

Financial Accounting

Module 5: Accounting for Cash



Module Learning Outcomes

Describe the accounting and reporting of cash and cash equivalents

- 5.1: Explain the concept of internal control over cash
- 5.2: Establish and maintain a petty cash system
- 5.3: Recognize the significance of the bank reconciliation as an internal control
- 5.4: Compare methods of recording credit card transactions
- 5.5: Present cash and cash equivalents on the financial statements

Establishing Internal Controls

Learning Outcomes: Establishing Internal Controls

5.1: Explain the concept of internal control over cash

5.1.1: Identify principles of internal control

5.1.2: Identify common internal control activities

5.1.3: Apply internal control concepts to receipts

5.1.4: Apply internal control concepts to payments

Identify Principles of Internal Control

- According to the Committee of Sponsoring Organizations of the Treadway Commission, there are five components of an internal control structure. When these components are linked to the organization's operations, they can quickly respond to shifting conditions.
- The components are:
 - Control environment
 - Risk assessment
 - Control activities
 - Information and communication
 - Monitoring

Identify Common Internal Control Activities

Companies protect their assets by:

1. Segregating employee duties.
2. Assigning specific duties to each employee.
3. Rotating employee job assignments.
4. Using mechanical devices.

Identify Common Internal Control Activities

- In 2002, Congress passed the Sarbanes-Oxley Act (SOX), which established rules to protect the public from fraudulent or erroneous practices by corporations and other business entities.
 - SOX applies to all publicly traded companies in the United States as well as wholly owned subsidiaries and foreign companies that are publicly traded and do business in the United State.
 - SOX also regulates accounting firms that audit companies which must comply with SOX.
 - Even though private companies, charities, and non-profits are generally not required to comply with every provision of SOX, there are penalties for those organizations that knowingly destroy or falsify financial data.



Identify Common Internal Control Activities

- Here are the most important SOX requirements:
 - CEOs and CFOs are directly responsible for the accuracy, documentation, and submission of all financial reports as well as the internal control structure to the Securities and Exchange Commission (SEC). Officers risk jail time and monetary penalties for compliance failures—intentional or not.
 - An Internal Control Report that states management is responsible for an adequate internal control structure for their financial records. Any shortcomings must be reported up the chain as quickly as possible.
 - Companies must have formal data security policies, communication of data security policies, and consistent enforcement of data security policies.
 - Companies maintain and provide documentation proving they are continuously in compliance.

Apply Internal Control Concepts To Receipts

- Companies vary in how they implement internal controls, but they usually observe the following principles:
 - Prepare a record of all cash receipts as soon as cash is received. Most thefts of cash occur before a record is made of the receipt. Once a record is made, it is easier to trace a theft.
 - Deposit all cash receipts intact as soon as feasible, preferably on the day they are received or on the next business day. Undeposited cash is more susceptible to misappropriation.
 - Arrange duties to ensure that the employee who handles cash receipts does not record the receipts in the accounting records. This control feature follows the general principle of segregation of duties given earlier in the chapter, as does the next principle.
 - Arrange duties to make sure the employee who receives the cash does not disburse the cash. This control measure is possible in all but the smallest companies.

Cash Disbursements

- Companies also need controls over cash disbursements. Since a company spends most of its cash by check or bank transfer (ACH, wire transfers, etc.), many of the internal controls for cash disbursements deal with the authorization process.
- The basic principle of segregation of duties applies in controlling cash disbursements.



Cash Disbursements (part II)

- Make all disbursements by check or from petty cash. Obtain proper approval for all disbursements and create a permanent record of each disbursement. Many retail stores make refunds for returned merchandise from the cash register. When this practice is followed, clerks should have refund tickets approved by a supervisor before refunding cash.
- Require all checks to be serially numbered and limit access to checks to employees authorized to write checks.
- Require two signatures on each check over a material amount, ensuring that one person cannot withdraw funds from the bank account.
- Arrange duties so the employee who authorizes payment of a bill does not sign checks. Otherwise, the checks could be written to friends in payment of fictitious invoices.
- Require approved documents to support all checks issued.

Cash Disbursements (part III)

- Instruct the employee authorizing cash disbursements to make certain the payment is for a legitimate purpose and is made out for the exact amount and to the proper party.
- Stamp the supporting documents as paid when liabilities are paid and indicate the date and number of the check issued. These procedures lessen the chance of paying the same debt more than once.
- Arrange duties so those employees who sign checks neither have access to canceled checks nor prepare the bank reconciliation. This policy makes it more difficult for an employee to conceal a theft.
- Have an employee who has no other cash duties prepare the bank reconciliation each month and discover errors and shortages quickly.
- Void all checks incorrectly prepared. Mark these checks void and retain them to prevent unauthorized use.

