UNIT 3
Bank Reconciliation Statement

(4 Hours) — Financial Accounting (CACS152)

1. Introduction to Bank Reconciliation Statement

Every business that maintains a current or savings account records its banking transactions twice: once in its own books, in the bank column of the Cash Book, and once by the bank itself, in the Pass Book (or bank statement) that it issues to the account holder. In theory, since both records relate to the same set of transactions, the balance shown by the Cash Book and the balance shown by the Pass Book on any given date should be identical. In practice, however, the two balances very often differ.

A Bank Reconciliation Statement (BRS) is a statement prepared to reconcile, or explain, the difference between the balance as shown by the bank column of the Cash Book and the balance as shown by the Pass Book, on a particular date. It does not itself correct the books — rather, it identifies and lists each item that accounts for the difference, so that the business can verify that no error or irregularity remains unexplained.

Note: A Bank Reconciliation Statement is a statement, not an account. It is prepared separately, outside the main books of account, purely to explain a difference — it does not require a journal entry by itself.

1.1 Why Do the Two Balances Differ?

The bank column of the Cash Book is written up by the business itself, while the Pass Book is written up by the bank. Because entries affecting the account are frequently made by one party before the other becomes aware of them — for example, a cheque issued by the business is recorded immediately in its Cash Book but is recorded by the bank only when the cheque is actually presented and paid — a temporary difference arises between the two records. Such differences are usually timing differences that resolve themselves in due course; occasionally, however, the difference arises from an outright error in either the Cash Book or the Pass Book.

2. Ascertaining the Causes of Difference

The causes of difference between the bank balance shown in the Cash Book and the balance shown in the Pass Book can be broadly grouped into timing differences and errors.

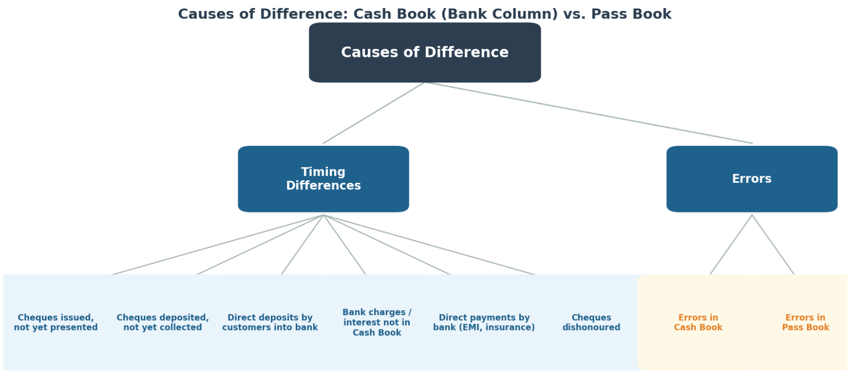

Fig 3.1 — Causes of difference between the Cash Book (bank column) and the Pass Book.

2.1 Timing Differences

- Cheques issued but not yet presented for payment — the business debits (reduces) its Cash Book balance the moment a cheque is issued, but the bank does not reduce the account until the cheque is actually presented by the payee and paid, which may take several days.
- Cheques deposited but not yet collected/credited — the business credits (increases) its Cash Book balance as soon as a cheque is deposited for collection, but the bank credits the account only after the cheque has actually been cleared and the proceeds realized.
- Direct deposits by customers into the bank account — a customer may deposit money directly into the business's bank account (e.g., through a bank transfer), which the bank records immediately, but the business becomes aware of it, and records it in the Cash Book, only on receiving the bank statement.
- Bank charges, interest, and commission debited by the bank — the bank deducts charges such as service fees, interest on overdraft, or commission on collections directly from the account, and the business records these in its Cash Book only after seeing the Pass Book.
- Direct payments made by the bank on standing instructions — amounts such as insurance premiums, loan installments (EMIs), or utility bills paid by the bank on the business's behalf under standing instructions are recorded by the bank immediately, but by the business only later.
- Interest allowed by the bank on the credit balance — credited by the bank to the account but often recorded in the Cash Book only upon receipt of the Pass Book.
- Cheques deposited but dishonoured — a cheque deposited by the business and initially credited by the bank may later be dishonoured (bounced) and reversed by the bank; if this reversal has not yet been recorded in the Cash Book, a difference arises.

