

Visual Learning Maps

Introductory Financial Accounting



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VIRTUAL TEXT BOOK

BANK RECONCILIATION – 1 OF 7

WHAT IS IT? And WHEN?

Every month the bank sends a package to the business called the bank statement. It has pages that summarize the individual transactions that went through the account during the month and it also contains the supporting documents - checks, debit memos and credit memos. On the month end date the bank statement shows a balance. This will be the opening balance on the next month's bank statement.

The books of the business also show a balance at the month end.

The book balance and the bank balance are rarely the same. "How rare?" you may ask - as close to never as you can imagine. The reason they are not the same has to do with the timing of the processing of documents in the business and the timing of transactions processed at the bank.

For example: pay checks are issued on the last day of the month; but not all of them reach the bank on the same day. The books show that all the checks have reduced the bank balance because they have been issued and recorded. This is not so at the bank - so the difference is the total amount of checks cashed at the bank after the last day of the month. The formal term for these checks that have not been cashed is "**outstanding checks.**"

Every business prepares the bank reconciliation every month when the bank statement is received. There is a specific cookie cutter format to the reconciliation and specific operating procedures to complete it. 99.999% of the time the reconciliation proves that the difference between the book balance and the bank balance relates solely to the timing differences.

WHY DO IT?

The most important control principle in business is Cash Control – control the cash! The first rule of Cash Control is to know how much cash the business really has.

Automatically through systematic procedures, the bank reconciliation becomes a tool that can uncover fraud or theft...more about this later. ←

BANK RECONCILIATION – 2 OF 7

How to Do It

Doing the bank reconciliation in reality, and in this course, **always begins** with writing down the two most important knowns – the book balance at month end; and the month end bank balance. These are the two figures that **must** be reconciled. Make two columns, one for sub totals and one for totals.

Leave space between these figures for the reconciling items. Put the 'book balance' at the top of the page and the 'bank balance' just below the middle of the page. Think of these as two sections - the 'book' section and the 'bank' section. In each section make a sub-section for + and - items. This makes space for the reconciling items you will encounter. **Do this first** - it looks like this:

Reconciliation Worksheet – The Answer Format

Book Balance		\$
+		
	see page 5	
-		
	see page 5	
		<u>TOTAL</u>
Bank Balance		\$
+		
	see page 4	
-		
	see page 4	
		<u>TOTAL</u>

Always Same Amount

BANK RECONCILIATION – 3 OF 7

How to Do It – continued

FORMATS OF PROBLEMS YOU WILL ENCOUNTER


Some problems will provide data listing details of checks (Check Numbers, Payee, Date) and deposits (deposit number, Payor, Date) on the books and on the bank statement. This is **the Detailed Format**. Some problems will not give all this detailed data, but rather, provide data about separate items in total. This is **the Short Format**.


The first step for each format is to set up your solution Reconciliation Worksheet page, as shown on page 2.

If the Problem you are working on is a Short Format – Go directly to the “Decision System” Section on page 4.

Caution: Items that are debits on the bank statement are credits in the books; items that are credits on the bank statement are debits in the books. WHY? Because when a business deposits money in the bank, the asset cash increases on the business’ books; but this same deposit on the bank’s books is a liability, *‘cash owed to depositor’* because the bank owes the depositor that amount of cash. Similarly, when a business issues a check, reducing cash; it is a credit to the asset ‘cash’ on the business’ books. The same check on the bank’s books is a debit to the bank’s liability *‘cash owed to depositor’* because the bank owes the business less cash than before the check cleared.

DETAILED FORMAT

The first step is to use  marks and make decisions about each item on the bank statement and the books.

Start with the first item on the bank statement, and then proceed line by line. When an item is the same on the bank statement and the books – put one of  these beside both figures. When items **are not the same or an item appears on the bank statement, but not the books; or on the books but not the bank statement – NO TICK MARK.**

When you finish all the items on the bank statement, you will have items without tick marks on the bank statement and on the books. These are the reconciling items. Go now to the “Decision System” section on page 4. These must be addressed one by one.

BANK RECONCILIATION – 4 OF 7

Decision System...getting the Worksheet completed

The key question in both the Detailed Format and the Short Format that you must ask yourself: ***“Is this an adjustment to the ‘Book’ section or the ‘Bank’ section; and is it plus or minus?”***

Each of the items will always fit one of the descriptions below or on page 5:

Adjustments to the ‘Bank’ Section on the Reconciliation Worksheet:

- A check is shown on the books as being issued, but has not cleared the bank (no tick mark)

This is an **Outstanding Check**. Outstanding checks **ALWAYS** go in the **minus** sub-section of the ‘Bank’ section on the Reconciliation Worksheet.

