Bank Reconciliation Statement

LEARNING OBJECTIVES

After studying this Chapter, you should be able to understand :

- Meaning of Bank Reconciliation Statement
- Causes for Differences in the Cash Book and Pass Book Balance
- Need and Importance of Bank Reconciliation Statement
- Procedure of Preparing Bank Reconciliation Statement

Meaning of Bank Reconciliation Statement :

Usually, all the firms open a current account with a Bank and in order to record the transactions entered into with the bank, maintain a Bank Column in the Cash Book. Bank also opens a separate account for each firm in its ledger and enters all the transactions in it. Periodically, bank supplies a copy of the firm's account in its ledger to the firm for information. This copy of the firm's account supplied by the bank is called bank pass book or bank statement.

Since all the transactions entered with the bank are recorded in both the books, there should be no difference between the balance shown by the cash book and the pass book. The balance of the two books must tally with each other, because when the money is deposited into the bank, the firm enters it on the debit side of the bank column of the cash book and at the same time bank also enters it on the credit side of the firm's account maintained by the bank. On the other hand, when money is withdrawn from the bank, firm enters it on the credit side of the bank column of cash book and at the same time bank also enters it on the debit side of the firm's account in its books.

Hence, all the entries recorded on the debit side of the cash book must tally with the entries recorded on the credit side of the pass book and conversely, all the entries recorded on the credit side of the cash book must tally with the entries recorded on the debit side of the pass book. Therefore, at any time, the bank balance shown by the cash book must tally with the balance shown by the pass book. However, sometimes it so happens, that these two balances do not tally. This is, because on a certain date it is possible that there may be some entries which may have been recorded in the cash book but not in the pass book and *vice versa*. 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 :— "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 :—

(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. In the case of crossed cheques, the time lag is very high since such cheques can be presented for payment only through some 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. Again there will be a gap of some days between the depositing of the cheques into the bank and credit given by the bank. In the case of outstation cheques, this gap will be very high. 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 the cheques are dishonoured, bank will not make any entry in the credit of customer's 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. Generally, the amount of such interest is credited by the bank at the end of six months. But the customer will come to know of the amount of interest only when he gets his pass book completed after a gap of time. In the intervening period, the 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 balances of the two books 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 notable charges levied by the bank are commission and collection charges on outstation cheques. 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.

(10) **Any wrong entry made by the bank in the Pass Book** :— 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. The difference will be eliminated when the error is detected.

(11) **Other reasons :—**

(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.

Need and Importance of Bank Reconciliation Statement