2.2 Errors

• Errors in the Cash Book — for example, an amount is entered on the wrong side, an entry is omitted, or a wrong amount is entered while recording a cheque issued or deposited.

• Errors in the Pass Book — for example, the bank wrongly debits or credits the account, or records an amount that does not belong to the business's account at all.

Note: Timing differences are self-correcting and require no rectification in the books — they simply need to be listed in the BRS. Errors, on the other hand, need to be corrected in whichever set of books (Cash Book or Pass Book) contains the mistake.

3. Procedure for Reconciling the Cash Book Balance with the Pass Book Balance

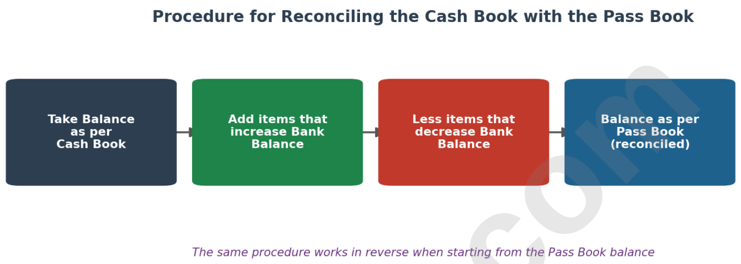

Fig 3.2 — General procedure for preparing a Bank Reconciliation Statement.

3.1 General Rule of Adjustment

A Bank Reconciliation Statement may be prepared starting from either balance, and in either case the same underlying rule applies: an item that would increase the balance in the other book is added, and an item that would decrease the balance in the other book is deducted.

Item	If starting from Cash Book balance	If starting from Pass Book balance
Cheques issued, not yet presented	Add	Deduct
Cheques deposited, not yet collected	Deduct	Add
Interest / dividend directly collected by bank	Add	Deduct
Bank charges / interest on overdraft debited by bank	Deduct	Add
Direct payments made by bank (EMI, insurance, etc.)	Deduct	Add
Direct deposits made by customers into the bank account	Add	Deduct
Cheques deposited but dishonoured by the bank	Deduct	Add

Item	If starting from Cash Book balance	If starting from Pass Book balance
Cheques issued but dishonoured (returned unpaid)	Add	Deduct

3.2 Step-by-Step Procedure (Starting from the Cash Book Balance)

- Step 1: Note the balance as per the Cash Book (bank column) on the given date.
- Step 2: Compare each entry in the Cash Book with the corresponding entry in the Pass Book, and list every item that appears in one book but not yet in the other.
- Step 3: Add all items that have increased the bank's record of the balance but have not yet been recorded in the Cash Book (or that reduce the Cash Book balance but not the bank's), following the rule above.
- Step 4: Deduct all items that have decreased the bank's record of the balance but have not yet been recorded in the Cash Book (or that increase the Cash Book balance but not the bank's).
- Step 5: The resulting figure should equal the balance shown by the Pass Book. If it does not, re-check for any overlooked item or an error in either book.

Example 3.1 — Preparing a Bank Reconciliation Statement

On 31 Ashadh, the Cash Book of M/s Gurung Traders showed a debit (favourable) balance of Rs. 42,000. On comparing it with the Pass Book, the following differences were noticed: (i) Cheques issued but not yet presented for payment, Rs. 12,000; (ii) Cheques deposited but not yet collected, Rs. 8,000; (iii) Bank charges debited by the bank but not recorded in the Cash Book, Rs. 300; (iv) A customer deposited Rs. 5,000 directly into the bank account, not yet recorded in the Cash Book. Prepare a Bank Reconciliation Statement as at 31 Ashadh.

