Chapter 4
Cash and Internal Controls

REVIEW QUESTIONS

Question 4-1 (LO 4-1)

Occupational fraud is the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources. Occupational fraud occurs through theft or misuse of the company's resources and through financial statement manipulation.

Question 4-2 (LO 4-1)

Internal control is a company's plan to (1) safeguard the company's assets and (2) improve the accuracy and reliability of accounting information. Effective internal control builds a wall to prevent misuse of company funds by employees and fraudulent or errant financial reporting. Strong internal control systems allow greater reliance by investors on reported financial statements.

Question 4-3 (LO 4-1)

Managers are entrusted with the resources of both the company's lenders (liabilities) and owners (stockholders' equity). They have an ethical responsibility to appropriately use and accurately report the company's funds.

Question 4-4 (LO 4-1)

Managers are motivated to manipulate financial statements to maximize their compensation, increase the company's stock price, and preserve their job.

Question 4-5 (LO 4-1)

The fraud triangle represents the three elements of fraud: motive, rationalization, and opportunity. To help prevent fraud, companies can eliminate the opportunity element by implementing internal controls.

Question 4-6 (LO 4-1)

The major provisions of the Sarbanes-Oxley Act include the Public Company Accounting Oversight Board, corporate executive accountability, limitation on nonaudit services, retention of work papers, auditor rotation, restrictions related to conflicts of interest, audit committee hires the auditor, and documentation of internal control.

Answers to Review Questions (continued)

Question 4-7 (LO 4-2)

1. Control Environment – The overall ethical tone of the company with respect to internal control.
2. Risk Assessment – Identification and analysis of internal and external risk factors that could prevent a company's objectives from being achieved.
3. Control Activities – The policies and procedures that help ensure that management's directives are being carried out.
4. Monitoring – Continuous observation of the internal control system.
5. Information and Communication – Systems designed to ensure accurate measurement of business transactions and reliability of financial reports.

Question 4-8 (LO 4-2)

Detective controls are designed to detect errors or fraud that have already occurred, while preventive controls are designed to keep errors or fraud from occurring in the first place. Preventive controls include separation of duties, physical controls, proper authorizations, and employee management. Detective controls include reconciliations and performance reviews.

Question 4-9 (LO 4-2)

Authorizing transactions, recording transactions, and maintaining control of the related assets should be separated among employees.

Question 4-10 (LO 4-2)

Everyone in a company has an impact on the operation and effectiveness of internal controls, but **the top executives are the ones who must take final responsibility for their establishment and success.** The CEO and CFO sign a report each year assessing whether the internal controls are adequate. Section 404 of SOX requires not only that companies document their internal controls and assess their adequacy, but that the company's auditors provide an opinion on management's assessment.

Question 4-11 (LO 4-2)

Internal controls cannot prevent financial misstatement in all cases, do not necessarily prevent collusion by two or more people to circumvent internal controls, are more susceptible to fraud by top-level employees**,** and do not ensure a company's success, or even survival.

Question 4-12 (LO 4-2)

Collusion occurs when two or more people act in coordination to circumvent internal controls.

Question 4-13 (LO 4-2)

Fraud is more likely to occur when it is being committed by top-level employees who have the ability to override internal control features. For example, managers may be required to obtain approval from the Chief Financial Officer (CFO) for all large purchases. However, if the CFO uses the company's funds to purchase a boat for personal use at a lake home, fewer controls are in place to detect this misappropriation. Even if lower-level employees suspect wrongdoing, they may feel intimidated to confront the issue.

Answers to Review Questions (continued)

Question 4-14 (LO 4-3)

Cash includes not only currency, coins, balances in checking accounts, and checks and money orders received from customers, but also cash equivalents, defined as investments that mature within three months from the date of purchase (such as money market funds, treasury bills, and certificates of deposit).

Question 4-15 (LO 4-3)

A purchase with a check is recorded as an immediate cash payment.

Question 4-16 (LO 4-4)

1. Record all cash receipts as soon as possible.
2. Open mail each day, and make a list of checks received, including the amount and payor’s name.
3. Designate an employee to deposit cash and checks into the company’s bank account each day, different from the person who receives cash and checks.
4. Have another employee record cash receipts in the accounting records. Verify cash receipts by comparing the bank deposit slip with the accounting records.

Question 4-17 (LO 4-4)

Credit cards extend credit (or lend money) to the cardholder each time the cardholder uses the credit card. The cardholder has a specified grace period before he or she has to pay the credit card balance in full. If the balance is not paid by the end of the grace period, the issuing company will charge a fee (interest). Credit card sales are recorded as a cash receipt by the seller.

Question 4-18 (LO 4-4)

Like credit cards, debit cards offer customers a way to purchase goods and services without a physical exchange of cash. They differ, however, in that most debit cards (sometimes referred to as check cards) work just like a check and withdraw funds directly from the cardholder’s bank account at the time of use. Debit card sales are recorded as a cash receipt by the seller.

