

Reconciliation

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Definition

Reconciliation of Cost Accounts and Financial Accounts involves the process of identifying and accounting for the items which have led to the difference in working results as shown by the Cost Accounts and Financial Accounts.

Definition of Cost & Financial Accounting

Cost Accounting is the classifying, recording and appropriating allocation of expenditure for the determination of the costs of products and services and for the presentation of suitably arranged data for purpose of control and guidance of management.

Financial Accounting is connected with the recording and summarizing of financial transactions and preparation of financial statements in accordance with GAAP. It reports on financial condition and profitability of the business to owners.

Need for Reconciliation

- I. To find out the reasons for the difference in profit or loss in Cost or Financial accounts.
- II. To ensure the mathematical accuracy and reliability of Cost accounts in order to have cost ascertainment, cost control, and to have a check on Financial accounts.
- III. To contribute to the standardization of policies regarding stock valuation, depreciation and overheads.
- IV. To facilitate coordination and promote better cooperation between the activities of financial and cost sections of the accounting department.
- V. To place management in better position to acquaint itself with the reasons for the variation in profits paving the way to more effective internal control.

Reasons for disagreement in profit

- ✓ Items shown only in Financial accounts;
 - * Purely financial charges,
 - * Appropriation of profit,
 - * Writing off intangible and fictitious assets,
 - * Purely financial incomes.
- ✓ Items shown only in Cost accounts.
- ✓ Over or under absorption of Overheads.
- ✓ Different bases of stock valuation.
- ✓ Different methods of charging depreciation.
- ✓ Abnormal gains and losses.

Methods of Reconciliation

The reconciliation of costing and financial profits can be attempted either:

1. By preparing a Reconciliation statement.
2. By preparation of a Memorandum Reconciliation Account.

Reconciliation Statement:

While preparing a reconciliation statement, profit shown by one set of accounts is taken as base profit & items of differences are added to it or deducted from it to arrive at the figure of profit shown by other set of accounts.

Procedure of Reconciliation

When there is differences between the profits disclosed by cost accounts & financial accounts, following steps is taken to prepare reconciliation statement:

1. Ascertain various reasons of disagreement between the profit disclosed by two sets of books of accounts.
2. If profit as per cost accounts is taken as:

Add:

- 1. Income included of financial accounts only.**
- 2. Expenditure included of cost accounts only.**
- 3. Amount of excess expenditure in cost accounts compared to entries in financial accounts.**
- 4. Amount of excess income in financial accounts compared to entries in cost accounts.**
- 5. Over-absorption of overheads in cost accounts.**
- 6. Undervaluing amount of closing stock inventory in cost accounts.**
- 7. Overvaluing amount of opening stock inventory in cost accounts.**
- 8. Overcharge of depreciation in cost accounts.**

Deduct:

- 1. Income included of cost accounts only.**
- 2. Expenditure included of financial accounts.**
- 3. Amount of excess income in cost accounts compared to entries in financial accounts.**
- 4. Amount of excess income in financial accounts compared to entries in cost accounts.**
- 5. Under-absorption of overheads in cost accounts.**
- 6. Overvaluing amount of closing stock inventory in cost accounts.**
- 7. Undervaluing amount of opening stock inventory in cost accounts.**
- 8. Overcharge of depreciation in cost accounts.**

Memorandum Reconciliation Account

MEMORANDUM RECONCILIATION ACCOUNT

To financial expenses	By profit as per cost A/C
Discount	Financial Income
Fines & penalties	Rent
Bank Interest	Interest
Underwriter's commission	Dividend
Donations	Profit on sales of assets
Goodwill written off	By Items charged in cost accounts
To under absorption of overheads	Interest on own capital
To under valuation of opening stock in cost accounts	Rent on own building
To over valuation of closing account in cost accounts	By over absorption of overheads
under charge of depreciation in cost accounts	By over valuation of opening stock in cost accounts
To profit as per Financial Accounts cost A/c	By under valuation of closing stock in cost accounts
	By Over charge of depreciation in cost A/c

Bibliography

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