Chapter 4
Accounting for cash

Nature of cash

Cash includes coins, paper money, certain deposited negotiable instruments such as checks, bank drafts and money orders and amounts in checking and saving accounts. We may think of cash as anything that a bank would accept for deposit in your account. Cash also includes deposits that are available for unrestricted withdrawals from banks to be considered cash it must be due and payable immediately

Characteristics of Cash

The following are some of the characteristics of cash

- ✓ The most liquid of all asset
- ✓ Easily canceled and transported
- ✓ Readily convertible in any other assets
- ✓ Highly desired by everybody.

Due to the above characteristics of cash, it is therefore necessary that designing special controls effectively to safeguard cash is important. Since many business transactions involve cash, it is a viable factor in the operation of a business. Of all the companies' assets, cash is the most easily mishandled either through theft or carelessness. To protect its cash, companies should

A. Account for all cash transactions accurately so that correct information will be available regarding cash flows and balances.
B. Make certain that enough cash is available to pay bills as they come due.
C. Avoid holding too much idle cash, because excess cash could be invested to generate income such as income such as interest.
D. Prevent loss of cash due to theft or fraud.

Methods of Controlling Cash

Although each business has varies specific procedures (methods) for controlling cash (receipts and disbursement or payments), the following are most commonly used methods for controlling cash:

- The bank checking account
- The petty cash fund
- The voucher system

The Bank Checking Account

Have you heard the term bank checking accounts? How do you understand it? Please write something before you read the upcoming paragraph

Banks seek to earn income by providing a variety of services to individuals, business and other entities. One of these services is the checking account. A **checking account** (a **bank account**) is

a money balance maintained in the bank that is subject to withdrawal by the depositor or owner of the money, on demand.

A bank account is one of the primary tools a business uses to control cash receipts and payment. When a business is using a bank account for controlling cash, all cash receipts be initially deposited in a bank account and likewise business usually use check to make all cash payment excepts for very small amounts. When such a system is used, there is a double record of cash transactions, one by the business and the other by the bank. In the books of the depositor, a bank account (cash in bank) is an asset and has a debit balance. In the books of the bank, the depositor account, is a liability for the bank and has a credit balance.

To provide depositor's with an accurate records of depositor funds (cash) received and disbursed, a bank uses the following business documents (forms used) with a bank account:

The signature card-when you open checking accounts, you are required to sign on the signature card. This card is used by the bank to verify the signature on checks that are submitted for payment. The card is used by the bank to determine the authenticity of the signature on checks presented to it payment.

Deposit ticket (slip) - the details of a deposit are listed by the depositor on a printed form (usually prepared in duplicate) supplied by the bank and given to the depositor as a receipt after it stamped or initialized by the bank's teller and given to the depositor as a receipt. This document provides the depositor written proof of the date and the total amounts of the deposit.

Check: is written document signed and issued by the depositor, ordering the bank to pay a certain sum of money to an individual or entity (or to the party designed as payee). Thus, three parties are involved in every check transaction.

a) **The maker (drawer) (depositor**): is the one who signs the check, ordering payment by the bank.
b) **The drawee (payer**): is the bank on which the check is drawn.
c) **The payee**: is the party to whom payment is to be made (or party to whom the check is made payable). The name and address of the depositor are usually printed on each check. Checks are pre-numbered (numbered in sequence) to facilitate the depositors internal control. **Transaction (checks) register:** is a small booklet used to record checks which has been written by the depositor.

Bank statement

It is a statement issued (usually monthly) by a bank to the depositor describing the activities in a depositor's following data. The beginning balance of bank account

- Deposit made to the bank account during the period.
- Checks paid out of the depositor's bank account by the bank on behalf of the depositor during the period. These checks are called **cancelled checks**.
- The ending balance of the depositor's bank account.

Note. In the bank statement:

- ✓ Deposit appear in chronological order and
- ✓ Checks appear in logical order, along with the date each check cleared the bank.