Question 4-19 (LO 4-4)

1. Make all disbursements, other than very small ones, by check, debit card, or credit card.
2. Authorize all expenditures before purchase and verify the accuracy of the purchase itself. The employee who authorizes payment should not also be the employee who prepares the check.
3. Make sure checks are serially numbered and signed only by authorized employees. Require two signatures for larger checks.
4. Periodically check amounts shown in the debit card and credit card statements against purchase receipts. The employee verifying the accuracy of the debit card and credit card statements should not also be the employee responsible for actual purchases.
5. Set maximum purchase limits on debit cards and credit cards. Give approval to purchase above these amounts only to upper-level employees.
6. Employees responsible for making cash disbursements should not also be in charge of cash receipts.

Answers to Review Questions (continued)

Question 4-20 (LO 4-4)

Credit card purchases are recorded as purchases on account.

Question 4-21 (LO 4-5)

A bank reconciliation matches the balance of cash in the bank account with the balance of cash in the company's own records by reconciling timing differences and errors. It is the possibility of errors, or even outright fraudulent activities, that make the bank reconciliation a useful cash control tool.

Question 4-22 (LO 4-5)

The two reasons are timing differences and errors. Timing differences arise when one party (the bank or the company) records a transaction at a different time than the other party. Errors are mistakes made by either the bank or the company.

Question 4-23 (LO 4-5)

Examples include deposits outstanding, checks outstanding, notes collected by the bank, interest earned, service charges, and NSF checks.

Question 4-24 (LO 4-5)

As a final step in the reconciliation process, the company must update the balance of cash for the items used to reconcile the *company's* cash balance.

Question 4-25 (LO 4-6)

Purchase cards are company-issued debit cards or credit cards that offer a convenient way for employees to make quick purchases for the company. The petty cash fund is cash kept on hand to pay for minor purchases.

Question 4-26 (LO 4-6)

- Employees should be required to provide receipts and justification for those receipts on a timely basis.
- A separate employee reviews receipts and supporting documents to ensure all expenditures are made appropriately.
- Credit card receipts are reconciled to credit card statements, just like we reconciled checks and debit card transactions to the bank statement.
- Spending limits are placed on employees who are authorized to use a company credit card or have access to company cash. Lower limits are given to lower-level employees, while major expenditures require pre-approval through formal purchasing procedures.
- Only those employees that need to make timely business expenditures should receive authorization.

Question 4-27 (LO 4-7)

In addition to the change in total cash which can be calculated using two consecutive balance sheets, the statement of cash flows provides details of inflows and outflows from operating, investing, and financing activities.

Question 4-28 (LO 4-7)

Operating activities include cash transactions involving revenue and expense events during the period. Investing activities include cash investments in long-term assets and investment securities. Financing activities include transactions designed to raise cash or finance the business.

Answers to Review Questions (continued)

Question 4-29 (LO 4-8)

To maintain normal operations, a company needs enough cash, or enough other assets that can quickly be converted to cash, to pay obligations as they become due. Having available cash also helps a company respond quickly to new, profitable opportunities. On the other hand, having too much cash represents idle resources that are not being used to produce revenues or that may be spent inefficiently. A company with too much cash may be a signal that management does not have additional opportunities for profitable expansion.

Question 4-30 (LO 4-8)

Cinemark has a higher ratio of cash to noncash assets than does Regal. The reasons include Cinemark having lower growth in investing activities, higher operating risk from international operations and paying fewer dividends.

BRIEF EXERCISES

Brief Exercise 4-1 (LO 4-1)

1. c.
2. a.
3. d.
4. b.
5. e.

Brief Exercise 4-2 (LO 4-2)

1. e.
2. d.
3. a.
4. c.
5. b.

Brief Exercise 4-3 (LO 4-2)

1. e.
2. a.
3. f.
4. c.
5. b.
6. d.

Brief Exercise 4-4 (LO 4-3)

1. Yes
2. No
3. Yes
4. Yes
5. No
6. Yes

Brief Exercise 4-5 (LO 4-4)

1.	$ 500,000	
2.	350,000	
3.	582,000	(= $600,000 less 3% service fee)
4.	198,000	(= $200,000 less 1% service fee)
	$1,630,000	

Brief Exercise 4-6 (LO 4-4)

	Debit	Credit
1.		
Salaries Expense	**500**	
Cash		**500**
(*Pay salaries by check*)		
2.		
Equipment	**1,000**	
Accounts Payable		**1,000**
(*Purchase computer equipment with credit card*)		
3.		
Repairs and Maintenance Expense	**400**	
Cash		**400**
(*Pay for vehicle maintenance with debit card*)		

Brief Exercise 4-7 (LO 4-5)

1. d.
2. c.
3. f.
4. e.
5. a.
6. b.

