**BANK RECONCILIATION STATEMENT**

Bank reconciliation is the process of making the balance on the bank column of a cash book to agree with the balance on the bank statement received from the bank. Put differently, bank reconciliation statement is a report prepared to show the process of agreeing entries in the bank statement with those in the cash book with a view to arriving at a reconciled balance. The reconciliation becomes necessary as a result of differences between the cash book prepared by an account holder and the bank statement prepared by the bank. These differences are corrected using adjusted cash book and bank reconciliation statement.

Most of the time, the differences do not occur deliberately, but could be as a result of:

i. Errors – These are mistake either by the bank and/or the customer.

ii. Timing differences – These are due to unpresented cheques and uncredited lodgements.

iii. Entries not brought to the notice of the company by the bank e.g. bank charges, interests, transfers, commission on turnover etc.

**1 Unpresented cheques**

These are cheques which have been issued for payment by a bank account holder but have not been presented for payment at the bank as at the date the bank prepared the bank statement. Unpresented cheques will appear on the credit side of the cash book but will not be seen on the debit column of the bank statement.

**2 Uncredited lodgements**

These are cheques deposited into the bank, but which have not been credited to the customer’s account by the bank as at the date of preparing the bank statement. This delay may be due to the

cheque being banked other than at the customer’s branch of the bank or delay in cheque clearing

system which may take up to three working days for local cheques to clear or even more for upcountry cheques.

**3 Direct transfers or Standing orders**

These are payments made directly by the bank as a result of previous instructions given by the customer to the bank. They include an order to pay annual insurance premium, professional membership subscription etc.

**4 Others**

These include bank charges, account maintenance fee, interest on loan and overdraft account,

dishonoured cheque etc. not brought to the notice of the account holder by the bank except through the bank statement.

**5 Reasons for Dishonoured Cheques**

A cheque may be dishonoured for the following reasons:

i. If the cheque is not dated.

ii. If the amount in words does not correspond to the amount written in figure on the cheque.

iii. If the balance on the drawer’s account is not sufficient to accommodate the amount to be drawn with the cheque.

iv. Cheque mutilations (i.e. unsigned alteration).

v. Stale cheques: The date on the cheque is more than six months beforeit is presented

to the bank for payment.

vi. Irregular signature from the issuer

vii. Unsigned cheques.

viii. Cheque post-dated: Presenting cheque at the bank before the date written on it.

ix. Notice of death of customer received by the bank.

**MERITS OF BANK RECONCILIATION STATEMENT**

i. It aids the bank customer to monitor unpresented cheques, uncredited lodgements etc.

ii. It assists in detecting errors that might have occurred in the cash book or in the bank statement.

iii. It is useful in detecting fraud either from the bank or office

iv. Where the bank reconciliation statement is prepared regularly, it helps to prevent fraud.

**3.3 PREPARATION OF BANK RECONCILIATION STATEMENT**

i. Ensure that both cash book and bank statement are prepared up to the same date

ii. Check off items in the cash book against the bank statement

iii. Update the cash book by preparing adjusted cash book which will be credited with bank charges, commission on turnover, interest on overdraft and loans, dishonoured

cheques, direct transfers, standing orders etc. Debit the adjusted cash book with direct payment to the bank like dividend received, interest on deposit account etc.

iv. Check for errors which occur in the cash book and bank statement for corrections, and correct cash book errors. But include bank errors in the reconciliation statement for notification to the bank.

v. Prepare the bank reconciliation statement using any of these two formats.

**Format of Bank Reconciliation Statement Starting with Cash Book Balance**

Big Life Ventures

Bank Reconciliation Statement As at 31st December 2015

N

Balance as per adjusted cash book x x

Add unpresented cheques x x

x x

Less uncredited lodgements/cheques (x)

x x

Add or deduct bank error(s) x

Balance as per bank statement x x

**Format of Bank Reconciliation Statement Starting with Bank Statement Balance**

Unlimited Grace& Company

Bank Reconciliation Statement As at 30th April 2016

N

Balance as per bank statement x x

Add uncredited cheques/lodgements x x

x x

Less unpresented cheques (x)

x x

Add or less bank error(s) x

Balance as per cash book x x

Where the balance from the bank statement or adjusted cash book is an overdraft, it does not change the formats above. Overdraft should be indicated in bracket to show that it is a negative balance.

