Bank Reconciliation Statements

A bank statement is issued by the bank at the end of each month and will contain details of the money paid out and into the firm's account.
In order to be able to understand the terms used in a bank statement some important terms need to be defined:

1- *Direct Bank Transfer* → An automatic transfer of money from a firm's account to a creditor, or to employees to pay their salaries and wages.

2- *Bank Overdraft* → When we have paid more out of our bank account than we have paid into it. In this situation the firm will owe the bank the difference in the balance.

3- *Direct Debit* → An agreement by the firm for a creditor to automatically draw out a *variable* amount of money from its bank account. For example, at the end of each month a firm might set up a direct debit which gives the mobile phone supplier the power to draw out enough money to pay the monthly charges for phone calls.

4- *Standing Order* → An agreement by the firm for a creditor to automatically draw out a *fixed* amount of money from it's bank account. For example, a firm may set up a standing order for it's insurance company to take out a fixed sum of money from it account over an agreed time period.

5- *Drawer* → The person writing the cheque and using it for payment.

6- *Payee* → The person to whom a cheque is paid.

Unpresented Cheques, Bank Lodgements and Dishonoured Cheques

When a firm pays a creditor by cheque it will usually take a period of time before the amount is deducted from the balance in your account. The following diagram explains why this occurs:

1st January: GLX firm pays its creditor Jones $700 by cheque which it sends by letter in the post.

↓

3rd January: The creditor Jones receives the cheque and pays into the firm's HSBC account.

↓

4th January: The HSBC bank will send the cheque back down to GLX's Lloyds bank so that they may verify that he has enough money to pay the amount written out in the cheque.

↓

5th January: Lloyds bank confirm that GLX has enough money in their bank account to pay creditor Jones. An electronic transfer of money is then made out of GLX firm's account into creditor Jones' account.

As can be seen from the example illustrated above the process of money changing hands from the firm to the creditor takes at least five working days. This time delay will often mean that the Bank Statement and the Cash Book do not match.

The three possible terms that might be used to describe this time delay are:
1-*Unpresented Cheque* → A cheque paid by your firm to a creditor which has not yet cleared through the banking system.
2- *Bank Lodgement* → A cheque received by your firm from a debtor which has not yet cleared through the banking system.
3- *A Dishonoured Cheque* → When a cheque is received from a customer and paid into the bank, it is recorded on the debit side of the cash book. It is also shown on the bank statement as a banking by the bank. However, at a later date it may be found that his bank will not pay us the amount due on the cheque. Therefore the bank has failed to honour the cheque.

A Bank Reconciliation Statement

Obviously when an accountant pays or receives a cheque he/she will immediately record it on the credit or debit side of the Cash Book bank colums. However very often cheques will not clear through the banking system until at least five days after they have been written and as a result there is often a time delay between when the money is recorded in the Cash Book and when it actually leaves or enters the firm's bank account. This time delay often means that the bank statement balance at the end of the month and the bank balance brought down in the Cash Book will be different. As a result accountants use a system to verify that the difference between the bank statement and the bank balance in the Cash Book is a result of a time delay and not an accounting error. This system is called a *Bank Reconciliation Statement*.

Where the closing balances differ between the Bank Statement and Cash Book

Where there is a difference between the closing balances in the Bank Statement and the Cash Book the following two steps must always be followed:
1- *Update the Cash Book* → Check the bank statement for transactions that have not been entered in the cash book.
2- *A Bank Reconciliation Statement* → A reconciliation of the difference between the remaining balance must be performed using an agreed format. This statement will prove that the different balances between the two business documents are a result of a time delay and not an accounting error.

The credit and debit entries on a bank statement

Obviously the bank statement that the firm receives at the end of the month is prepared by the bank's accountant and as a result from their point of view the business in question is a creditor of money. This is because they owe the firm the amount shown in the final balance as the end of the month. Consequently debit and credit entries are reversed in the bank statement. This means that on the Bank Statement a debit entry is shown for money leaving your account and a credit entry is shown for money entering your account.