Brief Exercise 4-8 (LO 4-5)

Reconciliation items	Bank balance	Company balance
1. Checks outstanding	*Subtract*	*No entry*
2. NSF checks	**No entry**	**Subtract**
3. Deposit recorded twice by company	**No entry**	**Subtract**
4. Interest earned	**No entry**	**Add**
5. Deposits outstanding	**Add**	**No entry**
6. Bank service charges	**No entry**	**Subtract**

Brief Exercise 4-9 (LO 4-5)

Bank balance	$2,000
Deposits outstanding	+4,200
Checks outstanding	−4,450
Reconciled bank balance	$1,750

Brief Exercise 4-10 (LO 4-5)

Company balance	$2,620
Service fees	−85
NSF check	−350
Note received	+1,000
Interest earned	+35
Reconciled company balance	$3,220

Brief Exercise 4-11 (LO 4-5)

	Debit	Credit
Cash	**1,035**	
Notes Receivable		**1,000**
Interest Revenue		**35**
(*Record note and interest collected by bank*)		
Service Fee Expense	**85**	
Accounts Receivable	**350**	
Cash		**435**
(*Record bank service fee and NSF check*)		

Brief Exercise 4-12 (LO 4-5)

Bank balance	$7,345	Company balance	$4,593
Checks outstanding	−2,803	Service fees	−85
		Interest earned	+34
Cash balance per reconciliation	$4,542	Cash balance per reconciliation	$4,542

Brief Exercise 4-13 (LO 4-6)

	Debit	Credit
Postage Expense	**60**	
Delivery Expense	**85**	
Supplies Expense	**50**	
Accounts Payable		**195**
(*Recognize expenditures from credit cards*)		

	Debit	Credit
Entertainment Expense	**25**	
Cash		**25**
(*Recognize expenditures from the petty cash fund*)		

Brief Exercise 4-14 (LO 4-7)

1. c.
2. a.
3. b.

Brief Exercise 4-15 (LO 4-7)

Receipts for lessons in June	$4,500
Receipts for lessons in May	500
Total cash received	$5,000

Brief Exercise 4-16 (LO 4-7)

Total investing cash flows = $13,000

Brief Exercise 4-17 (LO 4-7)

Issuance of stock	$11,000
Borrowing from bank	35,000
Payment of dividends	(3,000)
	$43,000

Brief Exercise 4-18 (LO 4-8)

	Cash	÷	Noncash Assets*	=	**Ratio**
Tuohy Incorporated	$4,200		$19,200		**21.88%**
Oher Corporation	$3,500		$22,200		**15.77%**

* Noncash assets = Total assets − Cash

EXERCISES

Exercise 4-1 (LO 4-1)

1. False
2. True
3. True
4. False
5. True
6. True

Exercise 4-2 (LO 4-1)

1. True
2. False
3. True
4. True
5. False
6. False

Exercise 4-3 (LO 4-2)

1. True
2. False
3. False
4. True
5. True
6. False
7. True
8. True
9. False

Exercise 4-4 (LO 4-2)

1. Performance reviews

2. Physical controls
3. Separation of duties
4. Reconciliations
5. None
6. Proper authorization

Exercise 4-5 (LO 4-3)

Currency located at the company	$ 1,050
Short-term investments that mature within three months	1,950
Balance in savings account	8,500
Checks received from customers but not yet deposited	650
Coins located at the company	110
Balance in checking account	6,200
Total cash	$18,460

Exercise 4-6 (LO 4-4)

Cash should be recorded and deposited more than once per week (on Friday). The employee recording cash receipts should not also be the employee making the deposit. The bank reconciliation should be prepared more than once each quarter.

Exercise 4-7 (LO 4-4)

The petty cash fund of $10,000 is too large. Employees should not be allowed to both place a receipt in the fund and withdraw cash. Employees should obtain permission before writing a check. While it is good that checks over $5,000 must be signed by Goldie or Kate, this amount is too high. A more realistic amount may be $200.

Exercise 4-8 (LO 4-4)

Jim should not deposit the checks and also record them.

Exercise 4-9 (LO 4-5)

Requirement 1

Spielberg Company
Bank Reconciliation
July 31, 2021

Bank's Cash Balance		*Company's* Cash Balance	
Per bank statement	$22,490	Per general ledger	$22,970
Deposits outstanding	+ 1,885	Service fees	− 55
Checks outstanding	− 1,460		
Bank balance per reconciliation	$22,915	Company balance per reconciliation	$22,915

Requirement 2

	Debit	Credit
Service Fee Expense	**55**	
Cash		**55**
(*Record bank service fee*)		

Exercise 4-10 (LO 4-5)

Requirement 1

The Dean Acting Academy
Bank Reconciliation
August 31, 2021

Bank's Cash Balance		*Company's* Cash Balance	
Per bank statement	$6,042	Per general ledger	$7,944
Deposits outstanding	+ 3,338	Service fees	− 35
Checks outstanding	− 1,425	Interest earned	+ 46
Bank balance per reconciliation	$7,955	Company balance per reconciliation	$7,955

Requirement 2

	Debit	Credit
Cash	**46**	
Interest Revenue		**46**
(*Record note and interest collected by bank*)		
Service Fee Expense	**35**	
Cash		**35**
(*Record bank service fee*)		

Exercise 4-11 (LO 4-5)

