

ACCOUNTING FOR CASH

Key Terms and Concepts to Know

Bank Reconciliation:

- Identifies and explains the differences or reconciling items between the cash balance in the depositor's general ledger and the cash balance according to the bank's records.
- Reconciling items are transactions which have been recorded by either the depositor or the bank, but not both, AND transactions which were not properly recorded by the depositor and/or the bank.
- The depositor records adjusting entries for all reconciling items on the depositor's side of the bank reconciliation. If the adjusting entries are not recorded, these items will continue to appear on the reconciliation if subsequent months until the adjusting entries have been made.

Cash and Cash Equivalents

- Cash is money, checking accounts and savings accounts
- Cash equivalents are other extremely short-term financial instruments
- Cash equivalents are extremely liquid, meaning they can be converted into cash at any time

Cash Budget

- Shows expected beginning and ending cash balances, cash inflows and cash outflows for a future period.
- Also shows any borrowings or repayments including interest paid necessary to maintain the minimum required cash balance

Key Topics to Know

Bank Reconciliation

The balance according to the bank statement and the balance according to the depositor's records must be adjusted on the reconciliation properly determine the cash balance that should be in the general ledger. Both the bank balance and the ledger balance are adjusted for items not previously recorded as follows:

	<u>Bank Balance</u>	<u>Ledger Balance</u>
Add:	Deposits in Transit Errors	Notes collected by the bank Errors
Deduct:	Outstanding Checks Errors	Service Charges NSF checks Errors

All adjustments to the ledger balance MUST be journalized in order for the cash account in the ledger to agree with the adjusted cash balance.

Example #1

The cash account for S Company on August 31, indicated a balance of \$9,420. The bank statement indicated a balance of \$12,785 on August 31. The following reconciling items were discovered.

- a) Checks outstanding totaled \$6,240.
- b) A deposit of \$5,375, representing cash receipts of August 31, had been made too late to appear on the bank statement.
- c) A check for \$240 was incorrectly charged by the bank as \$420.
- d) A check for \$658 returned with the statement had been recorded by S Company as \$568. The check was for the payment of an obligation to Y Company on account.
- e) The bank had collected for Ace \$2,800 on a note left for collection. The face of the note was \$2,000.
- f) Bank service charges for August amounted to \$30.

Required: Prepare the bank reconciliation and journalize the necessary entries.

Solution #1

Cash balance according to bank statement		\$12,785
Add: Deposit of August 30 not recorded by bank	\$5,375	
Bank error	<u>180</u>	<u>5,555</u>
		\$18,340
Deduct: Outstanding checks		<u>6,240</u>
Adjusted balance		<u><u>\$12,100</u></u>
Cash balance according to depositor's records		\$9,420
Add: Proceeds of note and interest collected by bank		<u>2,800</u>
		12,220
Deduct: Error in recording check	\$90	
Bank service charges	<u>30</u>	<u>120</u>
Adjusted balance		<u><u>\$12,100</u></u>

Journal entries

Cash	2,800	
Notes Receivable		2,000
Interest Revenue		800
A/P-Cahill Co.	90	
Misc. Adm. Expense	30	
Cash		120

Cash Budget

The Cash Budget shows the expected beginning and ending cash balances, cash inflows and outflows for a future period. If there is a minimum cash balance, it will also show borrowings to maintain the minimum balance or repayments of borrowings including interest if there is excess cash over the minimum cash balance.

The general format is:

- Beginning cash balance
- Add: Cash receipts
- Less: Cash disbursements
- = Excess (deficiency) of available cash
- Add: Borrowings
- Less: Repayments plus interest
- = Ending cash balance

Example #2

R Company is preparing its cash budget for July. The budgeted beginning cash balance is \$25,000. Budgeted cash receipts total \$121,000 from customers and \$19,000 from the sales of stock. Budgeted cash disbursements total \$139,000 for accounts payable and \$5,500 to repay a loan. The desired ending cash balance is \$30,000.

