

CHAPTER 8

Fraud, Internal Control, and Cash

ASSIGNMENT CLASSIFICATION TABLE

Learning Objectives	Questions	Brief Exercises	Do It!	Exercises	A Problems	B Problems
1. Define fraud and internal control.	1, 2, 3, 4	1, 2, 3				
2. Identify the principles of internal control activities.	5, 6, 7, 8, 9, 10, 11	4	1	1, 2, 3, 5, 6	1A, 6A	1B, 6B
3. Explain the applications of internal control principles to cash receipts.	6, 13, 14, 15	5, 6, 7	2	2, 5, 6	6A	1B, 6B
4. Explain the applications of internal control principles to cash disbursements.	16, 17, 18, 19	8		3, 4, 5, 6	1A, 6A	6B
5. Describe the operation of a petty cash fund.	21	9	3	7, 8	2A	2B
6. Indicate the control features of a bank account.	22	10				
7. Prepare a bank reconciliation.	20, 23, 24, 25	11, 12, 13, 14	4	9, 10, 11, 12, 13	3A, 4A, 5A	3B, 4B, 5B, 6B
8. Explain the reporting of cash.	12, 26, 27	15		14		

ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Identify internal control principles over cash disbursements.	Simple	20–30
2A	Journalize and post petty cash fund transactions.	Simple	20–30
3A	Prepare a bank reconciliation and adjusting entries.	Simple	20–30
4A	Prepare a bank reconciliation and adjusting entries from detailed data.	Moderate	40–50
5A	Prepare a bank reconciliation and adjusting entries.	Moderate	30–40
6A	Identify internal control weaknesses in cash receipts and cash disbursements.	Complex	35–45
1B	Identify internal control weaknesses over cash receipts.	Simple	20–30
2B	Journalize and post petty cash fund transactions.	Simple	20–30
3B	Prepare a bank reconciliation and adjusting entries.	Simple	20–30
4B	Prepare a bank reconciliation and adjusting entries from detailed data.	Moderate	40–50
5B	Prepare a bank reconciliation and adjusting entries.	Moderate	30–40
6B	Prepare comprehensive bank reconciliation with theft and internal control deficiencies.	Complex	40–50

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CHAPTER 8
FRAUD, INTERNAL CONTROL, AND CASH

Number	LO	BT	Difficulty	Time (min.)
BE1	1	C	Simple	2–4
BE2	1	C	Simple	2–4
BE3	1	C	Simple	4–6
BE4	2	C	Simple	3–5
BE5	3	C	Simple	4–6
BE6	3	AP	Simple	4–6
BE7	3	AP	Simple	2–4
BE8	4	C	Simple	4–6
BE9	5	AP	Simple	4–6
BE10	6	C	Simple	2–4
BE11	7	C	Simple	3–5
BE12	7	C	Simple	3–5
BE13	7	AP	Simple	2–4
BE14	7	AP	Simple	2–4
BE15	8	C	Simple	2–4
DI1	2	C	Moderate	6–8
DI2	3	C	Simple	4–6
DI3	5	AP	Simple	4–6
DI4	7	C	Simple	2–4
EX1	2	C	Simple	8–10
EX2	2, 3	E	Moderate	8–10
EX3	2, 4	E	Moderate	8–10
EX4	4	E	Moderate	12–15
EX5	2–4	C	Simple	6–8
EX6	2–4	C	Simple	6–8
EX7	5	AP	Simple	8–10
EX8	5	AP	Simple	6–8
EX9	7	AN	Simple	8–10
EX10	7	AP	Simple	3–5

FRAUD, INTERNAL CONTROL, AND CASH (Continued)

Number	LO	BT	Difficulty	Time (min.)
EX11	7	AN	Simple	10–12
EX12	7	AN	Simple	12–15
EX13	7	AN	Moderate	10–12
EX14	8	C, AP	Simple	8–10
P1A	2, 4	C	Simple	20–30
P2A	5	AP	Simple	20–30
P3A	7	AN	Simple	20–30
P4A	7	AN	Moderate	40–50
P5A	7	AN	Moderate	30–40
P6A	2–4	E	Complex	35–45
P1B	2, 3	E	Simple	20–30
P2B	5	AP	Simple	20–30
P3B	7	AN	Simple	20–30
P4B	7	AN	Moderate	40–50
P5B	7	AN	Moderate	30–40
P6B	2–4, 7	E	Complex	40–50
BYP1	2, 8	C	Simple	10–15
BYP2	8	AN	Simple	8–12
BYP3	8	AN	Simple	8–12
BYP4	2, 7	E	Simple	10–15
BYP5	3	AN	Moderate	15–20
BYP6	3	E	Simple	10–15
BYP7	3	E	Simple	10–15
BYP8	—	E	Simple	10–15
BYP9	8	AP	Simple	10–15

Correlation Chart between Bloom's Taxonomy, Learning Objectives and End-of-Chapter Exercises and Problems

Learning Objective	Knowledge	Comprehension	Application	Analysis	Synthesis	Evaluation
1. Define fraud and internal control.		Q8-1 Q8-2 Q8-3 Q8-4	BE8-1 BE8-2 BE8-3			
2. Identify the principles of internal control activities.		Q8-5 Q8-6 Q8-7 Q8-8 Q8-9	Q8-10 Q8-11 BE8-4 DI8-1 P8-1A			E8-2 E8-3 P8-6A P8-1B P8-6B
3. Explain the applications of internal control principles to cash receipts.		Q8-6 Q8-13 Q8-14 Q8-15	BE8-5 DI8-2 E8-5 E8-6	BE8-6 BE8-7		E8-2 P8-6A P8-1B P8-6B
4. Explain the applications of internal control principles to cash disbursements.	Q8-18 Q8-19	Q8-16 Q8-17 BE8-8	E8-5 E8-6 P8-1A			E8-3 E8-4 P8-6A P8-6B
5. Describe the operation of a petty cash fund.		Q8-21		BE8-9 DI8-3 E8-7	E8-8 P8-2A P8-2B	
6. Indicate the control features of a bank account.		Q8-22 BE8-10				
7. Prepare a bank reconciliation.	Q8-20 Q8-24	Q8-23 Q8-25 BE8-11 BE8-12	DI8-4 BE8-13 BE8-14 E8-10	E8-9 E8-11 E8-12 E8-13	P8-3A P8-4A P8-5A P8-3B	P8-4B P8-5B P8-6B
8. Explain the reporting of cash.	Q8-27	Q8-26 BE8-15	E8-14	Q8-12 E8-14		
Broadening Your Perspective		Financial Reporting	FASB Codification	Comparative Analysis Decision Making Across the Organization		Real-World Focus Communication Ethics Case All About You