Requirement 1

Damon Company
Bank Reconciliation
October 31, 2021

Bank's Cash Balance		*Company's* Cash Balance	
Per bank statement	$11,727	Per general ledger	$ 8,397
Deposits outstanding	+ 3,025	Note received	+5,000
Checks outstanding	− 1,485	Interest earned	+ 320
Bank Error	+ 300	Service fees	− 150
Bank balance per reconciliation	$13,567	Company balance per reconciliation	$13,567

Requirement 2

	Debit	Credit
Cash	**5,320**	
Notes Receivable		**5,000**
Interest Revenue		**320**
(*Record note and interest collected by bank*)		
Service Fee Expense	**150**	
Cash		**150**
(*Record bank service fee*)		

Exercise 4-12 (LO 4-6)

September 4	Debit	Credit
Petty Cash	**200**	
Cash		**200**
(*Establish the petty cash fund*)		

September 30	Debit	Credit
Repairs and Maintenance Expense	**420**	
Postage Expense	**575**	
Delivery Expense	**285**	
Accounts Payable		**1,280**
(*Recognize expenditures from credit cards*)		

September 30	Debit	Credit
Entertainment Expense	**170**	
Cash		**170**
(*Recognize expenditures from the petty cash fund*)		

Exercise 4-13 (LO 4-6)

April 3	Debit	Credit
Petty Cash	**200**	
Cash		**200**
(*Establish the petty cash fund*)		

April 30	Debit	Credit
Utilities Expense	**435**	
Repairs and Maintenance Expense	**630**	
Cash ($435 + $630)		**1,065**
(*Recognize expenditures from credit cards*)		

April 30	Debit	Credit
Entertainment Expense	**44**	
Postage Expense	**59**	
Cash		**103**
(*Recognize expenditures from the petty cash fund*)		

Exercise 4-14 (LO 4-7)

Transaction	Cash involved? (yes or no)	If yes, is it operating, investing, or financing?	Inflow or outflow?
a. Borrow cash from the bank.	**Yes**	**Financing**	**Inflow**
b. Purchase supplies on account.	**No**	**N/A**	**N/A**
c. Purchase equipment with cash.	**Yes**	**Investing**	**Outflow**
d. Provide services on account.	**No**	**N/A**	**N/A**
e. Pay cash on account for transaction b above.	**Yes**	**Operating**	**Outflow**
f. Sell for cash a warehouse no longer in use.	**Yes**	**Investing**	**Inflow**
g. Receive cash on account for transaction d above.	**Yes**	**Operating**	**Inflow**
h. Pay cash to workers for salaries.	**Yes**	**Operating**	**Outflow**

Exercise 4-15 (LO 4-7)

Requirements 1 and 2

Transaction	Cash Flows	Operating, investing, or financing?
a. Issue common stock for cash, $60,000.	**+ $60,000**	**Financing**
b. Purchase building and land with cash, $45,000.	**− $45,000**	**Investing**
c. Provide services to customers on account, $8,000.	**N/A**	**N/A**
d. Pay utilities on building, $1,500.	**− $1,500**	**Operating**
e. Collect $6,000 on account from customers.	**+ $6,000**	**Operating**
f. Pay employee salaries, $10,000.	**− $10,000**	**Operating**
g. Pay dividends to stockholders $5,000.	**− $5,000**	**Financing**
Net cash flows for the year	**+ $4,500**	

Requirement 3

December 31, 2021: **$5,400 + $4,500 = $9,900**

Exercise 4-16 (LO 4-7)

a. Cash used for purchase of office supplies	**− $2,400**
b. Cash provide from consulting to customers	**+ $50,600**
c. Cash used for purchase of mining equipment (**Investing**)	
d. Cash provided from long-term borrowing (**Financing**)	
e. Cash used for payment of employee salaries	**− $25,000**
f. Cash used for payment of office rent	**− $13,000**
g. Cash provided from sale of equipment purchased in c. above (**Investing**)	
h. Cash used to repay a portion of the long-term borrowing in d. above (**Financing**)	
i. Cash used to pay office utilities	**− $5,300**
j. Purchase of company vehicle (**Investing**)	
Cash flows from operating activities	**+ $4,900**

Exercise 4-17 (LO 4-7)

c. Cash used for purchase of mining equipment	**− $83,000**
g. Cash provided from sale of equipment purchased in c. above	**+ $23,500**
j. Purchase of company vehicle	**− $11,000**
Cash flows from investing activities	**− $70,500**

Exercise 4-18 (LO 4-7)

d. Cash provided from long-term borrowing	**+ $70,000**
h. Cash used to repay a portion of the long-term borrowing in d. above	**− $45,000**
Cash flows from financing activities*	**+ $25,000**

Exercise 4-19 (LO 4-7)

Requirement 1

1. Cash collected from customers for services provided	**+$70,000**
2. Salaries paid for the year	**−$35,000**
3. Advertising paid for the year	**−$10,000**
4. Supplies paid for the year	**0**
5. Utilities paid for the year	**−$11,000**
6. Cash collected in advance from customers	**+$2,000**
Net operating cash flows	**+$16,000**

Requirement 2

1. Service Revenue for the year	**+$80,000**
2. Salaries Expense for the year	**−$40,000**
3. Advertising Expense for the year	**−$10,000**
4. Supplies Expense for the year	**−$4,000**
5. Utilities Expense for the year	**−$12,000**
6. Cash collected in advance from customers	**0**
Net income	**+$14,000**

Requirement 3

Operating activities include cash transactions involving revenue and expense events during the period. In other words, operating activities include the cash effect of the same activities that are reported in the income statement to calculate net income.

