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BUS7C2

Finance and Accounting for Business

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Lecture 5: Bank Reconciliation & Suspense Account

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Learning Objective

At the end of this lecture; students will:

1. **Critically evaluate** the function of bank reconciliations and suspense accounts as key internal control mechanisms for ensuring financial accuracy.
2. **Construct** a bank reconciliation statement to resolve discrepancies between the cash book and bank statement, justifying the required cash book adjustments.
3. **Differentiate** between accounting errors that are detected by the extraction of a trial balance and those that are not.
4. **Formulate** correcting journal entries to resolve accounting errors, utilising a suspense account where appropriate.

Bank Reconciliation

A **bank reconciliation** is the process of matching the balances in a business's accounting records to the corresponding information on a bank statement.



Key Reasons for Performing Bank Reconciliation

- 1. Identifying Errors:** Helps detect discrepancies like incorrect transactions or missing entries in the records.
- 2. Preventing Fraud:** Uncovers unauthorized transactions, ensuring financial security.
- 3. Ensuring Accuracy:** Confirms that cash balances match between bank statements and internal records.
- 4. Tracking Cash Flow:** Provides a clear picture of cash movements, aiding financial planning and decision-making.

Bank Reconciliation

At regular intervals, the cashier/finance officer must check that the cash book is correct by comparing the cash book with the bank statement. They may not agree due to a number of factors.

Uncleared Lodgements

1. **Cheques deposited** but not yet cleared by the bank.
2. **Bank statement outdated**, reflecting uncleared transactions.
3. **Cash book up to date**, showing all recorded payments.

Unpresented Cheques

1. **Cheques issued** but not yet presented for payment.
2. **Still clearing** through the banking system.
3. **Bank statement outdated**, not reflecting unpresented cheques.
4. **Cash book up to date**, recording all transactions.

Unrecorded Transactions

1. **Bank charges, interest, or automated transactions** recorded in the bank statement but not in the cash book.
2. **Cash book outdated**, requiring updates to match bank records.
3. **Bank statement up to date**, reflecting all transactions.

The Bank Reconciliation Process

Step 1

- i. **Verify opening balances** on the bank statement and cash book.
- ii. **Identify discrepancies** caused by prior period reconciling items.
- iii. **Tick off reconciled items** that caused the imbalance.
- iv. **Ignore crossed-off items** in the bank statement going forward.

Agree the opening balance on the bank statement in the cash book.



Agree that items on the bank statement appear in the cash book (tick off).



Any unticked items in cash book (i.e. they do not appear on the bank statement) are reconciling items, i.e. unpresented cheques or uncleared lodgements.

Step 2

- i. **Verify that bank statement items** appear in the cash book.
- ii. **Tick off matching items** to confirm accuracy.
- iii. **Update the cash book** for any missing transactions from the bank statement.
- iv. **Tick off newly added items** after updating the cash book.

Step 3

Unticked cash book items are reconciling items.

Includes unpresented cheques or uncleared lodgements.

These items will appear in the bank reconciliation statement.

Bank Reconciliation Proforma

| | | |
|-----------------------------------|---|----------|
| | £ | £ |
| Balance per bank statement | | X |
| Add: Uncleared lodgements | | |
| <i>Detail</i> | X | |
| <i>Detail</i> | X | |
| | | X |
| Less: Unpresented cheques | | |
| <i>Detail</i> | X | |
| <i>Detail</i> | X | |
| | | (X) |
| Balance per cash book | | X |

- **Reverse adjustments** to reconcile from cash book balance to bank statement balance.
- **Ensure accuracy** when switching reconciliation direction.
- **Check for overdrawn balances** in the cash book or bank statement (*these will be 'negative' figures i.e. owed to the bank*)

Bank Reconciliation : Example

On 2nd July 2012, Mills Homes Ltd received the following bank statement as at 30th June 2012.

| HIGH STREET BANK PLC | | | | |
|---|------------------|---------------------|--------|--------------|
| High Street, Little Heath, Leeds LS28 1AD | | | | |
| To: Mills Homes Ltd | | Account No 48917508 | | 30 June 2012 |
| Date | Details | Debit | Credit | Balance |
| 2012 | | £ | £ | £ |
| 1 June | Bal b/f | | | 8,196C |
| 5 June | Cheque no 816078 | 800 | | 7,396C |
| 5 June | Bank Giro credit | | 2,000 | 9,396C |
| 8 June | Bank Giro credit | | 3,500 | 12,896C |
| 10 June | Cheque no 816079 | 1,864 | | 11,032C |
| 16 June | Direct debit | 700 | | 10,332C |
| 24 June | Bank charges | 52 | | 10,280C |
| 25 June | Direct debit | 400 | | 9,880C |
| 30 June | Cheque no 816081 | 1,290 | | 8,590C |
| D = Debit C = Credit | | | | |