There are two records of the business's cash, its cash account in its own ledger and the cash in the bank statement, which tells the actual amount of the cash account, has in the bank. The balance in the business's cash account rarely equals (agree with) the balance shown on the bank statement.

- The books (ledger0and the bank statement may show different amounts but both are correct. Generally , the difference may arise from two broad reasons:
    i. A time lag in recording certain transactions either by the depositor or the bank.
    ii. Error in recording transactions made by either the depositor or the bank.

Here afterwards for the sack of discussion, I have grouped in to three the common items (ledger) balance: the first two resulted from lag in time in recording transactions and the third group from errors in recording transaction by either parties.

Group 1- items recorded by the company (depositor) but not yet recorded by the bank.

a) **Deposit in transit**-these aredeposits which has already been recorded but bank has not yet recoded. I.e. deposits not yet credited by the bank. This is the case most of the time for deposit made at end of the month end processed by the bank after the monthly statement has been prepared.
b) **Outstanding checks**- these are checks which have been issued by the co. and recoded on its books but not yet have been paid by its bank (most of the time to the payee)

Group 2-items recorded by the bank but not yet recorded by the companies (the depositors).

a) **Bank collections**- the bank sometimes collect money on behalf of depositors and depositor's customers pay directly to the company bank account. An example is a bank is collecting cash on a note receivables and the related interest revenue for the depositor. The bank may notify the depositor of these bank collections on the bank statement.
b) **Service charge**- bank usually charges a fee for processing the depositor's transactions. The depositor bears the amount of the service charge from the bank statement and usually accumulates in miscellaneous expenses account.
c) **Interest revenue on bank account**- bank pay interest and depositor learns from the bank statement.
d) **NSF (Not Sufficient Fund) -**checks received from customers to understand how to handle the NSF checks. You first need to know the route a check takes**.**
   Note –depositors can act both as a maker and payee i.e. they will write a check and they are recorded as receivables by depositors (here the payee.)
e) **Checks collected, deposited and returned to payee by the bank for reasons other than NSF.** Bank returns checks to the payee if:
    - ✓ The maker account has closed.
    - ✓ The signature is not authorized.
    - ✓ The check has been altered or

- ✓ The check form is improper**.**

Note that Accounting for all returned checks is the same as for NSF checks.

f) The cost of printing checks. – is like service charge.

Group 3- errors in recording transactions by either the company or the bank

Example 1.A bank may improperly charge (decreases) the bank account balance of business research corporation for a check drawn by another company, perhaps business research association.

Example 2: A checks written by x co. for payment of supplies purchased on account for $240 is recorded by X Co. as $420.

Note –The following two documents (letters) may accompany the bank statement

- ❖ **Debit memorandum**(memo)-a notification send by the bank that indicate the bank has debited the depositor account in the bank for
  - ➢ Service charge
  - ➢ NSF
  - ➢ The cost of printing checks**.**
- ❖ **Credit memorandum-**a notification send by the bank that indicates the bank has credited(increase) the depositor account in the bank for
  - ➢ Collection of N/R and the related interest by the bank.
  - ➢ Interest revenue in checking (bank) account.

You should note have that a depositor's checking account balance in the bank's record is a liability with a credit balance. When we say the bank has debited the depositor account in the bank, it means the bank has decreased the account.

Bank Reconciliation

It is a schedule the company (depositor) prepares to reconcile, or explain, the difference between the cash balance shown on the bank statement and the cash balance on the company's books (ledger.

- ✓ It is a listing of the items and amounts that cause the difference.
- ✓ It is prepared by the depositor to determine the company's actual cash balance that should be depicted in the ledger (and then in the balance sheet).

Bank reconciliation is divided in to two main sections. One section begins with the balance shown on the bank statement and ends with adjusted balance, and the second section begins with the company's books and ends with the adjusted balance. The two sections adjusted balance should be the same.

For mat of bank reconciliation for a sample company

TATA Co.

