

CHAPTER 7

Fraud, Internal Control, and Cash

Learning Objectives

1. Define fraud and internal control.
2. Identify the principles of internal control activities.
3. Explain the applications of internal control principles to cash receipts.
4. Explain the applications of internal control principles to cash disbursements.
5. Prepare a bank reconciliation.
6. Explain the reporting of cash.
7. Discuss the basic principles of cash management.
8. Identify the primary elements of a cash budget.
9. Explain the operation of a petty cash fund.

Summary of Questions by Learning Objectives and Bloom's Taxonomy

Item	LO	BT	Item	LO	BT	Item	LO	BT	Item	LO	BT	Item	LO	BT
Questions														
1.	1	C	7.	2	C	13.	2	C	19.	4	C	24.	7	C
2.	1	C	8.	2	C	14.	6	AP	20.	4	K	25.	5	C
3.	1	C	9.	2	C	15.	3	C	21.	5	K	26.	6	C
4.	1	C	10.	2	C	16.	3	C	22.	5	C	27.	6	C
5.	1	K	11.	2	C	17.	3	C	23.	5	C	28.	9*	C
6.	2	C	12.	2	C	18.	4	C						
Brief Exercises														
1.	1	C	4.	3	C	7	4	C	10.	5	AP	13.	8	AP
2.	2	C	5.	3	AP	8.	5	C	11.	5	AP	14.	9*	AP
3.	2	C	6.	4	C	9.	5	C	12.	6	C			
Do It Review Exercises														
1.	2	C	2.	3	C	3.	5	K	4.	8	AP			
Exercises														
1.	2	C	5.	2, 4	E	8.	5	AP	11.	5	AP	14.	8	AP
2.	2	C	6.	5	AP	9.	5	AP	12.	6	AP	15.	9*	AP
3.	2, 3	E	7.	5	AP	10.	5	AP	13.	7	C	16.	9*	AP
4.	2, 4	E												
Problems: Set A														
1.	2, 3	C	3.	5	AP	5.	5	AP	7.	8	AP	8.	2, 3, 4, 5	E
2.	2, 3, 4	C	4.	5	AP	6.	8	AP						
Problems: Set B														
1.	2, 3	C	3.	5	AP	5.	5	AP	7.	8	AP	8.	2, 3, 4, 5	E
2.	2, 3, 4	C	4.	5	AP	6.	8	AP						

*Continuing Cookie Solutions for this chapter are available online.

ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Identify internal control weaknesses for cash receipts.	Simple	20–30
2A	Identify internal control weaknesses in cash receipts and cash disbursements.	Simple	20–30
3A	Prepare a bank reconciliation and adjusting entries.	Simple	20–30
4A	Prepare a bank reconciliation and adjusting entries from detailed data.	Moderate	40–50
5A	Prepare a bank reconciliation and adjusting entries.	Moderate	30–40
6A	Prepare a cash budget.	Moderate	30–40
7A	Prepare a cash budget.	Moderate	30–40
8A	Prepare a comprehensive bank reconciliation with theft and internal control deficiencies.	Complex	40–50
1B	Identify internal control principles for cash disbursements.	Simple	20–30
2B	Identify internal control weaknesses in cash disbursements.	Simple	20–30
3B	Prepare a bank reconciliation and adjusting entries.	Simple	20–30
4B	Prepare a bank reconciliation and adjusting entries from detailed data.	Moderate	40–50
5B	Prepare a bank reconciliation and adjusting entries.	Moderate	30–40
6B	Prepare a cash budget.	Moderate	30–40
7B	Prepare a cash budget.	Moderate	30–40
8B	Prepare a comprehensive bank reconciliation with theft and internal control deficiencies.	Complex	40–50

ANSWERS TO QUESTIONS

1. Fraud is a dishonest act by an employee that results in personal benefit to the employee at a cost to the employer. An example of fraud that might occur at a bank would be a computer operator embezzling funds by transferring a customer's deposits into another account.
2. The three main factors that contribute to employee fraud are opportunity, financial pressure, and rationalization. Opportunities that an employee can take advantage of occur when the workplace lacks sufficient controls to deter and detect fraud. Financial pressure occurs when employees want to lead a lifestyle that they cannot afford on their current salary. Rationalization involves employees justifying fraud because they believe they are underpaid while their employer is making lots of money.
3. The five components of a good internal control system are: (1) A control environment, (2) Risk assessment, (3) Control activities, (4) Information and communication, and (5) Monitoring.
4. Disagree. Internal control is also concerned with the safeguarding of company assets, increasing efficiency of operations, and ensuring compliance with laws and regulations.
5. The Sarbanes-Oxley Act requires that a company develop sound principles of internal control over financial reporting and continually verify that these controls are working. The act specifically requires top management to attest that the company's internal controls are reliable and effective.
6. The principles of internal control that apply to most businesses are: (a) establishment of responsibility, (b) segregation of duties, (c) documentation procedures, (d) physical controls, (e) independent internal verification, and (f) human resource controls.
7. Yes, this is a violation of the internal control principle of establishing responsibility. In this case, each sales clerk should have a separate cash register or cash register drawer.
8. The two applications of segregation of duties are:
 - (1) The responsibility for related activities should be assigned to different individuals.
 - (2) The responsibility for record keeping for an asset should be separate from the physical custody of that asset.
9. Documentation procedures contribute to good internal control by providing evidence of the occurrence of transactions and events and, when signatures (or initials) are added, the documents establish responsibility for the transactions. The prompt transmittal of documents to accounting contributes to recording transactions in the proper period, and the prenumbering of documents helps to ensure that a transaction is not recorded more than once or not at all.
10. Safes, vaults, and locked warehouses contribute to the safeguarding of company assets. Cash registers and computerized accounting equipment contribute to the accuracy and reliability of the accounting records, and electronic burglary systems and sensors help to safeguard assets.

Questions Chapter 7 (Continued)

11. (a) Independent internal verification involves the review, comparison, and reconciliation of data prepared by employees.
(b) Maximum benefit is obtained from independent internal verification when:
(1) The verification is made periodically or on a surprise basis.
(2) The verification is done by an employee who is independent of the personnel responsible for the information.
(3) Discrepancies and exceptions are reported to a management level that can take appropriate corrective action.
12. (a) The concept of reasonable assurance means that the costs of establishing control procedures should not exceed their expected benefit. Ordinarily, a system of internal control provides reasonable but not absolute assurance, since absolute assurance would be too costly.
(b) The human element is an important factor in a system of internal control. A good system may become ineffective as the result of employee fatigue, carelessness, or indifference. Moreover, internal control may become ineffective as a result of collusion.
13. The human resources department plays an important role in internal control by
(a) bonding employees who handle cash,
(b) rotating employees' duties and requiring employees to take vacations,
(c) conducting thorough background checks.
14. Cash should be reported at \$21,100 (\$8,000 + \$1,100 + \$12,000).
15. Daily cash counts pertain primarily to the principles of segregation of duties, documentation procedures, and independent internal verification. Daily cash counts also involve the establishment of responsibility for performing the counts.
16. Cash registers are readily visible to the customer. Thus, they prevent the sales clerk from ringing up a lower amount and pocketing the difference. In addition, the customer receives an itemized receipt, and the cash register tape is locked into the register for further verification, providing documentation and enabling independent internal verification.
17. Two mail clerks contribute to a more accurate listing of mail receipts and to the endorsement of all checks "For Deposit Only." In addition, two clerks reduce the likelihood of mail receipts being diverted to personal use.
18. True. Payment by check contributes to effective internal control over cash disbursements. However, effective control is also possible when small payments are made from petty cash.
19. The procedure and related principle are:
- | <u>Procedure</u> | <u>Principle</u> |
|---|--------------------------------------|
| (1) Treasurer signs checks. | • Establishment of responsibility. |
| (2) Checks imprinted by a checkwriter. | • Physical controls. |
| (3) Comparing check with approved invoice before signing. | • Independent internal verification. |

Questions Chapter 7 (Continued)

