PRACTICE MULTIPLE-CHOICE QUESTIONS

**7-1.** (LO 1)

Which of the following is **not**an element of the fraud triangle?

(a) Rationalization.

(b) Financial pressure.

(c) Segregation of duties.

(d) Opportunity.

**Answer**

(c) Segregation of duties.

**7-2.** (LO 1)

An organization uses internal control to enhance the accuracy and reliability of its accounting records and to:

(a) safeguard its assets.

(b) prevent fraud.

(c) produce correct financial statements.

(d) deter employee dishonesty.

**Answer**

(a) safeguard its assets.

**7-3.** (LO 2)

The principles of internal control do **not**include:

(a) establishment of responsibility.

(b) documentation procedures.

(c) management responsibility.

(d) independent internal verification.

**Answer**

(c) management responsibility.

**7-4.** (LO 2)

Physical controls do **not**include:

(a) safes and vaults to store cash.

(b) independent bank reconciliations.

(c) locked warehouses for inventories.

(d) bank safety deposit boxes for important papers.

**Answer**

(b) independent bank reconciliations.

**7-5.** (LO 3)

Permitting only designated personnel to handle cash receipts is an application of the principle of:

(a) segregation of duties.

(b) establishment of responsibility.

(c) independent check.

(d) human resource controls.

**Answer**

(b) establishment of responsibility.

**7-6.** (LO 3)

Which of the following control activities is **not** relevant when a company uses a computerized (rather than manual) accounting system?

(a) Establishment of responsibility.

(b) Segregation of duties.

(c) Independent internal verification.

(d) All of these control activities are relevant to a computerized system.

**Answer**

(d) All of these control activities are relevant to a computerized system.

**7-7.** (LO 4)

The use of prenumbered checks in disbursing cash is an application of the principle of:

(a) establishment of responsibility.

(b) segregation of duties.

(c) physical controls.

(d) documentation procedures.

**Answer**

(d) documentation procedures.

**7-8.** (LO 5)

A company writes a check to replenish a €100 petty cash fund when the fund contains receipts of €94 and €4 in cash. In recording the check, the company should:

(a) debit Cash Over and Short for €2.

(b) debit Petty Cash for €94.

(c) credit Cash for €94.

(d) credit Petty Cash for €2.

**Answer**

(a) debit Cash Over and Short for €2.

**7-9.** (LO 6)

The control features of a bank account do **not**include:

(a) having bank auditors verify the correctness of the bank balance per books.

(b) minimizing the amount of cash that must be kept on hand.

(c) providing a double record of all bank transactions.

(d) safeguarding cash by using a bank as a depository.

**Answer**

(a) having bank auditors verify the correctness of the bank balance per books.

**7-10.** (LO 7)

In a bank reconciliation, deposits in transit are:

(a) deducted from the book balance.

(b) added to the book balance.

(c) added to the bank balance.

(d) deducted from the bank balance.

**Answer**

(c) added to the bank balance.

**7-11.** (LO 7)

The reconciling item in a bank reconciliation that will result in an adjusting entry by the depositor is:

(a) outstanding checks.

(b) deposit in transit.

(c) a bank error.

(d) bank service charges.

**Answer**

(d) bank service charges.

**7-12.** (LO 8)

Which of the following items in a cash drawer at November 30 is **not**cash?

(a) Money orders.

(b) Coins and currency.

(c) An NSF check.

(d) A customer check dated November 28.

**Answer**

(c) An NSF check.

**7-13.** (LO 8)

Which of the following statements correctly describes the reporting of cash?

(a) Cash cannot be combined with cash equivalents.

(b) Restricted cash funds may be combined with cash.

(c) Cash is listed last in the current assets section.

(d) Restricted cash funds cannot be reported as a current asset.

**Answer**

(c) Cash is listed last in the current assets section.

QUESTIONS

**7-1.** A local bank reported that it lost €150,000 as the result of an employee fraud. Travis Witt is not clear on what is meant by an “employee fraud.” Explain the meaning of fraud to Travis and give an example of frauds that might occur at a bank.

**7-2.** Fraud experts often say that there are three primary factors that contribute to employee fraud. Identify the three factors and explain what is meant by each.

**7-3.** Identify and describe the five components of a good internal control system.

**7-4.** “Internal control is concerned only with enhancing the accuracy of the accounting records.” Do you agree? Explain.

**7-5.** What principles of internal control apply to most organizations?

**7-6.** At the corner grocery store, all sales clerks make change out of one cash register drawer. Is this a violation of internal control? Why?

**7-7.** Huan Lee is reviewing the principle of segregation of duties. What are the two common applications of this principle?

**7-8.** How do documentation procedures contribute to good internal control?

**7-9.** What internal control objectives are met by physical controls?

**7-10.** (a) Explain the control principle of independent internal verification.

(b) What practices are important in applying this principle?

**7-11.** The management of Yaeger Company asks you, as the company accountant, to explain (a) the concept of reasonable assurance in internal control and (b) the importance of the human factor in internal control.

**7-12.** Yorkville Fertilizer plc owns the following assets at the statement of financial position date.

|  |  |
| --- | --- |
| Cash in bank savings account | £ 6,000 |
| Cash on hand | 850 |
| Cash refund due from tax authority | 1,000 |
| Checking account balance | 12,000 |
| Postdated checks | 500 |

What amount should Yorkville report as cash in the statement of financial position?

**7-13.** What principle(s) of internal control is (are) involved in making daily cash counts of over-the-counter receipts?

**7-14.** Aurora Department Stores has just installed new electronic cash registers in its stores. How do cash registers improve internal control over cash receipts?

**7-15.** At Oswego Wholesale Company, two mail clerks open all mail receipts. How does this strengthen internal control?

**7-16.** “To have maximum effective internal control over cash disbursements, all payments should be made by check.” Is this true? Explain.

**7-17.** Hecuba Company's internal controls over cash disbursements provide for the treasurer to sign checks imprinted by a check-writing machine in indelible ink after comparing the check with the approved invoice. Identify the internal control principles that are present in these controls.

**7-18.** How do the principles of (a) physical controls and (b) documentation controls apply to cash disbursements?

**7-19.** (a) What is a voucher system?

(b) What principles of internal control apply to a voucher system?

**7-20.** What is the essential feature of an electronic funds transfer (EFT) procedure?

**7-21.** (a) Identify the three activities that pertain to a petty cash fund, and indicate an internal control principle that is applicable to each activity.

(b) When are journal entries required in the operation of a petty cash fund?

**7-22.** “The use of a bank contributes significantly to good internal control over cash.” Is this true? Why or why not?

**7-23.** Faye Uhlik is confused about the lack of agreement between the cash balance per books and the balance per bank. Explain the causes for the lack of agreement to Faye, and give an example of each cause.

**7-24.** What are the four steps involved in finding differences between the balance per books and balance per bank?

**7-25.** Paula Dominguez asks your help concerning an NSF check. Explain to Paula

(a) what an NSF check is,

(b) how it is treated in a bank reconciliation, and

(c) whether it will require an adjusting entry.

**7-26.** (a) “Cash equivalents are the same as cash.” Do you agree? Explain.

(b) How should restricted cash funds be reported on the statement of financial position?

BRIEF EXERCISES

**BE7-1.** *Identify fraud triangle concepts.*

(LO 1)

Match each situation with the fraud triangle factor—opportunity, financial pressure, or rationalization—that best describes it.

1. An employee's monthly credit card payments are nearly 75% of his or her monthly earnings.

2. An employee earns minimum wage at a firm that has reported record earnings for each of the last five years.

3. An employee has an expensive gambling habit.

4. An employee has check-writing and signing responsibilities for a small company, as well as reconciling the bank account.

**BE7-2.** *Indicate internal control concepts.*

(LO 1)

Yumi Nae has prepared the following statements about internal control.

1. One of the objectives of internal control is to safeguard assets from employee theft, robbery, and unauthorized use.

2. One of the objectives of internal control is to enhance the accuracy and reliability of the accounting records.

3. The three components of the fraud triangle are opportunity, financial pressure, and fear.

Identify each statement as true or false. If false, indicate how to correct the statement.

**BE7-3.** *Explain the importance of internal control.*

(LO 1)

Coco Leclerc is the new owner of Leclerc Parking. She has heard about internal control but is not clear about its importance for her business. Explain to Coco the four purposes of internal control and give her one application of each purpose for Leclerc Parking.

