cHAPTER 5  
fraud, internal control, and cash

# Student Learning Objectives and Related Assignment Materials

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| **Student Learning Objectives** | **Mini-Exercises** | **Exercises** | **Coached Problems** | **Problems (Groups  A & B)** | **Compre-hensive Problem** | **Skills Develop-ment Cases** | **Continuing Cases** |
| LO 5-1 Define fraud and internal controls. | 1 | 1, 2 |  |  |  | 4, 5, 6 | 2^£ |
| LO 5-2 Explain common principles and limitations of internal control. | 2, 3\*, 4 | 1, 2 |  |  |  | 1, 2, 3, 4, 6 |  |
| LO 5-3 Apply internal control principles to cash receipts and payments. | 2, 3\*, 4, 5, 6, 7, 10 | 3, 4 | 1 | A1, B1 |  |  | 1† |
| LO 5-4 Perform the key control of reconciling cash to bank statements. | 8\*, 9, 10, 11, 12, 13 | 5\*, 6 | 2, 3 | A2, A3, B2, B3 | 1# |  | 1† |
| LO 5-5 Explain the reporting of cash. | 14\* | 7, 8 | 2, 3, 4 | A2, A3, A4, B2, B3, B4 | 1# | 1, 2, 3, 5 | 1† |
| LO S-1 Describe the operations of petty cash systems. | 15, 16\* | 9\*, 10 | 4 | A4, B4 |  |  |  |

\* Animated solution included in the PowerPoint Slides.

^ Particularly challenging; requires students to combine multiple concepts in order to advance to the next level of accounting knowledge.

# Comprehensive Problem 5-1 also covers LO 2-2, LO 2-4, LO 2-5, LO 3-3, LO 3-5, LO 4-2, LO 4-3, and LO 4-4.

† Continuing Case 5-1 builds on the story of Nicole’s Getaway Spa, introduced in earlier chapters. This case focuses on analyzing transactions from source documents, the preparation of a bank reconciliation and resulting journal entries, and the determination of the amount of Cash and Cash Equivalents reported on the company’s balance sheet. This case will be extended in future chapters.

£ Continuing Case 5-2 introduces the story of Wiki Art Gallery (WAG), an instructional case in Connect. This case focuses on the fraud triangle and the risk of financial misreporting. The case will be extended in future chapters.

# Overview

Expanding from the key roles that accounting systems and financial statements play when establishing and operating a small business (covered in Chapters 1 through 4), we explore another key part of an accounting system: internal controls, which are the behind-the-scenes practices that help businesses achieve their objectives.

Students learn how internal controls can improve operations when those controls are operating effectively. They also learn what can happen when internal controls fail.

# Synopsis of Chapter Revisions

* Substantially changed from 4e: removed discussion of press releases, illustration of European financial statements, introduction of the basic business model, and repeated coverage of external users, and inserted explanation and examples of internal control and cash reporting
* New focus company (Koss Corporation) to illustrate how internal control deficiencies allowed the VP-Finance to steal $31.5 million to pay for extravagant credit card purchases
* New categorization of fraud types and new illustration of Fraud Triangle
* Expanded discussion of internal control to include new COSO cube
* New illustration of electronic documents used to process cash disbursements
* New discussion of petty cash transactions and p-cards in Spotlight on Controls
* New discussion and illustration of reporting restricted cash
* Reviewed, updated, and introduced new end-of-chapter material to support new topics and learning objectives, including new problem that automatically posts to T-accounts and new continuing case problem that includes cash disbursement documents

# PowerPoint Slides

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| **Student Learning Objective** | **PowerPoint® Slides** |
| LO 5-1 Define fraud and internal controls. | 5-2 through 5-8 |
| LO 5-2 Explain common principles and limitations of internal control. | 5-9 through 5-11 |
| LO 5-3 Apply internal control principles to cash receipts and payments. | 5-12 through 5-28 |
| LO 5-4 Perform the key control of reconciling cash to bank statements. | 5-29 through 5-35 |
| LO 5-5 Explain the reporting of cash. | 5-36 through 5-37 |
| LO S-1 Describe the operations of petty cash systems. | 5-38 through 5-42 |