ANSWERS TO QUESTIONS

1. Fraud is dishonest act by an employee that results in personal benefit to the employee at a cost to the employer. An example of fraud that might occur at a bank would be a computer operator embezzling funds by transferring a customer's deposits into another account.
2. The three main factors that contribute to employee fraud are opportunity, financial pressure, and rationalization. Opportunities that an employee can take advantage of occur when the workplace lacks sufficient controls to deter and detect fraud. Financial pressure occurs when employees want to lead a lifestyle that they cannot afford on their current salary. Rationalization involves employees justifying fraud because they believe they are underpaid while their employer is making lots of money.
3. The five components of a good internal control system are: (1) A control environment, (2) Risk assessment, (3) Control activities, (4) Information and communication, and (5) Monitoring.
 - **A control environment.** Top management must make it clear that the organization values integrity and that unethical activity will not be tolerated.
 - **Risk assessment.** Companies must identify and analyze the various factors that create risk for the business and must determine how to manage these risks.
 - **Control activities.** To reduce the occurrence of fraud, management must design policies and procedures to address the specific risks faced by the company.
 - **Information and communication.** The internal control system must capture and communicate all pertinent information both down and up the organization, as well as communicate information to appropriate external parties.
 - **Monitoring.** Internal control systems must be monitored periodically for their adequacy. Significant deficiencies need to be reported to top management and/or the board of directors.
4. Disagree. Internal control is also concerned with the safeguarding of company assets from employee theft, robbery, and unauthorized use.
5. The principles of internal control are: (a) establishment of responsibility, (b) segregation of duties, (c) documentation procedures, (d) physical controls, (e) independent internal verification, and (f) human resource controls.
6. This is a violation of the internal control principle of establishing responsibility. In this case, each sales clerk should have a separate cash register or cash register drawer.
7. The two applications of segregation of duties are:
 - (1) Different individuals should be responsible for related activities.
 - (2) Responsibility for the record keeping for an asset should be separate from the physical custody of that asset.
8. Documentation procedures contribute to good internal control by providing evidence that transactions and events have occurred and, when signatures (or initials) are added, the documents establish responsibility for the transactions. The prompt transmittal of documents to accounting contributes to recording transactions in the proper period, and the prenumbering of documents helps to ensure that a transaction is not recorded more than once or not at all.

Questions Chapter 8 (Continued)

9. Safes, vaults, and locked warehouses contribute to the safeguarding of company assets. Cash registers and time clocks contribute to the accuracy and reliability of the accounting records, and electronic burglary systems and sensors help to safeguard assets.
10. (a) Independent internal verification involves the review of data prepared by employees.
(b) Maximum benefit is obtained from independent internal verification when:
(1) The verification is made periodically or on a surprise basis.
(2) The verification is done by an employee who is independent of the personnel responsible for the information.
(3) Discrepancies and exceptions are reported to a management level that can take appropriate corrective action.
11. (a) The concept of reasonable assurance rests on the premise that the costs of establishing control procedures should not exceed their expected benefit.
(b) The human element is an important factor in a system of internal control. A good system can become ineffective through employee fatigue, carelessness, or indifference. Moreover, internal control may become ineffective as a result of collusion.
12. Cash should be reported at \$22,850 ($\$8,000 + \$850 + \$14,000$).
13. Daily cash counts pertain primarily to the principles of segregation of duties, documentation procedures, and independent internal verification. Daily cash counts also involve the establishment of responsibility for performing the counts.
14. Cash registers are readily visible to the customer. Thus, they prevent the sales clerk from ringing up a lower amount and pocketing the difference. In addition, the customer receives an itemized receipt, and the cash register tape is locked into the register for further verification, providing documentation and enabling independent internal verification.
15. Two mail clerks contribute to a more accurate listing of mail receipts and to the endorsement of all checks "For Deposit Only." In addition, two clerks reduce the likelihood of mail receipts being diverted to personal use because they serve as a check on each other.
16. Payment by check contributes to effective internal control over cash disbursements. However, effective control is also possible when small payments are made from petty cash.
17. The procedure and related principle are:
- | <u>Procedure</u> | <u>Principle</u> |
|---|--------------------------------------|
| (1) Treasurer signs checks. | * Establishment of responsibility. |
| (2) Checks imprinted by a machine in indelible ink. | * Physical controls. |
| (3) Comparing check with approved invoice before signing. | * Independent internal verification. |
18. Physical controls apply to cash disbursements when: (a) blank checks are stored in a safe, and access to the safe is restricted to authorized personnel, and (b) a checkwriting machine and indelible ink are used to imprint amounts on checks. Documentation procedures apply when the company uses prenumbered checks and account for them in sequence, and stamps invoices "paid".

Questions Chapter 8 (Continued)

19. (a) A voucher system is a network of approvals by authorized individuals acting independently to ensure that all disbursements by check are proper.
(b) The internal control principles applicable to a voucher system are: (1) establishment of responsibility, (2) segregation of duties, (3) independent internal verification, and (4) documentation procedures.
20. Electronic funds transfer is a cash disbursement system that uses wire, telephone, or computers to transfer cash from one location to another.
21. The activities in a petty cash system and the related principles are:
- | | |
|------------------------------------|---|
| (a) (1) Establishing the fund. | * Establishment of responsibility for custody of fund. |
| (2) Making payments from the fund. | * Documentation procedures because the custodian must use a prenumbered petty cash receipt. |
| (3) Replenishing the fund. | * Independent internal verification because the request for replenishment must be approved before the check is written. |
- (b) Journal entries are required for a petty cash fund when it is established and replenished. Entries are also required when the size of the fund is increased or decreased.
22. Yes. A bank contributes significantly to internal control over cash because it: (1) safeguards cash on deposit, (2) minimizes the amount of currency that must be kept on hand, and (3) provides a double record of all bank transactions.
23. The lack of agreement between the balances may be due to either:
(1) Time lags—a check written in July does not clear the bank until August.
(2) Errors—a check for \$110 is recorded by the depositor at \$101.
24. The four steps are: (1) determine deposits in transit, (2) determine outstanding checks, (3) discover any errors made, and (4) trace bank memoranda.
25. (a) An NSF check occurs when the checkwriter's bank balance is less than the amount of the check.
(b) In a bank reconciliation, a customer's NSF check is deducted from the balance per books.
(c) An NSF check results in an adjusting entry in the company's books, as a debit to Accounts Receivable and a credit to Cash.
26. (a) Yes. Cash equivalents are highly liquid investments that can be converted into a specific amount of cash with maturities of three months or less when purchased. Cash equivalents may be reported with cash in the current assets section of the balance sheet.
(b) Cash restricted for a special purpose should be reported as a current or noncurrent asset depending on when the cash is expected to be used.
27. Apple reports cash and cash equivalents of \$9,815 million in its 2011 consolidated balance sheet.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 8-1

