

Reconciliation of Cost and Financial Accounts

Reconciliation of

Cost Accounts and Financial Accounts

- When cost accounts and financial accounts are maintained separately in two different sets of accounting books (Non-integral System), the profit or loss shown by the both may not agree.
- Therefore, it becomes necessary that periodically the profit or loss shown by the two sets of accounts is reconciled.
- A Reconciliation Statement or a Memorandum Reconciliation Account is prepared showing the reasons for difference between the results disclosed by cost and financial books.



Need of Reconciliation of Cost Accounts and Financial Accounts

- To reveal the reasons for difference in profit or loss between cost and financial accounts.
- To check the arithmetical accuracy of both sets of accounts as well as to detect errors and omissions committed in the accounts.
- To ensures the reliability of cost accounts in order to correct ascertainment of cost of production.

Reasons for Difference in Profits/losses Shown by Cost Accounts and Financial Accounts

- Items shown only in Financial accounts.
- Items shown only in Cost accounts.
- Absorption of overheads in cost accounts : under-absorption and over-absorption.
- Difference in valuation of inventories: (a) Raw materials, (b) Semi-finished goods or work-in-progress and (c) finished goods.

Reasons for Difference.....

Items (Incomes) shown in Financial Accounts only

- Profit on sale of assets/investments
- Interest received
- Dividend received
- Discount received
- Commission received
- Rent received
- Brokerage or Transfer fees, etc. received.



Reasons for Difference.....

Items (Expenses) shown in Financial Accounts only

- Loss on sale of assets/investments
- Interest paid
- Penalties, fines and damages paid as per law
- Appropriation of profit:
 - Provision for tax
 - Transfer to reserve
 - Dividend paid
 - Goodwill, Preliminary expenses, Discount on issue of shares/debentures etc. written off

Reasons for Difference.....

Items (Expenses) shown in Cost Accounts only

- Notional rent of owned premises
- Notional salary of proprietor
- Depreciation on an asset having nil or negligible book value
- Interest on capital employed in production, but not actually paid

Reasons for Difference.....

Items (Expenses) shown in Cost Accounts only

- Notional rent of owned premises
- Notional salary of proprietor
- Depreciation on an asset having nil or negligible book value
- Interest on capital employed in production, but not actually paid

Reasons for Difference.....

Over-absorption and under-absorption of overheads

- **Over-absorption or over-recovery of overheads in cost accounts:**

When overheads charged in cost accounts are more than the overheads shown in financial books.

- **Under-absorption or under-recovery of overheads in cost accounts:**

When overheads charged in cost accounts are less than the overheads shown in financial books.



Reasons for Difference.....

Over Valuation or Under valuation of Inventories/ Stock

- **Valuation of raw materials**

- In Financial Books, stock is valued at cost or market price whichever is lower
- In cost accounts, stock is valued on the basis of FIFO, LIFO, Weighted Average method or any other method
- Different method may be adopted in financial accounts and cost accounts leading to difference in profit.

Reasons for Difference.....

Over Valuation or Under valuation of Inventories/ Stock

- **Work-in-Progress:**
- It may be valued at Prime cost or at Factory cost or cost of production.
- Different basis may be adopted in financial accounts and cost accounts creating difference in profit.

Reasons for Difference.....

Over Valuation or Under valuation of Inventories/ Stock

- **Finished Goods:**
- In Financial Books, finished goods is valued at cost or market price whichever is lower.
- In cost books, finished goods is valued at cost or market price whichever is lower.
- Different methods may be adopted in financial accounts and cost accounts causing difference in profit.

Reasons for Difference.....

Abnormal Gains and Losses

- Abnormal gains and losses are usually not shown in cost accounts or may be shown in costing Profit and Loss Account.
- In financial books, these are shown in Profit and Loss Account.
- Examples: abnormal wastage of materials, loss by theft or fire or accident, cost of abnormal idle time, etc.

Reconciliation Statement

| Particulars | + Items | - Items |
|--|---------|---------|
| Profit as per Cost Accounts | XX | |
| OR Loss as per Cost Accounts | | XX |
| 1. Incomes shown in Financial books only | XX | |
| 2. Expenses shown in Financial books only | | XX |
| 3. Incomes shown in Cost Accounts only | | XX |
| 4. Expenses shown in Cost Accounts only | XX | |
| 5. Over-absorption or over-recovery of overheads in cost accounts | XX | |
| 6. Under-absorption or over-recovery of overheads in cost accounts | | XX |
| Contd..... | | |

Reconciliation Statement

contd.. from last slide

| Particulars | + Items | - Items |
|---|------------|------------|
| 7. Over-valuation of opening stock of RM, WIP and FG in cost accounts | XX | |
| 8. Under-valuation of opening stock of RM, WIP and FG in cost accounts | | XX |
| 9. Over-valuation of closing stock of RM, WIP and FG in cost accounts | | XX |
| 10. Under-valuation of closing stock of RM, WIP and FG in cost accounts | XX | |
| 11. Error which increased Financial profit | XX | |
| 12. Error which decreased Financial profit | | XX |
| | XXX | XXX |
| <i>Profit as per Financial accounts</i> | | ??? |
| <i>OR Loss as per Financial Accounts</i> | ??? | |
| | XXX | XXX |

Memorandum Reconciliation Account

| Particulars | Amt. | Particulars | Amt. |
|---|------------|---|------------|
| Loss as per Cost Accounts | XX | Profit as per Cost Accounts | XX |
| Expenses shown in Financial books only | XX | Incomes shown in Financial books only | XX |
| Incomes shown in Cost A/cs only | XX | Expenses shown in Cost A/cs only | XX |
| Under-absorption or over-recovery of overheads in cost accounts | XX | Over-absorption or over-recovery of overheads in cost accounts | XX |
| Under-valuation of opening stock of RM, WIP and FG in cost accounts | XX | Over-valuation of opening stock of RM, WIP and FG in cost accounts | XX |
| Over-valuation of closing stock of RM, WIP and FG in cost accounts | XX | Under-valuation of closing stock of RM, WIP and FG in cost accounts | XX |
| Error which decreased Financial profit | XX | Error which increased Financial profit | XX |
| Profit as per Financial Accounts | ??? | Loss as per Financial accounts | ??? |
| | XXX | | XXX |

Types of Problems

1. Preparing Reconciliation Statement or Memorandum Reconciliation Account.
2. Preparing Cost Sheet and Reconciliation Statement.
3. Preparing Profit and Loss Account and Reconciliation Statement.
4. Preparing Cost Sheet, Profit and Loss Account and Reconciliation Statement.

THANKS