**BE7-4.** *Identify internal control principles.*

(LO 2)

The internal control procedures in Varma Company provide that:

1. Employees who have physical custody of assets do not have access to the accounting records.

2. Each month, the assets on hand are compared to the accounting records by an internal auditor.

3. A prenumbered shipping document is prepared for each shipment of goods to customers.

Identify the principles of internal control that are being followed.

**BE7-5.** *Identify the internal control principles applicable to cash receipts.*

(LO 3)

Rahman Ltd. has the following internal control procedures over cash receipts. Identify the internal control principle that is applicable to each procedure.

1. All over-the-counter receipts are entered on cash registers.

2. All cashiers are bonded.

3. Daily cash counts are made by cashier department supervisors.

4. The duties of receiving cash, recording cash, and custody of cash are assigned to different individuals.

5. Only cashiers may operate cash registers.

**BE7-6.** *Make journal entries for cash overage and shortfall.*

(LO 3)

The cash register tape for Leprechaun Industries Ltd. reported sales of £6,891.50. Record the journal entry that would be necessary for each of the following situations.

(a) Cash to be accounted for exceeds cash on hand by £46.25.

(b) Cash on hand exceeds cash to be accounted for by £28.32.

**BE7-7.** *Make journal entry using cash count sheet.*

(LO 3)

While examining cash receipts information, the accounting department determined the following information: opening cash balance €180, cash on hand €1,122.74, and cash sales per register tape €950.83. Prepare the required journal entry based upon the cash count sheet.

**BE7-8.** *Identify the internal control principles applicable to cash disbursements.*

(LO 4)

Helena Company has the following internal control procedures over cash disbursements. Identify the internal control principle that is applicable to each procedure.

1. Company checks are prenumbered.

2. The bank statement is reconciled monthly by an internal auditor.

3. Blank checks are stored in a safe in the treasurer's office.

4. Only the treasurer or assistant treasurer may sign checks.

5. Check signers are not allowed to record cash disbursement transactions.

**BE7-9.** *Prepare entry to replenish a petty cash fund.*

(LO 5)

On March 20, Yang Ltd.'s petty cash fund of ¥1,000 is replenished when the fund contains ¥90 in cash and receipts for postage ¥520, freight-out ¥260, and travel expense ¥100. Prepare the journal entry to record the replenishment of the petty cash fund.

**BE7-10.** *Identify the control features of a bank account.*

(LO 6)

Anthony Ferrari is uncertain about the control features of a bank account. Explain the control benefits of (a) a check and (b) a bank statement.

**BE7-11.** *Indicate location of reconciling items in a bank reconciliation.*

(LO 7)

The following reconciling items are applicable to the bank reconciliation for Kimura Company: (1) outstanding checks, (2) bank debit memorandum for service charge, (3) bank credit memorandum for collecting a note for the depositor, and (4) deposits in transit. Indicate how each item should be shown on a bank reconciliation.

**BE7-12.** *Identify reconciling items that require adjusting entries.*

(LO 7)

Using the data in BE7-11, indicate (a) the items that will result in an adjustment to the depositor's records and (b) why the other items do not require adjustment.

**BE7-13.** *Prepare partial bank reconciliation.*

(LO 7)

At July 31, Kowloon Ltd. has the following bank information: cash balance per bank HK$74,200, outstanding checks HK$7,640, deposits in transit HK$16,200, and a bank service charge HK$220. Determine the adjusted cash balance per bank at July 31.

**BE7-14.** *Prepare partial bank reconciliation.*

(LO 7)

At August 31, Felipe SA has a cash balance per books of €8,900 and the following additional data from the bank statement: charge for printing Felipe SA checks €35, interest earned on checking account balance €40, and outstanding checks €800. Determine the adjusted cash balance per books at August 31.

**BE7-15.** *Explain the statement presentation of cash balances.*

(LO 8)

Sokolov OAO has the following cash balances: Cash in Bank £15,742, Payroll Bank Account £5,000, and Plant Expansion Fund Cash £45,000 (to be used two years from now). Explain how each balance should be reported on the statement of financial position.

**DO IT! REVIEW**

**DO IT! 7-1.** *Identify violations of control activities.*

(LO 2)

Identify which control activity is violated in each of the following situations, and explain how the situation creates an opportunity for fraud or inappropriate accounting practices.

1. Once a month, the sales department sends sales invoices to the accounting department to be recorded.

2. Angela Marino orders merchandise for Lake Como SpA; he also receives merchandise and authorizes payment for merchandise.

3. Several clerks at Esposito's Foods use the same cash register drawer.

**DO IT! 7-2.** *Design system of internal control over cash receipts.*

(LO 3)

Eric Nilsen is concerned with control over mail receipts at Midtown Sporting Goods. All mail receipts are opened by Arne Johansen. Arne sends the checks to the accounting department, where they are stamped “For Deposit Only.” The accounting department records and deposits the mail receipts weekly. Eric asks for your help in installing a good system of internal control over mail receipts.

**DO IT! 7-3.** *Make journal entries for petty cash fund.*

(LO 5)

Arvel Ltd. established a £100 petty cash fund on August 1. On August 31, the fund had £6 cash remaining and petty cash receipts for postage £31, office supplies £44, and miscellaneous expense £16. Prepare journal entries to establish the fund on August 1 and replenish the fund on August 31.

**DO IT! 7-4.** *Explain treatment of items in bank reconciliation.*

(LO 7)

Ryou Kato owns Kato Blankets. Ryou asks you to explain how he should treat the following reconciling items when reconciling the company's bank account.

1. Outstanding checks.

2. A deposit in transit.

3. The bank charged to our account a check written by another company.

4. A debit memorandum for a bank service charge.

**DO IT! 7-5.** *Analyze statements about the reporting of cash.*

(LO 8)

Indicate whether each of the following statements is true or false.

1. A company has the following assets at the end of the year: cash on hand $40,000, cash refund due from customer $30,000, and checking account balance $22,000. Cash and cash equivalents is therefore $62,000.

2. A company that has received NSF checks should report these checks as a current liability on the statement of financial position.

3. Restricted cash that is a current asset is reported as part of cash and cash equivalents.

4. A company has cash in the bank of $50,000, pretty cash of $400, and share investments of $100,000. Total cash and cash equivalents is therefore $50,400.

EXERCISES

**E7-1.** *Identify the principles of internal control.*

(LO 2)

Luna Ernesto is the owner of Ernesto's Pizza. Ernesto's is operated strictly on a carryout basis. Customers pick up their orders at a counter where a clerk exchanges the pizza for cash. While at the counter, the customer can see other employees making the pizzas and the large ovens in which the pizzas are baked.

***Instructions***

Identify the six principles of internal control and give an example of each principle that you might observe when picking up your pizza. (*Note:* It may not be possible to observe all the principles.)

**E7-2.** *Identify internal control weaknesses over cash receipts and suggest improvements.*

(LO 2, 3)

The following control procedures are used at Aldean Ltd. for over-the-counter cash receipts.

1. To minimize the risk of robbery, cash in excess of £100 is stored in an unlocked attaché case in the stockroom until it is deposited in the bank.

2. All over-the-counter receipts are registered by three clerks who use a cash register with a single cash drawer.

3. The company accountant makes the bank deposit and then records the day's receipts.

4. At the end of each day, the total receipts are counted by the cashier on duty and reconciled to the cash register total.

5. Cashiers are experienced; they are not bonded.

***Instructions***

(a) For each procedure, explain the weakness in internal control, and identify the control principle that is violated.

(b) For each weakness, suggest a change in procedure that will result in good internal control.

**E7-3.** *Identify internal control weaknesses over cash disbursements and suggest improvements.*

(LO 2, 4)

The following control procedures are used in Monique's Boutique Shoppe for cash disbursements.

1. The company accountant prepares the bank reconciliation and reports any discrepancies to the owner.

2. The store manager personally approves all payments before signing and issuing checks.

3. Each week, 100 company checks are left in an unmarked envelope on a shelf behind the cash register.

4. After payment, bills are filed in a paid invoice folder.

5. The company checks are unnumbered.

***Instructions***

(a) For each procedure, explain the weakness in internal control, and identify the internal control principle that is violated.

(b) For each weakness, suggest a change in the procedure that will result in good internal control.

**E7-4.** *Identify internal control weaknesses for cash disbursements and suggest improvements.*

(LO 4)

At Teresa SpA, checks are not prenumbered because both the purchasing agent and the treasurer are authorized to issue checks. Each signer has access to unissued checks kept in an unlocked file cabinet.

