Unit 4: Accounting for Cash and Bank Reconciliation Statements LH 4

-Concept of cash and bank

-Types of bank account

- Cheques: concept and types, parties to a cheque, honor and dishonor of cheque

-Bank Statement: concept and importance

-Preparation of bank reconciliation statement

Cash and Banking Transactions

Cash and Cash transactions:

"Cash" typically refers to money in the form of physical currency, such as coins and paper bills, which is used for transactions. Here are a few key points about cash: *Physical Currency*, *Liquidity*, *Financial Transactions*, *Economic Indicator.*

Cash transactions refer to cash receipts and payments. The receipts of cash from various sources and payment of cash on various heads are important routine transactions of a business. The main sources of cash receipts are sale of goods and services, sale of old assets, contribution of capital, loan borrowed, interest, rent, commission and other receipt from customers. The main heads of payments are purchase of goods, wages, rent, stationary, interest on loan borrowed, drawing, repayment of liabilities, advertising and payment to suppliers.

Except the balance in petty cash account, no cash balance is maintained in the office of a modern business.

Bank and Banking Transactions :

A bank may be defined as an institution which deals in money. It accepts deposit from the public, provides credit facility (loan) to the customers, transfers money from one place to another, creates credit and works as an agent of the customers.

Banking transactions refer to all receipts and payment made through bank. It is inconvenient and risky affair to get and make payment of large sum directly in cash. A modern business operates bank account to settle all receipts and payment. It issues cheque for making payments accepts cheque for getting amount. It may also instructs its bank to pay and collect amount on its behalf. In fact, the bank is treated by the business as its agent for collecting all receipts and making all payments.

Bank account is a formal procedure to take services from the bank. Bank account records the transaction of an individual systematically. In other words, individuals open an account in the bank to deposit and withdraw of money. That account is called bank account.

Types of bank account :

Following are the types of bank account :-

i) **Current account :**

A current account is one in which there is no restriction in respect of the number of withdrawal and the extent of the amount to be withdrawn. Generally, it is opened by businessman. No interest is allowed by the bank on the deposit made in current account.

ii) **Saving account :**

A saving account is one in which there is restriction in respect of the number of withdrawal and the extent of the amount to be withdrawn. Generally, interest is allowed by the bank on the deposit made in saving account. It is not suitable for business. An individuals prefers to operate saving account to earn moderate interest.

iii) **Fixed deposit account :**

A fixed deposit account is one in which a large sum is deposited for fixed period of time i.e. one year or two year or more year. The account holder cannot withdraw the deposit before the fixed period expires. Generally, the rate of interest is the highest in the fixed deposit account.

Cheque :

A cheque is a tool to withdraw money from the bank. It is a written orders issued by the depositor directing a specified banker to pay un demand a certain sum of money to a certain person or to the bearer of the instrument. Following are the three parties involved in a cheque :

a) **Drawer :**

Drawer is the party who draws the cheque upon a specified banker. In other words, account holder is the drawer.

b) **Drawee :**

Drawee is the bank on which cheque is drawn or presented for payment.

c) **Payee :**

Payee is the party who presents the cheque for payment and receives money from the bank.

Types of cheque

There are three types of cheque :

i) Bearer cheque :

A bearer cheque is one which is made payable to the bearer of the cheque. The bank has to make payment to the person who presents the cheque into the bank without making enquiry whether the bearer is the right payee or not. This is not safe type of cheque. This type of cheque does not require endorsement.

ii) Order cheque :

An order cheque is one which is made payable only to a certain person or his order. The bank has to make payment only after making enquiry to satisfy that the person is the right payee. Such type of cheque requires proper endorsement.

iii) Crossed cheque :

A cheque in which two parallel lines drawn across the face of cheque is called crossed cheque. The amount of crossed cheque will not be paid by the bank directly to the payee. Rather, the amount of cheque is deposited in the account of payee. This type of cheque is safe. There are two types of crossed cheque :

a) **<u>General Crossing :</u>**

When two parallel lines on the top of the cheque are withdrawn with or without the word "& Co.", it is called general crossing. It does not include the name of the bank

b) **<u>Special Crossing :</u>**

When two parallel lines on the top of the cheque are drawn with some special instruction, the crossing is called special crossing. Special crossing includes the name of particular bank.

Honour and Dishonour the chque:

When Payee gives the cheque to the bank, there are two conditions, either the check will be accepted or rejected by the bank. In legal terms, if the bank gives the amount (written in the cheque) to the Payee, is called honour of cheque. But, if the bank refuses to pay money to the Payee, is known as the Dishonour of Cheque.