Solution — Bank Reconciliation Statement as at 31 Ashadh

Balance as per Cash Book Rs. 42,000

Add: Cheques issued but not yet presented Rs. 12,000

Add: Direct deposit by customer, not yet recorded Rs. 5,000

Sub-total Rs. 59,000

Less: Cheques deposited but not yet collected Rs. 8,000

Less: Bank charges not yet recorded in Cash Book Rs. 300

Balance as per Pass Book Rs. 50,700

Note: If, instead, the Pass Book balance of Rs. 50,700 were given as the starting point, the same four items would simply be applied with the opposite sign (deduct the items that were added above, and add the items that were deducted above) to arrive back at the Cash Book balance of Rs. 42,000.

3.3 Points to Remember While Preparing a BRS

- Always specify clearly whether the reconciliation begins with the Cash Book balance or the Pass Book balance, since the treatment of each item is reversed depending on the starting point.
- If the Cash Book shows a credit balance (i.e., an overdraft), the sign convention for every adjustment is reversed relative to a normal debit (favourable) balance.
- Any error found in the Cash Book should also be corrected in the Cash Book itself (through a rectifying entry), quite apart from its appearance in the BRS.

4. Importance of Bank Reconciliation Statement

Although a Bank Reconciliation Statement is not part of the double entry system and does not by itself alter any account, it plays a vital role in the financial discipline of a business.

4.1 Ensures Accuracy of the Cash Book

By comparing every entry in the Cash Book against the Pass Book, the business can be confident that its own record of bank transactions is complete and free from clerical errors such as omitted entries, wrong amounts, or entries posted to the wrong side.

4.2 Detects and Helps Prevent Fraud and Embezzlement

Regular reconciliation makes it far more difficult for an employee to misappropriate funds — for example, by recording a fictitious deposit or withholding a cheque — without detection, since any such manipulation would eventually surface as an unexplained difference between the two balances.

4.3 Reveals Errors Made by the Bank

Banks, despite their internal controls, occasionally make mistakes — crediting or debiting the wrong account, recording an incorrect amount, or omitting an entry altogether. A BRS brings such errors to light so that they can be brought to the bank's attention and corrected promptly.

4.4 Provides an Up-to-Date and Reliable Bank Balance

Preparing a BRS gives management a true picture of funds actually available with the bank at any point in time, which is essential for effective cash and liquidity management, for deciding on further payments, and for avoiding an inadvertent overdraft.

4.5 Helps Track Outstanding and Pending Items

The BRS specifically lists cheques issued but not yet presented and cheques deposited but not yet collected. This allows the business to follow up on long-outstanding cheques (which may indicate that a payee has misplaced or delayed depositing a cheque) and to anticipate when deposited cheques will actually be realized.

4.6 Supports Internal Control and Audit

A BRS forms an important part of a sound system of internal control over cash and bank transactions. Auditors routinely examine the bank reconciliation statements prepared by a business as part of verifying the accuracy of its cash and bank balances shown in the financial statements.

4.7 Assists in Timely Financial Decision-Making

Because the reconciled balance reflects the true, realizable cash position with the bank, management can make more informed decisions regarding investments, payments to creditors, and short-term borrowing, rather than relying on a Cash Book balance that may be temporarily out of step with reality.

4.8 Builds Confidence Among Stakeholders

A business that reconciles its bank balances regularly and can readily explain any difference between its books and the bank's records presents itself as well-managed and trustworthy to auditors, creditors, investors, and regulators.

Key Takeaways

✓ A Bank Reconciliation Statement explains, but does not itself correct, the difference between the Cash Book (bank column) balance and the Pass Book balance on a given date.

✓ Differences mainly arise from timing differences — cheques issued but not presented, cheques deposited but not collected, and items the bank records directly (charges, direct deposits, standing payments) — and, occasionally, from outright errors in either book.

✓ The reconciliation procedure follows a simple rule: an item that increases the balance in the other book is added, and an item that decreases the balance in the other book is deducted; the treatment reverses depending on which balance you start from.

✓ The BRS is an essential control tool: it verifies the accuracy of the Cash Book, helps detect fraud and bank errors, and supports sound cash management, audit, and decision-making.

— End of Unit 3 —