The purchasing agent pays all bills pertaining to goods purchased for resale. Prior to payment, the purchasing agent determines that the goods have been received and verifies the mathematical accuracy of the vendor's invoice. After payment, the invoice is filed by vendor name, and the purchasing agent records the payment in the cash disbursements journal. The treasurer pays all other bills following approval by authorized employees. After payment, the treasurer stamps all bills PAID, files them by payment date, and records the checks in the cash disbursements journal. Teresa Company maintains one checking account that is reconciled by the treasurer.

***Instructions***

(a) List the weaknesses in internal control over cash disbursements.

(b) Write a memo to the company treasurer indicating your recommendations for improvement.

**E7-5.** *Indicate whether procedure is good or weak internal control.*

(LO 2, 3, 4)

Listed below are five procedures followed by Zulma AG.

1. Several individuals operate the cash register using the same register drawer.

2. A monthly bank reconciliation is prepared by someone who has no other cash responsibilities.

3. Rosa Garcia writes checks and also records cash payment journal entries.

4. One individual orders inventory, while a different individual authorizes payments.

5. Unnumbered sales invoices from credit sales are forwarded to the accounting department every four weeks for recording.

***Instructions***

Indicate whether each procedure is an example of good internal control or of weak internal control. If it is an example of good internal control, indicate which internal control principle is being followed. If it is an example of weak internal control, indicate which internal control principle is violated. Use the table below.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Procedure** |  | **IC Good or Weak?** |  | **Related Internal Control Principle** |
| 1. |  |  |  |  |
| 2. |  |  |  |  |
| 3. |  |  |  |  |
| 4. |  |  |  |  |
| 5. |  |  |  |  |

**E7-6.** *Indicate whether procedure is good or weak internal control.*

(LO 2, 3, 4)

Listed below are five procedures followed by Bingham Enterprises Ltd.

1. Employees are required to take vacations.

2. Any member of the sales department can approve credit sales.

3. Blake Nayak ships goods to customers, bills customers, and receives payment from customers.

4. Total cash receipts are compared to bank deposits daily by someone who has no other cash responsibilities.

5. Time clocks are used for recording time worked by employees.

***Instructions***

Indicate whether each procedure is an example of good internal control or of weak internal control. If it is an example of good internal control, indicate which internal control principle is being followed. If it is an example of weak internal control, indicate which internal control principle is violated. Use the table below.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Procedure** |  | **IC Good or Weak?** |  | **Related Internal Control Principle** |
| 1. |  |  |  |  |
| 2. |  |  |  |  |
| 3. |  |  |  |  |
| 4. |  |  |  |  |
| 5. |  |  |  |  |

**E7-7.** *Prepare journal entries for a petty cash fund.*

(LO 5)

LaSalle SA established a petty cash fund on May 1, cashing a check for €100. The company reimbursed the fund on June 1 and July 1 with the following results.

June 1: Cash in fund €1.75. Receipts: delivery expense €31.25; postage expense €41.00; and miscellaneous expense €25.00.

July 1: Cash in fund €3.25. Receipts: delivery expense €21.00; entertainment expense €53.00; and miscellaneous expense €24.75.

On July 10, LaSalle increased the fund from €100 to €150.

***Instructions***

Prepare journal entries for LaSalle SA for May 1, June 1, July 1, and July 10.

**E7-8.** *Prepare journal entries for a petty cash fund.*

(LO 5)

Ankara A.S. uses an imprest petty cash system. The fund was established on March 1 with a balance of [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)100. During March, the following petty cash receipts were found in the petty cash box.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Date** |  | **Receipt No.** |  | **For** |  | **Amount** |
| 3/5 |  | 1 |  | Stamp Inventory |  | [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)39 |
| 7 |  | 2 |  | Freight-Out |  | 17 |
| 9 |  | 3 |  | Miscellaneous Expense |  | 6 |
| 11 |  | 4 |  | Travel Expense |  | 24 |
| 14 |  | 5 |  | Miscellaneous Expense |  | 7 |

The fund was replenished on March 15 when the fund contained [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)4 in cash. On March 20, the amount in the fund was increased to [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)150.

***Instructions***

Journalize the entries in March that pertain to the operation of the petty cash fund.

**E7-9.** *Prepare bank reconciliation and adjusting entries.*

(LO 7)

Basel AG is unable to reconcile the bank balance at January 31. Basel's reconciliation is as follows.

|  |  |
| --- | --- |
| Cash balance per bank | CHF3,660.20 |
| Add: NSF check | 590.00 |
| Less: Bank service charge | 30.00 |
| Adjusted balance per bank | CHF4,220.20 |
|  |  |
| Cash balance per books | CHF3,825.20 |
| Less: Deposits in transit | 480.00 |
| Add: Outstanding checks | 935.00 |
| Adjusted balance per books | CHF4,280.20 |

***Instructions***

(a) Prepare a correct bank reconciliation.

(b) Journalize the entries required by the reconciliation.

**E7-10.** *Determine outstanding checks.*

(LO 7)

On April 30, the bank reconciliation of Yazici Company shows three outstanding checks: no. 254, €650; no. 255, €720; and no. 257, €410. The May bank statement and the May cash payments journal show the following.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | | **Bank Statement** | | |  | |  |  |  |  | **Cash Payments Journal** | | | | |  |  |
|  | **Checks Paid** | | | | | | |  |  |  | **Checks Issued** | | | | | | |  |
|  | **Date** |  | | **Check No.** |  | | **Amount** |  |  |  | **Date** | |  | **Check No.** |  | **Amount** | |  |
|  | 5/4 |  | | 254 |  | | 650 |  |  |  | 5/2 | |  | 258 |  | 159 | |  |
|  | 5/2 |  | | 257 |  | | 410 |  |  |  | 5/5 | |  | 259 |  | 275 | |  |
|  | 5/17 |  | | 258 |  | | 159 |  |  |  | 5/10 | |  | 260 |  | 820 | |  |
|  | 5/12 |  | | 259 |  | | 275 |  |  |  | 5/15 | |  | 261 |  | 500 | |  |
|  | 5/20 |  | | 261 |  | | 500 |  |  |  | 5/22 | |  | 262 |  | 750 | |  |
|  | 5/29 |  | | 263 |  | | 480 |  |  |  | 5/24 | |  | 263 |  | 480 | |  |
|  | 5/30 |  | | 264 |  | | 560 |  |  |  | 5/29 | |  | 264 |  | 560 | |  |
|  |  |  | |  |  | |  |  |  |  |  | |  |  |  |  | |  |

***Instructions***

Using Step 2 in the reconciliation procedure, list the outstanding checks at May 31.

**E7-11.** *Prepare bank reconciliation and adjusting entries.*

(LO 7)

The following information pertains to Teresina Video SA.

1. Cash balance per bank, July 31, R$7,293.

2. July bank service charge not recorded by the depositor R$28.

3. Cash balance per books, July 31, R$7,427.

4. Deposits in transit, July 31, R$1,500.

5. Bank collected R$700 note for Teresina in July, plus interest R$356, less fee R$25. The collection has not been recorded by Teresina, and no interest has been accrued.

6. Outstanding checks, July 31, R$684.

***Instructions***

(a) Prepare a bank reconciliation at July 31.

(b) Journalize the adjusting entries at July 31 on the books of Teresina Video SA.

**E7-12.** *Prepare bank reconciliation and adjusting entries.*

(LO 7)

The information below relates to the Cash account in the ledger of Marin SA.

Balance September 1—£17,150; Cash deposited—£64,000.

Balance September 30—£17,404; Checks written—£63,746.

The September bank statement shows a balance of £16,122 on September 30 and the following memoranda.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Credit** | |  | **Debit** | |
| Collection of £1,500 note plus interest £30 | £1,530 |  | NSF check: Violet Jones | £725 |
| Interest earned on checking account | £45 |  | Safety deposit box rent | £65 |

At September 30, deposits in transit were £4,450, and outstanding checks totaled £2,383.

***Instructions***

(a) Prepare the bank reconciliation at September 30.

(b) Prepare the adjusting entries at September 30, assuming (1) the NSF check was from a customer on account, and (2) no interest had been accrued on the note.

**E7-13.** *Compute deposits in transit and outstanding checks for two bank reconciliations.*

(LO 7)

The cash records of Petit SA show the following four situations.

1. The June 30 bank reconciliation indicated that deposits in transit total €920. During July, the general ledger account Cash shows deposits of €15,750, but the bank statement indicates that only €15,600 in deposits were received during the month.

2. The June 30 bank reconciliation also reported outstanding checks of €880. During the month of July, Petit’s books show that €17,200 of checks were issued. The bank statement showed that €16,400 of checks cleared the bank in July.