Required: Prepare the cash budget for the month

Solution #2

Beginning cash balance		\$25,000
Add: Cash collections from customers	\$121,000	
Cash collection from sales of stock	<u>19,000</u>	
Total Cash Receipts		140,000
Less: Payments on accounts payable	139,000	
Repayment of loan	<u>5,500</u>	
Total Cash Disbursements		<u>144,500</u>
= Excess (deficiency) of available cash		20,500
Add: Borrowings		9,500
Less: Repayments plus interest		<u>0</u>
= Ending cash balance		\$30,000

Practice Problems

Practice Problem #1

The cash account for K Company on November 30, 2003, indicated a balance of \$5,699. The bank statement indicated a balance of \$13,167 on November 30, 2003. The following reconciling items were discovered.

- a) Checks outstanding totaled \$5,175.
- b) A deposit of \$3,842, representing cash receipts of November 30, had been made too late to appear on the bank statement.
- c) The bank had collected for Kahn \$4,800 on a note left for collection. The face of the note was \$4,200.
- d) Kahn had recorded a check for \$2,040 returned with the statement as \$2,400. The check was for the payment of a 3-year insurance policy.
- e) A check for \$1,176 had been incorrectly charged by the bank as \$176.
- f) Bank service charges for November amounted to \$25.

Required: Prepare the bank reconciliation and journalize the necessary entries.

Practice Problem #2

As of May 31, 2016, the bank statement of X Company showed an ending balance of \$8,632.52. The following information was available:

Bank service charge	\$	35.00
Outstanding checks		2,480.36
NSF check from a customer		127.50
Deposit in transit		799.55
Deposit erroneously recorded in F Company's account that should have been recorded in X Company's account		299.00

Required: Compute the correct cash balance.

True / False Questions

1. Common examples of cash equivalents are money market funds, Treasury bills, and certificates of deposit.
True False
2. A bank reconciliation matches the balance of cash in the bank account with the balance of cash in the company's own records.
True False
3. A company's cash receipts that have not been added to the bank's record of the company's balance are labeled outstanding checks.
True False
4. Outstanding checks are checks written by the company that the bank has not subtracted from the company's balance.
True False
5. An outstanding deposit will cause the bank's cash balance to be higher than the company's cash balance.
True False
6. An outstanding check will cause the bank's cash balance to be higher than the company's cash balance.
True False
7. An NSF check is an example of a cash transaction that is initially recorded by the bank and later by the company after notification.
True False
8. The final step in reconciling the bank's cash balance and the company's cash balance is to update the company's cash balance for the items used to reconcile the bank's cash balance.
True False
9. Bank Reconciliations are not that important because banks never make errors.
True False
10. A credit memorandum from a bank indicates that they have decreased the depositor's cash balance.
True False

Multiple Choice Questions

1. A debit or credit memorandum describing entries in the depositor's bank account may be enclosed with the bank statement. Which of the following items would be reported to the depositor on a credit memorandum?
 - a) Deposited checks returned for insufficient funds
 - b) A service charge
 - c) A promissory note collected by the bank
 - d) Notification that a customer's check for \$375 was recorded by the depositor as \$735 on the deposit ticket.

2. The bank reconciliation:
 - a) Should be prepared by an employee who records cash transactions
 - b) Is for information purposes only
 - c) Is part of the internal control system
 - d) Is sent to the bank for verification

3. Receipts from cash sales of \$7,500 were recorded incorrectly in the cash receipts journal as \$5,700. This item appear on the bank reconciliation as:
 - a) An addition to the balance per depositor's records
 - b) An addition to the balance per bank statement
 - c) A deduction from the balance per bank statement
 - d) A deduction from the balance per depositor's records

4. Accompanying the bank statement was a debit memorandum for an NSF check received from a customer. What entry is required in the depositor's accounts?
 - a) Debit Other Income, credit Cash
 - b) Debit Cash, credit Other Income
 - c) Debit Accounts Receivable, credit Cash
 - d) Debit Cash, credit Accounts Receivable

5. A person authorized to write checks drawn on a checking account at a bank must sign and have on file with the bank a:
 - a) Bank card
 - b) Deposit ticket
 - c) Checkbook
 - d) Signature card

6. Cash equivalents:
 - a) Are illegal in some states
 - b) Are highly liquid investments
 - c) Will be converted to cash within one year
 - d) Are only available to large companies

