1. Details of Module and its structure

Module Detail	
Subject Name	Accountancy
Course Name	Accountancy 01 (Class XI, Semester - 1)
Module Name/Title	Bank Reconciliation Statement: Concept Preparation, Ascertaining the correct cash balance – Part 8
Module Id	keac_10308
Pre-requisites	Basic knowledge of Preparation of Cash book
Objectives	After going through this lesson, the learners will be able to understand the following: • Concept of bank reconciliation statement • Reasons of difference between cash book and bank pass book • P reparation of adjusted cash book • Preparation of bank reconciliation statement
Keywords	Bank Reconciliation Statement, Cash book, Pass book.

2. Development Team

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1. Introduction

The business organizations keep a record of their cash and bank transactions in a cash book. The cash book also serves the purpose of both the cash account and the bank account and shows the balance of both at the end of the period. 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 complete and up to date and the current 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 enables 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. It will be observed that a bank statement/passbook shows all deposits in the credit column and withdrawals in the debit column. Thus, if deposits exceed withdrawals it shows a credit balance and if withdrawals exceed deposits it will show a debit balance (overdraft).

2. Need for Reconciliation

It is generally experienced that when a comparison is made between the bank balance as shown in the firm's cash book, the two balances do not tally. Hence, we have to first ascertain the causes of difference thereof and then reflect them in a statement called *Bank Reconciliation Statement* to reconcile (tally) the two balances.

In order to prepare a bank reconciliation statement we need to have a bank balance as per the cash book and a bank statement as on a particular day along with details of both the books. If the two balances differ, the entries in both the books are compared and the items on account of which the difference has arisen are ascertained with the respective amounts involved so that the bank reconciliation statement can be prepared.

3. Reasons of difference between Cash Book and Pass Book balances

The major reasons for differences between the balance shown by the cash book and the balance shown by the passbook are as follows:

1. *Timing differences on* recording of the transactions.
2. *Errors* made by the business or by the bank.

1. ***Timing Differences***

When a business compares the balance of its cash book with the balance shown by the bank passbook, there is often a difference, which is caused by the time gap in recording the transactions relating either to payments or receipts. The factors affecting time gap includes :

(a) ***Cheques issued by the bank but not yet presented for payment***

When cheques are issued by the firm to suppliers or creditors of the firm, these are immediately entered on the credit side of the cash book. However, the receiving party may not present the cheque to the bank for payment immediately. The bank will debit the firm's account only when these cheques are actually paid by the bank. Hence, there is a time lag between the issue of a cheque and its presentation to the bank which may cause the difference between the two balances.

(b) Cheques paid into the bank but not yet collected

When firm receives cheques from its customers (debtors), they are immediately recorded in the debit side of the cash book. This increases the bank balance as per the cash book. However, the bank credits the customer account only when the amount of cheques are actually realized. The clearing of cheques generally takes few days especially in case of outstation cheques or when the cheques are paid-in at a bank branch other than the one at which the account of the firm is maintained. This leads to a cause of difference between the bank balance shown by the cash book and the balance shown by the bank passbook.

(c) Direct debits made by the bank on behalf of the customer

Sometimes, the bank deducts amount for various services from the account without the firm's knowledge. The firm comes to know about it only when the bank statement arrives. Examples of such deductions include: cheque collection charges, incidental charges, interest on overdraft, unpaid cheques deducted by the bank – i.e. stopped or bounced, etc. As a result, the balance as per passbook will be less than the balance as per cash book.

(d) Amounts directly deposited in the bank account

There are instances when debtors (customers) directly deposits money into firm's bank account. But, the firm does not receive the intimation from any source till it receives the bank statement. In this case, the bank records the receipts in the firm's account at the bank but the same is not recorded in the firm's cash book. As a result, the balance shown in the bank passbook will be more than the balance shown in the firm's cash book.

(e) Interest and dividends collected by the bank

When the bank collects interest and dividend on behalf of the customer, then these are immediately credited to the customer's account. But the firm will know about these transactions and record the same in the cash book only when it receives a bank statement. Till then the balances as per the cash book and passbook will differ.

(f) Direct payments made by the bank on behalf of the customers

Sometimes the customers give standing instructions to the bank to make some payment regularly on stated days to the third parties. For example, telephone bills, insurance premium, rent, taxes, etc. are directly paid by the bank on behalf of the customer and debited to the account. As a result, the balance as per the bank passbook would be less than the one shown in the cash book.

(g) Cheques deposited/bills discounted dishonoured

If a cheque deposited by the firm is dishonoured or a bill of exchange drawn by the business firm is discounted with the bank is dishonoured on the date of maturity, the same is debited to customer's account by the bank. As this information is not available to the firm immediately, there will be no entry in the firm's cash book regarding the above items. This will be known to the firm when it receives a statement from the bank. As a result, the balance as per the passbook would be less than the cash book balance.