20. (a) Physical controls apply to cash disbursements when blank checks are stored in a safe, and access to the safe is restricted to authorized personnel, and a check-writing machine is used to print amounts on checks with indelible ink.
(b) Human resource controls apply when the company bonds personnel who handle cash, requires employees to take vacations, and conducts background checks.
21. Electronic funds transfer is a cash disbursement system that uses wire, telephone, or computers to transfer cash balances from one location to another.
22. True. A bank contributes significantly to internal control over cash because it: (1) safeguards cash on deposit, (2) minimizes the amount of cash that must be kept on hand, and (3) provides a double record of all bank transactions.
23. The lack of agreement between the balances may be due to either:
(1) Time lags—a check written in July does not clear the bank until August.
(2) Errors—a check for \$110 is recorded by the depositor as \$101.
24. The basic principles of cash management are: (1) increase the speed of receivables collection, (2) keep inventory low, (3) monitor payment of liabilities, (4) plan timing of major expenditures, and (5) invest idle cash.
25. (a) An NSF check occurs when the checkwriter's bank balance is less than the amount of the check.
(b) In a bank reconciliation, a customer's NSF check is deducted from the balance per books.
(c) An NSF check results in an adjusting entry in the company's books, as a debit to Accounts Receivable and a credit to Cash.
26. (a) Cash equivalents are short-term highly liquid investments that may be converted to a specific amount of cash. Cash equivalents may be reported with cash in the current assets section of the balance sheet.
(b) Cash restricted for a special purpose should be reported separately as a current or noncurrent asset depending on when the cash is expected to be used.
27. At December 31, 2011, Tootsie Roll reported cash and cash equivalents of \$78,612,000. It reported no restricted cash. In Note 1 to its financial statements it defines cash equivalents as "temporary cash investments with an original maturity of three months or less."
- *28. The activities in a petty cash system and the related principles are:
- | | |
|------------------------------------|---|
| (a) (1) Establishing the fund. | • Establishment of responsibility for custody of the fund. |
| (2) Making payments from the fund. | • Documentation procedures because the custodian must use a prenumbered petty cash receipt. |
| (3) Replenishing the fund. | • Independent internal verification because the request for replenishment must be approved before the check is written. |
- (b) Journal entries are required for a petty cash fund when it is established and replenished. Entries are also required when the size of the fund is increased or decreased.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 7-1

- (a) Financial Pressure**
- (b) Rationalization**
- (c) Financial Pressure**
- (d) Opportunity**

BRIEF EXERCISE 7-2

The purposes of internal control are to:

- 1. Safeguard a company's assets from employee theft, robbery, and unauthorized use. An application for Brighan Co. is the use of a cash register to safeguard assets.**
- 2. Enhance the accuracy and reliability of a company's accounting records by reducing the risk of errors (unintentional mistakes) and irregularities (intentional mistakes and misrepresentations) in the accounting process. An application for Brighan Co. is preparation of a bank reconciliation.**
- 3. Increase efficiency of operations. An application is assignment of responsibility to specific employees.**
- 4. Ensure compliance with laws and regulations. An application is use of cash register tapes to document sales and applicable sales taxes.**

All of these purposes are important to the success of any business endeavor.

BRIEF EXERCISE 7-3

- (a) Segregation of duties.**
- (b) Independent internal verification.**
- (c) Documentation procedures.**

BRIEF EXERCISE 7-4

- (a) Physical controls.
- (b) Human resource controls.
- (c) Independent internal verification.
- (d) Segregation of duties.
- (e) Establishment of responsibility.

BRIEF EXERCISE 7-5

Cash (\$1,125.74 – \$150.00)	975.74	
Cash Over and Short.....	12.88	
Sales Revenue		988.62

BRIEF EXERCISE 7-6

- (a) Documentation procedures.
- (b) Independent internal verification.
- (c) Physical controls.
- (d) Establishment of responsibility.
- (e) Segregation of duties.

BRIEF EXERCISE 7-7

- (a) The use of a checking account minimizes the amount of currency that must be kept on hand. Therefore, cash is safeguarded by using the bank as a depository and clearinghouse for checks written and received.
- (b) A bank statement provides a double record of a depositor's bank transactions. It also is used in making periodic independent bank reconciliations.

BRIEF EXERCISE 7-8

- (a) Outstanding checks—deducted from cash balance per bank.
- (b) Bank service charge—deducted from cash balance per books.
- (c) Collection of note by bank—added to cash balance per books.
- (d) Deposit in transit—added to cash balance per bank.

BRIEF EXERCISE 7-9

- (a) The reconciling items per the books, items (b) and (c) above, will require adjustment on the books of the depositor.
- (b) The other reconciling items, deposits in transit and outstanding checks, do not require adjustment because they have already been recorded on the depositor's books.

BRIEF EXERCISE 7-10

Cash balance per bank statement.....	\$7,291
Add: Deposits in transit	<u>1,350</u>
	8,641
Less: Outstanding checks	<u>762</u>
Adjusted cash balance per bank.....	<u>\$7,879</u>

BRIEF EXERCISE 7-11

Checks written in November.....	\$ 9,750
Less: Checks paid by bank in November	<u>8,800</u>
Checks outstanding at the end of November.....	950
Add: Checks written in December.....	11,762
Less: Checks paid by bank in December	<u>10,889</u>
Checks outstanding at the end of December.....	<u>\$ 1,823</u>

BRIEF EXERCISE 7-12

Span Company should report cash in bank and payroll bank account as current assets. Plant expansion fund cash should be reported as restricted cash, a non-current asset, assuming the fund is not expected to be used during the next year.

BRIEF EXERCISE 7-13

CONGER COMPANY Cash Budget For the Month of January

Beginning cash balance	\$12,000
Add: Cash receipts	<u>59,000</u>
Total available cash.....	71,000
Less: Cash disbursements.....	<u>67,000</u>
Excess of available cash over cash disbursements	4,000
Add: Borrowings	<u>5,000</u>
Ending cash balance.....	<u>\$ 9,000</u>

*BRIEF EXERCISE 7-14

Mar. 20	Postage Expense.....	40	
	Supplies	26	
	Travel Expense.....	15	
	Cash.....		81

SOLUTIONS TO DO IT! REVIEW EXERCISES

DO IT! 7-1

1. Violates the control activity of *documentation procedures*. Source documents should be promptly forwarded to the accounting department so accounting entries can be made. This control activity helps to ensure timely recording of sales transactions and contributes directly to the accuracy and reliability of the accounting records.
2. Violates the control activity of *segregation of duties*. Different individuals should be responsible for related activities, such as these three related purchasing activities. Many abuses could occur: placing orders with friends and getting kickbacks; approving fictitious invoices for payment.
3. Violates the control activity of *establishment of responsibility*. Guillen's would be unable to determine who was responsible for a cash shortage; this lapse could even encourage employee theft.

DO IT! 7-2

All mail receipts should be opened in the presence of two mail clerks. Those mail clerks should immediately stamp each check "For Deposit Only." The mail clerks should prepare, in triplicate, a list of the checks received each day. The checks and the original copy of the list should be sent on to the cashier's department each day. A copy of the list is sent to the accounting department for recording in the accounting process. The clerks also keep a copy.

DO IT! 7-3

Doug should treat the reconciling items as follows:

1. Outstanding checks: Deduct from balance per bank.
2. A deposit in transit: Add to balance per bank.
3. The bank charged to our account a check written by another company: Add to balance per bank and notify the bank of its error.
4. A debit memorandum for a bank service charge: Deduct from balance per books.

DO IT! 7-4

Beginning cash balance.....	\$ 12,270
Add: Cash receipts for September.....	<u>97,200</u>
Total available cash.....	109,470
Less: Cash disbursements for September.....	<u>115,000</u>
Excess (deficiency) of available cash over cash disbursements	(5,530)
Add: Borrowings.....	<u>13,530</u>
Ending cash balance	<u><u>\$ 8,000</u></u>

To maintain the desired minimum cash balance of \$8,000 Hull must borrow \$13,530 of cash.

SOLUTIONS TO EXERCISES

EXERCISE 7-1

The principles of internal control inherent in the “maker-checker” procedure are:

1. **Segregation of duties.** The employee records the transactions. The supervisor verifies and approves the transactions.
2. **Physical controls.** Access to the computer system is password-protected and task-specific.

EXERCISE 7-2

1. **Establishment of responsibility.** The counter clerk is responsible for handling cash. Other employees are responsible for making the pizzas.
2. **Segregation of duties.** Employees who make the pizzas do not handle cash.
3. **Documentation procedures.** The counter clerk uses your order invoice (ticket) in registering the sale on the cash register. The cash register produces a tape of all sales.
4. **Physical controls.** A cash register is used to record the sale.
5. **Independent internal verification.** The counter clerk, in handling the pizza, compares the size of the pizza with the size indicated on the order.
6. **Human resource controls.** No visible application possible.

