

Chapter 15

Bank

Reconciliation

Statement

MEANING OF BANK RECONCILIATION STATEMENT

Once the cash book has been balanced, it is usual to check its details with the records of the firm's bank transactions as recorded by the bank. To enable this check, the cashier needs to ensure that the cash book is completely up to date and a recent bank statement (or a bank passbook) has been obtained from the bank. A bank statement or a bank passbook is a copy of a bank account as shown by the bank records. This enable the bank customers to check their funds in the bank regularly and update their own records of transactions that have occurred.

The amount of balance shown in the passbook or the bank statement must tally with the balance as shown in the cash book. But in practice, these are usually found to be different. Hence, we have to ascertain the causes for such difference.

A statement is therefore prepared to identify the reasons for the difference and to reconcile the balances of the two books. Such a statement is called 'Bank Reconciliation Statement'.

DEFINITION OF BANK RECONCILIATION STATEMENT

"Bank reconciliation statement is a statement prepared mainly to reconcile the difference between the Bank Balance shown by the Cash Book and Bank Pass Book."

- Patil

CAUSES OF DIFFERENCES IN THE CASH BOOK AND PASS BOOK BALANCE

The difference may arise on account of the following reasons:

(a) Differences caused by Time gap in recording transactions.

(b) Differences caused by errors committed in recording transactions.

(A) Differences caused by Time Gap in recording transactions:

The reasons for time gap are as follows

(1) Cheques issued but not yet presented for

payment in the Bank: When a cheque is issued to a creditor by the firm, it is immediately recorded on the credit side of the bank column of the cash book. But the bank will debit the firm's account only when this cheque is actually presented to the bank for payment. Generally, there is a gap of some days between the issue of a cheque and its presentation to the bank. Thus, until the cheques are presented for payment, the cash book will show a reduced balance in comparison to the pass book.

(2) Cheques paid into the bank for collection but

not yet credited by the bank: When a firm receives cheques, drafts etc. from its customers, they are immediately deposited into bank for collection and an entry is made on the debit side of the bank column of the cash book. But the bank will credit the firm's account only when it has actually collected the payment of these cheques from other banks. Thus, until the cheques are collected and credited by the bank, the cash book will show an increased balance in comparison to the pass book.

(3) Cheques paid into the bank for collection but

dishonoured by the bank: When the cheques received from

outside parties are deposited with the bank these are immediately recorded on the debit side of the bank column of the cash book, but if cheques are dishonoured, bank will not make any entry in the credit of customer account. As a result, the cash book will show an increased balance in comparison to the pass book.

(4) Interest allowed by the bank: If a trader maintains a saving bank account the bank allows a certain percentage of interest on the minimum balance of each month in such an account. But the customer will come to know of the amount of interest on when he gets his pass book completed after a gap of time. In the intervening period balance of cash book will be comparatively less than the balance of pass book.

(5) Interest charged by the bank on Overdraft: When a bank gives a firm the facility of withdrawing in excess of its deposits, this excess withdrawal is called overdraft. The bank charges interest on this overdraft and debits the firm's account from such interest from time to time. But the entry for interest will be made in the cash book only when the customer receives a statement from the bank or when he receives the pass book duly completed. Until then, the two balance will differ.

(6) Bank Charges and Commission charged by the bank: Bank renders many services to its clients and charges certain amount for these services. The bank debits the customer's account with these charges but the customer will not make any entry in cash book until he receives a statement from the bank. In the intervening period, the two balances will differ.

(7) Direct deposit by customers into the bank: Some customers may directly deposit the amount in firm's bank account. The bank will immediately credit the firm's account on receipt of such a payment, but the firm will come to know of the deposit only when it receives the bank pass book duly completed after a gap of time. This also causes a difference.

(8) Interest and dividend collected by the bank: Sometimes bank collects interest and dividend on customer's investments. The bank credits the customer's account immediately on receipt of such payments, but the customer will make entries in the cash book only when he receives intimation from the bank pass book duly completed. Until such period, the two balances will differ.

(9) Direct payment made by the bank on behalf of customers: Sometimes an account holder gives a standing order to the bank to make certain payments such as insurance premium, rent etc. on his behalf. The bank makes these payments and debits the party's account, but the firm will be able to enter the same in its cash book only when the intimation is received from the bank. In the intervening period, the cash book will show an increased balance in comparison to the pass book.