3. In September, deposits per the bank statement totaled €26,700, deposits per books were €25,400, and deposits in transit at September 30 were €2,800.

4. In September, cash disbursements per books were €23,700, checks clearing the bank were €24,500, and outstanding checks at September 30 were €2,100.

There were no bank debit or credit memoranda. No errors were made by either the bank or Petit.

***Instructions***

Answer the following questions.

(a) In situation (1), what were the deposits in transit at July 31?

(b) In situation (2), what were the outstanding checks at July 31?

(c) In situation (3), what were the deposits in transit at August 31?

(d) In situation (4), what were the outstanding checks at August 31?

**E7-14.** *Show presentation of cash in financial statements.*

(LO 8)

Nayak plc has recorded the following items in its financial records.

|  |  |
| --- | --- |
| Cash in bank | £41,000 |
| Cash in plant expansion fund | 100,000 |
| Cash on hand | 8,000 |
| Highly liquid investments | 34,000 |
| Petty cash | 500, |
| Receivables from customers | 89,000 |
| Stock investments | 61,000 |

The highly liquid investments had maturities of 3 months or less when they were purchased. The share investments will be sold in the next 6 to 12 months. The plant expansion project will begin in 3 years.

***Instructions***

(a) What amount should Nayak report as “Cash and cash equivalents” on its statement of financial position?

(b) Where should the items not included in part (a) be reported on the statement of financial position?

(c) What disclosures should Nayak make in its financial statements concerning “cash and cash equivalents”?

PROBLEMS: SET A AND PROBLEMS: SET B

**P7-1A** *Identify internal control principles over cash disbursements.*

(LO 2, 4)

Contreras Supply SLU recently changed its system of internal control over cash disbursements. The system includes the following features.

Instead of being unnumbered and manually prepared, all checks must now be prenumbered and written by using the new check-writing machine purchased by the company. Before a check can be issued, each invoice must have the approval of Berta Rojas, the purchasing agent, and Tiare Diaz, the receiving department supervisor. Checks must be signed by either Amaika Blake, the treasurer, or Juan Perez, the assistant treasurer. Before signing a check, the signer is expected to compare the amount of the check with the amount on the invoice.

After signing a check, the signer stamps the invoice PAID and inserts, within the stamp, the date, check number, and amount of the check. The “paid” invoice is then sent to the accounting department for recording.

Blank checks are stored in a safe in the treasurer's office. The combination to the safe is known only by the treasurer and assistant treasurer. Each month, the bank statement is reconciled with the bank balance per books by the assistant chief accountant. All employees who handle or account for cash are bonded.

***Instructions***

Identify the internal control principles and their application to cash disbursements of Contreras Supply SLU.

**P7-2A** *Journalize and post petty cash fund transactions.*

(LO 5)

Arial Ltd. maintains a petty cash fund for small expenditures. The following transactions occurred over a 2-month period.

July 1 Established petty cash fund by writing a check on Coulter Bank for €200.

15 Replenished the petty cash fund by writing a check for €198.00. On this date the fund consisted of €2.00 in cash and the following petty cash receipts: freight-out €87.00, postage expense €51.40, entertainment expense €46.60, and miscellaneous expense €11.20.

31 Replenished the petty cash fund by writing a check for €192.00. At this date, the fund consisted of €8.00 in cash and the following petty cash receipts: freight-out €82.10, charitable contributions expense €45.00, postage expense €25.50, and miscellaneous expense €39.40.

Aug. 15 Replenished the petty cash fund by writing a check for €187.00. On this date, the fund consisted of €13.00 in cash and the following petty cash receipts: freight-out €75.60, entertainment expense €43.00, postage expense €33.00, and miscellaneous expense €37.00.

16 Increased the amount of the petty cash fund to €300 by writing a check for €100.

31 Replenished petty cash fund by writing a check for €277.00. On this date, the fund consisted of €23 in cash and the following petty cash receipts: postage expense €133.00, travel expense €95.60, and freight-out €47.10.

***Instructions***

(a) Journalize the petty cash transactions.

July 15, Cash short €1.80

(b) Post to the Petty Cash account.

Aug. 31 balance €300

(c) What internal control features exist in a petty cash fund?

**P7-3A** *Prepare a bank reconciliation and adjusting entries.*

(LO 7)

On May 31, 2017, Terrell Ltd. had a cash balance per books of £6,781.50. The bank statement from Home Town Bank on that date showed a balance of £6,804.60. A comparison of the statement with the Cash account revealed the following facts.

1. The statement included a debit memo of £60 for the printing of additional company checks.

2. Cash sales of £836.15 on May 12 were deposited in the bank. The cash receipts journal entry and the deposit slip were incorrectly made for £886.15. The bank credited Terrell Company for the correct amount.

3. Outstanding checks at May 31 totaled £276.25. Deposits in transit were £1,916.15.

4. On May 18, the company issued check No. 1181 for £685 to Barry Dietz on account. The check, which cleared the bank in May, was incorrectly journalized and posted by Terrell Company for £658.

5. A £3,000 note receivable was collected by the bank for Terrell Company on May 31 plus £80 interest. The bank charged a collection fee of £20. No interest has been accrued on the note.

6. Included with the cancelled checks was a check issued by Bridges plc to Jon Newton for £600 that was incorrectly charged to Terrell by the bank.

7. On May 31, the bank statement showed an NSF charge of £640 for a check issued by Sandy Grifton, a customer, to Terrell Company on account.

***Instructions***

(a) Prepare the bank reconciliation at May 31, 2017.

Adjusted cash balance per bank £9,064.50

(b) Prepare the necessary adjusting entries for Terrell at May 31, 2017.

**P7-4A** *Prepare a bank reconciliation and adjusting entries from detailed data.*

(LO 7)

The bank portion of the bank reconciliation for Rintala Ltd. at November 30, 2017, was as follows.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **RINTALA LTD.**  **Bank Reconciliation**  **November 30, 2017** | | | | | | | | |
| Cash balance per bank | | | | | | | £14,367.90 | |
| Add: Deposits in transit | | | | | | | 2,530.20 | |
|  | | | | | | | 16,898.10 | |
| Less: Outstanding checks | | | | | | | | |
|  | Check Number |  | Check Amount | | |  | |  |
|  | 3451 |  | £2,260.40 | | |  | |  |
|  | 3470 |  | 720.10 | | |  | |  |
|  | 3471 |  | 844.50 | | |  | |  |
|  | 3472 |  | 1,426.80 | | |  | |  |
|  | 3474 |  |  | 1,050.00 |  |  | | 6,301.80 |
| Adjusted cash balance per bank | | | | | | | | £10,596.30 |

The adjusted cash balance per bank agreed with the cash balance per books at November 30.

The December bank statement showed the following checks and deposits.

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | | | | **Bank Statement** | | |  | | |  |
|  | **Checks** | | | | | |  | **Deposits** | | |  |
|  | **Date** |  | **Number** |  | | **Amount** |  | **Date** |  | **Amount** |  |
|  | 12-1 |  | 3451 |  | | £2,260.40 |  | 12-1 |  | £2,530.20 |  |
|  | 12-2 |  | 3471 |  | | 844.50 |  | 12-4 |  | 1.211.60 |  |
|  | 12-7 |  | 3472 |  | | 1,426.80 |  | 12-8 |  | 2.365.10 |  |
|  | 12-4 |  | 3475 |  | | 1,640.70 |  | 12-16 |  | 2.672.70 |  |
|  | 12-8 |  | 3476 |  | | 1,300.00 |  | 12-21 |  | 2.945.00 |  |
|  | 12-10 |  | 3477 |  | | 2,130.00 |  | 12-26 |  | 2.567.30 |  |
|  | 12-15 |  | 3479 |  | | 3,080.00 |  | 12-29 |  | 2.836.00 |  |
|  | 12-27 |  | 3480 |  | | 600.00 |  | 12-30 |  | 1.025.00 |  |
|  | 12-30 |  | 3482 |  | | 475.50 |  | Total |  | £18.152.90 |  |
|  | 12-29 |  | 3483 |  | | 1,140.00 |  |  |  |  |  |
|  | 12-31 |  | 3485 |  | | 540.80 |  |  |  |  |  |
|  |  |  | Total |  | | £15,438.70 |  |  |  |  |  |
|  |  |  |  |  | |  |  |  |  |  |  |