Mills Homes Ltd's cash account for June 2012 was as follows:

| Date 2012 | Details | Bank £ | Date 2012 | Cheque number | Details | Bank £ |
|--------------|-------------------|-----------|--------------|------------------|-----------------|-----------|
| 1 June | Balance b/f | 7,396 | 1 June | 816079 | SpringRite | 1,864 |
| 5 June | Barbara's Beds | 2,000 | 5 June | 816080 | Fabric House | 2,120 |
| 29 June | JRB Ltd | 5,120 | 22 June | 816081 | Heads Up | 1,290 |
| | | | 29 June | 816082 | John Joiner | 7,400 |
| | | | 29 June | 816083 | Foamies | 200 |

Bank Reconciliation : Example

Required:

- a) Check the items on the bank statement against the items in the cash book.
- b) Enter any items in the cash book as needed.
- c) Total the cash book and clearly show the balance carried down at 30 June and brought down at 1 July.
- d) Complete the bank reconciliation statement as at 30 June.

- The opening balances on the cash book and the bank statement agree once the £800 cheque has been subtracted from the bank statement opening balance.
- This is a prior period reconciling item, i.e. was written into the cash book in the prior month but has only just cleared the banking system.

Bank Reconciliation : Example

Solution:

| | £ |
|----------------------------|-------|
| Balance per bank statement | 8,590 |
| Add: Uncleared lodgements | |
| Name: JRB Ltd | 5,120 |
| Name: | — |
| Total to add | 5,120 |
| Less: Unpresented cheques | |
| Name: Fabric House | 2,120 |
| Name: John Joiner | 7,400 |
| Name: Foamies | 200 |
| Total to subtract | 9,720 |
| Balance as per cash book | 3,990 |

- The opening balances on the cash book and the bank statement agree once the £800 cheque has been subtracted from the bank statement opening balance.
- This is a prior period reconciling item, i.e. was written into the cash book in the prior month but has only just cleared the banking system.

Bank Reconciliation : Example

The following differences have been identified when comparing the cash book with the bank statements.

1. Bank interest received £40, had not been entered in the cashbook
2. A BACS receipt of £6,200 and £460 from two customers has not been entered in the cashbook
3. A receipt for £650 has been recorded in the cashbook as £750
4. Cheques drawn for £3,940 entered in the cashbook are not showing on the bank statement.

Using the table below, show those items that would be required to update the **cashbook**.

| Adjustment | Amount £ | Debit | Credit |
|------------|----------|-------|--------|
| | | | |
| | | | |
| | | | |

Bank Reconciliation : Example

The following differences have been identified when comparing the cash book with the bank statements.

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Using the table below, show those items that would be required to update the **cashbook**.

| Adjustment | Amount £ | Debit | Credit |
|------------|----------|-------|--------|
| 1 | 40 | ✓ | |
| 2 | 6,660 | ✓ | |
| 3 | 100 | | ✓ |

