SECTION FOUR:

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.

Characteristics of Cash

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

Characteristics of Cash cont..

- Due to its characteristics, it is 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

- 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 interest income.

D. Prevent loss of cash due to theft or fraud.

Methods of Controlling Cash

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

- **The Bank Checking Account** (a **bank account**) is
- is a money balance maintained in the bank that is subject to withdrawal by the depositor or owner of the money, on demand.

- To get the most benefit from a bank account, all cash received must be deposited in the bank and all payments must be made by checks drawn on the bank or from special cash funds.

When such a system is strictly followed, there is a double record of cash:

- One maintained by the business and
- The other maintained by the bank

- 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:

a) **Signature card**

b)Deposit ticket

a) Signature card

- ✓ It is a form signed by all persons authorized to write checks on the account to limit access to a bank account.
- ✓ Bank employees use to verify signatures on checks.t

a) Deposit ticket

- ✓ It as a form provided by bank on which the depositor lists all the money and checks to be deposited.

- A deposit slip shows Date of deposit, Denomination of deposit and check number of the check to be deposited, Total amount deposited and Depositor’s signature.

- ✓ It may be prepared in duplicate, in which case the copy is stamped or initialed by the bank’s teller and given to the depositor as a receipt.
- ✓ It serve as a proof of the deposit

a) Check: a check is a written instrument signed by the depositor ordering the bank to pay a sum of many to the order of a designated person.

- **There are three parties to a check:**

1. The maker(drawer), the one who signs the check
2. The payee to whom the check is paid
3. The drawee, the bank on which the check is drawn

Bank statement

- 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.

✓ 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

- The books (ledger and 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

i) Items recorded by the company (depositor) but not yet recorded by the bank:

a) Deposit in transit

-these are deposits 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

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).

ii) 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.

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

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

f) The cost of printing checks: is like service charge (BSC) .

iii) Errors in recording transactions by either the company or the bank:

- **Example :** 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 and the cost of printing checks**.**

Credit memorandum-a notification send by

- ✓ Collection of N/R and the related interest by the bank.
- ✓ Interest revenue in checking (bank) account.

Bank Reconciliation

- It is a schedule the depositor prepares to reconcile the difference b/n 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 cont…

- 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

Sample Bank Reconciliation

Cash balance according to bank statement		**$xxx**
Add: addition by depositors not recorded on the bank statement	$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	$xxx	
: bank errors that overstate the bank balance	$xxx	$ xxx
Adjusted bank cash balance ***		**$ xxx**
Cash balance according to book(ledger)balance		$ xxx
Add: additions by the bank not yet recorded by depositors	$ 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	$ xxx	
: depositor's error that overstate the depositor's cash balance	$ xxx	$ xxx
Adjusted book cash balance***		**$ xxx**

THE STEPS TO PREPARE A BANK RECONCILIATION ARE:

a) The deposits listed on the bank statement are compared with the deposits shown in the accounting records. Any deposits not yet recorded by the bank are deposits in transit and should be added to the balance shown in the bank statements.

b) The paid and received checks from the bank are compared with the check stubs. Any checks issued but not yet paid by the bank are outstanding checks and should be deducted from the balance reported in the bank statements.

THE STEPS TO PREPARE A BANK RECONCILIATION ARE cont..:

c) Any credit memorandums issued by the bank that have not been recorded by the depositor, are added to the balance per depositor's record.

d) Any debit memorandums issued by the bank that have not been recorded by the depositor are deducted from the balance per depositor's record.

e) Any errors in the bank statement or depositor's accounting records are adjusted.

f) The equality of adjusted balance of statement and adjusted balance of the depositor's record is compared.

THE STEPS TO PREPARE A BANK RECONCILIATION ARE cont…

g) Journal entries are prepared to record any items delayed by the depositor.

Illustration of Bank Reconciliation

The January bank statement sent by Awash Bank to RAM Company shows Br. 4,262.83.

Assume also that on January 31, 2000, the Cash account of RAM Co. shows a balance of Br. 5,000.17. The accountant of RAM Company has identified the following items:

1. A deposit of Br. 410.90 made after banking hours on Jan. 31 does not appear on the bank statement.
2. Two checks issued in January have not yet been paid by the bank:

- Check No. 301 Br. 110.25
- Check No. 342

607.50

3. A credit memorandum was included in the bank statement, which was for proceeds from collection of a non-interest bearing note receivable from MAN company Br. 524.74.

4. Three debit memorandums accompanied the bank statement:

-Fee charged by bank for handling collection of notes receivable Br.5;

-a check of Br. 50.25 received from a customer, RON company, and deposited by RAM company was charged back as NSF; and service charge by bank for the month of January amounts to Br. 12.00.

5. Check No. 305 was issued by RAM Company for payment of telephone expense in the amount of Br. 85 but was erroneously recorded in the cash payments journal as Br. 58.

- The January 31 bank reconciliation for RAM Company is shown below:

RAM Company
Bank Reconciliation
January 31, 2000

- Balance per bank statement, Jan. 31,2000 Br. 5,000.17

Add: Deposit of Jan. 31 not recorded by bank 410.90

Subtotal Br. 5,411.07

Deduct: outstanding checks:

- No. 301 Br. 110.25
- No. 342 607.50

717.75

- Adjusted cash balance Br. 4,693.32

Balance per depositor’s record, Jan. 31,2000 Br. 4,262.83

Add: Note Receivable collected by bank 524.74

- Subtotal Br. 4,787.57
- Deduct: collection fee Br. 5.00
- NSF check of Ron Co. 50.25
- Service charge 12.00
- Error on check stub No. 305 27.00

94.25

- Adjusted cash balance Br. 4,693.32

The following are journal entries related to the bank reconciliation.

Jan. 31 2000 cash 524.74

N/ R 524.74

To record collection of Note Receivable collected by bank

Jan. 31 Miscellaneous Expense 17.00

Accounts Receivable-RON Co. 50.25

Utilities Exp. 27.00

- Cash 94.25
- To record bank service charges, NSF check and error in recording Check No. 305

Petty Cash Fund

- is part of the total cash balance, is used to handle many types of small payments such as employee transportation costs, purchase of office supplies, purchase of postage stamps, and delivery charges.
- Many businesses find it convenient to make minor expenditures instead of writing checks.
- The petty cash amount various from Br. 50 or less to more than Br. 1,000, which will cover small expenditures for a period of two or three weeks.

Petty Cash Fund cont…

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.

Establishing the Fund cont..

- Journal entry to record the establishment will be

Petty cash.....$XXX

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

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

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

- Expenses or asset accounts are debited each time the fund is replenished.

Cash Short and Over

- In handling cash receipts from daily sales, a few errors in making changes will occur.
- These errors may cause a cash shortage or overage at the end of the day.
- The account cash short and over is debited if there is shortage and credited if there is overage.
- At the end of the period if the account had a debit balance, it appears in the Income statement as miscellaneous expense; if it has a credit balance, it is shown as miscellaneous revenue.

Cash Short and Over cont…

- For example, assume that the total cash sales recorded during the day amounts to Br. 12,420. However, the cash receipts in the cash register drawer (actual cash count) total Br. 12,415.

Cash Short and Over cont…

- The following entry would be made to adjust the accounting records for the shortage in the cash receipts:

Cash Short and Over……5.00

Cash……5.00

To record a Br. 5.00 (Br. 12,420 – 12,415)

Shortage in cash receipts for the day

- THANK YOU