

**POTENTIAL AGENDA ITEM REQUEST
(STANDARD RECONCILIATION TEMPLATES)**

The issue: Currently while preparing the accounts under IFRS, some organizations are reconciling the transactions/accounts on Materiality base and due to that if any unidentified deviation left with the small amount then either organizations ignore the deviation and leave the balance as reconciling item or if any account consists large number of transaction with lower amount then some organizations do not even reconcile the account and in place of reconciling they carry forward the balancing figure due to “**In preparing accounts it is important to decide what is material and what is not, so that time and money are not wasted in the pursuit of excessive details**”.

And due to continuous negligence of unidentified small deviation, which accumulate to a big problem like: Large amount of unrecognized/unidentified received cash, miscalculation of tax payable since long etc.

Current practice: For better understanding of the subjected issue, mentioning below the accounting practices of 2 multinational companies (actual name not mentioned)

Case 1: ABC ltd has 7 national network companies (NNC) and maintaining their accounts in SAP. For cost cutting, NNC wise company outsourced their day to day accounting works in 3 different teams AP, AR & GL. And as per SOX compliance AR team members didn't have the access of AP and vice-versa. At period end both teams reconciled their accounts separately and their open balances allocated as outstanding payable/ receivable, paid in advance, Debit/ Credit Note and unidentified cash. Company provided a facility to its debtors that they can buy the goods from any NNC and can make the payment in any NNC and while introducing this new facility, company missed to update their reconciliation template.

Problem started when any debtor bought the goods from one NNC (X) and making the payment in any other NNC (Y) and informing the selling NNC (X) as payment is made to NNC Y.

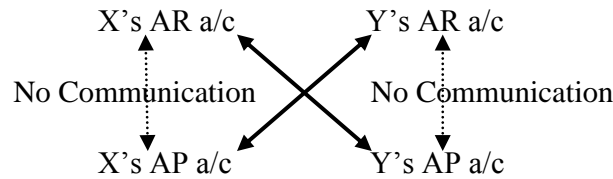
Accounting entries passed by NNC X's AR team (In the books of X):-

Y's AR a/c Dr
 To Debtor a/c
(Invoice amount transferred to Y's AR a/c)

Accounting entries passed by NNC Y's AR team (In the books of Y):-

Cash a/c Dr
 To X's AR a/c
(Cash posted in X's AR a/c)

At month end, X's AR team sent the monthly statement to Y's AP team for payment and vice-versa. Company had already given the instruction that, regarding NNC's amount AR team statement would consider for payment rather than AP's statement. So all NNC's were making payment as per AR's statement and entering the below mentioned entries:-



In the books of X: AR:

Cash a/c Dr
 To Y's AR a/c
(Clear the invoice amount)

AP:

Cash a/c Dr
 To Y's AP a/c
(unidentified cash received)

In the books of Y: AR:

X's AR a/c Dr
 To Cash a/c
(Transfer the payment of X)

AP:

X's AP a/c Dr
 To Cash a/c
(unidentified exp paid)

In early days when unidentified exp/cash balance was small in amount, company didn't pay attention as not material and BPO was also thinking that they are following the SOP. After 2 years, when group's consolidated unidentified cash balance reached to GBP 0.40 million, company asked me to look and after reconciling, I found that actual incorrect transaction amount is GBP 1.00 million, due to not only NNC's separate AP & AR a/c but with all those companies who were Debtor as well as Creditor. Where total duplicate transaction were GBP 0.70 million and GBP 0.10 million were belong to typo or transactions of high volume days, where payments were posted as unidentified cash and GBP 0.15 million were belong to actual loss, where a customer has taken the credit from more than 1 NNC against same credit note and actual unidentified cash was GBP 0.05 million only, which was pending due to contract not setup or invoice not generated in the system.

Case 2: XYZ ltd was maintaining their sub-ledger in a separate system and general ledger in a separate system (Oracle: People Soft). The MRP of the product of XYZ ltd is \$1.00 / unit. Company collects the money from his customers in advance for different small period (max for 1 year) and maintaining unearned revenue account. Company has to pay the following sales tax as per state rule, which was calculating and posting manually with the posting of cash:

Sales in 4 specified city within State (except Govt authorities/Institution) – 8%	
Sales in remaining city within State (except Govt authorities/Institution) - 10%	
Sales made out of State	- 0%
Sales to Govt authorities/Institution	- 0%

At month end accountant generate the report through interface and uploaded the JEs manually in GL system. Problem started when company upgraded the system to activate auto tax deduction facility. At month end when accountant tried to reconcile, every time he was ending with the deviation of \$15.00 - \$20.00, so he ignored the deviation due to materiality and posted the JEs on the basis of interface only. Because it was very sophisticated for him to check thousands of sub ledger accounts manually to find out the accounts in which system didn't calculate the correct ST amount. And accountant started following the same practice every month.