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| **Animated Builds and Animated Solutions** | **PowerPoint® Slides** |
| Mini-Exercise 5-3 | 5-44 |
| Mini-Exercise 5-8 | 5-45 |
| Mini-Exercise 5-14 | 5-46 |
| Mini-Exercise 5-16 | 5-47 |
| Exercise 5-5 | 5-48 through 5-50 |
| Exercise 5-9 | 5-51 through 5-52 |

# Chapter Summary

**LO 5-1 Define fraud and internal control.**

* Fraud is an attempt to deceive others for personal gain. Employee fraud includes collusion, asset misappropriation, and financial statement fraud.
* Internal control consists of the actions taken by people at every level of an organization to achieve its objectives relating to operations, reporting, and compliance. The components of internal control include the control environment, risk assessment, control activities, information and communication, and monitoring activities.

**LO 5-2 Explain common principles and limitations of internal control.**

* Most employees working within a company will encounter five basic principles: (1) establish responsibility for each task; (2) segregate duties so that one employee cannot initiate, record, approve, and handle a single transaction; (3) restrict access to those employees who have been assigned responsibility; (4) document procedures performed; and (5) independently verify work done by others inside and outside the business.
* Internal controls may be limited by cost, human error, and fraud.

**LO 5-3 Apply internal control principles to cash receipts and payments.**

* When applied to cash receipts, internal control principles require that (1) cashiers be held individually responsible for the cash they receive; (2) different individuals be assigned to receive, maintain custody of, and record cash; (3) cash be stored in a locked safe until it has been securely deposited in a bank; (4) cash register receipts, cash count sheets, daily cash summary reports, and bank deposit slips be prepared to document the cash received and deposited; and (5) cash register receipts be matched to cash counts and deposit slips to independently verify that all cash was received and deposited.
* When applied to cash payments, internal control principles require that (1) only certain individuals or departments initiate purchase requests; (2) different individuals be assigned to order, receive, and pay for purchases; (3) access to checks and valuable property be restricted; (4) purchase requisitions, purchase orders, receiving reports, and prenumbered checks be used to document the work done; and (5) each step in the payment process occurs only after the preceding step has been independently verified using the documents listed in (4).

**LO 5-4 Perform the key control of reconciling cash to bank statements.**

* The bank reconciliation requires determining two categories of items: (1) those that have been recorded in the company’s books but not in the bank’s statement of account and (2) those that have been reported in the bank’s statement of account but not in the company’s books. The second category of items provides the data needed to adjust the Cash account to the balance that will be reported on the balance sheet.

**LO 5-5 Explain the reporting of cash.**

* Cash is combined with cash equivalents in current assets. Cash equivalents are highly liquid investments purchased within three months of maturity.
* Restricted cash is reported separately, as a current asset if expected to be used up within one year or, if not, as a noncurrent asset.

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| Chapter Outline | Teaching Notes |
| I. Fraud and Internal Control |  |
| A. Fraud | Illustrated in Exhibit 5.1 |
| ***LO 5-1 Define fraud and internal controls.*** |  |
| 1. **Fraud**––A fraud is an attempt to deceive others for personal gain. |  |
| 2. Employee fraud is often grouped into three categories: | Exhibit 5.1 illustrates |
| a. Corruption—Involves misusing one’s position for inappropriate personal gain. | the frequency and median loss of each type of fraud |
| b. Asset misappropriation—Quite simply, theft (embezzlement); cash is usually the target, but other assets can be misappropriated. |  |
| c. Financial statement fraud—Involves misreporting amounts in the financial statements, usually to portray more favorable financial results than what actually exist. |  |
| 3. Three factors exist when fraud occurs; these factors work together as suggested by the *fraud triangle*: | Illustrated in margin |
| a. Incentive—The employee has a reason for committing fraud. |  |
| i. Sometimes the reason is personal financial pressure. |  |
| ii. Sometimes the incentive is to make the business appear successful so as to attract investors, bring in new business partners, or meet loan requirements. |  |
| * **Loan covenants**––Terms of a loan agreement which, if broken, entitle the lender to renegotiate loan terms or force repayment. |  |
| * If loan covenants are not met, the lender can require the company to pay a higher interest rate, repay its loan balance on demand, or put up extra collateral to secure the loan. | The “Spotlight on Ethics” feature addresses frauds |
| b. Opportunity—The employee has a means for committing fraud. | that involve blatantly unethical acts |
| c. Rationalization—The employee perceives the misdeed as unavoidable or justified. |  |
| B. The Sarbanes-Oxley Act (SOX) |  |
| 1. **Sarbanes-Oxley (SOX) Act**––A set of regulations passed by Congress in 2002 in an attempt to improve financial reporting and restore investor confidence. | Exhibit 5.2 sets forth the key requirements of the Sarbanes-Oxley Act (SOX) |
| a. Counteract incentives—Those who willfully misrepresent financial results face: |  |
| i. Fines of up to $5 million plus repayment of any fraud proceeds. |  |
| ii. Jail sentences of up to 20 years, which could add up with consecutive terms for each violation. |  |