- 1. Financial Pressure**
- 2. Rationalization**
- 3. Financial Pressure**
- 4. Opportunity**

BRIEF EXERCISE 8-2

- 1. True.**
- 2. True.**
- 3. False. The Sarbanes-Oxley Act requires U.S. corporations to maintain an adequate system of internal control.**

BRIEF EXERCISE 8-3

The purposes of internal control are to:

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

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

BRIEF EXERCISE 8-4

1. Segregation of duties.
2. Independent internal verification.
3. Documentation procedures.

BRIEF EXERCISE 8-5

1. Physical controls.
2. Human resource controls.
3. Independent internal verification.
4. Segregation of duties.
5. Establishment of responsibility.

BRIEF EXERCISE 8-6

(a) Cash.....	6,820.75	
Cash Over and Short	50.75	
Sales Revenue		6,871.50
(b) Cash.....	6,899.82	
Cash Over and Short.....		28.32
Sales Revenue		6,871.50

BRIEF EXERCISE 8-7

Cash (\$1,125.74 – \$160.00).....	965.74	
Cash Over and Short.....	15.09	
Sales Revenue		980.83

BRIEF EXERCISE 8-8

1. Documentation procedures.
2. Independent internal verification.
3. Physical controls.
4. Establishment of responsibility.
5. Segregation of duties.

BRIEF EXERCISE 8-9

Mar. 20	Postage Expense.....	52	
	Freight-Out.....	26	
	Travel Expense	10	
	Cash Over and Short.....	3	
	Cash.....		91

BRIEF EXERCISE 8-10

1. A check provides documentary evidence of the payment of a specified sum of money to a designated payee.
2. A bank statement provides a double record of a depositor's bank transactions. It also is used in making periodic independent bank reconciliations.

BRIEF EXERCISE 8-11

1. Outstanding checks—deducted from cash balance per bank.
2. Bank service charge—deducted from cash balance per books.
3. Collection of note by bank—added to cash balance per books.
4. Deposits in transit—added to cash balance per bank.

BRIEF EXERCISE 8-12

1. The reconciling items per the books, items (2) and (3) above, will require adjustment on the books of the depositor.
2. The other reconciling items, deposits in transit and outstanding checks, do not require adjustment by the bank. When these items reach the bank, the bank balance will automatically adjust itself. These items have already been recorded by the depositor so they do not need to make an adjustment.

BRIEF EXERCISE 8-13

Cash balance per bank	\$7,420
Add: Deposits in transit.....	<u>1,620</u>
	9,040
Less: Outstanding checks	<u>762</u>
Adjusted cash balance per bank	<u>\$8,278</u>

BRIEF EXERCISE 8-14

Cash balance per books	\$9,500
Add: Interest earned.....	<u>40</u>
	9,540
Less: Charge for printing company checks	<u>35</u>
Adjusted cash balance per books	<u>\$9,505</u>

BRIEF EXERCISE 8-15

Zhang Company should report Cash in Bank and Payroll Bank account as current assets. Plant Expansion Fund Cash should be reported as a noncurrent asset, assuming the fund is not expected to be used during the next year.

SOLUTIONS FOR DO IT! REVIEW EXERCISES

DO IT! 8-1

1. Violates the control activity of *documentation procedures*. Source documents should be promptly forwarded to the accounting department so accounting entries can be made. This control activity helps to ensure timely recording of sales transactions and contributes directly to the accuracy and reliability of the accounting records.

DO IT! 8-1 (Continued)

2. Violates the control activity of *segregation of duties*. Different individuals should be responsible for related activities, such as these three related purchasing activities. Many abuses could occur: placing orders with friends and getting kickbacks; performing cursory counts and inspections of delivered goods; approving fictitious invoices for payment.
3. Violates the control activity of *establishment of responsibility*. Great Foods would be unable to determine who was responsible for a cash shortage; this lapse could even encourage employee theft.

DO IT! 8-2

All mail receipts should be opened in the presence of two mail clerks. Those mail clerks should immediately stamp each check "For Deposit Only." The mail clerks should prepare, in duplicate, a list of the checks received each day. The checks and prelist should be sent on to the cashier's department each day, and the cashier should deposit the checks daily. The duplicate prelist should be sent to the treasurer's department and used to confirm that all receipts were deposited and recorded.

DO IT! 8-3

Aug. 1	Petty Cash	100	
	Cash		100
31	Postage Expense	31	
	Supplies	42	
	Miscellaneous Expense	16	
	Cash Over and Short	4	
	Cash (\$100 – \$7)		93

DO IT! 8-4

Roger should treat the reconciling items as follows:

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

SOLUTIONS TO EXERCISES

EXERCISE 8-1

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

EXERCISE 8-2

<u>Procedure</u>	<u>(a)</u>		<u>(b)</u>
	<u>Weakness</u>	<u>Principle</u>	<u>Recommended Change</u>
1.	Cash is not adequately protected from theft.	Physical controls.	Cash should be stored in a safe until it is deposited in bank.
2.	Inability to establish responsibility for cash with a specific clerk.	Establishment of responsibility.	There should be separate cash drawers and register codes for each clerk.

EXERCISE 8-2 (Continued)

Procedure	(a)		(b)
	Weakness	Principle	Recommended Change
3.	The accountant should not handle cash.	Segregation of duties.	The cashier's department should make the deposits.
4.	Cash is not independently counted.	Independent internal verification.	A cashier office supervisor should count cash.
5.	Cashiers are not bonded.	Human resource controls.	All cashiers should be bonded.

EXERCISE 8-3

Procedure	(a)		(b)
	Weakness	Principle	Recommended Change
1.	The bank reconciliation is not independently prepared.	Independent internal verification.	Someone with no other cash responsibilities should prepare the bank reconciliation.
2.	The approval and payment of bills is done by the same individual.	Segregation of duties.	The store manager should approve bills for payment and the treasurer should sign and issue checks.
3.	Checks are not stored in a secure area.	Physical controls.	Checks should be stored in a safe or locked file drawer.

