

## ACCT 100 - INTRODUCTION TO ACCOUNTING

### Chapter 9 - Bank Accounts and Cash Funds

Prof. Johnson

Note: I believe that this chapter will be one of the most important ones for your own personal financial lives. EVERYONE needs to have a basic understanding of how to manage your cash. Please give this chapter extra attention.

#### **Where we have been:**

We have finished the accounting cycle for a service-oriented business. (Can you list the steps of the accounting cycle in the proper order?) We have also looked at the accounting cycle for a merchandising business. We have come a long way since the beginning of the semester!

#### **Where we are going:**

We are now going to move into some more specialized topics. One of these topics is cash. THIS IS THE MOST IMPORTANT AND RELEVANT TOPIC THAT WE WILL COVER DURING THE SEMESTER. EVERY PERSON in this room needs to know how to record and reconcile their cash receipts and payments. PAY ATTENTION to the concepts in this chapter.

#### **Some General Comments about Cash:**

Cash is a very important asset. You can't do much without it. It is the most liquid of all assets and investments, and therefore tends to be one of the easiest assets to divert if certain controls are not in place. The management of cash, and the ways in which we bank have undergone a good deal of change lately, thanks mainly in part to the increased use of technology. Although the ways in which we bank have changed, many of the fundamental internal controls over cash have not. One of the most important things you can learn in this class is how to properly reconcile your checking account. This will be a major topic of this chapter.

#### **Cash Receipts:**

Cash receipts come in different forms depending on the type of business. The most common type of cash receipts are

- Over the counter
- Through the mail
- Remittances on account

We have already learned how to record these types of transactions in a previous

chapter. This chapter introduces the concept of what to do when a cash shortage or overage occurs. When the sales receipt does NOT EQUAL the amount of cash collected, we need to account for this. The account **Cash Short or Over** will be debited for shortages and credited for overages. Depending on the balance accumulated at the end of the year, it will be recorded as an expense on the income statement (if a net shortage) or a revenue on the income statement (if a net overage.)

Although not as common, another type of cash receipt when a company collects an amount due on a note receivable. You should be familiar with the basic JE for this transaction including the JE for conversion from an A/R to a N/R and also for the collection.

### **Petty Cash - We will not cover**

### **Internal Controls - What are they?**

Internal controls are procedures that must take place within a business to help safeguard assets against theft and misappropriations or misuse. These procedures should address an overall plan to safeguard all assets. It should also address specific items like who handles cash, where the cash goes, how it is recorded, and who and how it is reconciled, among a long laundry list of other items.

## **BANKING PROCEDURES**

### **Some basic internal control safeguards:**

(There are many of these. The following are listed as an example of some of them.)

- All payments should be made with checks - **You should be familiar with the basic parties to a check** and of course know how to write one.
- All cash that comes in should be deposited immediately
- Do not write checks when cash is not available (sounds logical - but you wouldn't believe how many people disregard this one)
- Personal checks should be endorsed immediately
- Signature cards should be maintained and updated annually
- Consideration should be given to requiring more than one signature on checks
- Preprinted deposit slips should be used
- Checks should be pre-numbered and all checks should be accounted for
- Checks should be placed in a locked cabinet with limited access
- Cash should be reconciled at least monthly
- The reconciliation process should be done by someone who does not record or touch cash
- In retail establishments, cash drawers should be reconciled to the sales register tape daily (as we will discuss later in the chapter)
- **Some basic documents that are important in this chapter:** (Your book does a good job of explaining them.)
  - Signature Cards
  - Deposit Slips

- Checks
- Bank Statements
- You should be familiar with the basic purposes and general appearance of all of the above. \_
- **The most important thing you will learn THIS WHOLE SEMESTER: How to reconcile your cash account (i.e. your checkbook) to the bank statement:**
- The bank statement represents an independent (or second party) proof of your cash activity. It is one of the most important things you can do to insure the accuracy of your cash. A bank reconciliation is exactly what the name implies - a bringing together (a reconciliation) of the two balances: YOURS AND THE BANKS!
- If your cash balance exactly matched the bank's cash balance, there would not be any reason to reconcile the account. THIS RARELY (IF EVER) HAPPENS. Most of the time, this is due to timing differences between you and the bank. This does not necessarily mean that there are errors - just a lag in time between when items get recorded. What you need to concern yourself with are items that don't match up between your records and the bank records. You must go through a comparison process to highlight these items as follows:

### **Steps in the bank reconciliation process: Do the legwork first!**

- You need your checkbook (or general ledger cash account if you are doing the company's books) and the bank statement:
  - Make sure that any reconciling items (due to timing differences) from the previous month have cleared. If they do, check them off. If not, circle them. These items are still outstanding and must be carried forward to this month's reconciliation.
  - Compare the deposits listed in your records to the deposits listed on bank statement. Check off those that match. Circle those that don't.
  - Compare the checks listed in your checkbook to the checks that cleared the bank, via the bank statement. Check off those that have cleared, and circle those that don't.
  - Compare any debit or credit memos per the bank statement to your records. (Remember that banks have their debits and credits backwards!) Circle any items that don't match.
  - Check out any other items per your checkbook (or G/L) that have not been checked off.

The circled amounts represent differences between you and the bank or reconciling items. These must be placed in the appropriate place of the bank reconciliation as described below:

### **I know what the differences are - Now What???**

Finding the differences is the time consuming part. What you need to remember is where these differences go in the bank reconciliation. I have found that students prefer a side-by-side presentation as shown below:

<b>BANK</b>		<b>BOOKS</b>	
Balance per Bank	XXX	Balance per Books or G/L	XXX
-			
<b>Add: Deposits In Transit</b>		<b>Add: Collections</b>	<b>XXX</b>
	<b>XXX</b>	<b>Interest Earned (not allowed on corporate accounts)</b>	
<b>Less: Outstanding Checks</b>	<b>(XXX)</b>	<b>Less: Fees</b>	<b>(XXX)</b>
		<b>Deposited NSF checks</b>	
<b>+/- Bank errors</b>	_____	<b>+/- Our errors</b>	_____
<b>Adjusted bank balance</b>	<b>XXX</b>	<b>Adjusted book balance</b>	<b>XXX</b>

***THESE BALANCES MUST MATCH WHEN YOU ARE DONE!!!***

**Are my books fixed?**

Almost. You have performed the reconciliation. But, as you know from previous chapters, the only way to get something formally into the accounting records is to journalize a transaction. Now, we don't care about the bank side-these items are the bank's problems and besides most of them are timing differences that will go away next month. What we must adjust for are any entries made on the right hand side or on the book side.

**How do you make the adjustments?**

Increases to cash will require that the cash account be debited. Decreases to cash will require that the cash account be credited. The offsetting entry will depend on the nature of the adjustment. We will discuss this further in class.

## Some more info on some other topics:

### The Change Fund

Simply stated, this is a cash fund that is placed in the cash drawer at the start of each day in order to make change for our customers. The amount and denominations stay the same. This is what's called an imprest account, because the amount doesn't change, and the funds are not deposited daily. The cash change fund account is only touched when it is established (for the initial dollar amount). It is not touched again unless it is later decided that the amount needs to be changed. The amount of the change fund is subtracted from the day's receipts and should be balanced against the sales tape. Small differences are expected and should be recorded to a cash short and over account. (See details on account below.) Big differences should be investigated.

### Cash short and over (described briefly above)

Purpose:	This account is used to track daily overages and shortages. The net balance is usually insignificant.
Type of account:	Revenue or Expense depending on the balance.
Normal balance of account:	Shortages are more common, so a <b>debit balance</b> is more likely.
Financial Statement Presentation:	Income Statement

### Other Important Stuff:

#### Endorsements

An endorsement is required before the bank will accept a check. An endorsement transfers title, but more importantly, it guarantees payment. (If the check bounces, the bank will deduct it from the person's account who deposited it.) There are several types of endorsements that you need to be familiar with:

- Restrictive Endorsements - restricts who can transfer the check
- Blank Endorsement - no restriction on who can transfer the check
- Qualified Endorsement - an endorsement which places a specific restriction on it, usually without recourse

#### Terms and Definitions

There are a lot of these listed throughout the chapter. Be familiar with the terms. You should be very familiar with the different types of reconciling items, such as:

- Deposits in Transit
- Outstanding Checks
- NSF Checks
- Promissory Notes
- Service Charges
- Debit Memos
- Credit Memos

You should also be familiar with generic terms such as EFTs, ATMs, etc.

**The best practice for this chapter is to go home and reconcile your own checkbook!**