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| Chapter Outline | Teaching Notes |
| b. Reduce opportunities—The part of the fraud triangle most affected by SOX; it requires all public companies to: |  |
| i. Establish an audit committee made up of independent directors to ensure the company’s accounting, internal controls, and audit functions are effective. |  |
| ii. Evaluate and report on the effectiveness of internal control over financial reporting; completed by management and, for large public companies, by external auditors as well. |  |
| iii. Encourage honesty in employees – Some provisions of SOX should help employees of good character confront those of poor character. |  |
| * Public companies must have tip lines. |  |
| * Whistle blowers have legal protection. |  |
| * Code of ethics required for senior financial officers. |  |
| C. Internal Control |  |
| 1. **Internal control**––Actions taken to promote efficient and effective operations, protect assets, enhance accounting information, and adhere to laws and regulations. |  |
| 2. Objectives—Internal control consists of actions taken throughout the organization to achieve its objectives relating to: |  |
| a. Operations—Operational objectives focus on completing work efficiently, and effectively, and protecting assets by reducing the risk of fraud. |  |
| b. Reporting—Reporting objectives include producing reliable and timely accounting information for use by people internal and external to the organization. |  |
| c. Compliance—Compliance objectives focus on adhering to laws and regulations. |  |
| 3. Components—An internal control system should include: |  |
| a. Control environment—The control environment refers to the attitude that people in the organization hold regarding internal control. | Exhibit 5.3 illustrates the relationship of control objectives and components to |
| b. Risk assessment—Managers continuously assess the potential for fraud and other risks that could prevent the company from achieving its objectives. | organizational levels |
| c. Control activities—Control activities include various work responsibilities and duties completed by employees to reduce risks to an acceptable level. |  |
| d. Information and communication—An effective internal control system generates and communicates information about activities affecting the organization to support sound decision making. |  |

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| Chapter Outline | Teaching Notes |
| e. Monitoring activities—The internal control system is evaluated often to determine whether it is working as intended |  |
| ***LO5-2 Explain common principles and limitations of internal control.*** | |
| 4. Principles of Control Activities | Summarized in Exhibit 5.4 |
| a. Establish responsibility—Assign each task to only one employee; doing so allows you to determine who caused any errors or thefts that occur. |  |
| b. **Segregation of duties**––An internal control designed into the accounting system to prevent an employee from making a mistake or committing a dishonest act as part of one assigned duty, and then also covering it up through another assigned duty. |  |
| i. Most effective when responsibilities for related activities are assigned to two or more people and when responsibilities for record keeping are assigned to people who do not also handle the assets that they are accounting for. |  |
| ii. One employee should not initiate, approve, record, and have access to items involved in a transaction. |  |
| c. Restrict access—Access to assets and records should be provided on an as-needed basis. If it’s not needed to fulfill an employee’s assigned responsibilities, the employee should be denied access to it. |  |
| d. Document procedures—Without documents, a company wouldn’t know what transactions have already been or still need to be entered into its accounting system. To enhance this control further, most companies: |  |
| i. Assign a sequential number to each document |  |
| ii. Check at the end of every accounting period that each document number corresponds to one, and only one, entry in the accounting system |  |
| e. Independently verify—Independent verification can occur in various ways: |  |
| i. The most obvious is to hire someone (an internal auditor) to check that the work done by others within the company is appropriate and supported by documentation. Independent verification also can be made part of a person’s job. |  |
| ii. A final form of independent verification involves comparing the company’s accounting information to information kept by an independent third party. |  |

