Chapter 6 – Cash, Fraud, and Internal Controls
MGMT 1A

Current Assets = CAMPs

C*ash*___________________________________

A*ccounts Receivable*__________________________

M*erchandise Inventory*________________________

P*repaid Expenses*_____________________________

S*upplies*_____________________________________

I. Cash
   A. Currency - *dollars*
   B. Coins - *cents*
   C. Check – even if it hasn't been deposited yet
   D. Money Order – *like a check written by the bank (more secure to send in the mail)*
   E. Checking/Savings account balances ← biggest part of cash in most companies

II. Management's Concerns – Goldilocks Principle.
Too much cash – management is not investing enough in growing and expanding the business
Too little cash – Company cannot afford to continue operating.

III. Cash Equivalents = short-term investments, with original maturity of 3 months or less

   A. Example: Certificate of Deposit (CD) matures in 60 days, 6% interest rate.

   B. Not quite cash, but close enough

   C. Presented with cash on the balance sheet, "Cash and Cash Equivalents"

   D. Original maturity > 3 months = S*hort*_______ T*erm*_________ I*nvestment*______________
   "Original maturity" means: Maturity was < 3 months when the security was FIRST sold (not when the Company bought it)

IV. Compensating Balance = minimum amount a company must keep in the bank. Usually as security for a loan. *Example: Company has a $10M loan from bank; they are required to keep a minimum of $1M in a savings account at the same bank. In case the Company can't make repayments, the bank can take the $1M deposit.*

A. Not liquid, therefore NOT presented as part of Cash and Cash Equivalents
Compensating balance – the Company can't use or spend that cash, therefore it is not liquid

V. Bank Reconciliation

A. Deposits in Transit (DIT) – deposits that we have made, but are not shown on the bank statement (yet) *We opened the mail, got checks, endorsed them, and sent to the bank with our deposit slip. The bank hasn't received the checks YET.*
B. Outstanding Checks – checks that have been written, but have not cleared our bank yet *We mailed a check to the electric company. They haven't received it or haven't cashed it yet*
C. NSF Check (bounced check) – a check written for an amount greater than the payor has in their account *Usually the bank ALSO charges a fee for bouncing the check*
D. Debit/Credit Memorandums – a bank adjustment to our account that either decreases our balance (debit) or increases our balance (credit)
E. Interest earned – Many savings accounts pay interest monthly

F. Class Problem: Given the following items, prepare a bank reconciliation. Start with what the bank says we have, what do we say we have, then try to balance them (make them equal).

Balance per Bank Statement	$21,431.25
Balance per our records	$17,473.35
Customer check returned (NSF)	$117.90
Service charge ($10 relates to NSF check)	$30
Revenue Collected – Direct Deposit	$4,675.80
Deposits in Transit (DIT)	$1,850
Interest earned	$5
Outstanding checks	$1,293
Check written to supplier for $675 recorded in the ledger as $657	

G. Two Rules:

1. Who **<u>doesn't</u>** know about it? *The reconciling item goes on that parties side*
2. Errors go on the side of the party that made the error

Balance per Bank		Balance per Company Books	
Balance	*$21,431.25*	*Balance*	*$17,473.35*
Deposit in Transit (DIT)	*+ 1,850*	*NSF Check*	*(117.90)*
O/S checks	*<u>(1,293)</u>*	*NSF Fee*	*(10)*
		Service Fee	*(20)*
		Direct deposit	*+ 4,675.80*
		Interest earned	*+ 5*
		Transposition error	*<u>(18)</u>*
Adjusted Bank Balance	*$21,988.25*	Adjusted Book Balance	*$21,988.25*

Direct Deposit:

If the Company initially recorded:
DR: A/R $4,675.80
CR: Revenue $4,675.80

Then the reconciliation entry is:
DR: Cash $4,675.80
CR: A/R $4,675.80

If the Company initially recorded:

NOTHING

Then the reconciliation entry is:
DR: Cash $4,675.80
CR: Revenue $4,675.80

H. Adjust the Book Balance of Cash:

1. The Company has to make entries on its books: Every reconciling item on **our** side requires a journal entry

DR: A/R	*$127.90*		*← For the NSF check of $117.90 + the $10 NSF fee*
DR: Bank Expense	*$20*		*(we make the customer pay us back for the fee)*
DR: A/P	*$18*		*← Other side of the transposition error entry*
CR: Cash		*$165.90*	
(To record reconciling items that decrease cash)			

DR: Cash	*$4,680.80*		
CR: Interest Revenue		*$5*	
CR: Revenue (or A/R)		*$4,675.80*	
(To record reconciling items that increase cash)			

	Cash		
	$17,473,35		*← Unadjusted balance*
Reconciling entry →		*$165.90*	
	$4,680.80		*← Reconciling entry*
	$21,988.25		*← Reconciled balance*

VI. Petty Cash – Small payments made in cash.

Cash and currency that a Company has on hand (on site at their physical location, not in a bank)
OUTSIDE THE SCOPE OF OUR COURSE

VII. Internal Control = system of checks and balances used to monitor and control business activities and minimize the risk of error, fraud, and theft

A. Establish responsibilities *divide and conquer – clearly define who will do what*

B. Segregation of Duties – If one person does everything, increases opportunity for fraud.

1. Recordkeeping – who records transactions involving the asset *(Post J/E, Reconcile cash)*

2. Custody – who controls or has access to the asset *(Open mail, prepare deposit, write checks)*

Recordkeeping and custody should always be separated (if possible)

VIII. Fraud = Intentional manipulation of financial records or statements

A. Key element – I*ntent ("Scienter" = intent to deceive ← What distinguishes fraud from error*__

B. Fraud triangle: *If all 3 elements are present, fraud is more likely to occur. Eliminate an element, then fraud is less likely/able to happen*

1. O*pportunity*__________ – Due to internal control weaknesses

2. P*ressure*__________________– Financial, societal, personal stress

3. R*ationalization*__________________ – Justifying the behavior

C. Error vs. Fraud

1. "To err is human…" – Alexander Pope

2. Error = Unintentional *(usually undiscovered)*

3. Result of carelessness, confusion, poor judgment