Reconciliation of Cost and Financial Accounts

Meaning

In business concern where Non-integrated Accounting System is followed, cost and financial accounts are maintained separately, the difference between the end result of these two are required to be reconciled. Reconciliation of cost and financial accounts mean tallying the profit or loss revealed by both set of accounts. The chief aim is to find out the reasons for the difference between the results shown by Cost Accounts and Financial Accounts.

Reasons for the Difference

The various reasons which create difference between cost and financial profit or loss shown by the two set of books may be listed under the following heads:

(1) Items shown only in Financial Accounts

(2) Items shown only in Cost Accounts

(3) Absorption of Overheads

(4) Methods of Stock Valuation

(5) Abnormal Loss and Gains

(1) Items shown only in Financial Accounts: Some items of income and expenses which are included only in financial accounts but are not shown in cost accounts and vice versa. The following items are shown in financial accounts but not in cost accounts:

(A) Income:

(1) Profit on sale of fixed assets

(2) Interest received on investment

(3) Dividend received on investment

(4) Rent, brokerage and commission received

(5) Premium on issue of shares

(6) Transfer fees received.

(B) Expenditure:

(1) Loss on sale of fixed assets, e.g., Plant, Machinery, Building etc.

(2) Interest paid

(3) Discount paid

(4) Dividend paid

(5) Losses due to scrapping of plant and machinery

(6) Penalties and, fines

(7) Expenses of shares' transfer fees

(8) Preliminary expenses written off

(9) Damages payable at law.

(2) Items shown only in Cost Accounts: There are some items which are recorded only in Cost Accounts but are not included in financial accounts, national interest on capital, notional rent of premises owned, salary to proprietor etc. are not recorded in financial account because the amount is not actually spent or paid. These expenses reduced the profit in cost account while in financial account it may be the reverse effect.

(3) Absorption of Overheads: In financial accounts actual amount of expenses paid are recorded while in cost accounts overheads are charged at predetermined rates. If overhead charged are not equal to the amount of overhead incurred the under or over absorption of overhead leads to difference in profits of two accounts.

(4) Methods of Stock Valuation: The term stock refers to opening or closing stock of raw materials, work in progress and finished goods. In financial accounts stocks are valued at cost price or market price whichever is lower. In Cost Account; stock of raw materials can be valued on the basis of FIFO, LIFO and Simple Average Method etc., and work in progress may be valued at Prime Cost or Work Cost. Finished stocks are generally valued on the basis of cost of production. Thus, the adaptation of different method of valuation of stock leads to difference in profits of two sets of accounts.

(5) Abnormal Losses and Gains: Different items of abnormal wastages, losses or gains which are included in financial accounts but are not recorded in cost accounts. Thus, the figures of abnormal losses and gains may affect the results in financial accounts alone.

Importance of Reconciliation

Reconciliation of cost and financial account is necessary for the following reasons :

(1) To ensure arithmetical accuracy of both set of accounts for effective cost ascertainment and cost control.

(2) To identify the reasons for different results in two sets of accounts.

(3) To evaluate the reasons for variations for effective internal control.

(4) To enable the smooth co-operation and co-ordination between the activities of cost and financial accounting departments.

(5) To ensure the standardization of policies relating to stock valuation, depreciation and absorption of overheads.

Methods of Reconciliation

For reconciling the profit or loss as disclosed by the financial accounting with that shown by the cost accounting, a Reconciliation Statement or Memorandum of Reconciliation Account is prepared.

The following steps have to be taken for preparation of Reconciliation Statement :

(l) Ascertain the extent of difference between the profit or loss disclosed by two set of book of accounts.

(2) Take the base profit or loss as per any set of books (either cost or financial) of accounts as the starting point.

(3) Prepare a statement by making suitable adjustment of items either added or subtracted included in one set of accounts but not in the other set.

(4) In other words, balances as per cost account has been taken as the starting point, then balance as per financial account is to be adjusted according to the transaction recorded in the financial accounts and vice versa.

The following table will help to prepare the reconciliation of cost and financial accounts:

Treatment of Causes for Differences

S. No.	Reasons For Differences	Suitable Adjustments: Base is Costing Pmfit or Financial Loss (+) or (—)	Suitable Adjustments: Base is Financial Profit or Costing loss (+) or (—)
l.	Over absorption of overhead in Cost Account	Add	Less
2.	Over valuation of closing stock in Financial Account	Add	Less (—)
3.	Over valuation of opening stock in Cost Account	Add	
4.	Excess provision for depreciation of building plant & machinery etc., charged in Cost Account	Add	
5.	Items of expenses charged in Cost Account but not in Financial Accounts (Example Notional interest on Capital, Notional rent on Premises)	Add	
6.	Items of income recorded in Financial Account but not in Cost Account	Add (+)	Less (–)
7.	Under absorption of overhead in Financial Account	Less (–)	Add (+)
8.	Over valuation of opening stock in Financial Account	Less (–)	Add (+)
9.	Over valuation of closing stock in Cost Account	Less (–)	Add (+)
10.	Item of income tax, dividend paid, preliminary expenses written off, goodwill written off, under writing commission and debenture discount written off and any appropriation of profit included in Financial Account only.	Less	Add (+)

Types of Problems

You are required to prepare a reconciliation of cost and financial account from the following situations:

(l) When profit or loss of financial and cost account are given

(2) When profit or loss of financial account is given

(3) When profit or loss of cost account is given

(4) When profit and loss account and additional information are given.