Practical example of a Bank Reconciliation Statement

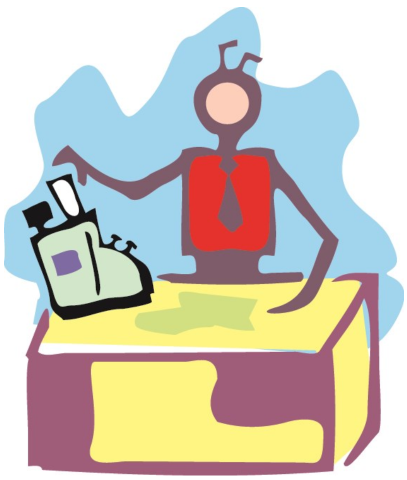
The following is the bank account in the cash book of a business for the month of September:

Dr **Cash Book (Bank Columns)** **Cr**

		$			$
Sept. 1	Bal. b/d	8,300	Sept. 5	Suppliers & Co.✓	3,090
Sept. 8	Cash Sales✓	2,100	Sept. 11	Wheel Garages✓	416
Sept. 19	A. Ali✓	984	Sept. 20	Wages✓	1,640
Sept. 29	Enni Co. **(B)**	627	Sept. 28	Brite Light **(B)**	772
Sept. 30	Cosi Bros. ✓	42	Sept. 29	Ojay Co. **(B)**	100
			Sept. 30	Bal. c/d	6,035
		12,053			**12,053**
Oct. 1	Bal. b/d	6,035			

The Crystal Bank - Anytown Branch
Bank Statement as at the 30th September

		Debit	Credit	Balance
		$	$	$
Sept 1	Balance			8,300
Sept 8	Cash & cheques		2,100✓	10,400
Sept 10	Suppliers & Co.	3,090✓		7,310
Sept 15	Wheel Garages	416✓		6,894
Sept 19	Cheque		984✓	7,878
Sept 20	Cash	1,640✓		6,238
Sept 30	Cheque		42✓	6,280
Sept 30	Bank Charges (a)	200 **(C)**		6,080
	Bank interest (b)	84 **(C)**		5,996



Step One - *Update the Cash Book* → Transactions (a) & (b) appear on the bank statement but have not been entered in the Cash Book. The updated Cash Book would appear as follows:

Dr **Cash Book (Bank Columns)** **Cr**

		$			$
Sept. 1	Bal. b/d	8,300	Sept. 5	Suppliers & Co.	3,090
Sept. 8	Cash Sales	2,100	Sept. 11	Wheel Garages	416
Sept. 19	A. Ali	984	Sept. 20	Wages	1,640
Sept. 29	Enni Co. [c]	627	Sept. 28	Brite Light Co. [d]	772
Sept. 30	Cosi Bros.	42	Sept. 29	Ojay Co. [e]	100
			Sept. 30	Bal. c/d	6,035
		12,053			**12,053**
Oct. 1	Bal. b/d	6,035	30 Sept	Bank Charges	200
			30 Sept	Bank Interest	84
			30 sept	Bal. c/d	5,751
		6,035			**6,035**
Oct 1	Bal. b/d	5,751			

Step 2 - *Prepare a Bank Reconciliation Statement* → A statement reconciling the different balances that still remain after the Cash Book has been updated needs to be drawn up to prove that the difference is a result of a delay in time and not an accounting error. To perform this we check which items have been entered in the Cash Book but do not appear in the Bank Statement (i.e [c],[d] &[e]).

Bank Reconciliation Statement as at the 30th September 1998

		$
Balance as per cash book		5,751
<u>Add</u>		
Unpresented Cheques →	Brite Lite co.	772
	Ojay Co.	100
		6,623
<u>Less</u>		
Bank Lodgements →	Enni Co.	627
		5,996

A *useful tip* for working out whether a transaction should be entered as an addition or subtraction in the Bank Reconciliation Statement is to think the *opposite* of the entry in the Cash Book. In other words:

a-Debit Transactions in the Cash Book add to income → They are subtracted in the Bank Reconciliation Statement.

b-Credit Transaction in the Cash Book minus from the firm's income → They are added in the Bank Reconciliation Statement.