Write the details in the sub-section – check number, date and amount.

Sometimes Problems will give you only the total of Outstanding Checks; in this case you don’t have the details, so just use the total.

- A deposit is shown on the books (usually the last day of the month), but does not appear on the bank statement.

This is an **Outstanding Deposit**. Outstanding deposits **ALWAYS** go in the **plus** sub-section of the Bank Section on the Reconciliation Worksheet.

Bank Errors - If the bank made an error in processing a check or a deposit; adjust the plus or minus sub-section of the ‘Bank’ section on the Reconciliation Worksheet. How do you know if it is plus or minus?

First find out how much the error is by deriving the difference between what was processed and what should have been processed. The plus or minus depends on how the bank made the error. Ask yourself in the case of a check *“Did the bank deduct too much or not enough?”* In the case of an error in recording a deposit, ask yourself - *“Did the bank add too much or not enough?”*

THESE ARE THE ONLY ADJUSTMENTS THAT ARE MADE TO THE ‘BANK’ SECTION OF THE RECONCILIATION WORKSHEET – ALL OTHERS GO TO THE BOOK SECTION

BANK RECONCILIATION – 5 OF 7

Decision System...getting the Worksheet completed

Adjustments to the 'Books' Section on the Reconciliation Worksheet:

Items that have **not** been recorded in the Books appear on the Bank Statement, so they must be identified, and recorded on the Reconciliation Worksheet. These are listed below: **Caution:** Not all of these items appear in all Problems, but you will encounter them all over the series of Problems you will work on.

These appear as DEBITS on the Bank Statement

- Bank Service Charges
- Interest paid to the bank
- Deposits that became NSF (non-sufficient funds)
- Debit Memos
- Errors on the books where the check that cleared the bank correctly is a higher amount than the check amount recorded on the books
- Errors on the books where the deposit shown correctly on the bank statement is lower than the amount of the deposit shown on the books
- EFT (**E**lectronic **F**unds **T**ransfers) payments to suppliers, creditors etc.

ALL OF THESE ALWAYS GO TO THE **MINUS** SUB-SECTION OF THE 'BOOKS' ON THE RECONCILIATION WORKSHEET

These appear as CREDITS on the Bank Statement

- Interest earned from the bank
- Collections from customers by the bank
- Credit memos
- Errors on the books where the check that cleared the bank correctly is a lower amount than the check amount recorded on the books
- Errors on the books where the deposit shown correctly on the bank statement is lower than the amount of the deposit shown on the books

ALL OF THESE ALWAYS GO TO THE **PLUS** SUB-SECTION OF THE 'BOOKS' ON THE RECONCILIATION WORKSHEET

BANK RECONCILIATION – 6 OF 7

Addition Steps...getting the Worksheet completed

NOW...the last steps

Add up each sub-section and carry the sub totals into the TOTAL column.

Sum the Book Balance and the sub-section sub totals

↑
The Final Totals MUST be the SAME
↓

Sum the Bank Balance and the sub-section sub totals

IT LOOKS LIKE THIS

Book Balance			\$
+			
see page 5	sub		
	Totals		\$
-			
see page 5	Column		(\$)
			<u>TOTAL</u>
Bank Balance			\$
+			
see page 4	sub		
	totals		\$
-			
see page 4	Column		(\$)
			<u>TOTAL</u>

Always Same Amount

BANK RECONCILIATION – 7OF 7

Fraud & Theft – a few words...

Every once in a while someone gets the idea that they will steal a check or create one in desk top publishing, forge the signature, cash it; and believes that no one will notice.

Frauds have also been committed where the numbers on the check have been changed, or the payee has been changed to the benefit of the perpetrator.

The bank reconciliation will catch these immediately; and the investigation will begin. Why? - **Because the check is not on the books of the company exactly as it cleared the bank.** Alarm bells go off instantly.

Cash is a very tempting asset. If controls are weak, a business can easily experience this problem. It is messy, costly and takes up time in legal matters that should be devoted to doing business. When fraud occurs and is discovered, management's reaction is typically surprise. "How did this happen?" is always the first question. Invariably, the answer relates to weaknesses in the control systems.

This is why businesses large or small must constantly review their systems of **Internal Control**. Paranoia in these matters is useful.