Exercise 4-20 (LO 4-8)

All other things equal, Glasco likely has the higher ratio of cash to noncash assets.

Based on the trend in operating cash flows, Glasco's operations are more volatile and therefore riskier. Riskier companies are more likely to incur negative economic shocks to their operations. As a result, they tend to hold more cash to make sure they are able to make debt payments as they become due and to maintain normal operations. In addition, Glasco has foreign operations. Companies with foreign operations often keep cash located in other countries to avoid additional taxes in the United States. A company's cash balance can also be affected by factors such as its dividend policy and growth opportunities.

PROBLEMS: SET A

Problem 4-1A (LO 4-4)

Requirement 1

Internal controls include:

- Tickets are serially numbered.
- The person issuing the ticket at the box office is physically separated from the person taking the ticket for admission.
- Half of the ticket is kept so that the number of tickets issued can be matched with the number of tickets received.
- A turnstile is used to automatically count those entering the theatre.
- The ticket stubs are stored in a locked box.

Requirement 2

At the end of each day, the ticket manager can match the money received with the number of tickets issued. In addition, the number of tickets issued can be matched with the number of tickets in the locked box which can also be verified with the count of the turnstile.

Requirement 3 and 4

Classroom discussion.

Problem 4-2A (LO 4-5)

Requirement 1

Oscar's Red Carpet Store
Bank Reconciliation
February 28, 2021

Bank's Cash Balance		*Company's* Cash Balance	
Per bank statement	$13,145	Per general ledger	$8,100
Deposits outstanding	+ 1,600	NSF check	− 200
Checks outstanding	− 2,100	Company error	− 300
		EFT for rent	−1,100
		Interest on account	+ 20
		Note collected	+6,000
		Interest on note	+ 250
		Service fees	− 125
Bank balance per reconciliation	$ 12,645	Company balance per reconciliation	$12,645

Requirement 2

	Debit	Credit
Cash	**6,270**	
Notes Receivable		**6,000**
Interest Revenue		**270**
(*Record note and interest collected by bank and interest earned on account balance*)		
Accounts Receivable	**200**	
Advertising Expense	**300**	
Rent Expense	**1,100**	
Service Fee Expense	**125**	
Cash		**1,725**
(*Record NSF check, recording error, automatic payment, and bank service fee*)		

Problem 4-3A (LO 4-5)

Requirement 1

Diaz Entertainment
Bank Reconciliation
May 31, 2021

Bank's Cash Balance		*Company's* Cash Balance	
Per bank statement	$6,210	Per general ledger	$5,100
Deposits outstanding	+3,180	NSF check	− 400
Checks outstanding (#475 and #476)	−4,150	Interest earned	+ 90
		Note collected	+1,100
Bank error	+ 600	Service fees	− 50
Bank balance per reconciliation	$5,840	Company balance per reconciliation	$5,840

Requirement 2

	Debit	Credit
Cash	**1,190**	
Notes Receivable		**1,100**
Interest Revenue		**90**
(*Record note and interest collected by bank and interest earned on account balance*)		
Accounts Receivable	**400**	
Service Fee Expense	**50**	
Cash		**450**
(*Record NSF check and bank service fee*)		

Problem 4-4A (LO 4-7)

Pixar Toy Manufacturing
Statement of Cash Flows
For the month ended August 31, 2021

Cash Flows from Operating Activities		
Cash inflows:		
From customers	$93,500	
Cash outflows:		
For salaries	(65,300)	
For office rent	(19,000)	
For office utilities	(11,800)	
For materials to make toys	(27,700)	
Net cash flows from operating activities		($30,300)
Cash Flows from Investing Activities		
Sale of unused warehouse	36,000	
Purchase of manufacturing equipment	(46,000)	
Net cash flows from investing activities		(10,000)
Cash Flows from Financing Activities		
Bank borrowing	26,000	
Payment of dividends	(6,700)	
Net cash flows from financing activities		19,300
Net decrease in cash		(21,000)
Cash at the beginning of the month		25,500
Cash at the end of the month		$ 4,500

Problem 4-5A (LO 4-7)

Requirement 1

October 2	Debit	Credit
Cash	**8,500**	
Service Revenue		**8,500**
(*Receive membership dues*)		

October 5	Debit	Credit
Cash	**12,000**	
Common Stock		**12,000**
(*Issue common stock*)		

October 9	Debit	Credit
Equipment	**9,600**	
Cash		**4,800**
Notes Payable		**4,800**
(*Purchase boxing equipment: one-half paid for with cash on this date and issue a note payable for one-half, due by the end of the year*)		