A bank reconciliation statement will only contain those entries that are necessary for the bank to make correction in future bank statements. Adjusted cash book should take care of all necessary entries to be made by the company.

**Example 1**

Joy Investment Company has the following transactions in its cash book and bank statement for July 2015.

Cash Book

Lodgement into bank Payment ordered

Chq. 6789 14,000 Chq. 123456 4,000

Chq. 4591 12,000 Chq 123457 6,000

Chq. 4826 9,500 Chq. 123458 7,500

Chq. 4725 19,000 Chq. 123459 12,500

Chq. 4228 9,000 Chq. 123460 8,000

Cash 66,000 Chq. 123461 1,500

Bal. c/d 90,000

129,500 129,500

Bal. b/d 90,000

**Bank Statement**

Debit Credit Balance

Chq. 123459 12,500 (12,500)

Chq. 123458 7,500 (20,000)

Chq. 4826 9,500 (10,500)

Chq. 6789 14,000 3,500

Chq. 123460 8,000 (4,500)

Chq. 4826 contra 9,500 (14,000)

ICAN- Standing order 250 (14,250)

Account maintenance fee 500 (14,750)

Commission 1,750 (16,500)

Chq. 4228 9,000 (7,500)

Chq. 123457 6,000 (13,500)

Cash 66,000 52,500

**You are required to**

1. Prepare an adjusted cash book

2. Reconcile the adjusted cash book balance with bank statement.

**Example 2:**

Okoro’s cash book showed a debit balance of N3,344 on 31st January, 2016. His bank statement for January, 2016 however showed a credit balance of N3,424. On investigation it was discovered that.

i. The opening balance on the cash book for the month had been wrongly brought down as

N1,505 instead ofN1,550.

ii. Payment for rent N250 had been debited in the cash book

iii. A customer had paid N600 direct into the bank

iv. The bank had paid, on a standing order, N300 to an insurance company

v. A cheque for N870 deposited in the bank on 25th January, was not credited until 3rd

February, 2016.

vi. Cheques paid to suppliers totalling N1,875, had not been presented for payment.

vii. Cost of cheque book and other charges by bank totalling N90 had not been entered in the Cash Book.

viii. The bank had paid a cheque of N680 in error from Okoro’s Account

**You are required to prepare:**

a. Adjusted Cash Book

b. Bank Reconciliation Statement as at 31st January, 2016.

**NOTE 2: WORKING CAPITAL MANAGEMENT**

Working capital management refers to the management of current or short-term assets and short-term liabilities. Components of short term assets include inventories, loans and advances, debtors, investments, and cash and bank balances. Short-term liabilities include creditors, trade advances, borrowings and provisions. The major emphasis is, however, on short-term assets, since short-term liabilities arise in the context of short-term assets. Working capital management is, therefore, concerned with the ways and means of making working capital adequate to meet the firm’s short-term obligations. The effective working capital management involves the adoption of appropriate management policy.

**The main components of Working capital management**

Cash management

Receivables management

Inventory management

**Cash management** focuses on managing cash flows in and out of an enterprise i.e. cash flows within and cash balances held by an enterprise at a given point in time which is utilised either by financing the deficit gap or investing surplus cash.

Note: Sales generate cash disbursed. Surplus cash is invested while deficit is borrowed to make-up. Cash management attempts to control cash cycle at a minimum cost and tries to achieve liquidity. Cash management places cash as the most significant and at the same time the least productive asset at the disposed of an enterprise. It is a means of settling indebtedness of the enterprise. It is not easy to predict cash flows accurately, that means, it takes time and dexterity to achieve its ideal position. That means the aim of cash management is to maintain adequate control over cash position to be able to keep the enterprise sufficiently liquid and to use excess cash in some profitable way.

