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Bank Reconciliation as a Due Process Imperative for Effective Financial Management

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Abstract

This paper establishes the importance of Bank Reconciliation as a mandatory activity for ensuring effective financial management. Every financial manager wants to keep close tab on the bank balances as his job involves real time decisions that have cost implications in his favour or against. A little delay in the clearing of an effect could result in huge financial losses to the organization in terms of interest charges or other opportunity costs. A delay could also be the source of loss of goodwill which can spell huge consequences for the entity's business relationships. The paper affirms that there are several ways of carrying out bank reconciliation. However, it further concludes that the bank reconciliation process ensures that undue losses are not sustained through inadvertence of the staff of either the focal organization or the bank.

Key words: Bank reconciliation; Opportunity cost; Uncleared effect; Uncredited cheques; Stale effects; Due date; Unpresented effects; Effective financial management; Fair view; Due process

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INTRODUCTION

Bank reconciliation prompts the accountant to the proof of actual funds balance for inclusion in the assets of the company at any given time. Timely bank reconciliation is a necessary tool in the hand of the financial manager to knowing the actual cash available for use or for investment on a given date. The bank reconciliation statement is required as frequently as possible. Unfortunately, however, several organizations do not attach adequate importance to the regular and timely preparation of bank reconciliations in spite of the fact that financial managers acknowledge its value. Those smaller entities with fewer bank transactions and fewer suppliers and customers doing less bank reconciliation might not experience as much risk as for bigger organizations. For the bigger and complex conglomerates, it is a very complex issue because of the myriad interfaces, parties and potential weaknesses involved in the process of reconciliation. This is so crucial that often internal auditors' vouching to confirm value and safety of a firm's assets (Nwaze, 2011) enlist verification of timeliness of bank reconciliations. The external auditor does not only want to verify the cash balance reported at the end of the accounting period; he practically wants to be certain that the amount reported in the books of the firm existed in reality on the cut off date, and that all the cash owned by the organization has been properly included in the reported funds.

This paper does not stop at the review of how bank reconciliations are carried out in the institution, but also the paper attempts to expose the relevance of bank reconciliation as a primary due process to enhance the strength of financial management in any enterprise. More specifically, this study focuses on areas where effective bank reconciliation could be applied to achieve the best management of organizational financial resources.

As Finkler (2010) asserts, "Financial management is the subset of management that focuses on generating financial information that can be used to improve decision making". The author also adds that accounting is a system for keeping track of the financial status of an organization and the results of its financial activities. As an essential bridge for accomplishing the outlined roles of financial management and accounting, the bank reconciliation function stands out as an indispensable tool in the hands of financial managers who constantly attempt to ensure that their cash tracking responsibility includes prevention of unauthorized funds leakages. As a financial information generation tool, bank reconciliation will rightly precede decision making and serve as an imperative for quality financial management. Also, it gives a great impetus to the fair view of the state of affairs of the organization.

Significance of the Study

Without bank reconciliation, the true cash balance of the organization will not be known and any financial decision taken is like grappling in the dark. On daily basis, so many transactions go to impact on the bank balance either positively or negatively. Some delays also occur with regard to incoming or outgoing effects. Because money has value in relation to time, it is important that the liquid assets of the organization are brought together in the right amounts and that financial decisions are not made based on uncertain balances. The issue of bank reconciliation, therefore, is not to be treated with less emphasis. That is the basis of the significance of this topic.

Purpose of the Study

This paper is generally intended to bring out the role of bank reconciliation in financial management along with the following subordinate objectives:

1) To establish the place of bank reconciliation as a best practice standard for effective financial management.
2) To identify the key elements in bank reconciliation and to establish the practice as a due process instrument for all managers of finance.
3) To denominate bank reconciliation as an imperative for all financial managers who want to be on top of their jobs.

METHODOLOGY

The data collection is the result of desk research involving secondary sources made up of published and unpublished books, journals articles, International Federation of Accountants' (IFAC's) 2003 Handbook of International Public Sector Accounting Pronouncements and other articles on the subject.

LITERATURE REVIEW

The following literature review will look at the definition of bank reconciliation, the reasons for the preparation of bank reconciliation, the perceived role of bank reconciliation in financial management and the concept of effective financial management.

Bank Reconciliation Defined

FRMP Baseline Report (2004) proposes that Bank reconciliation should be considered as the essential control machinery on the basis of which the preparation of excellent accounting information is achieved within an organization. It should be said that excellent accounting information is achieved in relation to timeliness, accuracy and validity of the reported data. Therefore, bank reconciliation can be said to provide the platform for all these essential qualities.