EXERCISE 7-3

Procedure	(a)		(b)
	Weakness	Principle Violated	Recommended Change
1.	Cashiers are not bonded and background checks are not conducted.	Human resource controls.	Cashiers should be bonded and background checks should be performed.
2.	Inability to establish responsibility for cash on a specific clerk.	Establishment of responsibility.	There should be separate cash drawers and register codes for each clerk.
3.	Cash is not adequately protected from theft.	Physical controls.	Cash should be stored in a safe until it is deposited in bank.
4.	Cash is not independently counted.	Independent internal verification.	A cashier office supervisor should count cash, and reconcile the total to the cash register tape.
5.	The accountant should not handle cash.	Segregation of duties.	The cashier's department should make the deposits.

EXERCISE 7-4

Procedure	(a)		(b)
	Weakness	Principle Violated	Recommended Change
1.	Checks are not stored in a secure area.	Physical controls.	Checks should be stored in a safe or locked file drawer.
2.	The approval and payment of bills is done by the same individual.	Segregation of duties.	The store manager should approve bills for payment and the treasurer should sign and issue checks.
3.	Unauthorized employees making purchases.	Establishment of responsibility.	Only employees granted authority should make purchases for the store.
	Use of cash instead of checks; no prenumbered invoices.	Documentation procedures.	Purchases should be paid with prenumbered checks and the purchases should be documented by a prenumbered invoice signed by the seller.
4.	Filing does not prevent a bill from being paid more than once.	Documentation procedures.	Bills should be stamped PAID after payment.
5.	The bank reconciliation is not independently prepared.	Independent internal verification.	Someone with no other responsibilities relating to cash should prepare the bank reconciliation.

EXERCISE 7-5

(a) Weaknesses

1. Checks are not prenumbered.
(Documentation procedures)
2. The purchasing agent signs checks.
(Establishment of responsibility)
3. Unissued checks are stored in unlocked file cabinet.
(Physical controls)
4. Purchasing agent approves and pays for goods purchased.
(Segregation of duties)
5. After payment, the invoice is filed.
(Documentation procedures)
6. The purchasing agent records payments in cash disbursements journal.
(Segregation of duties)
7. The treasurer records the checks in cash disbursements journal.
(Segregation of duties)
8. The treasurer reconciles the bank statement.
(Independent internal verification)

(b) Suggested Improvement

- Use prenumbered checks.
- Only the treasurer's department personnel should sign checks.
- Unissued checks should be stored in a locked file cabinet with access restricted to authorized personnel.
- Purchasing should approve bills for payment by the treasurer.
- The invoice should be stamped PAID.
- Only accounting department personnel should record cash disbursements.
- Same as answer to No. 6 above.
- An internal auditor should reconcile the bank statement.

EXERCISE 7-6

(a) Cash balance per bank statement.....		\$3,677.20
Add: Deposits in transit		<u>590.00</u>
		4,267.20
Less: Outstanding checks		<u>770.00</u>
Adjusted cash balance per bank.....		<u>\$3,497.20</u>
(b) Cash balance per books		\$3,975.20
Less: NSF check	\$450.00	
Bank service charge	<u>28.00</u>	<u>478.00</u>
Adjusted cash balance per books.....		<u>\$3,497.20</u>
(c) Accounts Receivable.....	450.00	
Cash		450.00
Miscellaneous Expense	28.00	
Cash		28.00

EXERCISE 7-7

The outstanding checks are as follows:

<u>No.</u>	<u>Amount</u>
255	\$ 700
261	500
264	<u>360</u>
Total	<u>\$1,560</u>

EXERCISE 7-8

(a)

JOYCE COMPANY
Bank Reconciliation
July 31, 2014

Cash balance per bank statement	\$7,328
Add: Deposits in transit	<u>2,700</u>
	10,028
Less: Outstanding checks	<u>686</u>
Adjusted cash balance per bank	<u>\$9,342</u>
 Cash balance per books	 \$7,364
Add: Collection of note receivable (\$2,000 plus accrued interest \$36, less collection fee \$20).....	 <u>2,016</u>
	9,380
Less: Bank service charge	<u>38</u>
Adjusted cash balance per books	<u>\$9,342</u>

(b)	July 31	Cash	2,016	
		Miscellaneous Expense.....	20	
		Notes Receivable.....		2,000
		Interest Revenue		36
	31	Miscellaneous Expense.....	38	
		Cash.....		38

EXERCISE 7-9

(a)

TREANOR COMPANY Bank Reconciliation September 30, 2014

Cash balance per bank statement.....		\$16,500	
Add: Deposits in transit		<u>4,738</u>	
		21,238	
Less: Outstanding checks		<u>2,383</u>	
Adjusted cash balance per bank.....		<u>\$18,855</u>	
Cash balance per books			\$17,600
Add: Collection of note receivable			
(\$1,800 + \$30).....		\$1,830	
Interest earned.....		<u>45</u>	
			<u>1,875</u>
			19,475
Less: NSF check		560	
Safety deposit box rent.....		<u>60</u>	
			<u>620</u>
Adjusted cash balance per books.....			<u>\$18,855</u>
(b)	Sept. 30	Cash	1,830
		Notes Receivable	1,800
		Interest Revenue	30
	30	Cash	45
		Interest Revenue	45
	30	Accounts Receivable—H. Kane.....	560
		Cash	560
	30	Miscellaneous Expense	60
		Cash	60

EXERCISE 7-10

(a) Deposits in transit:

Deposits per books in July		\$16,900
Less: Deposits per bank in July	\$15,600	
Deposits in transit, June 30	<u>(580)</u>	
July receipts deposited in July		<u>15,020</u>
Deposits in transit, July 31		<u>\$ 1,880</u>

(b) Outstanding checks:

Checks per books in July		\$17,500
Less: Checks clearing bank in July	\$16,400	
Outstanding checks, June 30	<u>(940)</u>	
July checks cleared in July		<u>15,460</u>
Outstanding checks, July 31		<u>\$ 2,040</u>

(c) Deposits in transit:

Deposits per bank statement in September		\$25,900
Add: Deposits in transit, September 30		<u>2,200</u>
Total deposits to be accounted for		28,100
Less: Deposits per books		<u>26,400</u>
Deposits in transit, August 31		<u>\$ 1,700</u>

(d) Outstanding checks:

Checks clearing bank in September		\$24,000
Add: Outstanding checks, September 30		<u>2,100</u>
Total checks to be accounted for		26,100
Less: Cash disbursements per books		<u>23,500</u>
Outstanding checks, August 31		<u>\$ 2,600</u>

EXERCISE 7-11

(a) Deposits in transit = \$74,000 – (\$71,000 – \$4,800) = \$7,800

(b) Outstanding checks = (\$73,570 + \$360) – (\$68,678 – \$4,500) = \$9,752

(c) **WERTH INC.**
Bank Reconciliation
August 31, 2014

Cash balance per bank statement.....			\$20,692*
Add: Deposits in transit			<u>7,800</u>
			28,492
Less: Outstanding checks			<u>9,752</u>
Adjusted cash balance per bank.....			<u>\$18,740</u>
Cash balance per books			\$19,130**
Add: Interest earned.....			<u>45</u>
			19,175
Less: Error in recording check (\$400 – \$40).....	\$360		
Service charge.....	50		
Safety deposit box rent.....	<u>25</u>		<u>435</u>
Adjusted cash balance per books.....			<u>\$18,740</u>

*Proof of cash balance per bank statement: \$18,400 + \$71,000 – \$68,678 + \$45 – \$25 – \$50 = \$20,692

**Proof of cash balance per books: \$18,700 + \$74,000 – \$73,570 = \$19,130

(d) Aug. 31	Cash.....	45	
	Interest Revenue		45
31	Accounts Payable.....	360	
	Cash		360
31	Miscellaneous Expense (\$50 + \$25).....	75	
	Cash		75

EXERCISE 7-12

(a) Cash and Cash Equivalents

1. Currency	\$ 60
2. U.S. Treasury bill	10,000
3. April checks	260
5. Checking account	2,500
6. Savings account	<u>4,800</u>
Total	<u>\$17,620</u>

- (b) 4. Post-dated check—Accounts Receivable; Balance Sheet
7. Prepaid postage in postage meter—Prepaid Postage Expense; Balance Sheet, or Postage Expense; Income Statement
8. IOU from company receptionist—Accounts Receivable; Balance Sheet

EXERCISE 7-13

Suggestions to improve cash management practices for Canzer, Morel and Wang:

1. Prepare a cash budget.
2. Bill clients as work progresses.
3. Establish a line of credit with bank.
4. Arrange a long-term loan for renovations and equipment and plan the timing of major expenditures.