EXERCISE 8-3 (Continued)

Procedure	(a)		(b)
	Weakness	Principle	Recommended Change
4.	After payment, bills are simply filed in a folder.	Documentation procedures.	Bills should be stamped PAID before being placed in the folder.
5.	Checks are not prenumbered.	Documentation procedures.	Checks should be prenumbered and subsequently accounted for.

EXERCISE 8-4

(a) <u>Weaknesses</u>	(b) <u>Suggested Improvement</u>
1. Checks are not prenumbered.	Use prenumbered checks.
2. The purchasing agent signs checks.	Only the treasurer's department personnel should sign checks.
3. Unissued checks are stored in unlocked file cabinet.	Unissued checks should be stored in a locked file cabinet with access restricted to authorized personnel.
4. After payment, bills are simply filed in a folder.	Bills should be stamped PAID before being placed in the folder.
5. After payment, the invoice is filed.	The invoice should be stamped PAID.
6. The purchasing agent records payments in cash disbursements journal.	Only accounting department personnel should record cash disbursements.

EXERCISE 8-4 (Continued)

(a) Weaknesses

7. The treasurer records the checks in cash disbursements journal.

8. The treasurer reconciles the bank statement.

(b) Suggested Improvement

Same as answer to No. 6 above.

An internal auditor should reconcile the bank statement.

(b) To: Treasurer, Danner Company

From: Accounting Student

I have reviewed your cash disbursements system and suggest that you make the following improvements:

1. Danner Company should use prenumbered checks. These should be stored in a locked file cabinet or safe with access restricted to authorized personnel.
2. The purchasing department should approve bills for payment. The treasurer's department should prepare and sign the checks. The invoices should be stamped paid so that they cannot be paid twice.
3. Only the accounting department personnel should record cash disbursements.
4. An internal auditor should reconcile the bank statement.

If you have any questions about implementing these suggestions, please contact me.

EXERCISE 8-5

<u>Procedure</u>	<u>IC good or weak?</u>	<u>Related internal control principle</u>
1.	Weak	Establishment of Responsibility
2.	Good	Independent Internal Verification
3.	Weak	Segregation of Duties
4.	Good	Segregation of Duties
5.	Weak	Documentation Procedures

EXERCISE 8-6

<u>Procedure</u>	<u>IC good or weak?</u>	<u>Related internal control principle</u>
1.	Good	Human Resource Controls
2.	Weak	Establishment of Responsibility
3.	Weak	Segregation of Duties
4.	Good	Independent Internal Verification
5.	Good	Physical Controls

EXERCISE 8-7

May 1	Petty Cash	100.00	
	Cash		100.00
June 1	Delivery Expense	31.25	
	Postage Expense	39.00	
	Miscellaneous Expense	25.00	
	Cash Over and Short	3.00	
	Cash		98.25
July 1	Delivery Expense	21.00	
	Entertainment Expense	51.00	
	Miscellaneous Expense	24.75	
	Cash		96.75
July 10	Petty Cash	30.00	
	Cash		30.00

EXERCISE 8-8

Mar. 1	Petty Cash.....	100	
	Cash.....		100
15	Postage Expense.....	39	
	Freight-Out.....	21	
	Miscellaneous Expense	11	
	Travel Expense	24	
	Cash Over and Short.....	3	
	Cash.....		98
20	Petty Cash.....	75	
	Cash.....		75

EXERCISE 8-9

(a)	Cash balance per bank statement		\$3,560.20
	Add: Deposits in transit.....		<u>530.00</u>
			4,090.20
	Less: Outstanding checks		<u>730.00</u>
	Adjusted cash balance per bank		<u>\$3,360.20</u>
	Cash balance per books		\$3,875.20
	Less: NSF check	\$490.00	
	Bank service charge	<u>25.00</u>	<u>515.00</u>
	Adjusted cash balance per books		<u>\$3,360.20</u>
(b)	Accounts Receivable	490.00	
	Cash		490.00
	Miscellaneous Expense.....	25.00	
	Cash		25.00

EXERCISE 8-10

The outstanding checks are as follows:

<u>No.</u>	<u>Amount</u>
255	\$ 620
260	890
264	<u>560</u>
Total	<u>\$2,070</u>

EXERCISE 8-11

(a) **CRANE VIDEO COMPANY**
Bank Reconciliation
July 31

Cash balance per bank statement	\$7,263
Add: Deposits in transit	<u>1,300</u>
	8,563
Less: Outstanding checks	<u>591</u>
Adjusted cash balance per bank	<u>\$7,972</u>
 Cash balance per books.....	 \$7,284
Add: Collection of note receivable (\$700 plus accrued interest \$36, less collection fee \$20)	 <u>716</u>
	8,000
Less: Bank service charge.....	<u>28</u>
Adjusted cash balance per books	<u>\$7,972</u>

(b) July 31	Cash.....	716	
	Miscellaneous Expense.....	20	
	Notes Receivable		700
	Interest Revenue		36
31	Miscellaneous Expense.....	28	
	Cash		28

EXERCISE 8-12

(a) **MINTON COMPANY**
Bank Reconciliation
September 30

Cash balance per bank statement		\$16,422
Add: Deposits in transit.....		<u>5,450</u>
		21,872
Less: Outstanding checks		<u>2,383</u>
Adjusted cash balance per bank		<u>\$19,489</u>
Cash balance per books		\$17,404
Add: Collection of note receivable (\$2,500 + \$30)	\$ 2,530	
Interest earned	<u>45</u>	<u>2,575</u>
		19,979
Less: NSF check	425	
Safety deposit box rent	<u>65</u>	<u>490</u>
Adjusted cash balance per books		<u>\$19,489</u>

(b) Sept. 30	Cash	2,530	
	Notes Receivable		2,500
	Interest Revenue.....		30
30	Cash	45	
	Interest Revenue.....		45
30	Accounts Receivable—Richard Nance ..	425	
	Cash		425
30	Miscellaneous Expense	65	
	Cash		65

EXERCISE 8-13

(a) Deposits in transit:		
Deposits per books in July		\$15,750
Less: Deposits per bank in July	\$15,600	
Deposits in transit, June 30	<u>(920)</u>	
July receipts deposited in July		<u>14,680</u>
Deposits in transit, July 31.....		<u>\$ 1,070</u>

EXERCISE 8-13 (Continued)

(b) Outstanding checks:

Checks per books in July		\$17,200
Less: Checks clearing bank in July	\$16,400	
Outstanding checks, June 30	<u>(680)</u>	
July checks cleared in July		<u>15,720</u>
Outstanding checks, July 31		<u>\$ 1,480</u>

(c) Deposits in transit:

Deposits per bank statement in September		\$26,700
Add: Deposits in transit, September 30		<u>2,100</u>
Total deposits to be accounted for		28,800
Less: Deposits per books		<u>26,400</u>
Deposits in transit, August 31		<u>\$ 2,400</u>

(d) Outstanding checks:

Checks clearing bank in September		\$25,000
Add: Outstanding checks, September 30 ...		<u>2,100</u>
Total checks to be accounted for		27,100
Less: Cash disbursements per books		<u>23,700</u>
Outstanding checks, August 31		<u>\$ 3,400</u>

EXERCISE 8-14

(a) Cash and cash equivalents should be reported at \$88,500.