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| Chapter Outline | Teaching Notes |
| 5. Control Limitations—It is impossible for internal controls to prevent and detect all errors and fraud for two reasons: |  |
| a. Internal controls should be implemented only to extent that their benefits exceed their costs. | The “Spotlight on Controls” feature addresses other |
| b. People can make mistakes when performing control procedures, override (disarm) internal controls, or collude (work together) to get around them. | control procedures. |
| II. Internal Control for Cash |  |
| ***LO 5-3 Apply internal control principles to cash receipts and payments.*** | |
| A. Controls for Cash Receipts  Primary internal control goal is to ensure that the business receives the appropriate amount of cash and safely deposits it in the bank. | Internal controls for processing cash received in person are illustrated in exhibit 5.5 |
| 1. Cash Received in Person |  |
| a. Segregation of duties—Ensures that those who handle the cash (cashiers and supervisors) do not have access to those who record it (the accounting staff); if this segregation of duties did not exist, employees could steal the cash and cover up the theft by changing the accounting records. |  |
| i. A cashier is responsible for collecting cash and issuing a receipt at the point of sale |  |
| ii. A supervisor is responsible for taking custody of the cash at the end of each cashier’s shift and depositing it in the bank. |  |
| iii. Members of the accounting staff are responsible for ensuring that the receipts from cash sales are properly recorded in the accounting system. |  |
| b. Use of a cash register and its accompanying point-of-sale accounting system performs three functions: |  |
| i. Restrict access to cash (to reduce the risk of cash being lost or stolen). |  |
| ii. Document the amount charged for each item sold (to reduce errors by allowing customers to dispute overcharges should they occur). |  |
| iii. Summarize the total cash sales (to provide an independent record of the amount of cash the cashier should have collected and passed on for deposit at the bank). |  |
| c. Use of a cash count sheet documents the amount of cash the cashier received and determines any cash short or over that occurred during the shift. |  |
| i. Supervisor independently verifies each count sheet and prepares a daily cash receipts summary that summarizes all cashiers’ count sheets. |  |
| ii. Places the cash in a locked vault until it is taken to the bank. |  |

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| Chapter Outline | Teaching Notes |
| d. Use of a deposit slip that lists the amounts included in the deposit is prepared and presented to the bank – The bank teller verifies the deposit and stamps the deposit slip, which is then forwarded to the accounting department. |  |
| i. Independent verification: |  |
| * The accounting department compares the record of cash sales maintained by the cash register with the count sheet prepared by the cashier, the daily cash receipts summary prepared by the supervisor, and the stamped bank deposit slip. |  |
| * Ensures that the amount of cash rung up at the time of sale was deposited. |  |
| ii. A journal entry is prepared to record Sales Revenue at the amount rung up by the cash register and Cash at the amount deposited in the bank. |  |
| * Any difference is recorded in a Cash Shortage (or Overage) account. |  |
| * The Cash Shortage (or Overage) account is reported on the income statement as a miscellaneous expense (or revenue). |  |
| 2. Cash Received from a Remote Source |  |
| a. Cash Received by Mail | *To help students visualize,* |
| i. Businesses receive checks in the mail when customers pay on account. The clerk who opens the mail performs the functions of the cash register. | *Have them go back to Exhibit 5.5 and replace the cash register with a mail clerk and* |
| ii. The mail clerk lists all amounts received on the cash receipt list with customers’ names and purpose of each payment. | *remove Step 1* |
| iii. Remittance advice—The customer includes with the payment; it explains the purpose of the payment. |  |
| iv. Ideally, someone supervises the mail clerk to ensure that he or she takes no cash receipts for personal use; the mail clerk and supervisor sign the completed cash receipts list to evidence. |  |
| v. The mail clerk stamps each check “For Deposit Only” (to ensure that no one diverts the checks for personal use). |  |