EXERCISE 7-14

ENRIGHT COMPANY
Cash Budget
For the Two Months Ending February 28, 2014

	<u>January</u>	<u>February</u>
Beginning cash balance	<u>\$ 46,000</u>	<u>\$ 24,000</u>
Add: Cash receipts		
Collections from customers	71,000	146,000
Sale of short-term investments	<u>12,000</u>	<u>0</u>
Total receipts.....	<u>83,000</u>	<u>146,000</u>
Total available cash.....	<u>129,000</u>	<u>170,000</u>
Less: Cash disbursements		
Payments to suppliers.....	40,000	75,000
Wages	30,000	40,000
Administrative expenses.....	20,000	23,000
Selling expenses.....	<u>15,000</u>	<u>20,000</u>
Total disbursements.....	<u>105,000</u>	<u>158,000</u>
Excess (deficiency) of available cash over disbursements	24,000	12,000
Financing		
Add: Borrowings	0	8,000
Less: Repayments.....	<u>0</u>	<u>0</u>
Ending cash balance.....	<u>\$ 24,000</u>	<u>\$ 20,000</u>

***EXERCISE 7-15**

Oct. 1	Petty Cash	150.00	
	Cash		150.00
31	Petty Cash	50.00	
	Postage Expense	39.70	
	Supplies.....	26.10	
	Miscellaneous Expense	16.40	
	Freight-Out	6.80	
	Cash Over and Short	1.30	
	Cash (\$200.00 – \$59.70).....		140.30

***EXERCISE 7-16**

(a) Aug. 1	Petty Cash.....	200.00	
	Cash.....		200.00
15	Freight-Out.....	74.40	
	Entertainment Expense	36.00	
	Postage Expense.....	33.70	
	Miscellaneous Expense	27.50	
	Cash Over and Short.....	3.40	
	Cash.....		175.00
16	Petty Cash.....	200.00	
	Cash.....		200.00
31	Postage Expense.....	145.00	
	Entertainment Expense	90.60	
	Freight-Out.....	46.40	
	Cash Over and Short.....	1.00	
	Cash.....		283.00

(b)	Petty Cash	
8/1	200	
8/16	200	
8/31 Bal.	400	

***EXERCISE 7-16 (Continued)**

(c) The internal control features of a petty cash fund include:

- (1) A custodian is responsible for the fund.**
- (2) A pre-numbered petty cash receipt signed by the custodian and the individual receiving payment is required for each payment from the fund.**
- (3) The treasurer's office examines all payments and stamps supporting documents to indicate they were paid when the fund is replenished.**
- (4) Surprise counts can be made at any time to determine whether the fund is intact.**

SOLUTIONS TO PROBLEMS

PROBLEM 7-1A

(a) Principles

Application to Granada Theater

Establishment of responsibility.	Only cashiers are authorized to sell tickets. Only the manager and cashier can handle cash.
Segregation of duties.	The duties of receiving cash and admitting customers are assigned to the cashier and to the doorperson. The manager maintains custody of the cash, and the company accountant records the cash.
Documentation procedures.	Tickets are prenumbered. Cash count sheets are prepared. Deposit slips are prepared.
Physical controls.	A safe is used for the storage of cash and a machine is used to issue tickets.
Independent internal verification.	Cash counts are made by the manager at the end of each cashier's shift. Daily comparisons are made by the company treasurer.
Human resource controls.	Cashiers are bonded.

(b) Actions by the doorperson and cashier to misappropriate cash include:

- (1) Instead of tearing the tickets, the doorperson could return the tickets to the cashier who could resell them, and the two could divide the cash.
- (2) The cashier could issue a lower price ticket than paid for and the doorperson would admit the customer. The difference between the price of the ticket issued and the cash received could be divided between the doorperson and cashier.

PROBLEM 7-2A

Trent has created a situation that leaves many opportunities for undetected theft. Here is a list of some of the weaknesses in internal control. You may find others.

- 1. Documentation procedures. The tickets were unnumbered. By numbering the tickets, the students could have been held more accountable for the tickets. See number 3 below.**
- 2. Physical controls and establishment of responsibility. The tickets were left in an unlocked box on his desk. Instead, Trent should have assigned control of the tickets to one individual, in a locked box which that student alone had control over.**
- 3. Documentation procedures. No record was kept of which students took tickets to sell or how many they took. In combination with items 1 and 2 above, the student assigned control over the tickets should have kept a record of which tickets were issued to each student for resale. (Note: This problem could have been largely avoided if the tickets had only been sold at the door on the day of the dance.)**
- 4. Documentation procedures. There was no control over unsold tickets. This deficiency made it possible for students to sell tickets, keep the cash, and tell Trent that they had disposed of the unsold tickets. Instead, students should have been required to return the unsold tickets to the student maintaining control over tickets, and the cash to Trent. In each case, the students should have been issued a receipt for the cash they turned in and the tickets they returned.**
- 5. Establishment of responsibility. Inadequate control over the cash box. In effect, it was operated like a petty cash fund, but too many people had the key. Instead, Trent should have had the key and dispersed funds when necessary for purchases.**
- 6. Documentation procedures. Instead of receipts, students simply wrote notes saying how they used the funds. Instead, it should have been required that they provided a valid receipt.**

PROBLEM 7-2A (Continued)

- 7. Segregation of duties. Sandy Overbay counted the funds, made out the deposit slip, and took the funds to the bank. This made it possible for Sandy Overbay to take some of the money and deposit the rest since there was no external check on his work. Trent should have counted the funds, with someone observing him. Then he could have made out the deposit slip and had Sandy Overbay deposit the funds.**
- 8. Documentation procedures. Trent did not receive a receipt from Jay Dee. Without a receipt, there is no way to verify how much Jay Dee was actually paid. For example, it is possible that he was only paid \$100 and that Trent took the rest.**
- 9. Segregation of duties. Deb Younger was collecting tickets and receiving cash for additional tickets sold. Instead, there should have been one person selling tickets at the door and a second person collecting tickets.**

PROBLEM 7-3A

(a)

REDEKER COMPANY
Bank Reconciliation
July 31, 2014

Cash balance per bank statement.....		\$7,690.80
Add: Deposits in transit		<u>1,193.30</u>
		8,884.10
Less: Outstanding checks		<u>1,860.10</u>
Adjusted cash balance per bank.....		<u><u>\$7,024.00</u></u>
 Cash balance per books		 \$6,140.00
Add: Collection of note receivable (\$1,500 plus accrued interest \$30, less collection fee \$10)		 <u>1,520.00</u>
		7,660.00
Less: NSF check	\$575.00	
Error in recording check No. 2480	36.00	
Bank service charge	<u>25.00</u>	<u>636.00</u>
Adjusted cash balance per books.....		<u><u>\$7,024.00</u></u>

(b) July 31	Cash.....	1,520	
	Miscellaneous Expense	10	
	Notes Receivable		1,500
	Interest Revenue		30
31	Accounts Receivable—K. Wagner.....	575	
	Cash		575
31	Accounts Payable—T. Laird	36	
	Cash		36
31	Miscellaneous Expense	25	
	Cash		25

PROBLEM 7-4A

(a) **LAROCHE COMPANY**
Bank Reconciliation
November 30, 2014

Cash Balance per bank statement.....		\$17,712.50
Add: Deposits in transit		<u>1,304.00</u>
		19,016.50
Less: Outstanding checks		
No. 2451	\$1,260.40	
No. 2472	426.80	
No. 2478	538.20	
No. 2482	612.00	
No. 2484	829.50	
No. 2485	974.80	
No. 2487	398.00	
No. 2488	<u>800.00</u>	<u>5,839.70</u>
Adjusted cash balance per bank		<u>\$13,176.80</u>
Cash Balance per books.....		\$11,073.80
Add: Collection of note receivable		
(\$2,100 plus accrued interest \$157		
less collection fee \$15).....		<u>2,242.00</u>
		13,315.80
Less: Check printing charge	\$ 85.00	
Error in recording check		
No. 2479 (\$1,750 – \$1,705).....	45.00	
Error in 11-21 deposit		
(\$2,954 – \$2,945).....	<u>9.00</u>	<u>139.00</u>
Adjusted cash balance per books		<u>\$13,176.80</u>