October 12	Debit	Credit
Advertising Expense	**1,500**	
Cash		**1,500**
(*Pay for current month advertising*)		

October 19	Debit	Credit
Dividends	**4,400**	
Cash		**4,400**
(*Pay dividends*)		

October 22	Debit	Credit
Prepaid Insurance	**6,900**	
Cash		**6,900**
(*Pay prepaid insurance*)		

Problem 4-5A (continued)

Requirement 1 (concluded)

October 25	Debit	Credit
Cash	**5,600**	
Deferred Revenue		**5,600**
(*Receive membership dues in advance*)		

October 30	Debit	Credit
Utilities Expense	**5,200**	
Utilities Payable		**5,200**
(*Receive current month utilities bill*)		

October 31	Debit	Credit
Salaries Expense	**7,300**	
Cash		**7,300**
(*Pay current month salaries*)		

Requirement 2

All transactions involve cash except for the utilities payable transaction on October 30.

Requirement 3

Cash

	Debits	Credits	
October 1	16,600	4,800	October 9
October 2	8,500	1,500	October 12
October 5	12,000	4,400	October 19
October 25	5,600	6,900	October 22
		7,300	October 31
	17,800		

Problem 4-5A (continued)

Requirement 4

Balboa's Gym
Statement of Cash Flows
For the month ended October 31

Cash Flows from Operating Activities		
Cash inflows:		
From customers	$14,100	
Cash outflows:		
For advertising	(1,500)	
For insurance	(6,900)	
For salaries	(7,300)	
Net cash flows from operating activities		$ (1,600)
Cash Flows from Investing Activities		
Purchase of boxing equipment	(4,800)	
Net cash flows from investing activities		(4,800)
Cash Flows from Financing Activities		
Issuance of common stock	12,000	
Payment of dividends	(4,400)	
Net cash flows from financing activities		7,600
Net increase in cash		1,200
Cash at the beginning of the month		16,600
Cash at the end of the month		$17,800

Requirement 5

Net cash flows in statement of cash flows = $1,200
Change in cash balance for the month = $17,800 (ending) − $16,600 (beginning)
= $1,200

PROBLEMS: SET B

Problem 4-1B (LO 4-4, 4-5)

Requirement 1

Howard Productions
Bank Reconciliation
February 28

Bank's Cash Balance		*Company's* Cash Balance	
Per bank statement	$ 735	Per general ledger	$19,225
Deposits outstanding	+7,692	NSF check	− 5,278
Checks outstanding	− 489	Service fees	− 159
Bank error	+1,350	Petty cash fund	− 4,500
Bank balance per reconciliation	$9,288	Company balance per reconciliation	$9,288

Requirement 2

The company has a large amount of NSF checks. This indicates that the company's procedures related to acceptance of customers' checks is not reliable. The company should tighten controls over the allowance of payment by check.

Deposits outstanding are relatively high. The company should more frequently deposit cash to avoid theft or loss of cash.

The amount established for the petty cash fund may be too high. Petty cash provides cash on hand for minor purchases. Having too much cash on hand creates the likelihood that a material amount of cash will be mishandled.

Problem 4-2B (LO 4-5)

Requirement 1

Blockwood Video
Bank Reconciliation
October 31, 2021

Bank's Cash Balance		*Company's* Cash Balance	
Per bank statement	$12,751	Per general ledger	$12,381
Deposits outstanding	+ 835	Company error	+ 27
Checks outstanding	− 1,280	EFT for note	− 560
Bank error	− 577	Service fees	− 34
		NSF check	− 85
Bank balance per reconciliation	$11,729	Company balance per reconciliation	$11,729

Requirement 2

	Debit	Credit
Cash	**27**	
Utilities Expense		**27**
(*Record correction of recording error*)		
Note Payable	**500**	
Interest Expense	**60**	
Service Fee Expense	**34**	
Accounts Receivable	**85**	
Cash		**679**
(*Record EFT of note and interest, bank service fee, and NSF check*)		

Problem 4-3B (LO 4-5)

Requirement 1

Glover Incorporated
Bank Reconciliation
July 31, 2021

Bank's Cash Balance		*Company's* Cash Balance	
Per bank statement	$3,750	Per general ledger	$5,670
Deposits outstanding	+2,820	Company error	− 400
Checks outstanding (#534 and #535)	−2,400	Interest earned	+ 60
		NSF check	− 500
		Service fees	− 60
		Office supplies	− 600
Bank balance per reconciliation	$4,170	Company balance per reconciliation	$4,170

Requirement 2

	Debit	Credit
Cash	**60**	
Interest Revenue		**60**
(*Record interest earned on checking account*)		
Equipment	**400**	
Accounts Receivable	**500**	
Service Fee Expense	**60**	
Supplies	**600**	
Cash		**1,560**
(*Record correction of recording error, NSF check, bank service fee, and EFT*)		

Problem 4-4B (LO 4-7)

Dreamworks Bedding Supplies
Statement of Cash Flows
For the month ended August 31, 2021

