account designated as the **Suspense Account**:

- If the **Debit column total is less than the Credit column total**, the difference is entered on the Debit column of the Trial Balance under *"To Suspense Account"*. In the Balance Sheet, a debit balance in Suspense Account is shown provisionally on the **Assets side**.
- If the **Credit column total is less than the Debit column total**, the difference is entered on the Credit column under *"By Suspense Account"*. In the Balance Sheet, a credit balance in Suspense Account is shown provisionally on the **Liabilities side**.
- *Disposal of Suspense Account:* As individual one-sided errors are subsequently detected and rectified through rectifying journal entries, the Suspense Account is progressively debited and credited until its balance is reduced to **strictly ZERO**. The Suspense Account must never become a permanent fixture on audited corporate balance sheets.

3.2 Stages of Error Rectification

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The accounting mechanics of error rectification depend entirely on the stage at which the error is discovered:

1. **Stage 1: Errors Rectified BEFORE the Preparation of the Trial Balance:** Because no Suspense Account exists at this stage, one-sided errors cannot be rectified through journal entries. They are corrected by writing an explanatory correcting note directly on the affected side of the ledger account (e.g., *"To undercasting of purchases book for April... Rs 500"*). Two-sided errors are rectified via standard journal entries.
2. **Stage 2: Errors Rectified AFTER Trial Balance Preparation but BEFORE Final Accounts:** Both one-sided and two-sided errors are rectified through formal **Rectifying Journal Entries** in the Journal Proper. Two-sided errors are rectified between the affected accounts. One-sided errors are rectified by debiting or crediting the affected account with the compensating leg posted to the **Suspense Account**.
3. **Stage 3: Errors Rectified in Subsequent Financial Years (AFTER Final Accounts):** To avoid distorting current-year operating revenues and expenses with prior-period corrections, nominal accounts are replaced by a specialized **Prior Period Adjustment Account (or Profit & Loss Adjustment Account)**, which transfers its net balance directly to Capital or Retained Earnings.

3.3 Comprehensive Practical Demonstration of Rectification Entries

To demonstrate the systematic three-step methodology for error rectification (1. What entry was actually made? 2. What entry should have been made? 3. What rectifying entry cancels the wrong and installs the right?), consider the following errors discovered in the books of Zenith Traders after the Trial Balance was prepared with a difference transferred to Suspense Account:

No.	Error Description	Rectifying Journal Entry	Dr (Rs)	Cr (Rs)
1	Credit purchase of office machinery for Rs 40,000 from Godrej Ltd was wrongly recorded in the Purchases Book.	Machinery A/c ..... Dr. To Purchases A/c *(Being capital expenditure on machinery wrongly debited to purchases, now rectified)*	40,000	40,000
2	Goods sold to Priya on credit for Rs 12,500 were correctly recorded in the Sales Book, but posted to her ledger account as Rs 15,200.	Suspense A/c ..... Dr. To Priya's A/c *(Being excess debit of Rs 2,700 [Rs 15,200 - Rs 12,500] in Priya's ledger account rectified via Suspense A/c)*	2,700	2,700
3	Wages of Rs 8,000 paid for the construction of an additional office storage shed	Building / Premises A/c ..... Dr. To Wages A/c	8,000	8,000

No.	Error Description	Rectifying Journal Entry	Dr (Rs)	Cr (Rs)
	were debited to Wages Account.	*(Being capital wages on building construction wrongly treated as revenue wages, now capitalized)*		
4	The total of the Sales Returns Book was undercast (under-added) by Rs 3,500.	Sales Returns A/c ..... Dr. To Suspense A/c *(Being undercasting of Sales Returns Book rectified via Suspense A/c)*	3,500	3,500
5	Cash discount of Rs 1,200 allowed to customer Rohan was correctly entered in the Cash Book, but was not posted to the Discount Allowed Account in the ledger.	Discount Allowed A/c ..... Dr. To Suspense A/c *(Being omission of posting to Discount Allowed A/c now rectified via Suspense A/c)*	1,200	1,200
6	Cheque received from debtor Alok for Rs 9,000 was dishonoured and debited by bank, but was credited to Sales Account in error.	Alok's A/c ..... Dr. Sales A/c ..... Dr. To Bank A/c To Suspense A/c *(Being dishonoured cheque wrongly credited to sales, now fully rectified)*	9,000 9,000	9,000 9,000