PROBLEM 7-4A (Continued)

(b)	Nov. 30	Cash	2,242	
		Miscellaneous Expense.....	15	
		Notes Receivable.....		2,100
		Interest Revenue		157
	30	Miscellaneous Expense.....	85	
		Cash.....		85
	30	Accounts Payable	45	
		Cash.....		45
	30	Accounts Receivable	9	
		Cash.....		9

PROBLEM 7-5A

(a) **ZIMMERMAN COMPANY**
Bank Reconciliation
May 31, 2014

Cash balance per bank statement		\$6,968.00
Add: Deposits in transit	\$1,880.15	
Bank error—Zinderberg	<u>360.00</u>	<u>2,240.15</u>
		9,208.15
Less: Outstanding checks.....		<u>276.25</u>
Adjusted cash balance per bank		<u><u>\$8,931.90</u></u>
Cash balance per books		\$6,738.90
Add: Collection of note receivable		
(\$2,600 plus accrued interest \$110		
less collection fee \$20)		<u>2,690.00</u>
		9,428.90
Less: NSF check	\$ 380.00	
Error in May 12 deposit	50.00	
Error in recording check No. 1181	27.00	
Check printing charge	<u>40.00</u>	<u>497.00</u>
Adjusted cash balance per books		<u><u>\$8,931.90</u></u>

(b) May 31	Cash	2,690	
	Miscellaneous Expense	20	
	Notes Receivable		2,600
	Interest Revenue		110
31	Accounts Receivable—		
	B. Sullivan	380	
	Cash		380
31	Sales Revenue	50	
	Cash		50
31	Accounts Payable—M. Hartley	27	
	Cash		27
31	Miscellaneous Expense	40	
	Cash		40

PROBLEM 7-6A

**LANGERHAN INC.
Cash Budget
For the Month Ending April 30, 2014**

Beginning cash balance	<u>\$11,000</u>
Add: Cash receipts	
Cash sales	42,000
Collections from customers	<u>18,400</u>
Total receipts	<u>60,400</u>
Total available cash.....	<u>71,400</u>
Less: Cash disbursements	
Payment of March purchases	22,400
April cash purchases	28,100
Cash operating costs	11,200
Equipment purchase	<u>2,500</u>
Total disbursements	<u>64,200</u>
Excess (deficiency) of available cash over disbursements.....	7,200
Financing	
Add: Borrowings	1,800
Less: Repayments	<u>0</u>
Ending cash balance.....	<u>\$ 9,000</u>

PROBLEM 7-7A

CASTLE CORPORATION
Cash Budget
For the Two Months Ending February 28, 2014

	<u>January</u>	<u>February</u>
Beginning cash balance.....	<u>\$ 46,000</u>	<u>\$ 43,000</u>
Add: Cash receipts		
Collections from customers	326,000	378,000
Notes receivable	15,000	
Sale of securities	<u>0</u>	<u>4,000</u>
Total receipts.....	<u>341,000</u>	<u>382,000</u>
Total available cash	<u>387,000</u>	<u>425,000</u>
Less: Cash disbursements		
Purchases.....	110,000	135,000
Salaries	84,000	81,000
Administrative expenses (Jan. \$72,000 – \$1,000; Feb. \$75,000 – \$1,000)	71,000	74,000
Selling expenses.....	79,000	88,000
Dividends.....	<u>0</u>	<u>10,000</u>
Total disbursements.....	<u>344,000</u>	<u>388,000</u>
Excess (deficiency) of available cash over disbursements	43,000	37,000
Financing		
Add: Borrowings.....	0	3,000
Less: Repayments	<u>0</u>	<u>0</u>
Ending cash balance	<u>\$ 43,000</u>	<u>\$ 40,000</u>

PROBLEM 7-8A

(a)

HEISEY COMPANY
Bank Reconciliation
October 31, 2014

Balance per bank statement				\$18,380.00
Plus: Undeposited receipts				<u>3,795.51</u>
				22,175.51
Less: Outstanding checks				
<u>No.</u>	<u>Amount</u>	<u>No.</u>	<u>Amount</u>	
62	\$140.75	862	\$190.71	
183	180.00	863	226.80	
284	253.25	864	165.28	<u>1,156.79</u>
Adjusted balance per bank				<u>\$21,018.72</u>
Cash balance per books				\$21,877.72
Add: Bank credit (collection of note receivable)				<u>185.00</u>
Adjusted balance per books (before theft)				22,062.72
Less: Theft (\$22,062.72 – \$21,018.72)				<u>1,044.00</u>
Adjusted balance per books				<u>\$21,018.72</u>

- (b) The cashier attempted to cover the theft of \$1,044.00 by:
1. Not listing as outstanding three checks totaling \$574.00 (No. 62, \$140.75; No. 183, \$180.00; and No. 284, \$253.25).
 2. Underfooting the outstanding checks listed by \$100. (The correct total is \$582.79.)
 3. Subtracting the \$185 credit from the bank balance instead of adding it to the book balance, thereby concealing \$370 of the theft.
- (c)
1. The principle of independent internal verification has been violated because the cashier prepared the bank reconciliation.
 2. The principle of segregation of duties has been violated because the cashier had access to the accounting records and also prepared the bank reconciliation.

PROBLEM 7-1B

(a) Weaknesses include the following.

- 1. There is no clear establishment of responsibility. All members appear to have the authority to take books and collect cash.**
- 2. There is little or no segregation of duties. The treasurer purchased the books, and will deposit cash as it is collected.**
- 3. There are no documentation procedures. Members are allowed to take books without completing a receipt. It does not appear that receipts are issued as books are sold.**
- 4. Physical controls are lacking. The books are kept on an open shelf in an office that is accessible to many people. Cash is kept in a desk drawer.**
- 5. Independent internal verification procedures are not used. The treasurer handles all cash transactions and no one tracks the supply of books.**

(b) Improvements include the following.

- 1. A club member should be assigned as the director of this fund-raising program. This member would track distribution, sales, and returns of books.**
- 2. Someone other than the treasurer should handle and track cash receipts from this activity. Receipts would then be forwarded to the treasurer for deposit.**
- 3. Members who take books should sign a pre-numbered receipt and be informed that they must return the book or payment within a designated amount of time.**

PROBLEM 7-1B (Continued)

- 4. The supply of books should be kept in a secure (locked) location, not on an open shelf. When students need more books, they must contact the member in charge of inventory and complete a receipt. Collections from sales must be kept in a secure (locked) location and deposited in the bank as collected.**
- 5. An independent club member with no responsibility for purchase, distribution, or sales of the books should perform an audit of cash receipts and disbursements as well as accounting for all books purchased, sold, and returned.**

PROBLEM 7-2B

Violations:

- 1. It is Sue's responsibility to post payments to patient accounts. In allowing Tom to assist her, the establishment of responsibility principle is violated.**
- 2. Although this may be a small office, it is not appropriate that Tom opens the mail, prepares a bank deposit form, and receives and records cash receipts from patients. This violates the segregation of duties principle.**
- 3. The documentation principle is violated when patients are not given cash receipts.**
- 4. Independent internal verification is also violated. There is no independent counting of the cash and comparison to total receipts.**
- 5. Leaving the computer program on all the time and failing to comply with employee specific user ID and password violates physical controls.**
- 6. Human resource controls are being violated. Tom should be required to take a vacation and since he handles cash, he should be bonded.**

PROBLEM 7-3B

(a)

TAGGERT COMPANY
Bank Reconciliation
March 31, 2014

Cash balance per bank statement.....	\$6,041.40
Add: Deposits in transit	<u>1,481.60</u>
	7,523.00
Less: Outstanding checks	<u>1,360.00</u>
Adjusted cash balance per bank.....	<u><u>\$6,163.00</u></u>
 Cash balance per books	 \$5,174.20
Add: Collection of note receivable (\$2,000 plus accrued interest \$115, less collection fee \$20)	 <u>2,095.00</u>
	7,269.20
Less: NSF check	\$1,033.20
Error in recording check No. 1245	45.00
Bank service charge	<u>28.00</u>
Adjusted cash balance per books.....	<u><u>1,106.20</u></u> <u><u>\$6,163.00</u></u>