Cash management is concerned with the managing of:

1. Cash flows into and out of the enterprise
2. Cash flows within the enterprise.
3. Cash balances held by the enterprise at a point of time by financing deficit or investing surplus cash.

**Steps to Cash Management**

This involves two paths of action –

(i) having the right amount on hand to pay your bills

(2) using any excess of that amount wisely.

We will now consider an approach for a reliable cash management which involves four steps:

1) Keeping adequate records on cash book control

2) Identifying the cash flow pattern

3) Estimating future cash balances and

4) Utilizing excess cash to generate income.

Cash comes from:

1. Daily cash sales
2. Payments made by customers to their accounts
3. Loans acquired for short-term needs
4. Additional capital borrowed on long term basis.

**Motives for holding cash**

Business need to hold cash to achieve the following three motives:

Transactions, Precautionary and Speculative

***Transaction Motive***

This requires an enterprise to hold cash to perform it ordinary business activities. This cash is to pay for purchase, wages and salaries, other operational expenses, tax dividends etc. With effective management of cash receipts and cash payment will make the holding of cash not necessary as there will be enough cash when payment is to be made.

***Precautionary Motive***

This is for the enterprise to meet up contingencies as they arise in the future. Cash at this stage is used to provide a cushion or buffer to withstand some unexpected emergency. The precautionary amount of cash will depend upon the predictable nature of the cash flow of the business.

***Speculative Motive***

This is holding cash for investing in profit -making opportunities as and when the need arises. The opportunity to make profit by an enterprise may arise when the security prices change. This is an opportunity to hold cash and expect a rise in interest rates and security prices will fall.

**2. Receivables Management**

Trade credit make way for trade debtors otherwise known as account receivable which a business (an enterprise) expects to receive in form of cash in the near future (usually which a short period within the financial period e.g. a week, fortnight, month, quarter, half a year, a year). The customers benefiting from this gesture are known as trade debtors or generally listed as debtors (to be claimed as asset of the organisation.

Receivables are risk elements, meaning that management must identify some elementary facts (characteristics).

1. It involves the analysis of the implication of value of credit sales. Cash sales are riskless. Credit sales need to be carefully analysed as cash payment will be in future. The integrity of the beneficiary of the sales must not be in doubt judging by the track record of the trade business.

2. Based on economic value, the purchaser benefits at the time sales immediately while the owner of the sales expects an equivalent of the trade value in future time.

3. It connotes that the buyer will provide the cash payment for the good/services received in a future period.

The time lag is the risk which is borne by the seller. He need be sufficient and surplus in its cash holding, control and management to stay afloat till that aspect of account is received as a whole. Any hiccup in repayment by the customer (beneficiary) will negative affect the cash flow level at the expected time. You should note that debtors form a reasonable part of current assets of many enterprise especially where the customer need this service to enhance their being in business as a going concern.

**3. Inventory management**

Inventory management is a tool to avoid excessive and inadequate levels of inventories and maintain sufficient inventory for the smooth operations of the enterprise in terms of production and sales output. The management should provide the enterprise with an order at the right time with the right source to acquire the right quantity at the right price and quality.

**An effective inventory management ensures**

1. A continuous supply of raw materials to facilitate functional production and distribution.
2. The maintenance of sufficient stocks of raw materials in short supply period and anticipate changes in price level
3. Sufficient finished goods inventory for smooth sales distribution in order to sustain efficient customer service.
4. Minimum carrying cost and time and Investment control in inventories and optimum level of operation.

**NOTE 3: BASIC FORMS OF BUSINESS ORGANISATION**

There are three main forms of business organizations- the Sole proprietorship, Partnership, and Limited Liability Company. Each of these has its own distinguishing features/characteristics, as well as merits and demerits.

1. **Sole Proprietorship**

A Sole proprietorship or one – man business, as the name implies, is a business concern owned by one person who often is also engaged actively in the running of the business. The sole owner subscribes to all of the equity capital of the business which in most cases are raised from personal savings or soft loans obtained from relations and friends. All incomes also accrue to the owner.