Cash in bank	\$42,000
Cash on hand	12,000
Petty cash	500
Highly liquid investments	<u>34,000</u>
	<u>\$88,500</u>

(b) "Cash in plant expansion fund" should be reported as part of long-term investments (a noncurrent asset). "Receivables from customers" should be reported as accounts receivable in the current assets. "Stock investments" should also be reported in the current assets.

(c) Wynn should disclose in the financial statements the details about the compensating balances. These are generally minimum cash balances the bank requires the borrower to maintain. They are a restriction on the use of cash that may affect the company's liquidity.

SOLUTIONS TO PROBLEMS

PROBLEM 8-1A

Principles

Application to Cash Disbursements

Establishment of responsibility.

Only the treasurer and assistant treasurer are authorized to sign checks.

Segregation of duties.

Invoices must be approved by both the purchasing agent and the receiving department supervisor. Payment can only be made by the treasurer or assistant treasurer, and the check signers do not record the cash disbursement transactions.

Documentation procedures.

Checks are prenumbered. Following payment, invoices are stamped PAID.

Physical controls.

Blank checks are kept in a safe in the treasurer's office. Only the treasurer and assistant treasurer have access to the safe. A checkwriting machine is used in writing checks.

Independent internal verification.

The check signer compares the check with the approved invoice prior to issue. Bank and book balances are reconciled monthly by the assistant chief accountant.

Human resource controls.

All employees who handle or record cash are bonded.

PROBLEM 8-2A

(a)	July 1	Petty Cash	200.00	
		Cash		200.00
	15	Freight-Out	92.00	
		Postage Expense	42.40	
		Entertainment Expense	46.60	
		Miscellaneous Expense	11.20	
		Cash Over and Short	3.80	
		Cash		196.00
	31	Freight-Out	82.10	
		Charitable Contribution Expense	45.00	
		Postage Expense	25.50	
		Miscellaneous Expense	39.40	
		Cash		192.00
	Aug. 15	Freight-Out	77.60	
		Entertainment Expense	43.00	
		Postage Expense	33.00	
		Miscellaneous Expense	37.00	
		Cash Over and Short		3.60
		Cash		187.00
	16	Petty Cash	100.00	
		Cash		100.00
	31	Postage Expense	140.00	
		Travel Expense	95.60	
		Freight-Out	47.10	
		Cash Over and Short	1.30	
		Cash		284.00

(b)

Petty Cash

Date	Explanation	Ref.	Debit	Credit	Balance
July 1		CP	200		200
Aug. 16		CP	100		300

PROBLEM 8-2A (Continued)

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

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

PROBLEM 8-3A

(a)

REBER COMPANY
Bank Reconciliation
May 31, 2014

Cash balance per bank statement		\$6,404.60
Add: Deposit in transit	\$2,416.15	
Bank error—Stiner check.....	<u>800.00</u>	<u>3,216.15</u>
		9,620.75
Less: Outstanding checks		<u>576.25</u>
Adjusted cash balance per bank		<u><u>\$9,044.50</u></u>
Cash balance per books.....		\$6,781.50
Add: Collection of note receivable		
(\$3,000 note plus \$80 interest		
less \$20 fee).....		<u>3,060.00</u>
		9,841.50
Less: NSF check	\$ 680.00	
Error in May 12 deposit		
(\$886.15 – \$836.15)	50.00	
Error in recording check No. 1181	27.00*	
Check printing charge.....	<u>40.00</u>	<u>797.00</u>
Adjusted cash balance per books		<u><u>\$9,044.50</u></u>

*\$685 – \$658

(b)	May 31	Cash.....	3,060	
		Miscellaneous Expense.....	20	
		Notes Receivable		3,000
		Interest Revenue		80
	31	Accounts Receivable—Sue Allison	680	
		Cash		680
	31	Sales Revenue	50	
		Cash		50
	31	Accounts Payable—Lynda Carsen	27	
		Cash		27
	31	Miscellaneous Expense.....	40	
		Cash		40

PROBLEM 8-4A

(a) **LANGER COMPANY**
Bank Reconciliation
December 31, 2014

Cash balance per bank statement		\$20,154.30
Add: Deposits in transit		<u>1,690.40</u>
		21,844.70
Less: Outstanding checks		
No. 3470	\$ 720.10	
No. 3474	1,050.00	
No. 3478	621.30	
No. 3481	807.40	
No. 3484	798.00	
No. 3486	<u>889.50</u>	<u>4,886.30</u>
Adjusted cash balance per bank		<u>\$16,958.40</u>
Cash balance per books		\$12,485.20
Add: Note collected by bank		
(\$5,000 note plus \$160 interest		
less \$15 fee)		<u>5,145.00</u>
		17,630.20
Less: NSF check	\$ 572.80	
Error in recording check No. 3485	90.00*	
Error in 12-21 deposit		
(\$2,954 – \$2,945)	<u>9.00</u>	<u>671.80</u>
Adjusted cash balance per books		<u>\$16,958.40</u>
*\$540.80 – \$450.80		

(b) Dec. 31	Cash	5,145.00	
	Miscellaneous Expense	15.00	
	Notes Receivable		5,000.00
	Interest Revenue		160.00
31	Accounts Receivable—L. Rees	572.80	
	Cash		572.80
31	Accounts Payable	90.00	
	Cash		90.00
31	Accounts Receivable	9.00	
	Cash		9.00

PROBLEM 8-5A

(a)