(b) Mar. 31	Cash.....	2,095	
	Miscellaneous Expense	20	
	Notes Receivable		2,000
	Interest Revenue		115
31	Accounts Receivable—R. Fross	1,033.20	
	Cash		1,033.20
31	Accounts Payable—T. Gilroy	45	
	Cash		45
31	Miscellaneous Expense	28	
	Cash		28

PROBLEM 7-4B

(a) **TRIAD IMPORTS, INC.**
Bank Reconciliation
August 31, 2014

Balance per bank statement.....		\$13,563
Add: Deposits in transit		500
		<u>14,063</u>
Less: Outstanding checks		
No. 3151	\$ 290	
No. 3172	1,000	
No. 3178	1,598	
No. 3182	1,508	
No. 3184	760	
No. 3185	1,038	
No. 3186	455	
No. 3188	273	
		<u>6,922</u>
Adjusted cash balance per bank		<u>\$ 7,141</u>
Balance per books		\$5,478
Add: Collection of note receivable		
(\$1,600 plus accrued interest \$80		
less collection fee \$10).....	\$1,670	
Error in Aug. 13 deposit		
(\$1,104 – \$1,014).....	<u>90</u>	<u>1,760</u>
		7,238
Less: Check printing charge	70	
Error in recording check		
No. 3181 (\$569 – \$596).....	<u>27</u>	<u>97</u>
Adjusted cash balance per books		<u>\$7,141</u>
(b) Aug. 31 Cash.....	1,670	
Miscellaneous Expense	10	
Notes Receivable		1,600
Interest Revenue		80
31 Cash.....	90	
Accounts Receivable.....		90
31 Miscellaneous Expense	70	
Cash		70
31 Accounts Payable.....	27	
Cash		27

PROBLEM 7-5B

(a) **BUG BUSTERS COMPANY**
Bank Reconciliation
October 31, 2014

Cash balance per bank statement.....		\$4,070
Add: Deposits in transit.....	\$2,390	
Bank error—Fig Leaf.....	<u>120</u>	<u>2,510</u>
		6,580
Less: Outstanding checks		<u>1,250</u>
Adjusted cash balance per bank.....		<u>\$5,330</u>
 Cash balance per books		 \$4,632
Add: Collection of note receivable		
(\$1,000 plus accrued interest \$50		
less collection fee \$15).....		<u>1,035</u>
		5,667
Less: NSF check.....	\$230	
Error in deposit.....	30	
Error in recording check No. 4263.....	27	
Check printing charge	<u>50</u>	<u>337</u>
Adjusted cash balance per books.....		<u>\$5,330</u>

(b) Oct. 31	Cash	1,035	
	Miscellaneous Expense.....	15	
	Notes Receivable		1,000
	Interest Revenue		50
31	Accounts Receivable—J. Simpson.....	230	
	Cash		230
31	Sales Revenue	30	
	Cash		30
31	Accounts Payable—T. Grey.....	27	
	Cash		27
31	Miscellaneous Expense.....	50	
	Cash		50

PROBLEM 7-6B

**ITEMS INC.
Cash Budget
For the Month Ending June 30, 2014**

Beginning cash balance	<u>\$19,000</u>
Add: Cash receipts	
Cash sales.....	18,000
Collections from customers	<u>47,600</u>
Total receipts.....	<u>65,600</u>
Total available cash.....	<u>84,600</u>
Less: Cash disbursements	
Payment of May purchases	18,200
June cash purchases	27,500
Cash operating costs.....	21,300
Equipment purchase	<u>6,000</u>
Total disbursements.....	<u>73,000</u>
Excess (deficiency) of available cash over disbursements	11,600
Financing	
Borrowings	0
Repayments	<u>600</u>
Ending cash balance.....	<u>\$11,000</u>

PROBLEM 7-7B

NOBLE CORPORATION
Cash Budget
For the Two Months Ending February 28, 2014

	<u>January</u>	<u>February</u>
Beginning cash balance	<u>\$ 52,000</u>	<u>\$ 40,000</u>
Add: Cash receipts		
Collections from customers.....	279,500	298,000
Interest receivable	7,500	
Sale of securities		<u>8,000</u>
Total receipts	<u>287,000</u>	<u>306,000</u>
Total available cash.....	<u>339,000</u>	<u>346,000</u>
Less: Cash disbursements		
Purchases	106,000	116,000
Salaries.....	72,000	78,000
Administrative expenses (Jan. \$58,000 – \$2,000; Feb. \$60,000 – \$2,000).....	56,000	58,000
Selling expenses	30,000	36,000
Note payable	35,000	
Dividends		<u>5,000</u>
Total disbursements	<u>299,000</u>	<u>293,000</u>
Excess (deficiency) of available cash over disbursements.....	40,000	53,000
Financing		
Borrowings	0	
Repayments	<u>0</u>	<u>13,000</u>
Ending cash balance.....	<u>\$ 40,000</u>	<u>\$ 40,000</u>

PROBLEM 7-8B

(a) **ELITE SERVICE COMPANY**
Bank Reconciliation
March 31, 2014

Balance per bank statement.....	\$5,931.51
Plus: Undeposited receipts	<u>1,591.63</u>
	7,523.14

Less: Outstanding checks

<u>No.</u>	<u>Amount</u>	<u>No.</u>	<u>Amount</u>	
206	\$358.53	781	\$286.00	
441	292.00	782	319.47	
590	283.00	783	303.14	<u>1,842.14</u>

Adjusted balance per bank.....	<u><u>\$5,681.00</u></u>
--------------------------------	--------------------------

Cash balance per books	\$6,889.53
Add: Bank credit (collection of note receivable).....	<u>175.00</u>
Adjusted balance per books (before theft)	7,064.53
Theft (\$7,064.53 – \$5,681.00)	<u>1,383.53</u>
Adjusted balance per books	<u><u>\$5,681.00</u></u>

(b) The cashier attempted to cover the theft of \$1,383.53 by:

1. Not listing as outstanding three checks totaling \$933.53 (No. 206, \$358.53; No. 441, \$292.00; and No. 590, \$283.00).
2. Underfooting the outstanding checks listed by \$100. (The correct total is \$908.61.)
3. Subtracting the \$175 credit from the bank balance instead of adding it to the book balance, thereby concealing \$350 of the theft.

PROBLEM 7-8B (Continued)

- (c) 1. The principle of independent internal verification has been violated because the cashier prepared the bank reconciliation.
2. The principle of segregation of duties has been violated because the cashier had access to the accounting records and also prepared the bank reconciliation.

COMPREHENSIVE PROBLEM SOLUTION

(a)	Dec. 7	Cash	3,600	
		Accounts Receivable		3,600
	12	Inventory	12,000	
		Accounts Payable.....		12,000
	17	Accounts Receivable	16,000	
		Sales Revenue		16,000
		Cost of Goods Sold.....	10,000	
		Inventory		10,000
	19	Salaries and Wages Expense.....	2,200	
		Cash.....		2,200
	22	Accounts Payable	12,000	
		Cash (\$12,000 X .99)		11,880
		Inventory		120
	26	Cash (\$16,000 X .98).....	15,680	
		Sales Discounts	320	
		Accounts Receivable		16,000
	31	Cash	2,700	
		Accounts Receivable		2,700

COMPREHENSIVE PROBLEM SOLUTION (Continued)

(b) & (e)

General Ledger

Cash			
12/1 Bal.	18,200	12/19	2,200
12/7	3,600	12/22	11,880
12/26	15,680	12/31	680
12/31	2,700		
12/31	2,000		
12/31 Bal.	27,420		

Notes Receivable			
12/1 Bal.	2,000	12/31	2,000
12/31 Bal.	– 0 –		

Accounts Receivable			
12/1 Bal.	7,500	12/7	3,600
12/17	16,000	12/26	16,000
12/31	680	12/31	2,700
12/31 Bal.	1,880		

Inventory			
12/1 Bal.	16,000	12/17	10,000
12/12	12,000	12/22	120
12/31 Bal.	17,880		

Prepaid Insurance			
12/1 Bal.	1,600	12/31	400
12/31 Bal.	1,200		

Equipment			
12/1 Bal.	28,000		

Accumulated Depreciation—Equipment			
	12/1 Bal.	3,000	
	12/31	200	
	12/31 Bal.	3,200	

Income Taxes Payable			
	12/31	425	
	12/31	Bal. 425	

Accounts Payable			
12/22	12,000	12/1 Bal.	6,100
		12/12	12,000
		12/31 Bal.	6,100