Cash Book

Cash book is a ledger account prepared by a business organization in the name of bank. In this book, all the transactions preformed by the organization through cash and bank are recorded in chronological order. Cash or cheque deposited are recorded in debit side of this book and all the payment made through Cash and cheque are recorded in credit side but Credit transactions are not recorded in cash book The cash book is balanced in the same manner an account is balanced in the ledger.

Types of Cash Book

1. Single column or simple cash book
    a. Single cash book with cash column
    b. Single cash book with bank column
2. Double column cash book
    a. Cash book with cash and discount column
    b. Cash book with bank and discount column
    c. Cash book with cash and bank column
3. Triple column cash book
    Cash book with cash, bank and discount column

4.Petty cash book

Bank Statement:

A bank statement is a document (also known as an account statement) that is typically sent by the bank to the account holder every month, summarizing all the transaction of an account during the month. Bank statements contain bank account information, such as account numbers and a detailed list of deposits and withdrawals.

The statement includes deposits, charges, withdrawals, as well as the beginning and ending balance for the period.

BANK RECONCILIATION STATEMENT

Concept:

Business concern maintains the cash book for recording cash and bank transactions. The cash book serves the purpose of both the cash account and the bank account. It shows the balance of both at the end of a period. Bank also maintains an account for each customer in its book. All deposits by the customer are recorded on the credit side of his/her account and all withdrawals are recorded on the debit side of his/her account. A copy of this account is regularly sent to the customer by the bank. This is called Bank statement. It is usual to tally the firm's bank transactions as recorded by the bank with the cash book. But sometimes the bank balances as shown by the cash book and that shown by the bank statement do not match. If the balance shown by the bank statement is different from the balance shown by bank column of cash book, the business firm will identify the causes for such difference. It becomes necessary to reconcile them.

So, Bank reconciliation is the process of matching the bank balances reflected in the cash book of a business with the balances reflected in the bank statement of the business in a given period. Such a process determines the differences between the balances as per the cash book and bank statement.

Reasons for difference between bank balance and cash book:

a) Items recorded by the company book but not yet recorded by the bank:

- Outstanding cheque/ un cleared cheque(cheque issue but not presented for payment)
- Deposit in transit /outstanding deposits/cheque under collections.

b) Items recorded by the bank but not yet recorded by the company book:

- Bank collections(Notes/Account receivable collected by bank)
- Electronic fund transfer(EFT)i.e. (Receipts or payment by EFT)
- Bank Service charges (Cheque clearing charges, Charges for fund transfer, Collection charges, etc)
- Cheque printing charges
- Interest revenue earned
- Not-sufficient funds(NSF)cheques

c) Errors:

- Errors by the bank (balance of bank statement increase or decrease)
- Errors by the company book(balance of bank in company book increase or decrease)

Importance of Bank reconciliation Statement

- *I*dentify fraud
- Validate data entry
- Confirm the accuracy of financial statements
- Accurate tax reporting
- Controls theft
- Helpful for final audit

Process of Preparation a Bank Reconciliation Statement

There are two part of Process for Preparation of Bank Reconciliation Statement:

I. To Identify Adjusting the balance as per bank statement

The following point should be considered for finding Adjusting balance as per bank statement:

- Outstanding cheque/ un cleared cheque(cheque issue but not presented for payment)
- Deposit in transit /outstanding deposits/cheque under collections
- Errors by the bank

II. To Identify Adjusting the balance as per company book

The following point should be considered for finding Adjusting balance as per company book:

- Bank collections(Notes/Account receivable collected by bank)
- Electronic fund transfer(EFT)i.e. (Receipts or payment by EFT)
- Bank Service charges (Cheque clearing charges, Charges for fund transfer, Collection charges, etc)
- Cheque printing charges
- Interest revenue earned
- Not-sufficient funds(NSF)cheques
- Errors by the company book

III. Comparing the adjusted balance of bank statement and company book

IV. Preparing adjusting entries

.Preparing adjusting entries

Account title	Date	Particulars	PR	Dr. Amount	Cr. Amount
: 1. Bank service charge , cheque printing charge :		Bank service charge a/c....... Dr. To cash a/c (For………………		xxx	 Xxx
2. Not-sufficient funds(NSF)cheques		Account receivable a/c .... Dr Bank service fee a/c………Dr.. To cash a/c (for…………		Xxx xxx	 xxx
3.Notes receivables and interest received		Cash a/c............. Dr. To Notes receivable a/c To interest received a/c (For …………………		xxx	 xxx xxx
4 EFT payment EFT receipts		…..expenses a/c....... Dr. To Cash a/c Cash a/c ……….Dr. To……..expenses a/c		Xxx xxx	 Xxx xxx
5. Errors in the company book: If balance reduce If balance increase		cash a/c ………Dr. To Account payable Account payable a/c ……Dr. To cash a/c		Xxx xxxx	 Xxx xxxx