3.4 Rectification of Errors in Subsequent Accounting Periods (Prior Period Adjustments)

When accounting errors occurring in one financial year are discovered after the final accounts have been closed, signed, and audited in a subsequent financial year, passing rectifying entries through regular nominal accounts (e.g., Salaries, Purchases, Rent) is strictly prohibited. Doing so would distort the operating revenues and expenses of the current financial year with prior-period distortions, violating the accrual and matching concepts. Instead, all nominal accounts are routed through a specialized clearing account termed the **Profit and Loss Adjustment Account (Prior Period Adjustment Account)**:

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No.	Nature of Prior-Period Error	Rectifying Entry via P&L Adjustment A/c	Dr (Rs)	Cr (Rs)
1	Credit purchase of goods for Rs 25,000 in previous year was completely omitted from books.	Profit & Loss Adjustment A/c ..... Dr. To Creditor's A/c *(Being omitted credit purchase of prior year rectified)*	25,000	25,000
2	Wages of Rs 12,000 paid for installing machinery in previous year was debited to Wages A/c.	Machinery A/c ..... Dr. To Profit & Loss Adjustment A/c *(Being capital installation wages wrongly expensed in prior year, now capitalized)*	12,000	12,000
3	Credit sale of goods for Rs 18,000 in previous year was omitted from Sales Book.	Debtor's A/c ..... Dr. To Profit & Loss Adjustment A/c *(Being omitted credit sale of prior year rectified)*	18,000	18,000
4	**Closing Transfer of Net Balance** Total Credit to P&L Adjustment = Rs 30,000. Total Debit = Rs 25,000. Net Credit Balance = Rs 5,000 (Prior period net profit gain).	Profit & Loss Adjustment A/c ..... Dr. To Capital A/c *(Being net prior period profit transferred directly to owner's capital account)*	5,000	5,000

3.5 Comprehensive Demonstration: Suspense Account Ledger Resolution

To demonstrate the complete lifecycle of a Suspense Account, consider the following ledger account opened with an initial difference of Rs 6,900 debit on March 31, and subsequently closed as errors 2, 4, 5, and 6 from Section 3.3 were rectified:

Dr. SUSPENSE ACCOUNT Cr.

Date	Particulars	Rs	Date	Particulars	Rs
2024 Mar 31	To Difference in Trial Balance	6,900	2024 Apr 4	By Sales Returns A/c (Error 4)	3,500
Apr 4	To Priya's A/c (Error 2)	2,700	Apr 4	By Discount Allowed A/c (Error 5)	1,200
			Apr 4	By Sales A/c (Error 6)	4,900
Total	-	**9,600**	**Total**	-	**9,600**

Audit Proof: Total Debits (Rs 9,600) exactly equal Total Credits (Rs 9,600). The Suspense Account closes with a **NIL Balance**, proving that all underlying one-sided discrepancies have been successfully rectified.

3.6 Advanced Case Problem: Complex Multi-Account Error Rectification

To demonstrate advanced auditing and error rectification under examination conditions, consider the following eight complex errors discovered in the books of Modern Tech Enterprises during the post-trial-balance audit:

Case	Transaction Error Discovered	Rectifying Journal Entry in Journal Proper	Dr (Rs)	Cr (Rs)
A	Goods worth Rs 15,000 purchased on credit from Sharma & Co. were entered in the Sales Book in error.	Purchases A/c ..... Dr. Sales A/c ..... Dr. To Sharma & Co. A/c *(Being credit purchase wrongly entered in sales book, now reversed and correctly debited)*	15,000 15,000	30,000
B	Sale of old office furniture for Rs 8,000 was credited to Sales Account.	Sales A/c ..... Dr. To Furniture A/c *(Being sale of capital asset wrongly treated as revenue merchandise sales, now rectified)*	8,000	8,000
C	Cheque of Rs 14,000 received from debtor Vikram was deposited in bank, but credited to Vivek's account in error.	Vivek's A/c ..... Dr. To Vikram's A/c *(Being customer credit posted to wrong personal account within the same category, now rectified)*	14,000	14,000
D	Freight of Rs 3,500 paid on the purchase of a new printing machine was debited to Carriage Inward Account.	Machinery A/c ..... Dr. To Carriage Inward A/c *(Being capital transport cost on machine acquisition wrongly expensed as revenue freight)*	3,500	3,500

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Case	Transaction Error Discovered	Rectifying Journal Entry in Journal Proper	Dr (Rs)	Cr (Rs)
E	A bill receivable of Rs 20,000 accepted by customer Ankit was dishonoured on due date, but no entry was passed.	Ankit's A/c ..... Dr. To Bills Receivable A/c *(Being omitted dishonour of customer acceptance now recorded in books)*	20,000	20,000
F	Goods of Rs 6,000 taken by the proprietor for personal domestic consumption were omitted from accounting records.	Drawings A/c ..... Dr. To Purchases A/c *(Being proprietor's drawing of merchandise at cost now recorded)*	6,000	6,000

3.7 Internal Controls and Automated Error Prevention in Computerized Accounting

Modern cloud accounting software packages (such as SAP S/4HANA, Tally Prime, and QuickBooks) embed structural internal validation controls designed to prevent accounting errors before vouchers are committed:

- *Enforced Double-Entry Mathematical Balance:* The software mathematically prohibits the saving of any journal voucher where total debits do not equal total credits. This structural restriction makes one-sided posting errors physically impossible within the database.
- *Mandatory Sub-Ledger Linking:* Personal accounts (debtors and creditors) cannot be posted without linking to specific tax invoice numbers, preventing unallocated collections.
- *Automated Tax Engine Calculations:* Goods and Services Tax (CGST, SGST, IGST) and Tax Deducted at Source (TDS) are calculated automatically based on standardized HSN/SAC codes, eliminating human casting and mathematical rate errors.
- *Digital Audit Trails (Edit Logs):* In compliance with the Ministry of Corporate Affairs (MCA) statutory rules under the Companies Act 2013, accounting software must maintain an immutable, tamper-evident log capturing every creation, edit, or cancellation of a transaction, permanently recording user login credentials, timestamp, and previous transaction states.

3.4 Summary of Trial Balance and Error Governance

The Trial Balance is the indispensable audit checkpoint confirming the mathematical integrity of double-entry ledgers. Recognizing its limitations is crucial for accounting vigilance: while it instantly exposes one-sided casting and posting errors, it remains blind to errors of principle, complete omissions, and compensating mistakes. The disciplined deployment of the Suspense Account provides temporary operational balance, enabling systematic error rectification before audited financial statements are signed, safeguarding corporate transparency and statutory compliance.

2.3 Practical Significance of the Trial Balance in Corporate Audit

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While the agreement of debit and credit column totals in a trial balance confirms mathematical parity under the double entry bookkeeping system, corporate auditors view it only as a preliminary screening mechanism rather than conclusive proof of absolute transactional accuracy:

- **Audit Verification Baseline:** The trial balance serves as the starting audit documentation schedule from which statutory auditors extract general ledger balances, examine posting schedules, and initiate substantive analytical procedures.
- **Detection Limitations:** As established by forensic accounting practice, errors of complete omission, compensating errors of identical amounts, and errors of principle bypass the trial balance screen entirely. External auditors must therefore employ vouching, physical asset inspection, third-party balance confirmations, and cut-off testing.
- **Suspense Account Clearance:** When a trial balance refuses to balance at year-end, the unexplained discrepancy is lodged temporarily in a Suspense Account to permit draft financial statement compilation. Standard corporate governance mandates that the Suspense Account must be investigated and eliminated prior to final board approval.

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