Practice Question 1

Sandy works in the accounting department of a small company. One coworker is in charge of the Petty Cash account. Sandy notices a few discrepancies when she takes over the Petty Cash account when the coworker goes on vacation. Sandy looks back in the books and sees around \$25 a month it has been short for for the last three years. It looks like petty theft has occurred. How could this theft have been avoided?

- A. Put \$25 dollars less in the Petty Cash fund each month.
- B. Set up a spreadsheet for the coworker to fill out himself.
- C. Having the Petty Cash checked monthly by another employee.
- D. Increase the Petty Cash allowance \$25 each month.

Accounting for Petty Cash

Learning Outcomes: Accounting for Petty Cash

5.2: Establish and maintain a petty cash system

5.2.1: Explain the voucher system

5.2.2: Demonstrate petty cash journal entries and reconciliation

Explain the Voucher System

The company treasurer or CFO establishes the petty cash fund by writing a check, usually payable to “cash.” After the check is cashed, the petty cash custodian places the money in a small box that can be locked. The fund is now ready to be disbursed as needed.

The custodian staples any source documents (usually a receipt) to the petty cash voucher (some petty cash vouchers are printed on envelopes to hold the receipts). At all times, the employee responsible for petty cash is accountable for having the cash and the petty cash vouchers equal to the total amount of the fund.



Journalizing Petty Cash Transactions

	Checking		Petty Cash	
	DEBIT	CREDIT	DEBIT	CREDIT
Bal. fwd.	15,286.81		0.00	
		100.00	100.00	
Ending bal.	15,186.81		100.00	

Journalizing Petty Cash Transactions (cont.)

Date	Description	Post. Ref.	Debit	Credit
20-				
Feb. 1	Shipping Expense		22.75	
Feb. 1	Postage		50.80	
Feb. 1	Office Supplies		19.05	
Feb. 1	Cash Over/Short		1.15	
Feb. 1	Checking Account			93.75
Feb. 1	To record check #1041 replenishing petty cash			

Preparing a Bank Reconciliation

Learning Outcomes: Preparing a Bank Reconciliation

5.3: Recognize the significance of the bank reconciliation as an internal control

5.3.1: Identify common reconciling items

5.3.2: Prepare a bank reconciliation

5.3.3: Demonstrate journal entries related to bank reconciliations

Reconciling Items

- Most companies use checking accounts to handle their cash transactions. The company deposits its cash receipts in a bank checking account and writes checks to pay its bills. Keep in mind—a bank account is an asset to the company BUT to the bank, your account is a liability because the bank owes the money in your bank account to you.
- The bank sends the company a statement each month that is really just a printout of the bank's ledger for your account, which is really a subsidiary ledger because the bank doesn't have a general ledger (GL) account for every depositor. The company checks this statement against its records to determine if it must make any corrections or adjustments in either the company's balance or the bank's balance. A bank reconciliation is a schedule the company (depositor) prepares to reconcile, or explain, the difference between the cash balance on the bank statement and the cash balance on the company's books.
- And that is the main internal control for our “cash” accounts.

Reconciling Items (cont.)

Bank statement and GL should match. In accounting, we don't think of reconciling as making the records agree. It's more about explaining the differences.