The International Federation of Accountants' (IFACs) 2003 Handbook of International Public Sector Accounting Pronouncements states that when the cash basis of accounting underlies the preparation of financial statements, the principal financial statement is the cash flow statement. In other words, true and fair view can exist only where proper cash reporting is present. This is why the Baseline Report (2004) contends that this IFAC pronouncement "is simply not possible without effective bank reconciliation processes."

Bank reconciliation is described as involving the process of comparing one's record of transactions and balances with the record of transactions and balances of the one's bank account. In this process, every transaction must be considered in one's account to ensure that the person and the bank do agree on the transaction (Pritchard, 2011). Another source puts it tersely: "A *Bank reconciliation* is a process that explains the difference between the bank balances shown in an organization's bank statement, as supplied by the bank, and the corresponding amount shown in the organization's own accounting records at a particular point in time". This definition imports the fact that separate records are kept by the individual or business on the one hand, and the bank on the other hand. It also implies that the comparison need to be made of the records which are within an exact time frame – the beginning and the end dates of the two different records should be the same. This then means that the cause of any variations has to be as a result of the presence of transactions that do not exist in equal amounts in the two separate books.

Going by Averkamp (2011) version of definition, it would be said that the above definitions lack some important information. Averkamp (2011, p. 1) states that: "A company's Cash Account, which is a general ledger account contains a record of its bank transactions, usually in the forms of checks written, receipts from customers, etc. The bank also generates a parallel record of the company's checking account and in it processes all the company's deposits, cheques, service charges, and other transactions." Averkamp's definition highlights the important items that give reason for the disparity between the bank's balance and the one produced by the business. It, however, agrees with that of Pritchard (2011) suggesting that the difference in the books occurred, in the first instance, because of the entries either the business or the bank left undone.

The major concentration of the bank reconciliation effort, therefore, is to make these differently sourced documents to agree. Some errors and omissions may induce overstatement or understatement of the bank figures over the account balance in the company's books or vice versa. Through thorough verifications, the cause of disequilibrium is determined and once corrected, brings out the fair view that would represent the true liquid asset of the organization.

Reasons for Preparation of Bank Reconciliation Statement

There are several reasons that account for urgency to do accurate, complete and timely bank reconciliation. The balance shown in the cash analysis book may not be the same as that shown on the bank statement, and it is probable that neither of the reports shows the correct financial state of the organisation. This is because these two documents are not usually prepared on the same date. Even if the same date rules apply, it is also possible that the items that made it into one did not make it to the other or that some items did not make it into any of the two records at all.

The commonest reasons for the differences between the two documents as referred to earlier are outlined by Amponsah (2009) as follows:

a) Unpresented cheques: These are effects issued by the business which the payees are yet to present for payment. The implication of this is to overstate the balance in the bank. Without adjusting the bank balance for such, the correct cash at bank will not show.
b) Uncredited cheques: These are lodgments made by the organization which have not yet been credited by the bank. The situation here is that the business has taken account of the figure in its books, and until the bank reflects the same, the useable cash in the bank will be understated.
c) Bank charges, including cost of cheque books, interest on loans and or overdrafts, and interest on savings may prevent the bank balance from agreement with the balance in the company's books.
d) Dishonoured cheques, instruments duly lodged alright, but which are returned unpaid for reasons of insufficient fund; irregular signature; staleness or figures on the cheque not agreeing with the amount in words, or for any other suspicious reasons.
e) Direct payments, into and/or from the organization's bank account arise from time to time and may be the cause of the difference in the books until the cash book entry is made by the organization.
f) Errors committed either by the organization or the bank.

The effect of any of the above is to cause the bank balance to be different from the balance in the books of the company, and this creates the environment requiring reconciliation.

The Perceived Role of Bank Reconciliation in Financial Management

The accounting system will not induce the necessary impetus of belief by stakeholders where the bank reconciliation process is omitted. It can, therefore, be said that bank reconciliation is the foundation stone of any accounting system in which there is movement of cash. Without accurate, complete and timely bank reconciliation, there will be no successful guardianship of the organization's funds. Bank reconciliation, therefore affords a solid base upon which the quality of an accounting information may be assessed; bank reconciliation, is a key element in ensuring the reliability of financial accounting data. In other words, the absence of bank reconciliation presents a serious hazard to the integrity and quality of an entity's accounting records and reports which, in turn, engenders a lack of confidence by users of the accounting information (FRMP Baseline Report, 2004). The affected users may include shareholders, suppliers, customers, and a host of others. It does also impact on the dividend payout policy of the organization as this is often predicated on actual cash available for distribution.

Errors may exist in the cash and bank balances even though the company's books might show agreement. Bank and cash balances reconciliations are priceless management tools; they are the highest quality assurance for proof of liquidity of the business. How regularly and accurately the bank reconciliation is carried out can help an organization determine if its employees are doing their jobs right; whether or not payoffs are being made timely; if preventable losses are being incurred, and if the policy unit is up to date on reporting accounting information. Also, the Global Finance School (2010) further asserts that the most important reason for reconciling bank statements is to avoid accounting errors which can be committed both by the firm and the bank.