RODRIGUEZ COMPANY
Bank Reconciliation
July 31, 2014

Cash balance per bank statement			\$24,514
Add: Deposits in transit (1)			<u>10,400</u>
			34,914
Less: Outstanding checks (2)	\$ 8,460		
Bank error (\$255 – \$155)	<u>100</u>		<u>8,560</u>
Adjusted cash balance per bank			<u>\$26,354</u>
 Cash balance per books			\$21,850
Add: Collection of note receivable by bank			
(\$4,400 note plus \$70 interest)	\$ 4,470		
Book error (\$320 – \$230)	<u>90</u>		<u>4,560</u>
			26,410
Less: Check printing charge			<u>56</u>
Adjusted cash balance per books			<u>\$26,354</u>
 (1) July receipts per books			\$81,400
July deposits per bank	\$79,000		
Less: Deposits in transit,			
June 30	<u>8,000</u>		<u>71,000</u>
Deposits in transit, July 31			<u>\$ 10,400</u>
 (2) Disbursements per books			
in July			\$77,150
Less: Book error			<u>90</u>
Total disbursements to			
be accounted for			77,060
Checks clearing bank			
in July	\$74,700		
Add: Bank error	\$ 100		
Less: June 30			
outstanding checks	<u>6,200</u>	<u>6,100</u>	<u>68,600</u>
Outstanding checks,			
July 31			<u>\$ 8,460</u>

PROBLEM 8-5A (Continued)

(b)	July 31	Cash.....	4,470	
		Notes Receivable.....		4,400
		Interest Revenue		70
	31	Cash.....	90	
		Accounts Payable		90
	31	Miscellaneous Expense.....	56	
		Cash		56

PROBLEM 8-6A

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

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

PROBLEM 8-6A (Continued)

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

PROBLEM 8-1B

(a) Principles

Application to Granada Theater

Establishment of responsibility.

Only cashiers are authorized to sell tickets. Only the manager and cashier can handle cash.

Segregation of duties.

The duties of receiving cash and admitting customers are assigned to the cashier and to the usher. The manager maintains custody of the cash, and the company accountant records the cash.

Documentation procedures.

Tickets are prenumbered. Cash count sheets are prepared. Deposit slips are prepared.

Physical controls.

A safe is used for the storage of cash and a machine is used to issue tickets.

Independent internal verification.

Cash counts are made by the manager at the end of each cashier's shift. Daily comparisons are made by the company treasurer.

Human resource controls.

Shifts are rotated among the cashiers.

(b) **Actions by the usher and cashier to misappropriate cash might include:**

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

PROBLEM 8-2B

(a)	July 1	Petty Cash	100.00	
		Cash.....		100.00
	15	Freight-Out	51.00	
		Postage Expense	20.50	
		Entertainment Expense	23.10	
		Miscellaneous Expense	6.10	
		Cash.....		96.90
		Cash Over and Short.....		3.80
	31	Freight-Out	43.50	
		Charitable Contribution Expense.....	20.00	
		Postage Expense	20.10	
		Miscellaneous Expense	12.30	
		Cash.....		95.90
	Aug. 15	Freight-Out	40.20	
		Entertainment Expense	21.00	
		Postage Expense	16.00	
		Miscellaneous Expense	19.80	
		Cash Over and Short.....	1.00	
		Cash.....		98.00
	16	Petty Cash	50.00	
		Cash.....		50.00
	31	Freight-Out	74.00	
		Entertainment Expense	43.20	
		Postage Expense	17.70	
		Cash Over and Short.....	2.10	
		Cash.....		137.00

(b)

Petty Cash

Date	Explanation	Ref.	Debit	Credit	Balance
July 1		CP	100		100
Aug. 16		CP	50		150

PROBLEM 8-2B (Continued)

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

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

PROBLEM 8-3B

(a) **DAVANEY GENETICS COMPANY**
Bank Reconciliation
May 31, 2014

Cash balance per bank statement		\$13,332
Add: Deposit in transit	\$2,600	
Bank error—Murray check	900	3,500
		16,832
Less: Outstanding checks		1,225
Adjusted cash balance per bank		<u>\$15,607</u>
Cash balance per books		\$13,287
Add: Collection of note receivable (\$4,500 note plus \$80 interest less \$25 fee)		4,555
		17,842
Less: NSF check	\$1,308	
Error in May 12 deposit	100	
Error in recording check No. 1181	792*	
Check printing charge	35	2,235
Adjusted cash balance per books		<u>\$15,607</u>

*\$911 – \$119

(b) May 31	Cash	4,555	
	Miscellaneous Expense	25	
	Notes Receivable		4,500
	Interest Revenue		80
31	Accounts Receivable—Peter Reser	1,308	
	Cash		1,308
31	Sales Revenue	100	
	Cash		100
31	Accounts Payable—J. Tallgrass	792	
	Cash		792
31	Miscellaneous Expense	35	
	Cash		35

PROBLEM 8-4B

(a)

PHILLIPS COMPANY
Bank Reconciliation
November 30, 2014

Cash balance per bank statement		\$ 9,100
Add: Deposits in transit		<u>2,541</u>
		11,641
Less: Outstanding checks		
No. 2451.....	\$700	
No. 2472.....	270	
No. 2478.....	300	
No. 2482.....	350	
No. 2484.....	460	
No. 2485.....	525	
No. 2487.....	210	
No. 2488.....	<u>635</u>	<u>3,450</u>
Adjusted cash balance per bank		<u>\$ 8,191</u>
Cash balance per books.....		\$ 5,958
Add: Note collected by bank		
(\$2,300 note plus \$91 interest		
less \$16 fee)		<u>2,375</u>
		8,333
Less: Check printing charge.....	\$ 34	
Error in recording check No. 2479	90*	
Error in 11-21 deposit		
(\$1,642 – \$1,624)	<u>18</u>	<u>142</u>
Adjusted cash balance per books		<u>\$ 8,191</u>
*\$980 – \$890		

PROBLEM 8-4B (Continued)

(b)	Nov. 30	Cash	2,375	
		Miscellaneous Expense	16	
		Notes Receivable		2,300
		Interest Revenue		91
	30	Miscellaneous Expense	34	
		Cash.....		34
	30	Accounts Payable.....	90	
		Cash.....		90
	30	Accounts Receivable	18	
		Cash.....		18

PROBLEM 8-5B

(a)

