UNIT 10: FINANCIAL ACCOUNTING

LO 4: RECONCILE CONTROL ACCOUNTS AND SHIFT RECORDED TRANSACTIONS FROM THE SUSPENSE ACCOUNTS TO THE RIGHT ACCOUNTS

UNIT 10: FINANCIAL ACCOUNTING

D4: PRODUCE ACCURATE ACCOUNTS THAT HAVE BEEN RECONCILED APPLYING THE APPROPRIATE METHODS

OVERVIEW

- Reconciliation is an accounting process that uses two sets of records to ensure figures are correct and in agreement. It confirms whether the money leaving an account matches the amount that's been spent, and ensures the two are balanced at the end of the recording period. Reconciliation provides consistency and accuracy in financial accounts.

WHY IS RECONCILIATION REQUIRED?

- A regular review of your accounts can help you identify problems before they get out of hand.
- Business bank accounts receive less protection than consumer accounts under federal law, so it’s especially important for businesses to stop problems quickly. You can’t necessarily count on the bank to cover fraud or errors in your account.

WHY IS RECONCILIATION REQUIRED?

› **Catch Fraud Before It's Too Late**

› Signs of fraud should be your priority when reconciling transactions in your bank account.

- Were legitimate checks that you issued duplicated or changed, resulting in more money leaving your checking account?
- Were checks issued without authorization?
- Are there unauthorized transfers out of the account, or did anybody make unauthorized cash withdrawals?
- Does the account have any missing deposits?

WHY IS RECONCILIATION REQUIRED?

Reconciling your account also helps you identify internal administrative issues that need attention. For example, you might need to re-evaluate how you handle cash flow and accounts receivable, or perhaps change your recordkeeping system and the accounting processes you use.

WHY IS RECONCILIATION REQUIRED?

- Proper processes for managing your banking transactions result in outcomes such as the following:
- Knowing how much cash you really have available in your accounts.
- Avoiding bounced checks (or making failed electronic payments) to partners and suppliers.
- Avoiding bank fees for insufficient funds or using lines of credit when you don’t really need to.

WHY IS RECONCILIATION REQUIRED?

› Knowing if customer payments have bounced or failed, and determining if any action is needed.

› Keeping track of your outstanding checks and following up with payees.

› Making sure every transaction gets entered into your accounting system properly.

› Catching any bank errors.

HOW IS THIS CONDUCTED?

Reconciling ledger accounts means verifying that you can support each transaction and making sure that each transaction posted correctly. If you make reconciliations a part of your monthly closing procedures, you can always be confident in your month-end reporting.

HOW IS THIS CONDUCTED?

Review the trial balance report for the general ledger to ensure that the debits equal the credits. If the balance of the debit column does not match the credit column, identify the amount of the difference so that you have an idea of how much the discrepancy is.

HOW IS THIS CONDUCTED?

Look at the balance of each account in the trial balance report to ensure that the balance is reasonable. For example, asset accounts should have a credit balance. Liability accounts should have a debit balance. If an account that should have a debit balance has a credit balance or vice versa, you should then pull the activity in that account and evaluate each transaction to find the error.

HOW IS THIS CONDUCTED?

Check the transactions of each account against the journal entry logs for the account. This step ensures that you have a record of each transaction, that each one posted correctly and that the supporting documentation is accurate.