After 2 years of it, when process outsourced to India and I asked for the reconciliation template then I had been told that materiality is not there and also there is no report from which we can reach to the incorrect entry except manually checking because of the system incapability. But as per the accounting principles (which we have learned), **“Materiality is only an eligibility condition and only after qualifying it, any transaction needs to record in books and if once transaction is recorded then it has to be as accurate as possible and accuracy can claim only after reconciliation”**.

So, I personally designed a template to reconcile the ST account transaction wise and found that the reason of incorrect tax calculation was errors, which occurred while setting up an a/c (city / tax code not correctly updated in the system) and due it system was not calculating the correct tax amount and when I reported my finding to the BPO and to XYZ ltd that, in last month when company had paid the ST more than \$22k, company still short paid the ST by \$40.00 and same error happening from last 2 years since the system up gradation. XYZ ltd shown the interest in implementation of new template (because of the penalty, which is 25 times in case of short ST paid) and also asked me to visit/create the transaction wise reconciliation templates for other accounts too, but in the views of my BPO which is also an IAS (now IFRS) compliance company that, miscalculation of \$40.00 in the thousand million SOCI is not material and we should not waste the time and effort in designing / implementing new reconciliation templates, because most of the ledger accounts has multi thousand transactions in a month and even without designing new reconciliation templates the data & numbers are relevant. So there should not be wasting of time to get the accuracy where deviation amount is still not material.

Reasons for the FASB to address the issue: Apart from the above mentioned 2 practices, when I discussed it with my colleagues, who are working in other US based MNC's, I found that many companies are following same kind of practices in different accounts (Sales Tax/ unidentified cash/ fixed assets etc) Like: consideration of materiality, not only while taking the decision on adopting a new policy or while recording the transactions in the books but also at the time of reconciliation. Companies are misinterpreting the materiality concept and leaving/adjusting reconciling item without proper verification/ reconciliation and it is not only limited here, companies are spending their time and effort in designing new practices but not reviewing and updating their reconciliation templates in timely manner. And in starting when any new deviation appear then either neglecting the deviation or leaving the deviation without proper validation as reconciling item. And gradually small non material deviation becomes the big problem. Whereas in one company, unidentified cash (where payer or the reason is not identified) balance reached to more than \$15 million.

As the above mentioned issue is wide spread across the companies, so it is requested that kindly provide your valuable feedback on the issue "Improper Reconciliation Template/ Method" and if find require then kindly take necessary steps to implement an ideal reconciliation procedure across he companies, as negligence of it may lead to the following major disadvantage:

- 1) Large and uncontrollable amount of reconciling item: whereas if companies properly reconciled their account and timely update/ redesign the reconciliation template then issue can control at the starting stage.
- 2) Improper reconciliation leads to the inaccurate reporting: where figures are not accurate and claiming of accurate figure become void because "Accuracy can be claimed only after proper research & reconciliation.
- 3) When due to continuous negligence a big amount start appearing as reconciling item, then some companies in place of search and removal of error they try to hide the errors like: where unidentified cash handle by AR team, then sometimes on the name of materiality, do not make proper research in system and just show the balancing figure of Debtors in SOFP and in the result knowingly or unknowingly companies start carrying hidden suspense account in their books.
- 4) Accounting of Void Transactions: Reconciliation on the basis of materiality indirectly encourages keeping open small reconciling amount even without proper verification of that amount belongs to a valid/ voids transaction, which is again against the accounting policy as "Account should not be prepared for the void or illegal transactions regardless of materiality."

- 5) Impact on investor's decision: It is true that deviation of a small amount will not make much impact on investor's decision. But in which accounts the small amount deviation is appearing may make a significant impact on investor's decision and from "Standard Reconciliation Template" investor would also be able to know that, "is company paying minimum attention while reconciling of an account which is required to get accurate figure."

So it is requested, that FASB validate the issue and take necessary steps to control it. However I have also raised the issue to IASB, because IFRS has some guidelines on reconciling item. But to save time and effort some companies do not update their reconciliation template/ procedure with the small change in their policy/ practices. Whereas many companies do want to keep their record accurate but they are requiring guidance and support in designing of "Globally Accepted Standard Reconciliation Templates." And as FASB & IASB are working together to standardize the accounting standards, so I am highlighting the issue to FASB too, because it would be really good if both organizations would work together to control the issue.

However my total experience belong to big MNC's where they try to update the record as accurate as possible but leave the small amount reconciling item due to the effort which is required in searching and clearing of the deviation. And I am afraid if someone is keeping the same knowingly for non legal transactional purpose. And we have already experienced that due to one or two odd companies whole economy has to suffer.

In the end, I (Niten Kumar) as individual contributor of finance and accounts strongly recommend the need of "Standard Reconciliation Templates/ Instruction" across the companies and I hope that the above mentioned reason are enough for issuing the same. I would welcome for a further discussion to clear up any queries you may have. And would also welcome, if I would be given a chance to discuss or represent my views and working on the pro-forma of "Standard Reconciliation Templates."

Looking forward to hear from you!

Submitted by

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