ZHANG COMPANY
Bank Reconciliation
August 31, 2014

Cash balance per bank statement		\$16,856
Add: Deposits in transit (1)	\$ 5,729	
Bank error (\$277 – \$275)	<u>2</u>	<u>5,731</u>
		22,587
Less: Outstanding checks (2)		<u>4,156</u>
Adjusted cash balance per bank		<u>\$18,431</u>
 Cash balance per books		 \$13,215
Add: Collection of note receivable by bank		
(\$5,000 note plus \$105 interest)	\$ 5,105	
Book error (\$430 – \$340)	90	
Interest earned	<u>41</u>	<u>5,236</u>
		18,451
Less: Safety deposit box rent		<u>20</u>
Adjusted cash balance per books		<u>\$18,431</u>
 (1) August receipts per books		 \$50,050
August deposits per bank	\$47,521	
Less: Deposits in transit, July 31	<u>3,200</u>	<u>44,321</u>
Deposits in transit, August 31		<u>\$ 5,729</u>
 (2) Disbursements per books in		
August		\$47,794
Less: Book error		<u>90</u>
Total disbursements to be		
accounted for		47,704
Checks clearing bank in		
August	\$46,475	
Less: Bank error	\$ 2	
July 31 outstanding		
checks	<u>2,925</u>	<u>2,927</u>
Outstanding checks,		<u>43,548</u>
August 31		<u>\$ 4,156</u>

PROBLEM 8-5B (Continued)

(b)	Aug. 31	Cash	5,105	
		Notes Receivable		5,000
		Interest Revenue		105
	31	Cash	90	
		Accounts Payable		90
	31	Cash	41	
		Interest Revenue		41
	31	Miscellaneous Expense	20	
		Cash.....		20

PROBLEM 8-6B

(a)

GAMEL COMPANY
Bank Reconciliation
October 31, 2014

Cash balance per bank statement				\$15,313.00
Plus: Undeposited receipts				<u>3,226.18</u>
				18,539.18
Less: Outstanding checks				
<u>No.</u>	<u>Amount</u>	<u>No.</u>	<u>Amount</u>	
62	\$107.74	862	\$132.10	
183	127.50	863	192.78	
284	215.26	864	140.49	<u>915.87</u>
Adjusted cash balance per bank				<u>\$17,623.31</u>
Cash balance per books.....				\$18,608.81
Add: Bank credit (collection of note receivable)				<u>460.00</u>
Adjusted balance per books (before theft)				19,068.81
Less: Theft				<u>1,445.50*</u>
Adjusted cash balance per books				<u>\$17,623.31</u>

*\$19,068.81 – \$17,623.31

(b) The cashier attempted to cover the theft of \$1,445.50 by:

1. Not listing as outstanding three checks totaling \$450.50 (No. 62, \$107.74; No. 183, \$127.50; and No. 284, \$215.26).
2. Underfooting the outstanding checks listed by \$75.00 (The correct total is \$465.37.)
3. Subtracting the \$460 bank credit from the book balance instead of adding it to the book balance, thereby concealing \$920 of the theft.

PROBLEM 8-6B (Continued)

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

COMPREHENSIVE PROBLEM SOLUTION

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

COMPREHENSIVE PROBLEM SOLUTION (Continued)

(b) & (e)

General Ledger

Cash

12/1 Bal.	18,200	12/19	2,200
12/7	3,600	12/22	11,880
12/26	15,680	12/31	680
12/31	2,700		
12/31	2,200		
12/31 Bal.	27,620		

Notes Receivable

12/1 Bal.	2,200	12/31	2,200
12/31 Bal.	- 0 -		

Accounts Receivable

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

Inventory

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

Prepaid Insurance

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

Equipment

12/1 Bal.	28,000		
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Accumulated Depreciation— Equipment

	12/1 Bal.	3,000
	12/31	200
	12/31 Bal.	3,200

Accounts Payable

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

Owner's Capital

	12/1 Bal.	64,400
--	-----------	--------

Sales Revenue

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

Sales Discounts

12/26	320	
12/31 Bal.	320	

Cost of Goods Sold

12/17	10,000	
12/31 Bal.	10,000	

Depreciation Expense

12/31	200	
12/31 Bal.	200	

Salaries and Wages Expense

12/19	2,200	
12/31 Bal.	2,200	

Insurance Expense

12/31	400	
12/31 Bal.	400	

COMPREHENSIVE PROBLEM SOLUTION (Continued)

(c)

FULLERTON COMPANY Bank Reconciliation December 31, 2014

Cash balance per bank statement	\$26,130
Add: Deposits in transit	<u>2,700</u>
	28,830
Less: Outstanding checks	<u>1,210</u>
Adjusted cash balance per bank	<u>\$27,620</u>
 Cash balance per books	 26,100
Add: Collection of note receivable	<u>2,200</u>
	28,300
Less: NSF check	<u>680</u>
Adjusted cash balance per books	<u>\$27,620</u>

(d) Dec. 31	Cash	2,200	
	Notes Receivable		2,200
31	Accounts Receivable	680	
	Cash		680
31	Depreciation Expense	200	
	Accumulated Depreciation— Equipment		200
31	Insurance Expense	400	
	Prepaid Insurance		400

COMPREHENSIVE PROBLEM SOLUTION (Continued)

(f) **FULLERTON COMPANY**
Adjusted Trial Balance
December 31, 2014

	DR.	CR.
Cash	\$27,620	
Accounts Receivable	1,880	
Inventory	17,880	
Prepaid Insurance	1,200	
Equipment.....	28,000	
Accumulated Depreciation—Equipment ...		\$ 3,200
Accounts Payable		6,100
Owner's Capital		64,400
Sales Revenue		16,000
Sales Discounts	320	
Cost of Goods Sold.....	10,000	
Depreciation Expense	200	
Salaries and Wages Expense	2,200	
Insurance Expense.....	400	
	<u>\$89,700</u>	<u>\$89,700</u>

(g) **FULLERTON COMPANY**
Income Statement
For the Month Ending December 31, 2014

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

COMPREHENSIVE PROBLEM SOLUTION (Continued)

(g)

FULLERTON COMPANY

Balance Sheet

December 31, 2014

<u>Assets</u>		
Current assets		
Cash	\$27,620	
Accounts receivable.....	1,880	
Inventory	17,880	
Prepaid insurance	<u>1,200</u>	
Total current assets		\$48,580
Property, plant, and equipment		
Equipment.....	28,000	
Less: Accumulated		
depreciation—Equipment	<u>3,200</u>	<u>24,800</u>
Total assets		<u>\$73,380</u>
<u>Liabilities and Owner's Equity</u>		
Current liabilities		
Accounts payable.....		\$ 6,100
Owner's equity		
Owner's capital (\$64,400 + \$2,880)		<u>67,280</u>
Total liabilities and owner's equity		<u>\$73,380</u>