The foremost reason for bank reconciliation, according to the Basis Project (n.d.), is to ensure that the accounting records are complete. There may still be errors, however, at least, it will be seen that all that needed to be recorded have all been entered. Failure to do the bank reconciliation leaves a grave risk that the accounting records are not reliable. Such unreliable data will not inspire confidence in the minds of financial managers and/or users of the accounting information. Bank reconciliation, therefore, comes in as a due process tool ahead of any reasonable decisions by the financial management office.

The Concept of Effective Financial Management

What might be described as effective financial management could be seen from the point of view of the role of the finance office in the establishment. Payne (2009) asserts that the role of the finance function requires close scrutiny especially in the face of the current financial crises. How well the finance office serves the organization in terms of treasury functions, funds control, allocation of available resources to viable ends and general financial advisory to the management come to the forefront. In every organization, funding and funds management come close to the running of the enterprise like the brain-box in an automobile determines the functionality of the car.

The treasury functions include identifying the sources of funds, making the funds available at the right time and in the right quantity, and ensuring that the cost of funds, where borrowing comes in, is reasonable and match the various tenor needs. In her funds management and control function, the finance office ensures that funds belonging to the establishment stay in the business of the organization and do not face undue dissipation by theft or other forms of cash erosion. The knowledge of the correct bank balances is a crucial requirement for taking intelligent decisions that bother on resource allocation and direction of the enterprise.

There is a constant struggle between running the business with debts or with own equity. Finkler (2010) suggests that every organization needs keep some cash on hand or in the bank accounts to take care of transactions, safety and investment needs. Sometimes, a business goes into temporary funding with overdraft due to the carelessness of the finance office or the administration as a whole where proper planning is neglected. Proper planning will entail use of cash projections to foresee the areas of difficulty and making plans for correction before getting face to face with the actual period. How the financial management admits of unbudgeted items and/or whether the projected revenues return to scale may explain some of the pressures on cash. No wonder Jayeola, Adebayo and Oluwafemi (2011, p. 93) insist that "corporate organizations lay strong emphasis on cash management because cash shortage disrupts company's operations and corporate goals, while excess cash remains idle without contributing anything, in terms of returns, to the profitability level of the company". They, therefore, conclude that the job of the finance manager is essentially making sure that there is equilibrium.

What bank reconciliation does for the finance office is to give a timely prompt of the cash available or overdrawn so that effort will be made to stay on, or return to, equilibrium from time to time. Interest can be earned by placing any noticeable surpluses in an income generating account; and on the other hand, unnecessary costs may be incurred by allowing the bank position to be in unauthorized deficit. Timely reconciliation dims the chances of unauthorized overdraws. The concept of effective financial management, therefore, includes a near to real time knowledge of how much funds the organization carries in liquid form and ensuring that there are adequate cash resources to run the business in abundance or lean times. In doing this, bank reconciliation provides the control edge.

CONCLUSION

This paper has reviewed the meaning and importance of bank reconciliation as a pre-requisite for effective financial management. The conclusion here is that the finance manager must be a minute man with his bank balances for him to take advantage of any opportunities in his environment. Good bank reconciliation culture helps to ensure that funds are not left idle when they could be employed to earn some income. Again good bank reconciliation culture will ensure that the organization does not lose money unnecessarily to over charges or under credits. The paper further holds that bank reconciliation should be done consistently and timely and that there is need for a dedicated unit within the accounting office that regularly ensures that this due process imperative is upheld every month. The financial management office would find grounding from the knowledge of the various funds sources, and the bank reconciliation process helps management to keep tabs on the movements of cash that could affect proposed plans, decisions and actions.

RECOMMENDATIONS

Drawing from the literature review and going by the findings summarized above, it is hereby recommended as follows:

The management should insist on a regular timely preparation of bank reconciliation of all the accounts of the organization every month or after several movements of cash. Where, for complex organizations, there is a high traffic, the reconciliation can be done more frequently.

A unit of the organization within the accounting department should be assigned the responsibility of monitoring and reconciling all the checking accounts of the entity. A double check by internal audit unit will be in proper place.

Every identified difference in the books, either on the bank statement or the on the organization's books, should be fully investigated and corrected. Adequate notes should be made for any outstanding on the reconciliation statement.

A senior member of the accounting office should review and sign off on all reconciliation pages or query all uncleared effects.

Identified reconciliation items should be corrected in the books after all investigations and/or followed up to the bank. This should be done as frequently as issues arise in the course of the reconciliation exercise.

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