ACCOUNTING

Why you need to do a bank reconciliation every month

By Ahmed Muneeb June 5, 2019

Sometimes your current bank account balance is not a true representation of cash available to you, especially if you have transactions that have not settled yet. If you're not careful, your business checking account could be subjected to overdraft fees.

You should perform monthly bank reconciliations, so you can better understand your cash flow and true cash position.

A bank reconciliation is a process of matching the balances in a business's accounting records to the corresponding information on a bank statement. The goal of the bank reconciliation process is to find out if there are any differences between the two cash balances. If there are any discrepancies, you have to recheck your company's accounting records as appropriate.

We strongly recommend performing a bank reconciliation at least on a monthly basis to ensure the accuracy of your company's cash records. A monthly reconciliation helps to catch and identify any unusual transactions that might be caused by fraud or accounting errors, especially if your business uses more than one bank account.

To perform a bank reconciliation, you need a few items including a bank statement and your internal accounting records. Hopefully, you have developed proper accounting or bookkeeping procedures to keep track of any pending cash transactions (either inflows or outflows). This will make the reconciliation process much easier.

We'll show you why and how to conduct a bank reconciliation.

1. Compare your two statements

The information on the bank statement is the bank's record of all transactions impacting the company's bank account during the past month. Compare the ending balance of your accounting records to your bank statement to see if both cash balances match.

Go through each transaction individually to make sure the amounts match perfectly. Any differences should be noted and investigated. You want to make sure that your bank statements show an ending account balance that aligns with your internal accounting records or that you have specific explanations for the difference.

In many cases, you will notice slight differences in the cash accounts between your bank statement and accounting records that can be easily reconciled. The reasons for this can include bank-only transactions that may have impacted the ending balance, such as interest income or outstanding checks that haven't been processed yet. The former will only be shown on the bank statement, while the latter will only be reflected on your internal accounting records.

Most accounting software has a reconciliation module that allows you to enter the ending cash balances of your bank account to assist you with the reconciliation process. Your bank can provide online access to your account, so you can view and download transactions regularly for comparison.

2. Add bank-only transactions to your book balance

There are bank-only transactions that your company's accounting records most likely don't account for. These transactions include interest income, bank deposits, and bank fees.

When performing a bank reconciliation, begin by adding positive transactions. An example of a positive transaction would be interest income earned from your bank throughout the period (usually one period equals one month). Next subtract negative transactions such as bank service charges from your book cash balance.

There will be very few bank-only transactions to be aware of, and they're often grouped together at the bottom of your bank statement.

Once you've added or subtracted bank-only transactions, you can take a look at transactions that have not affected your bank statement yet, including deposits in transit or outstanding checks.

Deposits in transit are cash and checks that you've received and recorded in your internal accounting records, but which haven't yet cleared your bank account. Outstanding checks, on the other hand, are checks that have been issued by your company to creditors but the payments have not yet cleared your bank account.

Accounting best practices ensure that any checks issued or deposits in transit are documented in your internal accounting records as "pending" transactions. The cash balance will not reflect these transactions until they have been processed.

It's important to document and track pending deposits or checks issued, especially because banks do not see these transactions until they're cashed and cleared. Only then, will you see it reflected in your bank statement.

This leads us to the next section.

3. Add book transactions to your bank balance

Often as a small business, you find yourself paying vendors and creditors by issuing check payments. When a check is issued, your bank statement won't reflect the outstanding checks if they haven't been cashed yet. On the flipside, your bank statement may not show deposits if they're still being processed by the bank.

If you have bank deposits in transit, then you want to add those inflows. If you have outstanding checks, then you want to subtract those outflows from the bank balance.

Transactions that aren't accounted for in your bank statement won't be as obvious as bank-only transactions. This is where your accounting software can really help you reconcile and keep track of outstanding checks and deposits. Most reconciliation modules allow you to check off outstanding checks and deposits listed on the bank statement.

Now you should have adjusted balances from your bank and your accounting records to compare to one another.

4. Compare both adjusted balances

Compare your adjusted bank balance to your adjusted book balance. Since you've already adjusted the balances to account for common discrepancies, the numbers should exactly match one another. If you find that the adjusted balances still do not match, then it's very likely an error, or worse, fraud occurred.

If your balances don't match, there are some common errors to look for.

Transposition error

This is a simple data-entry error that occurs when two digits that are accidentally reversed (i.e. transposed) when posting a transaction. For example, you wrote a check for $32, but you recorded it as $23 in your accounting software. You can avoid these errors by printing checks directly from your accounting system.

Forgetting to record a transaction

In this case, a check went out or a deposit was made, and you forgot to record it. It's very important to immediately track any outstanding checks so that you're aware of all activities. If a check went out, record it. If you're expecting a check to come in, make a note of it. Go line-by-line on your company's bank statement to double check if they match your internal records.

The beginning cash balance is incorrect

If your beginning balance in your accounting software isn't correct, the bank account won't reconcile. This can happen if you're reconciling an account for the first time or it wasn't properly reconciled last month. You may need to go back to previous months to locate the issue.

Journal entry mistakes

You could have accidentally booked a journal entry that debited or credited cash. This is where a general ledger helps you reconcile day-to-day transactions. You can go to your list of journal entries and ensure that none of them impacted your bank account balance.

Performing bank reconciliations is best practices

To help see the flow of a bank reconciliation process, begin with the bank's ending cash balance and add to it any cash or checks that have been received (i.e. deposits in-transit) from the company to the bank. Then subtract any checks that have not yet cleared the bank, and either add or deduct any other items. After, go to the company's ending cash balance and deduct any bank service fees and penalties, and add to it any interest income earned.

At the end of this process, the adjusted bank balance should equal the company's ending adjusted cash balance.

Check yourself

It's very important to perform a bank reconciliation periodically to identify fraudulent activities or bookkeeping and accounting errors. Many companies perform a reconciliation monthly when the bank sends your company a new monthly statement at the beginning of each month for the previous month.

This way you can ensure your business is in great standing and never be caught off-guard.

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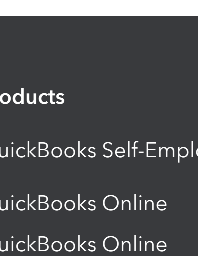

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