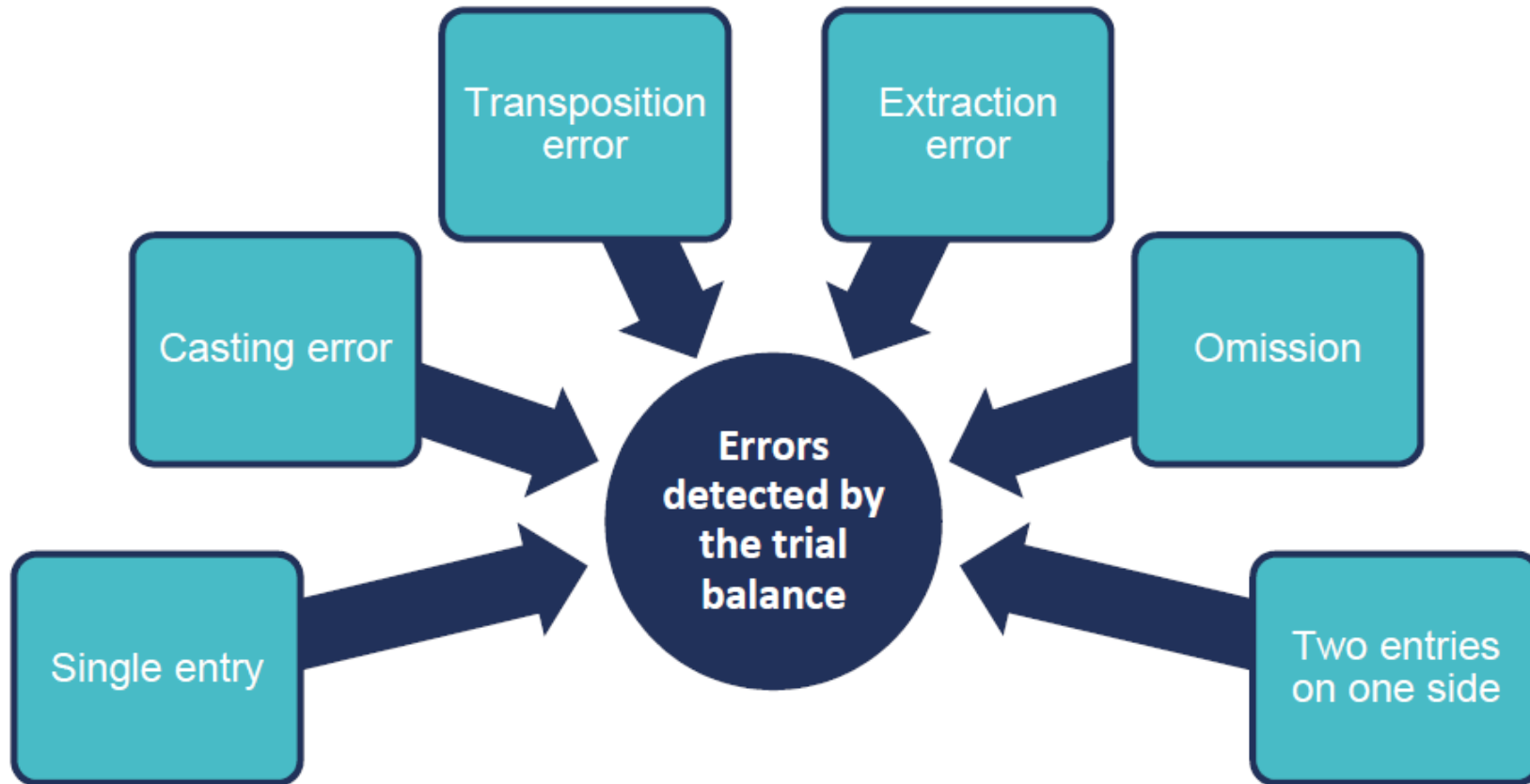
The Suspense Account : Purpose

Suspense accounts are set up when a problem arises

- The totals of the debit and credit columns of the trial balance are not the same;
- The correct posting for one half of the double entry is unknown.

- **Trial balance differences** or unknown postings go into a suspense account.
- **Investigate and resolve** the discrepancy.
- **Clear the suspense account** with the appropriate correcting entry.

Errors Detected By The Trial Balance



Errors Detected By The Trial Balance

Transposition Error

A transposed amount in a ledger account results in an incorrect record.

Casting (addition) Error

A ledger account has not been balanced correctly due to a casting error

Single Entry

A missing entry on one side of a double-entry system prevents the trial balance from balancing.

Extraction Error

An incorrectly recorded ledger account balance leads to errors in the trial balance, either due to a wrong figure or placement on the wrong side.