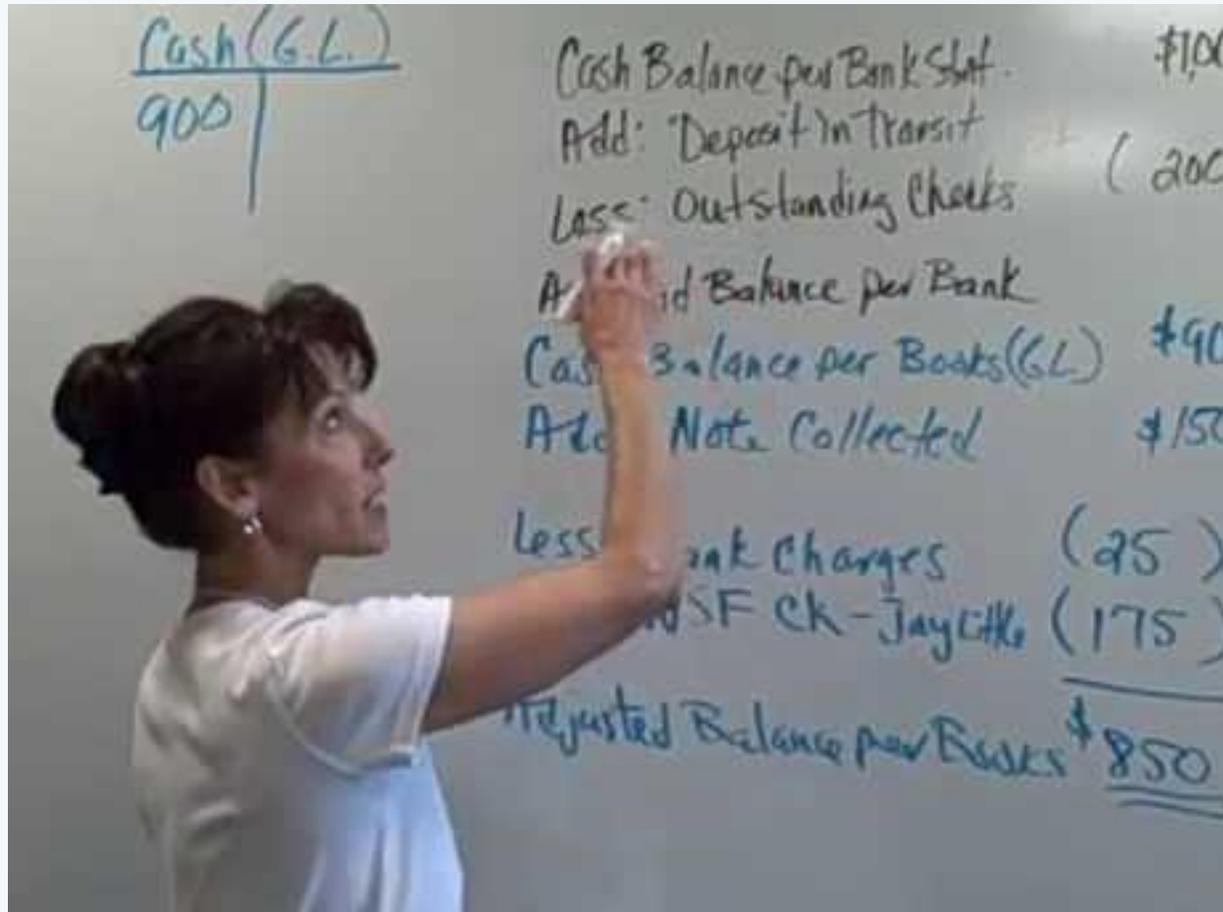
GENERAL LEDGER						
Account: Checking			Account No. 110			
DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20--						
Oct	1	Balance				0.00
Oct	1		GJ1	20,000.00		20,000.00
Oct	4		GJ1		12,000.00	8,000.00
Oct	15		GJ1	1,500.00		9,500.00
Oct	25		GJ1		2,600.00	6,900.00
Oct	26		GJ1		1,000.00	5,900.00
Oct	30		GJ2	1,600.00		7,500.00
Oct	31		GJ2		4,000.00	3,500.00

Bank Reconciliation

- The first steps are to:
 - Adjust the bank balance for any timing differences and/or the rare bank error
 - Add deposits in transit
 - Subtract outstanding checks so the bank balance is adjusted to reflect transactions the business made in one month the bank didn't record until the following month because of lag time.



Reconciling Journal Entries



The image shows a woman in a white shirt writing on a whiteboard. The whiteboard contains two columns of handwritten financial entries. The left column shows a T-account for 'Cash (G.L.)' with a balance of 900. The right column shows a reconciliation process starting with a 'Cash Balance per Bank Stmt.' of \$1,000, adding a 'Deposit in Transit' of \$100, and subtracting 'Outstanding Checks' of \$200 to arrive at an 'Adjusted Balance per Bank' of \$900. This is then compared to the 'Cash Balance per Books (G.L.)' of \$900. Further adjustments include adding a 'Note Collected' of \$150 and subtracting 'Bank Charges' of \$25 and an 'NSF CK - Jay Little' of \$175. The final 'Adjusted Balance per Books' is \$850.

Account	Debit	Credit
Cash (G.L.)		900
Cash Balance per Bank Stmt.		\$1,000
Add: Deposit in Transit		100
Less: Outstanding Checks		(200)
Adjusted Balance per Bank		\$900
Cash Balance per Books (G.L.)		\$900
Add: Note Collected		150
Less: Bank Charges		(25)
NSF CK - Jay Little		(175)
Adjusted Balance per Books		<u>\$850</u>

Practice Question 2

What is one of the common reasons that a bank statement and a company's checking statement are not always exactly indicating the same amount of funds?