The cash records per books for December showed the following.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Cash Payments Journal** | | | | | | | | | | |  |  |  | **Cash Receipts Journal** | | |  |
|  | **Date** |  | **Number** |  | **Amount** |  | **Date** |  | **Number** |  | **Amount** |  |  |  | **Date** |  | **Amount** |  |
|  | 12-1 |  | 3475 |  | £1,640.70 |  | 12-20 |  | 3482 |  | £475.50 |  |  |  | 12-3 |  | £1,211.60 |  |
|  | 12-2 |  | 3476 |  | 1,300.00 |  | 12-22 |  | 3483 |  | 1140.00 |  |  |  | 12-7 |  | 2,265.10 |  |
|  | 12-2 |  | 3477 |  | 2,130.00 |  | 12-23 |  | 3484 |  | 798.00 |  |  |  | 12-15 |  | 2,672.70 |  |
|  | 12-4 |  | 3478 |  | 621.30 |  | 12-24 |  | 3485 |  | 450.80 |  |  |  | 12-20 |  | 2,954.00 |  |
|  | 12-8 |  | 3479 |  | 3,080.00 |  | 12-60 |  | 3486 |  | 1,889.50 |  |  |  | 12-25 |  | 2,567.30 |  |
|  | 12-10 |  | 3480 |  | 600.00 |  | Total |  |  |  | £14,933.20 |  |  |  | 12-28 |  | 2,836.00 |  |
|  | 12-17 |  | 3481 |  | 807.40 |  |  |  |  |  |  |  |  |  | 12-30 |  | 1,025.00 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | 12-31 |  | 1,190.40 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | Total |  | £16,822.10 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

The bank statement contained two memoranda:

1. A credit of £3,645 for the collection of a £3,500 note for Rintala plus interest of £160 and less a collection fee of £15. Rintala has not accrued any interest on the note.

2. A debit of £572.80 for an NSF check written by D. Chagnon, a customer. At December 31, the check had not been redeposited in the bank.

At December 31, the cash balance per books was £12,485.20, and the cash balance per the bank statement was £20,154.30. The bank did not make any errors, but two errors were made by Rintala.

***Instructions***

(a) Using the four steps in the reconciliation procedure, prepare a bank reconciliation at December 31.

Adjusted balance per books £15,458.40

(b) Prepare the adjusting entries based on the reconciliation. (*Hint:* The correction of any errors pertaining to recording checks should be made to Accounts Payable. The correction of any errors relating to recording cash receipts should be made to Accounts Receivable.)

**P7-5A** *Prepare a bank reconciliation and adjusting entries.*

(LO 7)

Cayemberg AG maintains a checking account at the Commerce Bank. At July 31, selected data from the ledger balance and the bank statement are shown below.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Cash in Bank** | | |
|  | **Per Books** |  | **Per Bank** |
| Balance, July 1 | €17,600 |  | €16,791 |
| July receipts | 81,100 |  |  |
| July credits |  |  | 82,470 |
| July disbursements | 77,150 |  |  |
| July debits |  |  | 74,756 |
| Balance, July 31 | €21,550 |  | €24,505 |

Analysis of the bank data reveals that the credits consist of €81,000 of July deposits and a credit memorandum of €1,470 for the collection of a €1,400 note plus interest revenue of €70. The July debits per bank consist of checks cleared €74,700 and a debit memorandum of €65 for printing additional company checks.

You also discover the following errors involving July checks: (1) A check for €230 to a creditor on account that cleared the bank in July was journalized and posted as €320. (2) A salary check to an employee for €255 was recorded by the bank for €155.

The June 30 bank reconciliation contained only two reconciling items: deposits in transit €7,000 and outstanding checks of €6,200.

***Instructions***

(a) Prepare a bank reconciliation at July 31, 2017.

Adjusted balance per books €23,045

(b) Journalize the adjusting entries to be made by Cayemberg. Assume that interest on the note has not been accrued.

**P7-6A** *Identify internal control weaknesses in cash receipts and cash disbursements.*

(LO 2, 3, 4)

Nature Hill Middle School wants to raise money for a new sound system for its auditorium. The primary fund-raising event is a dance at which the famous disc jockey Obnoxious Al will play classic and not-so-classic dance tunes. Rob Drexler, the music and theater instructor, has been given the responsibility for coordinating the fund-raising efforts. This is Rob's first experience with fund-raising. He decides to put the eighth-grade choir in charge of the event; he will be a relatively passive observer.

Rob had 500 unnumbered tickets printed for the dance. He left the tickets in a box on his desk and told the choir students to take as many tickets as they thought they could sell for £5 each. In order to ensure that no extra tickets would be floating around, he told them to dispose of any unsold tickets. When the students received payment for the tickets, they were to bring the cash back to Rob and he would put it in a locked box in his desk drawer.

Some of the students were responsible for decorating the gymnasium for the dance. Rob gave each of them a key to the money box and told them that if they took money out to purchase materials, they should put a note in the box saying how much they took and what it was used for. After 2 weeks the money box appeared to be getting full, so Rob asked Erik Radley to count the money, prepare a deposit slip, and deposit the money in a bank account Rob had opened.

The day of the dance, Rob wrote a check from the account to pay the DJ. Obnoxious Al, however, said that he accepted only cash and did not give receipts. So Rob took £200 out of the cash box and gave it to Al. At the dance, Rob had Sobia Hamm working at the entrance to the gymnasium, collecting tickets from students, and selling tickets to those who had not prepurchased them. Rob estimated that 400 students attended the dance.

The following day, Rob closed out the bank account, which had £250 in it, and gave that amount plus the £180 in the cash box to Principal Coleman. Principal Coleman seemed surprised that, after generating roughly £2,000 in sales, the dance netted only £430 in cash. Rob did not know how to respond.

***Instructions***

Identify as many internal control weaknesses as you can in this scenario, and suggest how each could be addressed.

**Problems: Set B**

**P7-1B** *Identify internal control weaknesses over cash receipts.*

(LO 2, 3)

Orpheum Theater is located in the Vancouver Mall. A cashier's booth is located near the entrance to the theater. Three cashiers are employed. One works from 1-5 P.M., another from 5-9 P.M. The shifts are rotated among the three cashiers. The cashiers receive cash from customers and operate a machine that ejects serially numbered tickets. The rolls of tickets are inserted and locked into the machine by the theater manager at the beginning of each cashier's shift.

After purchasing a ticket, the customer takes the ticket to an usher stationed at the entrance of the theater lobby some 60 feet from the cashier's booth. The usher tears the ticket in half, admits the customer, and returns the ticket stub to the customer. The other half of the ticket is dropped into a locked box by the usher.

At the end of each cashier's shift, the theater manager removes the ticket rolls from the machine and makes a cash count. The cash count sheet is initialed by the cashier. At the end of the day, the manager deposits the receipts in total in a bank night deposit vault located in the mall. The manager also sends copies of the deposit slip and the initialed cash count sheets to the theater company treasurer for verification and to the company's accounting department. Receipts from the first shift are stored in a safe located in the manager's office.

***Instructions***

(a) Identify the internal control principles and their application to the cash receipts transactions of the Orpheum Theater.

(b) If the usher and cashier decide to collaborate to misappropriate cash, what actions might they take?

**P7-2B** *Journalize and post petty cash fund transactions.*

(LO 5)

De Smet SA maintains a petty cash fund for small expenditures. The following transactions occurred over a 2-month period.

July 1 Established petty cash fund by writing a check on Star Bank for €100.

15 Replenished the petty cash fund by writing a check for €94.90. On this date, the fund consisted of €5.10 in cash and the following petty cash receipts: freight-out €51.00, postage expense €20.50, entertainment expense €23.10, and miscellaneous expense €4.10.

31 Replenished the petty cash fund by writing a check for €92.90. At this date, the fund consisted of $7.10 in cash and the following petty cash receipts: freight-out €43.50, charitable contributions expense €20.00, postage expense €20.10, and miscellaneous expense €9.30.

Aug. 15 Replenished the petty cash fund by writing a check for €98.00. On this date, the fund consisted of €2.00 in cash and the following petty cash receipts: freight-out €40.20, entertainment expense €21.00, postage expense €14.00, and miscellaneous expense €19.80.

16 Increased the amount of the petty cash fund to €150 by writing a check for €50.

31 Replenished the petty cash fund by writing a check for €137.00. On this date, the fund consisted of €13 in cash and the following petty cash receipts: freight-out €74.00, entertainment expense €43.20, and postage expense €17.70.

***Instructions***

(a) Journalize the petty cash transactions.

July 15 Cash over €3.80

(b) Post to the Petty Cash account.

Aug. 31 balance €150

(c) What internal control features exist in a petty cash fund?