**Characteristics/features of one – man business include the following:**

1. A sole proprietorship has no distinct legal entity.
2. The owner has freedom to deal with the organisation’s assets without any restrictions; it is often small and can be recognised easily;
3. Its capacity to borrow (especially from banks) is limited;
4. It has very high risk because of the inseparability of the owner with the business;
5. The structure is simplistic in nature.

**2. Partnership**

A partnership is generally defined as a legal relationship between two or more persons where each person contributes something in order to carry on a lawful business with a view of profit which is to be shared between the partners in a proportion agreed upon by them.

Therefore, for a partnership to exist:

1. the association must be engaged in a business which may be a trade or a profession;
2. the trade or the profession must be carried on together, jointly, for the benefit of all the partners; and
3. there must be an intention to earn a profit.

The above description, therefore, distinguishes a partnership from a political, religious, social, or philanthropic club or association.

A partnership agreement, which need not necessarily be in written form (although it is advisable or wiser that any agreements between the partners be reduced to writing as this will tend to lead to fewer possibilities of misunderstandings and disagreements between partners), will govern the relationships between the partners, including:

1. name of organisation, the type of business, and duration;
2. capital to be introduced by partners;
3. sharing of profits between parties, including salaries since not all the partners may be employed by the partnership on a full-time basis. Such salaries will be normal operating expenses;
4. drawings by partners;
5. arrangements for dissolution, or on the death or retirement of partners;
6. settling of disputes;
7. preparation and audit of accounts.

At this juncture, it is necessary to note that, although the partnership agreement creates a legal relationship between the partners, the partnership itself is not a legal entity.

**Essential features of a partnership are as follows**:

(i) Partnership is not separated from the partners.

(ii) Setting-up cost is low and it is easy to form.

(iii) Life of partnership is limited because it is a legal entity.

(iv) Regarding liability, the partners must risk all their personal assets, even those not invested in the business, for under the partnership each partner is for the business’ debts.

(v) Partners share in the profits of the business according to their individual financial contribution to the business.

(vi) The death of a partner can dissolve the partnership.

1. **Limited Liability Company**

A limited liability company (or company) may be defined as an artificial creature, invisible, intangible, and existing only in contemplation of law. As a legal (artificial) person, it is separate from the owners. It can enter into a contract, sue and be sued in its name. Examples are First Bank, Julius Berger etc.

A company is legally formed by meeting the conditions stipulated in the Companies and Allied Matters Act (Decree), 1990. The promoters must apply for registration at the Corporate Affairs Commission together with both a Memorandum and Articles of Association.

**The Memorandum of Association must contain the following information:**

1. name of the company, with the term “Limited” as the last word of the name;
2. objects for which the company is formed;
3. amount of the share capital with which the company proposes to be registered and the division into shares of a fixed amount;
4. address of the registered office of the company; and
5. a statement to the effect that the ‘liability’ of the members or shareholders is ‘limited’.

The Articles of Association, on the other hand, setting out the regulations for internal organisation, and contains provisions relating to:

1. proceedings at meetings;
2. alteration of capital;
3. appointment of directors;
4. borrowing powers of directors;
5. transfer or transmission of shares;
6. winding-up procedure, etc.

The Memorandum and Articles of Association, duly stamped for stamp duties and fees, and accompanied by certain other forms, are lodged with the Registrar-General, who if everything is in order, issues a Certificate of Incorporation. At that point, a Limited Liability Company is formed, and those who signed the memorandum are its “foundation members”.

**Features of a company as follows:**

1. Separate legal entity, which is not affected by changes in its ownership;
2. Can own assets and incur liabilities in its own right;
3. Can sue or be sued in its own name;
4. Has perpetual succession – does not cease to exist upon the death of any or all of the owners;
5. Liability of owners/shareholders is limited to the amount paid for shares allocated;
6. Has the right to borrow on its own account;
7. External audit is compulsory;
8. Profits are subject to Company Income Tax;
9. Statutory annual returns to the Corporate Affairs Commission.