Cash Flows from Operating Activities		
Cash inflows:		
From customers	$ 80,400	
From interest	300	
Cash outflows:		
For salaries	(47,100)	
For advertising	(5,900)	
For office supplies	(3,800)	
For bedding material	(13,000)	
Net cash flows from operating activities		$ 10,900
Cash Flows from Investing Activities		
Sale of unused land	15,700	
Purchase of delivery truck	(34,500)	
Net cash flows from investing activities		(18,800)
Cash Flows from Financing Activities		
Issuance of common stock	30,000	
Repayment of borrowing	(9,000)	
Net cash flows from financing activities		21,000
Net increase in cash		13,100
Cash at the beginning of the month		8,300
Cash at the end of the month		$ 21,400

Problem 4-5B (LO 4-7)

Requirement 1

June 2	Debit	Credit
Cash	**19,000**	
Notes Payable		**19,000**
(*Borrow from the bank*)		

June 3	Debit	Credit
Rent Expense	**1,200**	
Cash		**1,200**
(*Pay current month rent*)		

June 7	Debit	Credit
Cash	**5,200**	
Accounts Receivable	**3,500**	
Service Revenue		**8,700**
(*Provide services for cash and on account*)		

June 11	Debit	Credit
Equipment	**8,400**	
Cash		**8,400**
(*Purchase equipment*)		

June 17	Debit	Credit
Salaries Expense	**6,500**	
Cash		**6,500**
(*Pay salaries*)		

June 22	Debit	Credit
Dividends	**1,550**	
Cash		**1,550**
(*Pay dividends*)		

Problem 4-5B (continued)

Requirement 1 (concluded)

June 25	Debit	Credit
Cash	**2,100**	
Deferred Revenue		**2,100**
(*Receive cash in advance*)		

June 28	Debit	Credit
Utilities Expense	**3,300**	
Cash		**3,300**
(*Pay current month utilities bill*)		

June 30	Debit	Credit
Salaries Expense	**6,500**	
Salaries Payable		**6,500**
(*Owe current month's salaries*)		

Requirement 2

All transactions involve cash except for the salaries payable transaction on June 30.

Requirement 3

Cash

	Debits	Credits	
June 1	14,700	1,200	June 3
June 2	19,000	8,400	June 11
June 7	5,200	6,500	June 17
June 25	2,100	1,550	June 22
		3,300	June 28
	20,050		

Problem 4-5B (continued)

Requirement 4

Homeward Bound
Statement of Cash Flows
For the month ended June 30

Cash Flows from Operating Activities		
Cash inflows:		
From customers	$ 7,300	
Cash outflows:		
For rent	(1,200)	
For salaries	(6,500)	
For utilities	(3,300)	
Net cash flows from operating activities		($ 3,700)
Cash Flows from Investing Activities		
Purchase equipment	(8,400)	
Net cash flows from investing activities		(8,400)
Cash Flows from Financing Activities		
Borrow from bank	19,000	
Pay dividends	(1,550)	
Net cash flows from financing activities		17,450
Net increase in cash		5,350
Cash at the beginning of the month		14,700
Cash at the end of the month		$20,050

Requirement 5

Net cash flows in statement of cash flows = $5,350
Change in cash balance for the month = $20,050 (ending) − $14,700 (beginning)
= $5,350

ADDITIONAL PERSPECTIVES

Additional Perspective 4-1

Requirement 1

Suzie should make deposits more often than once per month, such as each day or each time a major deposit is needed. Suzie should also reconcile the bank statement more than once every six months, such as once per month.

Requirement 2

Great Adventures, Inc.
Bank Reconciliation
December 31, 2021

Bank's Cash Balance		*Company's* Cash Balance	
Per bank statement	$50,500	Per general ledger	$64,200
Deposits outstanding	+20,000	Interest earned	+ 500
Checks outstanding	− 6,000	Service fee	− 200
Bank balance per reconciliation	$64,500	Company balance per reconciliation	$64,500

Dec. 31, 2021	Debit	Credit
Cash	**500**	
Interest Revenue		**500**
(*Record interest earned*)		
Dec. 31, 2021		
Service Fee Expense	**200**	
Cash		**200**
(*Record bank service fee*)		

Requirement 3

Failure to record the interest revenue would cause assets and revenues to be understated by $500. Failure to record the service charge fee causes expenses to be understated and assets to be overstated by $200. The net effect of both transactions is an understatement of assets by $300 and an understatement of stockholders' equity (retained earnings) and net income by $300.

Additional Perspective 4-2

($ in thousands)

Requirement 1

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of February 3, 2018, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) and our report dated March 16, 2018 expressed an unqualified opinion thereon.

Requirement 2

The Company considers all highly liquid investments purchased with a remaining maturity of three months or less to be cash equivalents.

Requirement 3

The amount of cash reported in the current year is $413,613, and the amount of cash reported in the previous year is $378,613. This is an increase of $35,000.

Requirement 4

The amounts reported for operating, investing, and financing cash flows for continuing operations are $394,426, $(172,150), and $(188,772), respectively. The cash flows from continuing operations are $33,504. The difference of $1,496 is related to the effect of exchange rates on cash.