**P7-3B** *Prepare a bank reconciliation and adjusting entries.*

(LO 7)

Aglife Genetics Ltd. of Lancaster, Wisconsin, spreads herbicides and applies liquid fertilizer for local farmers. On May 31, 2017, the company's Cash account per its general ledger showed the following balance.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **CASH NO. 101** | | | | | |
| **Date** | **Explanation** | **Ref.** | **Debit** | **Credit** | **Balance** |
| May 31 | Balance |  |  |  | 13,287 |

The bank statement from Lancaster State Bank on that date showed the following balance.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Checks and Debits** |  | **Lancaster Bank Deposits and Credits** |  | **Daily Balance** |
| XXX |  | XXX |  | 5/31 12,648 |

A comparison of the details on the bank statement with the details in the Cash account revealed the following facts.

1. The statement included a debit memo of £35 for the printing of additional company checks.

2. Cash sales of £1,720 on May 12 were deposited in the bank. The cash receipts journal entry and the deposit slip were incorrectly made for £1,820. The bank credited Aglife Genetics for the correct amount.

3. Outstanding checks at May 31 totaled £1,425, and deposits in transit were £2,100.

4. On May 18, the company issued check no. 1181 for £1,102 to M. Datz on account. The check, which cleared the bank in May, was incorrectly journalized and posted by Aglife Genetics for £110.

5. A £4,000 note receivable was collected by the bank for Aglife Genetics on May 31 plus £100 interest. The bank charged a collection fee of £25. No interest has been accrued on the note.

6. Included with the cancelled checks was a check issued by River Lune Company to Carol Mertz for £900 that was incorrectly charged to Aglife Genetics by the bank.

7. On May 31, the bank statement showed an NSF charge of £2,012 for a check issued by Tyler Gricius, a customer, to Aglife Genetics on account.

***Instructions***

(a) Prepare the bank reconciliation at May 31, 2017.

Adj. cash bal. £14,223

(b) Prepare the necessary adjusting entries for Aglife Genetics Company at May 31, 2017.

**P7-4B** *Prepare a bank reconciliation and adjusting entries from detailed data.*

(LO 7)

The bank portion of the bank reconciliation for Brasilia SA at October 31, 2017, was as follows.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **BRASILIA SA**  **Bank Reconciliation**  **October 31, 2017** | | | | | | | |
| Cash balance per bank | | | | | | | R$6,000 |
| Add: Deposits in transit | | | | | | | 842 |
|  | | | | | | | 6,842 |
| Less: Outstanding checks | | | | | | | |
|  | Check Number |  | Check Amount | | |  |  |
|  | 2451 |  | R$700 | | |  |  |
|  | 2470 |  | 396 | | |  |  |
|  | 2471 |  | 464 | | |  |  |
|  | 2472 |  | 170 | | |  |  |
|  | 2474 |  |  | 578 |  |  | 2,308 |
| Adjusted cash balance per bank | | | | | | | R$4,534 |

The adjusted cash balance per bank agreed with the cash balance per books at October 31.

The November bank statement showed the following checks and deposits:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | | | | **Bank Statement** | | |  | | |  |
|  | **Checks** | | | | | |  | **Deposits** | | |  |
|  | **Date** |  | **Number** |  | | **Amount** |  | **Date** |  | **Amount** |  |
|  | 11-1 |  | 2470 |  | | R$396 |  | 11-1 |  | R$ 842 |  |
|  | 11-2 |  | 2471 |  | | 464 |  | 11-4 |  | 666 |  |
|  | 11-5 |  | 2474 |  | | 578 |  | 11-8 |  | 545 |  |
|  | 11-4 |  | 2475 |  | | 903 |  | 11-13 |  | 1,416 |  |
|  | 11-8 |  | 2476 |  | | 1,556 |  | 11-18 |  | 810 |  |
|  | 11-10 |  | 2477 |  | | 330 |  | 11-21 |  | 1,624 |  |
|  | 11-15 |  | 2479 |  | | 980 |  | 11-25 |  | 1,412 |  |
|  | 11-18 |  | 2480 |  | | 714 |  | 11-28 |  | 908 |  |
|  | 11-27 |  | 2481 |  | | 382 |  | 11-30 |  | 652 |  |
|  | 11-30 |  | 2483 |  | | 317 |  | Total |  | R$8,875 |  |
|  | 11-29 |  | 2486 |  | | 495 |  |  |  |  |  |
|  |  |  | Total |  | | R$7,115 |  |  |  |  |  |
|  |  |  |  |  | |  |  |  |  |  |  |

The cash records per books for November showed the following.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Cash Payments Journal** | | | | | | | | | | |  |  |  | **Cash Receipts Journal** | | |  |
|  | **Date** |  | **Number** |  | **Amount** |  | **Date** |  | **Number** |  | **Amount** |  |  |  | **Date** |  | **Amount** |  |
|  | 11-1 |  | 2475 |  | R$ 903 |  | 11-20 |  | 2483 |  | R$ 317 |  |  |  | 11-3 |  | R$ 666 |  |
|  | 11-2 |  | 2476 |  | 1,556 |  | 11-22 |  | 2484 |  | 460 |  |  |  | 11-7 |  | 545 |  |
|  | 11-2 |  | 2477 |  | 330 |  | 11-23 |  | 2485 |  | 525 |  |  |  | 11-12 |  | 1,416 |  |
|  | 11-4 |  | 2478 |  | 300 |  | 11-24 |  | 2486 |  | 495 |  |  |  | 11-17 |  | 810 |  |
|  | 11-8 |  | 2479 |  | 890 |  | 11-29 |  | 2487 |  | 340 |  |  |  | 11-20 |  | 1,642 |  |
|  | 11-10 |  | 2480 |  | 714 |  | 11-30 |  | 2488 |  | 635 |  |  |  | 11-24 |  | 1,412 |  |
|  | 11-15 |  | 2481 |  | 382 |  | Total |  |  |  | R$ 8,197 |  |  |  | 11-27 |  | 908 |  |
|  | 11-18 |  | 2482 |  | 350 |  |  |  |  |  |  |  |  |  | 11-29 |  | 652 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | 11-30 |  | 1,581 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | Total |  | R$ 9,632 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

The bank statement contained two bank memoranda:

1. A credit of R$1,375 for the collection of a R$1,300 note for Brasilia plus interest of R$91 and less a collection fee of R$16. Brasilia has not accrued any interest on the note.

2. A debit for the printing of additional company checks R$35.

At November 30, the cash balance per books was R$5,969, and the cash balance per the bank statement was R$9,100. The bank did not make any errors, but two errors were made by Brasilia.

***Instructions***

(a) Using the four steps in the reconciliation procedure described on pages 350-351, prepare a bank reconciliation at November 30.

Adjusted cash balance per bank R$7,201

(b) Prepare the adjusting entries based on the reconciliation. (*Hint:* The correction of any errors pertaining to recording checks should be made to Accounts Payable. The correction of any errors relating to recording cash receipts should be made to Accounts Receivable.)

**P7-5B** *Prepare a bank reconciliation and adjusting entries.*

(LO 7)

Tizani SpA's bank statement from Eastern National Bank at August 31, 2017, shows the information below.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Balance, August 1 | €11,284 |  | Bank credit memoranda: |  |
| August deposits |  |  | Collection of note |  |
| Checks cleared in August |  |  | receivable plus €105 | €4,505 |
| Balance, August 31 |  |  | interest | 41 |
|  |  |  | Interest earned |  |
|  |  |  | Bank debit memorandum: | 30 |
|  |  |  | Safety deposit box rent |  |

A summary of the Cash account in the ledger for August shows: balance, August 1, €10,559; receipts €50,050; disbursements €47,794; and balance, August 31, €12,815. Analysis reveals that the only reconciling items on the July 31 bank reconciliation were a deposit in transit for €2,200 and outstanding checks of €2,925. The deposit in transit was the first deposit recorded by the bank in August. In addition, you determine that there were two errors involving company checks drawn in August: (1) A check for €340 to a creditor on account that cleared the bank in August was journalized and posted for €480. (2) A salary check to an employee for €275 was recorded by the bank for €295.

***Instructions***

(a) Prepare a bank reconciliation at August 31.

Adjusted balance per books €17,471

(b) Journalize the adjusting entries to be made by Tizani at August 31. Assume that interest on the note has not been accrued by the company.

