Lesson 6 - Accounting for Current Assets – Cash and Bank Balances

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6.1 What is Current Asset

- Current assets are all the assets of a company that are expected to be sold or used because of standard business operations over the next year.

- They have short period of life span usually less than one year.

- The value change frequently and are readily to convert into cash.

- Current assets are important to businesses because they can be used to fund day-to-day business operations and to pay for the ongoing operating expenses.

6.2 Type of Current Asset

There are five main kinds of current assets:

a) Cash and Bank Balances
b) Fixed Deposits
c) Trade receivable.
d) Other Receivable
e) Inventories.

6.3 Cash and Bank Balances

The most liquid assets that business needs in running its daily operation, it consists of:

a) Cash in hand
b) Balances available with banks

Companies holding more than one currency can experience currency exchange risk. Currency from foreign countries must be translated to the reporting currency for financial reporting purposes.

6.3.1. Cash in Hand

A business may keep some cash to be used in its daily operations to pay for small expenses for example buying stationery.

This cash in hand is either:

a) transfer from company bank account and the double entry would be:

Dr Cash in Hand

Cr Bank

b) generate from cash sales and the double entries would be:

Dr Cash in Hand

Cr Cash Sales

When the company use its cash in hand to purchase of bill any small value bill, the double entries would be:

Dr Expenses / cash purhcases
Cr Cash in Hand

At month end, they will have a cash count to tally with the Cash in Hand Ledger.

6.3.2. Bank Balances

A bank balance is a sum of money that temporary hold by bank and the owner of the bank account can withdraw it at any time when they need it.

It is an account which record for all monies derived from business transactions flow in and out to the company bank account.

Inflow of money into the bank account may occurred at the following circumstances

a) Receipts from a customer after a sales transactions take place and the double entry as below:

Dr Bank
    Cr Account Receivable

Dr Bank
    Cr Cash Sales / Other Income

b) Transfer of company's petty cash/ cash in hand into bank account

Dr Bank
    Cr Cash in Hand

c) Payment to supplier or expenses

Dr Account Payables
    Cr Bank

Dr Expenses
    Cr Bank

At every month end, bank usually will send Bank Statement to the company. The bank statement lists the activity in the bank account during the month as well as the month end balance.

When the company received the bank statement, the company should verify that the transactions and amount appear on bank statement are consistent with the data that the company entered in Bank Ledger.

This process if confirmation the amounts and transactions is referred as Bank Reconciliation.

6.4 Bank Reconciliation

It is extremely unlikely that a company's ending bank balance and the bank's ending balance will be identical. Therefore, Bank reconciliation is needed to determine “missing” transactions in both the bank statement and ledger and to ensure that a company's cash records are correct.

6.5 Factors that cause the differences

When a business compares its balance in its bank ledger with a bank statement will often having differences.

These differences may arise from different recording time for a transaction or errors made by either business or by bank.

The following are the usual reasons that could lead to the differences between bank statement and bank ledger.

6.5.1. Cheques issued by company but not yet presented for payment

A cheques payment that has been recorded by the company into the bank ledger, but which has not yet cleared its bank account as a deduction from cash and therefore it does not appear on the month-end bank statement, and so is a reconciling item in the month-end bank reconciliation.

For example, the company performed a Giro transfer of an amount to supplier on 31st Dec 2020 and posted into Bank Ledger. However, this payment does not appear on bank statement as at 31 Dec 2020 instead it shown on bank statement on 3rd January 2021. Therefore, it is term as Unpresented Cheque as at 31st Dec 2020

6.5.2. Cheques bank in by company but not yet credited into the bank account

An amount or cheques that have been received by the company and posted into the company's bank ledger, but this transaction does not appear on bank statement at month end, and so becomes a reconciling item in the bank reconciliation.

For example, customer email a Giro transfer slip to the company on 31st Dec 2020 and the company record and posted this transaction into Bank Ledger. However, this receipt does not appear on bank statement as at 31 Dec 2020 instead it shown on bank statement on 3rd January 2021. Therefore, it is term as Uncredited deposits as at 31st Dec 2020.

6.5.3. Amount direct debit by bank on behalf of company

Sometimes, company will issue a standing instruction / order to the bank and required the bank to made certain payment on behalf on a specific date. Upon received this standing instruction, bank will perform payment directly without further enquires, and so may caused this transaction omitted from bank ledger.

Expenses with fixed amount and fixed payment date normally it is more convenient to arrange a direct debit. For example, insurance premium, membership subscription and others.

6.5.4. Amount direct credit into bank

Sometimes, the customers / debtors will make payment directly to the company but only received the information either from bank statement or from customer few days later and so this direct credit transaction not recorded by the company until it was informed.