Requirement 5

The amounts in requirement 3 and requirement 4 are equal.

Requirement 6

The ratio of cash to noncash assets is $413,613/$1,402,700 = 29.5%.

Additional Perspective 4-3

($ in thousands)

Requirement 1

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of February 3, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 4, 2018, expressed an unqualified opinion on the Company's internal control over financial reporting.

Requirement 2

The Company considers all highly liquid debt instruments with an original maturity of three months or less when purchased to be cash equivalents.

Requirement 3

The amount of cash reported in the current year is $165,086, and the amount of cash reported in the previous year is $196,536. This is an decrease of $31,450.

Requirement 4

The amounts reported for operating, investing, and financing cash flows are $119,721, $(17,297), and $(133,874). Total cash flows are $(31,450).

Requirement 5

The amounts in requirement 3 and requirement 4 are equal.

Requirement 6

The ratio of cash to noncash assets is $165,086/$373,030 = 44.3%.

Additional Perspective 4-4

($ in thousands)

Requirement 1

American Eagle's ratio of cash to noncash assets is $413,613/$1,402,700 = 29.5%.

Buckle's ratio of cash to noncash assets is $165,086/$373,030 = 44.3%.

Riskier companies are more likely to incur negative economic shocks to their operations. As a result, they tend to hold more cash to make sure they are able to make debt payments as they become due and to maintain normal operations. In addition, companies with foreign operations often keep cash located in other countries to avoid additional taxes in the United States. Only American Eagle operates in foreign countries. A company's cash balance can also be affected by factors such as its dividend policy and growth opportunities.

Requirement 2

American Eagle's ratio of cash to current liabilities is $413,613/$485,221 = 85.2%.
Buckle's ratio of cash to current liabilities is $165,086/$97,906 = 168.6%.

Based on this analysis alone, Buckle is more able to pay its current liabilities if they were all to be paid immediately. American Eagle would have to borrow short-term, or to collect on its receivables to pay all current liabilities immediately. It can be noted that Buckle has very minimal receivables and American Eagle has more than enough receivables to make up the shortage it would need to pay current liabilities. Therefore, on this analysis alone, receivables balances may be a factor in consideration of cash balances to have at a point in time. For example, it is unknown how cash might have been (legitimately) manipulated for the balance sheet date such that bills may or may not have been paid at the very end of the year to provide balances desired for balance sheet analysis pertaining to the year-end balance sheet date.

Additional Perspective 4-5

1. Yes.
The rules explicitly state that friends and family are not allowed to watch free movies, and full price is to be paid for all concession items.

2. Yes.
While everyone else, including upper management, is breaking rules of written policy, Jack is still able to make the choice to follow policy.

3. Yes.
Managers should consider the tone they are setting for the company. By violating the policies themselves, managers are not establishing a good control environment for an overall ethical tone by employees with respect to internal controls.

4. Yes.
However, in such a situation, it would be easy for Jack to justify not following the policy and to feel pressure from others. Jack could believe that because many workers, including upper management, are violating policies in the employee handbook, it is less unethical to allow friends and family to see free movies and have free popcorn and beverages. Plus, Jack needs to save for college. Unethical actions seem to be easier to justify if one of the outcomes is achieving something positive, like a college education. By not engaging in these unethical actions, Jack also portrays a sense of ethical responsibility and trustworthiness among his peers and management. In the long-term, these characteristics could lead to Jack being promoted to higher positions because of management trust, receiving additional compensation, obtaining positive reference letters from management for college and scholarship applications, and other benefits.

Additional Perspective 4-6

Requirement 1
The Kroger Company ($ in thousands) for January 28, 2017.

Operating cash flows =	$ 4,272,000
Investing cash flows =	(3,875,000)
Financing cash flows =	(352,000)
	$ 45,000

Requirement 2
Sprouts Farmers Market ($ in millions) for December 31, 2017.

Operating cash flows =	$ 309,567
Investing cash flows =	(198,594)
Financing cash flows =	(103,959)
	$ 7,014

Requirement 3
The Kroger Company:

Cash (January 28, 2017)	$322,000
Cash (January 30, 2016)	277,000
	$ 45,000

Sprouts Farmers Market

Cash (December 31, 2017)	$19,479
Cash (January 1, 2017)	12,465
	$ 7,014

Additional Perspective 4-7

Some of the internal control weaknesses include:

1.
- The employee who authorizes payment should not also be the employee who disburses cash.
- The employee responsible for making cash disbursements should not also be the employee in charge of the cash receipts.
- The fund balance should be verified by two or more employees.

2.
- The employee who authorizes payment should not also be the employee who prepares the check.
- The employee who authorizes the payment should not also be the employee who records the payment.
- The employee who records the payment should not also be the employee who reconciles the bank statement.

3.
- The employee who opens the mail should not also be the employee that makes a list of checks and cash received.
- The employee who opens the mail should not also be the employee that makes the deposit at the bank.
- The employee who makes deposits at the bank should not also be the employee that maintains a record of cash receipts.