(B) Differences caused by Errors Committed in Recording Transactions:

Sometimes the difference between the Cash Book and Pass Book balance may arise due to errors committed in recording

transactions in the Cash Book or in the Pass Book. Hence, such errors may be of two types:

(1) Errors committed in recording transactions by the firm: Sometimes the firm may commit errors while recording entries in the Cash book. Such errors may be:

(i) Cheque issued to a creditor but omitted to be recorded in the Cash Book.

(ii) Cheques deposited into the bank but omitted to be recorded in the Cash Book.

(iii) Error in totalling or balancing the bank column of the Cash Book.

(2) Errors committed in recording transactions by the bank: Sometimes the bank commits an error and records a wrong entry in the customer's account which causes a difference between the bank balance shown by the cash book and the balance shown by the pass book.

NEED AND IMPORTANCE OF BANK

RECONCILIATION STATEMENT

It is essential to prepare a bank reconciliation statement due to the following reasons: -

(1) A bank reconciliation statement locates the errors or omissions that may have been committed either on the part of the customer or the bank.

(2) By preparing a bank reconciliation the customer becomes sure of the correctness of the bank balance shown by the cash book.

(3) A reconciliation statement facilitates the preparation of a revised cash book.

(4) Periodic preparation of this statement reduces the chances of embezzlement by the staff of the firm or even that of the bank.

(5) A reconciliation statement helps in revealing the unnecessary delay in the collection of cheques by the bank.

(6) It also helps in keeping a track of cheques which have been sent to the bank for collection.

PROCEDURE OF PREPARING BANK RECONCILIATION STATEMENT

A reconciliation statement is prepared when the account holder gets the duly completed pass book from the bank. Immediately on receiving the pass books, he tallies bank balance shown by the cash book with the balance shown by the pass book and in case of any difference, items appearing in the pass book are checked and ticked with the items appearing in the cash book. Unticked items in both the books will be the points of difference.

A bank reconciliation statement can be prepared by taking the balance either as per cash book or as per pass book as a starting point. If the statement is started with the balance as per bank column of the cash book, the answer arrived at in the end will be the balance as per pass book. Alternatively, if the statement is started with the balance as per pass book, the answer arrived at in the end will be the balance as per cash book

The balance as per cash book may be either debit or credit and similarly the balance as per pass book may also be either debit or credit: -

1. (a) Dr. Balance as per cash book indicates that the trader has so much balance of deposit at the bank.

(b) Cr. Balance as per cash book is also called 'Overdraft Balance as per Cash Book'.

2. (a) Cr. Balance as per pass book indicates that the trader has so much balance of deposit at the bank.

(b) Dr. Balance as per pass book is also called 'Overdraft as per Pass Book'.

Notes: (1) If cash book balance is given in the question at the start, but it is not clearly stated that this balance is debit or credit, it will be treated as a debit balance.

(2) If pass book balance is given in the question at the start, but it is not clearly stated that this balance is debit or credit, it will be treated as a credit balance.

(3) Balance as per Ledger Account means the Balance as per Cash Book.

(4) Balance as per Bank Book' or 'Balance as per Bank Statement' means the Balance as per pass book.

A bank reconciliation statement can be started from any of the balances mentioned below: -

A. Dr. Balance (Favourable balance) as per Cash Book

B. Cr. Balance (Unfavourable or Overdraft balance) as per Cash Book

C. Dr. Balance (Unfavourable or Overdraft balance) as per Pass Book.

D. Cr. Balance (Favourable balance) as per Pass Book.

Method of preparing a bank reconciliation statement from each of the above balances is explained below: -

(A) Method of preparing Bank Reconciliation Statement by Debit Balance of Bank Column of Cash Book: - Entries on account of which the debit balance of the cash book is lesser in comparison to the credit balance of the pass book will be added while preparing a bank reconciliation statement and vice versa.

Items to be added (Plus Items):

(1) Cheques issued but not yet presented for payment: When a businessman issues cheques to its creditors, he immediately enters them on the credit side of his cash book. It reduces the balance of his cash book but the pass book balance will remain the same because the cheques have not been presented for payment in the bank. As such, the cheques should be added to the balance of the cash book to make it equal to the pass book balance.