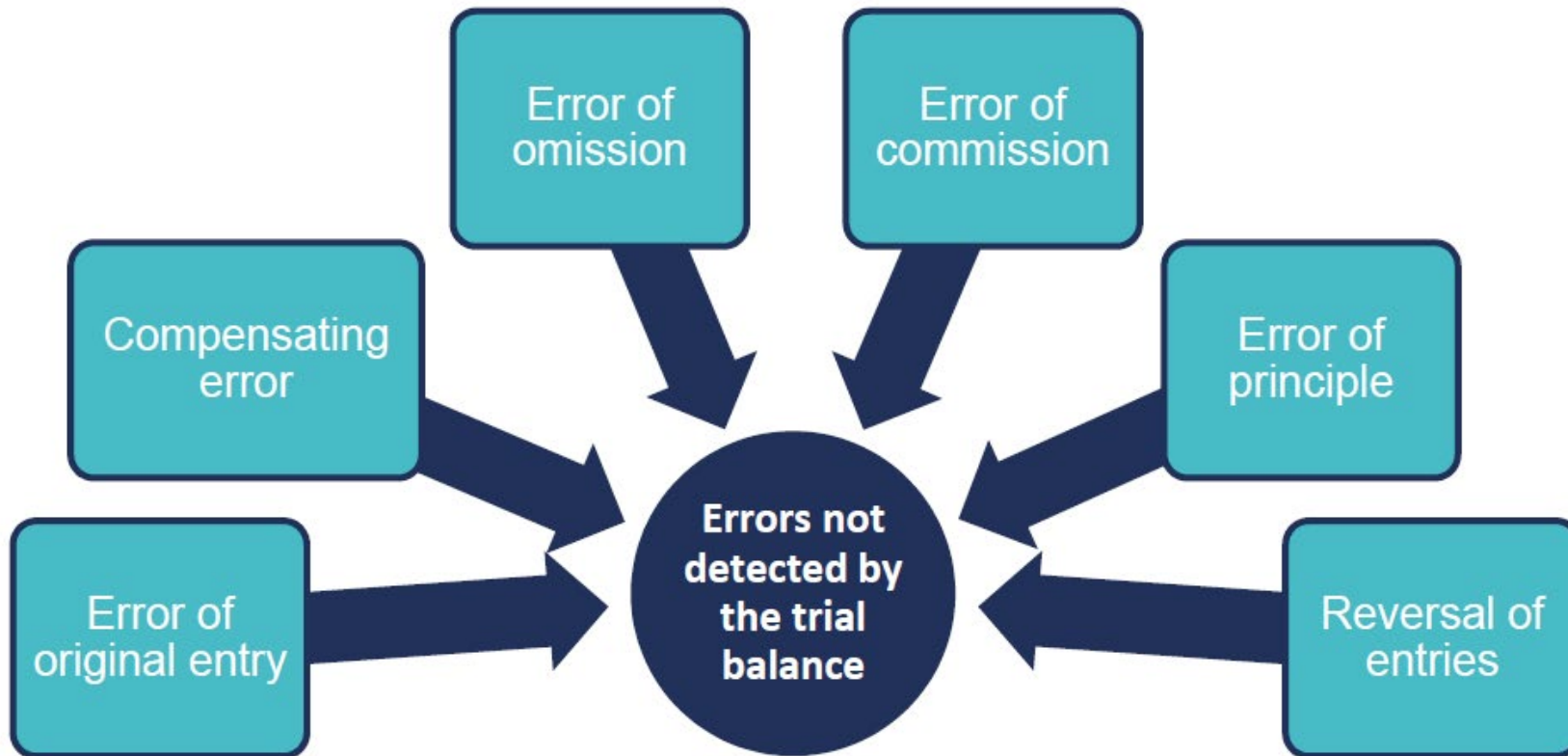
Omission (one ledger)) Error

A ledger account balance is inadvertently omitted from the trial balance

Two Entries on One Side Error

A transaction is entered as a debit in two accounts or as a credit in two accounts.

Errors Not Detected By The Trial Balance



Errors Not Detected By The Trial Balance

Error of Original Entry

A wrong figure is entered as both the debit and credit entry

Compensating Error

Two errors of equal amounts on opposite sides of the accounts cancel each other out by coincidence.

Error of Omission

An entire double entry is omitted from the ledger accounts

Error of Commission

A correctly balanced debit and credit entry is mistakenly posted to the wrong account.
e.g., if the heat and light expense was debited to the rent account.