Bank reconciliation

Dec 31, 2002

Cash balance according to bank statement		$xxx
Add: addition by depositors not recorded on the bank statement (like deposit in transit)	$XXX	
:bank errors that understate the bank statement balance	$xxx	$ xxx
Sub total		$xxx
Less: deductions by depositor not yet recoded on the bank statement(like outstanding checks)	$xxx	
: bank errors that overstate the bank balance	$xxx	$ xxx
Adjusted cash balance ***		**$ xxx**
Cash balance according to book(ledger)balance		$ xxx
Add: additions by the bank not yet recorded by depositors(like bank collections of N/R and the related interest i.e. all credit memos)	$ xxx	
: depositor's errors that understate the depositor cash balance	$ xxx	$ xxx
Sub total		$ xxx
Less: deductions by bank not yet recoded by the depositors (all debits memo)	$ xxx	
: depositor's error that overstate the depositor's cash balance	$ xxx	$ xxx
Adjusted cash balance***		**$ xxx**

Example: The bank statement for Urethane Company for June 30, 2006, indicates a balance of $9,143.11. All cash receipts are deposited each evening in a night depository, after banking hours. The accounting records indicate the following summary data for cash receipts and payments for June:

Cash balance as of June 1 $ 3,943.50

Total cash receipts for June 28,971.60

Total amount of checks issued in June 28,388.85

Comparing the bank statement and the accompanying canceled checks and memorandums with the records reveal the following reconciling items:

a. The bank had collected for Urethane Company $1,030 on a note left for collection. The face of the note was $1,000.

b. A deposit of $1,852.21, representing receipts of June 30, had been made too late to appear on the bank statement.

c. Checks outstanding totaled $5,265.27.

d. A check drawn for $139 had been incorrectly charged by the bank as $157.

e. A check for $30 returned with the statement had been recorded in the depositor's records as $240. The check was for the payment of an obligation to Avery Equipment Company for the purchase of office supplies on account.

f. Bank service charges for June amounted to $18.20.

Instructions

1. Prepare bank reconciliation for June.
2. Journalize the entries that should be made by Urethane Company.

Solution

Urethane Company
Bank Reconciliation
June 30, 2006

Cash balance according to bank statement		$ 9,143.11
Add: Deposit of June 30 not recorded by bank	$1,852.21	
Bank error in charging check as $157 instead of $139	18.00	1,870.21
		$11,013.32
Deduct: Outstanding checks		5,265.27
Adjusted balance		$ 5,748.05
Cash balance according to depositor's records	---------	$ 4,526.25*
Add: Proceeds of note collected by bank, including $30 interest	$1,030.00	
Error in recording check	210.00	1,240.00
		$ 5,766.25
Deduct: Bank service charges		18.20
Adjusted balance		$ 5,748.05

Journal entry

Cash	1,240.00	
Notes Receivable		1,000.00
Interest Revenue		30.00
Accounts Payable—Avery Equipment		210.00
Miscellaneous Administrative Expense	18.20	
Cash		18.20

Exercise 1: The bank statement for XYZ Co. shows cash balance of $3,359.78 as of July 31. The cash balances in XYZ's ledger as of the same date is $2,549.99. The following reconciling items are revealed when XYZ Co. checks deposits slips, checks registers and bank statement:

a) Deposits of July 31, not recorded on bank statement, $816.20.
b) Checks outstanding, $1,544.99.
c) Notes plus interest of $8 collected by the bank (credit memorandum), not recorded in the journal, $408.00.
d) Checks from customers (ABC) returned by the bank because of insufficient funds (NSF), $300.
e) Bank services charges (debit memos), not recorded in the journal, $18.

f) Check NO 002 for $732.26 to LMN Co. on account, recorded in the journal as $723.26

Required:

Prepare bank reconciliation as of July 31.
Prepare the necessary journal entries

Note: Remember that all items shown on the bank reconciliation as adjustments of the book (ledger) balance will require journal entries to adjust the cash account; items appearing on the Bank balance side don't requires adjusting entries by the depositor. Any bank errors, of course, should be called to the bank's attention.