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| Chapter Outline | | Teaching Notes |
| vi. The cash received is separated from the record of cash received. | |  |
| * Checks and money orders are given to the person who prepares the bank deposit whereas the cash receipts list and remittance advices are sent to the accounting department. | |  |
| * The accounting department then compares the total on the cash receipts list with the stamped deposit slip received from the bank; this comparison serves to independently verify that all cash received by mail was deposited in the bank | |  |
| * The accounting department then uses the cash receipts list to record the journal entries that debit Cash and credit Accounts Receivable from each customer | |  |
| b. Cash Received Electronically. | |  |
| i. Electronic funds transfer (EFT) – Occurs when a customer electronically transfers funds from its bank account to the company’s bank account; EFTs speed up collections. | |  |
| ii. Because these payments are deposited directly into the company’s bank account, EFTs eliminate the need for some internal controls. | |  |
| iii. The accounting department merely records journal entries to debit Cash and credit each customer’s account receivable. | |  |
| B. Controls for Cash Payments  Primary internal control is to ensure that the business pays only for properly authorized transactions. |  |
| 1. Cash Paid by Check for Purchases on Account |  |
| a. Businesses usually purchase goods and services on account and pay later by check. |  |
| b. **Voucher system**––A process for approving and documenting all purchases and payments made on account; a voucher is a collection of the documents prepared at each step in the system. | Steps, documentation, and controls in a voucher system are set forth in exhibit 5.6 |
| i. At each step, employee responsibilities are limited to specific tasks that occur only after obtaining and documenting proper authorization in the prior step. |  |
| ii. Purchasing, receiving, and bill payment duties are segregated to ensure that the company obtains and pays only for the goods or services that have been properly authorized. |  |

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| Chapter Outline | | Teaching Notes |
| c. Steps: |  |
| i. Purchase requisition prepared and approved by supervisor; copy to purchasing agent. |  |
| ii. Purchasing agent completes purchase order; copies to supplier (who is on preapproved list) and accounting department. |  |
| iii. Receiving report prepared when goods are received; copy to accounting department for use in preparing journal entry for purchase on account. |  |
| iv. When invoice is received from supplier, accounting department matches to purchase order and receiving report and prepares voucher package, which contains these supporting documents. |  |
| v. Check of EFT is prepared to pay for items purchased and received; voucher is then marked “paid” so that it cannot be resubmitted for duplicate payment. |  |
| 2. Cash Paid to Employees via Electronic Funds Transfer |  |
| a. Most companies pay cash to their employees through EFTs, which are known by employees as direct deposits. |  |
| i. Company initiates EFT by instructing bank to transfer the net pay due each employee directly from the company’s bank account to each employee’s checking account. |  |
| ii. Convenient and efficient for both the employer and employee. |  |
| iii. Risk is that the bank might accidentally overpay or underpay an employee by transferring the wrong amount of money; imprest system reduces risk. |  |
| b. **Imprest system**––A process that controls the amount paid to others by limiting the total amount of money available for making payments to others. |  |
| i. If the transfers occur without error, the special payroll account equals zero after all employees have been paid. |  |
| ii. If the account is overdrawn or a balance remains, the company knows an error has occurred. |  |

