ACCT 101 – Fundamentals of Accounting
Chapter 6 – Cash and Internal Controls
Prof. Johnson

<u>Where we have been</u>:
We have finished the accounting cycle for a merchandiser. We also spent time discussing inventory issues which are very important to a merchandiser. Now your author is going to take us through the Balance Sheet on an account by account basis. The first account on the Balance Sheet is Cash. That is the focus of the chapter.

<u>Where we are going</u>:
We are now going to move into some more specialized topics. One of these topics is cash. Other line items on the Balance Sheet will follow.

<u>Some General Comments about Cash</u>:
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.

<u>Internal Controls – What are they?</u>
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.

Legislation has dramatically changed how internal controls are assessed. The Sarbanes-Oxley Act of 2002 (often referred to as "Sox") came about after heavily publicized scandals, such as Enron, WorldCom, and Tyco caused investors and creditors to lose millions -- if not billions - of dollars. It is one of the most important laws affecting publicly held companies in recent history. It highlighted the need to assess financial controls and report on such for all publicly traded companies. Since the act was enacted, fraud of theft have decreased dramatically and public accounting firms have been forced to spend lots of time assessing companies internal controls. This act even required companies and auditors to specifically report on the effectiveness of internal controls.

Objectives of internal controls: You can read about these in your text. Some of the more important objectives are to assure that the system protects assets, ensures reliable reporting, promotes efficient operations, and urges adherence to company policies. There are many important concepts discussed in your book related to internal controls. Some of these include

1 Establishing responsibilities
2 Maintain adequate records
3 Insure assets and bond key employees
4 Separate the recordkeeping from the custody of the assets
5 Divide responsibility for related operations.
6 Apply technological controls.
7 Perform regular and independent reviews

You should READ and be familiar with these concepts

Cash: What is it? Cash and Cash equivalents are liquid assets that can be readily used to pay for obligations. Cash includes currency, coins, and amounts on deposit in bank accounts, and many savings accounts. Cash also includes items that are acceptable for deposit in these accounts, such as customer checks, certified checks, cashier's checks, and money orders. Cash Equivalents are short-term, highly liquid investments that are (1) readily convertible to cash and (2) sufficiently close to their due date so that the market value is not sensitive to interest rate changes.

Cash Management

Goals are to plan cash receipts to meet cash payments when due and to keep a minimum level of cash necessary to operate. Effective cash management includes the following:

- Encourage collection of receivables
- Delay payment of liabilities
- Keep only necessary levels of assets.
- Plan Expenditures
- Invest Excess Cash

Control of Cash Receipts

- Over the Counter -
- Cash Receipts through the mail - **Control of Cash Disbursements**

- Read about the voucher system
- Read about Petty Cash

Banking Activities as Controls

Some basic internal control safeguards related to cash:

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

- All payments should be made with checks
- 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)

<u>Some basic documents that are important in this chapter</u>: (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.

<u>The most important thing you will learn in this chapter: How to reconcile your cash account (i.e. your checkbook) to the bank statement</u>: Note: **This should be a review from your ACCT 100 class**.

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:

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BANK		BOOKS	
Balance per Bank	XXX	Balance per Books or G/L	XXX
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Add: Deposits In Transit	**XXX**	**Add: Collections**	**XXX**
		Interest Earned (not allowed on corporate accounts)	
Less: Outstanding Checks	**(XXX)**	**Less: Fees**	**(XXX)**
		Deposited NSF checks	