The petty cash fund

Under some circumstances, it is not practical to make all disbursements (payment) by check. In most business, for example it is sometimes necessary to make small payments of cash for such things as postage stamps, incoming postage, transportation charges due, or minor purchases of pens, paper, and the like.

For those situations in which it is inconvenient to pay with a check, most companies set up a petty cash fund.

A petty cash fund- is a fund established by a business for making small payments of cash.

The operation (steps) in petty cash fund: there are three steps in the operation of a petty cash fund:

a) Established the fund
b) Making payments(disbursements)from the fund
c) Reimbursing (replenishing) the fund.

Establishing the Fund

Two steps involved in establishing the fund.

a) Appointing a petty cash custodian (the person who is responsible for the operation of the fund.) and
b) Determining the size of the fund and establishing

When the fund is established, check payables to the custodian is issued for the stipulated amounts. And the check is cashed and the proceeds are placed under control of the custodian in the petty cash box.

Journal entry to record the establishment will be

Petty cash	$XXX	
Cash (cash in bank)		$XXX

Note – no entry that will change the balance of the petty cash account is made unless the stipulated amount of the find is changed (increased or decreased)

The custodian has the authority to make payments from the find that conform tom prescribed management policies.

Making Payments from the Fund

The custodian of the petty cash fund should prepare a written authorization for each expenditure and is called petty cash receipt. On each petty cash receipt, the custodian enters the date, amount and purpose of the expenditures (payments). The receipts are signed by the person who receives the payments and kept in the petty cash box until the fund is replenished. The cash in the fund plus the petty cash receipts amount should equal the amount shown in the petty cash account at all times. No entry is made to record a payment at the time it is made from the fund. Instead, the accounting effects of each payment are recognized when the fund replenishing

Reimbursing the Petty Cash Fund

At specific interval, when the fund becomes low (too small), and at the end of an accounting period. The petty cash fund is replenishing by issuing a check payable to the custodian for the exact amount of the expenditures.

The entry to record reimbursement:

Postage expenses	$XXX	
Supplies expenses	$XXX	
Cash(cash in bank)		$XXX

From time to time, there may be minor discrepancies in the amount of cash left in the fund at the time of reimbursement. In this case, the amount of the discrepancies are recorded in cash short and over account, as a debit if short or as credit if over.

Note –petty cash account is debited only when it is re-established.

- Expenses or asset accounts are debited each time the fund is replenished.
- In some cases, no further entries to the petty cash accounts are needed unless the business wants to change the fixed amounts of the fund.

- A debit balance in cash short and over –reported in the miscellaneous expenses in the

Example: MTR Company maintains a petty cash fund for a small expenditure. The following transactions occurred over a 2- month's period.

July 1. Established a petty cash fund by writing a check fund on CBE of $200.

15. Replenished the petty cash fund by writing a check for $194.30. On this date the fund consisted of $5.70 in cash and the following petty cash receipts: freight in, $94.00, postage expenses $42.40, entertainment expenses $46.60, and miscellaneous expenses $10.70.

31. Replenished the petty cash fund by writing a check fund for $192.00. At this date, the fund consisted of $8.00in cash and the following petty cash receipt; freight in $82.10, charitable contribution expenses $30.00, postage expense $47.80 and miscellaneous expenses $32.10.

Aug.15. Replenished the petty cash fund by writing a check for $188. on this date, the fund consisted of $12 in cash and the following petty cash receipts: freight in,$74.40, entertainment expenses $43.00, postage expenses 433.00, and miscellaneous expenses, $38.00

16. Increase the amount of the patty cash fund to $300 writing a check for $100. Replenished a petty cash fund by writing a check for $283.00. on this date

the fund consisted of $17 in cash and the following petty cash receipts: postage expenses $145,000, entrainment expenses $90.60 and freight in $45.40

Instructions

a. Journalize the petty cash transactions.