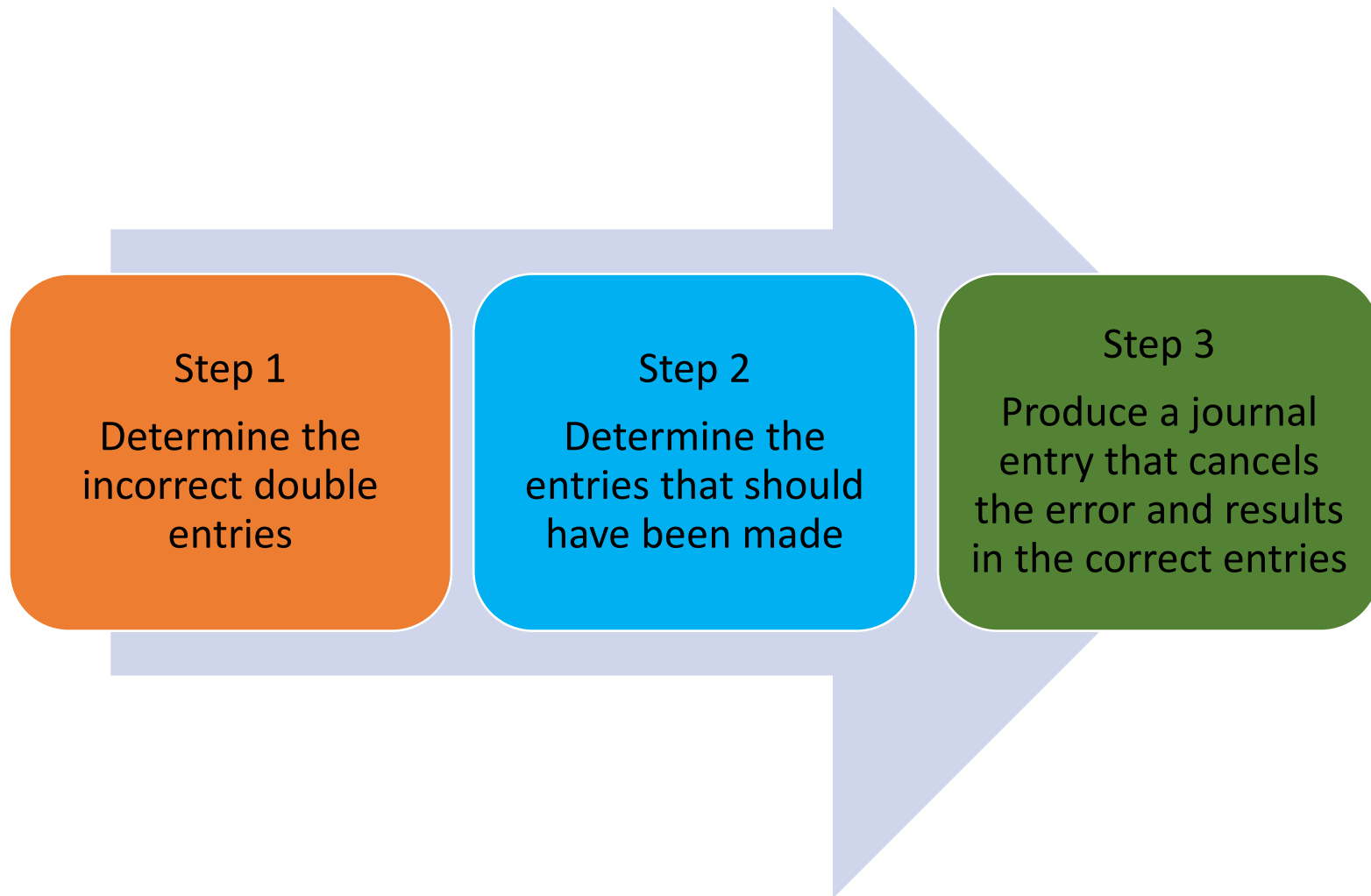
Error of Principle

An entry is posted to the wrong type of account, similar to an error of commission.
e.g., if the electricity expense was debited to a non-current asset account.

Reversal of Entries Error

Debit and credit entries are correctly placed in the general ledger but posted to the wrong sides of the accounts.

Correcting Errors



Correcting Errors : Examples

The rent expense of £100 was credited correctly to the bank but the debit entry went to repairs and renewals.

Required:

Prepare the journal to correct the error.

Step 1

The incorrect entry has been debited to repairs and renewals with £100

Step 2

The correct entry is to debit rent with £100

Step 3

The journal entry required to correct this is:

| | | |
|----|----------------------|------|
| Dr | Rent | £100 |
| Cr | Repairs and renewals | £100 |

Some purchases for cash of £600 had been correctly debited to the purchases account. No other entry was made.

Required:

Prepare the journal to correct the error

Step 1

An entry has been omitted

Step 2

The correct entry is to credit cash with £600

Step 3

The journal entry required to correct this is:

| | | |
|----|----------|------|
| Dr | Suspense | £600 |
| Cr | Cash | £600 |

Correcting Errors : Points to Note

1. **Errors are corrected** using journal entries.
2. **Suspense accounts** help when transactions can't be properly categorized.
3. **Bookkeepers use suspense accounts** when unsure where to post an entry.
4. **Accounting software may create suspense accounts** for unmatched bank transactions.
5. **Suspense accounts are temporary** and must be cleared before financial statements are prepared.
6. **Financial statements should never include suspense accounts**; errors must be resolved first.
7. **Corrections impact financial accuracy**, ensuring proper reporting.
8. **Adjustments may affect draft profit calculations** made before errors were fixed.

Thank you, very much!

Any questions?



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References

ICAEW (2023) Accounting. 17th edn

Kaplan Publishing (2023) *AAT Level 3 Financial Accounting: Preparing Financial Statements (FAPS) Study Text*. Kaplan UK.