**P7-6B** *Prepare a comprehensive bank reconciliation with theft and internal control deficiencies.*

(LO 2, 3, 4, 7)

Stupendous Ltd. is a very profitable small business. It has not, however, given much consideration to internal control. For example, in an attempt to keep clerical and office expenses to a minimum, the company has combined the jobs of cashier and bookkeeper. As a result, Jake Burnett handles all cash receipts, keeps the accounting records, and prepares the monthly bank reconciliations.

The balance per the bank statement on October 31, 2017, was £15,313. Outstanding checks were no. 62 for £107.74, no. 183 for £127.50, no. 284 for £215.26, no. 862 for £132.10, no. 863 for £192.78, and no. 864 for £140.49. Included with the statement was a credit memorandum of £460 indicating the collection of a note receivable for Stupendous by the bank on October 25. This memorandum has not been recorded by Stupendous.

The company's ledger showed one cash account with a balance of £18,608.81. The balance included undeposited cash on hand. Because of the lack of internal controls, Burnett took for personal use all of the undeposited receipts in excess of £3,226.18. He then prepared the following bank reconciliation in an effort to conceal his theft of cash.

|  |  |  |  |
| --- | --- | --- | --- |
| **Bank Reconciliation** | | | |
| Cash balance per books, October 31 |  |  | £18,608.81 |
| Add: Outstanding checks |  |  |  |
| No. 862 | £132.10 |  |  |
| No. 863 | 192.78 |  |  |
| No. 864 | 140.49 |  | 390.37 |
|  |  |  | 18,999.18 |
| Less: Undeposited receipts |  |  | 3,226.18 |
| Unadjusted balance per bank, October 31 |  |  | 15,773.00 |
| Less: Bank credit memorandum |  |  | 460.00 |
| Cash balance per bank statement, October 31 |  |  | £15,313.00 |

***Instructions***

(a) Prepare a correct bank reconciliation. (*Hint:* Deduct the amount of the theft from the adjusted balance per books.)

Adjusted balance per books £17,623.31

(b) Indicate the three ways that Burnett attempted to conceal the theft and the pound amount pertaining to each method.

(c) What principles of internal control were violated in this case?

COMPREHENSIVE PROBLEM

**7-CP7** On December 1, 2017, Westmoreland Company had the following account balances.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Debit** |  |  | **Credit** |
| Cash | €18,200 |  | Accumulated Depreciation— |  |
| Notes Receivable | 2,000 |  | Equipment | €3,000 |
| Accounts Receivable | 7,500 |  |  | 6,100 |
| Inventory | 16,000 |  |  | 50,000 |
| Prepaid Insurance | 1,600 |  |  | 14,200 |
| Equipment | 28,000 |  |  | €73,300 |
|  | €73,300 |  |  |  |

During December, the company completed the following transactions.

Dec. 7 Received €3,600 cash from customers in payment of account (no discount allowed).

12 Purchased merchandise on account from Spiro Co. €12,000, terms 1/10, n/30.

17 Sold merchandise on account €16,000, terms 2/10, n/30. The cost of the merchandise sold was €10,000.

19 Paid salaries €2,200.

22 Paid Spiro Co. in full, less discount.

26 Received collections in full, less discounts, from customers billed on December 17.

31 Received €2,700 cash from customers in payment of account (no discount allowed).

Adjustment data:

1. Depreciation €200 per month.

2. Insurance expired €400.

***Instructions***

(a) Journalize the December transactions. (Assume a perpetual inventory system.)

(b) Enter the December 1 balances in the ledger T-accounts and post the December transactions. Use Cost of Goods Sold, Depreciation Expense, Insurance Expense, Salaries and Wages Expense, Sales Revenue, and Sales Discounts.

(c) The statement from Dodge Bank on December 31 showed a balance of €25,930. A comparison of the bank statement with the Cash account revealed the following facts.

1. The bank collected a note receivable of €2,000 for Westmoreland Company on December 15.

2. The December 31 receipts were deposited in a night deposit vault on December 31. These deposits were recorded by the bank in January.

3. Checks outstanding on December 31 totaled €1,210.

4. On December 31, the bank statement showed an NSF charge of €680 for a check received by the company from A. Quinn, a customer, on account.

Prepare a bank reconciliation as of December 31 based on the available information. (*Hint:* The cash balance per books is €26,100. This can be proven by finding the balance in the Cash account from parts (a) and (b).)

(d) Journalize the adjusting entries resulting from the bank reconciliation and adjustment data.

(e) Post the adjusting entries to the ledger T-accounts.

(f) Prepare an adjusted trial balance.

(g) Prepare an income statement for December and a classified statement of financial position at December 31.

MATCHA CREATIONS

(*Note*: This is a continuation of the Matcha Creations problem from Chapter 1-6.)

**MC7**

**Part 1** Mei-ling is struggling to keep up with the recording of her accounting transactions. She is spending a lot of time marketing and selling mixers and giving her cookie classes. Her friend Mike is an accounting student who runs his own accounting service. He has asked Mei-ling if she would like to have him do her accounting. Mike and Mei-ling meet and discuss her business.

**Part 2** Mei-ling decides that she cannot afford to hire Mike to do her accounting. One way that she can ensure that her cash account does not have any errors and is accurate and up-to-date is to prepare a bank reconciliation at the end of each month. Mei-ling would like you to help her.

**Broadening Your Perspective**

Financial Reporting and Analysis

**BYP7-1. Financial Reporting Problem: TSMC, Ltd. (TWN)**

The financial statements of TSMC are presented in Appendix A at the end of this textbook. The complete annual report, including notes to the consolidated financial statements, is available in the Investors section of the company's website, *www.tsmc.com*.

***Instructions***

(a) What data about cash and cash equivalents are shown in the consolidated statement of financial position?

(b) In its notes to consolidated financial statements, how does TSMC define cash equivalents?

**BYP7-2. Comparative Analysis Problem: Nestlé SA (CHE) vs. Petra Foods Ltd. (SGP)**

Nestlé's financial statements are presented in Appendix B. Financial statements of Petra Foods are presented in Appendix C.

***Instructions***

(a) Based on the information contained in these financial statements, determine each of the following for each company (ignore overdrafts):

1. Cash and cash equivalents balance at December 31, 2013.

2. Cash provided by operating activities during the most recent fiscal year shown (from the statement of cash flows).

(b) What conclusions concerning the management of cash can be drawn from these data?

**BYP7-3. Real-World Focus**

All organizations should have systems of internal control. Universities are no exception. This site discusses the basics of internal control in a university setting.

***Address:* www.bc.edu/offices/audit/controls**

***Steps:*** Go to the site shown above.

***Instructions***

The home page of this site provides links to answer the following questions.

(a) In a university setting, who has responsibility for evaluating the adequacy of the system of internal control?

(b) What are some red flags indicating white-collar crime?

(c) What role does an internal audit play at Boston College?

(d) What are two IT controls over computer operations?

Critical Thinking

**BYP7-4. Decision-Making Across the Organization**

The board of trustees of a local church is concerned about the internal accounting controls for the offering collections made at weekly services. The trustees ask you to serve on a three-person audit team with the internal auditor of a local college and a public accountant who has just joined the church.

At a meeting of the audit team and the board of trustees, you learn the following.

1. The church's board of trustees has delegated responsibility for the financial management and audit of the financial records to the finance committee. This group prepares the annual budget and approves major disbursements. It is not involved in collections or recordkeeping. No audit has been made in recent years because the same trusted employee has kept church records and served as financial secretary for 15 years. The church does not carry any fidelity insurance.

2. The collection at the weekly service is taken by a team of ushers who volunteer to serve one month. The ushers take the collection plates to a basement office at the rear of the church. They hand their plates to the head usher and return to the church service. After all plates have been turned in, the head usher counts the cash received. The head usher then places the cash in the church safe along with a notation of the amount counted. The head usher volunteers to serve for 3 months.

3. The next morning, the financial secretary opens the safe and recounts the collection. The secretary withholds £150-£200 in cash, depending on the cash expenditures expected for the week, and deposits the remainder of the collections in the bank. To facilitate the deposit, church members who contribute by check are asked to make their checks payable to “Cash.”

4. Each month, the financial secretary reconciles the bank statement and submits a copy of the reconciliation to the board of trustees. The reconciliations have rarely contained any bank errors and have never shown any errors per books.

***Instructions***

With the class divided into groups, answer the following.

(a) Indicate the weaknesses in internal accounting control over the handling of collections.

(b) List the improvements in internal control procedures that you plan to make at the next meeting of the audit team for (1) the ushers, (2) the head usher, (3) the financial secretary, and (4) the finance committee.

(c) What church policies should be changed to improve internal control?