6.5.5. Bank Charges

Bank will charge the company certain service fees and the company will not know this until it received a bank statement. This is because the bank seldom issue invoice for services fee charged. As a result, the company will be omitted to record this bank charges until the company received bank statement.

6.5.6. Dishonored Cheques

A receipt from customer / debtors that was deposited into bank account and recorded into bank ledger, however few days later the bank rejected this receipt. The rejection was commonly due to:

- Insufficient fund of customers' bank balance
- Incorrect authorized signature of customers' bank account

6.5.7. Error committed by company or bank

Sometimes there might be a human error during processing. For example:

- Double recorded in bank ledger
- Amount wrongly entered
- Bank wrongly debit/credit into company bank account

6.6 Steps to preparing bank reconciliation

The bank reconciliation process involves comparing the internal and bank records for a bank account and adjusting the internal records as necessary to bring the two into alignment. This is done to ensure that an organization's recorded cash balance is accurate.

Bank reconciliation carried out as per following steps:

- Step 1

  Obtained last month bank reconciliation and match last month unreconciled item with this month bank statement

- Step 2

  Match and tick off current month items that appear in both bank ledger and bank statement

- Step 3

  Update / revise bank ledger for those untick items that shown in bank statement but not in bank ledger

- Step 4

  Prepare bank reconciliation

6.7 Bank Reconciliation Format

6.7.1. Reconcile from Bank Ledger to Bank Statement

Bank Reconciliation As At 30th Nov 2020

<table>
<tr><th>Date</th><th>Description</th><th>RM</th></tr>
<tr><td>30/11/2020</td><td>Balances As Per Bank Ledger</td><td></td></tr>
<tr><td colspan="3"><u>Add: Unpresented Cheque</u></td></tr>
<tr><td></td><td>Should add unpresented cheque because this payment not appear on bank statement and so the bank balance is more.

Therefore, to obtain the bank balances figure we should add back unpresented cheque from bank ledger as if this payment not happened in Bank Ledger</td><td></td></tr>
<tr><td colspan="3"><u>Less: Uncredited Deposits</u></td></tr>
<tr><td></td><td>Should less uncredited deposits because this receipts not appear on bank statement and so bank balance is less.

Therefore, to obtain the bank balance figure we should less out from bank ledger as if this receipt we never recorded in bank ledger</td><td></td></tr>
<tr><td>30/11/2020</td><td>Balance As Per Bank Statement</td><td></td></tr>
</table>

6.7.2. Reconcile from Bank Statement to Bank Ledger

Bank Reconciliation As At 30th Nov 2020

Date	Description	RM
30/11/2020	Balances As Per Bank Statement	
Less: Unpresented Cheque		
	Should less unpresented cheque because this payment appears on bank ledger and so the bank ledger is less. Therefore, to obtain the bank ledger figure we should less unpresented cheque from bank statement as if this payment already recorded in bank statement	
Add: Uncredited Deposits		
	Should add uncredited deposits because this receipt appears on bank ledger and so bank ledger amount is higher. Therefore, to obtain the bank ledger figure we should add the amount to bank statement as if this receipt we already received in bank statement	
30/11/2020	Balance As Per Bank Ledger	

6.8 Bank Overdraft

An overdraft is a credit facility from a lending institution that is granted when an account reaches zero. This facility pledged with security to secure the lending institution.

The overdraft allows the account holder to continue withdrawing money even when the account has no funds in it or has insufficient funds to cover the amount of the withdrawal.

Finance Expenses expected to incur:
- Commitment Fee – Bank Charges (P&L)
- Overdraft Interest – Interest Expense (P&L)

Bank Ledger cannot have negative balance if the company does not have any OD facility granted by any financial institution.

Overdraft will always appear on a credit side of the bank ledger.

A negative sign must put when we perform a bank reconciliation for an overdraft bank ledger.

6.9 Importance of Bank Reconciliation

Here are a few other reasons why businesses should reconcile their bank statement each month:

6.9.1 Validate data entry

Reconciling your bank statements allows you to identify any irregularities, such as entering wrong amounts, duplicating entries, and other data entry errors.

6.9.2 Confirm the accuracy of financial statements

It's rare, but banks can make mistakes. Reconciling your bank statements is one way to confirm that your financial statement matches your bank's statement.

6.9.3 Identify fraud

To detect unauthorized payment and missing deposits.

Reconciling your bank statements can also prevent employees or other people from stealing from your company.

In general, reconciling bank statements can help you identify any unusual transactions that might be caused by fraud or accounting errors. This process can be done formally or informally.