Common Stock			
		12/1 Bal.	50,000

Retained Earnings			
		12/1 Bal.	14,200

Sales Revenue			
		12/17	16,000
		12/31 Bal.	16,000

Sales Discounts			
12/26	320		
12/31 Bal.	320		

Cost of Goods Sold			
12/17	10,000		
12/31 Bal.	10,000		

Depreciation Expense			
12/31	200		
12/31 Bal.	200		

Salaries and Wages Expense			
12/19	2,200		
12/31 Bal.	2,200		

Insurance Expense			
12/31	400		
12/31 Bal.	400		

Income Tax Expense			
12/31	425		
12/31 Bal.	425		

COMPREHENSIVE PROBLEM SOLUTION (Continued)

(c) **HAVENHILL COMPANY**
Bank Reconciliation
December 31, 2014

Cash balance per bank statement	\$25,930
Add: Deposits in transit.....	<u>2,700</u>
	28,630
Less: Outstanding checks	<u>1,210</u>
Adjusted cash balance per bank	<u>\$27,420</u>
 Cash balance per books	 26,100
Add: Collection of note receivable	<u>2,000</u>
	28,100
Less: NSF check	<u>680</u>
Adjusted cash balance per books	<u>\$27,420</u>

(d) Dec. 31	Cash	2,000	
	Notes Receivable		2,000
31	Accounts Receivable.....	680	
	Cash		680
31	Depreciation Expense	200	
	Accumulated Depreciation— Equipment		200
31	Insurance Expense	400	
	Prepaid Insurance.....		400
31	Income Tax Expense	425	
	Income Taxes Payable.....		425

COMPREHENSIVE PROBLEM SOLUTION (Continued)

(f)

HAVENHILL COMPANY Adjusted Trial Balance December 31, 2014

	DR.	CR.
Cash	\$27,420	
Accounts Receivable	1,880	
Inventory	17,880	
Prepaid Insurance	1,200	
Equipment	28,000	
Accumulated Depreciation—Equipment....		\$ 3,200
Accounts Payable		6,100
Income Taxes Payable.....		425
Common Stock.....		50,000
Retained Earnings		14,200
Sales Revenue.....		16,000
Sales Discounts	320	
Cost of Goods Sold	10,000	
Depreciation Expense	200	
Salaries and Wages Expense	2,200	
Insurance Expense	400	
Income Tax Expense	425	
	<u>\$89,925</u>	<u>\$89,925</u>

(g)

HAVENHILL COMPANY Income Statement For the Month Ending December 31, 2014

Sales revenue.....		\$16,000
Less: Sales discounts		<u>320</u>
Net sales		15,680
Cost of goods sold		<u>10,000</u>
Gross profit		5,680
Operating expenses		
Salaries and wages expense	\$2,200	
Insurance expense	400	
Depreciation expense	<u>200</u>	<u>2,800</u>
Income before income taxes.....		2,880
Income tax expense.....		<u>425</u>
Net income.....		<u>\$ 2,455</u>

COMPREHENSIVE PROBLEM SOLUTION (Continued)

(g) **HAVENHILL COMPANY**
Balance Sheet
December 31, 2014

<u>Assets</u>		
Current assets		
Cash	\$27,420	
Accounts receivable	1,880	
Inventory	17,880	
Prepaid insurance	<u>1,200</u>	
Total current assets		\$48,380
Property, plant, and equipment		
Equipment	28,000	
Less: Accumulated depreciation—Equipment	<u>3,200</u>	<u>24,800</u>
Total assets		<u>\$73,180</u>
<u>Liabilities and Stockholders' Equity</u>		
Current liabilities		
Accounts payable	\$6,100	
Income taxes payable	<u>425</u>	\$6,525
Stockholders' equity		
Common stock	50,000	
Retained earnings (\$14,200 + \$2,455) ...	<u>16,655</u>	
Total stockholders' equity		<u>66,655</u>
Total liabilities and stockholders' equity		<u>\$73,180</u>

- (a) The first paragraph of the independent registered public accounting firm's report states that: In our opinion, the accompanying consolidated statements of financial position and the related consolidated statements of earnings, comprehensive earnings and retained earnings, and of cash flows present fairly, in all material respects, the financial position of Tootsie Roll Industries, Inc. and its subsidiaries at December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America.
- (b) The consolidated statement of financial position shows the combined cash and cash equivalent balances (in thousands) at December 31, 2011 and 2010:

2011—\$78,612 and 2010—\$115,976

- (c) The consolidated statement of cash flows indicates that three activities are responsible for the change in cash in 2011: (1) operating, (2) investing, and (3) financing.
- (d) The notes say: The company considers temporary cash investments with an original maturity of three months or less to be cash equivalents.
- (e) The management of Tootsie Roll Industries, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting. After performing an evaluation of company procedures, management concluded that its internal control over financial reporting was effective.

Management's assessment of Tootsie Roll's internal control was audited by and addressed in the opinion of its public accounting firm, PricewaterhouseCoopers, LLP.

(In thousands)	<u>Tootsie Roll</u>	<u>Hershey Company</u>
(a) Cash/cash equivalents balance	\$78,612	\$693,686
(b) Cash as a percentage of total assets		
2011:	9.2%*	15.7%***
2010:	13.5%**	20.7%****

Cash as a percentage of total assets decreased 32% for Tootsie Roll and 24% for Hershey Company.

- (c) Cash provided by operating activities \$50,390 \$580,867
- (d) The objective in cash management is to ensure that a company has sufficient cash to meet payments as they come due, yet minimize the amount of non-revenue-generating cash on hand. The decrease in cash as a percentage of total assets experienced by both companies is a cause of concern only if they are missing opportunities to generate revenue. If not, both companies have probably done a better job managing cash in 2011 than 2010. Data from several years would be necessary to look for trends to draw more reliable conclusions.

*\$78,612/\$857,856

**\$115,976/\$857,959

***\$693,686/\$4,412,199

****\$884,642/\$4,272,732

- (a) The article lists 8 different forms of payment. They are: wire transfer, paper checks, automated clearing house (ACH) credits, ACH debits, purchasing cards (p-cards), paying from statements, petty cash, payment via travel and expense (T&E) reimbursement.**
- (b) As more payment options become available, it is more likely that companies will pay the same bill twice.**
- (c) The controls suggested in the article are:**
 - 1. Limit payment type i.e. only p-card.**
 - 2. Make sure purchase orders are extinguished whenever a payment is made.**
 - 3. Make sure the invoice number is entered using the coding standard whenever payments are made.**
 - 4. Make sure the same coding standards are used.**
 - 5. Establish a payment timing policy adhered to by everyone.**

- (a) The global percentage of companies that experienced a significant instance of fraud during the period covered by the survey was 16% and Western Europe had the highest rate at 21%.**
- (b) 44% of survey respondents performed a fraud risk assessment in the six months prior to the survey. 15% of survey respondents have never performed a fraud risk assessment.**
- (c) 43% of respondents thought members of the board of directors were “very concerned” and 33% thought “fairly concerned” about board members’ personal legal liability resulting from fraud at their companies.**
- (d) The top three issues of concern to compliance officers according to the survey were: data security; unethical business conduct; and competition law.**

- (a) The mission of the Financial Accounting Standards Board is to establish and improve standards of financial accounting and reporting that foster financial reporting by non-governmental entities that provides decision-useful information to investors and other users of financial reports.**
- (b) The Chairman will consult with FASB members, staff directors, and others as appropriate before making a decision to add or remove a project from the FASB's technical agenda or to change the priorities of existing projects.**

The FASB and its Chairman consult with FASAC concerning, among other things, major technical issues, the FASB's agenda of projects and the priorities of the projects, and matters likely to require the attention of the FASB. The FASB also considers timely suggestions from other individuals and organizations.