- (a) In the Report, it states that “the financial statements referred to above [including the statement of cash flows] present fairly, in all material respects, the financial position of Apple Inc. as of September 24, 2011 and September 25, 2010, and the results of its operations and its cash flows for each of the three years in the period ended September 24, 2011, in conformity with accounting principles generally accepted in the United States of America.”
- (b) Cash and cash equivalents are reported at \$9,815 million for 2011 and \$11,261 million for 2010.
- (c) Cash equivalents are defined as “all highly liquid investments with maturities of three months or less at the date of purchase.”
- (d) The Company’s management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). Management conducted an evaluation of the effectiveness of the Company’s internal control over financial reporting based on the criteria set forth in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based on the Company’s assessment, management has concluded that its internal control over financial reporting was effective as of September 24, 2011 to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with U.S. generally accepted accounting principles. The Company’s independent registered public accounting firm, Ernst & Young LLP, has issued an audit report on the Company’s internal control over financial reporting, which appears in Item 15(a) of this Annual Report on Form 10-K.

	<u>PepsiCo</u>	<u>Coca-Cola</u>
(a) (1)	\$4,067 million	\$12,803 million
(2)	\$1,876 million decrease	\$4,286 million increase
(3)	\$8,944 million	\$9,474 million

- (b) Both companies generated over 8.9 billion dollars from operating activities. This cash is used for investing and financing activities. Both companies use the cash provided by operating activities to purchase land, buildings and equipment, to make acquisitions of other companies, to buy back their stock, and to pay dividends. Both companies have large cash balances at the end of 2011 and are capable of generating huge amounts of cash.

	<u>Amazon</u>	<u>Wal-Mart</u>
(a) (1)	\$5,269 million	\$6,550 million
(2)	\$1,492 million increase	\$845 million decrease
(3)	\$3,903 million	\$24,255 million

(b) Both companies generated over 3.9 billion dollars from operating activities. Wal-Mart generated an amazing 24 billion dollars from operating activities. This cash is used for investing and financing activities. Both companies use the cash provided by operating activities to purchase land, buildings and equipment, to make acquisitions of other companies, to buy back their stock, and to pay dividends. Both companies have large cash balances at the end of 2011 and are capable of generating huge amounts of cash.

- (a) The system of internal control should be evaluated by: (1) responsible individuals from a particular university unit, (2) internal auditors, and (3) university management.**
- (b) Reconciliations ensure accuracy and completeness of transactions. In particular, a reconciliation ensures that all cash received is: (1) properly deposited in university bank accounts and (2) recorded accurately in the financial records. The reconciliation should be reviewed by the department manager.**
- (c) Some examples given of physical controls are a safe, vault, locked doors, campus police, computer passwords, and card key systems.**
- (d) Two ways to accomplish inventory counts are: (1) annual complete inventory or (2) cycle counting programs.**

- (a) The weaknesses in internal accounting control over collections are:
- (1) Each usher could take cash from the collection plates enroute to the basement office.
 - (2) The head usher counts the cash alone.
 - (3) The head usher's notation of the count is left in the safe.
 - (4) The financial secretary counts the cash alone.
 - (5) The financial secretary withholds \$150 to \$200 per week.
 - (6) The cash is vulnerable to robbery when kept in the safe overnight.
 - (7) Checks are made payable to "cash."
 - (8) The financial secretary has custody of the cash, maintains church records, and prepares the bank reconciliation.
- (b) The improvements should include the following:
- (1) The ushers should transfer their cash collections to a cash pouch (or bag) held by the head usher. The transfer should be witnessed by a member of the finance committee.
 - (2) The head usher and finance committee member should take the cash to the office. The cash should be counted by the head usher and the financial secretary in the presence of the finance committee member.
 - (3) Following the count, the financial secretary should prepare a deposit slip in duplicate for the total cash received, and the secretary should immediately deposit the cash in the bank's night deposit vault.
 - (4) At the end of each month, a member of the finance committee should prepare the bank reconciliation.
- (c) The policies that should be changed are:
- (1) Members should make checks payable to the church.
 - (2) A petty cash fund should be established for the financial secretary to be used for weekly cash expenditures and requests for replenishment of the fund should be sent to the chairperson of the finance committee for approval.
 - (3) The financial secretary should be bonded.
 - (4) The financial secretary should be required to take an annual vacation.

Mr. Danny Peak
Pritchard Company
Main Street, USA

Dear Mr. Peak:

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

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

BYP 8-6 (Continued)

Weaknesses

5. Mail receipts are deposited weekly.

Suggested Improvement

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

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

Yours sincerely,

Eaton, Quayle, and Hale
Certified Public Accountants

- (a) You, as assistant controller, may suffer some negative effects from Lisa Infante, the financial vice-president, if you don't follow her instructions. Maybe the insurance company will react the way Lisa suggests, but probably not.

If you comply and falsify the June 30 cash balance by holding the cash receipts book open for one day, you will suffer personally by sacrificing your integrity. If you are found out, you could be prosecuted for preparing a fraudulent report. The insurance company, as the lender and creditor, is deceived.

- (b) Holding the cash receipts book open in order to overstate the cash balance is a fraudulent, deceitful, unethical action. The financial vice-president should not encourage such behavior and a controller should not follow such instructions.
- (c) (1) You can follow the vice-president's instructions and misstate the cash balance—wrong! (2) You can advise the vice-president against holding the books open, prepare an accurate report, and have the vice-president or the president discuss the situation with the insurance company. It can be explained that the low cash balance was only temporary. Honesty is still the best policy.

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

- (a) **Consistent with common usage, cash includes not only currency on hand but demand deposits with banks or other financial institutions. Cash also includes other kinds of accounts that have the general characteristics of demand deposits in that the customer may deposit additional funds at charges and credits to those accounts are cash receipts or payments to both the entity owning the account and the bank holding it. For example, a bank's granting of loan by crediting the proceeds to a customer's demand deposit account is a cash payment by the bank and a cash receipt of the customer when the entry is made. Codification reference (305-10-20).**
- (b) **Cash equivalents are short-term, highly liquid investments that have both of the following characteristics:**
 - a. **Readily convertible to known amounts of cash**
 - b. **So near their maturity that they present insignificant risk of changes in value because of changes in interest rates.**

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

BYP 8-9 (Continued)

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

IFRS8-1

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

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

IFRS8-2

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

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