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| Chapter Outline | | Teaching Notes |
| 3. Cash Paid to Reimburse Employees (Petty Cash) |  |
| a. P**etty cash fund**—Asystem used to reimburse employees for expenditures they have made on behalf of the organization. |  |
| i. Acts as a control by establishing a limited amount of cash to use for specific types of expenses. |  |
| ii. Rather than transfer funds from a general bank account to another special account at the bank, the company removes cash from its general bank account to hold at its premises in a locked cash box |  |
| b. The company’s petty cash custodian is responsible for operating the petty cash fund; he or she should be supervised and the petty cash fund should be subject to surprise audits. | The “Spotlight on Controls” feature addresses the use of Pcards for small dollar transactions |
| III. Cash Reporting  The balance in a company’s cash records usually differs from the balance in the bank’s records for a variety of valid reasons |  |
| ***LO 5-4 Perform the key control of reconciling cash to bank statements.*** | | |
| A. Bank Statement |  |
| 1. **Bank reconciliation**––An internal report prepared to verify the accuracy of both the bank statement and the cash accounts of a business or individual. |  |
| 2. Checks cleared—The payee presents the check to a financial institution, which contacts the check writer’s bank, which in turn withdraws the amount of the check from the check writer’s account and reports it as a deduction on the bank statement; the check has then cleared the bank. | A bank statement is illustrated in Exhibit 5.7 |
| 3. Deposits made—Deposits are listed on the bank statement in the order in which the bank processes them. |  |
| 4. Other transactions—The balance in a bank account can change for a variety of other reasons. |  |
| a. The bank statement is presented from the bank’s point of view; the amounts in a company’s bank account are liabilities to the bank. |  |
| b. Increases are reported as credits on the bank statement. |  |
| c. Amounts that are removed from a bank account are reported as debits on the bank statement. |  |
| B. Bank Reconciliation |  |
| 1. Company’s records can differ from bank’s statement of account for two basic reasons: | Reconciling differences are listed in Exhibit 5.8 |
| a. The company has recorded some items that the bank doesn’t know about at the time it prepares the statement of account. |  |
| b. The bank has recorded some items that the company doesn’t know about until the bank statement arrives. |  |

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| Chapter Outline | | Teaching Notes |
| 2. Causes of differences: |  |
| a. Bank errors—If you discover a bank error, you’ll need to ask the bank to correct its records, but you should not change yours. |  |
| b. Time lags—Common: |  |
| i. Deposit in transit—Time lag occurs when you make a deposit after the bank’s normal business hours. You know you’ve made the deposit, but your bank doesn’t know until it processes the deposit the next day. |  |
| ii. Outstanding check—Occurs when you write and mail a check to a company, but your bank doesn’t find out about it until that company deposits the check in its own bank, which then notifies your bank. |  |
| c. Interest deposited—You probably do not know the amount of interest until you read your bank statement. |  |
| d. Electronic funds transfer (EFT)—Occasionally funds may be transferred into or out of your account without your knowledge. |  |
| e. Service charges—Amounts the bank charges you for processing your transactions. |  |
| f. **NSF (not sufficient funds) checks**––Another name for bounced checks; they arrive when the check writer (your customer) does not have sufficient funds to cover the amount of the check. |  |
| i. Because the bank increased your account when you first deposited the check, the bank will decrease your account when it discovers the deposit was not valid. |  |
| ii. You will need to reduce the Cash balance by the amount of these bounced checks (plus any additional bank charges), and you’ll have to try to collect the amount from the check writer. |  |
| g. Your errors—These are mistakes that you’ve made or amounts that you haven’t yet recorded in your checkbook. |  |
| 3. Bank Reconciliation Illustrated | Illustrated in Exhibit 5.9 |
| a. To prepare the bank reconciliation, the entries in the Cash account are compared to the bank statement with the following goals: | * Supplemental Enrichment Activity (Activity) #1 * Activity #2 |
| i. Identify the deposits in transit. |  |
| ii. Identify the outstanding checks. |  |
| iii. Record other transactions on the bank statement and correct your errors. |  |

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| Chapter Outline | | Teaching Notes |
| b. Journal entries that will bring the Cash account to that balance are then prepared and recorded. |  |
| i. Entries on the Bank Statement side of the bank reconciliation do not need to be adjusted because they will work out automatically when the bank processes them next month. | The “Spotlight on Controls” |
| ii. Only the items on the Company’s Books side of the bank reconciliation need to be recorded in the company’s records. | feature addresses frauds committed by “trustworthy” employees. |
| ***LO 5-5 Explain the reporting of cash.*** | | |
| C. Reporting Cash—Cash, as reported on the balance sheet, includes: cash deposited with banks, petty cash on hand, and cash equivalents. | |  |
| 1. **Cash**––Money or any instrument that banks will accept for deposit and immediate credit to a company’s account, such as a check, money order, or bank draft. | |  |
| 2. **Cash equivalents**––Short-term, highly liquid investments purchased within three months of maturity; equivalent to cash because they are both readily convertible to known amounts of cash and so near to maturity that there is little risk their value will change. | |  |
| D. **Restricted cash**––Not available for general use but rather restricted for a specific purpose. | |  |
| 1. Restricted cash must be reported separately on the balance sheet. | |  |
| 2. Classification on balance sheet: | |  |
| a. Restricted cash that is expected to be used up within a year would be classified as a current asset. | |  |
| b. Restricted cash that is not expected to be used up within a year would be classified as a noncurrent asset. | |  |
| III. Petty Cash Systems | |  |
| ***LO 5-S1 Describe the operations of petty cash systems.*** | | |
| A. A petty cash system involves three steps: | |  |
| 1. Putting money into petty cash to establish a fund. | |  |
| a. The company establishes the fund by writing a check to the petty cash custodian; the amount of the check equals the total estimated payments to be made from the fund over a fairly short period. | |  |
| b. Entry includes debit to Petty Cash and credit to Cash. | |  |