- A. Outstanding checks not received by the bank in the same time period.
- B. Because the account is a liability to the bank.
- C. Because the bank uses a subsidiary ledger rather than a general ledger.
- D. Deposits arrive simultaneously for both the company and the bank.

Accounting for Credit Card Transactions

Learning Outcomes: Accounting for Credit Card Transactions

- 5.4: Compare methods of recording credit card transactions
 - 5.4.1: Differentiate between three methods of recording sales by credit card
 - 5.4.2: Demonstrate recording purchases by credit card
 - 5.4.3: Describe the internal control processes related to credit card purchases and sales

Record Sales by Credit Card

A company's accounting procedures for recording credit card sales will depend on how the credit card or charge card transaction is being posted to the bank (which depends on how you set up your service) and how the company then decides to make the entry.

There are three possibilities:

- Net Method
- Gross Method
- Accounts Receivable Method

Record Purchases by Credit Card

GENERAL LEDGER						
Account: First World Bank VISA Payable				Account No. 210		
DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
Bal fwd						427.89
Jan 20		GJ101		18.66		446.55
Jan 22		GJ101		452.32		898.87
Jan 22		GJ101		88.99		987.86
Jan 26		GJ101		54.54		1,042.40
Jan 31		GJ101		12.49		1,054.89
Feb 10		GJ101	427.89			627.00

Internal Controls for Credit Card Transactions

Here are three key internal controls for credit card use that you may want to consider putting in place in your business:

1. **A formal credit card policy.** A written credit card policy serves as the foundation of a good credit (or debit) card expense control system.
2. **Substantiation.** Original receipts must be submitted for all credit card charges, as these receipts substantiate the purchases made with the card. The business purpose should be documented on the receipt to ensure the charge was a legitimate business expense.
3. **Regular statement reviews.** A supervisor who is knowledgeable about the nuances of the business (ideally not a credit card holder) should open and review all credit card statements and supporting receipts to verify the propriety of the charges.

Financial Statement Presentation

Learning Outcomes: Financial Statement Presentation

5.5: Present cash and cash equivalents on the financial statements

5.5.1: Identify cash and cash equivalents

5.5.2: Demonstrate proper financial statement presentation of cash and cash equivalents

Cash and Cash Equivalents

- Cash and cash equivalents consist of cash on deposit with banks and highly liquid investments with maturities of 90 days or less from the date of purchase.
 - Coins
 - Currency
 - Cash in checking accounts
 - Cash in savings accounts
 - Bank drafts
 - Money orders
 - Petty Cash
 - Commercial paper
 - Marketable securities
 - Money market funds
 - Short-term government bonds
 - Treasury bills

Proper Financial Statement Presentation of Cash and Cash Equivalents

FACEBOOK, INC.
CONSOLIDATED BALANCE SHEETS
(In millions, except for number of shares and par value)

	December 31,	
	2019	2018
Assets		
Current assets:		
Cash and cash equivalents	\$ 19,079	\$ 10,019
Marketable securities	35,776	31,095
Accounts receivable, net of allowances of \$206 and \$229 as of December 31, 2019 and December 31, 2018, respectively	9,518	7,587
Prepaid expenses and other current assets	1,852	1,779
Total current assets	66,225	50,480
Property and equipment, net	35,323	24,683
Operating lease right-of-use assets, net	9,460	—
Intangible assets, net	894	1,294
Goodwill	18,715	18,301
Other assets	2,759	2,576
Total assets	\$ 133,376	\$ 97,334

Practice Question 3

All of the following choices are examples of cash equivalents EXCEPT:

- A. Money Orders
- B. Inventory
- C. Treasury Bills
- D. Marketable Securities

Quick Review

- What are the principles of internal control?
- What are common internal control activities?
- How do you apply internal control concepts to receipts?
- How do you apply internal control concepts to payments?
- What is the voucher system?
- How does an accountant perform petty cash journal entries and reconciliation?
- What are common reconciling items?

More Quick Review

- How do you prepare a bank reconciliation?
- How are journal entries related to bank reconciliations?
- What is the difference between the three methods of recording sales by credit card?
- How are purchases by credit card recorded?
- What is the internal control processes as related to credit card purchases and sales?
- What are cash and cash equivalents?
- How are cash and cash equivalents presented properly on financial statements?