2. ***Differences Caused by Errors***

Sometimes the difference between the two balances may be accounted for by an error on the part of the bank or an error in the cash book of the business. This causes difference between the bank balance shown by the cash book and the balance shown by the bank statement.

(a) Errors committed in recording transaction by the firm

Omission or wrong recording of transactions relating to cheques issued, cheques deposited and wrong totaling, etc. committed by the firm while recording entries in the cash book cause difference between cash book and passbook balance.

(b) Errors committed in recording transactions by the bank

Omission or wrong recording of transactions relating to cheques deposited and wrong totaling, etc. committed by the bank while posting entries in the passbook also cause differences between passbook and cash book balance.

Preparation of Bank Reconciliation Statement

After identifying the causes of difference, the reconciliation may be done in the following two ways:

(a) Preparation of bank reconciliation statement without adjusting cash book balance.

(b) Preparation of bank reconciliation statement after adjusting cash book balance.

It may be noted that in practice, the bank reconciliation statement is prepared after adjusting the cash book balance.

4. *Preparation of Bank Reconciliation Statement without adjusting Cash Book Balance*

To prepare bank reconciliation statement, under this approach, the balance as per cash book or as per passbook is the starting item. The debit balance as per the cash book means the balance of deposits held at the bank. Such a balance will be a credit balance as per the passbook. Such a balance exists when the deposits made by the firm are more than its withdrawals. It indicates the *favourable balance as per cash book or favourable balance as per the passbook*. On the other hand, the credit balance as per the cash book indicates *bank overdraft*. In other words, the excess amount withdrawn over the amount deposited in the bank. It is also known as *unfavourable balance as per cash book or unfavourable balance as per passbook.*

We may have four different situations while preparing the bank reconciliation statement. These are :

1. When debit balance (favourable balance) as per cash book is given and the balance as per passbook is to be ascertained.
2. When credit balance (favourable balance) as per passbook is given and the balance as per cash book is to be ascertained.
3. When credit balance as per cash book (unfavourable balance/overdraft balance) is given and the balance as per passbook is to ascertained.
4. When debit balance as per passbook (unfavourable balance/overdraft balance) is given and the balance as per cash book is to be ascertained.

Dealing with favourable balances

The following steps may be initiated to prepare the bank reconciliation statement:

i. The date on which the statement is prepared is written at the top, as part of the heading.
ii. The first item in the statement is generally the balance as shown by the cash book. Alternatively, the starting point can also be the balance as per passbook.
iii. The cheques deposited but not yet collected are deducted.
iv. All the cheques issued but not yet presented for payment, amounts directly deposited in the bank account are added.
v. All the items of charges such as interest on overdraft, payment by bank on standing instructions and debited by the bank in the passbook but not entered in cash book, bills and cheques dishonoured etc. are deducted.
vi. All the credits given by the bank such as interest on dividends collected, etc. and direct deposits in the bank are added.
vii. Adjustment for errors are made according to the principles of rectification of errors.
viii. Now the net balance shown by the statement should be same as shown by the passbook.

It may be noted that treatment of all items shall be the reverse of the above if we adjust passbook balance as the starting point.

Now we take an example to learn how to prepare Bank Reconciliation Statement.

Example

From the following particulars of Mr. Vinod, prepare bank reconciliation statement as on March 31, 2017.

1. Bank balance as per cash book ₹ 50,000.
2. Cheques issued but not presented for payment ₹ 6,000.
3. The bank had directly collected dividend of ₹ 8,000 and credited to bank account but was not entered in the cash book.
4. Bank charges of ₹ 400 were not entered in the cash book.
5. A cheques for ₹ 6,000 was deposited but not collected by the bank.

Solution

Bank Reconciliation Statement of Mr. Vinod as on March 31, 2016

Particulars	**(₹)** +	**(₹)** -
Balance as per cash book	50,000	
Cheques issued but not presented for payment	6,000	
Dividends collected by the bank	8,000	
Cheque deposited but not credited by the bank		6,000
Bank charges debited by the bank		400
Balance as per passbook.		57,600
	64,000	64,000

Example: Pass book balance

The bank passbook of M/s. Boss & Co. showed a balance of ₹ 45,000 on May 31, 2017.

1. Cheques issued before May 31, 2017, amounting to ₹ 25,940 had not been presented for encashment.
2. Two cheques of ₹ 3,900 and ₹ 2,350 were deposited into the bank on May 31 but the bank gave credit for the same in June, 2017.
3. There was also a debit in the passbook of ₹ 2,500 in respect of a cheque dishonoured on 31.5.2017.

Prepare a bank reconciliation statement as on May 31, 2017.