**BYP7-5. Communication Activity**

As a new auditor for the public accounting firm of Murphy, Mooney, and Feeney, you have been assigned to review the internal controls over mail cash receipts of Sullivan Company. Your review reveals the following: Checks are promptly endorsed “For Deposit Only,” but no list of the checks is prepared by the person opening the mail. The mail is opened either by the cashier or by the employee who maintains the accounts receivable records. Mail receipts are deposited in the bank weekly by the cashier.

***Instructions***

Write a letter to Michael Kelly, owner of Sullivan Company, explaining the weaknesses in internal control and your recommendations for improving the system.

**BYP7-6. Ethics Case**

You are the assistant controller in charge of general ledger accounting at Prince Edward Bottling. Your company has a large loan from an insurance company. The loan agreement requires that the company's cash account balance be maintained at €200,000 or more, as reported monthly.

At June 30, the cash balance is €80,000, which you report to Anne Shirley, the financial vice president. Anne excitedly instructs you to keep the cash receipts book open for one additional day for purposes of the June 30 report to the insurance company. Anne says, “If we don't get that cash balance over €200,000, we'll default on our loan agreement. They could close us down, put us all out of our jobs!” Anne continues, “I talked to Gilbert Distributors (one of Prince Edward's largest customers) this morning. They said they sent us a check for €150,000 yesterday. We should receive it tomorrow. If we include just that one check in our cash balance, we'll be in the clear. It's in the mail!”

***Instructions***

(a) Who will suffer negative effects if you do not comply with Anne Shirley's instructions? Who will suffer if you do comply?

(b) What are the ethical considerations in this case?

(c) What alternatives do you have?

A LOOK at U.S. GAAP

Fraud can occur anywhere. And because the three main factors that contribute to fraud are universal in nature, the principles of internal control activities are used globally by companies. While the U.S. Sarbanes-Oxley Act (SOX) does not apply to international companies, most large international companies have internal controls similar to those indicated in the chapter. GAAP and IFRS are also very similar in accounting for cash. *IAS No. 1 (revised)*, “Presentation of Financial Statements,” is the only standard that discusses issues specifically related to cash.

**Key Points**

* The fraud triangle discussed in this chapter is applicable to all international companies. Some of the major frauds on a U.S. basis are Enron, WorldCom, and more recently the Bernie Madoff Ponzi scheme.
* Rising economic crime poses a growing threat to companies, with 34% of all organizations worldwide being victims of fraud in a recent 12-month period. The survey data shows that the incidence of economic crime varies by industry sector, some (notably insurance, governmental, hospitality and leisure, and financial services) reporting higher levels of fraud than others, and by size and type of organization. But However, no organization is immune (*PricewaterhouseCoopers' Global Economic Crime Survey*, 2011).
* Internal controls are a system of checks and balances designed to prevent and detect fraud and errors. While most companies have these systems in place, many have never completely documented them, nor had an independent auditor attest to their effectiveness. Both of these actions are required under SOX.
* Companies find that internal control review is a costly process but badly needed. One study estimates the cost of SOX compliance for U.S. companies at over $35 billion, with audit fees doubling in the first year of compliance. At the same time, examination of internal controls indicates lingering problems in the way companies operate. One study of first compliance with the internal-control testing provisions documented material weaknesses for about 13% of companies reporting in a two-year period (*PricewaterhouseCoopers' Global Economic Crime Survey*, 2005).
* As indicated earlier, SOX internal control standards apply only to companies listed on U.S. exchanges. There is continuing debate over whether foreign issuers should have to comply with this extra layer of regulation.

**Similarities**

* + Accounting scandals both in the United States and internationally have re-ignited the debate over the relative merits of GAAP, which takes a “rules-based” approach to accounting, versus IFRS, which takes a “principles-based” approach. The FASB announced that it intends to introduce more principles-based standards.
  + The accounting and internal control procedures related to cash are essentially the same under both GAAP and this textbook. In addition, the definition used for cash equivalents is the same.
  + Most companies report cash and cash equivalents together under GAAP, as shown in this textbook. In addition, GAAP follows the same accounting policies related to the reporting of restricted cash.
  + GAAP and IFRS define cash and cash equivalents similarly as follows.
    - **Cash** is comprised of cash on hand and demand deposits.
    - **Cash equivalents** are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

**Differences**

* + After numerous corporate scandals, the U.S. Congress passed the Sarbanes-Oxley Act (SOX). Under SOX, all publicly traded U.S. corporations are required to maintain an adequate system of internal control.
  + As a result of SOX, corporate executives and boards of directors must ensure that internal controls are reliable and effective. In addition, independent outside auditors must attest to the adequacy of the internal control system.
  + SOX created the Public Company Accounting Oversight Board (PCAOB) to establish auditing standards and regulate auditor activity.

**Looking to the Future**

Ethics has become a very important aspect of reporting. Different cultures have different perspectives on bribery and other questionable activities, and consequently penalties for engaging in such activities vary considerably across countries.

High-quality international accounting requires both high-quality accounting standards and high-quality auditing. Similar to the convergence of GAAP and IFRS, there is movement to improve international auditing standards. The International Auditing and Assurance Standards Board (IAASB) functions as an independent standard-setting body. It works to establish high-quality auditing and assurance and quality-control standards throughout the world. Whether the IAASB adopts internal control provisions similar to those in SOX remains to be seen.

Under proposed new standards for financial statements, companies would not be allowed to combine cash equivalents with cash.

**GAAP Practice**

**GAAP Self-Test Questions**

**1.** Non-U.S. companies that follow IFRS:

(a) do not normally use the principles of internal control activities described in this textbook.

(b) often offset cash with accounts payable on the statement of financial position.

(c) are not required to follow SOX.

(d) None of the above.

**Answer**

(c) are not required to follow SOX.

**2.** Which of the following is the correct accounting under GAAP for cash?

(a) Cash cannot be combined with cash equivalents.

(b) Restricted cash funds may be reported as a current or non-current asset depending on the circumstances.

(c) Restricted cash funds cannot be reported as a current asset.

(d) Cash on hand is not reported on the statement of financial position as Cash.

**Answer**

(b) Restricted cash funds may be reported as a current or non-current asset depending on the circumstances.

**3.** The Sarbanes-Oxley Act applies to:

(a) all U.S. companies listed on U.S. exchanges.

(b) all companies that list shares on any securities exchange in any country.

(c) all European companies listed on European exchanges.

(d) Both (a) and (c).

**Answer**

(a) all U.S. companies listed on U.S. exchanges.

**4.** High-quality accounting requires both high-quality accounting standards and:

(a) a reconsideration of SOX to make it less onerous.

(b) high-quality auditing standards.

(c) government intervention to ensure that the public interest is protected.

(d) the development of new principles of internal control activities.

**Answer**

(b) high-quality auditing standards.

**5.** Cash equivalents under GAAP:

(a) are significantly different than the cash equivalents discussed in the textbook.

(b) are generally disclosed separately from cash.

(c) may be required to be reported separately from cash in the future.

(d) None of the above.

**Answer**

(c) may be required to be reported separately from cash in the future.

**GAAP Exercises**

**GAAP7-1.** Some people argue that the internal control requirements of the Sarbanes-Oxley Act (SOX) put U.S. companies at a competitive disadvantage to companies outside the United States. Discuss the competitive implications (both pros and cons) of SOX.

**GAAP7-2.** State whether each of the following is true or false. For those that are false, explain why.

(a) A proposed new financial accounting standard would not allow cash equivalents to be reported in combination with cash.

(b) Perspectives on bribery and penalties for engaging in bribery are the same across all countries.

(c) Cash equivalents are comprised of cash on hand and demand deposits.

(d) SOX was created by the International Accounting Standards Board.

**GAAP Financial Reporting Problem: Apple Inc.**

**GAAP7-3.** The financial statements of Apple are presented in Appendix D. The company's complete annual report, including the notes to its financial statements, is available at *http://investor.apple.com*.

**Instructions**

Using the financial statements and notes to the financial statements, answer these questions about Apple's internal controls and cash.

(a) What comments, if any, are made about cash in the “Report of Independent Registered Public Accounting Firm”?

(b) What data about cash and cash equivalents are shown in the consolidated balance sheet (statement of financial position)?

(c) What activities are identified in the consolidated statement of cash flows as being responsible for the changes in cash during 2013?

(d) How are cash equivalents defined in the Notes to Consolidated Financial Statements?

(e) Read the section of the report titled “Management's Report on Internal Control Over Financial Reporting.” Summarize the statements made in that section of the report.