- (c) The FASB is committed to following an open, orderly process for setting standards. The FASB designed its comprehensive due process procedures to permit timely, thorough, and open study of financial accounting and reporting issues and to encourage broad public participation in the standards-setting process by creating channels for the communication of all points of view and expressions of opinion at all stages of the process. The cooperation of all concerned with or affected by financial accounting and reporting is fundamental to the operation of the FASB. Of particular importance to the FASB is the receipt of thoughtful, reasoned, and timely input during the FASB's research, discussion, and deliberative processes. The FASB recognizes that acceptance of its conclusions is enhanced by demonstrating that the comments received in due process are considered carefully.**

- (a) The PCAOB is a private-sector, non-profit corporation, created by the Sarbanes-Oxley Act of 2002 to oversee the auditors of public companies in order to protect investors and the public interest by promoting informative, fair, and independent audit reports.**
- (b) The PCAOB is required to conduct inspections of public accounting firms to assess compliance with the Sarbanes-Oxley Act, the rules of the Board, the rules of the SEC, and professional standards in connection with the firm's performance of audits, issuance of audit reports, and related matters involving U.S. public companies and other issuers. Inspections occur annually for larger firms and at least triennially for smaller firms. The PCAOB prepares written reports concerning each inspection for regulatory authorities and the public.**
- (c) The PCAOB has authority to investigate and discipline registered public accounting firms and persons associated with those firms for noncompliance with the Sarbanes-Oxley Act of 2002, the rules of the PCAOB and the Securities and Exchange Commission, and other laws, rules, and professional standards governing the audits of public companies. When violations are found, the PCAOB can impose appropriate sanctions. As required by the Sarbanes-Oxley Act, the Board's investigations are confidential and nonpublic. The Sarbanes-Oxley Act also requires that disciplinary proceedings are confidential and nonpublic, unless and until there is a final decision imposing sanctions.**

- (a) The material weaknesses and the related principle(s) of internal control that was violated are as follows:

Material Weakness

- Non-timely deposit of cash receipts
- Excessive past due accounts receivable
- Disregard of advantages offered by vendors for prompt payment of invoices
- Absence of segregation of duties
- Inadequate procedures for applying accounting principles
- Lack of qualified management personnel
- Lack of supervision by outside board of directors
- Overall poor record keeping

Internal Control Principle

- Physical controls—cash should be deposited in total daily
- Establishment of responsibility
- Establishment of responsibility
- Segregation of duties
- Documentation procedures
- Establishment of responsibility
- Establishment of responsibility; independent internal verification
- Documentation procedures

- (b) Under the Sarbanes-Oxley Act, publicly traded companies are required to maintain adequate systems of internal control. Failure to comply with the Act can result in fines and imprisonment of officers. Managers should recognize that good internal control is necessary to stay in business. In addition, good internal control principles should benefit the company by safeguarding its assets and enhancing the accuracy and reliability of accounting records.

Mr. D. A. Flynn
Lyman Company
Main Street, USA

Dear Mr. Flynn:

During our audit of your financial statements, we reviewed the internal controls over cash receipts. The weaknesses we discovered and our suggested improvements are listed below.

Weaknesses

Suggested Improvement

- | | |
|--|--|
| 1. A list of checks received is not prepared by the person who opens the mail. | This list should be prepared so that it can later be compared with the daily cash summary. While this procedure does not assure that all checks will be listed, it does allow the company to verify that all checks on the list did get deposited. |
| 2. Mail is opened by only one person. | When this occurs, there is no assurance that all incoming checks are forwarded to the cashier's department. |
| 3. The cashier is allowed to open the mail. | Under this arrangement, it is possible for the cashier to open the mail, prepare the cash summary and make the bank deposit. This involves no segregation of duties as the cashier controls the cash from the time it is received until it is deposited in the bank. |
| 4. The accounts receivable clerk is allowed to open the mail. | Again, there is poor segregation of duties. In this case, the clerk could write off a customer's account as uncollectible and then misappropriate the collection when it's received. |

BYP 7-8 (Continued)

Weaknesses

5. Mail receipts are deposited weekly.

Suggested Improvement

This makes the receipts vulnerable to robbery and to misappropriation. The receipts should be deposited daily.

We would be pleased to discuss the weaknesses and our recommended improvements with you, at your convenience.

Yours sincerely,

**Good and Rich
Certified Public Accountants**

- (a) The amount of fee revenue depending on order of processing would be:
- | | |
|-------------------------------|---------------------------------|
| (1) Largest to smallest: | 5 bounced checks X \$30 = \$150 |
| (2) Smallest to largest: | 1 bounced check X \$30 = \$30 |
| (3) In order of check number: | 2 bounced checks X \$30 = \$60 |
- (b) Whether this is ethical is subject to debate. On the one hand, it can be argued that customers have a responsibility to maintain an adequate balance in their accounts. Some customers are frequently overdrawn; thus only severe penalties will persuade them to maintain an adequate balance. However, it could be argued that charging \$30 for something that has a cost to the bank of \$1.50 is “gouging”—that is, taking unfair advantage of the customer.
- (c) In deciding what approach to take, the bank must consider its relationship with the customer. Clearly, by adopting a “largest to smallest” approach, it is going to anger some customers, who may well decide to leave the bank and go to a more customer-friendly bank. However, it could be argued that some of the customers the bank may lose are customers that are frequently overdrawn and therefore costly to the bank. Also, it can be time-consuming to change banks, and most people don’t have the spare time to change banks unless they really need to.
- (d) Answer will vary depending on student’s opinion.

Answers will vary depending on article chosen.

Answers are provided to students on the government website as they complete the ID Theft Faceoff quiz.

- (a) Consistent with common usage, cash includes not only currency on hand but demand deposits with banks or other financial institutions. Cash also includes other kinds of accounts that have the general characteristics of demand deposits in that the customer may deposit additional funds at any time without prior notice or penalty. All charges and credits to those accounts are cash receipts or payments to both the entity owning the account and the bank holding it. For example, a bank's granting of a loan by crediting the proceeds to a customer's demand deposit account is a cash payment by the bank and a cash receipt of the customer when the entry is made. Codification reference (305-10-20).
- (b) Cash equivalents are short-term, highly liquid investments that have both of the following characteristics:

 - a. Readily convertible to known amounts of cash
 - b. So near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

Generally, only investments with original maturities of three months or less qualify under that definition. Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months. Examples of items commonly considered to be cash equivalents are Treasury bills, commercial paper, money market funds, and federal funds sold (for an entity with banking operations). Codification reference (305-10-20).

BYP 7-12 (Continued)

- (c) Cash and cash items.** Separate disclosure shall be made of the cash and cash items which are restricted as to withdrawal or usage. The provisions of any restrictions shall be described in a note to the financial statements. Restrictions may include legally restricted deposits held as compensating balances against short-term borrowing arrangements, contracts entered into with others, or company statements of intention with regard to particular deposits; however, time deposits and short-term certificates of deposit are not generally included in legally restricted deposits. In cases where compensating balance arrangements exist but are not agreements which legally restrict the use of cash amounts shown on the balance sheet, describe in the notes to the financial statements these arrangements and the amount involved, if determinable, for the most recent audited balance sheet required and for any subsequent unaudited balance sheet required in the notes to the financial statements. Compensating balances that are maintained under an agreement to assure future credit availability shall be disclosed in the notes to the financial statements along with the amount and terms of such agreement.

IFRS7-1

Companies listed on U.S. stock exchanges must comply with the Sarbanes-Oxley Act. This compliance gives investors greater assurance that these companies have adequate internal controls in place. In addition, the auditors for these publicly traded companies must attest to the effectiveness of such controls. This process can result in discovery of weaknesses that companies had previously overlooked. After correcting these weaknesses to satisfy auditors, investors may find such companies to be less risky and therefore better investments.

In order to comply with SOX, a company must document its internal control procedures and have an auditor attest to their effectiveness. Doing so costs money. A recent study indicated that audit fees can double in the first year of a company's compliance. Since this cost is incurred only if a company lists on U.S. exchanges, many investors see SOX compliance as a costly undertaking.

IFRS7-2

- (a) True.**
- (b) False. Different cultures have different perspectives on bribery and other questionable activities.**
- (c) False. Cash (not cash equivalents) is comprised of cash on hand and demand deposits.**
- (d) False. Sox was created by the U.S. Congress.**

- (a) Zetar's Audit Committee reviews management's reports on internal control.**
- (b) The key control procedures include**
 - 1. A comprehensive system of financial budgeting, forecasting and then reporting and reviewing actual monthly results for the current year against these expectations and against the results of prior years.**
 - 2. A system of operational and financial Key Performance Indicators ("KPIs"), which are reviewed on a weekly and monthly basis.**
 - 3. Procedures for appraisal, review and authorization of capital expenditures.**
 - 4. Properly authorized treasury procedures and banking arrangements.**
 - 5. Regular review of materials and services supply commitments.**
 - 6. Regular review of tax, insurance, and health and safety matters.**
- (c) No, Zetar's Board does not consider it appropriate to establish an internal audit department.**
- (d) Bank overdrafts are reported as the last item in the current liabilities section of its consolidated balance sheet.**