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| Chapter Outline | Teaching Notes |
| 2. Paying money out to reimburse others. |  |
| a. The custodian determines when to make payments out of the cash box following policies established by the company’s managers. |  |
| b. The custodian attaches any related documents to the petty cash receipt and places it in the cash box. |  |
| c. Payments out of petty cash are not recorded in the accounting system until the fund is replenished. |  |
| 3. Putting money back into petty cash to replenish the fund. |  |
| a. When the amount of cash in the cash box runs low, the petty cash custodian asks that the fund be replenished. |  |
| b. The amount of the check is recorded as a reduction in Cash (with a credit), and the various items that were paid are recorded in their corresponding accounts (with debits). |  |

# Supplemental Enrichment Activities

Note: These activities would be suitable for individual or group activities.

1. Handout 5**–**1

Use Handout 5**–**1 for an in-class activity designed to review the preparation of a bank reconciliation. The solution follows the handout master.

1. Handout 5**–**2

Use Handout 5**–**2 for a second in-class activity designed to review the preparation of a bank reconciliation. The solution follows the handout master.

# HANDOUT 5–1

**BANK RECONCILIATION**

Information from the records and bank statement and of Matrix, Inc. as of July 31, 2016 is set forth below

|  |  |
| --- | --- |
| Cash balance per bank, July 31, 2016 | $9,610 |
| Cash balance per general ledger, July 31, 2016 | 7,430 |
| Outstanding checks at July 31, 2016 | 2,417 |
| Check mailed to the bank for deposit that had not reached the bank by July 31, 2016 | 500 |
| NSF check (from a customer for a payment on account) returned by bank | 281 |
| July interest earned per bank statement | 30 |
| Check no. 781 for supplies expense cleared the bank for $240, but was erroneously recorded in the books at $268 |  |
| Deposit by Acme Company erroneously credited by the bank to our account | 486 |

**Part A**

Prepare the bank reconciliation for Matrix, Inc.

**HANDOUT 5–1, continued**

**Part B**

Prepare any journal entries that should be made as a result of the bank reconciliation.

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| Date | Accounts | Debit | Credit |
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**HANDOUT 5–1 SOLUTION**

**BANK RECONCILIATION**

Information from the records and bank statement and of Matrix, Inc. as of July 31, 2016 is set forth below

|  |  |
| --- | --- |
| Cash balance per bank, July 31, 2016 | $9,610 |
| Cash balance per general ledger, July 31, 2016 | 7,430 |
| Outstanding checks at July 31, 2016 | 2,417 |
| Check mailed to the bank for deposit that had not reached the bank by July 31, 2016 | 500 |
| NSF check (from a customer for a payment on account) returned by bank | 281 |
| July interest earned per bank statement | 30 |
| Check no. 781 for supplies expense cleared the bank for $240, but was erroneously recorded in the books at $268 |  |
| Deposit by Acme Company erroneously credited by the bank to our account | 486 |

**Part A**

Prepare the bank reconciliation for Matrix, Inc.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Matrix, Inc. | | | | |
| Bank Reconciliation | | | | |
| July 31, 2016 | | | | |
|  |  |  |  |  |
| Updates to Bank Statement | |  | Updates to Company’s Books | |
| July 31 cash balance | $9,610 |  | July 31 cash balance | $7,430 |
| Additions: |  |  | Additions: |  |
| Deposit in transit | 500 |  | Interest earned | 30 |
| Deductions: |  |  | Recording error check 781 | 28 |
| Bank error | (486) |  | Deductions: |  |
| Outstanding checks | (2,417) |  | NSF check | (281) |
| Up-to-date cash balance | $7,207 |  | Up-to-date cash balance | $7,207 |
|  |  |  |  |  |