(2) Credit made by the Bank for Interest: - When the bank allows interest to a customer, the bank credits the customer's account with the amount of such interest. It increases the pass book balance but the balance of the cash book will be the same, as there is no entry of interest in the cash book. Hence, it should be added to the cash book balance.

(3) Amount directly deposited by the customers in our bank account: - Such deposits must have increased the balance of the

pass book but the cash book will show an unchanged balance. Therefore, this amount should be added to the cash balance.

(4) Interest and dividend collected by the bank: - The bank must have credited these amounts to the customer's account. As such, the pass book balance must have increased whereas the cash book will show an unchanged balance. Therefore, this amount should be added to the cash balance.

(5) Cheques paid into the bank but omitted to be recorded in the cash book: - Bank must have credited these cheques in the customer's account, but as there is no entry in the cash book it shows a lesser balance. Hence, the amounts should be added to the cash book balance.

Items to be deducted (Minus Items):

(1) Cheque sent to the bank for collection but not yet credited by the bank: - When the cheque was deposited into bank entry must have been made on the debit side of the cash book. The balance as per cash book must have increased but the bank will not entered them unless they have been collected. As such, the cash balance will show an increased balance in comparison to the pass book. Hence, the amount will be deducted while preparing a bank reconciliation statement.

(2) Cheques sent to the bank for collection but dishonoured by the bank: - Such cheques must also have been entered on the debit side of the cash book but there will be no entry in the pass book, as the cheques have dishonoured. As a result, the cash book will show an increased balance in comparison to the pass book.

(3) Direct payment made by the bank on behalf of customers: The bank makes payment for insurance premium, rent etc., and debits the customer's account. As such, the pass book balance is reduced whereas the cash book balance remains the same. Hence, this amount should be deducted from the balance of the cash book.

(4) Debits made by the bank for Commission, Bank Charges etc.: - It also reduces the pass book balance whereas the cash book balance remains the same. Hence, the amount of bank commission and charges should be deducted from the balance of the cash book.

(5) Cheques issued but omitted to be recorded in the cash book: The bank, while making payment of these cheques, will debit the customer's account. Hence, the balance of the pass book will be reduced, whereas the cash book balance will remain unchanged, i.e., increased as compared to pass book. Hence, the amount of such cheques should be deducted from the cash book balance.

PREPARATION OF AMENDED CASH BOOK

This is another method for preparing bank statement, the procedure for which is as follows: -

(1) First of all, a Cash Book will be prepared (with bank columns only). It will be started by writing down the balance of Cash Book given in the question.

(2) All errors that have been committed in the Cash Book will have to be rectified by passing adjusting entries in the cash book. Usual errors are

(i) Overcasting or undercasting of debit or credit column of the Cash Book.

(ii) Cheques issued to creditors but omitted to be recorded in the Cash Book

(iii) Cheques deposited into the bank but omitted to be recorded in the Cash Book.

(iv) Incorrect amount entered in the Cash Book.

(v) Entries on incorrect side or in wrong columns.

(vi) Any amount recorded twice in the Cash Book etc.

(3) Certain amounts for which bank has given credit in the Pass Book will be recorded on the debit side of Cash Book. Such items are:

(i) Interest allowed by bank.

(ii) Amount directly deposited by customers into the bank.

(iii) Interest and dividend collected by bank on our behalf.

(4) Certain amounts for which bank has debited our account will be recorded on the credit side of Cash Book. Such items are:

(i) Interest charged by bank on overdraft.

(ii) Debits made by bank for bank charges, commission etc.

(iii) Direct payment made by bank on our behalf for insurance premium, rent etc.

(iv) Cheques sent for collection but dishonoured by the bank.

(5) Cash Book is then balanced and the new balance of Cash Book is taken as a starting point for preparing the bank reconciliation statement.

(6) It should be noted that the following items must not be recorded in the Amended Cash Book:

- (i) Cheques deposited into bank but not credited by bank.**
- (ii) Cheques issued but not presented for payment in the bank.**
- (iii) Any wrong entry in Pass Book.**

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