Solution

Bank Reconciliation Statement of Bose & Co. as on May 31, 2016

Particulars	**(₹)** +	**(₹)** -
Balance as per Passbook	45,000	
Cheque deposited but not credited by the bank (₹ 3900 + ₹ 2350)	6,250	
Cheque dishonoured recorded only in passbook	2,500	
Cheques issued but not presented for payment		25,940
Balance as per Cash book.		27,810
	53,750	53,750

Dealing with overdrafts

So far we have dealt with bank reconciliation statement where bank balances has been positive – i.e., there has been money in the bank account. However, businesses sometimes have overdrafts at the bank. Overdrafts are where the bank account becomes negative and the businesses in effect have borrowed from the bank. This is shown in the cash book as a credit balance. In the bank statement, where the balance is followed by Dr. (or sometimes OD) means that there is an overdraft and called debit balance as per passbook. An overdraft is treated as negative figure on a bank reconciliation statement.

Example

On March 31, 2016 the bank column of the cash book of Agrawal Traders showed a credit balance of ₹ 1,18,100 (Overdraft). On examining of the cash book and the bank statement, it was found that:

1. Cheques received and recorded in the cash book but not sent to the bank for collection ₹ 12,400.
2. Payment received from a customer directly by the bank ₹ 27,300 but no entry was made in the cash book.
3. Cheques issued for ₹ 1,75,200, but not presented for payment.
4.Interest of ₹ 8,800 charged by the bank was not entered in the cash book.

Prepare bank reconciliation statement.

Solution

Particulars	**(₹)** **(+)**	**(₹)** **(-)**

Overdraft as per cash book		1,18,100
Cheques received and recorded in the cash book but not sent to the bank for collection		12,400
Interest on bank overdraft debited by the bank but not entered in the cash book		8,800
Payment received from the customer directly Credited in the bank a/c but not entered in the cash book	27,300	
Cheques issued but not presented for payment	1,75,200	
Balance as per the passbook (favourable balance)		63,200
	2,02,500	**2,02,500**

Example

From the following particulars of Asha & Co. prepare a bank reconciliation statement on December 31, 2017.

- Overdraft as per passbook 20,000
- Interest on overdraft 2,000
- Insurance Premium paid by the bank 200
- Cheque issued but not presented for payment 6,500
- Cheque deposited but not yet cleared 6,000
- Wrongly debited by the bank 500

Solution

Bank Reconciliation Statement of Asha & Co. as on March 31, 2014

Particulars	**(₹)** **(+)**	**(₹)** **(-)**
Overdraft as per passbook		20,000
Interest on overdraft	2,000	
Insurance premium paid by the bank	200	
Cheque issued but not presented for payment		6,500
Cheques deposited but not yet cleared	6,000	
Wrongly debited by the bank	500	
Balance as per the cash book (overdraft)	17,800	

	26,500	**26,500**

5. Preparation of Bank Reconciliation Statement with Adjusted Cash Book

When we look at the various items that normally cause the difference between the passbook balance and the cash book balance, we find a number of items, which appear only in the passbook. Why not first record such items in the cash book to work out the adjusted balance (also known as amended balance) of the cash book and then prepare the bank reconciliation statement. This shall reduce the number of items responsible for the difference and have the correct figure of balance at bank in the balance sheet. In fact, this is exactly what is done in practice whereby only those items which cause the difference on account of the time gap in recording appear in bank reconciliation statement.

These are as (i) cheques issued but not yet presented, (ii) cheques deposited but not yet collected, and (iii) due to an error in the passbook.

Example

The bank overdraft of Smith Ltd., on December 31, 2017 as per cash book is ₹18,000 From the following information, ascertain the adjusted cash balance and prepare bank reconciliation statement

	(₹)
(i) Unpresented cheques	6,000
(ii) Uncleared cheques	3,400
(iii) Bank interest debited in the passbook only	1,000
(iv) Bills collected and credited in the passbook only	1,600
(v) Cheque of Arun traders dishonoured	1,000
(vi) Cheque issued to Kapoor & Co. not yet entered in the of cash book.	600

Solution

Dr. **Amended Cash Book (Bank Column)** **Cr.**

Date	Particulars	L.f.	Amount (₹)	Date	Particulars	L.f.	Amount (₹)

	Bills collected as per passbook Balance c/d		1,600 19,000		Balance b/d Interest Cheque dishonoured (Arun Traders) Kapoor and Co. (cheque)		18,000 1,000 1,000 600
			20,600				**20,600**
					Balance b/d		**19,000**

Bank Reconciliation Statement as on December 31, 2017

Particulars	**(₹)** **(+)**	**(₹)** **(-)**
Bank overdraft as per cash book		19,000
Uncleared cheques		3,400
Unpresented cheques	6,000	
Bank overdraft as per passbook	16,400	
	22,400	**22,400**

6. Summary with Reference to Learning Objectives

Bank Reconciliation Statement: A statement prepared to reconcile the bank balance as per cash book with the balance as per passbook or bank statement, by showing the items of difference between the two accounts.

Reasons of difference

- Timing of recoding the transaction
- Errors made by business or by the bank.

Correct cash balance

It may happen that some of the receipts or payments are missing from either of the books and errors, if any, need to be rectified. This arise the need to look at the entries/errors recorded in both statements and other information available and compute the correct cash balance before reconciling the statements.