**HANDOUT 5–1 SOLUTION, continued**

**Part B**

Prepare any journal entries that should be made as a result of the bank reconciliation.

|  |  |  |  |
| --- | --- | --- | --- |
| Date | Accounts | Debit | Credit |
| July 31 | Cash | 30 |  |
|  | Interest Revenue |  | 30 |
|  |  |  |  |
| July 31 | Cash | 28 |  |
|  | Supplies Expense |  | 28 |
|  |  |  |  |
| July 31 | Accounts Receivable | 281 |  |
|  | Cash |  | 281 |

**HANDOUT 5–2**

**BANK RECONCILIATION**

Prepare the bank reconciliation for Donna’s Day Care using the following information:

|  |  |
| --- | --- |
| Cash balance per bank, June 30, 2016 | $5,586 |
| Cash balance per general ledger, June 30, 2016 | 5,055 |
| Outstanding checks, June 30, 2016 | 1,816 |
| Deposit in transit, June30, 2016 | 750 |
| NSF check (from a customer for a payment on account) returned by bank | 450 |
| June interest earned per bank statement | 15 |
| Check no. 800 in payment of accounts payable cleared the bank for $1,100, but was erroneously recorded in the books at $800 |  |
| Deposit in amount of $6,000, recorded properly on books, erroneously credited on bank statement as $6,200 |  |

**Part A**

Prepare the bank reconciliation for Donna’s Day Care.

**HANDOUT 5–2, continued**

**Part B**

Prepare any journal entries that should be made as a result of the bank reconciliation.

|  |  |  |  |
| --- | --- | --- | --- |
| Date | Accounts | Debit | Credit |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |

**HANDOUT 5–2 SOLUTION**

**BANK RECONCILIATION**

Prepare the bank reconciliation for Donna’s Day Care using the following information:

|  |  |
| --- | --- |
| Cash balance per bank, June 30, 2016 | $5,586 |
| Cash balance per general ledger, June 30, 2016 | 5,055 |
| Outstanding checks, June 30, 2016 | 1,816 |
| Deposit in transit, June30, 2016 | 750 |
| NSF check (from a customer for a payment on account) returned by bank | 450 |
| June interest earned per bank statement | 15 |
| Check no. 800 in payment of accounts payable cleared the bank for $1,100, but was erroneously recorded in the books at $800 |  |
| Deposit in amount of $6,000, recorded properly on books, erroneously credited on bank statement as $6,200 |  |

**Part A**

Prepare the bank reconciliation for Donna’s Day Care.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Donna’s Day Care | | | | |
| Bank Reconciliation | | | | |
| June 30, 2016 | | | | |
|  |  |  |  |  |
| Updates to Bank Statement | |  | Updates to Company’s Books | |
| June 30 cash balance | $5,586 |  | June 30 cash balance | $5,055 |
| Additions: |  |  | Additions: |  |
| Deposit in transit | 750 |  | Interest earned | 15 |
| Deductions: |  |  | Deductions: |  |
| Bank error | (200) |  | Recording error check 800 | (300) |
| Outstanding checks | (1,816) |  | NSF check | (450) |
| Up-to-date cash balance | $4,320 |  | Up-to-date cash balance | $4,320 |
|  |  |  |  |  |

**HANDOUT 5–2 SOLUTION, continued**

**Part B**

Prepare any journal entries that should be made as a result of the bank reconciliation.

|  |  |  |  |
| --- | --- | --- | --- |
| Date | Accounts | Debit | Credit |
| June 30 | Cash | 15 |  |
|  | Interest Revenue |  | 15 |
|  |  |  |  |
| June 30 | Accounts Payable | 300 |  |
|  | Cash |  | 300 |
|  |  |  |  |
| June 30 | Accounts Receivable | 450 |  |
|  | Cash |  | 450 |