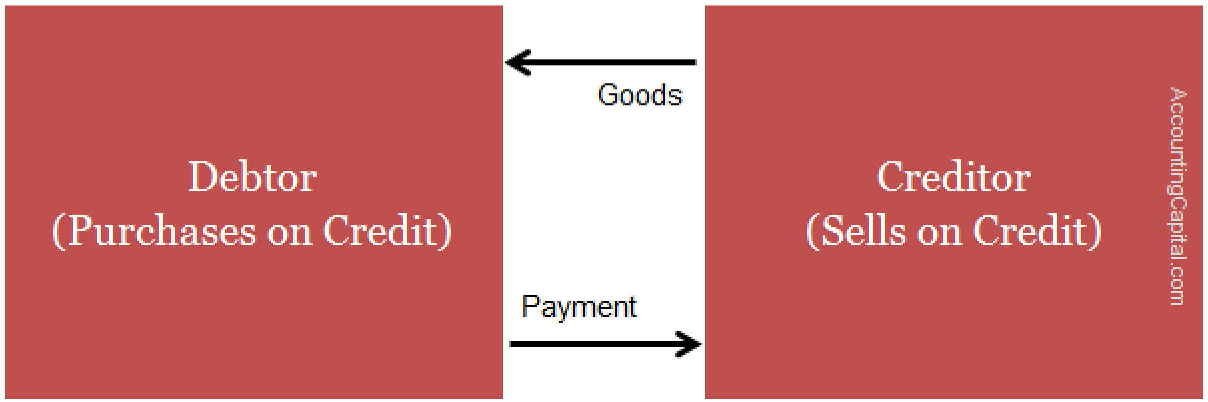
HOW IS THIS CONDUCTED?

Validate the transactions on the bank statement against the cash account in the ledger so that you can be sure that your cash transactions and ledger statements are accurate as well.

THE ROLE OF DEBTORS AND CREDITORS ACCOUNTS

- While purchasing goods on credit a buyer may not make the payment immediately instead both the seller and buyer may enter into a lending & borrowing arrangement. This allows delayed payments for current invoices. Even though payment terms are mutually agreed upon there is still a difference between debtors and creditors.
- Typically such agreements involve a short interest-free credit period during which the buyer can make its payment. Debtors and creditors may be defined as follows;

THE ROLE OF DEBTORS AND CREDITORS ACCOUNTS



THE ROLE OF DEBTORS AND CREDITORS ACCOUNTS

- Debtors – In a business scenario, a person or a legal body who owes money to another party is called a debtor. For a business, the amount to be received is usually a result of a loan provided, goods sold on credit, etc.
- Example – AMY Corp. purchased 1000 kg of cotton for 100/kg from SILVER Ltd. to use as raw material for their clothes manufacturing business. The total invoice amount of 100,000 was not paid by AMY Corp. In this example, AMY Corp. is a debtor for SILVER.

THE ROLE OF DEBTORS AND CREDITORS ACCOUNTS

- Creditors – In day to day business a person or a legal body to whom money is owed is known as a creditor. For a business, the amount to be paid may arise due to repayment of a loan, goods purchased on credit, etc.
- Example – AMY Corp. purchased 1000 kg of cotton for 100/kg from SILVER Ltd. The total invoice amount of 100,000 was not received immediately by SILVER Ltd. In this example, SILVER Ltd is a creditor for AMY Corp.

THE ROLE OF DEBTORS AND CREDITORS ACCOUNTS

- Nearly every business is both a creditor and a debtor, since businesses extend credit to their customers, and pay their suppliers on delayed payment terms. The only situation in which a business or person is not a creditor or debtor is when all transactions are paid in cash.

THE ROLE OF DEBTORS AND CREDITORS ACCOUNTS

Additional Points on Difference Between Debtors and Creditors (Table Format)

Debtors	Creditors
1. Debtors avail credit facility as they borrow.	1. Creditors extend credit as they act as lenders.
2. It is a **current asset** for the business.	2. It is a **current liability** for the business.
3. Debtors are a result of credit sales by the business.	3. Creditors are a result of credit purchases by the business.
4. **Discount** is allowed to debtors.	4. **Discount** is received from creditors.
5. Total amount to be received (total debtors) is also known as Sales Ledger Control.	5. Total amount to be paid (total creditors) are also known as **Purchase Ledger Control.**
6. Collectively they form company's accounts receivables.	6. Collectively they form company's accounts payables.
7. Also known as **Trade Debtors** or **Trade Receivables**.	7. Also known as **Trade Creditors** or **Trade Payables**.
8. A **provision for doubtful debts** is created for debtors.	8. No such **provision or reserve** is created.

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