SHERSHAH COLLEGE,SASARAM

COST ACCOUNTING

BBA PART II, PAPER X

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COST RECONCILIATION STATEMENT

cost accounts and financial accounts are maintained in two different sets of books, there will be prepared two profit and loss accounts - one for costing books and the other for financial books. The profit or loss shown by costing books may not agree with that shown by financial books. Such a system is termed as, 'Non-Integral System'. where two sets of accounting systems are being maintained, the profit shown by the two sets of accounts may not agree with each other. The difference in purpose and approach generally results in a different profit figure thus arises the need for the reconciliation of profit figures given by the cost accounts and financial accounts.

CAUSES OF DIFFERENCE

Difference in profit or loss between cost and financial accounts may arise due to following reasons.

1. Items shown only in financial accounts : There are a number of items which are included in, financial accounts but find no place in cost accounts.

The items may be classified as under :

(a) Pure financial charges : (i) Loss arising from the sale of fixed assets, Loss on investments, (Hi) Discount on debentures, (iv) Interest on bank loan, mortgages and debentures, (v) Expenses of the company's share transfer office.

(b) Appropriation of Profit : (i) Donations and Charities, (ii) Income tax, (iii) Dividend paid, (iv) Transfers to reserves and sinking funds.
(c) Purely financial incomes : (i) Rent receivable, (ii) Profits on the sale to fixed assets, (iii) Transfer fees received, (iv) Interest received on bank deposits, (v) Dividend received.
(d) Writing off intangible and fictitious assets : (i) Goodwill, Patents and copyrights, (ii) Advertisement, preliminary expenses, Organisation exps etc.

2. Items shown only in cost accounts : There are certain items which are included in cost accounts but not in financial accounts. For example, interest may be calculated on capital employed in production to show the nominal cost of employing the capital though, in fact, no interest has been paid. Similarly, production may be charged with a nominal rent for premises owned, to enable the concern to compare its cost production with that of a rented factory.

3. Estimates and actual
Estimates or standards can be nearer to the actuals but in most cases they cannot be the same. This necessarily means that the profit shown by the cost accounts is bound to be different from the profit shown by the financial accounts.
Following are some of the important items the costs of which may be different in financial books and costing books
(a) Direct materials : The estimated or standard cost of the direct materials purchased or consumed in the, production process may be different from the actual costs. This difference will be due to change in price or quantity or both.
(b) Direct Labour : The estimated or standard cost of direct labour may be different from the actual costs because of difference in wage rates or hours of work or both.
(c) Overheads : In cost accounts the recovery of overheads is generally based on estimates while in financial accounts the

actual expenses incurred are recorded. This results in under or over-recovery of overheads.
(d) Depreciation : Different methods of charging depreciation may be adopted in cost and financial books.

4. Valuation of stocks
(a) Raw materials : In financial accounts stock of raw materials is valued at cost or market price, whichever is less, while in cost accounts stock can be valued on the basis of FIFO or LIFO or any other method. Thus, the figure of stock may be inflated in cost or financial accounts.
(b) Work-in-progress : Difference may also exist regarding mode of valuation of work-in-progress. It may be valued at prime cost or factory cost or cost of production. The most appropriate mode of valuing is at factory cost in cost accounts. In financial accounts; work-in-progress may be valued after considering a part of administrative expenses also.
(c) Finished goods : Under financial accounts, stock of finished goods is valued at cost or market price whichever is, lower. In cost accounts, finished stock is generally valued at total cost of production. Thus, mode of valuation of stocks gives rise to different results in the two sets of books.

5. Abnormal gains and losses
Abnormal gains or losses may completely be excluded from cost accounts or may be taken to costing profit and loss account. In financial accounts such gains and losses are taken to profit and loss, account.

PREPARATION OF RECONCILIATION STATEMENT
Results shown by any sets of books may be taken as the base and necessary adjustment should be made to arrive at the results shown by the other set of books. The following steps shall be taken to prepare a Reconciliation Statement

1 Ascertain the various reasons of disagreement between the profits disclosed by two sets of books of accounts.

2. If profit as per cost accounts (or loss as per financial accounts) is taken as the base :

ADD:

(i) Items of income included in financial accounts but not in cost accounts.

(ii) Items of expenditures (as interest on capital, rent on owned premises, etc.) included in cost accounts but not in financial accounts.

(iii) Amounts by which items of expenditure have been shown in excess in cost accounts as compared to the corresponding entries in financial accounts.

(iv) Amounts by which items of income have been shown in excess in financial accounts as compared to the corresponding entries in cost accounts

(v) Over-absorption of overheads in cost accounts.

(vi) The amount by which closing stock of inventory is under-valued in cost accounts.

(vii) The amount by which the opening stock of inventory is over-valued in cost accounts.

DEDUCT:

(i) Items of income included in cost accounts but not in financial accounts

(ii) Items of expenditure included in financial accounts but not in cost accounts.

(iii) Amounts by which item of income have been shown in excess in cost accounts over the corresponding entries in financial accounts.

(iv) Amounts by which items of expenditure have been shown in excess in financial accounts over the corresponding entries in' cost accounts.

(v) Under absorption of overheads in cost accounts.

(vi) The amount by which closing stock of inventory is over-valued in cost accounts.
(vii) The amount b which the opening stock of inventory is under - valued in cost accounts.

3. After making all the above additions and deductions, the resulting figure will be profit as per financial accounts.

Note : If, profit as per financial accounts (or loss as per cost accounts) is taken as the base, then items added shall be deducted and items to be deducted shall be added.

Preparation of Memorandum Reconciliation Account
This is an alternative to Reconciliation Statement. The only difference is that the information shown above in the reconciliation statement is shown in the form of an account. The profit as per cost accounts is the starting point and is shown on the credit side of this account. All items which are ‘added’ to costing profit for reconciliation are shown on the debit side.
The balance figure is the profit as per financial accounts.
It is only a memorandum account and does not form part of the double entry books of accounts.