7. A minimum cash balance required by a bank is called:
 - a) Cash in the bank
 - b) Cash equivalent
 - c) EFT
 - d) Compensating balance

8. A check drawn by a depositor for \$195 in payment of a voucher was recorded in the journal as \$915. This item would appear on the bank reconciliation as a(n):
 - a) Addition to the balance per the bank statement
 - b) Addition to the balance per the depositor's records
 - c) Deduction from the balance per the bank statement
 - d) Deduction from the balance per the depositor's records

9. A Company had outstanding checks totaling \$4,500 on its September bank reconciliation. In October, checks totaling \$45,700 were issued. The October bank statement shows that checks totaling \$39,800 cleared the bank. In addition, a customer's check in the amount of \$500 was returned as NSF. The outstanding checks on the October bank reconciliation should total
 - a) \$5,900
 - b) \$9,900
 - c) \$10,400
 - d) \$1,400

10. An adjusting entry is required for
 - a) Outstanding checks
 - b) Deposits in transit
 - c) Bank errors
 - d) NSF checks

11. J Company collected the following information to prepare its May bank reconciliation:

Cash balance per books, May 31	\$5,300
Deposits in transit	510
Notes Receivable with interest collected by bank	580
Bank Service Charges	30
Outstanding Checks	1,800
NSF check	150

The adjusted cash balance per books on May 31 is

- a) \$5,700
 b) \$5,810
 c) \$6,210
 d) \$5,660
12. B Company collected the following information to prepare its November bank reconciliation:

Cash balance per bank, November 30	\$21,000
Note Receivable plus interest collected by bank	9,000
Outstanding checks	6,000
Deposit in Transit	5,400
Bank Service charges	85
NSF check	2,100

The cash balance per books, before adjustment, is

- a) \$20,400
 b) \$13,585
 c) \$6,815
 d) \$27,815
13. Journal entries are not required for reconciling items related to the bank balance because:
- a) The depositor cannot make entries on the bank's books
 b) The amounts cannot be determined
 c) Journal entries are never required for these items
 d) The bank does not make errors

14. The following information was taken from the C Company cash budget for the month of April:

Beginning cash balance	45,000
Cash Receipts	27,000
Cash Disbursements	51,000

If the company has a policy of maintaining a minimum cash balance of \$37,000, the amount the company would have to borrow is:

- a) \$24,000
- b) \$8,000
- c) \$16,000
- d) \$14,000

Solutions to Practice Problems

Practice Problem #1

Cash balance according to bank statement		\$13,167
Add: Deposit of November 30 not recorded by bank		3,842
		<u>\$17,009</u>
Deduct: Outstanding checks	\$5,175	
Bank error	1,000	6,175
Adjusted balance		<u>\$10,834</u>
Cash balance according to depositor's records		\$5,699
Add: Proceeds of note and interest collected by bank	4,800	
Error recording check for insurance policy	360	5,160
		<u>10,859</u>
Deduct: Bank service charges		25
Adjusted balance		<u>\$10,834</u>

Journal entries

Cash	5,160	
Notes Receivable		4,200
Interest Income		600
Prepaid Insurance		360
Misc. Adm. Expense	25	
Cash		25

Practice Problem #2

Bank balance		\$8,632.52
Deposit in transit		+ 799.55
Deposit erroneously recorded in F Company's account that should have been recorded in X Company's account		- 299.00
Outstanding checks		<u>-2,480.36</u>
Correct cash balance		<u>\$6,652.71</u>

Solutions to True / False Problems

1. True
2. True
3. False - these are referred to as deposits outstanding.
4. True
5. False - the company's balance will be higher.
6. True
7. True
8. False - the cash balance needs to be updated for items used to reconcile the company's cash balance.
9. False – banks do make errors and it is important for the errors to be identified and the bank notified so that the errors can be corrected.
10. False – since the depositor's account is a liability to the bank, a credit memo would increase the balance in the depositor's account.

Solutions to Multiple Choice Questions

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|-----|---|
| 1. | C |
| 2. | C |
| 3. | A |
| 4. | C |
| 5. | D |
| 6. | B |
| 7. | D |
| 8. | D |
| 9. | C |
| 10. | D |
| 11. | A |
| 12. | B |
| 13. | A |
| 14. | C |